FINANCIAL CONDUCT AUTHORITY

Transaction cost disclosure in workplace pensions

Policy Statement
PS17/20

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This relates to

Consultation Paper 16/30 which is available on our website at www.fca.org.uk/publications

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How to navigate this document onscreen

returns you to the contents list

takes you to helpful abbreviations

Contents

1 Overview 3
2 The disclosure of transaction costs in DC workplace pension schemes 7

Annex 1
List of non-confidential respondents 24

Annex 2
Abbreviations in this paper 26

Appendix 1
Made rules (legal instrument) 27

1 Overview

Introduction

1.1 We are publishing Handbook rules that require firms managing money on behalf of defined contribution (DC) workplace pension schemes to disclose administration charges and transaction costs to the governance bodies of those schemes[1], using a standard approach.

1.2 With effect from 3 January 2018, in response to a request from the governance body of a relevant pension scheme, firms must provide:

- information about transaction costs calculated according to the 'slippage cost' methodology
- information about administration charges
- appropriate contextual information

Where firms do not have the relevant information, they must seek it from other firms, and those other firms, where they are Financial Conduct Authority (FCA) authorised, must provide the information.

1.3 The methodology for calculating transaction costs matches that required for products subject to the Packaged Retail and Insurance-based Investments (PRIIPs) Regulation. This aligns our final rules with work firms will already be required to do and ensures consistency with firms' European obligations.

1.4 By setting out a methodology for calculating transaction costs in a consistent way, and by placing obligations on firms to respond to requests for information about costs, we are building the foundations that will enable the governance bodies of these schemes to meet their obligations to review and consider the value for money of transaction costs and administration charges.

1.5 Beyond this, following our Asset Management Market Study[2], we have set in train a number of initiatives that will further enhance the ability of both governance bodies and consumers to obtain the information that they need, in a way that helps them to assess those managing money on their behalf.

Who does this affect?

1.6 This Policy Statement (PS) will primarily interest those involved in the DC workplace pensions market. This includes those who provide services in that market, such

1 Independent Governance Committees (IGCs) for workplace personal pensions and trustees for occupational pensions
2 Further details of this may be found at: www.fca.org.uk/publications/market-studies/asset-management-market-study

as pension providers and asset managers, and the governance bodies of pension schemes, such as trustees and Independent Governance Committees (IGCs).

Is this of interest to consumers?

1.7 This work will indirectly affect all members of workplace pension schemes subject to the new governance requirements, ie DC workplace pension schemes and DC parts of hybrid workplace pension schemes. The governance bodies responsible for overseeing their investments will get more information about transaction costs enabling them to assess value for money more effectively.

Context

1.8 This PS is our response to the feedback we received to our Consultation Paper on transaction cost disclosure in workplace pensions (CP16/30). We set out in that paper the series of measures that the Government and the FCA have put in place to require greater transparency of costs and charges in workplace DC pensions, in response to the Office of Fair Trading (OFT) review into the workplace DC market.[3] This includes a duty on governance bodies to report on the level of transaction costs in their schemes.

1.9 The rules contained here will enable these governance bodies to meet their existing requirements to review transaction costs and assess whether they represent value for money. Furthermore, section 44 of the Pensions Act 2014 places a duty on the FCA[4] to make rules requiring governance bodies to disclose information about transaction costs to scheme members and to publish it. The rules in this PS will enable governance bodies to meet these obligations, by giving them the ability to obtain information about these costs.

1.10 We are working with the Department for Work and Pensions (DWP) on the next steps. We understand that the DWP is planning to consult on proposals as to how costs and charges relating to occupational pension schemes should be published and disclosed to scheme members. Subject to their final regulations coming into force, we intend to consult in the second quarter of 2018 on our proposals to achieve similar outcomes for workplace personal pension schemes.

1.11 Beyond the workplace DC pensions market, regulators, including the FCA, have introduced, or are in the process of introducing, a number of changes to the way that the costs and charges of investing are disclosed to consumers. Regulators have focused in particular on identifying hidden costs such as transaction costs, and on aggregating costs so that investors can see the full picture of the costs they are likely to incur or have incurred. These initiatives include:

- the recast Markets in Financial Instruments Directive (MiFID II)
- the PRIIPs Regulation

3 OFT Defined Contribution workplace pension market study, available at: http://webarchive.nationalarchives.gov.uk/20131101172428/http://oft.gov.uk/shared_oft/market-studies/oft1505

4 An equivalent duty is also placed on DWP with regard to occupational pension schemes.

- the FCA's competition market study of the asset management market

1.12 Two new pieces of European Union (EU) legislation will come in effect at the start of 2018. MiFID II will require those providing investment services, including advisers and fund supermarkets, to disclose information about all costs and charges to consumers, both prior to sale and annually on an ongoing basis. PRIIPs will require investment product manufacturers to disclose information about indirect costs such as transaction costs. Neither MiFID II nor PRIIPs directly applies to workplace DC pensions, although some firms providing services to workplace pension schemes will fall within the scope of MiFID II.

1.13 The FCA carried out an asset management market study which reviewed how competition is working in the asset management market. We concluded that investors' awareness and focus on charges is mixed and often poor. We also concluded that costs which are complex or costly for the asset manager to control, such as transaction costs, are not controlled as effectively as other costs.

1.14 As a result of this, we have appointed a chair[5] to establish a working group of industry and investor representatives with a view to agreeing a template for disclosure of costs and charges to institutional investors. We are also assessing the behavioural impact of certain measures that are complementary to the changes introduced by MiFID II and PRIIPs.

1.15 In developing these rules our general approach has been to write rules that will help us to meet our obligations under the Pensions Act 2014. Our approach is also consistent with the methodology for calculating transaction costs in PRIIPS and with MiFID II. The rules in this PS place requirements on firms to disclose certain information and set out a methodology for calculating transaction costs, but do not set out how that information should be disclosed. We have noted elsewhere in this document additional work that is ongoing on how information should be disclosed, and how it may interact with the rules made here.

Summary of feedback and our response

1.16 We received 43 written responses to our consultation from a variety of stakeholders, including industry bodies, firms, pension scheme governance bodies, consumer representatives and expert commentators. Respondents largely agreed with a number of the key elements of the proposed rules.

1.17 There was widespread support for the overall approach that we proposed, placing a requirement on asset managers to respond to requests for information about transaction costs. Similarly the way in which the proposed rules would allow firms to make reasonable assumptions when amalgamating costs was broadly supported, although respondents noted some potential complexities.

