CACEIS Academy Insight

The allocation to private market investments continues to rise. Data quality and submission timeliness has improved. Global equities are now the top allocated asset class and transaction costs have steadily declined. These are just some of the themes highlighted in 2022.

COST TRANSPARENCY AND BENCHMARKING STUDY 2022

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ABOUT THE REPORT

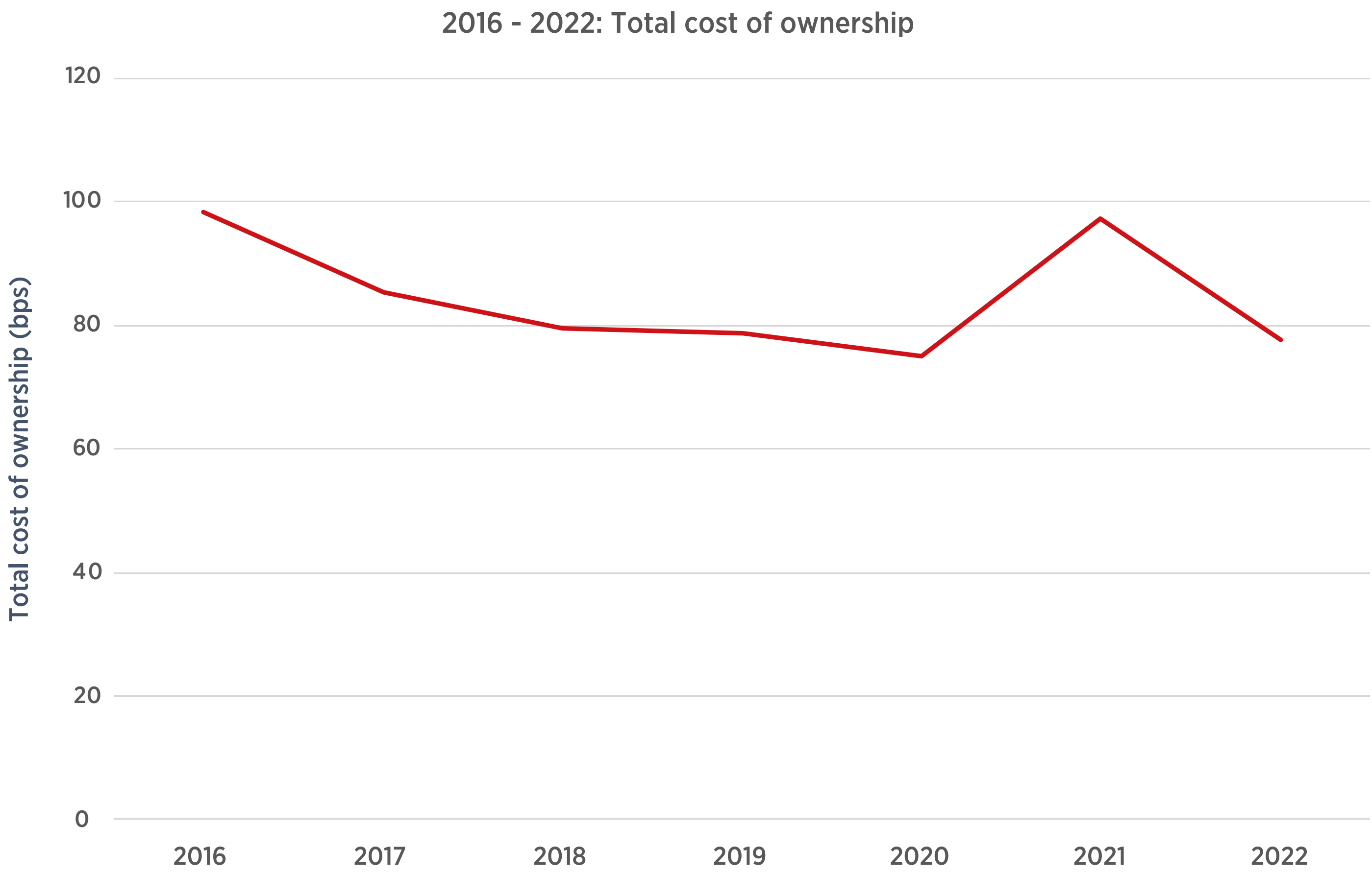
This study looks at total cost of ownership (TCO) trends over the last five years from the universe of pension schemes that leverage our cost transparency and benchmarking services.

