March 2016

The Drive towards Cost Transparency in UK Pension Funds

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Executive Summary

This paper was commissioned by the Financial Services Consumer Panel (FSCP) and follows two earlier papers commissioned in 2014 that focused on the lack of transparency and clarity of retail investments costs and charges. Subsequently, the FSCP held a roundtable to discuss the findings of the research and consider next steps. One of the promises was to reconvene at a later date to discuss how the market had moved towards more transparency, if at all. To help fuel the debate the FSCP commissioned new research, this time considering costs and charges in pension funds, essentially to see whether theory could be put into practice. This paper therefore discusses how to bring comprehensive cost transparency to the UK pension market.

There is a general belief that the cost structure of pension funds, not just in the UK but globally, is transparent and that pension fund costs are obtainable. Neither of these assertions are true and have been challenged in several jurisdictions, most notably The Netherlands. They are now beginning to be challenged more recently in the UK and there are initiatives in play that could change the landscape for cost transparency dramatically. This local challenge has come from various independent sources, such the author of this paper, the Transparency Task Force (set up by Andy Agathangelou), David Pitt-Watson, Henry Tapper and others; journalists such as Mike Foster of the Financial News; the DWP with their work on costs and charges; Unison with their work on the Local Government Pension Schemes; and the FCA with their work with Novarca.

Nevertheless, the UK, although regarded as having a sound overall pension regime, is still behind the curve in terms of pension fund cost transparency when compared to The Netherlands.

There is no doubt that reducing costs can have a material upward impact on the performance of pension funds. Even small cost reductions can lead to long-term benefits through compounding of the savings. However, until trustees and governance committees who have jurisdiction over pension funds can identify what the costs are and meaningfully compare them against other providers, the drive towards lower costs will have no basis.

A new standard for cost transparency

In this paper I propose a data standard for collecting cost data from pension funds in the UK and from their providers (asset managers, custody banks, consultants and so on) and discuss how this standard might be agreed and implemented. This standard is based on my own experience of collecting cost data. It is designed to be the right mix of information relevant to the aim of delivering cost transparency whilst being relatively easy to collect, based as it is on data that any 'reasonable' pension fund or service provider to pension funds (e.g. an asset manager) would be expected to possess and have to hand.

The need for some form of standard is not something for which any coherent or reasonable objection can be raised. Therefore, the key questions are: how will this standard be agreed or imposed; who should hold responsibility for administering the standard; what analysis can be done with this data that is immediately useful to pension funds, and who would carry out that analysis?

The first and most obvious option is for the UK Regulator, either The Pension Regulator (TPR) or the Financial Conduct Authority (FCA), to set the new data standard for the disclosure of costs. However this presents some logistical challenges as the 'regulator' will need to police data submission and accuracy which is a resource-intensive activity. Moreover, a standard set by a regulator will need legislation to support it and therefore will take time and also be slow to adapt should that standard need to progress.

Experience shows the alternative, a voluntary code of practice, may also be problematic given the complexity of data and the habitual obfuscation of service providers. So, how might such a voluntary code of practice be adopted?

One possibility is that the standard could be set in conjunction with industry and guided by the regulator (with the implicit threat of sanctions) and other interested parties. To work, the standard would have to be flexible and progressive and, in the first instance, aimed at collecting data that is already theoretically easily collectible. This would include data that providers already collect to manage their own businesses, but don't necessarily readily disclose.

A voluntary code would have the benefit of being able to be put in place quickly resulting in more rapid potential cost savings that can compound as large performance uplifts over time.

Asset managers and providers would need to be incentivised to comply with a voluntary standard. This could happen by making cost transparency a source of competitive advantage. Pension funds could then be encouraged (or even forced by the regulator) to pick service providers based upon their willingness to adhere to the code of practice. Cost transparency to the voluntary standard should be a fundamental pre-requisite of Requests For Proposal (RFP - the formal process of asking for bids) participation and written into contracts between pension funds and their service providers. Ideally the standard or code of practice could be developed into a form of 'kitemark' providing trustees and governance committees with an easy rule of thumb in fund selection. This may be important as trustees and governance committees are, in general, struggling to understand and get to grips with the charging regimes to which they are subject. A kitemark demonstrating providers comply with the standard is therefore a powerful incentive.

Administration of this kitemark is another issue. Again, administration by a regulator (as happens in Holland) means more work for an already resource-strapped body. Alternatively, the kitemark could be managed by an external organisation via consensus mandate. Such an organisation would be responsible for producing useful and actionable information to provide effective market performance and comparative metrics useful to both consumer and those responsible for pension fund governance.

The impetus to develop such an external kitemark provider may come from the reforms proposed for the Local Government Pension Schemes. The LGPS represents a very large pool of assets (collectively in the top 5 pools by size globally at £200-250bn AUM). Before the currently-proposed reforms for the LGPS to create large asset pools can go ahead, the costs of the current system of 88 pension funds (England and Wales) or 105 (to include Scotland and Northern Ireland) procuring fund services from hundreds of asset managers needs to be calculated. The plan is to collect 3 consecutive years of data from all asset managers servicing LGPS funds to a standard currently under development. This standard is similar to the one I propose in this paper. Funding for this process is likely to come from a levy on the LGPS, but it is possible that the private sector, asset managers and other service providers, could also contribute. It is in their interest to ensure that the methodology for collection fits with their internal data systems to minimise the effort of collating the required data.

It is not a difficult stretch to develop this LGPS initiative into something for the whole pension market in the UK, and for this organisation to remain independent.

Given my conclusion that a regulatory standard is a possibility but other models should be explored first (a voluntary code), the main role the FCA and FSCP could play currently is to clearly indicate that collaboration by the industry is key; put forward reasonable suggestions as to what a standard might look like and point out that alternatives might be extremely expensive and complicated to deliver.

1. Introduction

The costs of pension funds in the UK, and to a large extent globally, are not well understood, neither by the consumer/beneficial owner of a pension fund, nor by many of the intermediaries in the pension fund value chain.

By this I mean that the consumer has little or no idea of the total cost of ownership of a pension fund (how much it costs to own a pension fund). Crucially , and shockingly, neither do the providers of pension funds or the intermediaries that service them.

A recent article in the Financial Times (FT) quoted one fund manager as saying: "I myself do not know the exact costs that we are charging to our funds." Another, veteran UK fund manager who oversees more than £7bn of assets said: "But I am now looking into this very closely. Our industry must do better" (Financial Times, 21st December 2015).

This lack of understanding and lack of clarity can be characterised by suggesting that the entire cost of the pension value chain as applied to consumer assets is similar to a 30cm ruler:

- The first 10cm are clearly understood and have empirical studies that iterate these costs, such as invoiced asset management fees and other fees disclosed in annual reports. However, it should be noted that even these are sometimes not accurately reported (see section 5.4)

- The existence of fees in the next 10cm are known but not understood by anyone other than real experts, and no empirical analysis of these costs has been made (such as 'captive FX' where the custody bank looking after cash and assets executes a foreign exchange transaction on behalf of a pension fund to liberate cash in a currency other than the core currency of the pension fund)

- And the final 10cm are neither understood or known, albeit the current relatively aggressive interest in costs is uncovering these new items almost daily (such as subtle or legacy arrangements in investment mandates that give preferential rates or timings on various transactions to asset managers or brokers, or issues like market impact of trading)

This paper examines the art-of-the-possible rather than the art-of-the-(ultimately)-desirable. The former being what could be implemented with relative ease and with consensus across all stakeholders; the latter being currently difficult to implement because of the excessive layers of intermediation and the complexity in the pension fund value chain.

In my view, it is better to start somewhere now and reap smaller, compounding benefits than to aim straight away for a difficult to achieve comprehensive standard. To illustrate this art-of-the-possible I will outline what I believe is an acceptable standard of data collection, one based on a proven model. In Section 5 I will show the results of real case studies where this standard has been adopted in the UK by this author. In Section 2 I start by outlining global initiatives that are starting to emerge around pension fund transparency.

It is also worth considering that there appear to be only limited differences in the cost structures of Defined Benefit and Defined Contribution pensions. Certainly, the risk-bearing counterparties are different (company vs. consumer directly), but both require the acquisition of services from asset managers and, as such, asset managers are the major cost component of any pension. How these funds are then structured into a product will differ, and the responsibility for hedging risk will differ. But nothing can remove the fact that any pension fund requires asset managers, and how cost data is collected from these asset managers is key to understanding the costs of a pension fund.

2. Global Regulatory Initiatives

2.1 Global Perspective

Increasingly, European Union initiatives are already progressing to include transaction costs in any pre-contractual cost figure disclosed to the end consumer for retail investment products. Both the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation and the recast Markets in Financial Instruments Directive (MiFID II) focus on this as a key issue. Neither PRIIPs nor MiFID apply to workplace pensions but there is a growing movement towards achieving consistency across the information consumers will receive in relation to these and other retail investments. Discussions continue on European Commission governance and transparency proposals within a revised directive on Institutions for Occupational Retirement Provision (IORP II).

However, the issue of assessing the impact of transaction costs on fund performance is complicated, because the ways in which trading impacts costs are complex. To the overt brokerage commissions, taxes and, in the UK, research commissions, one must also add bid/offer spread, market impact and implementation shortfall. On top of these explicit and implicit charges must be added the impact of any foreign exchange transactions that might be involved and the result is an extremely complicated formula involving market level benchmarks and detailed information on the timing of individual trades.

A good summary of current European regulation relevant to both the retail and pensions arena may be found in the March 2015 edition of Investment & Pensions Europe (I&PE) magazine (http://www.ipe.com/pensions/pensions/briefing/regulation-round-up-europes-changing-pensions/10006824.article). Below, I highlight some of the key legislative issues and initiatives in more detail.

2.1.1 IORP II and EIORP

The European Commission (EC) has reviewed the European Union's (EU) 2003 pension directive (Directive on Institutions for Occupational Retirement Provision - IORP). The EC sought to align and update the Directive with the insurance industry's Solvency II Directive, to strengthen the Internal Market of the EU by encouraging the development of cross-border pension schemes.

The most contentious element of the proposal, the Solvency II-based 'Holistic Balance Sheet' approach to pension scheme funding, received severe criticism and an alliance of five EU Governments (Belgium, Germany, Ireland, Netherlands and the UK) opposed the plans to align Solvency II and IORP. Consequently, the European Commissioner for the Internal Market announced in May 2013 that he was postponing work on incorporating a Solvency II-style pension-funding regime into the new IORP Directive and, in March 2014, he published proposals for IORP II with a focus on communications and governance.

This proposed IORP II transformed the Directive requiring extensive new governance requirements and included a very detailed plan for a harmonised EU-wide format for member benefit statements. The number of Articles rose from 24 to 80. Key points included:

- A mandatory, EU-harmonised Pension Benefit Statement, to be sent at least annually to every scheme member, encompassing a wide range of information such as total capital expressed as an annuity per month (for DC schemes); risk profiles of investment options using a 'synthetic graphical indicator' (DC again); a breakdown of costs and charges – all on two pages of A4.
- Those who 'effectively run the scheme', including trustees, will need to have professional qualifications.
- Schemes must have remuneration policies and publish the pay of those who run them
- New requirements on outsourcing, internal audit and risk management, including the compilation of a detailed new Risk Evaluation for Pensions report
- The current requirement for cross-border schemes to always be fully funded is retained. A new Article permitting transfers of all or part of schemes across borders (Article13) is included.
- Restrictions on long-term investments are banned
- DC schemes must appoint a depository for safe-keeping of assets and oversight
- One-off implementation costs of the new Directive are estimated to be €22 per member, or around £328 million for UK private sector schemes. Recurring costs are €0.27-0.80 per member per year, or around a further £7.5m per year in annual recurring costs
- Member States will be required to bring the new Directive into force by 31 December 2016.

These changes met with general approval albeit the EC working group removed the prescriptive approach to issues such as the format of the annual pension benefits statement. Detailed rules are likely to be left to national regulators. However, the proposed qualification requirements for pension fund trustees remain, which may cause some friction.

Despite being postponed by the Commission in 2013, the European Insurance and Occupational Pensions Authority (EIOPA) has taken up the issue of solvency reform, publishing proposals towards the end of 2014, including models for a holistic balance sheet. Consultation closed in January 2015. Unfortunately, strong opposition from the European pension fund community to such requirements remains. Firm announcements are pending.

2.1.2 Solvency II

Solvency II reviews the prudential regime for insurance and reinsurance undertakings in the European Union:

- Jan 2015 – enters into force
- June 2015 – preparatory phase annual reporting
- Nov 2015 - preparatory phase quarterly reporting
- Jan 2016 - compliance deadline

- April 2016 - first reporting

The first set of Solvency II Implementing Regulations setting out technical standards with regard to the supervisory approval procedures for undertaking-specific parameters, ancillary own funds, matching adjustment, special purpose vehicles, internal models, and joint decision on group internal models was adopted in March 2015.