1.18 The majority agreed that the FCA should not seek to define a template for disclosing costs, although a small number of respondents felt that this was necessary.

5 For further details, please see www.fca.org.uk/publications/market-studies/asset-management-market-study

1.19 There was general support for a requirement to provide relevant contextual information, supported by guidance, rather than for us to set out exactly what information should be provided.

1.20 Responses were mixed in other areas, in particular on the methodology that we proposed for calculating transaction costs.

1.21 For the reasons set out in the rest of this paper, we consider our original analysis was appropriate, but have made some further clarifications around particular points raised by respondents.

Equality and diversity considerations

1.22 We have considered the equality and diversity issues that may arise from the proposals in this PS.

1.23 Overall, we do not consider that the proposals in this PS adversely impact any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

Next steps

1.24 Firms need to comply with the requirements in these rules with effect from 3 January 2018.

2 The disclosure of transaction costs in DC workplace pension schemes

2.1 We received 43 responses to CP16/30 from a variety of stakeholders, including industry bodies, firms, pension scheme governance bodies, consumer representatives and expert commentators.

2.2 This chapter summarises the feedback and sets out our response, including where we consider that changes to our proposals are necessary.

2.3 We consider that the changes we have made to the draft instrument are minor and technical in nature, providing greater clarity or improving the wording, in response to feedback. Therefore the compatibility statement and cost benefit analysis as set out in CP16/30 remain valid.

The flow of information

2.4 We proposed rules to require firms that manage the investments of defined contribution workplace pension schemes to provide information about transaction costs to the governance bodies of those schemes in response to a request.

2.5 We asked:

> **Q1:** ***Do you agree that our proposed rules will enable information on transaction costs to reach governance bodies? If not, what alternative(s) would you propose?***

2.6 The vast majority of respondents agreed with our proposal to require firms to provide information on transaction costs in response to a request from a governance body, and for the rules to empower firms who receive a request to seek information from others within the investment chain. One respondent pointed out that, as drafted, the rules require firms to respond to requests from governance bodies and authorised firms, but do not create the same requirement to respond to a non-authorised firm acting as an intermediary in the information gathering process.

2.7 Some respondents felt that all pension scheme governance bodies, or all bodies responsible for retail investment products, should be able to use these rules to request information, not just those responsible for DC schemes subject to the new governance requirements.

2.8 A small number thought that firms should be required to provide information as a matter of course, and not just in response to a request.

2.9 Others commented on how the rules might apply to firms other than asset managers. One said that those firms should not be required to provide information. Another expressed concerns that it may not be possible to obtain the relevant information from investment banks who provide swaps or other similar arrangements.

Our response

We will make the rules as proposed, with some minor changes.

We did not intend to stop third-party firms acting as intermediaries or aggregators of information, and we have amended the rules to clarify this.

The governance bodies of other pension schemes, and the governance bodies of other retail investment products, may wish to obtain the information that we are requiring firms to provide under these rules. In many cases they will receive equivalent information under the incoming requirements of MiFID II and PRIIPs. We have also appointed a chair to set up a working group to agree a template for the disclosure of costs and charges to institutional investors.

Nevertheless, we do not propose to require in these rules that firms provide this information to all parties who request it. As set out in CP16/30, the purpose of making these rules is to enable the governance bodies of certain pension schemes to obtain information about the transaction costs relevant to their scheme. This is because existing rules and regulations require them to assess transaction costs. We understand that DWP is exploring whether there is a case to require other schemes to assess transaction costs. If it decides to require this, we will consider extending these rules to such schemes in the future.

In particular we are applying the rules to those schemes which are subject to the new governance requirements, brought in by COBS 19.5 and, for occupational pension schemes, by the Occupational Pension Schemes (Charges and Governance) Regulations 2015.[6] Section 44 of the Pensions Act 2014 requires the FCA and DWP to make rules regarding the publication of information about transaction costs and administration charges and its disclosure to scheme members. As part of the work to make those rules, we will consider whether to more closely align the definition of 'relevant scheme' with the scope of section 137FA of the Financial Services and Markets Act 2000 (FSMA).[7]

We considered requiring firms to provide information as a matter of course, rather than in response to a request. Our view was that this could lead to uncertainty about when the rules would apply. A firm would not necessarily know that they were managing money on behalf of a relevant pension scheme, particularly if that scheme is not a direct client. We think that the requirement for governance bodies to obtain the information means that there is no need to require firms to provide it as a matter of course.

We drafted the rules to require firms other than asset managers (for example investment banks or custody banks) to provide information about transaction costs and administration charges, if they have that information. The intention is to give those who need this information

6 SI 2015/879
7 Which is inserted by s.44 of the Pensions Act 2014

the ability to obtain it. While we expect the information will normally be available from an asset manager, the rules are drafted so that it can be obtained from other firms if necessary. To make it clear that the rules apply to arrangements such as swaps, we have changed the term 'investment vehicles' to 'investments' where relevant in the rules.

Proposed approach for calculating transaction costs

2.10 We proposed a standard way of calculating transaction costs using the approach known as 'slippage cost'. We noted that the intention of the rules[8] on considering the value for money of transaction costs was that implicit as well as explicit costs should be considered. While explicit costs are relatively straightforward to calculate and disclose, we recognise that implicit costs are not so straightforward. Following the Call for Evidence on transaction cost disclosure (DP15/2), we considered a number of ways of calculating implicit costs, concluding that, although there is no perfect way of calculating implicit transaction costs, the slippage cost methodology would be the best way of evaluating them.

Feedback to proposed approach

2.11 We asked:

> **Q2:** ***Do you agree with the approach set out for calculating transaction costs? If not what alternative(s) would you propose?***

2.12 We received a wide range of feedback to this question. Respondents focused on a number of areas, including:

- whether slippage cost was an accurate assessment of costs
- whether implicit costs could be calculated at all
- how firms might seek to game the rules
- whether the output of slippage cost would be of use to a governance body
- what alternative approaches might be used to achieve the objective of disclosing transaction costs

2.13 Respondents were divided about the methodology, with some broadly agreeing with the proposed approach, some agreeing but having reservations, while others disagreed. Some of those who disagreed set out alternative proposals.

8 COBS19.5.5R(2)(e) and regulation 25 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715) as amended by the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879)

Proposed methodology

2.14 Opinions were mixed as to whether the information provided by slippage cost would be a useful measure of transaction costs. Some respondents argued that an alternative approach, based on the spread of the fund, would be a more appropriate way to calculate transaction costs. Others pointed to the disclosures now being made by pension funds in the Netherlands as a potential model for calculating transaction costs.