We've summarised the universe of pension schemes as they stand in 2022 below:

£430bn	£8.2bn	55
Total AUM	Average client AUM	Total number of schemes

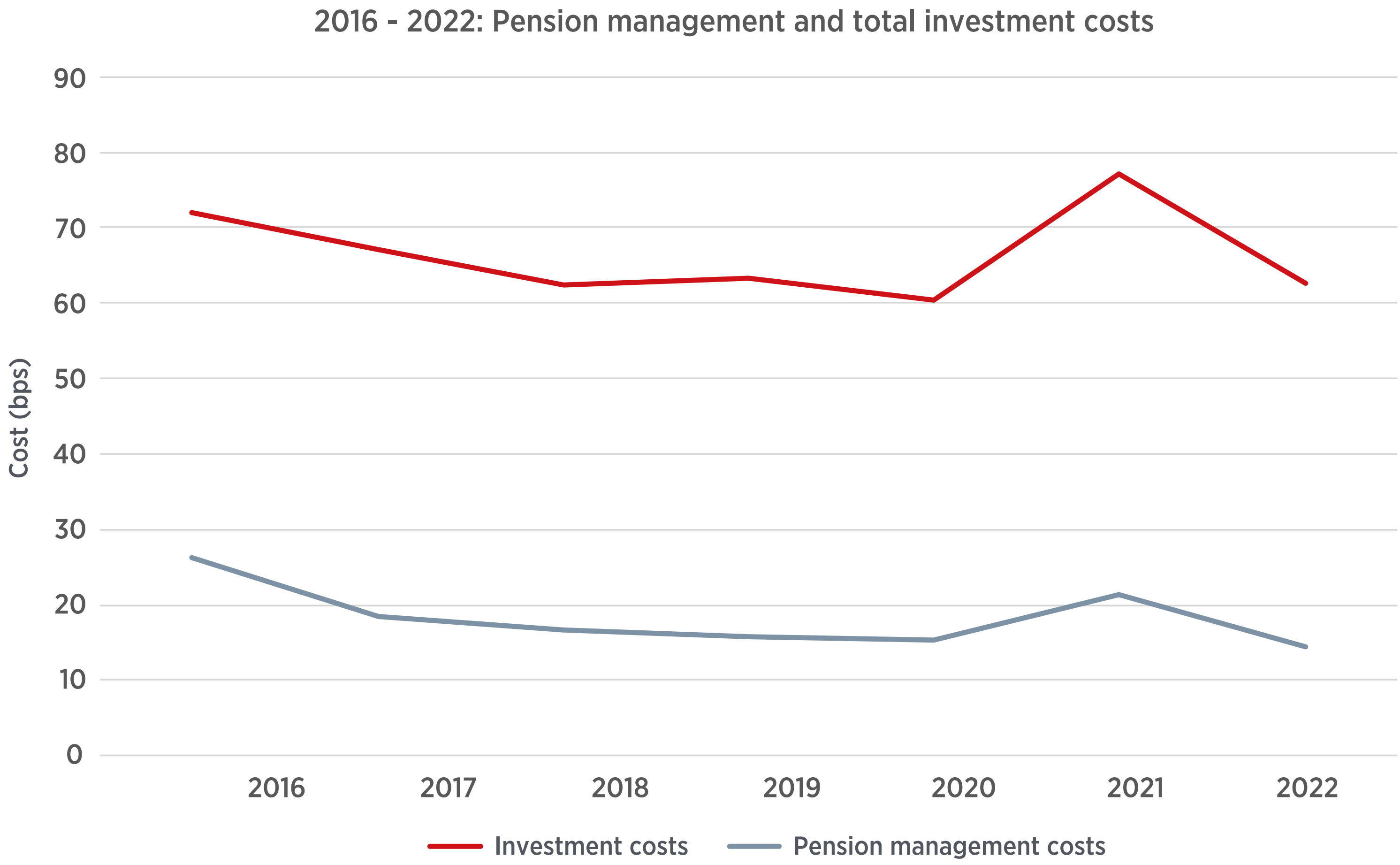
TOTAL COST OF OWNERSHIP TRENDING LOWER

Over the last five years, across our universe of pension schemes, the Average TCO trended lower from 98 basis points to 78 basis points by 2022. During this time, the average assets under management of our universe increased, suggesting that economies of scale and stronger negotiating positions helped schemes to reduce overall total costs. In 2020, however, TCO experienced an uptick as a result of increasing transaction costs due to market volatility in the early stages of the COVID pandemic. We outline this in more detail below.



