FCA consults on transaction cost disclosure in workplace pensions

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Introduction

On 5 October 2016, the FCA published a consultation paper which proposes rules and guidance to improve the disclosure of transaction costs in workplace pensions.

Key points

- Trustees and IGCs are required to report on and assess transaction costs in an annual statement. However, there is currently no corresponding obligation on parties involved in pension investments to disclose this information.
- The FCA proposes a standard approach to the disclosure of transaction costs, together with a requirement for those managing investments to report administration charges and transaction costs to an IGC or the trustees of an occupational pension scheme when asked to do so.
- The consultation does not propose rules on how transaction costs should be presented, nor on the timing or frequency of their disclosure.

Background

The 2013 OFT market study into the DC workplace pensions market identified significant issues and made recommendations to improve the functioning of the market. As a result, in March 2014, the DWP published a Command Paper: Better workplace pensions: further measures for savers which outlined measures for workplace pensions which would give full transparency of all costs and charges (see our Alert for details).

In 2015, new requirements for both IGCs and trustees of occupational pension schemes to report on the level of transaction costs in their schemes were introduced. However, no corresponding duty was placed on asset managers to disclose this information.

What are transaction costs?

According to the FCA, transaction costs can be broken down into a number of broad categories:

- costs for money flowing into and out of the fund because of pension scheme members contributing to their pension or leaving the scheme
- costs for members who make their own investment decisions switching between funds
- costs from switching activities as a result of investment decisions taken by the trustees or pension provider
- costs from investment decisions taken by the scheme's investment managers

Depending on its structure, there are different levels at which pension arrangements may incur transaction costs. For example, where an arrangement uses a "fund of funds" that then invests in underlying funds, the underlying funds incur transaction costs through investments in securities, while the fund of funds is likely to incur transaction costs when it buys and sells funds.

Facilitating the disclosure of transaction costs

Given the potential for multiple parties to be involved in managing pension investments and for transaction costs to be incurred at different levels, the FCA considers it essential that any rules of disclosure "enable the flow of information to the governance bodies of those schemes". It therefore proposes to require all those managing investments to report administration charges and transaction costs in response to a request from a pension scheme that is required to obtain them.

Proposed approach

The disclosure of transaction costs will be based on a comparison of actual prices with the value of the asset immediately before the order to transact entered the market, often referred to as the "slippage cost". This approach is suggested because:

- it uses data that is widely available for most assets and can be independently audited
- there is no need to engage in complicated calculations or to make estimates
- the principle can be applied across different asset classes and can be used as the basis for a methodology to calculate costs in any asset, whether liquid or illiquid
- firms who would prefer not to use a commercial provider to conduct the calculation would be able to build their own system.

As both trustees and IGCs are required to report on transaction costs annually, the FCA does not propose to set a specific timetable for their disclosure. Instead, it suggests that information be included within the standard reporting cycle of the provider or investment manager to the governing body.

Presentation of transaction costs

The FCA proposes that asset managers provide transaction costs, on request, as a total cost with a breakdown into categories of identifiable cost (such as taxes, explicit fees and charges, and securities lending costs). It also sets out, in guidance, examples of the contextual information which might be provided alongside transaction costs, if it is available. For example, information about the return and risk of the fund, and the administration charges involved, which should enable transaction costs to be seen in the context of the net return being generated. The disclosure of such information will not be required as governance bodies will have differing needs and the FCA is keen to avoid unnecessary duplication of reporting.

The FCA recognises that how transaction costs are presented is a key aspect of their disclosure. However, on the basis that there are already a number of initiatives to standardise their presentation, it has opted not to put forward its own rules for this.

Inability to obtain transaction costs

If it is not possible for a governance body to obtain information on transaction costs, it should explain this in its annual report and note the steps it will take to get that information in the future.

Where an investment manager is not FCA-regulated (and as such, not subject to FCA rules), the FCA suggests contractually requiring disclosure of transaction costs through the investment management agreement.

If it is not possible for a party to disclose transaction cost information, the FCA proposes that they disclose this clearly to the governance body with an explanation of why this has not been possible. The FCA also suggests that the party disclose the percentage of assets for which they have not obtained transaction costs and how those costs are invested. This is intended to help the governance body meet its assessment obligations.

Next steps

The consultation closes on 4 January 2017, with the FCA intending to publish its rules in a Policy Statement in the second quarter of 2017.

The interim findings of the FCA's market study into the asset management sector are expected later this year.

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