A framework for success

With the long-running issues surrounding fee transparency still mostly unresolved, Jack Gray investigates the framework that could go a long way in creating a fairer environment for trustees and members

As the issue of cost transparency rumbles on into 2019, the cries for a solution to hidden fees continue to be heard, from consumers to industry experts. Trustees, employers and members of both defined benefit and defined contribution schemes are still sometimes subject to additional, unexpected costs that can have a direct and negative impact on member benefits in the long term.

However, it's not all doom and gloom, as the industry seems to be embracing

Summary

- Fee transparency has been an industry-wide issue for over a decade, but the end could be in sight.
- Organisations such as the IDWG and the CTI have been working towards a standardised framework to tackle the issue.
- More needs to be done to educate trustees about cost transparency and the new standardised template.

the new standards framework and data collection for fee transparency is becoming easier through technological advancements. It is currently a work in progress, and it will take time to educate trustees on the changes, but the industry appears to be moving in the right direction.

Group initiative

In 2017, the Financial Conduct Authority's (FCA) *Asset management market* study concluded that more needed to be done to tackle the lack of cost transparency across the financial sector. "Following the FCA's study, it was apparent that the full breadth of retail and institutional fund charges was not always visible to investors," begins Kas Bank UK managing director, Pat Sharman. "However, on the information that was readily available, costs and charges were often overlooked and generally misunderstood; this is especially the case with transaction costs."

Once the study had been completed, the FCA established the Institutional Disclosure Working Group (IDWG) to investigate the issue and attempt to reduce the impact of hidden costs by creating a simpler, all-encompassing and standardised framework of regulations and guidelines for schemes and their trustees to abide by.

The IDWG was provided with additional support when it recommended to the FCA that a successor group should be established to assist with the rollout of the IDWG's new cost transparency template. The FCA agreed and the Cost Transparency Initiative (CTI) was formed in November 2018.

Template

ClearGlass chairman and former IDWG chair, Chris Sier, explains that the standardised system is necessary to give schemes the ability to provide accurate data that is essential in improving fee transparency.

He says: "In the past, I ascribed cynical reasons to suppliers for their failure to give data. Things like unintegrated and complex operational infrastructure preventing the collection of data, or the fear of exposing themselves to criticism of the high costs of asset management and asset servicing, or just plain 'why should we'.

"My position on this has changed somewhat since I chaired the IDWG and built ClearGlass. I can say that the main reason seems to be a lack of a solid standard for collection. In the old world an asset manager might have been subject to data requests from a range of clients or benchmarking and data collection organisations, each of which demanded data in a different format – their format. And this just isn't acceptable."

As a result, the IDWG and the CTI have launched a pilot, to test how easy people find using the template to be, which is expected to conclude in March.

PLSA head of DB, LGPS and standards and CTI board member, Joe Dabrowski, defines the CTI's role in the framework initiative, saying: "The intention of the CTI is to have a board representation from across the stakeholder groups and to make sure that we roll out the template very quickly.

"We have set ourselves the aspiration to roll out the templates across the industry in the spring and promote as far and a deep a take up as possible."

A key aspect of the template is that it is adopted on a purely voluntary basis. The FCA hope that there is enough motivation within the industry to resolve the issues surrounding fee transparency that it will not have to create legislation that will force people to follow the framework.

Currently, the IDWG and the CTI have not had any issues in persuading schemes to adopt their templates, as there seems to be a consensus amongst industry members that they would prefer to have a clear, simple and time-efficient framework that will allow them to focus on other aspects of running a scheme.

"Asset managers have signed up willingly to it because it is that standard upon which they can hang their hat," continues Sier. "It means they only need to present data in one format, and they will all be compared using the same yardstick.

"Several managers have told me since July they have happily sent the aforementioned data collection agencies packing on the basis of 'we will only give data in one way, the IDWG way, and we will no longer fulfil you orthogonal data formats.'"

Dabrowski adds: "The IDWG made a recommendation that the template usage should be on a voluntary basis in the first instance. The FCA has taken that up, and the CTI intends on making a success of the voluntary approach. The FCA has committed to keeping an eye on how successful it has been, and if it isn't successful, to potentially write rules."