Under the regulation's 'look-through' element, asset managers and servicers must deliver transparency on the investments they hold on behalf of insurance company clients in accordance with technical standards outlined by the European Insurance and Occupational Pensions Authority (EIOPA). The standards set quality requirements for complete, timely, accurate and appropriate data, and apply to both asset data and risk data. As it stands costs and charges associated with asset management will not be collected, but it is a step along the path of transparency in an area that was once opaque.

Both managers and servicers must also provide detailed information on entities issuing securities and the component elements of derivative instruments. It seems likely that the legislation will lead to some asset managers divesting instruments that create a large capital charge and are seen as disadvantageous in terms of solvency capital requirements as well as asset classes lacking the underlying performance data required for Solvency II compliance.

The Investment Association in the UK, BVI in Germany and Club Ampere in France has created a common data template (the 'tripartite template') which will assist with the exchange of data between insurers and asset managers. Insurers had until January 1, 2016 to comply with Solvency II.

2.1.3 Markets in Financial Instruments Directive II (MiFID II) and Markets in Financial Instruments Regulation (MiFIR)

There is no doubt that MiFID II will force greater transparency on key metrics that will influence the understanding of costs as applied to pension funds. Specifically, it will enforce greater transparency on transactions across multiple asset classes (including OTC derivatives), and ensure disclosure of information on research costs ('full-service' trading activities) bundled with execution-only trading costs for listed equities.

Much is being made of the impact such disclosure of trading volumes, spreads, commissions and research costs provides as the panacea for transparency, and it may help. Whilst transaction costs are one of the largest areas of opacity for pension funds currently, they are by no means the only area of significance and whether there are larger prizes for transparency out there has yet to be determined.

MiFID II and MiFIR are going through a process of being enacted and countries have until 3 July 2016 to adapt their domestic laws and regulation to the revised legislation. Sadly the process is beset with delays and the timing of compliance has been set back once again from its 2017 go-live. Whilst these pieces of legislation do not apply directly to pension funds it is entirely possible that transparency in one part of the market (retail funds) may well roll over into or influence the agenda of pension fund transparency.

2.1.4 Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation)

PRIIPS is aimed at retail and insurance investments and does not apply to pension funds. However, it does deal with some issues that are relevant to the issue of cost transparency in pension funds, namely the issue of assessing the impact of transaction costs on fund performance. As previously stated, this is very complicated because the ways in which trading impacts costs are complex. So, whilst PRIIPS seeks to calculate the impact of trading on performance by assessing its cost, this will not be easy to achieve. Moving the PRIIPS methodology for retail assets to the larger institutional world of pension funds may be a step to far for the near future. Once simpler measures are bedded in we can move to this more complex assessment.

2.2 Key Country-specific Initiatives

Different countries have developed transparency in different ways. Below I summarise initiatives from some of the more progressive country-specific pension regimes.

2.2.1 Australia

Australia has a widely admired pension regime. The country introduced compulsion in 1992, when it made contribution into the superannuation fund system mandatory for all employees over 17 and younger than 70 earning more than AUS$450 a month. This is a defined contribution system that requires a minimum contribution to a superannuation fund. Before the compulsory superannuation system was introduced, DB schemes were the more popular form of occupational pension provision.

The country has a number of types of superannuation funds including industry-wide funds and retail funds, which are offered to the public and to employers by financial service providers. Employees may make voluntary contributions and employer contributions are subject to an annual cap of $50,000 (AUD).

Recent initiatives around improving transparency include:

- **2013 –** 'My Super' introduced – low cost default option following Super System Review
    - Features standardised fees
    - Sets new legally-enforceable standards for governance, costs and investment approach.
    - Has had profound impact on fees within the commercial sector
- **Dec 2014** - Financial System Inquiry (Murray Inquiry) concluded fees should be lower. Consequently, the Australian Securities & Investments Commission (ASIC) asked for complete and better disclosure of costs for investment products available in pension funds after a government-backed inquiry called for more efficiency

- **Sep 2015** – ASIC surveyed superannuation websites to check industry compliance with the new executive officer remuneration and systemic transparency disclosure requirements introduced as part of the Stronger Super reforms
- **Oct 2015** – Australian Government announced response to the Murray Inquiry, including developing legislation to improve governance and transparency in superannuation by the end of 2015.
- Product Disclosure Statement publishes fee scale for corporate super master trust superannuation
- Annual Superannuation Fees Report produced by research house RiceWarner for the Financial Services Council (FSC)

2.2.2 Denmark

A summary of how consumers benefit from a high level of transparency was published in a 2012 report from the RSA, "Seeing Through British Pensions – How to Increase Cost Transparency in UK Pension Schemes", written by David Pitt-Watson and Hari Mann.

"In Denmark, consumers are able to log on to a government-backed site that provides them with information of their pension provision (www. pensionsinfo.dk). The site, which is now subscribed to by most pension suppliers, provides comprehensive information to all Danish citizens. It explains how the pension system works, and once logged in, it provides individuals with details of all their pensions.

For example, the site provides information such as:

- How the consumer is covered, in which funds they are invested.
- What contributions have been made into the fund
- What returns have been made
- What has been paid out in costs and expenses, for each element of the pension (for example, for life insurance)
- How much money they currently hold in the fund and its present value.
- Illustration of what the pension might be worth in the future

The account holder can then obtain further information and detail on the funds. This depends on the type of investments that the portfolio has. In terms of transparency, the definitions given for costs and the figures that have to be included are as follows:

- Direct and indirect administrative costs. These can include fund trustee and administration expenses, along with general set costs.

- Direct and indirect investment costs. These include the actual trades made on the customer's account, such as any money the company receives from investment managers, performance fees charged by fund managers and fees on stock lending. In real estate funds, these might also include other expenditures related to the properties' current income, such as expenditure for collecting rent, salaries of caretakers, property taxes, maintenance, improvements and any other administration costs.

- Annuity costs. The costs associated with buying an annuity in a pension.

- Risk-free return. The risk of return is calculated as the excess return over the risk-free rate the capital could obtain on market conditions. The system provides the account holder with the same level of detail and information that the pension fund itself has on its costs, its performance and its benchmarks

The system provides the account holder with the same level of detail and information that the pension fund itself has on its costs, its performance and its benchmarks." (Seeing Through British Pensions, RSA 2012)

Other initiatives operating in Denmark can be found summarised in Table 4.

Table 4: Danish Insurance Association initiatives

Initiative	Description
Pensionsinfo	An online portal which allows consumers to access and get an overview of all of their pensions and associated life insurance entitlements from all of their providers including public pensions.
Cost Initiative (Omkostningsinitiativet)	Requires all pension providers to disclose to consumers the total annual personal pension costs (ACK and ACP)incurred that year and provides technical guidance on how to calculate the cost, and requires the calculation to be reviewed by an external auditor.
Cost Calculator (Omkostningsmåler)	Requires all pension providers to have a calculator on their website which allows consumers to input their details and calculate their expected future annual pension costs.
Pensions Overview (Pensionsoverblik)	Requires pension companies to display six key types of pensions information (entitlements, contributions, premium for insurance, costs, investment return, value of the scheme) in an easy accessible way in their annual pension statements or continuously on their web-based statement.
Comparing Pensions (Fakta om pension)	A website which consumers and other interested stakeholders, such as journalists, can use to compare the elements of different standard pensions offered by Danish pension providers.
Pensions Calculator (Pensionsmåler)	An internet tool which, after input from the consumer, calculates their projected income on retirement and compares it to their current day

	salary. It can also be used to calculate the effects of later retirement, higher contributions etc.
Your first pension scheme (Den første pensionsordning)	Web pages which provide information on the different elements that consumers should be aware of in a pension scheme given marital, dependents status, etc.
Does your pension fit your needs? (Passer din pension)	Web pages which detail the pension and insurance needs of an average consumer together with advice on what consumers need to be aware of in certain situations.
Payout Methods (Udbetalinger)	Web pages which outline the different types of payments that consumers may be entitled to under circumstances such as retirement, illness, disability or death.
Pensions ABC	A teaching tool where the consumer chooses modules on different topics such as the Danish pension system, the sources of retirement income (public, occupational and personal) and information on types of products, providers, costs etc.
Pensions Dictionary (Ordbog)	An online dictionary allowing consumers to look-up explanations of pension terminology.
Pensions Exam (Pensionseksamen)	An online test which consumers can use to evaluate their knowledge about pension related topics. Topics include term annuity pensions, life-long pensions, lump sum pensions, voluntary early retirement (efterløn), divorce etc.
Pensions Hotline (Pensionsoplysningen)	An independent advice service offered by the DIA to consumers. Consumers can access the service via telephone or email.

Source: Towers Watson (2013), *Evaluation of Openness and Transparency Initiatives of the Danish Insurance Association*, Towers Watson

2.2.3 Finland

The pension system in Finland is based on two complementary pension schemes: The National Pension public plan, and a compulsory occupational pension scheme. Voluntary occupational schemes and private pension savings are not well developed due to the dominance of the existing compulsory scheme.

The statutory earnings-related occupational pension insurance is the backbone of the Finnish pension system, which is partially pay-as-you-go-financed and partly funded.

The administration of the compulsory scheme is decentralised to pension providers such as insurance companies, company pension funds and industry-wide pension funds that are independently acting as private sector financial institutions. Competition ensures more efficient implementation. The public sector has its own institutions for pension provision. The private pension providers do not seek profit but work to secure earnings-related pensions.
In 2011, the system cost about €1.1 billion a year to operate, (with total benefit administration of about €440 million) which is roughly €107 per member and is significantly higher than the average €60 per member of an international peer group assessed by CEM Benchmarking at the time.

However, it is worth pointing out that the pension administration costs cover both pension pillar one, the universal old age pension, and pillar two, employment based pensions. This is unusual compared to other countries.

Jan 2015 - new rules on transparency for private sector providers in Finland's earnings related pension system were due to come into force requiring pension insurance companies to hold an insider register of board members and their substitutes, chief executives and their deputies, auditors and employees able to influence the company's investment decisions. Pension providers will then have a maximum of five months to have an updated insider register in place. The new legislation requires boards of the pension insurance companies to establish a set of corporate governance principles. The proposed law also sets guidelines for reward systems at the pension insurers, stating they should serve the firm's operations and objectives and be in its long-term interests. "Reward systems should not encourage excessive risk taking," it said. The spotlight fell on pension fund governance in Finland in late 2014 after a management scandal at the country's largest pension fund, Keva.

2.2.4 Sweden

Sweden's public scheme was originally created with a clear design to keep administration costs low. Fund managers must be licensed to do business and sign an agreement with the PPM, a central clearinghouse that makes all transactions on behalf of participants and provides information on returns, costs, measures of risks for all funds. The agreement with the PPM requires managers to provide fund share values for every working day, periodic reports of costs and accept the PPM discount schedule for fees.

Sweden is currently considering significant change to its pension system – there is a proposal being discussed at present, which suggests insurance and pension firms be separated so that the former are regulated under Solvency II and the latter under IORP.

One of the main state pension funds, AP1, is seeking to reduce management costs of its equity and fixed income mandates and also increase transparency overall in a current tender to the marketplace.

Table 5: Summary of Swedish Transparency Initiatives for Pension Funds

Initiative	Description
Jämförelse Pension	Enables the consumer to compare pension products. Two aims: 1) A comparison of fees, insurance cover etc. 2) A calculator showing the effect of different fees on pillar 2 pension providers
Standard för pensionsprognoser (Guidelines on pension forecasts)	An initiative to harmonise the calculations of pension forecasts. The Standard specifies what assumptions the factors behind the forecasts should be based on. There are 6 general factors (inflation, economic growth, future income/premiums, yield, tax yield and presentation) where the assumptions made in the standard should be used. There are also 4 product specific factors for which the standard states that factual figures should be used. If these are not available the assumptions made in the standard should be used. These factors are fees, survivor protection, inheritance gain, and longevity assumptions/ interest rate forecast.
Rekommendation om faktablad för livförsäkringsprodukter av sparandetyp (Industry recommendation on fact sheets for life insurance products with a savings element)	Further standardisation and simplification of fact sheets which are compulsory according to the supervisory authority's regulatory code. The recommendation focus is on the structure of the fact sheets and giving detailed guidance regarding the cost example to be provided.