INVESTMENT COSTS ARE FOLLOWING DIFFERENT TRACKS

Overall, pension management and total investment costs are on a downward trend, despite the short-term spike during the Covid pandemic.



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INVESTMENT COSTS ARE FOLLOWING DIFFERENT TRACKS

Transaction costs moving back lower after the post-Covid spike

Transaction costs are charges applied to facilitate a transaction, or to compensate a stakeholder in the investment chain. They are incurred during the process of buying and selling a financial instrument and are often not entirely captured in the annual financial reports and statements. There are explicit transaction costs, such as stamp duty or brokers' commission for facilitating the trade. There are also implicit transaction costs, which are the difference between the buying and selling price of a security (security (the bid-offer spread, or what is known as 'slippage cost').

In 2021, there was a spike in reported transaction costs, which we believe were incurred because of the volatile market conditions the previous year due to the COVID pandemic. This volatility had an impact on market movements and widening spreads, which largely impacted implicit transaction costs.

Despite the blip during the pandemic, the overall trend in transactions costs are moving lower from five years ago. This is probably the result of more transparency around transaction costs, and the unbundling of research services from commissions paid for the execution of securities trades resulting directly from the full implementation of the European Union's MiFID II directive.

Performance costs trending higher

Performance costs began to climb in 2020, which we believe reflected the market environment at that time. Coming out of the pandemic, the MSCI World Index, for example, returned 16.50% in 2020 and 22.35% in 2021[1] and higher market returns would have resulted in the uplift in performance fees.

The increasing allocation we are seeing to illiquid, private funds can also partly explain why performance costs are trending higher as some of these strategies typically have performance fees.

Another factor to be mindful of is other costs (such as fund admin, set up and legal fees), which have risen considerably. Borrowing, lending and property expenses are new cost categories implemented in the Cost Transparency Initiative (CTI) template in 2019, which ultimately uncovered further costs.

1 MSCI World Index data sheet, returns in US dollars for the calendar year shown.

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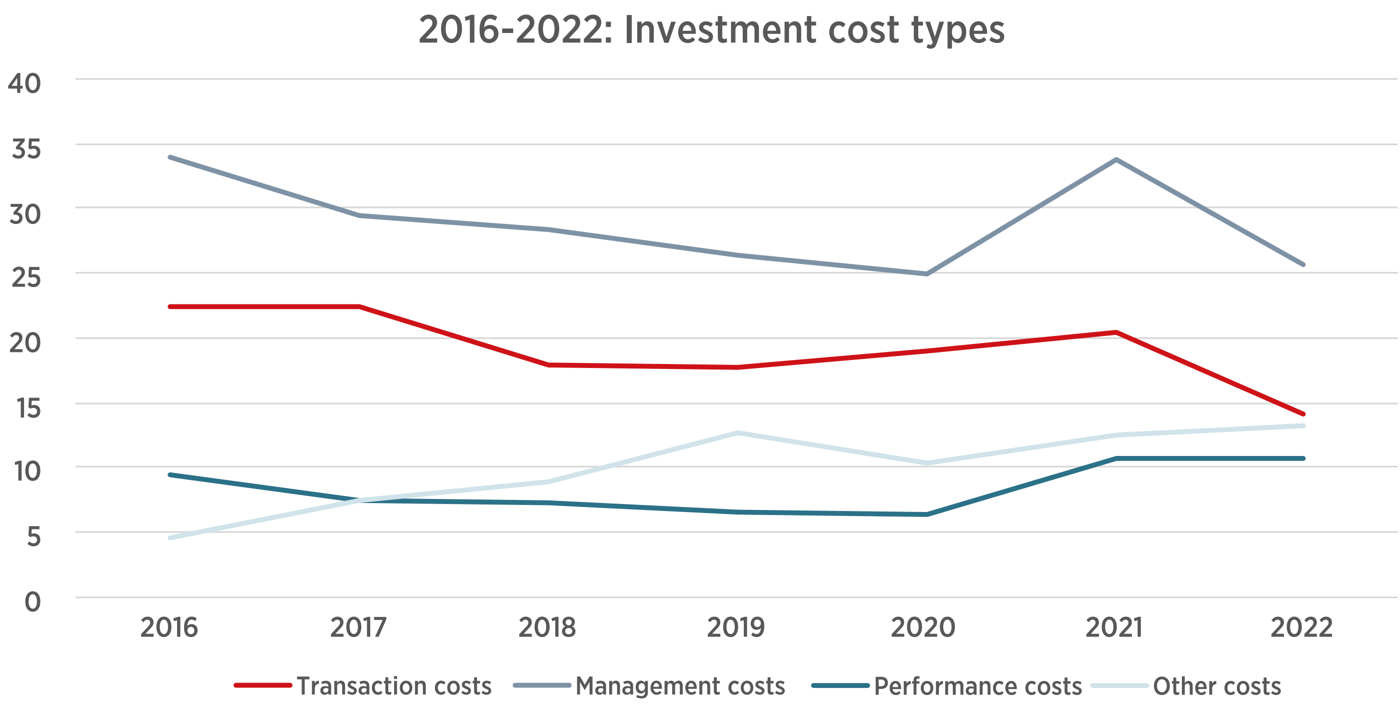

