

A new concept to mitigate investment risk

- Posted by [Philippe Gautier](#), January 12, 2011



Among the many ideas that are being discussed at the moment to make management more accountable for the risks they are taking, I recently came across a really interesting concept that is being promoted by UK-based Kirill Iliniski of Fusion Asset Management, called Shock Absorber Fees ("SAFe")..

The Shock Absorber Fees ("SAFe") is a new fee structure that addresses the inherent conflict of interest between investors and investment managers on the risk return equation. Under the standard fee structure, the fund manager enjoys a free call on the performance of the fund – if the fund performs, the fund manager gets remunerated but he does not suffer any losses if the fund loses money. Although most fund managers will have the interest of their investors at heart and will not engage in strategies that are too risky, there is still a perverse incentive to take risks in the knowledge that if things go wrong only investors will suffer a loss.

The way it works is that a percentage of the performance fee is paid into an account held with a trust company until such time as the amount accumulated reaches a certain proportion of funds under management. It is only then that the fund manager gets paid the full fees. Investors have a claim on the account held in trust if the fund later loses money; this has the effect of reducing the risk profile for investors and making the fund more attractive. In addition, investors are more inclined to stay with the fund because of their recourse on the trust account.

The structure has the effect of aligning investors' interest with that of managers. Investors benefit from a more favourable risk return equation, which in turn allows fund managers to attract more investors, and in the end more resulting in increased fees once the agreed amount has been paid into the trust account.

The concept is currently aimed at the asset management industry but could be easily extended to other sectors of the financial services industry. It might be an answer to the issues currently being raised about the structure of bankers' remuneration.