Source: Towers Watson (2013), *Evaluation of Openness and Transparency Initiatives of the Danish Insurance Association*, Towers Watson

2.2.5 United Kingdom

The UK pensions system involves multiple agencies who each, over the past 5 years or so, have gradually taken a growing interest in the need for greater transparency in the sector:

- **2008 & 2011** - Pensions Act introduced and extended a charge cap for qualifying schemes
- **2008 –** Pensions Act introduces low-cost national pension saving scheme – National Employment Savings Trust (NEST) to match the anticipated demand for pensions set by auto-entrolment.
- **2012 –** Investment Association (IA) issued guidance on "Enhanced disclosure of fund charges & costs". In the guidance, Investment Managers

should provide a single location where entry and exit fees, on-going charges and performance fees are displayed and explained. In addition, the transaction costs incurred when buying and selling underlying investments should be displayed together with explanations of how these affect investors' returns. All of this information should be made readily accessible for investors, for example, by clearly signposting it on company websites. This does not appear to have been implemented to date.

- **2012 –** National Association of Pension Funds (NAPF) and the ABI issued 'Pension Charges Made Clear: Joint Industry Code of Conduct' which sets the standard for providing clear and accurate information to employers about costs, charges and associated services when they are selecting a DC scheme.
- **2013 –** ABI published 'Agreement on the Disclosure of Pension Charges & Costs'
- **2013 –** ABI created Pension Charges Calculator to allow employers to compare the effect of pension charges on the pension pots of their employees. An employer selecting an automatic enrolment scheme can obtain, from their adviser or directly from a pension provider, a summary of charges template outlining the charges that will apply under a particular provider's scheme. The calculator is designed to allow employers (independently, with their advisers or with their employees) to obtain an idea of the combined effect of those charges on an average employee's pension fund in automatic enrolment schemes using various scenarios based on age, average salary and anticipated length of service
- **2013 –** The Pensions Regulator issued a Code of Practice and regulatory guidance for Trustees of DC Schemes underlining their need to "take care to understand and monitor the member-borne costs of the default strategy"
- **2013 –** Office of Fair Trading (OFT) "Defined Contribution Workplace Pension Market Study" concluded that competition alone could not be relied upon to drive value for money for all savers.
- **2014** - FSCP publishes a discussion paper looking at costs and charges associated with investment schemes and outlined a number of possible options for reform.
- **2014** - Pensions Act 2014 places a duty on the FCA and DWP to require the disclosure and publication of transaction cost information and administration charges.
- **2014 –** Chartered Institute for Public Finance and Accountancy (CIPFA) published new 'Accountancy Rules for Local Government Pension Scheme Management Costs'. The guidance around rules allows for inclusion of transaction costs with reported Investment Management expense figures. "Investment management costs should also include transaction costs associated with the acquisition, issue or disposal of fund assets and associated financial instruments. These include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties."

- **2014 & 2015** - DWP Command papers outlined vision for workplace pension schemes that will involve transparency of costs and charges throughout the value chain.
- **2015** - Government and the FCA are committed to introducing transparency of costs and charges in pension funds. This will be undertaken in two phases – the first phase, from April 2015, will require trustees and Independent Governance Committees (IGCs) to prepare an annual report about their scheme, including information about transaction costs as well as administration charges. To fulfil this requirement, IGCs and trustees will need to obtain information about transaction costs from those managing their scheme's assets and investments. While IGCs and trustees are encouraged to report this information in as full and useful a way as possible, there is flexibility in this first phase for governance bodies to choose how best to do this, based on the needs of their scheme and the information they have obtained. The second phase will build on these reporting requirements to require disclosure of information about transaction costs and administration charges in a standardised, comparable format. The Government's commitment to requiring greater disclosure of transaction costs is reinforced by Section 44 of the Pensions Act 2014, which places a duty on the FCA and the Department for Work and Pensions (DWP) to require disclosure of some or all transaction cost information in workplace pension funds to members, or other prescribed persons.
- **2015** - IA publishes Principles including intention to: "…make all costs and charges transparent and understandable. We explain our fee structures as simply as possible and the structure itself must be understandable. We also disclose all other costs that could be expected to affect returns in a simple transparent manner. We use standardised approaches to provide comparability." 25 member firms have signed up to the Principles.
- **2015** –DWP/FCA consultation on 'Transaction Costs Disclosure: Improving Transparency in Workplace Pensions' was issued. The consultation response has not yet been published.
- **2015** - YouGov survey for the People's Pension reveals over 94 per cent of working people with a pension think it should be compulsory for providers to tell savers how much they are being charged. The demand for greater transparency comes as over half of pension savers also declared they were not aware if they are being charged by their pension provider. The survey found 51 per cent of working age people don't know if they're being charged by their provider to manage their savings, while 20 per cent were aware, but didn't know how much. Just 11 per cent knew they were being charged and knew how much.

In addition, the IA has revised its Statement of Recommended Practice (SORP) which will require managers of UK authorised collective investment schemes to provide a new comparative table in the annual report and accounts of each fund from January 2016. This summarises (amongst other items) operating charges and direct transaction costs. Although this is for retail funds, it paves the way for similar reporting in funds into which pensions are invested.

3. The Dutch Pension Market

3.1 The Dutch 'Story' of Cost Transparency

Transparency and cost management have been topics in the Dutch pension market for many years with the consequence that Dutch pension funds are considered some of the most transparent in the world. One word of caution though – visibility (look-through) into the transactions of holdings in pooled funds is not yet possible. This is a general condition globally and despite the look-through into holdings implicit through Solvency II, this does not mean that transaction volumes and costs of underlying holdings will be reported.

Despite being widely viewed as a model example for countries, the whole of the Dutch national pension system is currently under review with the intention of developing a new and sustainable pensions system. However, understanding the timeline of how transparency and cost management within pension funds emerged in the Netherlands is useful as it demonstrates where problems may emerge when the UK implements cost transparency:

- **2007** - The Financial Assessment Framework (FTK) was introduced as part of the Pension Act following fears for the future of pensions during the global financial crisis. FTK primarily assesses the financial health of schemes. The Dutch National Bank (DNB – Dutch central bank) developed additional reporting requirements on costs together with the market - sheet J402 (on costs) was added to the FTK later.

- **2011 Q2**- The AFM (Dutch authority for Financial Markets) released a report in response to political pressure from Dutch MPs who were demanding legislation to capture and expose costs ("Pension funds costs deserve more attention - Kosten pensioenfondsen verdienen meer aandacht"). In this report the AFM argued that the transaction costs of Dutch pension funds were not being reported accurately to members. Key findings included:

    - "Costs have a large influence on…pension [values]. In general, a cost reduction of 0.25 percentage point over a period of forty years leads to an approximately 7.5% higher collective pension assets. The higher this ability, the higher the retirement benefits, partly because there is more available for indexation at benefit agreements."

    - "The cost of pension funds of equal size varies widely, certainly in respect of the administration costs. There are several pension funds that have ten times the administration costs than the average of the size class to which they belong."

    - "Small to medium-sized pension funds in particular may still save costs by exploiting economies of scale and simplify arrangements at the same time. It appears that scale is an important cost factor, especially when it comes to administration costs. In these cases: the bigger the fund the more cost efficient it is. For the smallest pension funds (<€10 m AUM) the level of the administration costs (expressed as a percentage of total assets of the Fund) was 1.18% on average. This figure is twelve times as high as that of the biggest pension funds (at 0.10%). "

  - "Many pension funds do not report all costs, in particular investment costs. The research indicates that the actual investment cost is on average two to three times higher than the reported costs. This is equivalent to € 1.5 to € 3 billion a year that is not reported. In particular the smaller pension funds get inadequate visibility on the actual investment cost because asset managers and external managers charge through net returns. Understanding the investment costs is necessary in order to assess investment performance."

- **2011 Q4** - the Pensioenfederatie (Dutch pension fund trade association) recommended that its pension fund members should record in their annual reports administration costs per participant; asset management costs as a percentage AuM, benchmarked against the appropriate asset mix and investment strategy, and long-term rates of return; and transaction costs, as a percentage of average capital invested.

- **2013 Q4** - Pensioenfederatie released their follow-up report 'Recommendations implementation costs', a revised version with additions

- **2014 Q1** - The Dutch National Bank (DNB, the Dutch Regulator) published their report 'DNBulletin: Pension sector reports 0.53% of costs'

- **2014 Q2** – DNB published 'DNBulletin: Pension funds report completely about costs'

- **2014 Q 3** - research report published by the AFM (*Autoriteit Financiële Markten* - Netherlands Authority for the Financial Markets) 'Annual reports pension funds concerning costs of asset management' made the following recommendations for enhancing cost transparency:
-
  - Asset management firms should provide sufficient transparency on the gross return, the costs incurred and the corresponding net return.
  - Pension funds must include a note in the Annual Report on asset management fees in the context of return and risk.
  - Pension funds should express, for each asset class, the asset management costs broken down to reveal the total cost at the

  portfolio level. This should include information such as active versus passive.
  - Pension funds must reduce differences between the costs in the financial statements and the management report (asset management costs). These variations are due to different regulations for reporting in the financial statements vs. the management report. In the financial statements, only the cost of the 'first asset "reported in the investment chain is reported, whilst in the management report costs are calculated by looking in the investment portfolio and reporting on all costs (including underlying asset managers and fund-of-fund investments).
  - Pension funds must include a note in their Annual Reports on performance-related fees.
  - Pension funds must certify cost changes compared to the previous year.
  - Pension funds must provide an explanation for incidentals (disbursements)

- **2014 Q3/Q4** - 'Raad Jaarverslaggeving' (Council Annual Coverage) report on big and medium incorporations – Bundel RJ (Kluwer)

- **2015** - AFM and DNB news announcement on the outcome of their research into pension costs, describing how and where costs have been made transparent and the impact this has had:

  - Some pension funds had to submit revised reports because their initial reports were not comprehensive. The pension funds had outsourced their asset management activities to parties who subsequently outsourced such activities to another party. As a result, the pension funds were unable to gain an insight into the costs of the underlying activities, as the underlying parties were not providing the required data. The DNB has suggested to pension funds that they should consider whether they want to be dealing with such firms if they are unwilling to provide detailed information on their incurred costs

  - Performance-related costs are often forgotten by pension funds in their reporting to the DNB, while these costs can be extracted from the annual report of the investment fund concerned

  - Often costs are either placed under the wrong investment category (or under the investment category 'Other') or they are simply forgotten

  - Despite being optional for pension funds to include transaction costs in their annual statements, the DNB and the AFM strongly suggest that they do so, as the Dutch Pension Act requires pension funds to include information on implementation costs in their annual report.

A new Pensions Act is currently being considered and will make reporting of transaction costs in annual reports mandatory, with pension funds being required to 'understand' outsourced asset management costs fully. In addition, a new FTK reporting standard was introduced in January 2015 requiring further detail from pension funds.

Additional commitment to transparency can be seen in the Code of the Dutch Pension Funds (Pensioenfederatie/STVDA), which requires Boards of Trustees to 'determine an acceptable level of costs'. There is also ongoing commitment to transparency, evolution of standards and investment in research by the DNB.

To reap the benefits of scale, a new pensions vehicle, the general pension fund (APF), has been proposed. The APF will be a pooling vehicle similar to industry-wide schemes but with ring-fenced assets. APFs should operate at relatively low cost because of their huge scale but there is concern amongst some industry-wide funds that they are a serious threat to business.

New legislation to raise awareness of pensions, the Pensions Communication Act, will introduce a four-pronged approach to raise participants' knowledge about pensions. Included in this will be improving the uniform pensions statement (UPO) for a single fund and the online pensions register (Pensioenregister) which shows a participant's combined accrual of all their pension funds.

To conclude, Table 6 offers a summary of additional Dutch pension fund transparency initiatives.

Table 6: Summary of Dutch Transparency Initiatives for Pension Funds

Initiative	Description
Pension Register	Provide insight into overall personal pension situation. On one single website (www.mijnpensioenoverzicht.nl) consumers get an overview of all their current and past pension claims (currently, for first and second pillar)
Uniform Pension Overview (UPO)	Each pension fund and pension insurer provides each individual participant with a uniform pension overview once a year. The overview contains (amongst others) accrued pension and expected pension (gross amount, per year).
Pension3Day	During the Pension3Day, pension providers, financial advisors, government and employers help consumers to get insight into their pension situation
MoneyWise	MoneyWise is the Dutch implementation of the National Strategy for Financial Education. Over 40 partners from

	financial services industry, NGOs and government work together in the MoneyWise Platform. MoneyWise aims at raising levels of Financial Literacy. Openness is one of the means of achieving this. Pensions form one of the three priorities of MoneyWise. (www.wijzeringe ldzaken.nl)
Pension Law	In the Pension Law 2011, there are a number of requirements to pension funds and pension insurers with respect to the way that they communicate to pension plan participants. Based on evaluations of the effectiveness of pension communication, the Pension Law will be changed to incorporate (scientific) insights. e.g. the new Pension Law will include requirements w.r.t. communicating about risk and inflation. New version due in 2015.
The modellen de Ruter	Provide greater transparency of premiums, costs and values of investment to pillar 3 consumers. Mandatory information leaflets supplied to pillar 3 consumers when they consider buying a product, before effecting the insurance, as an attachment to the yearly policy documents and on surrender. The formats/models are supplied by the Dutch Association of Insurers
Pension Dashboard	Project in development. The goal is to give people oversight and insight into their current and future financial situation, and to give them potential actions that they can take – target date for completion is 2018.