CACEIS asset classes	Average
Top 5 least costly asset classes	Bps
1. Passive Equity	10
2. Gilts	13
3. Cash	20
4. LDI	21
5. Bond	26

CACEIS asset classes	Average
Top 5 most costly asset classes	Bps
1. Private Equity	283
2. Global Infrastructure	256
3. Private Credit	245
4. Hedge Fund	242
5. Private Debt	187

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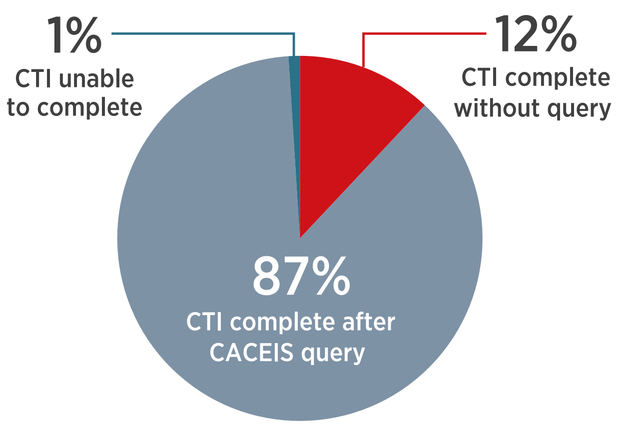
DATA QUALITY REMAINS AN ISSUE

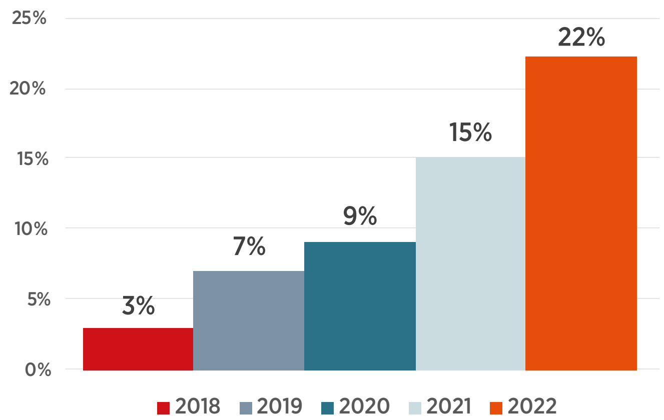
Our report finds that data validation is a key part of the cost transparency process. Insights cannot be gained or comparisons made without absolute confidence in the accuracy of the underlying data. To put this in context, by applying strict governance around data control and validation in 2022, we uncovered £5.2m of costs, largely from ongoing charges and performance fees.