Our response

We will retain the slippage cost methodology as the way in which we require transaction costs to be calculated.

We set out in CP16/30 the reasons why we consider slippage cost to be the best methodology for calculating transaction costs for the purposes of disclosure. We explained why we consider it preferable to alternative approaches to calculating transaction costs, including measures based on spread.

The slippage cost methodology calculates transaction costs as the difference between the price at which a transaction was executed, and the price when the order to transact was transmitted to a third-party (the arrival price). This approach was developed by academics in the 1980s to assess transaction costs and it has been widely used in the investment industry for over 20 years. It identifies the loss of value, from the consumer's perspective, that happens when a transaction takes place. It includes a comprehensive measure of implicit costs. This means that it provides an overall picture of the costs incurred and reduces the risk that some costs remain hidden.

Slippage cost uses actual transaction data to assess transaction costs, unlike other methodologies which tend to use standardised data. Reporting actual costs should enable governance bodies to understand the costs that have been incurred in their scheme and should incentivise asset managers to transact more efficiently, which would not happen using standardised data. We consider that any methodology that uses standardised data to estimate costs risks creating the wrong incentives for firms.

The same methodology will be required to calculate transaction costs under the EU's PRIIPs Regulation.[9] In addition, the European Securities and Markets Authority (ESMA) expects firms to use this same methodology to comply with the costs and charges disclosure requirements under MiFID II.[10]

Some asset managers argued that the spread on a fund could be used to estimate the transaction costs within the fund. While the concept of spread seems intuitively easy to understand compared with slippage cost, as we set out in CP16/30, there are a number of considerations

9 PRIIPs Delegated Regulation 2017/653, Annex VI

10 Questions and answers on MiFID II and MiFIR investor protection and intermediaries topics (ESMA35-43-349)

which make spread hard to use as the basis of a standard calculation of implicit costs and experts in transaction cost analysis generally agree that spread by itself cannot be viewed as the whole cost of transacting.

Firstly, there is no standardised way to calculate the spread on a fund nor detailed rules on how to do it. A fund's spread is, therefore, the judgement of the manager, and there are no requirements which make these judgements consistent. If spread were used to estimate implicit transaction costs, there is a risk of creating incentives for the fund manager to change their judgements about what the fund spread should be.

Secondly, the spread on a fund should represent the cost of buying or selling a cross-section of all the investments held within the fund. While the transactions undertaken by the manager might represent a cross-section of the holdings, this does not have to be the case.

Finally, while the spread on a dual-priced authorised fund is publicly available and hence transparent, we are concerned that spread may not be transparent or subject to outside scrutiny for other types of product.

Gaming of the rules

2.15 Some respondents, whether or not they agreed with the proposed methodology, highlighted ways in which they were concerned that market participants might seek to game the methodology. One example of potential gaming that was described was breaking down orders into smaller units or 'child orders' and calculating transaction costs as if each smaller unit was a discrete order.

Our response

We note the comments on gaming. We have made some minor amendments to the rules and guidance to address the ways in which respondents have described possible gaming activities.

While it would not be possible to prevent every attempt at gaming, the objective of these rules is clear. It is to enable governance bodies to obtain, as far as possible, the actual costs associated with transactions. They then have the responsibility to consider whether transaction costs represent value for money.

Firms are under other broader obligations, such as acting in the client's best interests and best execution, which mean that they should not be engaging in transactions simply to game the transaction cost disclosure rules. Where a firm adopts a complex process in an attempt to game the rules, this should be capable of being identified during a due diligence exercise, which should reduce the risk of firms choosing to operate in this way. If we have evidence that firms are attempting to game the rules and are not acting in the client's best interests, we will take action as appropriate.

We set out below our response to some specific points made in this area.

Definition of arrival time

2.16 Some respondents noted the definition of arrival price as the price at the time when the order is transmitted into the market. They argued that asset managers who use the methodology that we proposed to calculate transaction costs typically use the time that the portfolio manager sends the order to the dealing desk, rather than the time at which the order is transmitted into the market.

Our response

We will retain the definition of arrival time as proposed and provide some further guidance as to how to treat certain specific situations.

We acknowledge that many asset management firms use an arrival time when an order is sent from a portfolio manager. We considered this as an alternative for arrival time when developing the proposals in the CP.

There are some advantages to considering this to be the arrival time. For example, it ensures that an order from a portfolio manager is treated as a single unit, rather than being broken into multiple units when being placed in this market. However there are also disadvantages. Many factors may influence the time between an order being generated by a portfolio manager and it entering the market. However, when an order has been transmitted to deal, we consider it to be in the market, and therefore to be incurring transaction costs.

To address the issue that firms might choose to break down an order from a portfolio manager into artificially smaller orders for the purposes of execution, we are amending the rules to make it clear that an order should be treated as a single entity, so that there is no incentive to break an order down into smaller components (so-called 'child orders') to make it appear to have lower costs. We clarify that where an order is transmitted to the market in multiple tranches over the course of a day, it should be treated as a single order using the arrival time of the first tranche.

Reporting implicit as well as explicit costs

2.17 Some respondents argued that implicit costs are too difficult to calculate, or too difficult for governance bodies to understand, and that therefore only explicit costs should be disclosed.

Our response

We will continue with our proposal to require a methodology that calculates implicit costs as well as explicit costs.

We set out the considerations and challenges around reporting implicit costs as well as explicit costs in the 2015 Call for Evidence (DP15/2). As we set out in that paper, calculations of explicit costs are clearly more straightforward than calculations of implicit costs. Nonetheless, our view remains unchanged that the intention of the Pensions Act 2014 was for implicit costs to be disclosed as well as explicit costs.

Both implicit and explicit costs impact on the returns that investors receive. If governance bodies only receive information about explicit costs they will only get a partial picture of the total costs.

While there are technical challenges in calculating implicit costs, and while any calculation will be an estimate rather than a precise number, the same could be said of a number of other areas in the financial markets. Calculations of risk are based on models and estimates which make certain assumptions, for example about the correlations between different assets. While there might sometimes be specific circumstances where the output needs some explanation, this does not invalidate the exercise.

By requiring the disclosure to governance bodies of a breakdown of costs, including major categories of explicit costs, we think those governance bodies should be able to review explicit costs separately from implicit costs, if that would be useful or if the governance body considers that implicit costs are too difficult to understand.

Market movements contained within slippage costs

2.18 Some respondents argued that slippage costs capture market movements rather than the costs associated with transactions.

