Investment perspectives

Cost Transparency Initiative

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"Poor decisions on costs or investments can have negative consequences for scheme members. Value for money is not solely about costs, but costs inevitably form an important part of the equation"

Extracts from a Work and Pensions Committee report dated July 2019

What is it and why do it?

Carrying out a cost transparency exercise lets asset owners see what costs are being incurred in practice at a much deeper and more granular level than they ever have before, and provides a more complete understanding of the type and level of costs that are being incurred as part of the ongoing management of a pension scheme's assets. This includes the managers' annual management charge, but also other costs such as administration, custody, and transaction costs, which can be material but go largely unreported.

Having this information available helps to inform decision-making by allowing a like-for-like comparison to be carried out between managers. It also helps with assessing value for money in light of past performance and the mandate's ongoing role in a scheme's investment strategy.

The cost transparency exercises that we have carried out for our clients so far have resulted in a range of actions being taken to improve future value for money, including:

- **Managers being challenged on the extent to which they are minimising costs**, particularly in relation to transaction costs, which can be relatively high for some active mandates. In a small number of cases, refunds have been sought where (performance-related) fees have been applied incorrectly;
- **Fee and cost benchmarking against appropriate ranges for the asset class and size of mandate**. This has led to the renegotiation of fees, or reviews of mandates, where costs are out of line or not reflective of past performance. Managers have come under pressure in recent years to reduce fees in order to win new appointments, and a review of mandates which have been in place for many years can be especially beneficial; and
- **Consideration of alternative fund structures to reduce costs.** More modern fund structures such as Authorised Contractual Schemes (ACSs), or in some cases segregated mandates, can have some benefits over more traditional structures.

How a manager responds to a request for information on costs can also reveal a great deal about the quality of their governance processes and record-keeping; a slow or incomplete response could suggest that understanding and minimising costs for the benefit of investors is not a sufficiently high priority for the manager.

> "… poor decisions on costs or investments may in some cases lead to an underfunded scheme, which can have negative consequences for scheme members. There is no reason for there to be a lower level of scrutiny by trustees of defined benefit schemes than there is for defined contribution schemes.
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> We have received worrying evidence that some trustees are making investment decisions without a clear understanding of how much those decisions cost. … Complexity and layers of intermediaries mean that many trustees do not have access to suitable information to make judgements about the costs of managing their schemes."
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> ***Work and Pensions Committee***

To help put this into context, a recent article in the Financial Times noted that some pension schemes who had successfully obtained data as part of a cost transparency exercise had found that their costs were twice as high as they had previously believed. The same article also named 29 fund managers, including some very well-known ones, who had failed the 'fee disclosure' test following requests from pension scheme investors for information on costs.

Why is it important now?

The Pensions Regulator, and other industry bodies, have been increasingly focused on reducing costs and ensuring value-for-money, and this topic has been gradually moving up most trustees' agendas.

The most recent changes to SIP and related reporting requirements which came into effect in October 2020 require trustees to set out their policy on the following (or explain why they haven't):

- how the method (and time horizon) of the evaluation of the asset manager's performance and the remuneration for asset management services are in-line with the trustees' investment policies; and
- how the trustees monitor "portfolio turnover costs" incurred by the asset manager, and how they define and monitor targeted portfolio turnover or turnover range.

The CTI (see below) is actively encouraging trustees and advisers to engage with their managers about obtaining information.

TPRs guidance states:

> "… understanding what you are paying, and the range of charges for a cost type, is the first step to considering how to ensure you are getting value for money…. You may find it helpful to compare what you pay to run your own scheme against the typical cost for schemes in your size band, although cost alone does not indicate whether the scheme is getting value for money."

What is the Cost Transparency Initiative?

The Cost Transparency Initiative (CTI) is a partnership between the Pensions and Lifetime Savings Association (PLSA), the Investment Association (IA), and the Local Government Pension Scheme (LGPS) Advisory Board. Following a report from the Institutional Disclosure Working Group in November 2018, the CTI has produced a suite of voluntary templates and guidance designed to help asset owners understand and compare the costs of their investment services by using a standardised reporting format. This is rapidly becoming the industry standard.

How does the CTI framework interact with the LGPS Code of Transparency?

The CTI are encouraging existing code signatories to make use of the new templates as soon as possible but anticipate a transition period of up to 12 months to ensure they can adapt systems without interrupting the current flows of data. New signatories, including those property and private markets managers who can take advantage of the new templates, are expected to use them immediately.

How can I collect the cost data for my scheme?

There are various ways in which you can collect cost data for your scheme. The data can be requested directly from managers using the templates available from the CTI's website. Alternatively, there are various third-party providers who can collect the data from managers on your behalf.

Hymans Robertson offers such cost transparency analysis, which is provided in conjunction with ClearGlass, an industry leader in this area of the market.

Please speak to your Hymans Robertson consultant or contact David Morton (David.Morton@hymans.co.uk) to find out more.