Data quality still remains an issue in the submission process, and illustrates the importance of applying strong governance processes around validating the cost information.

Chart showing value of CACEIS service



Average CTI templates completed first time



Consequently, around 87% of submitted CTI templates don't meet our data requirements and require further validation with asset managers. Issues have included irregular year-on-year cost changes, missing information and/or unusually high/low reported costs.

This is still a marked difference when making comparisons five years ago – then, only 3% of templates supplied met our cost transparency team's quality check.

As the cost transparency process evolves, we are finding that pension schemes are increasingly looking at their costs in context. This includes comparing costs vs performance, transaction costs vs turnover, and costs by different asset classes.

The most common omissions from the completed CTI templates are the average value client holding, and performance information. And the most common costs to be uncovered was borrowing fees

The first two omissions are important because it allows pension schemes to look at their costs in context.

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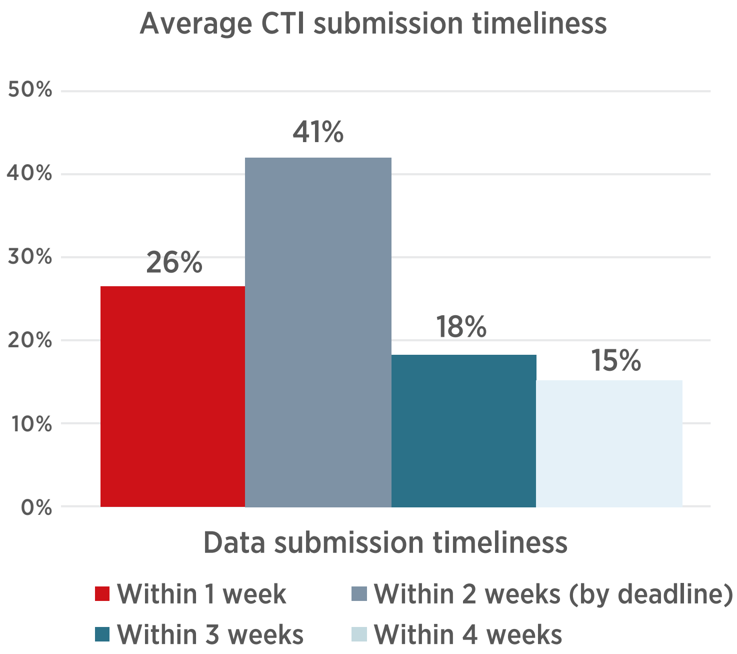
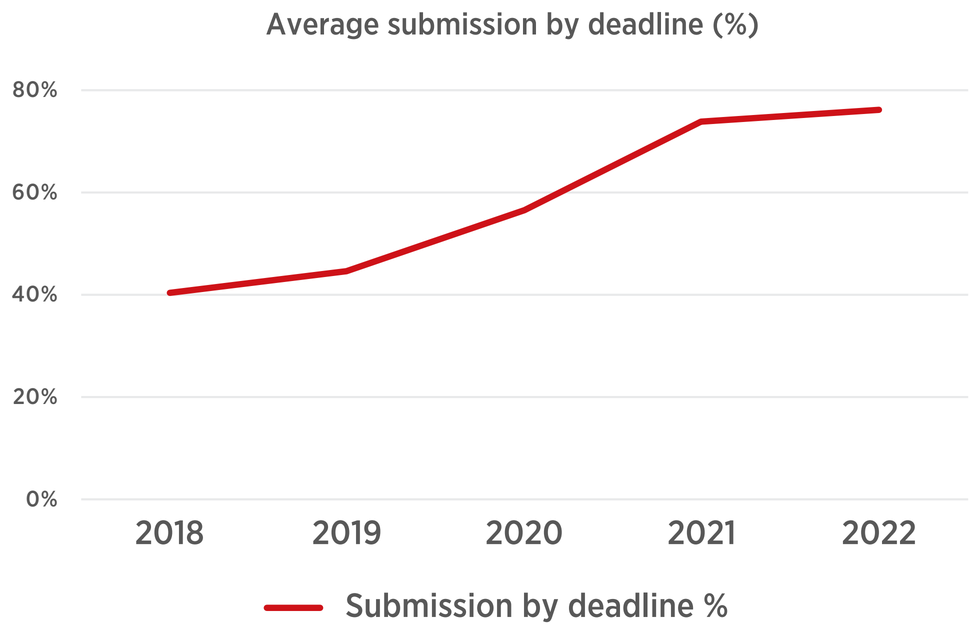
SUBMISSION TIMELINES CONTINUE TO IMPROVE

As the industry becomes more familiar with the CTI templates, we're seeing a general improvement in submission timeliness. It's little surprise that during 2022, 70% of UK-based asset managers submitted their CTI templates by the agreed deadline, compared to 44% of US-based asset managers – simply because of the familiarity of CTI in the UK.





