Could the charity sector pay less for investment services?

Evidence suggests the potential for meaningful cost savings exists

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A DIFFICULT LANDSCAPE

As government spending declines in real terms, communities and people in need are progressively looking towards charities to fill the void. Coupled with an environment of changing regulatory demands and market volatility, the charity sector is under increased pressure.

In trying to address these issues, one area it might cross-examine is investment management fees. Are trustees currently benefitting from the scale and resource available in the market? Could a reassessment help charities reduce costs and free up further spending from their investment portfolios to further aid their mission?

One of the key tenets of the Charity Commission's CC14, which acts as a guide for trustees in investment-related matters, is that **trustees consider the costs of appointing a manager or adviser.**

While costs account for only one side of the equation, and the following analysis does not look to examine returns, a closer look at the sector **through a number of lenses** reveals that — on the surface — fees paid by charities appear high, and there may be the potential to save significant amounts of money.

IDENTIFYING FEES: A MULTI-FACETED APPROACH

Because there are challenges in obtaining comprehensive and complete data on all fees that charities in the UK pay, we have approached this analysis from a number of angles:

A. Evaluating the financial statements of charities from the charity commission's website

B. Analysing the fees charged by the largest charity unit trusts

C. Analysing the fees that wealth managers charge to charities

We present the methodology and results from each 'lens' below.

A Evaluating financial statements

We reviewed the largest 250 charities by investible assets (ranging between £20 million and £300 million) using publically available financial statements found on the charity commission's website at charitycommission.gov.uk.

In doing so, we were able to uncover the cost of investment management services as a percentage of investible assets:

- 66 schemes qualified for a full audit based on the clarity of information available
- **This subset with complete data showed an average fee of 0.93%**

B The three largest charity unit trusts

Using the three leading single manager Charity Investment Funds (CIFs) available to trustees, we allocated a sample £60 million endowment across them equally. The resulting average weighted total **fund charges were found to be 1.18%.**

By comparison, using our multi-manager building blocks within our investment management solution for charities, we constructed the same weighted strategic asset allocation (SAA) as the three CIFs and found **the resulting total charges to be 0.68%.**

C Fund-of-funds structure

Lastly, we considered a fund-of-funds approach. This type of solution is typically offered by wealth managers, who use an open-architecture platform and populate charity investment portfolios with third-party funds. By taking a real investment valuation for a charitable endowment of £30 million and using publically available data to retrieve the fee for each fund, we were able to calculate that the charity was currently paying a **weighted investment management fee of 1.08%.**

This charity's allocation was heavily weighted to actively managed equity funds. By comparison, **we replicated this strategic asset allocation, and in applying** our multi-manager building blocks within our investment management solution for charities, **achieved a fee of 0.81%.**

HOW MUCH ARE UK CHARITIES PAYING?

Several lines of enquiry point to the fact that considerable cost savings could be made within the charity sector. Based on this analysis, if we assume the sector is paying a fee within the range of 0.93% to 1.18%, and apply these figures to a total sector of assets worth £100 billion[1], it suggests that investment management could be costing the charitable sector as a whole anything from **£930 million to £1.18 billion.**

HOW MUCH IS TOO MUCH?

While the above may be interesting in the abstract, it raises further questions, namely:

1. Is this figure high compared to other sectors?
2. Are charities getting value for these costs?

While #2 is beyond the scope of this brief analysis, we explored #1 in more detail by comparing the fees paid with the pension sector and with typical outsourced chief investment officer (OCIO) charging structures.