Our response

We are retaining the methodology to calculate slippage costs without making any adjustments to reduce the impact of market movements.

We considered the extent to which the slippage cost methodology includes market movements, including whether it distorts the overall picture of transaction costs. As set out in CP16/30, we have analysed this issue previously and do not consider that any of the arguments made in response to the consultation are sufficient to change our view

on this point. As explained in paragraph 3.28 of CP16/30, it would be theoretically possible to strip out the impact of market movements by adjusting the arrival price by the movement in the underlying market. This might increase accuracy, but would create significant additional complexity.

We remain of the view that the component of slippage costs that relates to market movements is random and as such it should tend towards zero when a material number of trades is analysed.

Unusual results, including negative costs

2.19 A number of respondents highlighted the potential for slippage costs to generate significant positive or negative numbers. Some argued that such numbers were not a true reflection of the costs, while others argued that governance bodies may have difficulty interpreting them.

Our response

We have reviewed a number of portfolios where there are examples of negative transaction costs or unusually large transaction costs. In many cases, our analysis suggests that the unusual results are the outcome of the slippage cost methodology not being applied correctly.

One common issue appears to arise around initial public offerings (IPOs). Where an asset manager purchases stock in an IPO, it is not appropriate to use as the arrival price the trading price of the stock in the after-market. The order must have been transmitted prior to the IPO (or the asset manager could not be allocated stock). In this instance we consider it more reasonable for the IPO price to be used as the arrival price, which would normally lead to no transaction cost (since buyers of IPO stock do not normally pay commission or transaction taxes). We are clarifying this approach in the rules. We are also applying this rule to other securities bought on issuance.

There may be some operational and practical difficulties in knowing whether a security has been bought in response to issuance. Nevertheless, where an individual transaction generates material negative transaction costs, the asset manager should review whether this has been generated by an issue of stock, and if so use the transaction price as the arrival price.

One respondent noted that, when they review individual transactions, some transactions appear to have anomalously large or negative transaction costs, but that this is frequently the result of an incorrect price being entered. They noted that sometimes these costs can distort the total reported transaction costs. If this is the consequence of a transaction that has actually been executed at the wrong price, it seems reasonable to calculate the transaction costs that have actually been incurred. If this is the result of a data error, we consider that a firm with adequate systems and controls should be able to identify a data error and rectify it in reporting to the client.

Feedback to proposals specific to asset classes

2.20 We asked:

> **Q3:** ***Do you agree with the proposals in [chapter 4 of CP16/30, on issues specific to asset classes]? If not, what alternative(s) would you propose?***

2.21 Some respondents argued that there is a difference between transaction costs, which they argue are the costs paid to other parties to make a transaction, and the price at which an agreement can be reached between willing buyers and sellers to effect a transaction. One respondent argued that, where transaction prices include an element that is the cost paid to a third party, the FCA should change the way that transactions are effected, so that all costs are charged explicitly.

Treatment of physical assets such as property

2.22 A number of respondents argued that the methodology for calculating transaction costs for physical assets, particularly property, was

- inappropriate
- did not provide useful information, and
- needed to make assumptions which would be unlikely to be made consistently by market participants

Most acknowledged that there are significant explicit costs associated with transactions in property, but many argued that there was not a 'fair value' price for the property which would generate implicit costs.

Our response

We are making some amendments to the rules as they apply to physical (in other words, real or tangible) assets.

Having considered the feedback on property, we agree that it is not realistic to try to generate an arrival price for this type of asset. Instead it is more likely that a governance body would receive useful information about transactions in physical assets, such as property, if firms are required to report the explicit costs associated with relevant transactions. We have, therefore, removed the requirement to calculate or estimate the prior valuation of the property, but expect that the transaction costs will be calculated as the charges, commissions, taxes and other payments associated with the transaction, which should not be included as part of the transaction price.

We retain the general requirement to calculate transaction costs for other assets which do not meet the requirements set out in COBS 19.8.10R(1), (2) or (3) by using the previous independent valuation (appropriately adjusted) or the fair value. We envisage that this requirement would apply, for example, to a bespoke derivative.

Equity market issues

2.23 A number of respondents raised concerns about the position we took in 4.4 of CP16/30 regarding orders sent to be executed at a specific time. Some argued that it was not appropriate to use the time when an order is transmitted if that order includes an instruction to deal at a specific time. Others argued that managers who wish to trade at specific times will choose to transmit orders as late as possible, creating operational risk and meaning that brokers will not understand as fully what they would need to do to fulfil such an order.

Our response

Having considered these points, we have decided to retain the approach set out in the CP.

Our view, as stated in the CP, remains that allowing flexibility to amend order times would create complexity (and the associated risk of abuse) without much benefit.

We recognise that a number of respondents, particularly those engaged in passive investment management, do not agree with this approach. However, other respondents cited situations where clients suffer high transaction costs because of the way that asset managers trade. For example they pointed to the 4pm foreign exchange (FX) fix, noting that many asset managers target this and that there is strong evidence that they incur significant transaction costs by doing so. Passive asset managers also target market closing prices for equities. We have considered the arguments, and conclude that it is not reasonable to argue that simply because a transaction is executed at the same price used by an index, that there is no transaction cost. We have been made aware of one historical example where the index inclusion price materially differed from the price shortly before and shortly after index inclusion.[11] Allowing the flexibility to amend order times to the intended time of execution is unlikely to enable governance bodies to understand the costs associated with such practices.

Bond market issues

2.24 A number of responses noted that, while the slippage cost methodology is already widely used within the equity market, the information required to calculate slippage cost is less available in the bond market. Some respondents argued that prices in the bond market are not consistent, and that it is therefore not possible to establish an arrival price, since there is no quoted mid-market price available at any point in time.

Our response

We do not make any amendments to the methodology to calculate the arrival price for bonds.

11 The inclusion of Dimension Data in the FTSE indices on 15th September 2000, when the index inclusion price of 1000p was materially higher than the closing price on the previous and subsequent trading days (669p and 688p respectively)

We considered whether the methodology should be used for bonds as well as for equities. As noted in the CP, we are aware that many bonds do not trade on a frequent basis. However, market data providers maintain prices for bonds on a daily basis that show the current valuation. Bonds are inherently more capable of being accurately valued than equities. Most bonds entitle the holder to a series of cashflows over a period of time, and the value of these cashflows (and the risk of not receiving them) can generally be modelled with a fairly high degree of accuracy at any point in time, based on the prices of other similar instruments. Furthermore, following the introduction of MiFID II, there is a specific requirement for firms taking decisions to deal in over-the-counter (OTC) products, which includes most bonds, to check the fairness of the price.[12]

When an asset manager transacts in a bond, it may not always be possible to trade at the theoretical fair price of the bond, but (except in the case of very high-risk credits) it is normally possible to agree a price for a bond that reflects the current value. Where the transaction price is different from this fair market price, this reflects the effective spread of the bond, which in our view should be disclosed as a transaction cost.