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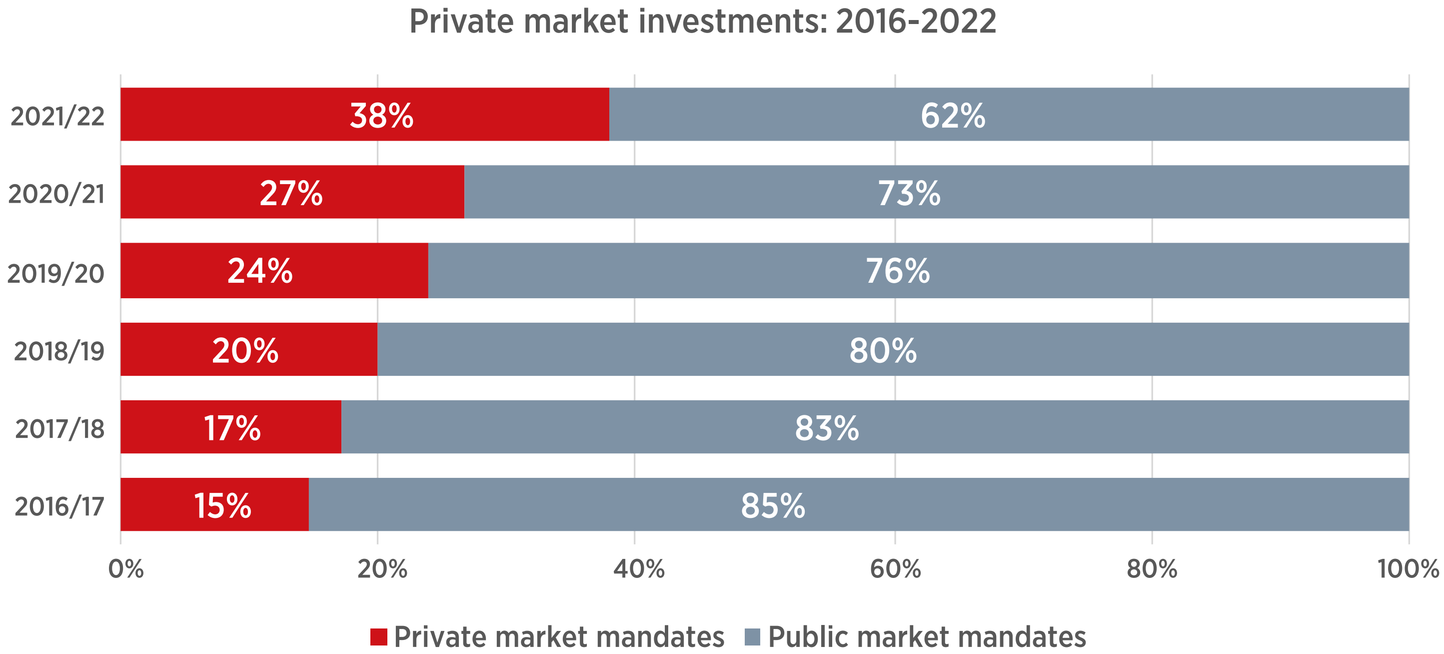
2 Willis Towers Watson Global Pensions Assets Study, 2022

ALLOCATIONS HAVE SHIFTED

The rise of private assets

There is a general industry trend to diversify sources of return by investing into private market investments. This has been a theme for some of the largest DB pension schemes in the UK while there are Master Trusts such as nest, and Local Government Pension Schemes are also planning to increase their allocation to local social investments over the next few years.



