

Media Comments 2014

Pensions forced to conceal fees

Oct 27, 2014: Anger has erupted over the practice of asset managers coercing pension funds into signing non-disclosure agreements about fees they charge. FTfm's Steve Johnson discusses the issue with Professor David Blake, director of the Pensions Institute at Cass Business School.

<http://video.ft.com/3861172761001/Pensions-forced-to-conceal-fees/Markets>

Complex pension choices require expert advice, by Sophia Grene, *Financial Times*, December 14, 2014

There is an inevitable tension between the desire to give people responsibility for their own futures and the need to ensure they do the right thing with that responsibility.

In pensions terms, the focus has been on how to ensure people build a nest egg to guard against poverty in old age. But as populations age, the question arises of how to make sure they use that nest egg wisely.

Australia is among the economies most advanced in developing retirement funding systems that balance individual responsibility with institutional frameworks. Its [superannuation system](#) obliges workers to save for the future, but so far has then allowed them complete freedom in what to do with those savings in retirement.

Last week, the [Financial System Inquiry](#) report, led by David Murray, called for more support for savers when they reach retirement.

“Evidence suggests that the major worry among retirees and pre-retirees is exhausting their assets in retirement,” says the report.

“An individual with an account-based pension can reduce the risk of outliving their wealth by living more frugally in retirement and drawing down benefits at the minimum allowable rates. This is what the majority of retirees with account-based pensions do, which reduces their standard of living.”

To improve outcomes, the report recommends fund trustees should nominate a “comprehensive income product for retirement”, or CIPR. This would be the default option for retirees, although it would also leave them free to take the money as a lump sum or look for alternative arrangements.

This moves in the opposite direction from recent developments in the UK, where since March it is no longer mandatory to convert pensions savings into an annuity. Although critics were concerned this would leave individuals without expertise facing difficult decisions, the new freedom was generally welcomed. This was in part thanks to the perception that the annuities market was uncompetitive and overpriced.

The Financial Conduct Authority, the UK regulator, last week published a review of the [market for annuities](#), begun when annuitisation was still compulsory. It found “competition in this market is not working well for consumers”, with eight out of 10 retirees buying their annuities from the same provider as their pensions.

“All evidence shows that enforcing choice on savers lead to poor investment outcomes and high fees as has been the experience in all major pensions markets, be it the UK when that choice was generally constrained to annuities or Australia and the US where self-managed drawdown dominate,” says David Hutchins, head of pensions strategies at AllianceBernstein, the asset manager.

The defined contribution pensions market in the UK is likely to grow rapidly in years to come, following the introduction of auto-enrolment, which pushes all employees to join pension schemes. So far, the experience shows that most of these new savers are unlikely to feel comfortable with complex financial decisions.

“Among the auto-enrolment population, around 98 per cent of savers make no active investment choice and end up in the scheme default fund,” says Morten Nilsson, chief executive of Now Pensions, which provides auto-enrolment products.

“In recent months and years, the government has introduced a number of initiatives to ensure that default funds are fit for purpose, but little attention has been given to the charges and quality of products available in the decumulation phase.”

The Murray report describes what a CIPR should include — “a regular and stable income stream, longevity risk management and flexibility” — but declines to be more specific. Instead it calls for policy support for more innovation by product providers.

Innovation, although important in providing value for money for savers, would not be sufficient, it concludes, saying the “nudge” created by a default option is necessary to change behaviour and create the required scale to allow cost-effective innovation.

“That makes a lot of sense,” says David Blake, professor of pension economics at Cass Business School. “No amount of good product design is going to make up for poor understanding of risks that people have never encountered before.”

Mr Hutchins adds: “Our research suggests that even with guidance the majority of savers want to have these complex decisions, at least initially on retirement, made for them by trustworthy experts.”

The agreements, signed when pension schemes appoint a fund company to manage some of their assets, are of particular concern with respect to public sector pension plans, which are effectively funded by the taxpayer.

BlackRock said: “A corporate or public sector pension fund looking to appoint an investment manager can access pricing information from a number of sources: by requesting proposals from different market participants; by reviewing third-party surveys on fees; and by using consultants to assist in the search.

“It is sometimes deemed desirable to enter into an agreement that contains an NDA to protect confidential information of one or both parties.”

Many want the agreements outlawed, believing they allow fund managers to overcharge clients. David Blake, director of the Pensions Institute at Cass Business School in London, told FTfm last month: “Local authorities are not allowed to compare fee deals, and that is an outrage. It should be made illegal.”

The UK’s pensions regulator has also [warned](#) about the potential dangers of signing non-disclosure agreements and said it would be concerned if schemes were putting their members’ interests at risk as a result.

Fund managers counter that if pension funds do not want to sign the agreements then they are free to go elsewhere.

