The cost of cost transparency

Summary
- The FCA has watered down its initial proposals for DC scheme cost disclosure.
- Opinion is split as to whether the changes provide simplification or add further complexity for DC trustees.
- Members may also be confused by the level of detail and a lack of comparability.
- The PLSA is actively working to assess how the information can usefully be communicated to members.

Following the FCA's confirmation of how it expects DC schemes to report fees, Ellie Duncan looks at the impact it will have on the sector

Defined contribution (DC) scheme providers finally have some clarity about what is expected in terms of cost disclosures.

The Financial Conduct Authority (FCA) has watered down some of its requirements around the reporting of costs and charges to members of workplace pension schemes following an industry consultation.

Initial responses from the industry at the time the document was published on 4 February suggested that the amendments to the cost disclosure plans are largely welcome.

Hargreaves Lansdown's head of policy, Tom McPhail, called what the FCA had come up with "a proportionate and well-considered response to this challenge", while Interactive Investor's personal finance campaigner, Myron Jobson, said the reforms "will result in better transparency and governance".

Engaging and digestible

In the FCA document, *Publishing and disclosing costs and charges to workplace pension scheme members and amendments to COBS 19.8,* it is revealed that respondents "argued that disclosing a huge volume of data would pose significant implementation issues, be difficult for members to digest, and could disincentivise member engagement".

In response, the regulator said it would phase the introduction of the cost disclosure rules so that for the first scheme year, scheme governance bodies will only have to report costs and charges information in respect of default options/funds.

Thereafter, they will be required to report the information for all of the investment options that members are able to select. In addition, the FCA now only requires the chair's report to include costs and charges for the default options/fund.

It provides some clarity on a timetable as well, setting out that scheme governance will run from 1 January to 31 December 2020, and that costs and charges information for 2020 should be published by 31 July 2021 – with subsequent scheme governance years to follow the same pattern.

The FCA received 24 responses to its consultation and found that in relation to the proposal to require illustrations of the compounding effect of the aggregated costs and charges for each available fund or option, some respondents said it would require "a huge number of illustrations with questionable benefit for members".

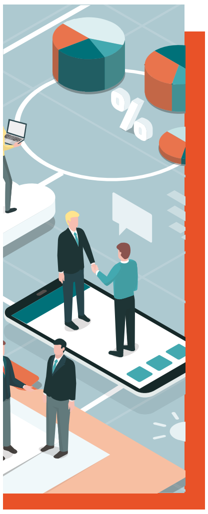
Instead, the FCA has set out that it will not ask for illustrations for all available funds or options, just for a representative range.

The changes and further detail suggest the regulator has listened to industry concerns. Firms will have to comply with the requirements from April this year, so there is no time to lose.

Information overload

State Street Global Advisors head of pensions and retirement strategy for EMEA, Alistair Byrne, says the FCA has delivered a "helpful simplification" that would reduce the burden on providers as well as the potential "information overload" on members and those who support them.

But Caceis UK managing director, Pat Sharman, says: "From speaking with trustees there is some confusion as to which guidance to follow as currently you have two sets of guidance – that of the Department for Work and Pensions (DWP), enforced by The Pensions Regulator and that of the FCA."



She adds that, while these are very similar, the FCA is beginning to divert from DWP regulations.

"These updates to COBS 19.8 are beginning to specify the requirements of cost disclosure in defining technical details on negative costs, defining reporting windows (calendar year), and has also pushed the deadline to report this information to 2021," she notes.

"There is also clearly a push by the FCA to simplify the reporting of this cost data on the chair's statement that will be more digestible by members.

"We believe the underlying assumption of most schemes is to carry on producing what the DWP is asking for, as it is legislated in the Pensions Act. It's also good practice as it goes further in delivering on cost transparency."

However, McPhail, commenting at the time the FCA document was published, said the regulator had "mirrored the DWP rules where possible, which helps ensure consistency across the pensions ecosystem".

He added: "They have stipulated the governance committee should be responsible for the charges disclosure, which will strengthen confidence in the information, rather than it coming directly from product providers."

Value for money?

Many in the industry believe that the requirement to be more transparent about costs will help member engagement with pensions, ultimately boosting trust in pension providers.

Sharman notes that anything that increases transparency "can only be a good thing".

She adds: "We strongly believe that cost transparency and value for money help build a framework of trust among all pension scheme members, which is crucial in lifting member engagement and encouraging all generations to save into pensions."

Byrne suggests that while few members will engage with all of the cost disclosures and make detailed comparisons between providers or funds, he insists the information "should be available to those who are interested".

"More significantly, advisers, employers and other commentators will be able to review costs and help ensure value for money for members," he says.

But many believe the challenge that remains is how to interpret the costs and charges figures that members will be presented with. Members can only reap the numerous benefits of cost transparency if they understand the information they are being given.

"What do the numbers mean? How comparable are they? Can the past be taken as an indication of the future?" Byrne asks.

"Also, what constitutes value for money, given investment strategies and product features will vary, and quality and future return need to be considered alongside cost?"

Gatemore Capital Management partner, Mark Hodgson, says: "On the one hand, disclosure allows members to see exactly how different charges are applied, and transparency helps to keep fund managers in check.

"However, the downside is that different funds have different cost structures and just because it is more expensive because it transacts more, does not mean it is worse."

He cautions that most members of workplace schemes will not understand the intricacies of different investment approaches and may end up choosing a fund for the wrong reasons.

The PLSA policy lead for DC, Alyshia Harrington-Clark, acknowledges: "Contextualising and explaining costs and charges can be complicated, as savers often find it difficult to assess and understand this kind of information."

She says the PLSA is working with industry and government on some areas to share good practice, such as the simpler annual statement.

Education, education, education

This is where education comes in, with Hodgson commenting that members will need to understand what they are looking at to be able to make informed decisions.

Sharman agrees that the first challenge to overcome is education to make sure transparency avoids becoming simply a 'tick-box exercise'.

"From trustees through to members, there is still a job to do to get everyone at a base line understanding of what cost transparency is, its benefits, and why it should be reviewed annually (at least) as a good governance measure," she adds.

Sharman explains: "First, cost transparency needs to become the new normal. Schemes need to understand what they're investing in, how much that is costing and then how to interpret that data to best match to member outcomes.

"Second, asset managers need to focus more on their operations to ensure that their reporting systems and mechanisms are fit for a more transparent and demanding call on data.

"Finally, schemes need to play their part in pushing their managers to change behaviour by explicitly voicing their demand for transparency."

The FCA's announcement makes clear what is expected of workplace pension schemes – now the onus is on DC providers to enact the new rules and for the industry as a whole to inform scheme members.

Byrne says: "I think we should err on the side of simpler, more summarised disclosure – more likely to be read and understood – and perhaps with information about where to find more detail."

Written by Ellie Duncan, a freelance journalist