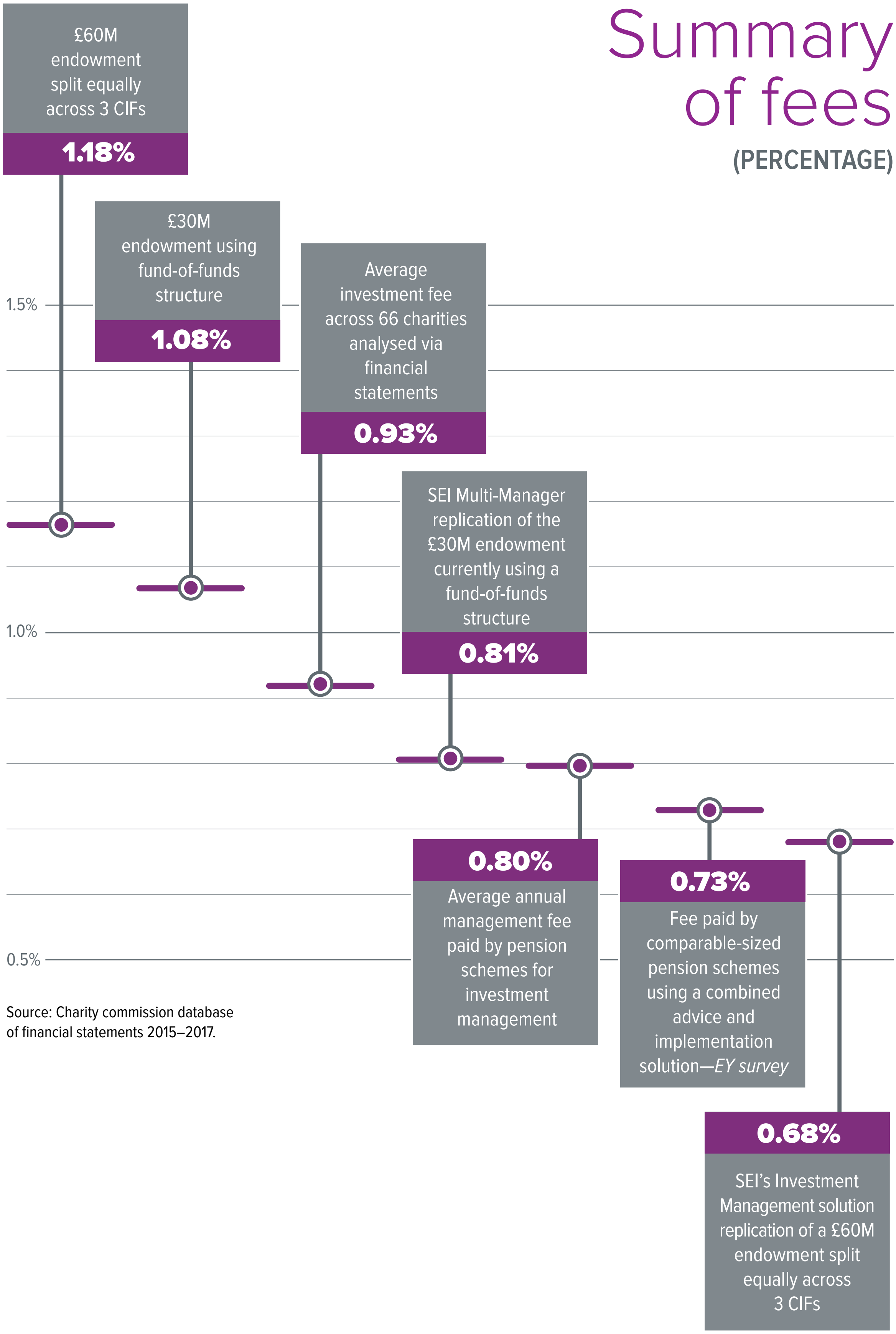
According to industry data, the average annual management charge paid by Trustees of pension schemes for investment management services can be up to **0.80%**, depending upon the asset class[2].

TIME FOR A DIFFERENT MODEL

Investment management for charities provides the resources and expertise to improve focus and overall results. Increasingly complex and volatile markets have caused organisations to take a hard look at their investment management approach. Through a manager of manager approach, many are welcoming the opportunity to gain additional resources, often at lower fees. Those adopting a manager of manager model have the ability to gain timely asset allocation and manager decisions, professional advice and economies of scale. Trustees of pension schemes with similar sized assets using a manager of manager approach (advice combined with implementation), typically **pay up to 0.73%** in fees[3].

Summary of fees

(PERCENTAGE)



Source: Charity commission database of financial statements 2015–2017.

CAPTURING ECONOMIES OF SCALE

As these preliminary investigations show, a manager of manager model has the potential to unlock cost benefits to charities; savings that the sector does not appear to be able to currently access through traditional means.

And costs are only one part of the equation. An open-architecture investment management platform means that charities can access a global level of infrastructure whilst maintaining a customised path for their scheme. So whilst fees are a crucial benchmark, there are other key factors that a charity should look for in a manager of manager partnership.

- **Depth of resource:** Across the provider's entire platform, from advice through to implementation, this can result in cost-effective access to some of the best products and managers within asset classes.

- **The ability to personalise:** A good manager of managers will deliver a bespoke allocation that integrates spending policy and assets, and will offer actively managed portfolios that allow trustees to react quickly to capture opportunities and manage risk.

- **Experience:** The ability to communicate complicated and sophisticated investment content in a way that is clear and accessible to charity organisations and their trustees, along with the ability to demonstrate a track record in helping trustees.

CONCLUSION

While data availability is challenging, our preliminary analysis suggests that as a sector, charitable foundations are paying between £930 million and £1.18 billion in investment fees. At first glance—when compared with high-level numbers from other sectors—these fees do appear to be high.

Applying the low-end range of our fee analysis (between 0.68% and 0.73%), shows that the sector could potentially pay between £680 million and £730 million for the same services; a saving of between £250 million and £288 million.

Clearly there may be very good reasons for this disparity, and indeed the charitable sector may have benefitted from positive investment results in return for these fees. However, it is also possible that the sector as a whole could benefit from greater economies of scale. This builds a case for a manager of manager solution to help drive down costs.

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At SEI, we provide a variety of services to charity trustees, from strategic advice and tactical asset allocation, to environmental social and governance (ESG), socially responsible investment management, trustee training, manager selection and comprehensive reporting.

For more information or to find out if you could benefit from a new fee structure, contact us.

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**Source: Charity commission database of financial statements 2015–2017.

[1]Kay, Liam. 'Charity investments reach more than £100bn for first time'. Third Sector. 23 May 2017. www.thirdsector.co.uk/charity-investments-reach-100bn-first-time/finance/article/1434372

[2]Lane Clark & Peacock. 'The fee paradox: LCP investment management fees survey report'. April 2017. https://insight.lcp.uk.com/acton/attachment/20628/f-0549/1/-/-/-/-/LCP%20Investment%20Management%20Fees%20Survey%20Report%202017.pdf

[3]Ernst & Young LLP. '2015 Fiduciary Management Fees Survey.' (OCIO is also commonly referred to as Fiduciary Management or FM.) April 2016. http://www.ey.com/Publication/vwLUAssets/ey-fiduciary-management-fees-survey-2015/$FILE/ey-fiduciarymanagement-fees-survey-2015.pdf