Daniel Godfrey, chief executive of the Investment Management Association, which represents the interests of the fund industry, said: “[Pension funds] are the clients and if clients tell investment managers they only want to hire managers that allow them to publish details of fees, then investment managers will have no choice but to allow them to do so.”

He added: “We believe NDAs regarding fees are rarely used.”

But the belief is the practice is widespread. The UK’s National Association of Pension Funds, which represents more than 1,300 schemes, has raised the issue with the Financial Conduct Authority, the regulator.

The NAPF believes pension funds have little option but to sign the deals. “Pension schemes are simply the price takers – the negotiating strength is in the hands of the investment firms,” said Paul Lee, head of investment affairs at the NAPF.

A pension consultant, who asked to remain anonymous, added that it is difficult for pension schemes to challenge such agreements after they have spent six months selecting a fund manager. “It is hard for them to [start over],” he said.

The disparity in fees was evidenced by research published in the FT last year, which showed the Staffordshire public pension fund paid £7.2m in fund management fees in 2011/12, while Devon’s public pension fund spent just £2.7m for almost identical investment contracts.

Robert Higginbotham, head of global institutional services at T Rowe Price, a large US fund company, condemned the use of NDAs: “If [the use of NDAs] does go on, I am not a supporter of it. We are only going to get through any debate about costs if we have transparency and buyers can figure out if they are getting a reasonable deal. “It is good this is being highlighted. Anyone doing it should have to explain themselves.”

The FCA told FTfm it is not responsible for regulating pension funds, while the Competition and Markets Authority said it has no plans to look at competition issues in the pension industry.

The UK government's Department for Work and Pensions said it plans to consult on draft legislation bringing about full public disclosure of costs and charges for pension scheme members next year.

Susan Martin, chief executive of the London Pensions Fund Authority, said: "We expect our investment partners to show clarity on where we are investing and offer transparency on fees. We have shown in the past that we may come out of strategic relationships if our investment partners do not meet

Consultation under way on retirement incomes By Dave Baxter, *FT Adviser*, Dec 03, 2014

The Pensions Institute at Cass Business School has launched a national consultation on the future of retirement incomes from defined contribution pension schemes.

The independent review of retirement income, led by Pensions Institute director professor David Blake, will look at how to ensure a maximum, predictable retirement income.

The consultation, which runs until February 2015, looks at how workplace pension retirement products can give people security and confidence in retirement, what kind of support people need to make the right choices at retirement, longevity risk, and the roles of both the National Employment Savings Trust and collective pension schemes.

The 17-page Independent Review of Retirement Income: Consultation Paper, asked: "Can we design a pension system that produces lifelong retirement incomes that are more predictable than existing systems?"

It also looked at generating the best possible value for each pound saved and how people can be encouraged into schemes that are well designed and regulated.

Professor Blake said: "We are interested in generating good consumer outcomes in the face of the significant structural and social challenges facing people at retirement."

The Labour party, which commissioned the review earlier this year, has called for measures to be taken against hefty charges on income drawdown as April's pension changes approach.

Gregg McClymont, shadow pensions minister, said: "We are concerned that the government has not thought through the risks of rip-off charges being taken from the savings of hardworking people."

Frances O'Grady, general secretary of the Trades Union Congress, said: "There is an urgent need to ensure that low and middle earners who are starting pension savings thanks to auto-enrolment can turn them into reliable income in retirement."

Mark Stopard, head of product development for the London-based enhanced annuity provider Partnership, said the concept that providers should not be able to make

excessive profits from consumers accessing their pension savings was a good idea, and all part of treating customers fairly.

BlackRock defends non-disclosure deals, Chris Newlands and Madison Marriage, *FTfm*, November 17, 2014

BlackRock has defended the practice of asset managers requiring pension funds to sign [non-disclosure agreements](#) despite an outpouring of anger that such arrangements prevent fee transparency.

The world's largest fund house said it was "neither in the interest of institutional investors nor of investment managers to ban non-disclosure agreements". Pension schemes argue the arrangements prevent them from comparing fees and securing the best deals for their members.

The agreements, signed when pension schemes appoint a fund company to manage some of their assets, are of particular concern with respect to public sector pension plans, which are effectively funded by the taxpayer.

BlackRock said: "A corporate or public sector pension fund looking to appoint an investment manager can access pricing information from a number of sources: by requesting proposals from different market participants; by reviewing third-party surveys on fees; and by using consultants to assist in the search.

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US allows savers to default into annuities to boost take-up, By [Samuel Dale](#), *Money Marketing*, 28 October 2014

The United States is making further moves to boost take-up of annuities by allowing parts of funds to default into lifetime income products.

Most US savers put money into a 401K defined contribution scheme, which can be withdrawn from age 59 and a half. Any withdrawals before this age are subject to massive tax penalties.

On Friday, the US Treasury said it will allow retirement funds to offer long-term deferred annuities as a default investment in 401K retirement accounts.