Source: Towers Watson (2013), *Evaluation of Openness and Transparency Initiatives of the Danish Insurance Association*, Towers Watson

3.2 In Practice: How it Works, the Benefits and Feedback from Dutch Pension Funds

In general, there is a greater emphasis on cost management across the Dutch pension industry, largely as a result of the significant improvement in cost reporting over the past five years. This has been the result of the combined efforts of multiple interested parties, such as the pension funds themselves, their asset managers, the Pensioenfederatie, the Council for annual reporting and the DNB.

Key outcomes as a result of developing this framework of cost awareness include:

- Zero-cost asset management reports are a thing of the past
- The *actual* versus *reported* costs of asset management have tripled. This is in line with the AFM publication ' Pension funds costs deserve more

attention ' which calculated that the actual costs were three times higher than reported.

- There has been a dramatic reduction in the number of pension fund holders with reported total costs (including administration costs) above 1.5% per annum of the total assets: In 2011 there were approximately 790,000 participants (on the basis of the above DIM publication from that year) and approximately 66,000 participants by 2013.
- However, there are unexplained and unexpectedly low costs reported for certain asset classes and for the total investment mix. Recent DNB and AFM research indicates that the quality of the cost data in real estate, private equity and hedge funds is low and the AFM is seeking improved detail in these areas.

The development in transparency of costs and charges in the Dutch pension market has largely been a collaborative and industry-led series of initiatives. To quote one large Dutch pension fund, "In The Netherlands we had a concrete threat of undesirable legislation. We had to do something. The initial drive for transparency was supported from the beginning by the three largest Dutch funds and their mantra was - do not reach for the impossible. We knew that transparency of transaction costs would be difficult to achieve. We started with defaults and a simplified model and opted for a 'comply or explain' model. We also put a lot of effort in talking to all stakeholders [auditors, supervisors, asset managers, journalists]."

In fact this last point is emphasised by Tomas Wijffels (Pensioenfederatie) who recounts that the Pensioenfederatie invested a lot of time in explaining the recommendations to auditors, asset managers and especially the media, to prevent invidious comparisons of pension fund costs or politically embarrassing stories about the billions of euros paid to asset managers by pension funds. In a country where 4.5 million out of 5.8 million participants are contributing 20 per cent of their earnings to pension funds on a mandatory basis, it is easy to see how pension fund costs disclosure could become politically contentious. However, it is worth remembering that the goal of the early recommendations and initiatives was never simply to lower costs. High costs can be positive for pensioners, but only if they are linked to better performance. It seems natural to assume that if we pay more we get more and this is sometimes the case. But it is a struggle to get that idea across to the public, especially when funds are paying managers performance fees as a reward for high returns achieved two or three years earlier.

Four years on from the initial work by the AFM in 2011, cost disclosure is now well established. Of the 250 pension funds in the country, 100 per cent now report pension administration costs, and reporting of both asset management and transaction costs are both well above 90 per cent. Given that there was effectively zero transparency as recently as 2010 (beyond normal recording of invoices submitted by fund managers in the annual accounts) this represents impressively rapid progress.

It is worth considering some of the key difficulties the industry in the Netherlands faced when applying the collection frameworks:

- There was resistance from within the pension sector: Nobody likes to be shown to be wrong about a subject like costs. However, after a few months almost everybody was convinced.

- Early adopters showed higher costs than slow movers. The benefit of being a transparency champion is in some ways countered by a possible penalty in outing the misreported costs.

- The message is a difficult one. High asset management costs may be positive for participants in the case of performance related fees. In other words, net performance is good but costs are high as the performance-related component is also high. The focus therefore needs to be on more than just cost.

- There is an actual cost to compliance. Capturing and reporting data can be complicated, expensive and time-consuming.

The Dutch cost collection regime aims at collecting data from pension funds, rather than directly from asset managers and other suppliers. Costs are segmented into management and performance fees (invoiced fees) by asset class, as well as costs associated with turnover. These turnover costs include overt costs (such as commission on equity trading) as well as estimates of turnover costs through bid/offer spreads on fixed income funds. Turnover into and out of pooled funds is also captured (and costs associated with such turnover are estimated) but turnover WITHIN pooled funds is not collected. There is 'look-through' into pooled funds for assets, in accordance with Dutch compliance rules on issues such as cluster-mines. The data collection regime is shown below in Figure 1.

Figure 1: Dutch cost collection template. This is not an exhaustive list of all costs to which a pension fund is subject, but does represent what is practical, easy, valuable and therefore worthwhile.

Specificatie Rekening Van Baten En Lasten

	retirement benefits	Bruto-uitkering	Frequentie
1.1	Regular pension payments	€ -	
1.2	redemption	€ -	
1.3	Other retirement suddenly	€ -	
1.4	total	-	

	Cost (excluding cost management)	Interne kosten	Inkoop bij derden	Totaal
2.1	Management costs	€ -	€ -	-
2.2	administration costs	€ -	€ -	-
2.3	Consultancy and audit costs	€ -	€ -	-
2.4	Rent (including imputed rent own building)	€ -	-	-
2.5	total	-	-	-

	costs asset	
4.1	Is use is made of estimation methods?	Ja
4.2	explanation	*Deze staat is gevuld op basis van de directe kosten welke*
5.1	Transaction costs in question 5.2 t / m 5:11 inclusive buying and selling completed investment titles?	Ja

	Kosten per beleggingscategorie	Beheerkosten	Performance gerelateerde kosten	Acquisitie en in en uitstapvergoeding	transactiekosten	Totaal
5.2	Realty	€ -	€ -	€ -	€ -	€ -
5.3	shares	€ -	€ -	€ -	€ -	€ -
5.4	private equity	€ -	€ -	€ -	€ -	€ -
5.5	Fixed Income	€ -	€ -	€ -	€ -	€ -
5.6	hedge Funds	€ -	€ -	€ -	€ -	€ -
5.7	Commodities	€ -	€ -	€ -	€ -	€ -
5.8	Other investments	€ -	€ -	€ -	€ -	€ -
5.9	Total costs attributable to categories excl. Overlay	€ -	€ -	€ -	€ -	€ -
5.1	Costs overlay investments	€ -	€ -	€ -	€ -	€ -
5.11	Total costs attributable to catagories incl. Overlay	€ -	€ -	€ -	€ -	€ -
	Other asset management costs					
5.12	Cost pension fund and asset management office	€ -	€ -		€ -	€ -
5.13	Cost fiduciary management	€ -	€ -		€ -	€ -
5.14	Custody	€ 3	€ -		€ -	€ -
5.15	Consultancy costs asset	€ -	€ -		€ -	€ -
5.16	other costs	€ 0	€ -		€ -	€ -
5.17	Total other investment management fees	€ 3	€ -		€ -	€ -
5.18	Total cost asset					€ -

6.1	Notes asset management fees:	

The impact of the regime has been significant. Not only have costs fallen (see above) but also pension funds enthuse about the immediate and long-term impact of collecting data on costs, and have adopted the regime with enthusiasm.

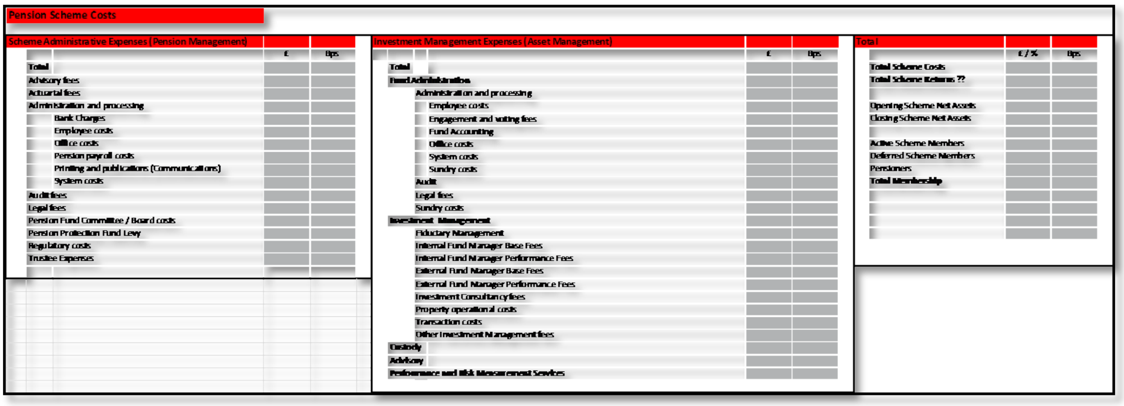
Gerard Warmerdam of the Stichting Pensionenfonds Achmea recently said: “For me, transparency of costs has a clear added value. However, you'll need to understand what those costs are and where they are made in the chain. Maybe there are 'responsible' costs where you can do little more, or may not want to. **But there are also costs that can be influenced and you can start to actively manage them.** Therefore you should always ask questions of all your providers and not only your asset managers.”

In the context of what the UK needs to do, this means start with simple measure and start now. This point is made in the case study in Section 5.4 of this paper.

4. A Proposed Standard for the UK

The conversation in the UK has been analogous, but slower moving, to that in The Netherlands. However, it is useful for the UK not only to understand how the conversations about cost transparency started and proceeded in The Netherlands, but to also directly base a UK cost data standard on that used in The Netherlands. Accordingly, the standard I am proposing for the UK is based directly on the Dutch example but also allows for the wisdom of five years of attempts to obtain data from Freedom Of Information Act (FIOA) requests from UK pension funds. Figures 2, 3 and 4 show the three elements of this proposed standard (also see Appendix 1)

Figure 2: Collection template for Pension Fund Administration costs



Pension Scheme Costs

Scheme Administrative Expenses (Pension Management)	£	Bps
Total		
Advisory fees		
Actuarial fees		
Administration and processing		
Bank Charges		
Employee costs		
Office costs		
Pension payroll costs		
Printing and publications (Communications)		
System costs		
Audit fees		
Legal fees		
Pension Fund Committee / Board costs		
Pension Protection Fund Levy		
Regulatory costs		
Trustee Expenses		

Investment Management Expenses (Asset Management)	£	Bps
Total		
Fund Administration		
Administration and processing		
Employee costs		
Engagement and voting fees		
Fund Accounting		
Office costs		
System costs		
Sundry costs		
Audit		
Legal fees		
Sundry costs		
Investment Management		
Fiduciary Management		
Internal Fund Manager Base Fees		
Internal Fund Manager Performance Fees		
External Fund Manager Base Fees		
External Fund Manager Performance Fees		
Investment Consultancy fees		
Property operational costs		
Transaction costs		
Other Investment Management fees		
Custody		
Advisory		
Performance and Risk Measurement Services		

Total	£ / %	Bps
Total Scheme Costs		
Total Scheme Returns ??		
Opening Scheme Net Assets		
Closing Scheme Net Assets		
Active Scheme Members		
Deferred Scheme Members		
Pensioners		
Total Membership		

Figure 3: Collection template for Asset Manager costs

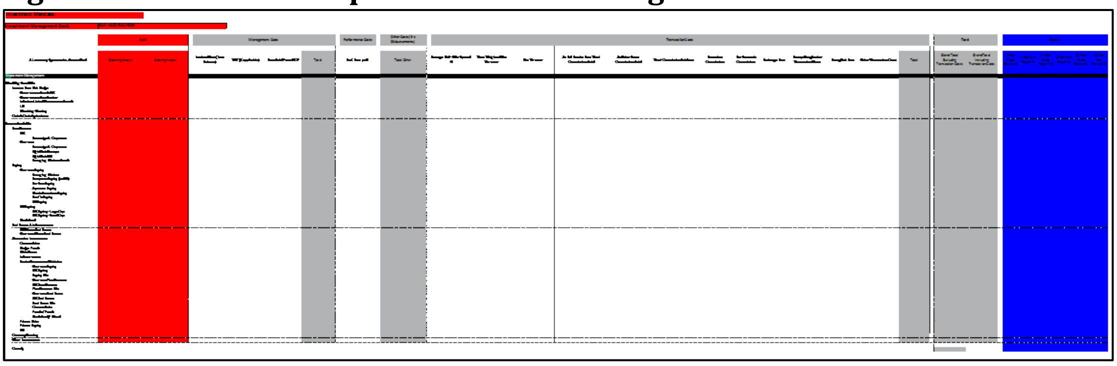
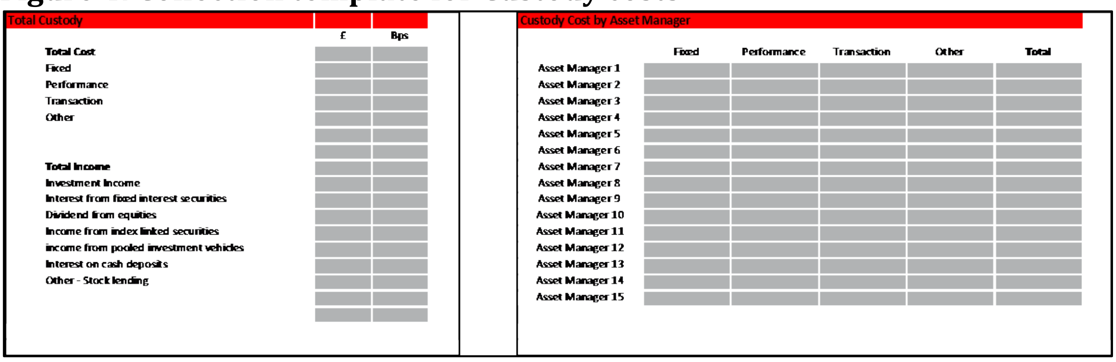