Currency market issues

2.25 Some respondents commented on the supplemental provisions for FX. They argued that the rule should be more explicit and better aligned to the PRIIPs requirement to use a consolidated market price, providing examples of situations when the current proposed wording might be used to justify a less transparent approach. Others raised concerns about the existence of a market price in the FX market, and questioned why we were requiring the use of a consolidated price. One respondent asked whether the proposed supplemental provisions for FX were intended to stand alone, on the basis that they considered that the term 'investment' did not include FX transactions.

Our response

We have amended the text in line with the PRIIPs requirement.

We agree with respondents that using the PRIIPs wording will articulate the policy intent more clearly than the previous wording. We are aware of concerns about abuses within the FX market, whereby a provider or a platform compares an execution to their own mid-rate, which is not a fair reflection of the rate available in the wider market. The intention is for governance bodies to be able to review the transaction costs incurred for FX, and we consider there to be a substantial risk that, if the rate of a single provider or platform is used, rather than a consolidated rate, it would obscure the actual cost of transactions.

We consider that the term 'investment' has a broad application, and so any transactions in FX would be caught by the rules in COBS 19.8.10R.

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12 MiFID II Delegation Regulation EU 2017/565, Article 64(4)

Derivatives issues

2.26 Some respondents commented on the approach to derivatives proposed in COBS 19.8.12G. They argued that the guidance proposing a distinction between linear and non-linear derivatives was unnecessary and over-complicated. They argued that the fair value price described for non-linear derivatives could equally be applied to linear derivatives.

Our response

We agree with the points made by respondents and are simplifying the guidance in this area by deleting the reference to linear and non-linear derivatives.

Amalgamation of transaction costs at arrangement level

2.27 We asked:

Q4: ***Do you agree that our proposed rules will enable pension arrangements and funds that invest in other funds to amalgamate the total transaction costs from underlying funds?***

2.28 Respondents agreed in principle that our proposal would achieve this objective. They acknowledged the complexity inherent in amalgamation but recognised the need for it. One respondent explained that, without amalgamation, the disclosure of transaction costs would always underestimate costs.

2.29 A number of respondents made the point that significant work will need to be carried out by the industry to ensure that amalgamation of costs is coherent, accurate and comparable. Similarly, a respondent highlighted that there could be inconsistencies with the way different asset classes are treated. One firm stated that the FCA had not captured all of the practical complexities of calculating a single transaction cost figure from those within the underlying funds.

2.30 Some respondents suggested that the standard cost template developed by the Investment Association would facilitate the amalgamating of costs in relation to underlying investment vehicles at the arrangement level.

2.31 Others asked for clarification of responsibility for calculating transaction costs where a provider is investing on an execution-only basis and on the application of the methodology to with-profits funds.

Our response

We will retain the requirements proposed around the amalgamation of transaction costs.

The rules place an obligation on the manager of an underlying fund to respond to a request by disclosing an aggregation and breakdown of transaction costs. To ensure consistency when amalgamating and presenting information, costs from vehicles that are not the primary investment vehicle will need to be accounted for. Any disclosure of transaction costs should consolidate the transaction costs of underlying investment vehicles. We agree that this might present some operational issues but believe that standard cost templates should facilitate the process of amalgamating costs in relation to underlying investment vehicles. Our discussions with firms tell us that the issues are one-off in nature and we do not agree that we have significantly underestimated the difficulties.

There is an obligation to calculate transaction costs if a provider is investing on an execution-only basis. Where a fund holds an investment in a with-profits fund, if transactions within the fund will have an impact on the amount of money that the investor receives over the life of the contract, then we believe that the costs associated with those should be reported as transaction costs.

Anti-dilution mechanisms

2.32 A significant number of respondents did not agree with our view that anti-dilution mechanisms such as an anti-dilution levy or a dual-price system constitute transaction costs. Some suggested deleting the proposed rule.

2.33 Those who argued against anti-dilution mechanisms being seen as transaction costs explained that prices may be swung to protect funds from dilution. Money flowing in or out could be invested in underlying assets and therefore it would not be appropriate to disclose the potential benefit as if it were a cost. Their arguments were both theoretical and practical.

2.34 On the theoretical side, some respondents argued that where a fund has a single price, there is no transaction cost incurred in buying or selling it, even when the single price is swung towards the bid or offer. Others disagreed with this, arguing that investors might incur significant costs because their scheme bought or sold a fund at a swung price.

2.35 On the practical side, a number of respondents noted that there are differences in the transparency of different anti-dilution mechanisms. Dual-priced funds are priced with a clear and transparent spread. Anti-dilution levies are charged as an explicit cost, which should be identifiable. However, funds with a swinging single price do not disclose the level of the swing, and this is not routinely available to enable those investing in funds to understand the price at which they transacted.

2.36 One respondent argued that, in respect of single-priced funds, the draft rules should be amended to require the provision of more generic information to governance bodies on the size and direction of swing factors applied where swing pricing mechanisms are in place.

Our response

We will proceed with our rules as proposed.

We have considered the arguments around whether anti-dilution mechanisms should be considered a transaction cost, and remain of the view that, when a pension scheme transacts in a fund, it may incur transaction costs either by

- paying an anti-dilution levy or
- dealing at a price that differs from the mid-price.

Spreads on funds and anti-dilution levies are imposed for the specific purpose of protecting the ongoing investors in a fund, by passing on to incoming investors the transaction costs associated with investing their money and to investors leaving the fund the costs of disinvesting.

The rules are intended to work so that a scheme transacting in a fund can identify the transaction costs associated with that transaction. The fund can then offset the benefit that it receives from the anti-dilution mechanism against the transaction costs incurred. It would be inconsistent not to consider anti-dilution mechanisms as transaction costs, while allowing underlying funds to remove the impact of anti-dilution mechanisms from their transaction costs.

Assumptions around amalgamation

2.37 We asked:

> **Q5:** ***Do you agree that transaction costs should be amalgamated on the assumption that underlying funds incur them evenly over a reported period? If not, what alternative solution(s) would you propose?***

2.38 Most respondents agreed that this was the most practical approach to addressing amalgamation. Some noted that the assumption was unlikely to be entirely accurate, but felt that it would lead to broadly the right data being reported. A small number of respondents argued that transaction cost data should be reported more frequently, or even daily.