It means US workplace pension funds can automatically use savings to buy an annuity product available upon retirement.

In July, the US Treasury offered savers who buy annuities extra tax relief in a bid to boost take-up. The US Treasury says it wants to stop savers running out of cash and outliving their savings.

New research from Hargreaves Lansdown today shows [12 per cent of UK savers](#) are expected to blow their pension pots next April when new freedoms kick in.

Experts have accused Chancellor George Osborne of discouraging the use of annuities when he abolished the so-called “death tax” on pension funds last month. Pensions minister Steve Webb has even suggested existing [annuity contracts could be unwound](#).

US Treasury deputy assistant secretary for retirement and health policy J. Mark Iwry says: “As boomers approach retirement and life expectancies increase, income annuities can be an important planning tool for a secure retirement. Treasury is working to expand the availability of retirement income options for working families.

“By encouraging the use of income annuities, today’s guidance can help retirees protect themselves from outliving their savings.”

Cass Business School Professor David Blake, who is leading Labour’s taskforce into pensions, says: “The Chancellor and his friends are sufficiently rich that they will never need to buy an annuity and hence do not understand why anyone else would want to either.”

Partnership head of corporate affairs Jim Boyd says: “One of the most significant risks facing all advanced economies is that ageing populations are not only growing rapidly but are living longer.

“Annuities, which guarantee an income for life offer one of the few ways of managing longevity risk and people outliving their savings and falling back on the state. The UK annuity market has been viewed with envy by many advanced countries - so it is hardly surprising that the US is moving in this direction.”

Are ghosts in the machine increasing the price of de-risking?, Natasha Browne, Professional Pensions, 27 Oct 2014

Overestimates on older age populations may have led to schemes overspending on buyouts, but to what extent? Natasha Browne investigates

Buyout contracts are increasingly attractive as scheme sponsors look to get defined benefit (DB) liabilities off their balance sheets. The market has gone from strength-to-strength over the past few years, with the value of business quadrupling in the first half of 2014, according to LCP ([PP Online, 11 August](#)).

But what if sponsors found out they were overpaying for buyouts? Would this be acceptable if they were happy with the price at the time, or would it erode trust in these transactions? Schemes could be faced with these questions after a recent report from the Pensions Institute (PI) found buyouts may be overpriced.

The cause is significant flaws in mortality data calculated by the Office for National Statistics (ONS), according to the PI. These data discrepancies can be traced back to 1919 and Spanish flu.

It was the end of the Great War and soldiers were returning home. While birth rates were low in the first half of 1919, because of a Spanish flu pandemic, they were considerably higher in the second half. This is important because the ONS estimated populations on a mid-year basis.

PI director professor David Blake explains: "The ONS assumes that babies are born evenly throughout the year and that you can get a good estimate of the mid-year population by taking the estimate at the beginning of the year, the estimate at the end of the year, and halving it.

"But if you've had an uneven pattern of births during the course of the year, your mid-year estimate will be wrong and that will follow that cohort throughout its life so you will either be systemically overestimating or underestimating the mortality rate."

There was a similar distortion in birth rates after the Second World War. There was the well-documented 'baby boom', which is the era when many of today's pensioners were born.

Essentially, the ONS overestimated the number of people born during these periods, introducing 'phantoms' into the data. This is problematic because mortality rates are determined by the number of people who die at a given age divided by the population who remain alive at that age.

Blake says: "It is quite important because the people doing the buyout are trying to project ahead how long people are going to live. If it's got the wrong estimate it could be out by a few percent."

Blake adds: "Although there aren't many people from 1919 left, there are a lot of people who were born in 1947 who are now pensioners and who would be part of these buyout deals. For 1947, the error was about 4% or 5%, whereas the normal error is around plus or minus 1%."

Data concentration

Hymans Robertson partner Douglas Anderson notes the impact will be greatest in mature pensioner portfolios. "Data on deaths among the oldest in society is sparse, so actuaries tend to place lines of best fit through that data. Changes in the data can change where those lines of best fit sit.

"This shouldn't have a huge effect on estimates of the baseline mortality, but it does impact on how we project mortality improvements." The Continuous Mortality Investigation (CMI) is proposing to make an allowance for this in the next version of its mortality projections model, according to Anderson.

LCP partner Ken Hardman is sceptical about the impact the flawed assumptions have on buyout prices. This is because insurers and reinsurers limit their reliance on ONS

data, preferring to gather their own figures. "Now some of that ONS data might feed into some of the projections about how mortality assumptions will change in the future, but there are other sources of data," he says.

Longevity rates are only part of the picture, according to Hardman. Mortality assumptions also take into account expected medical advancements over the following two or three decades. He says: "There's inevitably some subjectivity in that. I can see why there are potential flaws in that methodology but I don't think they are necessarily directly feeding into pricing."