Figure 4: Collection template for Custody costs



Total Custody	£	Bps
Total Cost		
Fixed		
Performance		
Transaction		
Other		
Total Income		
Investment Income		
Interest from fixed interest securities		
Dividend from equities		
Income from index linked securities		
income from pooled investment vehicles		
Interest on cash deposits		
Other - Stock lending		

Custody Cost by Asset Manager	Fixed	Performance	Transaction	Other	Total
Asset Manager 1					
Asset Manager 2					
Asset Manager 3					
Asset Manager 4					
Asset Manager 5					
Asset Manager 6					
Asset Manager 7					
Asset Manager 8					
Asset Manager 9					
Asset Manager 10					
Asset Manager 11					
Asset Manager 12					
Asset Manager 13					
Asset Manager 14					
Asset Manager 15					

The aim of these templates is to collect cost data on and for UK pension funds. The template is set at an 'appropriate' level of detail, covering both the overt costs and a reasonable and accessible portion of the implicit and less overt costs to which a pension fund is subject.

Overt costs include items that otherwise are normally collected and represented, such as the invoiced charges applied by funds both pre and post performance calculations (equivalent to an Annual Management Charge (AMC)). They also include other charges that might otherwise make up what is known in the retail fund space as the Total Expense Ratio (TER).

Implicit costs are items aimed at discovering the costs of turnover by funds, hence the sections on commission and turnover (for equity funds, for example) and bid/offer spread (for fixed income funds).

The complexity lies with pooled funds. Historically, look-through into even the assets held within pooled funds has been weak. So whilst the purchase costs of units in a pooled fund are routinely captured by pension funds (through bid/offer spreads and volumes of units), the trading of assets that make up a pooled fund have been undisclosed. The aim of the template it to ask asset managers to not only reveal the turnover of **units**, but also of the underlying **assets**.

Consequently, for pooled funds (listed under alternative assets) there are two sets of data that are needed: turnover of units, and turnover of assets within the pooled fund.

There are three sections to the proposed standard and all are self-explanatory:

1. **Pension Fund Costs (Figure 1)**. These are the costs that the scheme itself incurs and includes all the items for which the scheme is liable (such as audit fees) as well as for which it receives invoices (such as the total of external asset manager charges, on invoice).

2. **Asset Manager (Figure 2)**. This is information that would be provided by each asset manager. Therefore, each asset manager (or even fund) should receive a copy of the template to be completed independently. The information is aimed at capturing the costs they present to the pension fund, or otherwise incur (such as turnover). Pooled Investment Vehicles are captured under the Alternative Investments section. Unit turnover and bid/offer spread into and out of the Pooled Fund, can be captured, and also the turnover of the underlying assets.

3. **Custody (Figure 3)**. These are the costs incurred or levied by the custodian or passed on by asset managers from their custodians

The data collected by this proposed model does not represent the entirety of costs to which a pension fund is subject, and the same *caveats* apply here as apply to the Dutch framework. Namely, cost data on pooled funds will meet resistance when extended to turnover of assets within the funds; data on some asset classes will be incomplete or weak, largely as a result of weak data from providers or limited compliance (private equity, hedge, property…etc funds); anything that requires too great an effort at this stage to collect is excluded (e.g. market impact).

The difference between this standard and the more aggressive measures suggested in PRIIPS (should they be adopted for pension funds) is that this standard would be relatively quick and easy to implement. PRIIPS will need not only industry-wide data to measure items like market-impact, but possibly new technology to collect and analyse the data. It will eventually become both necessary and possible to adopt a PRIIPS-like methodology, but I advocate small steps so that we can start as soon as possible, start the industry moving in the right direction, and reap the rewards of compounding of savings.

5. Implementing the Proposed Standard

In this section I will outline five examples where I have been involved in attempts to obtain wider data on pension costs than was available in either annual reports or the public domain. The practical efforts made in this arena led me and others to develop what I believe is a 'compromise' data standard (outlined in Section 4) that should be easy to implement and based on data that is already collected and used by various stakeholders (such as asset managers). When the data is too complicated or too controversial to collect, the ways in which the industry can obfuscate are near infinite. A gentle progression is therefore what is required.

5.1 Case Study 1 – UK Local Government Pension Funds – FOIA requests for IMA Level 2 Disclosure Tables on Turnover

In 2008, Prof Tim Jenkinson of Oxford University started submitting FOIA requests to Local Government Pension Schemes for IMA Level 2 Disclosure Tables ('Comparative Disclosure Tables') on equity turnover and commission. He subsequently published a paper looking at turnover vs. commission on equity trading over time ("Does Transparency Overcome Conflicts of Interest? Evidence from Investment Managers and Their Brokers"). The paper demonstrated, through the analysis of aggregate data (without revealing the identities of any one asset manager) that commission rates had indeed fallen as a result of the transparency enabled by the IMA disclosure code. However, turnover had increased by an even larger amount over the same time period meaning that funds paid more commission in the round, rather than less. I continued this process of FOIA requests in 2009-2013, using the template FOIA request letter developed by Prof. Jenkinson.

There are several key points to the Disclosure tables:

- They are a voluntary code of practice to which, in reality, every asset manager subscribes
- Data is collected and collated on turnover and commission, split into two component parts: Trading/execution commission and research commission
- This data is segmented by broker for each of the top 10 brokers by volume of trading, as well as the total across all brokers used by an asset manager
- This data allows for calculation and publication of benchmark commission rates
- The data is useful for asset managers themselves to track with whom they principally trade and from who they obtain research and at what costs
- In other words, they collect the data anyway even without applying this voluntary code of practice
- The data is captured in a standard template (see Figure 5 below) and submitted to pension funds. In my experience, sometimes this submission is routine, sometimes it requires a specific request, and sometimes it is not sent to pension fund clients at all

- As such the data falls under FOIA rules and should be obtainable on request from Local Government Pension Schemes (LGPS)
- Over time, every asset manager has developed their own template to capture and submit the data (see Figures 6 and 7 below for two different examples)

Figure 5: Standard template for IMA Comparative Disclosure Table (taken from IMA Pension Fund Disclosure Code, Sept 2007)

IMA COMPARATIVE DISCLOSURE TABLE
How commissions paid have been generated and how they have been used
Report for: Client A
Asset type:

	Analysis of Trading in period				Sources of Commissions Paid(£)			Uses of Commissions Paid (£)			
	Total (£)	Of which:						Of which:			
		% Net	% with Commission					For Execution (£)		Other[1] (£)	
Counterparty			*At Full Service Rate*	*At Other Rates*	*At Full Service Rate (£)*	*At Other Rates(£)*	*Total Paid Out (£)*	*Retained by Executing Broker*	*Paid to Third Parties*	*Retained by Executing Broker*	*Paid to Third Parties*
1											
2											
9											
10											
Other											
ALL											
	(a)	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*	*(i)*	*(j)*	*(k)*
Firm-Wide Comparators											
All (Equity/Bond/Other) Trading	100%	%	%	%	%	%	100%	%	%	%	%
Client A Trades	100%	%	%	%	%	%	100%	%	%	%	%
Average Firm-Wide Commission Rate (bp)							XXbp				
Client A Average Commission Rate (bp)							XXbp				

My expectation on sending the FOIA requests to all LGPS funds was that I would get multiple years of data for every equity asset manager used by each pension fund. I also expected this process to be seamless, swift and for responses to be sent as soft copy spreadsheets to allow easy data manipulation and transformation.

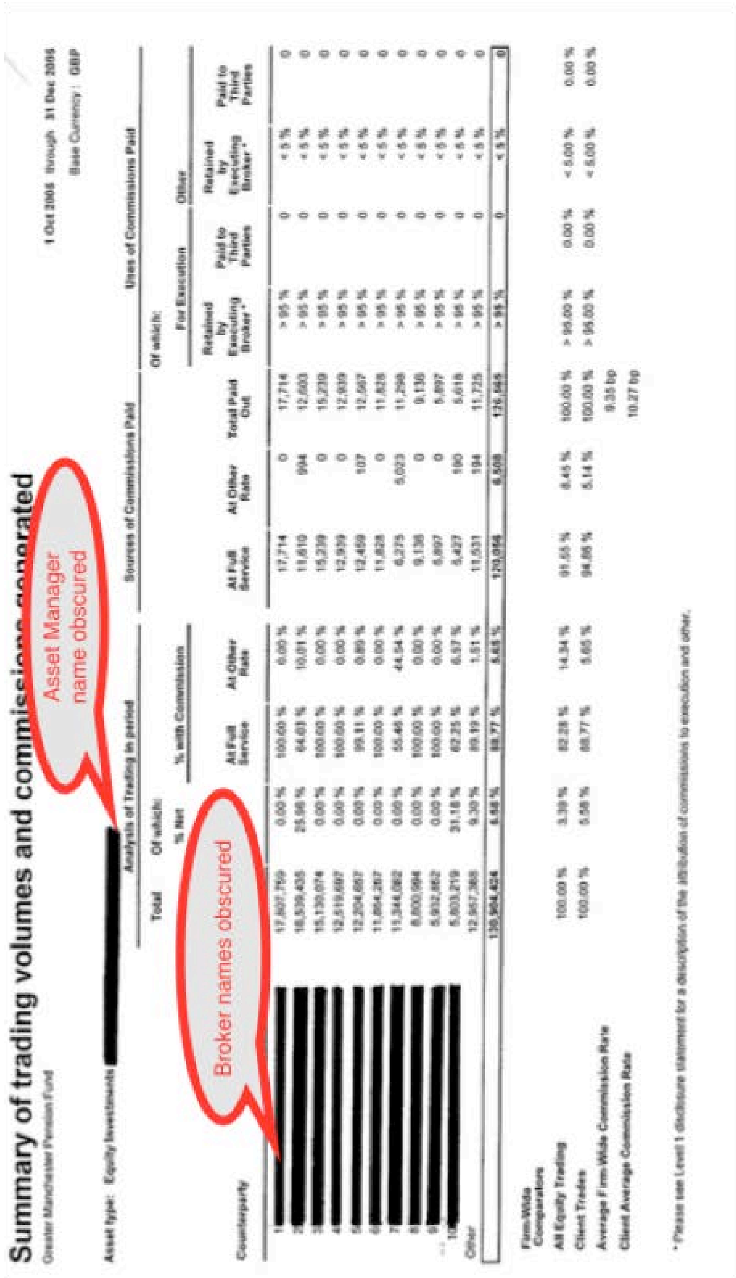
The reality was very different. Only approximately 40% of pension funds responded, and not one pension fund gave me a complete data set, either because information on one or more asset managers was missing, or some of the years were missing. As time went on, all pension funds stopped responding. Moreover, responses were in hard copy form, often badly photocopied and routinely with key information missing, redacted or otherwise obscured (see Figured 6 and 7). There is an argument (although weak) for redacting the broker names as this may or may not be relevant for client confidentiality. But there is no excuse for redacting the names of the asset managers. The upshot was that I received approximately 3000 badly photocopied pieces of paper that lacked key information.

However, some limited analysis was eventually possible as asset managers had customised the standard template (Figure 5) to fit their own needs. Identifying some managers was possible as some pension funds had only one equity asset manager and this name can be obtained from annual reports. This limited analysis showed that mean turnover was high (approx. 140% per annum) with some extreme outliers in excess of 1000% (10x PTR per annum).

One conclusion from this effort is that equity turnover in LGPS funds was high (and in some cases very high). More important though is the conclusion that efforts to obtain data, even data that is both lawfully and reasonably requested, can result in negative behaviors. There was no good or lawful reason for obscuring the names of asset managers but without this information I struggled to calculate Portfolio Turnover Rate (PTR – the proportion of the portfolio traded in a year), which requires Assets Under Management (AUM - obtainable only from the LGPS Annual Reports).