2.39 Some respondents highlighted the likely reduction in costs for firms of reporting data in line with the accounting period of a fund rather than on an ad hoc basis for each client, and noted that the Investment Association's Disclosure Code would potentially assist with the flow of data. One respondent suggested that reporting periods should be standardised to enhance the ability for governance bodies to compare different vehicles. Another pointed out that the guidance in COBS 19.8.6G could be argued to be over-ridden by the requirement in the rules in COBS 19.8.5R to report 'for that period'.

Our response

We will retain our proposed approach to the assumptions behind amalgamation.

We acknowledged in CP16/30 that this approach is not perfect, but conclude that it is the most practical way of dealing with the challenges in this area. We do not currently consider it proportionate to require reporting over a standardised period. We understand that, in practice, IGCs report on a common cycle, even though there is no obligation for them to do so.

While some governance bodies may wish to work with their asset managers to obtain data on a more frequent basis, we do not consider it proportionate to require this within our rules.

We consider that the guidance in COBS 19.8.6G clarifies how firms should respond to a request when it is not possible to calculate costs for a specific period, and we have deleted the words 'for that period' from COBS 19.8.5R.

Approach to presentation of transaction costs

2.40 We asked:

Q6: ***Do you agree that the approach set out in this chapter is adequate to provide governance bodies with sufficient information to assess transaction costs? If not, what alternative(s) would you propose?***

2.41 There was general support for our proposed approach. However, a significant number of respondents were in favour of standardisation, arguing that it would help governance bodies to easily and efficiently aggregate information from all their services providers.

2.42 One firm suggested that the FCA should consider whether there might be a case for introducing a prescribed / standardised format as part of the MiFID II costs and charges disclosures.

2.43 The Consumer Panel went further and argued that only a template, agreed by both the FCA and the Pensions Regulator, would be appropriate to ensure that governance bodies received consistent and technically correct data that could be assessed and used for comparisons.

Our response

We retain the approach proposed in the consultation.

We note the comments in favour of standardisation and agree that there may be some advantages to it.

We do not see a need to make rules to specify how information should be presented to the governance bodies of DC pension schemes, and these rules do not contain any specific requirements in this area. However, we see the value of more consistent and standardised disclosure of costs and charges to institutional investors, and we have appointed a chair to set up a working group of industry and investor representatives on institutional disclosure, with a view to agreeing a template for disclosure of costs and charges. We consider that these rules are consistent with that initiative.

Breakdown of costs

2.44 Respondents had mixed views on this point. Some supported the breakdown of identifiable costs into defined categories, noting that this should aid interpretation by governance bodies. Others had concerns over the costs compared to benefits of requiring funds to provide a more detailed breakdown on request. They argued that fund managers would need to build the functionality to provide a detailed breakdown on request, hence incurring costs even if they were to receive few requests.

2.45 There was support for a general requirement that firms include other relevant information, while giving them the flexibility to decide what the relevant information will be for a given circumstance or audience.

Our response

We retain the approach proposed in the consultation.

Some firms noted that categories of explicit cost can be relatively easily extracted from existing accounting systems, and that the costs of doing this should be small. We are also aware that, under MiFID II, firms will be obliged to provide their clients with a detailed breakdown of costs and charges on request.[13]

Cost-benefit analysis (CBA)

2.46 We asked:

> **Q7:** ***Do you have any comments on our analysis of the costs and benefits of introducing rules on transaction cost disclosure?***

2.47 We set out in CP16/30 that our view was that the direct costs of implementing this proposal would be more than offset by the benefits of firms not having to respond to ad hoc queries from IGCs and trustees who are obliged under existing rules and

13 MiFID II Article 24(4)

regulations to seek information about transaction costs to enable them to consider whether they represent value for money.

2.48 We received a number of comments on the CBA. Some firms argued that we had underestimated the costs of calculating transaction costs. Others argued that there was no benefit in setting out a standardised approach to calculating costs, or in disclosing implicit costs. Others argued that for most firms the costs of reporting the information would be lower than anticipated.

Our response

We acknowledge the feedback on the CBA but note that we considered these points as part of the original CBA. We have not received any significant new information that would warrant us making changes to our CBA. The changes that we have made to the instrument do not significantly differ from the consultative draft, and on that basis we consider that the CBA still applies.

One respondent argued that we should have provided a comparison of the costs of our proposed methodology against the costs of using an alternative methodology which they proposed. Our obligation under FSMA is to compare the costs and benefits of our proposed approach with the baseline of what we expect to happen if we do not intervene. This is the approach we have taken in this CBA.

In terms of the benefits, our analysis focused on the direct benefit to firms of not needing to deal with ad hoc requests from clients who are obliged to seek the information, rather than the less direct benefits which may arise from greater scrutiny of transaction costs, although we gave some indication of the potential scale of such benefits, if this were to happen. We do not consider that the responses provide any particular evidence that our conclusions were inaccurate.

Annex 1
List of non-confidential respondents

Aegon

AllianceBernstein

Aon Hewitt

Ashmore

Association of British Insurers

Association of Pension Lawyers

BlackRock

Cardano Risk Management

Depositaries and Trustees Association

Ensign Pensions

Financial Services Consumer Panel

Hymans Robertson

Institute and Faculty of Actuaries

Metcalfe

Modular FX Services

Nest Corporation

New Change FX

Nico Aspinall Consulting

Now Pensions

Pensioen Federatie

Pension PlayPen

Pensions and Lifetime Savings Association

Phoenix IGC

Pitman Trustees

Prudential

Schroders

Scottish Widows

SIFMA

Standard Life Investments

State Street

The Investment Association

The Peoples Pension

The Society of Pension Professionals

Transparency Task Force

UNISON

Vanguard

Willis Towers Watson

Zurich Insurance

Annex 2
Abbreviations in this paper

CBA	Cost-benefit analysis
CP	Consultation Paper
DC	Defined contribution
DWP	Department for Work and Pensions
ESMA	The European Securities and Markets Authority
EU	European Union
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
FX	Foreign exchange
IGC	Independent Governance Committee
IPO	Initial public offering
MiFID II	The recast Markets in Financial Instruments Directive (2014/65/EU)
OFT	Office of Fair Trading
OTC	Over-the-counter
PRIIPs	The Packaged Retail and Insurance-based Investment Products Regulation (EU 1286/2014)
PS	Policy statement

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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Appendix 1
Made rules (legal instrument)

PENSION SCHEMES (DISCLOSURE OF TRANSACTION COSTS AND ADMINISTRATION CHARGES) INSTRUMENT 2017

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(1) section 137A (The FCA’s general rules);
(2) section 137T (General supplementary powers); and
(3) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 3 January 2018.

