Summary
- With the advent of auto-enrolment, charges are more important than ever.
- In a low return environment, charges take a bigger slice of the cake.
- Since 3 January 2018, transaction costs must be disclosed.
- There is still standardisation work to be done. Very often you are comparing 'apples with pears'.

Comparing apples and pears

Until now comparing charges has been difficult because there is no standardisation, but things are improving, writes Stephanie Hawthorne

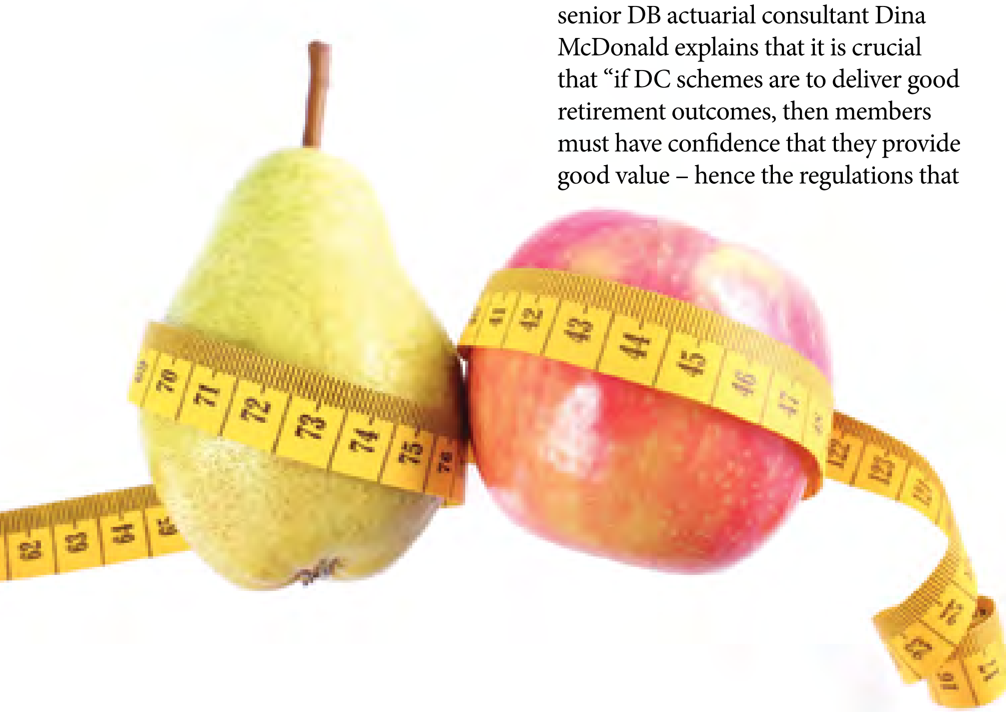
Since the arrival of auto-enrolment in 2012, millions of people are now in pension schemes they haven't chosen so it is more important than ever that charges are fair.

The effect of high charges can be dramatic. The Department for Work and Pensions estimated in 2013 that a 1.5 per cent annual charge would reduce the size of a pension pot by 34 per cent over a working life, whereas a 0.5 per cent charge would only reduce it by 13 per cent.

As Transparency Task Force chair Andy Agathangelou says: "It is desperately important that members get value for money or they will opt out and nobody wants that."

Low returns

Indeed, costs assume ever-more importance in a low return environment, as CEM Benchmarking principal John Simmonds explains: "Bond and equity returns over the past 30 years have exceeded long-term averages. Many of our clients believe the returns we have seen in recent years are unsustainable and that we are entering a lower return environment. Costs matter more when returns are low because those costs take a bigger slice of the return 'cake'. With that in mind, it's not surprising that attention turns to cost. This is happening all over the world."



DC schemes have had a bad press in the past with many legacy arrangements having outdated charging structures. Poor fee transparency led to suggestions that providers weren't always treating members fairly, which led to erosion of public trust in pensions. So Mercer senior DB actuarial consultant Dina McDonald explains that it is crucial that "if DC schemes are to deliver good retirement outcomes, then members must have confidence that they provide good value – hence the regulations that require governing boards to assess value annually".

The charge cap

In 2015, a charge cap on the annual amount that can be charged to savers in a pension scheme was imposed at 0.75 per cent of the fund held in the saver's pension account. The cap applies to all scheme administration and investment costs. It is currently still set at 0.75 per cent of the fund held in the saver's pension account. The cap applies to all scheme administration and investment costs.

