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ETFs are the ‘fake news’ of our industry: AM boss

The drive to create zero-fee passive funds and ETFs presents a huge reputational risk to asset managers, as many investors will be unaware of related charges on securities lending, IM Global Partners’ CEO has warned.

In a commentary on fee pressure, Philippe Couvrecelle said the recent surge for ultra-low or zero-cost ETFs has drawn much media attention but the marketing of such products could cause a major problem for the industry as a whole.

Couvrecelle, while talking about the need to pay for quality in active management, said passives have become a lightning rod for all discussions around fees.

‘For those who are charging no fees, this is because they are, to coin a phrase, “fake news”. If your passive fund manager is charging very low or no fees, they are likely to be remunerated through securities lending.

‘This has two major downside risks: first, the increased financial risks associated with securities lending are significant, from counterparty risk to collateral management risk or basis risk.

‘Then there is a major reputational risk: without transparency around securities lending and income derived from it, an entirely above-board operation in terms of compliance can feel like unfair treatment to clients, who may believe they deserve a share, if not all, of the income.’

Performance-linked pay

The response from active managers was to adopt a performance-related fee model – which has been criticized and commented on by competing CEOs – as a means of staying relevant. However, Couvrecelle said efforts in that regard are equally misguided.

‘In an effort to convince clients they are being offered value for money, some long-only managers have introduced performance fees. On the face of it, this seems reasonable, aligning the portfolio manager’s interest with investors.

‘However, unless the investment horizon is also aligned, performance fees could lead to a misalignment of risk. Performance fees charged on an annual basis could push portfolio managers to take inappropriate risks, or conversely to put portfolio into cash to lock in a bonus if a high-wat

Fees: not a new concern

Couvrecelle said the asset management is, ultimately, changing. However, the question of fees is a drum that has been beaten loudly for many years. ‘In the three decades I have been in the asset management industry, there has always been “huge pressure on fees”.

‘It is understandable that clients are keen to pay as little as possible for investment management services; sometimes with a roaring bull market, the pressure slackens a little as returns feel generous enough not to quibble over a basis point or two, but as soon as the irrational exuberance dies back, clients start to question management fees again.

‘In all goods and services pricing, the equilibrium price must, in the long term, be linked to the quality of the product/service and the quality of the distribution/client relationship,’ he said.