A fair price

JLT head of buyouts Martyn Philips asks whether schemes are really overpaying if the price matches their affordability criteria. He says: "Prices can always be lower, but if the scheme was happy to pay it and the sponsor was happy with the transaction, then a happy set of trustees have done a trade at a price they felt was fair."

Philips says insurers also guard their view of longevity risk "like the crown jewels". This is because it can set them apart from their competitors. "They have invested money in building their own books of mortality information, and therefore won't be that reliant on things like ONS information."

Legal & General says its dataset is based on exact dates of birth. This means the mortality rates it uses for people who were born in the 'uneven' years is accurate. The insurer says: "With our experience within the retail and bulk annuity markets we've developed, and use, our own dataset, so we are not reliant on the ONS data."

Still, Blake points out that even an error of 1% is significant in the case of multi-billion pound transactions. "In the cases that we have discussed, the population has been estimated to be too high, which means the mortality rates are too low, which means you are predicting more people will survive. That means the buyout price is higher than it needs to be."

Philips agrees that a 1% error is material. However, he adds: "At the end of the day, buy-ins and buyouts only happen if the price that's on the table is deemed to be affordable. And it's not just mortality; there are many other factors that go into pricing as well." But more deals would become affordable if prices fell by 1% across the board, Philips says.

Ultimately, pension schemes must ensure their member data is complete and easy-to-use because this will form the backbone of insurers' pricing estimates. Hardman says: "Anything that can be done to improve the general information set that is out there on this will just increase the understanding of longevity."

Experts warn 'reckless' Govt over flood of DB transfers, By [Samuel Dale](#), *Money Marketing*, 27 October 2014

Pension experts have warned about "reckless" Government encouragement for savers to transfer out of defined benefit pensions into defined contribution schemes to access new freedoms.

Cass Business School Professor David Blake, who is heading a Labour taskforce into pensions, warns transfers out of DB could see money pouring into buy-to-let.

Hymans Robertson estimates up [one-third of those in DB schemes at retirement](#) could transfer to DC to take advantage of new freedoms next April.

Providers have expressed alarm at possible [“insistent” DB transfers](#) who want to transfer to a DC pot despite being advised not to do so. But pensions minister Steve Webb told *Money Marketing* last week providers should not block individuals who want to do so.

The Association of Consulting Actuaries said banning DB transfers would have put the UK at a “commercial disadvantage”.

Professor Blake says: “I was particularly interested in the reaction of the ACA which came out immediately in support of the proposal to allow pension transfers from DB to DC.

“If members did this, they would have transfer values that were reduced to allow for any scheme deficit.

“If all members did this - either by choice or at the suggestion of the employer - then, of course, the pension deficits would disappear.

“At the same time, more than £1trn of funds would either end up in buy-to-let or sit in bank accounts - subject to just £85,000 credit protection. We will be living through interesting times next year.”

Hargreaves Lansdown head of pensions research Tom McPhail says: “We are into Tea Party territory. The way the Government has so enthusiastically championed pension freedoms, not just for DC members but DB too, they seem to have an issue with any form of guaranteed income. I find it reckless. This is a bunch of politicians desperate to look after their job security.”

Pension funds forced to sign non-disclosure agreements, Madison Marriage and Chris Newlands, *FTfm*, October 27, 2014

Anger has erupted over the practice of asset managers coercing pension funds into signing non-disclosure agreements. Pension schemes argue it is uncompetitive and prevents them from securing the best deals for their members.

The imposition of confidentiality agreements means pension funds are not able to compare how much they are being charged by fund managers, potentially exposing them and their scheme members to unnecessarily high fees.

The practice is of particular concern with respect to public sector pension plans, which are effectively funded by the taxpayer.

David Blake, director of the Pensions Institute at Cass Business School in London, said: “Local authorities are not allowed to compare fee deals, and that is an outrage. It

should be made illegal that fund managers demand an investment mandate is confidential.”

The non-disclosure agreements are signed when pension funds appoint a fund company to manage some of their assets.

In defence of fund managers, Daniel Godfrey, chief executive of the Investment Management Association, the mouthpiece of the fund industry, questioned whether non-disclosure clauses were “common practice”. He added: “Companies also have the commercial right to require commercial arrangements to be confidential.”

But the head of investment at a large local government pension scheme, who requested anonymity, dismissed this. He said: “It is not uncommon to have confidentiality clauses, and they are clearly not fair. Asset managers want to charge as much as they can, and they know the more public the information is, the less room to manoeuvre they have.”

Critics believe the non-disclosure agreements allow fund managers to overcharge some of their pension fund clients significantly. [Research published in the FT](#) last year, for example, showed the Staffordshire public pension fund paid £7.2m in fund management fees in 2011/12, while Devon’s public pension fund spent just £2.7m for almost identical investment contracts.