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the Pension Schemes (Disclosure of Transaction Costs and Administration Charges) Instrument 2017.

By order of the Board
12 September 2017

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

IGC	(in *COBS* 19.5 <u>and *COBS* 19.8</u>) an independent governance committee established by a *firm* with terms of reference which satisfy *COBS* 19.5.5R with the purpose, in summary, to represent the interests of *relevant policyholders* in the *firm's relevant schemes*.
relevant scheme	(1) (except in *FEES* 6<u>, *COBS* 19.5 and *COBS* 19.8</u>) a *collective investment scheme* managed by an *EEA UCITS management company*.
	…
	(4) <u>(in *COBS* 19.8):</u> (a) <u>a *personal pension scheme* or *stakeholder pension scheme* in (3); or</u> (b) <u>a 'relevant scheme' for the purposes of regulation 25 of The Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715) as defined in regulation 1 of those Regulations which is, in summary, an occupational pension scheme (as defined in section 1(1) of the Pension Schemes Act 1993) that provides money purchase benefits (as defined in section 181(1) of that Act with certain exceptions).</u>

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

After COBS 19.7 (Retirement risk warnings) insert the following new section. The text is not underlined.

19.8 Disclosure of transaction costs and administration charges in connection with workplace pension schemes

Interpretation

19.8.1 R In this section:

(1) 'administration charges', in relation to a member of a pension scheme, means any of the following to the extent that they may be used to meet the administrative expenses of the scheme, to pay commission or in any other way that does not result in the provision of pension benefits for or in respect of members:

(a) any payments made to the scheme by, or on behalf or in respect of, the member; or

(b) any income or capital gain arising from the investment of such payments; or

(c) the value of the member's rights under the scheme;

but an administration charge does not include any charge made for costs:

(d) incurred directly as a result of buying, selling, lending or borrowing *investments*; or

(e) incurred solely in providing benefits in respect of the death of such a member; or

(f) incurred in complying with a court order, where that order has provided that the *operator*, trustee or manager of the scheme may recover those costs; or

(g) arising from earmarking orders or pension sharing arrangements pursuant to regulations made under section 24 or section 41 of the Welfare Reform and Pensions Act 1999.

(2) 'anti-dilution mechanism' is any method used to the benefit of an *investment* to offset the impact of inflows or outflows from that *investment*, whether by way of:

(a) a levy; or

(b) any adjustment enabling further investment into, or redemption of investments from, the *investment*.

(3) 'arrangement', in connection with *a relevant scheme,* is any *investment* available to scheme members for the investment of their pension contributions.

(4) 'transaction costs' are costs incurred as a result of the buying, selling, lending or borrowing of *investments*.

Application

19.8.2 R This section applies to:

(1) an *operator* of a *relevant scheme*; and

(2) a *firm* which holds information needed for the calculation of transaction costs or administration charges in the course of providing services in connection with:

(a) a *relevant scheme*;

(b) an arrangement; or

(c) an *investment* in which an arrangement is directly or indirectly invested.

Purpose

19.8.3 G (1) The purpose of the *rules* in this section is to enable governance bodies of workplace pension schemes to meet their obligations as set out in (2) and (3) by obliging *firms* which hold the relevant information to calculate transaction costs to a common standard and provide that information, and information on administration charges, to governance bodies.

(2) An *operator* of a workplace *personal pension scheme* or *stakeholder pension scheme* is obliged under *COBS* 19.5.7R(2) to take reasonable steps to provide its *IGC* (or *governance advisory arrangement*) with all information reasonably requested by it for the purpose of carrying out its role. The role of an *IGC*, under *COBS* 19.5.5R(2), must include the assessment of value for money delivered by relevant schemes through the assessment of transaction costs (among other things).

(3) The trustees or managers of an occupational pension scheme are obliged to calculate, insofar as they are able to do so, the transaction costs borne by scheme members, and to assess the extent to which those costs represent good value for members. (See regulation 25 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715) as amended by the Occupational

Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879)).

Obligation to disclose transaction costs and administration charges

19.8.4 R A *firm* must respond in a reasonable time and in a reasonably acceptable format to a request for information relating to transaction costs and administration charges relating to a particular arrangement (or any *investment* in which the arrangement is directly or indirectly invested) over a period of time from or on behalf of:

(1) an *operator*, trustee or manager of a *relevant scheme*; or

(2) another *firm* seeking to comply with its obligations under this section.

19.8.5 R In responding to the request referred to in *COBS* 19.8.4R, the *firm* must:

(1) calculate the transaction costs incurred in relation to the arrangement or *investment* to which the request relates (including transaction costs incurred in any *investment* in which the arrangement or *investment* is directly or indirectly invested) in accordance with this section;

(2) disclose the results of the aggregation of those transaction costs to the requesting *person*, along with a breakdown of the identifiable elements of those costs;

(3) disclose the administration charges incurred in that arrangement or any *investment* to which the request relates (including administration charges incurred in any *investment* in which the arrangement or *investment* is directly or indirectly invested); and

(4) provide other relevant information which would or may assist in making comparisons between the costs or charges in (1) to (3) and the equivalent costs or charges of other pension schemes where available.

19.8.6 G (1) The breakdown of identifiable transaction costs should include at least taxes, explicit fees and charges, and costs in connection with securities lending and borrowing**.**

(2) Other relevant information regarding transaction costs or administration charges might include, in relation to each arrangement (or *investment* in which the arrangement is directly or indirectly invested): the investment return, measures of risk, portfolio turnover rate, proportion of securities loaned or borrowed, costs other than transaction costs, and typical and maximum levels of entry, exit and switching costs. This is not an exhaustive list, and *firms* should use discretion based on the composition of each particular arrangement (or *investment* in which the arrangement is

directly or indirectly invested).

(3) Where it is not possible to calculate the amount of transaction costs or administration charges attributable to an arrangement (or *investment* in which the arrangement is directly or indirectly invested), a pro rata approach may be used, which assumes that transaction costs and administration charges are incurred evenly over time. A pro rata approach may also be used where information is not available for a full period or in other situations where the provision of information would otherwise be subject to unreasonable delay.

(4) When calculating administration charges for a default arrangement, *firms* should have regard to *COBS* 19.6 (Restriction on charges in qualifying schemes) and the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879).