Key findings: Despite there being a code of practice for submitting data many suppliers, in this case asset managers, do not adhere to it. In addition, a code of practice needs to be understood by those who would use the data otherwise the data is useless. This last point is important: If the data collected is too complex, or the way it needs to be interpreted is too complex, then it is not useful. It is for this reason that I advocate an independent organisation, an expert, to collect and collate pension cost data, and to report on this data in a way that is standardised and useful. The alternative is that trustees, or equivalent, will have to become skilled in analysing and interpreting the data and in aggregating the results.

Figure 6: Typical response from FOIA request. Note format and redacted information



Summary of trading volumes and commissions generated

Greater Manchester Pension Fund

1 Oct 2005 through 31 Dec 2005

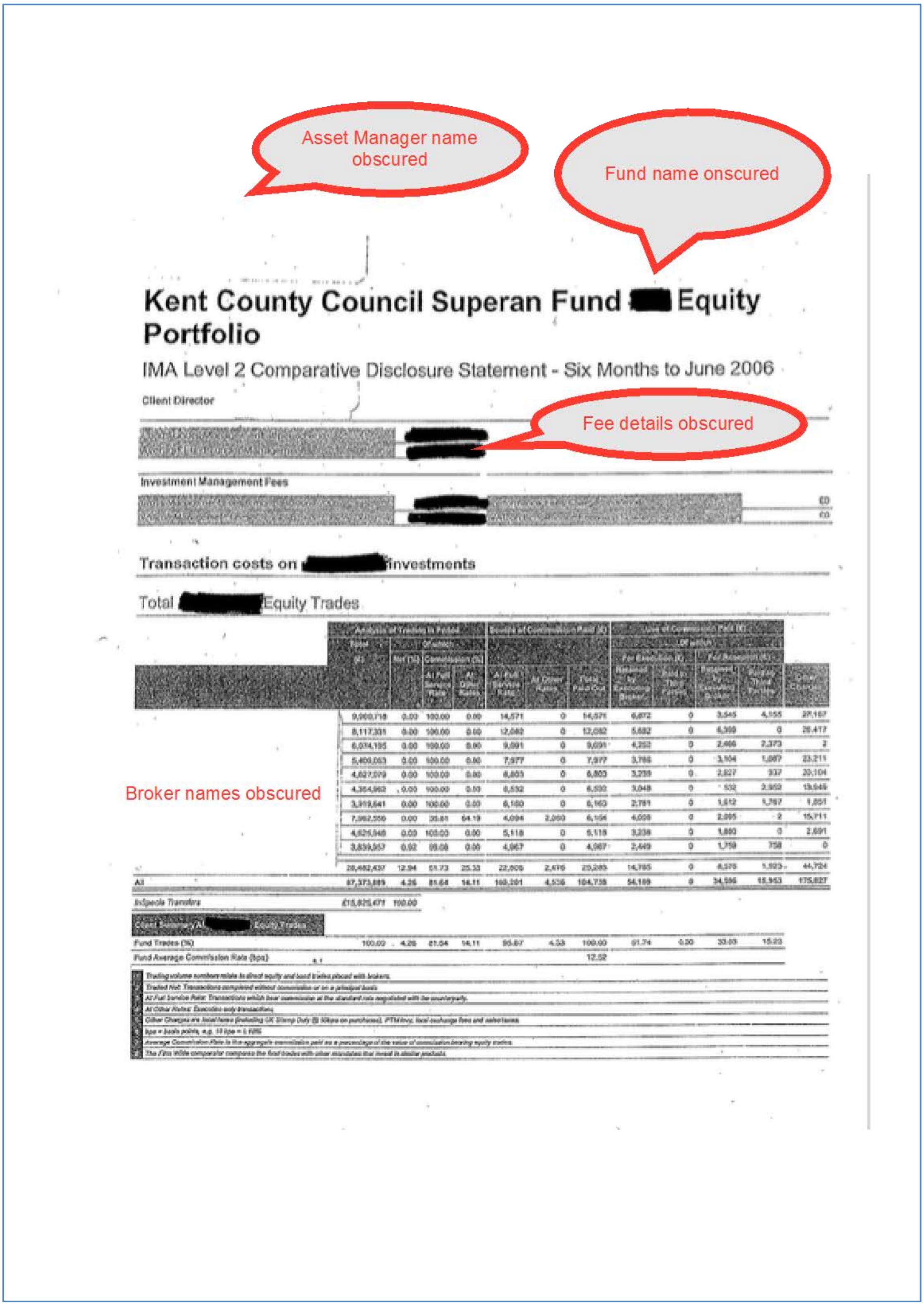
Base Currency : GBP

Asset type: Equity Investments [redacted]

Counterparty	Analysis of Trading in period: Total	Of which: % Net	% with Commission: At Full Service	% with Commission: At Other Rate	Sources of Commissions Paid: At Full Service	Sources of Commissions Paid: At Other Rate	Total Paid Out	Uses of Commissions Paid, Of which: For Execution: Retained by Executing Broker *	For Execution: Paid to Third Parties	Other: Retained by Executing Broker *	Other: Paid to Third Parties
1 [redacted]	17,807,759	0.00 %	100.00 %	0.00 %	17,714	0	17,714	> 95 %	0	< 5 %	0
2 [redacted]	18,539,435	25.96 %	64.03 %	10.01 %	11,610	994	12,603	> 95 %	0	< 5 %	0
3 [redacted]	15,130,074	0.00 %	100.00 %	0.00 %	15,239	0	15,239	> 95 %	0	< 5 %	0
4 [redacted]	12,519,697	0.00 %	100.00 %	0.00 %	12,939	0	12,939	> 95 %	0	< 5 %	0
5 [redacted]	12,204,657	0.00 %	99.11 %	0.89 %	12,459	107	12,567	> 95 %	0	< 5 %	0
6 [redacted]	11,864,267	0.00 %	100.00 %	0.00 %	11,828	0	11,828	> 95 %	0	< 5 %	0
7 [redacted]	11,344,082	0.00 %	55.46 %	44.54 %	6,275	5,023	11,298	> 95 %	0	< 5 %	0
8 [redacted]	8,800,994	0.00 %	100.00 %	0.00 %	9,136	0	9,136	> 95 %	0	< 5 %	0
9 [redacted]	5,932,862	0.00 %	100.00 %	0.00 %	5,897	0	5,897	> 95 %	0	< 5 %	0
10 [redacted]	5,803,219	31.18 %	62.25 %	6.57 %	5,427	190	5,618	> 95 %	0	< 5 %	0
Other	12,957,388	9.30 %	89.19 %	1.51 %	11,531	194	11,725	> 95 %	0	< 5 %	0
	130,904,424	5.58 %	88.77 %	5.65 %	120,056	6,508	126,565	> 95 %	0	< 5 %	0
Firm-Wide Comparators											
All Equity Trading	100.00 %	3.39 %	82.28 %	14.34 %	91.55 %	8.45 %	100.00 %	> 95.00 %	0.00 %	< 5.00 %	0.00 %
Client Trades	100.00 %	5.58 %	88.77 %	5.65 %	94.86 %	5.14 %	100.00 %	> 95.00 %	0.00 %	< 5.00 %	0.00 %
Average Firm-Wide Commission Rate							9.35 bp				
Client Average Commission Rate							10.27 bp				

* Please see Level 1 disclosure statement for a description of the attribution of commissions to execution and other.

Figure 7: Typical Response from FOIA request. Note format and redacted information



Kent County Council Superan Fund [redacted] Equity Portfolio

IMA Level 2 Comparative Disclosure Statement - Six Months to June 2006

Client Director

[illegible] [redacted]

Investment Management Fees

[illegible] [redacted] [illegible] £0 £0

Transaction costs on [redacted] investments

Total [redacted] Equity Trades

	Total (£)	Net (%)	Commission (%) At Full Service Rate	Commission (%) At Other Rates	Source of Commission Paid (£) At Full Service Rate	At Other Rates	Total Paid Out	For Execution (£) Retained by Executing Broker	For Execution (£) Paid to Third Parties	For Research (£) Retained by Executing Broker	For Research (£) Paid by Third Parties	Other Charges
	9,900,718	0.00	100.00	0.00	14,571	0	14,571	6,872	0	3,545	4,155	27,167
	8,117,301	0.00	100.00	0.00	12,082	0	12,082	5,682	0	6,399	0	28,417
	6,074,195	0.00	100.00	0.00	9,091	0	9,091	4,252	0	2,466	2,373	2
	5,409,063	0.00	100.00	0.00	7,977	0	7,977	3,786	0	3,104	1,087	23,211
	4,627,079	0.00	100.00	0.00	6,803	0	6,803	3,239	0	2,827	337	20,104
	4,364,962	0.00	100.00	0.00	6,532	0	6,532	3,048	0	532	2,952	19,646
	3,919,641	0.00	100.00	0.00	6,160	0	6,160	2,781	0	1,612	1,767	1,851
	7,962,556	0.00	35.81	64.19	4,094	2,060	6,154	4,008	0	2,095	2	15,711
	4,625,946	0.00	100.00	0.00	5,118	0	5,118	3,238	0	1,880	0	2,691
	3,839,957	0.92	99.08	0.00	4,067	0	4,067	2,449	0	1,759	758	0
	28,482,437	12.94	61.73	25.33	22,808	2,476	25,285	14,785	0	8,575	1,923	44,724
All	87,373,889	4.26	81.64	14.11	100,201	4,536	104,738	54,189	0	34,596	15,953	175,827
In Specie Transfers	£15,825,471	100.00										
Client Summary/All [redacted] Equity Trades												
Fund Trades (%)	100.00	4.26	81.64	14.11	95.67	4.33	100.00	51.74	0.00	33.03	15.23	
Fund Average Commission Rate (bps)							12.52					

5.2 Case Study 2 – UK Pension Fund: Detailed Approach

The purpose of this exercise was to conduct a detailed study and obtain as much information on the costs impacting a pension fund as could be obtained over a sustained period of time. The pension fund in question was a mature DB scheme that managed under £3bn of pension fund assets with strict investment guidelines. The pension fund was well-diversified and had appointed many asset managers, who were in the main UK-based, with investments across a variety of asset classes including equity, fixed income, property and alternative assets, such as hedge funds and infrastructure.

Investments were in a number of segregated discretionary managed portfolios that were actively and passively managed. In addition, the pension fund had made a small number of large investments directly into pooled traditional and alternative investment funds with all investments part of either a "Return Seeking Pool" (a pooled fund with a specific absolute return objective) or a "Liability Matching Pool" (a pooled fund with a specific objective to match returns to the liabilities of the pension fund) to reflect the broader investment strategy.

With this complex example, some time was spent understanding the structure with respect to investments as only then could the location of essential documentation and data be identified and sourced. In addition, a detailed approach to collecting data was adopted and considerable time and effort was expended to analyse all documentation and data received to identify every possible investment cost-related item and then to resolve numerous related queries with the pension fund to obtain a clean starting point data set. The process was multi-iterative until such a point as each potential cost item was either included or excluded from the scope.

Requested documentation included: Asset management fee invoices, Investment Management Agreements, pooled fund documentation (including the Fund Prospectuses, Subscription Agreements and any relevant Side Letters) and Custodian Invoices. The pension fund also made standard IMA Level II Disclosure Table requests (the same table reference in Section 5.1) to each asset manager managing a segregated discretionary mandate.

Obtaining all relevant documentation in one go was not possible so repeated requests and clarifications had to be made via the respective Chief Operating Officer of the pension fund and various staff members. Only by undertaking a detailed review of all documentation received did it become apparent that certain other important documents were missing. Most pension funds hold documentation in physical hardcopy so more-or-less every document had to be scanned in and e-mailed. Some documentation had to be re-sent due to scanning errors that occasionally rendered documents and/or specific pages illegible.

All investment-related services provided by asset managers and service providers were identified to attempt to uncover all layers of cost. An asset manager may provide services other than pure fund management and could provide, for example, portfolio transition services. Custodians not only provide asset safe-keeping services but may be contracted for other services such as performance measurement, performance attribution, risk analytics, stock lending, portfolio transition services and FX hedging services and so on.

Various static and other data was collected from the pension fund such as: The size of the total asset pool, size of allocations to each asset manager, asset manager details (including fee structure, valuation/fee cycle, benchmark, fund management style and appointment date…etc) and whether or not each segregated discretionary mandate was long-only active, long/short active or passive.

The whole process around the collection of documentation was extremely time-consuming and involved much iteration. Additionally, due to the sheer number of issues trying to keep a track of them all proved to be time-consuming and involved a high level of disruption for pension fund staff.

A lot of the trade and holdings data needed to pursue the analysis was in the hands of the custody bank used by the pension fund and, to access the systems of the custodian a rigorous and lengthy NDA process had to be followed resulting in several weeks of delays. It could be questioned why an NDA was needed given that the data belongs to the pension fund and not the custodian. Once the NDA was agreed a lengthy process of drilling down into the trade data followed, and sometimes the only way to obtain meaningful data and information was to generate complex data tables from the accounting systems of the custodian. Very few useful standard reports for the purposes of cost analysis existed.