The UK’s National Association of Pension Funds, which represents more than 1,300 schemes with over £900bn of assets, has raised the issue with the Financial Conduct Authority, the regulator.

Paul Lee, head of investment affairs at the NAPF, said: “The growing prevalence of non-disclosure agreements [makes it] hard for pension schemes to know if they are getting a good deal or not. [They are] unhelpful to the proper functioning of a competitive market.”

A spokesperson for the government’s Department for Work and Pensions said: “We are working closely with pensions and asset management industries, the FCA and consumer groups to ensure full public disclosure of costs and charges members face. We plan to consult on draft legislation next year.”

Fund managers argue that if pensions funds do not want to sign the agreements then they are free to go elsewhere. Mr Godfrey said: “It could be stamped out by pension funds refusing to hire managers who require a non-disclosure agreement. The answer is in their hands if they think it important.”

He added: “I would also like to see Professor Blake’s list of all the things he thinks should be illegal.”

But the belief is trustees have no option but to sign the agreements. “Pension schemes are simply the price takers – the negotiating strength is in the hands of the investment firms,” said the NAPF’s Mr Lee.

Prof Blake added: “It would not matter where you went, pension funds would find that effectively all fund managers are using [non-disclosure agreements]. It is collusion between asset managers to disguise the true fees. It is very anti-competitive.”

UK mortality data flawed, says Pensions Institute, Rachel Fixsen, Investments & Pensions Europe, 23 October 2014

The true mortality rates for UK people born between 1919 and 1929 are understated in official figures produced by the Office for National Statistics (ONS) due to the impact of uneven birth rates, academics say.

A joint study from the Pensions Institute — part of Cass Business School, City University London — and Heriot-Watt University, Durham University Business School and Prudential Financial, found that anomalies in mortality rates can often be linked to uneven patterns of birth.

The study showed these uneven birth patterns can lead to errors of more than 9% in the estimated size of some England and Wales birth cohorts.

David Blake, director of the Pensions Institute, said: “Mortality rates are determined by the number of people who die at a given age divided by the population who remain alive at that age.

“We have accurate data on the number who die each year, but the exposed population has to be estimated and it is usually estimated at mid-year,” he said.

The researchers found that an uneven pattern of births within a given calendar year was a major cause of error in the estimated mid-year population, Blake said.

An analysis of mortality data produced by the ONS showed a “puzzling” pattern of mortality improvements among people who were now aged over 90, going back to 1992, the institute said.

It found this was due to a combination of effects.

In 1919, births were much lower at the mid-point of the year — when they are measured — than they were on average that year, and then in 2001, a change in the method used to derive mid-year population estimates led to the number of people born in 1919 being overstated, it said.

In its conclusions, the Pensions Institute called for a “fundamental review of all official mortality data and how users interpret these data.”

Andrew Cairns of Heriot-Watt University said the study was a “reminder that real-world datasets are rarely as accurate as we would like them to be.”

Sponsors overpaying for buyouts due to ONS assumptions flaw, By: Natasha Browne, Professional Pensions, 22 Oct 2014

Scheme sponsors may have overspent on buyout contracts as a result of irregular mortality data, the Pensions Institute (PI) has warned.

Director professor David Blake explained mortality rates have been distorted by uneven birth patterns witnessed after the Great War and the Second World War.

And the effects were particularly sharp in longevity swaps because these were based on narrower age groups than buyouts, he said.

The Office for National Statistics (ONS) assumed that babies were born evenly throughout the year and calculated the mortality rate on a mid-year estimate based on the number of births at the beginning, or end, of a year and halving it.

Blake said: "If you've had an uneven pattern of births during the course of the year, your mid-year estimate will be wrong and that will follow that cohort throughout its life. You will either be systematically overestimating or underestimating that mortality rate.

"It's quite important because the people doing the buyout are trying to project ahead how long people are going to live. If it's got the wrong estimate, it could be out by a few percent."

At the height of the Spanish flu in 1919, more babies were born in the second half of the year than the first, which distorted the mid-year estimate.

A similar phenomenon was witnessed in 1947 after the Second World War, with this cohort typically making up pensioner groups that are currently being put through buyouts.

Where a population estimate is inaccurate, further projections based on that figure will be wrong.

Blake explained: "If you have a group of 90-year-olds, they will be 91 next year. Your estimate of the number of people alive at 91 is going to be the number of people you've got at 90 minus the numbers who have died.

"But if your initial estimate is wrong then although you might have an accurate estimate of the number of people who died, you're subtracting that from an incorrect number. And that will get worse and worse."

He added: "In the cases that we have discussed, the population has been estimated to be too high which means that the mortality rates are too low, which means that you are predicting more people will survive. This means the buyout price is higher than it needs to be."

