

Investment, Governance and Engagement Sub Committee

Item 7 – Paper C

Transparent Investment fees

At the SAB meeting on 6th March, Jeff Houston (JH) provided an overview of progress made on the SAB Code of Transparency developed in collaboration with the Investment Association (IA). **See Annex 1)**

Signing up to the Code would be on the understanding that the template may change to be kept in line with the IA's Disclosure of Charges and Transaction costs. Complexities around the legal framework to protect commercially sensitive information and allow flow of data to a third party auditor were currently being worked on, and release of the Code was expected to be before the next meeting.

Information submitted under the LGPS Code of Transparency would be subject to some form of external audit to be discussed at the next meeting.

Attached at **Annex 1** below is a copy of the paper given to the Board by Chris Sier (CS) to set up a utility to audit the submissions under the Board's code, and act as an independent, private, non-profit organisation to provide the necessary assurances to all stakeholders in order for the Code, and transparency, to work.

The Board agreed with the principles of the proposals and agreed that the next stage should be to produce a detailed report including risk register, cost analysis and fund consultation.

Recommendation – that the committee notes the work of the Board

Annex 1

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Investment costs – Code of Transparency

Background

1. Investment fee transparency and consistency is a target for a revised CIPFA accounting standard issued for inclusion in the statutory annual report and accounts. Transparency of investment costs is also included in the government's criteria for pooling investments.

2. In order to assist LGPS funds to better comply with the accounting standard and the pools to be able to produce transparent costs the Board is working to develop a voluntary Code of transparency for LGPS asset managers.

The Template

3. The core of the Code is a template for completion by asset managers. This template was drafted and tested with the help of Dr Chris Sier (who has worked extensively with the Dutch pension schemes in this area), West Midlands Pension Fund and the Investment Association.

4. The template was uploaded to the Board website in September and an informal consultation period was run during October, which included round-table meetings with both LGPS Fund accountants and asset managers.

5. The template has been adopted and developed by the Investment Association who using it as a building block within their new disclose code.

6. The template is now complete (attached as ANNEX 1) and has been uploaded to the Board website and be circulated to LGPS asset managers and administering authorities for use from winter of this year onwards.

7. The template lists a series of broad headings for reporting costs and expenses and in its initial form will concentrate on those areas which should already be available but may not have been supplied by asset managers either proactively or in a format easily useable by LGPS funds.

8. Where possible the template will link with other industry initiatives in this area for example the (International Limited Partners Association (ILPA) private equity fee reporting template.

The Code

9. This template will form the basis of a 'Code of Transparency' to be published by the Scheme Advisory Board. It is proposed that those managers who sign up to it are listed on the Board website and able to use the Code logo on their marketing literature.

10. The Code is not designed to enable comparisons of manager costs but rather to enable individual LGPS administering authorities to access the data they need for transparent reporting. Administering authorities may continue submit their cost

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data to third parties (for example CEM or other similar companies) for use in comparative analysis however that would be a separate exercise.

11. The Code will be voluntary with asset managers encouraged to sign up to it to demonstrate their commitment to transparent reporting of costs. Those that do will agree to supply the information on the template in the format requested and in a timely manner. They would further agree to the data being checked by a third party to ensure they are continuing to comply with the requirements of the Code.

Future development

12. The initial template is designed to cover the listed market (equities, bonds and pooled funds) and an additional template is now under development for unlisted (private) markets, including private equity, property and alternatives.

13. It is envisaged that the template would develop over time to encompass other more challenging areas of cost transparency and would remain flexible to enable changes to meet the rapidly developing market for investment products.

14. Once the code is in place the Board will need to consider how best to take forward both the development and policing roles required for the effective operation of the Code.

15. Also it is proposed that the views on the support administering authorities may wish it to receive in respect of related work (e.g. procurement of a comparative data analysis service across the scheme) should be sought.

Liaison with other industry and Government bodies

16. Discussions are also ongoing with CIPFA to ensure the data collected using the Code will continue to provide LGPS funds with the information required to meet the reporting standard.

17. As well as ongoing discussions with the IA, DWP have expressed an interest in the work and although this is very early days they wish to discuss the template with FCA for potentially wider application.

18. The paper at **Annex 1a** is to be given by Dr Chris Sier regarding a proposal to establish an independent cost collection utility to collect, collate, check and summarise pension cost data for LGPS funds.

The Board is asked to note the attached template and Code, and support the continuing actions set out in this report and launch of the Code following the meeting. The Board is also to consider the proposal from Dr Chris Sier to establish an independent cost collection utility.

Annex 1a

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‘GlassBrick’ – Proposal for a Pension Cost Data Collection Utility

Introduction

There is a general belief that the cost structure of pension funds, not just in the UK but globally, is transparent and that pension fund costs are obtainable. Neither of these assertions is true and they have been challenged by several actors, most notably The Netherlands, the World Bank and, more recently, by the UK Regulator, as well as by empirical evidence from the UK.

Understanding the costs of pension provision is fundamental and there is no doubt that reducing costs can have a material upward impact on the performance of pension funds. Even small cost reductions can lead to long-term benefits through compounding of the savings. In addition, knowing costs is the only way to calculate gross performance, since gross performance is net performance (which is reported) plus all costs (which are not collected or reported). Only by seeing net performance in the light of gross performance can true value for money be calculated.