In addition, the custodian was not able to provide its own fee invoice data for the period required in an electronic format. Initial custodian fee invoices were supplied by the pension fund in hardcopy format, which then had to be manually re-keyed into a spreadsheet for further analysis and aggregation.

Overall and once the NDA was signed, the custodian proved to be fairly open and helpful; but that might be because they were not the main focus of the project. Errors were evident in the data provided by them and only additional reconciliation processes brought these errors out into the open for rectification. Clearly, the potential for unknowingly extracting inaccurate data from their systems is high.

Sensitive areas where custodian resistance might be felt in the future include where FX is executed by them or via another party that may be related to the custodian as part of either an FX hedging or Cash Management programme. Spreads on these trade executions may be larger than expected and hence the custodian might be sensitive to questions and data requests concerning this revenue stream. Requests for data around stock lending costs, revenues and hence profitability will also generate resistance.

Pooled fund costs, other than the costs of trading in and out of the pool were extremely difficult to obtain. For example, the pooled fund asset manager may take the view that the pension fund does not have the right to view any underlying transactional data or holdings data as it arguably reflects their intellectual property around the investment process. It is their “differentiator” in a highly competitive market place. Should this information be in the public domain then it might be possible for a third-party to use this information and “trade against” the fund’s positions, thereby reducing expected investor returns and the asset manager’s expected management fee and performance fee income. However, I struggle with this point of view. The pension fund is a client and there are ways and means of delivering useful cost data without breaking any confidences.

Asset managers of hedge funds, funds that invest in illiquid or OTC securities and funds that deploy “black box” models to generate trades will be the least likely to provide any colour around trades and positions. These asset managers have the highest sensitivity to the risk of IP loss and others trading against them in the market. However, some larger and/or strategic investors in alternative investment funds negotiate better transparency and disclosure terms before making their initial investment via the use of a Side Letter.

The IMA Level 2 Disclosure Table findings were disappointing in that completed responses were in the main fragmented and inconsistent. The majority of responses did not use the agreed format suggested by the Investment Association meaning that making an accurate comparison by asset manager and/or strategy was extremely difficult or virtually impossible. However, a very small number of asset managers, whilst not using the correct reporting format, went to great length to be highly transparent, thereby easily exceeding the minimum level of data disclosure and reporting that the Pension Fund Disclosure Code requires.

All asset managers based in jurisdictions other than the UK had little or no understanding of the Investment Association’s Pension Fund Disclosure Code and failed to accurately adhere to it with respect to the quantity and quality of data reported.

Some interesting findings include levels of trading significantly in excess of expectations resulting in high trading costs and reported data that didn’t match the ‘Books and Records’ of the pension fund. The level of transparency around portfolio turnover and the use of soft commissions is a concern worthy of further investigation.

Some non-UK asset managers wanted to hold detailed conference calls with pension fund staff to better understand why they had to supply the data and how to go about it. Again, this represented a considerable amount of noise around the process and lots of aggravation for pension fund staff.

In the end the process was useful for the pension fund but almost prohibitively complicated and time-consuming. Even though the pension fund was completely on board with the data requests and subsequent analysis and follow-up requests, progress was painfully slow.

Key findings: The extent to which data was not available or was inaccurate was, frankly, shocking. We live in a world where precision around data should be a given. This lack of precision and the extent to which data is kept in hardcopy made this analysis extremely time consuming. There is no doubt that doing this hard graft consultancy-style analysis and audit is useful. But in terms of driving the market towards transparency at speed rather than at a snails pace, detailed analysis such as this is not useful as it is so labour intensive. A more targeted approach is needed where key information is identified and adopting a consistent market standard adopted is the way forward. This targeted approach is what I suggest for the cost collection standard; it might not get all the data, but it will get a lot of it, and certainly some very important items, with minimal effort.

5.3 Case Study 3 – UK Pension Fund: Targeted Approach

The purpose of this exercise was to obtain the costs of a DB staff pension scheme using a template similar to that shown in Section 4 and test whether a more targeted approach would work.

The work first started in January 2015 and a pension fund employee sent formal requests to Asset Managers on 19th March 2015. Of the four asset managers used by the pension fund, all eventually responded in some form or other but mostly incompletely.

Excuses used in email communications included (anonymised quotes):

- "I can provide a Net return over the period but we are unable to breakdown the return by asset class / Net of fees."
- "We cannot separate exchange fees, stamp duty etc. as trades for this fund is combined with other funds to ensure the lowest costs are achieved."
- "'We only provide gross (their net is standard fees which isn't always applicable to all clients), but you can calculate net by taking the AMC they charge (the pension fund) off the gross figure for the 1 year period to 30 June 2014"
- "We unfortunately cannot provide an overall net return due to the limitations of our performance system."
- "Please find attached information on your Annual Management Charge (AMC), which is an all-inclusive fee and can be treated as a Total Expense Ratio (TER). We do not charge our clients separately for any broker or

custody fees and as such we unfortunately cannot break-out this information for you."

- "The actual fee charged will vary, though typically could be between 0.50% and 1.00% per annum, with specialist funds generally charging more than general funds. These funds will also have other expenses to pay, such as trustee fees or audit fees, which again will be paid directly from the assets of each fund. The effect of these charges depends on the size of each fund, but could amount to 0.1% per annum."

In addition, and on more than one occasion, all that was sent was raw trading data, which often meant thousands of trades, making analysis near impossible.

Ultimately, the four asset managers used by the pension fund all submitted their invoiced management and performance fees. Additional costs, such as turnover and commission-related costs had to be derived from benchmarks I have developed from my experience and wider data-sets. Therefore the analysis, particularly on pooled funds and property funds was at best incomplete and at worst implied or missing entirely. So despite the assistance of the fund's pension fund consultant, who was instructed to assist me, a line was drawn under the data collection process in November 2015 with data still missing from each of the asset managers. Most notably this missing data included:

- Average bid-offer spreads on all fixed income trades
- Any breakdown on the detail between equity sub-classes for one asset manager
- The breakdown for turnover by sub-fund, including execution and research fees and stamp duty and performance figures for one asset manager
- Almost any data on pooled funds including: Turnover within pooled funds, spreads in trading in and out of the pooled funds, management fees of underlying funds, performance fees of underlying funds… etc. In fact the only piece of data offered was the management fee of the pooled structure.
- Any costs associated with the property portfolio managed by one asset manager, including the management charges of the underlying funds, performance fees, estate agent commissions, land registration fees, taxes and stamp duties…and so on.

Given the high costs usually associated with property funds and large exposure to pooled funds, the lack of information and transparency here is particularly worrying.

In fact, the costs that were collected (little more than the invoiced investment management expense) totaled 63bps, including scheme administration costs. The incremental amount identified added an additional 20bps (i.e. a 50% uplift in expected costs), consisting of implied turnover costs on the small active equity portfolios and fixed income portfolios.

Key findings: Going through an intermediary (the pension fund employee) complicated matters as employees may not properly understand the costs structure of a pension fund. The employee could not answer either the reasonable or unreasonable questions posed by the asset managers in relation to the data requests. Additionally, obfuscation was not recognised, and neither was inaccuracy in data or non-submission of data. There are still large amounts of cost to be identified and to obtain this requires willing compliance from the asset managers.

One suggestion put to the pension fund consultant was to require cost data transparency as part of any contract with an asset manager or other service provider. This would need to be written in as a clause into RFPs, which is when negotiations start. The organisations that are best suited to include such a clause in RFPs (the time of maximum contractual leverage) are the pension fund consultants.

So a targeted approach using the template was useful and actually far less effort than the example in 5.2, but without willing compliance from providers it is unlikely to succeed. The task therefore becomes one of incentivising asset managers to give up easy data readily.

5.4 Case Study 4 – UK LGPS Fund using the new CIPFA guidelines

In 2015 The Chartered Institute of Public Finance & Accountancy issued new guidelines for reporting costs by Local Government Pension Schemes. This new regime required the collection of all invoiced costs, including some data on costs associated with equity turnover. These guidelines are not mandatory but are recommendations; nevertheless most LGPS use these guidelines when reporting.

Until the new guidelines were issued the simple requirement for all LGPS was to accurately report invoices submitted by suppliers in annual accounts, with no requirement to understand or collect turnover data. This led to the ridiculous position where some funds were reporting their investment management expense as low as a few bps. After all, if invoices were not submitted, how could they be reported? So long as those that were submitted were accurately reported all was good and there was no requirement to either police or chase invoices that were not submitted.

To rectify this, the Shadow Advisory Board of the LGPS recommended in 2015 that all schemes collect all invoices per the new CIPFA recommendations. Of the 89 schemes in England and Wales only 10 complied. Of these, only one made a concerted effort, Fund A. The following is a summary of what Fund A established:

- On a like-for-like basis, reported costs associated with investment management in 2013-14 rose from 10bps to 92bps. The cost to the scheme did NOT rise, merely the way the costs were reported. In other words, costs that were ‘hidden’ in the nebulous figure “change in market value of assets” (a figure that reports asset value net of costs) were identified and reclassified as “investment management expense”.

- The dramatic rise came only as a result of chasing invoices that had not been submitted

- The asset class where they found most cost and where invoice compliance was weakest (only 30% of managers responded and, of these, half supplied unusable information) was private equity. Here, invoiced costs equated to approximately 250bps. The absolute return portfolio was also high at almost 225bps, as were alternative investments (which included property and infrastructure) at 131bps. The active equity and fixed income portfolios were much lower at 14bps and 24bps, respectively. These latter numbers, whilst they did include all of the comparatively easy-to-collect asset manager invoices, did not include any transaction costs (neither explicit not implicit costs).

- So great was the effort to collect only the unsubmitted invoices that there was no data collected according to the extended CIPFA guidelines. i.e. no data on turnover or transaction costs was collected.

- Having identified a range of previously uncollected costs, Fund A immediately negotiated with suppliers and achieved a reduction in costs of approximately 10bps for 2014-15.

Key findings: There are many costs that have not been collected or submitted, even some obvious ones. Knowing some information provides leverage in negotiations. In this case study the costs that were collected were not new or complicated in any way. They were just invoices from asset managers that should have been submitted but weren’t. Essentially they were items that would be accounted for as ‘Investment Management Expense’ in a pension fund annual report. Collecting these unsubmitted invoices from one year to the next resulted in an approximate 900% increase in reported costs. This immediately gave room for negotiation and the following year, invoices were reduced by £10mn or 8-9bps on a like-for-like basis. Scale that up across the whole of the LGPS (£250bn) and it represents a saving of more than £200mn per year. This particular case study confirms that going for the low-hanging fruit is worthwhile and can achieve early savings in costs.

5.5 Case Study 5 – UK-based Active Institutional Asset Manager

Late in 2015 I was approached by an asset manager (Firm A), in connection with a number of papers I had published regarding the development of best practice in the Netherlands. Firm A is one of the largest active managers of LGPS assets investing in a number of different asset classes. They asked if they could view the template for data collection I was proposing (Section 4) and agreed it was an appropriate level of detail to allow initial comparative analysis of costs to be generated. They confirmed that the template was consistent with the costs that they routinely disclose in their clients' quarterly reports.

To demonstrate this they shared with me an anonymised quarterly report from one of their LGPS clients. I can report that this form contains the following information:

- Turnover and commission by broker counterparty, per the IMA level 2 code template shown in Figure 5
- Total turnover segmented by market, with a summary of commissions paid in both cash value and bps by market
- Income derived from underwriting and stocklending
- Invoiced manager fees (management and performance)
- Custody costs paid out
- VAT
- Stamp Duty
- Other transaction taxes and levies

In summary, all the information needed from an active equity asset manager, packaged in a clear and concise format.

Key findings: Not all service providers are the same. There are those that are more than willing to collaborate with reasonable requests for cost and other data. Such service providers should be in a position to differentiate themselves and gain significant competitive advantage. As a matter of urgency such providers, and also pension funds, should be approached and asked to support moves for costs transparency.

5.6 Case Study 6 – Emerging Market Solution to Cost Transparency: Turkey

This last case study summarises some research I carried out recently on the private ('third pillar') DC pension market in Turkey, which is relatively small at only a few 10's of billions of Turkish Lira in size (£1 = approximately TRL 4.2). The belief in Turkey is that private pensions are expensive for consumers. Given the relatively novelty and naivety of and about the private pension market in Turkey, officials have taken some interesting steps to support growth. The most interesting and relevant (to this paper) of these is to cap fees.

This fee cap is placed on pension fund companies (of which there are 19) and represents a maximum level of fees they can derive from their customers (pensioners). This cap has two components: The first is a management fee, presented as a % of AUM, which varies according to the type of product being purchased by the customer; the second is an 'onboarding' fee, 8.5% of monthly minimum wage, and can only be charged for 5 years (this fee is comparatively small and is currently only TRL140 per annum).