Spanish flu gives pension groups 100-year headache, By Josephine Cumbo, Pensions Correspondent, *Financial Times*, October 22, 2014

It is hard to imagine the Spanish flu epidemic of 1919 having significant financial implications for today's [pension](#) industry. But a UK statistical blip caused by an uneven pattern of births during the epidemic has led to the mortality rate being underestimated, according to researchers.

They are calling on the Office for National Statistics to carry out a fundamental review of its mortality database as any flaws in the figures would impact on [longevity insurers](#) and reinsurers, who use the data to price multibillion pound deals.

The research revealed a “puzzling pattern” of mortality improvements among people who are now aged over 90, starting in 1992.

The study, which was carried out by Cass Business School's Pensions Institute, Heriot-Watt University, Durham University Business School and Prudential Financial, found that an uneven pattern of births in 1919 had created a blip and introduced “phantoms” into the official data.

“In 1919, just after the first world war, and at the height of the Spanish flu epidemic, the births at the midpoint of the year were significantly lower than the average for that year,” said David Blake, director of the Pensions Institute with London's Cass Business School.

“We found that an uneven pattern of births within a given calendar year is a major cause of error in the estimated midyear population.

“There was also a change in the method used to derive midyear population estimates in the 2001 census. As a result, the number of people born in 1919 was now overstated – introducing ‘phantoms’ into the data.”

Professor Blake said these “phantoms” had served to “understate” the true mortality rate for 82-year-olds in 2001 and this error had grown during the next 10 years.

“Any error in estimating the true size of the population at the time of its birth will follow that cohort through time,” Prof Blake said.

The study's authors say the findings will have implications for the multibillion pounds pension de-risking sector – where insurers rely on mortality data to price “longevity swaps”. Mercer, the employee benefit consultants, recently estimated that, for each month of increased life expectancy, the liabilities of a defined benefit pension scheme, with £100m in liabilities, would increase by about £300,000.

Any error in estimating the true size of the population at the time of its birth will follow that cohort through time

“We agree that there are anomalies in the ONS national mortality data set and we welcome this valuable research into the matter,” said the Institute and Faculty of Actuaries.

“In terms of the overall impact, this is something that is more likely to be of concern to longevity insurers and reinsurers rather than having wider implications.”

However, the IoFA said it believed the “overall impact” was likely to be minor in most cases and was unlikely to have led to any “material under or overpricing”.

The ONS said it was aware of many of the issues raised in the research, in particular the effect of the unusual birth patterns around the end of both world wars.

However it added: “ONS does not accept that an analysis of mortality for those born in 1919 can support the conclusion that all mortality data are flawed requiring a ‘fundamental review of mortality data’.

“ONS will review the work done by the Pension’s Institute and is happy to work with them if that can improve mortality estimates.”

NAPF 2014: Trustee firms ‘must be restricted from dominating IGCs’, By: Natasha Browne, Professional Pensions, 16 Oct 2014

Independent governance committees (IGCs) should be made up of single candidates rather than a professional trustee firm, according to Cass Business School.

Visiting professor at the Pensions Institute (PI) Debbie Harrison told delegates to the National Association of Pension Funds (NAPF) annual conference that she thought there should be an open selection process for appointments to IGCs.

She said: "I'm totally opposed to the idea of a firm, however lovely the trustees might be - it should be an individual. For accountability, you've got to have individuals."

According to Harrison, IGCs must possess expertise, authority and power, as well as have an appetite to act in members' best interests.

But she raised concern about a lack of mandatory protection for individuals sitting on these boards.

Harrison said: "[IGCs] must feel empowered to act, and to act even if there is disagreement. I don't think there is a requirement for indemnity, which concerns me.

"It's always been a principle of trusteeship that you speak your mind and actually, there is some form of protection. I personally wouldn't want to be on a board that doesn't have some form of protection, some form of indemnity for the members."

Pension fund competition for diversification risks hurting returns, by Natasha Browne, Professional Pensions, 3 Oct 2014

Pension funds vying for asset classes freshly introduced to the market could erode the expected returns, SEI has warned.

The effects could be worsened as traditional investors sought to take advantage of the opportunities created by newly-launched asset classes, which were often recommended as diversifiers, according to director of advice for UK institutional David Hickey.

Even small allocations from "the herd" could significantly hurt projected returns, with insurance-linked securities and timber singled out as recent examples.

This comes in response to the **Pensions Institute's** (PI) paper - published last week - which said pension fund managers' tendency to "herd like lemmings" was threatening the stability of the financial markets ([PP Online, 23 September](#)).

Hickey said herding was not always bad, however.

"For instance, the large-scale shift of equities into matching assets has created opportunities for selling interest rate upside, rate volatility and more recently arbitrage swap-spread and forward rate dislocations," he said.

Experts recently spoke to *PP* about the factors that contribute to asset bubbles and whether schemes had become particularly cautious post-2008 ([PP Online, 3 October](#)).