However, collecting cost data is difficult:

- There are many different costs, which may be explicit and captured on invoice, or may be implicit and captured in valuations. In other words valuations (of assets or funds) may be returned NET of fees, so fees are not transparent.
- Implicit costs are almost never captured or offered to pension funds for accounting purposes. However, the situation is so dire that there have been numerous examples where even explicit fees (costs) are not submitted to pension funds (e.g. West Midland Pension Fund).
- Expertise on the full range of costs does not exist in pension funds and is expensive to buy-in either on an outsourced basis (benchmarking companies) or fulltime (a junior analysts will cost the fund possibly £100k per annum.)
- To compound the issue, asset managers and service providers are used to giving anything but the most basic of explicit costs, both at the operational/system level and the emotional level, and show strong aversion to detailed questions that might expose potentially commercially sensitive data.
- A requirement to disclose all costs, both explicit and implicit is routinely not part of RFPs or Term Sheets with Asset Managers or other service providers so it is hard to demand costs data. Costs therefore need at least a modicum of consent from asset managers if collection is to be easy.
- There is no common standard for data collection.

A paper written for the FSCP/FCA in March 2016 on cost transparency in pension funds proposed a standard for cost data collection. This standard is

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detailed and comprehensive, and goes well beyond any data currently collected by pension funds from their service providers. The IA has adopted it as their standard for cost data collection for listed asset managers. This code has also been adopted by the SAB for collecting cost data from listed asset managers, and another code is being prepared for the unlisted market.

The complexity of both these codes, combined with issues of proprietary data, privacy and inertia (resistance to change) mean that data collection and collation will require a new layer of administration within pension funds in order to obtain transparency and the trust and savings it will bring.

Proposal for a Cost Collection Utility

This proposal is for a **cost collection Utility** to overcome the challenges listed above. The utility will have the following characteristics:

- It will be an **independent, private** organization. This will prevent possibly malign actors from using FOIA requests to obtain market sensitive data that might be used to damage the reputation of individual pension funds and/or asset managers.
- It will have an independent Board of Governors, with representation from a wide set of stakeholders, including the LGPS.
- **It will not conduct benchmarking** between individual pension funds or between asset managers, and it will **never release data** in its possession to third parties.
- When sufficient data has been collected, the Utility will produce **market level metrics** to allow funds to determine if they are at an appropriate level of '**value for money**'.
- It will be **non-profit for the LGPS** and operate in a provably 'costs-only' model. This is to respect the long-term efforts of the LGPS to drive pension cost transparency into the UK marketplace. It will also minimize the cost to individual funds.
- It will **remove the need for pension funds to collect and collate this data individually**. Therefore it will remove the need to hire either expensive benchmarking organizations and/or analysts, either of which might cost up to £100k per annum per pension fund.
- Because it will operate at scale and will be non-profit, the expected price to collect, to check, to collate and to report value for money information to LGPS funds is **only £10k per pension fund**. This price is likely to reduce if all LGPS funds procure from the utility, as a **rebate** will be given to maintain the non-profit status.
- **Asset managers will also want to use the Utility**. As it is independent and neutral the market sensitive data within the cost collection standard will not be exposed to scrutiny of competitors or commentators. This overcomes one of the major stumbling blocks in any transparency initiative.
- The Utility will check asset manager data submissions and issue '**kitemarks**' of **transparency/accuracy** if data is accurately submitted. Asset managers will use the kitemarks to confirm to pension fund clients that they have honestly complied with the requirement to submit data. They will pay for this 'kitemark' and thus share in the operating costs of the utility, maintaining its neutrality. The expected price for this service will also be £10k.

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- Asset managers will submit data to the Utility to the cost collection standard under instruction from their pension funds client.

An independent, Swedish market data utility has approached me offering to underwrite the two-year operational costs of the organization and then maintain the non-profit status for LGPS going forward. This negates the need to ask the SAB for working capital to hire the staff needed to build the utility. For them to provide such funding, in exchange for a % of the equity in the Utility, the company seeks assurances of LGPS usage for a period of time, such that from their perspective the LGPS component of the Utility is break-even.

“It is well known that a vital ingredient of success is not knowing that what you're attempting can't be done. A person ignorant of the possibility of failure can be a halfbrick in the path of the bicycle of history.” Terry Pratchett.

A proposed name for this organization is therefore ‘GlassBrick’ as pension cost transparency will change the direction of the asset management industry forever. It will correct the market failure of information asymmetry highlighted in the latest FCA paper on the asset management industry. The LGPS will therefore be at the heart of the systemic change in the way in which financial services operates, to the benefits of its members and the wider UK and global consumer.

Summary

I propose to build a market Utility for collecting, collating, checking and summarizing pension cost data, using a standard adopted by the SAB and the IA. This Utility will operate as non-profit for LGPS, reducing the cost of the service to approx. £10k per annum for an annualized service, which is likely to be one tenth of the cost of the alternatives per pension fund. The set-up and operational costs will be underwritten by an independent, Swedish data utility that already operates in such a fashion within the insurance industry in the UK. This company is happy to maintain the non-profit model for LGPS clients. The Utility (‘Glassbrick’) represents a systemic change in the way financial markets and companies operate, moving them from opaque to transparent. This is a seminal step forward and will be enabled by the LGPS.