

INVESTIGATING BEST PRACTICES IN SERVICE FEE CAPS



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WHAT IS A BEST PRACTICES SURVEY?

At the root of a *Best Practices* Survey is an issue that a client wants to explore with other fund companies/ investment managers in a timely, cost effective manner. The ground rules for a *Best Practices* Survey are straightforward. The sponsor pays all costs for this research; in return for completing a questionnaire or responding to a phone interview, all participants receive the unattributed aggregated results as a *quid pro quo* for their time.

When we conduct a *Best Practice* Survey, invariably it is a topic that resonates across our client base.

In the fall of 2017 a client wanted to assess the current intermediary service fee caps landscape and agreed to sponsor a *Best Practices* Survey.¹ We were not surprised at the level of interest in this topic, as evidenced by the thirty-five fund companies that quickly signed up to participate. Survey questions covered a broad swathe of caps-related issues, including (but not limited to) omnibus and Level 3 cap structures, calculation of caps, approach to high balance accounts, and changes in service fee caps being contemplated.

We wanted to share several selected findings with our Barrington client base.

CAP STRUCTURES

There is no uniformity in the structure of intermediary fee caps. We typically see caps in the following configurations:

- BPs – Exclusively in BPs; \$ arrangements are converted
- \$ Cap – Exclusively in dollars, BPs arrangements are converted
- Dual Cap with no conversions – Arrangements in \$ are subject to the \$ cap and arrangements in BPs rely on the BPs cap.
- Dual Cap with conversion (lesser of) – Intermediary fees paid by the funds are computed in both \$ and BPs, and the funds are responsible for the less costly amount.
- No Cap, Fund Pays All

The Most Popular Cap Structure – The dual cap with no conversion option continues to gain traction as an ever-increasing number of firms are opting for this format. Almost two-thirds of participants determine fund-paid intermediary compensation with dual caps (no conversion), up meaningfully from the slim majority in the 2016 Barrington Intermediary Fee Survey². In a distant second place was the BPs configuration, which was almost halved from the results just two years ago. The other cap structures received only a paltry number of votes.

¹ The topic of service fee caps in intermediary arrangements is also addressed in the bi-annual Intermediary Fee Survey. The 2018 Intermediary Fee Survey will be launched in December 2017.

² In the 2016 Intermediary Fee Survey we did not distinguish between dual caps with no conversions and the 'lesser of' dual caps structure.

Fund Boards Routinely Approve Caps – Almost two-thirds of participants submit their caps to the Board for approval, and almost one dozen additional firms establish internal caps which may (but are not required to) be reviewed by the Funds’ Board.

The percentages did not vary meaningfully from the 2016 Intermediary Fee survey results, suggesting the value placed on the scrutiny of caps.

Different Cap Structures by Class, Platform and/or Investment Style Are Relatively Infrequent – We wanted to ascertain the extent to which firms distinguish their caps – whether by platform, share class, or investment style. The words ‘extent to which’ proved a poor choice, because a majority of survey participants remain dedicated to a single cap structure across their intermediated business.

The next largest cohort was the handful of fund companies that carved out a different cap for one distribution platform. Most often – but not always – that unique slice was associated with the retirement business. Investment styles and classes were infrequently cited as distinguishing factors.

Steady State for Caps – Few firms are considering adjustments in their caps at the present time. Absent a catalyst, we do not expect to see consequential cap changes.

If your firm would like to gather industry intelligence on a particular topic, consider sponsoring a *Best Practices* survey. Feel free to contact either Judy Benson (jbenson@barringtonp.com – 617.482.3303) or Hubbard Garber (hgarber@barringtonp.com – 617.482.3300).