Pension fund manager 'herd mentality' risks market stability, By: Tanjil Rashid, Professional Pensions, 23 Sep 2014

The tendency of pension fund managers to "herd like lemmings" is threatening the stability of financial markets, according to the Pensions Institute (PI) at Cass Business School

Pension funds of a similar size and sector "herd" in and out of asset classes at the same time, causing assets to depart from their fundamental values, the study said.

In *The market for lemmings: Is the investment behaviour of pension funds stabilising or destabilising?*, researchers gleaned this tendency after examining 108 corporate and 81 local authority pension funds between 1987 and 2012 - one third of the value of the UK pensions industry.

"We find that pension funds herd and, in particular, they herd in subgroups defined by size and sector type. Public sector funds follow other public sector funds of a similar size and large private sector funds do the same," said Bank of Italy economist Dr Gabriele Zinna, one of the report's authors.

Pension funds' practice of rebalancing portfolios to match liabilities rather than in response to expected risks and returns on assets is also endangering market stability.

Cass Business School economist Professor Lucio Sarno, another co-author, said: "The average pension fund's investment behaviour can be destabilising, since it does not respond to the release of new information.

"This mechanical rebalancing risks driving prices away from, rather than towards, equilibrium prices."

The report also tested claims - widespread in the industry - that the long-term nature of pension funds' liabilities and predictable cash outflows allow them to earn higher net investment returns by investing in illiquid securities when other investors face liquidity shortages.

But the researchers found no evidence of such a positive liquidity premium.

PI director Professor David Blake said: "The bottom line is that, although they are long-term investors, UK pension funds have not earned a positive long-run liquidity premium on their investments.

"This is because their behaviour is driven by different incentives," he explained. "Pension fund managers fear relative underperformance against their peer-group, which encourages them in the short-term to herd around the average fund manager, who turns out to be a closet index matcher."

Pension fund manager 'herding' threatens market stability – research, by Adam Cadle, Pension Age, 22/09/2014

Pension fund managers are threatening the stability of financial markets by "herding" in and out of asset classes at the same time, a study has shown.

Entitled *The market for lemmings: Is the investment behaviour of pension funds stabilising or destabilising?*, the study by the Pensions Institute at Cass Business School found that pension funds of a similar size and sector herd together in the short-term, potentially driving assets away from their fundamental values.

Market stability is also being put at risk as pension funds rebalance their portfolios to match liabilities rather than in response to changes in the expected risks and returns on the assets in their portfolios.

The short-term objective of pension fund managers is to automatically rebalance their portfolios when valuation changes violate short-term investment mandate restrictions, while their long-term objective is to systematically switch from equities to bonds as their liabilities mature.

"As a result, the average pension fund's investment behaviour can be destabilising, since it does not respond to the release of new information," Cass Business School professor Lucio Sarno said.

"This mechanical rebalancing risks driving prices away from, rather than towards, equilibrium prices."

The study also examined the liquidity premiums earned by pension funds over 25 years.

"The long-term nature of pension funds' liabilities and their predictable cash flows should allow them to earn higher net investment returns by investing in illiquid securities at times when other investors are facing liquidity shortages," it said.

However, the study found no evidence of a positive liquidity premium in the pension funds' total return in excess of the peer group return.

Cass Pensions Institute director Professor David Blake said "the bottom line is that, although they are long-term investors, UK pension funds have not earned a positive long-run liquidity premium on their investments.

"This is because their behaviour is driven by different incentives. Pension fund managers fear relative underperformance against their peer-group, which encourages them in the short-term to herd around the average fund manager, who turns out be a closet index matcher."

Cass Business School: Markets threatened by pension fund 'herding'

22 September 2014 2:42 pm | By [Tom Selby](#) | Money Marketing

<http://www.moneymarketing.co.uk/news-and-analysis/pensions/cass-business-school-markets-threatened-by-pension-fund-herding/2014506.article>

<http://www.fundweb.co.uk/news-and-analysis/pensions/cass-business-school-markets-threatened-by-pension-fund-herding/2014506.article>

Pension funds are threatening to destabilise financial markets by “herding” in and out of asset classes at the same time, new research warns.

A study by the Cass Business School, titled ‘The market for lemmings: Is the investment behaviour of pension funds stabilising or destabilising?’, concludes that market stability is being “put at risk” as pension funds alter their portfolios to match liabilities rather than in response to changes in expected risks and returns.

The study covered 108 corporate and 81 local authority pension funds between 1987 and 2012.

Cass Business School director Professor David Blake says: “The bottom line is that, although they are long-term investors, UK pension funds have not earned a positive long-run liquidity premium on their investments.

“This is because their behaviour is driven by different incentives. Pension fund managers fear relative underperformance against their peer-group, which encourages them in the short-term to herd around the average fund manager, who turns out be a closet index matcher.”

