THE CLEAR CASE FOR COST TRANSPARENCY

Scott Foster of KAS BANK argues for the importance of educating the industry

COST TRANSPARENCY CAN OFFER A COMPREHENSIVE OVERVIEW OF A PENSION SCHEME'S ADMINISTRATION AND INVESTMENT COSTS, PROVIDING A HOLISTIC UNDERSTANDING OF THE UNDERLYING COSTS INCURRED WITHIN A SCHEME. ACCESS TO THIS INFORMATION CAN HELP TRUSTEES MAKE MORE INFORMED DECISIONS ANALYSING THEIR COST DATA, IN CONTEXT OF THE PENSION SCHEME STRATEGY AND/OR PERFORMANCE OF THEIR EXISTING OR POTENTIAL ASSET MANAGERS.

The benefits of widespread cost transparency implementation by pension schemes has been made clear in the Netherlands. KAS BANK, which services around a third of the Dutch pension market, found that the average total cost of ownership (TCO)[1] per pension scheme it services decreased by 37%[2] between 2015-2016. These findings coincide with the introduction of a cost transparency framework, and widespread consolidation of Dutch pension schemes.

KAS BANK launched the first UK pension cost transparency dashboard in 2017, with the Superannuation Arrangements of the University of London (SAUL) leading the way on cost transparency for DB pension schemes. The scheme has been utilising the dashboard to achieve greater visibility of its total costs, with an emphasis on transaction costs at an investment mandate level.

80% THOUGHT THAT MORE WORK NEEDED TO BE DONE ON EDUCATING TRUSTEES ON THE COMPLEX SUBJECT OF COST TRANSPARENCY

1. The total cost of ownership (TCO) is the sum of the pension management costs and investment costs.
2. The reduction in TCO is calculated by the combined decrease in average pension management cost and in average investment cost.

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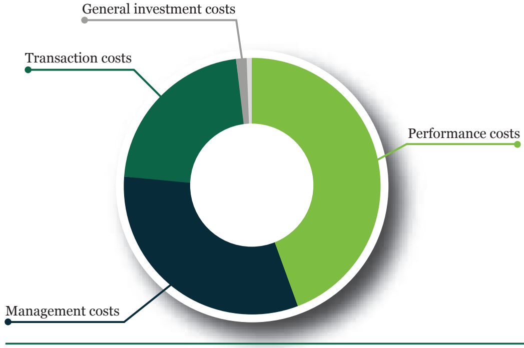
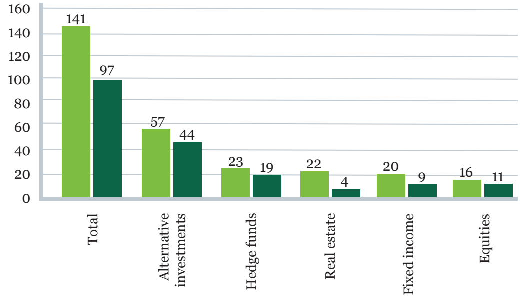
KAS BANK PENSION COST TRANSPARENCY DASHBOARD