Sharman shares the IDWG's and

CTI's enthusiasm for the potential positive effect of the framework as "it would improve current reporting standards and further improve investor understanding on costs".

She says: "The creation and successful use of these templates will boost trust in the industry, increase awareness of costs and charges, and potentially address asset management pricing competition concerns. All of this will benefit the end users and pension members."

Foundations

The foundation for the IDWG's framework is new requirements in providing high-level data that went live in January 2018: the Markets in Financial Instruments Directive II (MiFID II) and the Packaged Retail and Insurance-based Investment Products (PRIIPS) regulations. These initiatives should make it easier for schemes and companies to comply with the new template, as they have already been collecting data on the costs and charges of certain investment products or services.

In the DC landscape, there are already some requirements in regard to cost disclosure and, according to Dabrowski, "there is talk of similar requirements *[for DB schemes]* coming through in the pensions bill".

He continues: "The post regulators are looking at how to they make the market engage with this, so I suspect there will be more noises coming from the regulators as well as to encouraging trustee take-up and encouraging provider usage. I think all of these things should hopefully work together to make the voluntary approach a success."

Further evidence that a cost transparency framework could be successful has been provided by Kas Bank, which, in August 2018, found that a standardised template could reduce the total ownership cost of a pension fund by 37 per cent. At the time, Sharman said that improved fee transparency as a result of the framework "delivers multiple benefits, including better decision making and ultimately an overall reduction in costs".

We may already be seeing the effects of cost reduction, as the Pensions Policy Institute head of policy research Daniela Silcock explains: "Consolidation and/or closures of small schemes, coupled with natural growth in schemes over the next few decades should start to reduce charging differences based on scale between UK DC schemes.

"However, it is important not to view charges in isolation. Some international schemes have higher charges but these may be coupled with more sophisticated investment strategies, higher and/or more secure returns, a better quality of administration or communications that produce more engagement from members and lead to higher contributions and/or more informed active decision making."

Implementation

Although the vast majority of industry members agree that the new framework is a positive change for the industry and its members, there is some disagreement on how it should be implemented.

In December 2018, PLSA director of policy, Nigel Peaple, stated that should the template not be adopted over the next two years, he would be "making the case to parliament that it should be mandatory".

He explained that he believes smaller schemes will be much slower in being able to put the initiative into action, saying: "The larger schemes, which are well resourced and where trustees are well supported in their decision making, are already doing something with this and I'm confident they will do it quickly.

"For the smaller schemes it will be slower, but I think through education and from the asset management and consultancy industry, fund managers are also very keen to demonstrate that they are being open with what they do, I am optimistic."

Dabrowski admits that it may take some time before people are used to the new structure and that the new template is not necessarily a miracle cure for such a wide reaching issue.

He explains: "People will need a while to get used to the combination of templates and understanding the results that come out of them. None of it is a silver bullet to any immediate issues. It's a process that we'll need to go through."

Optimism and education

Despite this, the collective feeling of most people in the industry is that the journey towards finding a cost transparency solution is heading in the right direction.

"I think the solutions are here," says Sier. "An accepted standard, operated by an organisation and not driven by profit motive on a 'utility/for all' basis."

Dabrowski adds: "We're really encouraged by the support that we've had from all corners. I think everybody is on the same page and wants to make this happen, and so I'm really optimistic."

However, it seems as if more needs to be done to educate trustees on cost transparency. A Kas Bank study in November 2018 found that eight in 10 scheme managers believe that more should be done to educate trustees. The same study also finds that 32 per cent of trustees either do not know or do not factor in transaction costs when evaluating asset managers, despite the fact that transaction costs can amount to 20 per cent of total cost of ownership.

Sharman concludes: "Beyond education, the next step for cost transparency will be the practical decision making involved in using this new cost data. Moving away from Excel, and onto intuitive and smart cost transparency platforms will be crucial to the modernisation of the sector and will improve the likelihood that effective cost reporting and value for money assessments persist."

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