Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Transaction cost disclosure in workplace pensions

Lead regulator: FCA

Date of assessment: 24 August 2017

Commencement date: 3 January 2018

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of the UK

Brief outline of proposed new or amended regulatory activity

We are introducing a requirement for asset managers to disclose transaction costs and administration charges when this information is requested by certain pension schemes (essentially workplace defined contribution (DC) pension schemes). The rules for asset managers are an FCA initiative, to align with the required disclosure of transaction costs by pension schemes under s.44 of the Pensions Act 2014[1]. To enable firms to do this, the FCA decided to set out a standard methodology to calculate costs and place this requirement on the managers of the assets held within pension schemes. The methodology uses the same calculation basis as incoming requirements to calculate transaction costs under the EU Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation.

The rules that we brought in require asset managers managing money on behalf of a workplace DC pension scheme to respond to a request for information about transaction costs and administration charges from the governance bodies of those pension schemes. We consider that there will be costs to the asset managers from setting up systems to calculate and report this information.

Current rules and regulations require trustees of occupational DC schemes and Independent Governance Committees (IGCs) of contract-based workplace personal pension schemes to obtain (among other things) transaction cost information to assess on an annual basis whether these costs represent value for money. Without a standardised form of disclosure, requests for information about transaction costs occur on an ad hoc basis, whenever a trustee or IGC wants

[1] The FCA is obliged to make rules requiring pension scheme governance bodies to disclose information about transaction costs to members of workplace personal pension schemes. The DWP is obliged to make equivalent rules for occupational pension schemes

to review this material, to whatever specification they feel appropriate for their needs. We sought information from firms to understand the likely costs and benefits of our approach.

There are three different types of arrangement that we consider:

- trustees of a stand-alone scheme
- trustees of a mastertrust, and
- IGCs of a contract-based pension provider

The rules were the subject of a consultation (CP16/30) which included a cost benefit analysis. They were published in a Policy Statement (PS17/20) in September 2017.

Which type of business will be affected? How many are estimated to be affected?

This will largely affect asset managers who manage money on behalf of workplace DC pension schemes. We estimate that there are around 50 asset managers in scope.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2018	3/1/2018	10	51.1	-5.5	-27.7

Please set out the impact to business clearly with a breakdown of costs and benefits

We make a number of assumptions to assess the benefits of standardising transaction cost disclosure:

- Each standalone pension scheme uses a single insurer/asset manager.
  Since there are many schemes that use more than one provider, this is almost certainly an underestimate. We assume that each pension scheme offers around 10 investment options[2].
- Each mastertrust offers a wide range of products, in a similar way to a contract-based scheme[3].
- A contract-based scheme offers around 150–250 different investment options from multiple asset managers[4].

Table 1: Numbers of pension schemes[5]

Type	Number of schemes	Evidence
Standalone schemes	6,700	The Pensions Regulator (TPR) DC returns of schemes with over 12 members (less mastertrusts) plus

[2] Based on supervisory knowledge of defined contribution workplace pension schemes
[3] Based on supervisory knowledge of firms operating mastertrusts
[4] Based on supervisory knowledge of firms operating contract-based pension schemes
[5] Assets managed on behalf of both FCA regulated contract-based schemes and tPR regulated trusts are in scope of the rules

Type	Number of schemes	Evidence
		TPR/DWP estimates of number of micro-trusts subject to new governance requirements
Mastertrusts	50	TPR DC returns
Contract-based schemes	30	FCA estimates, based on supervisory knowledge of the number of firms active in this market

We estimate the annual cost to an asset manager of responding to an ad hoc query from a standalone scheme client to be around £1,000[6]. We assume that an ad hoc request from a mastertrust or a contract-based scheme create materially more cost for asset managers because of the greater number of investment options. Given that we estimate these schemes to offer around 20 times the number of funds offered by a stand-alone scheme, we estimate a cost of around £20,000 per mastertrust / contract-based scheme.

Benefits of standardising disclosure

We consider that standardising cost disclosure will provide a benefit to asset managers by eliminating the need for trustees and IGCs from pension schemes to ask for information on an ad hoc basis. This data is currently requested annually by each scheme. Using the data set out above, we estimate the annual benefits of this to be £8.3m, which consists of £6.7m for stand-alone schemes (6,700 x £1,000) and £1.6m for mastertrusts / contract-based schemes (80 x £20,000).

Costs of standardising disclosure

We estimate the costs of a standardised solution in two parts:

- costs of calculating transaction costs
- costs of reporting transaction costs to clients

Costs of calculating transaction costs

Our rules will require asset managers to calculate the transaction costs they are incurring on relevant portfolios. Most of the asset managers who gave us information currently use either third-party providers or in-house systems to calculate transaction costs. Information given to us from third-party providers of transaction cost analysis implies that their systems will be capable of producing reports on our proposed standardised basis with limited amendment.

In response to our information requests, around half of the top 60 UK asset managers report that they manage assets for DC pension schemes. Of these, the top 10 asset managers manage around 90% of all DC assets. Further, we assume that the vast majority of firms in this market also manage retail funds. The Investment Association lists 90 firms as managing retail funds as at September 2015. On this basis, we base our cost estimate on the assumption that, at most, 50 asset managers manage money that will put them in scope of the rules in this consultation.

Based on information that we have received and our understanding of the market, we assume that, of these 50 firms, 40 are buying systems from third-party providers, five have in-house systems, and five currently have no transaction cost analysis capability.

[6] Based on responses to an FCA request for information to firms managing money on behalf of defined contribution workplace pension schemes

Based on information we have received from transaction cost analysis firms and asset management firms, we estimate the calculation cost for a firm which is currently buying a system from a third-party provider will be around £10,000 per annum, for a firm with an in-house system, a one-off cost of £25,000, and a firm with no system currently will incur a cost of £75,000 per annum.

On this basis, we estimate that the market will incur one-off costs of £125k. We also estimate that the market will incur £775k per annum on an ongoing basis.

Firms already disclose information about certain explicit costs via the Pension Fund Disclosure Code. In response to information requests, most firms stated that there would be no marginal cost to providing this information in any standardised disclosure of transaction costs, so we do not assume additional costs for firms disclosing this breakdown of information.

Costs of reporting transaction costs to clients

Based on supervisory knowledge of the market, we believe that there are 21 insurance firms currently operating in the workplace DC pensions market, with around another 10 not currently active but with legacy schemes. We assume there are about 30 providers who will need to produce these reports.

Based on responses to FCA information requests, we estimate that reporting costs will be around £150,000 per independent asset management firm and £250,000 per insurance firm. We assume that around ten insurers also have asset management subsidiaries and that the reporting costs will be shared across these businesses. This gives an estimate of one-off costs associated with reporting of £13.5m.

Summary of costs and benefits of proposals

	Estimated direct costs and benefits	
	One-off	Ongoing (per annum)
Firm costs (£m)	13.6	0.8
Firm benefits (£m)		8.3

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

Link to consultation paper: https://www.fca.org.uk/publication/consultation/cp16-30.pdf
Link to policy statement: https://www.fca.org.uk/publication/policy/ps17-20.pdf