Investment costs



Cost efficiency

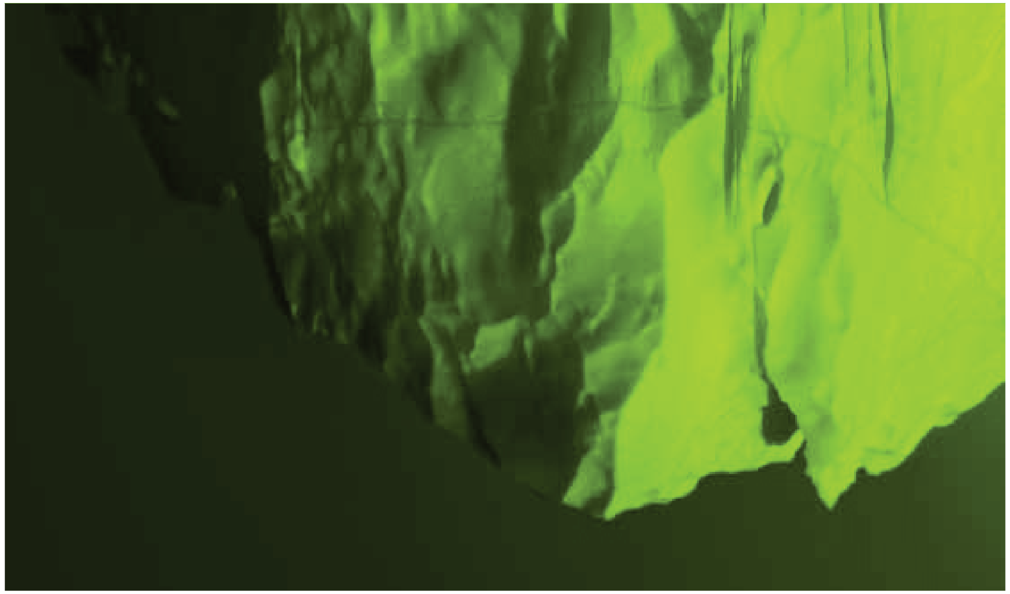


Although it has taken some time for the UK pensions industry to get to grips with cost transparency, and there has been some heated debate, KAS BANK are now seeing a spike in interest from UK pension schemes on the subject. This has come as the industry continues to rally in support of cost transparency, with schemes recognising the benefits of better understanding their costs, and the necessity to assess and report on value for money.

TWO CHALLENGES

Despite the momentum gathered, two key challenges remain, the first being a widespread adoption of cost transparency, the second being the education of trustees and pension scheme executives on the subject.

The announcement of the Cost Transparency Initiative (CTI) – aligning the PLSA, the Investment Association and the Local Government Pension Scheme Advisory Board, to carry on the work of the FCA institutional disclosure working group (IDWG) templates – is a great step forward for the industry. The templates will provide the UK industry with an all-inclusive standardised framework for collecting the costs incurred by a pension scheme. The templates will support a deeper dive into the alternative investment strategies (often criticised for the opaqueness of fees) and will scrutinise custody and administration fees. The templates focus in particular on investment costs, which often make up 75% of a scheme's TCO.



32%

THE SURVEY FURTHER REVEALED THAT 32% OF THE ATTENDEES EITHER DIDN'T KNOW OR DON'T FACTOR TRANSACTION COSTS WHEN REVIEWING ASSET MANAGERS.

COST TRANSPARENCY IS ON THE REGULATORY AGENDA AS PART OF THE DRIVE FOR IMPROVING GOVERNANCE

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There is also a greater emphasis on investigating the more elusive transaction costs, which can typically make up 20% of the TCO of a pension scheme.

While this will give pension schemes a standard framework to collect costs from their service providers, there remains the challenge for pension schemes to contend with, and effectively digest the large volume of new information coming their way. Clear and simplified reporting on what is relatively unfamiliar to pension schemes will be equally as important.

On the topic of education, the 2017 FCA Asset Management study found that investor awareness of costs and charges is poor, this being the case for both retail and institutional investors. A similar sentiment is shared in the findings of a survey recently conducted at KAS BANKS's Cost Transparency Trustee Learning Zone at the PLSA Annual Conference. The results of the learning zone, attended by over 100 pension professionals, showed that 80% thought that more work needed to be done on educating trustees on the complex subject of cost transparency. The survey further revealed that 32% of the attendees either didn't know or don't factor transaction costs when reviewing asset managers. Both results highlight that further work is needed to ensure that cost transparency is understood and made accessible to all in the industry.

Following an hour-long educational session with the trustees, there was a 30% increase in the number of attendees saying they would now scrutinise investment costs, including transaction costs, when evaluating their asset managers, now that they had a better understanding of the subject and the associated benefits. These findings reveal that trustee confidence, through education, is vital to the successful adoption of cost transparency across the pension sector.

EDUCATION AND REGULATION

KAS BANK is taking the lead on educating trustees and pension executives on cost transparency through a number of initiatives including a Trustee Learning Zone at the PLSA Annual Conference, and the sponsorship of the PLSA Made Simple Guide in 2018. In 2019, KAS BANK will continue its commitment to education, signing on as a PLSA Education Partner for Cost Transparency in the new year. The partnership will include a series of teach-ins and webinars throughout 2019.

In addition to supporting trustees in more informed decision-making, cost transparency is on the regulatory agenda as part of the drive for improving governance, with the regulator demanding trustees assess value for money on the costs. This assessment has to be reported on each DC chair's statement, and non-compliance will incur a fine, so it is important to ensure chairs are well informed and supported to carry out these fiduciary duties. We believe that reporting costs will become a regulatory obligation in the next 12-18 months for DB pension schemes.

Once the CTI has implemented a standardised industry framework, the collection of costs and charges will be simplified.

However, as an industry we need to ensure trustees and pension executives correctly interpret costs and charges in the context of investment strategy, risk and returns, more informed decision-making and potential improved member outcomes.

20%

THERE IS ALSO A GREATER EMPHASIS ON INVESTIGATING THE MORE ELUSIVE TRANSACTION COSTS, WHICH CAN TYPICALLY MAKE UP 20% OF THE TCO OF A PENSION SCHEME.