Looking at the background, JLT Employee Benefits head of DC investment consulting Maria Nazarova-Doyle says: "For some time, there has been a requirement on trustees of DC pension schemes to disclose transaction costs and charges in the DC chair's statement, however, there has been no corresponding requirement on investment managers to provide these. In September 2017, the FCA evened out the position by publishing their policy statement, setting out the requirement for the firms managing DC money to fully disclose the transaction costs involved in managing the funds. This has taken effect from 3 January 2018."

KPMG head of DC consulting Richard Birkin says: "We now have FCA rules for fund managers on the disclosure of investment costs, including transition costs, using a common methodology ('slippage costs'). So from 3 January pension schemes and providers have at least been able to ask for these details. This is important in a DC context as it should allow trustees and governance committees to compare costs across all the funds they offer members. So far we have not seen much by way of data coming back."

Barnett Waddingham associate Sonia Kataora agrees: "Obtaining cost transparency in the past has been hindered by the lack of data on costs, particularly transaction/hidden costs, from service providers. Regulations imposed on DC providers will mean this data should be more forthcoming in future. But there is likely to remain difficulty initially in how the data will be presented, interpreted and ultimately what it means for value to members."

Reforms over the decades

People have been trying to reform this area for years, going back to the Myners Review in 2001, with a plethora of work in this area, as PLSA policy lead for investment and defined benefit Caroline Escott explains: "There have been many different regulatory developments on cost transparency at both the UK and EU levels. MiFID II placed new duties on investment managers in terms of cost disclosure; costs need to be aggregated and expressed both as a percentage amount and a monetary value, and disclosed both at point of sale and annually afterwards. 2018 has also seen the advent of PRIIPs, which requires investment product manufacturers to disclose information about transaction and other indirect costs to clients."

She adds: "In the UK, the programme of work that came out of the FCA's *Asset Management Market Study* has had a significant focus on better cost disclosure, building upon the work of others such as the LGPS Cost Transparency Code. The Institutional Disclosure Working Group (IDWG) was set up by the FCA to create a set of cost disclosure templates for use by trustees when comparing the costs of different products. The FCA has also recently referred the investment consultancy market to the Competition and Markets Authority (CMA) for investigation; should any evidence of anti-competitive practices be found in this market, one potential remedy under consideration by the FCA is improving consultants' approach to fee disclosure."

The People's Pension director of policy Darren Philp says this is not enough: "Fund managers should be required to follow a consistent set of assumptions, and present them to pension schemes in a coherent, standardised fashion. Such steps would allow scheme governance to compare and contrast, and really do their jobs in ensuring scheme value for the members."

He adds: "Although moves to require transparency of transaction costs are a positive and crucial step forward, costs can only be truly comparable if headline charging structures are standardised across the industry. At the moment it is too difficult to compare headline value. Regulators and the government need to sort this out."

Aon principal Neil Smith welcomes the greater transparency but does not believe that, "for those looking for an overall reduction in costs, this should be seen as a panacea. We have seen evidence in the early part of this century of cost disclosure resulting in an increase in average fee levels as those managers at the lower end of the scale take the opportunity 'to raise their fee levels to market averages".

But he expects "it to result in a culture where asset owners are paying for services that add-value, and not paying for those that don't. If this increased scrutiny results in an overall lower level of charges being paid with no adverse impact on the level of investment performance then that will be a clear benefit".

Simplitium head of product development for pensions Stewart Bevan says: "Managing costs and charges associated with a pension scheme is central to its operations, and can have a significant impact over the long term. Monitoring expenditure accurately is central to operating a scheme efficiently. With greater transparency, schemes gain greater insight, allowing them to improve their investment decision making and ultimately maximise outcomes for members, which is obviously the key aim."

He adds: "Only when you know and understand the full costs, can you manage the entity efficiently and begin discussions about value for money."

The pensions and investment sector is in a state of transformation. In conclusion, as Agathangelou says: "There is a close correlation between transparency, truthfulness and trustworthiness and the asset management and pension sectors desperately need to rebuild trust.

"The winners of the future will be those that don't see the demands for greater transparency and the resultant value for money as a threat, but as a commercial virtue. Now is the right time for all parts of the market to not just tolerate the change that is happening but to also embrace and welcome it. It's time for principles before profit, in the full knowledge that a more enlightened approach will maximise shareholder value in the long term; and also give is all the sense of pride that can only be achieved when you know you are doing all you can to give clients and scheme members the value for money they deserve."

Written by Stephanie Hawthorne, a freelance journalist