The range of asset classes used by pension funds is narrow and limited to equities, fixed income, commodities and not much else. This makes for a limited number of fee caps, with equities having the highest cap at 2.28% of assets. Customers buy products that are mixes of funds so the highest management fee a customer will ever pay is 2.28% for a pension consisting of entirely equities.

In addition pension funds often have to offer discounts on management fees to large corporate DC schemes that negotiate hard by offering scale, which does introduce an element of unfairness to the system.

Finally, and from 2021, pension fund companies will have to offer rebates to customers who keep their pension funds with that company for more than 5 years.

What this means is that the pension fund company's revenues are capped. Profit comes from managing down costs as the pension fund company bears most, if not all, of the costs of trading, custody and the other implicit costs that drain value from pension funds in the UK. In other words the pension fund company makes money by negotiating fees down with asset managers, and in also controlling turnover, as the costs of turnover are the pension fund company's problem and not the problem of the pensioner. Other costs that need to be actively managed are internal operational costs, and other costs of doing business, including customer acquisition.

What is also interesting is that transaction commissions have to be expressed for all asset classes and reported to the regulator and to pension fund companies (because they have to pay these commissions). This is for all the asset classes used in the Turkish private pension market, i.e. not just equities, but also fixed income, and even commission on overlay products such as swaps.

It is possible there are some gray areas in the system, where some costs are incorporated into the post hoc valuation of assets (bid/offer spread and so on), but given the reporting of explicit commissions across all asset classes, pricing variability between brokers may be lower – but I have not yet explored this.

Key findings: What has happened in Turkey is interesting and may represent the model for how we might price pensions in the UK – make the pension fund company responsible for managing all explicit and implicit costs on a pension fund, with the consumer seeing a cap which represents an absolute maximum, all-in, cost. Whether the levels of this cap in Turkey are set correctly (at 2.28%) is yet to be determined, and all pension companies in Turkey will tell you they are hard pressed to make a profit. In the UK the ‘cap’ has been set at 0.75% excluding implicit costs, compared to the all-in caps in Turkey.

What this suggests to me is that implicit costs, including the cost of trading are actually very high if the caps in Turkey can go up to 2.28% and pension companies can still be very profitable. This confirms the need to collect data on unreported explicit and implicit costs in the UK.

6. Conclusions and Recommendations

Throughout this paper I have followed a narrative that I believe draws out some of the key points that I think are relevant in developing cost transparency regimes. In summary, these key points are:

- There is a general belief that the cost structure of pension funds, not just in the UK but globally, is transparent and that pension fund costs are obtainable. Neither of these assertions is true.

- This belief has been challenged in several jurisdictions, most notably The Netherlands

- The UK, although regarded as having a sound overall pension regime, is still behind the curve in terms of pension fund cost transparency when compared to The Netherlands

- Reducing costs can have a material upward impact on the performance of pension funds. Small cost reductions can lead to long-term benefits through compounding of the savings. Any changes made now will reap the benefits in the long-term.

- When developing a cost reduction and transparency regime, step incrementally into the process of cost discovery. Do not reach for the impossible.

- Ensure involvement and consensus from all stakeholders.

- Manage communications about the process carefully.

- Some cost components are easy to assess and obtain; others are not. Aim for low-hanging fruit.

- Set as a requirement professional qualifications and a wider set of skills required for Trustees and those otherwise responsible for pension fund governance

- Learn from others like the Dutch who have already trodden the path.

- Incentivise the market to move to cost transparency. Make cost transparency a source of competitive advantage in the manner of, for example, Firm A in the case study in Section 5.5.

As to how we collect and manage these costs, I find myself torn. On the one hand it is obvious to me that without some enforcement asset managers and other service providers will not comply if just asked politely. It is also obvious that pension funds seem to lack the skills and the teeth to require submission.

Ideally, a wise and knowledgeable fund will know what to ask for, when to stop asking as the effort is too extreme and expensive, and when to dismiss an asset manager or other service provider for non-compliance, however we are still some way from that ideal.

An alternative is to ensure cost data submission is contractual and this may be possible in the future if all RFPs and then all contracts contain such a clause. The RFP and the contract negotiation is the time where a pension fund has the greatest leverage over contractual terms; after all asset managers, for example, really want the annuity revenue that comes with a long-term contract predicated on a relatively large management fee (when compared to earnings from performance). By this I mean that management fees always apply, regardless of market or fund performance, so there is a heavy incentive to win the contract, and start making money even if performance is dire. But we are left with the problem that it is currently not contractual and the average length of time any one manager is kept by a pension fund is in the order of seven years. That is seven years of wasted negotiation time, and seven years of lost compounding on any negotiated savings.

So should a regulator set a data standard for cost collection? This would ensure compliance and hopefully do away with all of the dubious obfuscation and omission to which I have been party. However there are some potential problems with a regulatory standard:

- Who will police data submission and accuracy? This sounds like a burden for a regulator which will drive up costs for the industry (and ultimately for the consumer).

- Who will safeguard and assure the privacy of the data? Again, a problem for a regulator.

- Once the standard is set it will be immediately subject to regulatory arbitrage. This is what has happened and will happen to the '75bps' maximum fee for DC pension funds. Overt costs will be managed into the 'implicit' cost bucket.

- Once the standard is set it will require huge efforts to change it. Just think how long it has taken to get to where we are now, i.e. questions about costs are becoming routine but I have been chasing this information for six years already. A voluntary standard is not set in stone and can be changed without complex regulatory and statutory changes. It can be more readily expanded to mitigate the arbitrage suggested in the point above.

- Once the data standard is set, the asset management industry and other providers will manage to this transparency standard and getting additional cost information will be met with the following rejection "we submit data according to the regulatory standard".

Given these restrictions, my belief is that a voluntary code of practice, set in conjunction with industry and guided by the regulator (with the implicit threat of sanctions) and other interested parties is the way forward.

This standard should be flexible and progressive and, in the first instance, aimed at collecting data that is already theoretically easily collectible. I have outlined such a standard in Section 4. This will allow for cost savings to be obtained ***as soon as possible,*** maximising the impact of compounding of these savings. The data collection should be managed by an independent body, possible a private company, via consensus mandate and funded either from revenues derived producing reports, a levy on pension funds or the industry, or voluntary contributions by those companies in industry that desire transparency…or a combination of all of these. Such a body would be responsible for producing useful and actionable information to provide effective market performance and comparative metrics useful to both consumer and those responsible for pension fund governance.

To remove the ability of asset managers and other service providers to obfuscate around such a voluntary code of practice these providers need to be incentivised to comply. I suggest that this happens by making cost transparency a source of competitive advantage. Pension funds need to pick service providers based upon their willingness to adhere to the code of practice. Pensions funds will therefore need to understand the benefits of knowing and managing costs. This requires evidence, analysis and education.

My suggestion is to work with key pension funds, asset managers and other service providers to develop the standard and produce insight and analysis. Fortunately, the current drive to baseline the costs of the Local Government Pension Schemes might provide such an opportunity. This drive comes from the need to pool assets and derive the benefits of scale within the massive pension pool that is the LGPS (collectively in the top 5 pension funds in the world by AUM). To understand these savings, a costs baseline is needed and obtaining such a baseline is of interest to the LGPS, the Treasury and the DCLG. This then could be the kernel from which the data standard is derived. With the willing participation of key asset managers and other service providers, data and analysis could be available in months.

Given my conclusion that a regulatory standard is a possibility but other models should be explored first (a voluntary code), the main roles the FCA, TPR and FSCP could play currently are to clearly indicate that collaboration by the industry is key; to offer reasonable suggestions as to what a standard might look like; and to encourage trustees and governance committees to look for providers who comply with the standard so that the industry is incentivised to provide the information so badly needed by consumers and their representatives. The alternative is to impose something that might be extremely expensive and complicated to deliver whilst bringing us no nearer to the prize of full transparency and accountable asset managers and other service providers.

Acknowledgements
I would like to thank for the following for their kind assistance in preparing this report: Con Keating, Dominic Hobson, Colin Meech, KAS Bank, Tomorrow's Investor, Deloitte LLP and Sunil Chadda

Appendix 1

Cost Collection Templates

Collection template for Pension Fund Administration costs

Pension Scheme Costs

Scheme Administrative Expenses (Pension Management)	£	Bps
Total		
Advisory fees		
Actuarial fees		
Administration and processing		
Bank Charges		
Employee costs		
Office costs		
Pension payroll costs		
Printing and publications (Communications)		
System costs		
Audit fees		
Legal fees		
Pension Fund Committee / Board costs		
Pension Protection Fund Levy		
Regulatory costs		
Trustee Expenses		

Investment Management Expenses (Asset Management)	£	Bps
Total		
Fund Administration		
Administration and processing		
Employee costs		
Engagement and voting fees		
Fund Accounting		
Office costs		
System costs		
Sundry costs		
Audit		
Legal fees		
Sundry costs		
Investment Management		
Fiduciary Management		
Internal Fund Manager Base Fees		
Internal Fund Manager Performance Fees		
External Fund Manager Base Fees		
External Fund Manager Performance Fees		
Investment Consultancy fees		
Property operational costs		
Transaction costs		
Other Investment Management fees		
Custody		
Advisory		
Performance and Risk Measurement Services		

Total	£ / %	Bps
Total Scheme Costs		
Total Scheme Returns ??		
Opening Scheme Net Assets		
Closing Scheme Net Assets		
Active Scheme Members		
Deferred Scheme Members		
Pensioners		
Total Membership		

Collection template for Asset Manager costs

Investment Mandate:

Investment Management Costs	2014 - 2015 (FULL YEAR)																											
	AuM		Management Costs				Performance Costs	Other Costs (inc Disbursements)	Transaction Costs												Total		Return					
All currency figures to be denoted in £	Opening Assets	Closing Assets	Invoiced Fees (Less Rebates)	VAT (if applicable)	Fees Paid From NAV	Total	Perf. Fees paid	Total Other	Average Bid - Offer Spread %	Time Weighted Net Turnover	Net Turnover	Affiliate/Related Party Total Commission Paid	All Other Sales Commission Paid	Total Commission Paid out	Execution Commission	Research Commission	Exchange Fees	Stamp Duty / other Transaction Taxes	Entry/Exit Fees	Other Transaction Costs	Total	Grand Total Excluding Transaction Costs	Grand Total Including Transaction Costs	1 Year Gross Return %	1 Year Net Return %	3 Year Gross Return %	3 Year Net Return %	10 Year Gross Return %	10 Year Net Return %
Investment Management																												
Matching Portfolio																												
Interest Rate Risk Hedge																												
Government Bonds UK																												
Government Bonds other																												
Inflation Linked Government Bonds																												
LDI																												
Matching Overlay																												
Cash & Cash Equivalents																												
Return Portfolio																												
Fixed Income																												
UK																												
Sovereign & Corporate																												
Overseas																												
Sovereign & Corporate																												
High Yield Europe																												
High Yield US																												
Emerging Markets Bonds																												
Equity																												
Overseas Equity																												
Emerging Market																												
European Equity (ex UK)																												
Far East Equity																												
Japanese Equity																												
North American Equity																												
Pacific Equity																												
US Equity																												
UK Equity																												
UK Equity – Large Cap																												
UK Equity – Small Cap																												
Unallocated																												
Real Estate & Infrastructure																												
UK Direct Real Estate																												
Overseas Direct Real Estate																												
Alternative Investments																												
Commodities																												
Hedge Funds																												
Multi-Asset																												
Infrastructure																												
Pooled Investment Vehicles																												
Overseas Equity																												
UK Equity																												
Equity Mix																												
Overseas Fixed Income																												
UK Fixed Income																												
Fixed Income Mix																												
Overseas Real Estate																												
UK Real Estate																												
Real Estate Mix																												
Commodities																												
Fund of Funds																												
Multi-asset / Mixed																												
Private Debt																												
Private Equity																												
SRI																												
Currency Overlay																												
Other Investments																												
Custody																												

Collection template for Custody costs

Total Custody	£	Bps
Total Cost		
Fixed		
Performance		
Transaction		
Other		
Total Income		
Investment Income		
Interest from fixed interest securities		
Dividend from equities		
Income from index linked securities		
income from pooled investment vehicles		
Interest on cash deposits		
Other - Stock lending		

Custody Cost by Asset Manager

	Fixed	Performance	Transaction	Other	**Total**
Asset Manager 1					
Asset Manager 2					
Asset Manager 3					
Asset Manager 4					
Asset Manager 5					
Asset Manager 6					
Asset Manager 7					
Asset Manager 8					
Asset Manager 9					
Asset Manager 10					
Asset Manager 11					
Asset Manager 12					
Asset Manager 13					
Asset Manager 14					
Asset Manager 15					