The Willis Towers Watson Global Pensions Asset Study 2022 cited that 'Asset allocation to real estate, private equity and infrastructure in the 20-year period has moved from about 7% to above 26%' – this is at a global level[2].

When reviewing the asset allocations across our cost transparency and benchmarking universe, we've seen the allocation to private markets growing from 15% in 2016/2017 to 38% in 2021/2022. This partly explains why we've also seen an overall increase in performance fees mentioned earlier in this report.

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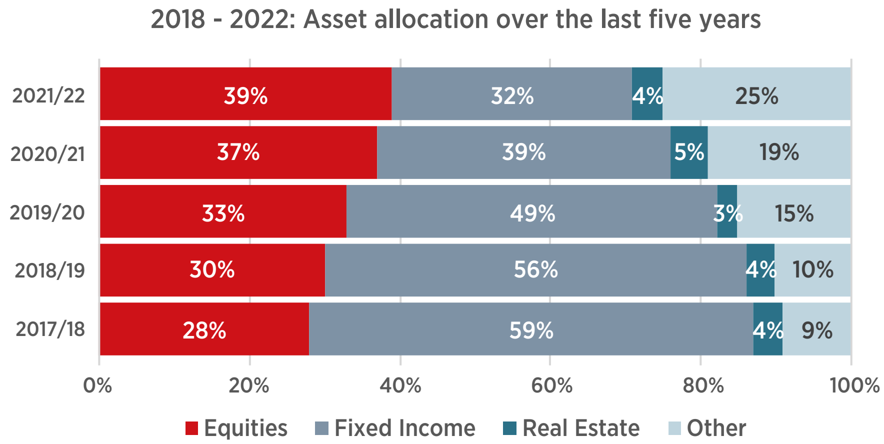

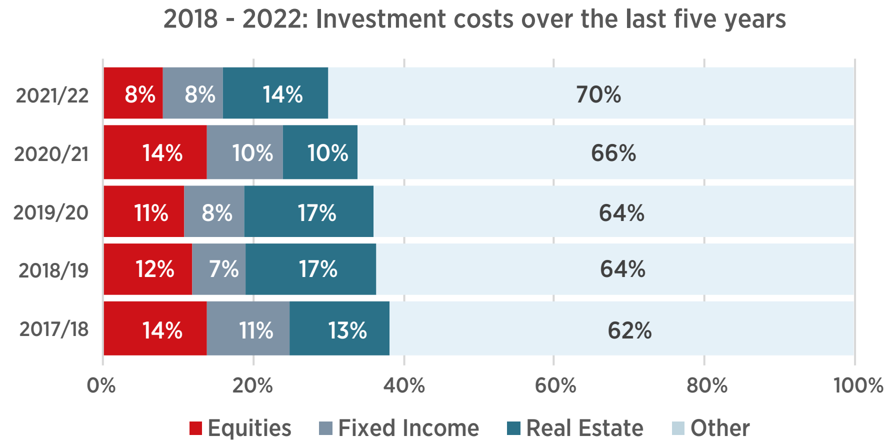

When looking at our universe, we've also seen a gradual increase in equity-based investments over the last five years, with Global Equities now in the top five allocated asset class in 2022. Asset allocation changes, especially from lower costing fixed income assets to equities, will have an impact on TCO trends. This change could also be the result of more technical factors if pension schemes were impacted by the recent LDI crisis and had to sell their most liquid assets, fixed income and gilts, to fund margin calls.

The total allocation to LDI mandates across our universe has fallen significantly, from a total of £16.4bn in 2021 to £10.3bn today.

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LOOKING AHEAD

Since mid-2020, markets have been supported by quantitative easing as central banks worked to support the financial system post the pandemic. The market environment changed in 2022, with the conflict between Russia and Ukraine, and the emergence of inflation and rising interest rates. This could change the dynamic of market returns and, in this environment, understanding and managing costs could rise to the top of the agenda for pension schemes.

In November 2022, we hosted a roundtable for Master Trusts and it was observed that 'delivering investment outcomes in a high inflationary environment is more challenging and may require increased use of more actively managed strategies' – if this becomes the general sense of direction for some pension schemes, costs could edge higher.

There is also more focus now on sustainable governance and corporate social responsibility, and managing costs play a big part in this.