Taking reasonable steps to obtain necessary information

19.8.7 R If a *firm* does not have the information necessary to comply with *COBS* 19.8.4R and *COBS* 19.8.5R, then it must:

(1) take reasonable steps to obtain that information; or

(2) where, despite having taken such reasonable steps, it remains unable to comply with *COBS* 19.8.4R and *COBS* 19.8.5R, provide a written explanation to the requesting party explaining why, including the percentage of *investments* in the arrangement (or *investment* in which the arrangement is directly or indirectly invested) for which information cannot be obtained, and indicating the categories of *investments* involved.

19.8.8 G (1) In taking reasonable steps to obtain information about transaction costs or administration charges, a *firm* should request the information from other *firms* involved in providing services in connection with the *relevant scheme*, arrangement, or *investment* in which the arrangement is directly or indirectly invested.

(2) A *firm*, when seeking information about transaction costs or administration charges, should consider the materiality of that information to the calculation of costs and charges overall for each arrangement, in particular the degree to which it is necessary to look through to transactions in underlying *investments* in order to arrive at a fair assessment of the costs or charges of each arrangement.

Calculation of transaction costs for buying and selling transactions

19.8.9 R A *firm* must calculate the transaction cost of buying or selling an *investment* as the difference between arrival price (AP) and execution price (EP) of that *investment*, multiplied by the number of units of, or in, the *investment* transacted, as follows:

(1) AP and EP are determined in accordance with this section;

(2) where an *investmen*t is purchased:

transaction cost = (EP-AP) x (units); and

(3) where an *investment* is sold:

transaction cost = (AP-EP) x (units).

Arrival Price (AP)

19.8.10 R A *firm* must determine the arrival price as follows:

(1) for a *transferable security*, or other *investment* which there are frequent opportunities to dispose of, redeem, or otherwise realise at a price publicly available to market participants that is either a market price or a price made available or validated by valuation systems independent of the *issuer*:

(a) the market mid-price at the time the order was transmitted to another *person* for execution or was executed, whichever is earlier; or

(b) if no such price is available, then the last available mid-price on the day the order was *executed*, or, if this is not available, the closing mid-price on the day before; or

(c) if the order to transact was executed on a day other than the day it was transmitted to another *person* for execution, the market opening mid-price on the day of execution, or, if this is not available, the closing mid-price the day before; or

(d) if the order was *executed* during an auction, the most recently available mid-price of the asset prior to the auction; or

(e) if an order is transmitted to another *person* for execution outside trading hours, the subsequent market opening mid-price.

(2) for an investment fund or other vehicle priced on a periodic basis:

(a) for a dual-priced vehicle, the fair value mid-price of the vehicle at the pricing point when the transaction took place; or

(b) for a single-priced vehicle, the fair value price of the vehicle at the pricing point when the transaction took place, prior to any dilution adjustment.

(3) for physical (in other words, real or tangible) assets, the price paid for that physical asset, excluding all charges, commissions, taxes and

other payments associated with the transaction.

(4) for any other *investment* which does not fall into (1), (2) or (3):

(a) the most recent independent valuation prior to the order to transact being executed, or, if earlier, transmitted to another *person* for execution, adjusted appropriately for market movements using an appropriate benchmark index; or

(b) if no such valuation is available, then an estimate based on a reasonable appraisal of the fair value of the asset prior to the order to transact being executed.

Arrival Price (AP): supplemental provision for multiple orders on the same day

19.8.11 R Where an order is split into multiple orders ('child orders') in the same *investment* and transmitted on the same day, the arrival price of the first child order must be used as the arrival price of all subsequent child orders on that day.

Arrival Price (AP): supplemental provision for initial public offerings, placings and other issuance of securities

19.8.12 R For orders in initial public offerings, placings and other issuance of securities, the transaction price must be used as the arrival price.

Arrival Price (AP): supplemental provisions for derivatives

19.8.13 R When determining the arrival price for a *derivative* where there is no publicly available price, a firm must determine the fair value price of the *derivative*.

19.8.14 G (1) When considering the basis for determining transaction costs relating to *derivatives*, a *firm* should take into account:

(a) the existence of any multiplier or scalar in arriving at the correct number of units;

(b) the nature of the *derivative*;

(c) the availability and transparency of prices of the *derivative* itself;

(d) where applicable, the nature and value of the assets underlying the *derivative*, including their price transparency and relative proportions within that *derivative*; and

(e) any other costs associated with the *derivative*.

(2) When determining the fair value price, a firm should adopt a fair value approach in line with prevailing market conventions.

Arrival Price (AP): supplemental provision for foreign exchange

19.8.15 R A *firm* must, in relation to a transaction involving foreign exchange, determine the arrival price using a reasonable estimate of the consolidated price rather than the price available from a single counterparty or foreign exchange platform, even if an agreement exists to undertake all foreign exchange transactions with a single counterparty.

Execution Price (EP)

19.8.16 R A *firm* must determine the execution price as the price at which a transaction is executed including all charges, commissions, taxes and other payments associated with the transaction, directly or indirectly, where those payments are made from the assets of the arrangement or of any *investment* in which the arrangement is directly or indirectly invested.

Calculation of transaction costs for lending and borrowing transactions

19.8.17 R A *firm* must calculate the transaction cost of a loan transaction as the difference between the charge paid by the ultimate borrower in relation to that loan and the amount received by the arrangement (or underlying *investment*).

19.8.18 G The amounts used to calculate the transaction cost of a loan transaction should include all fees, commissions, charges and other costs levied by intermediaries involved in the transaction regardless of the legal structures involved.

19.8.19 R To determine the transaction cost of a borrowing transaction, a *firm* must use the amount paid for the loan.

Aggregation

19.8.20 R The *firm* must aggregate and disclose, separately, the following transaction costs for each arrangement or *investment* and period to which the request relates:

(1) the sum of the transaction costs for buy and sell transactions factoring in anti-dilution mechanisms (see *COBS* 19.8.21R); and

(2) the sum of the transaction costs for lending and borrowing transactions.

Treatment of anti-dilution mechanisms

19.8.21 R A *firm* using an anti-dilution mechanism in connection with an arrangement or *investment* may factor this into the aggregate transaction costs calculation as follows:

(1) where a levy is used, the monetary value of that levy may be subtracted from the aggregate transaction costs; and

(2) where an adjustment is made by enabling further investment into or redemption from an *investment*, the value of the benefit accruing to the *investment* may be subtracted from the aggregate transaction costs.

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