Retirement fund managers behave ‘like lemmings’, By Chris Flood, Financial Times, September 21, 2014

Pension fund managers are threatening to destabilise financial markets by behaving like a herd of lemmings.

Although long regarded as safety-conscious investors, pension funds tend to herd together as they move in and out of asset classes, threatening market stability, according to research by Cass Business School.

Market stability is also being put at risk as pension funds rebalance their portfolios to match liability shifts and not in response to changes in expected risks and asset returns, finds Cass.

“The average pension fund’s investment behaviour can be destabilising since it does not respond to the release of new information,” says Professor David Blake, director of the Pensions Institute at Cass Business School, part of City University London.

He adds that “mechanical rebalancing” by pension funds could prevent asset prices from reaching fundamental values.

The study examined the behaviour of 108 corporate and 81 local authority pension funds between 1987 and 2012, representing around one-third of the value of the UK pensions industry.

Regulatory changes had strongly influenced pension funds’ investment strategies, says Prof Blake, linking asset-allocation choices more closely with developments in a scheme’s liabilities. Pension fund trustees also relied heavily on advice from a narrow group of consultants and asset managers.

“This is likely to lead to trustees in different plans being given the same advice at the same time. This could, in turn, encourage herding behaviour,” cautions Prof Blake. “Public sector funds follow other public sector funds of a similar size and large private sector funds do the same.”

However, John Ralfe, an independent pensions consultant, says the move from equities into bonds for pension funds had been a gradual shift over the past 15 years and was “the right thing to do”.

But the report criticises UK pension funds for not taking advantage of their role as [long-term investors](#).

With predictable cash outflows, pension funds should be able to earn higher returns by exploiting market downturns and buying assets that other investors are forced to sell.

But the research finds that UK pension funds have failed to benefit from other investors’ liquidity shortages.

Several factors explain this, says Prof Blake. Pension fund managers fear underperforming against their peer group, which encourages them to copy the average manager who in turn was no better than a [closet indexer](#).

Restrictions on mandates forced rebalancing if asset weightings breached certain constraints, requiring managers to sell automatically rather than at a time of their choosing.

“The bottom line is that, although they are long-term investors, UK pension funds have not earned a positive long-run liquidity premium on their investments,” says Prof Blake.

Is Labour preparing to overturn George Osborne's pensions revolution?, By [Tom Selby](#), [Samuel Dale](#), Money Marketing, 18 September 2014

Insurers have held behind-closed-doors meetings about the political risk attached to Chancellor George Osborne’s pension revolution as fears grow Labour could reverse the policy if it wins power next May.

The Chancellor’s decision to hand savers aged 55 and over total freedom over how they spend their pension pot from April has been hailed by some as a political masterstroke.

The opposition, caught off guard by the surprise nature of the March announcement, has broadly welcomed the thrust of the reforms, which are likely to prove popular with voters.

However, senior figures within the Labour party are understood to have privately expressed reservations about the changes, describing them as “opportunistic and cynical” and warning they will “harm the weakest”.

Labour MP Tom Watson and John McTernan, the former political secretary to Tony Blair, have been vocal in their criticism of the reforms.

And with Professor David Blake – who is leading a Labour policy review into decumulation – claiming the big winners from the Budget will be the wealthiest in society, the future of pensions remains shrouded in uncertainty.

Political risk

Two senior industry sources have told Money Marketing discussions have taken place about whether the Chancellor’s reform package will endure under a future Labour government.

One says: “One of the issues being discussed by insurers is the risk that if Labour comes into power next year, they will look to overturn the Budget reforms.

“There are senior figures within the Labour party who believe the Chancellor’s announcement was opportunistic, cynical and will harm the weakest. There is concern among some providers about the cost of processes if Labour does decide to reverse the policy if it wins power.”

A second source confirms talks have been held within the industry about the political risks attached to the reforms ahead of the general election.

“Often insurers will do scenario planning on risks, and one of those is political risks,” the source says. “In Labour’s DNA they just do not agree with these reforms because their view is that pensions should equal income.

“Osborne has completely destroyed that settlement because no longer does a pension provide you with an income in later life. I can see Labour reintroducing the minimum income requirement at a level just above the state pension.

“These conversations are going on in the corridors. Privately lots of Labour MPs and peers are telling us they are uneasy about the Budget reforms.”

An ABI spokesman says: “The focus of the industry continues to be on ensuring implementation of the pension reforms within a challenging timetable to ensure customers are best placed to make the right decisions about their retirement options.

“Labour has pledged to continue with the reforms and this remains our working assumption, albeit that we do analyse different political scenarios.”

Backlash

When asked about its position on the pension reforms, Labour pointed to the “three tests” shadow work and pensions secretary Rachel Reeves laid out in the aftermath of the Budget.

These include ensuring people have independent support to maximize their retirement income; ensuring people on low to middle incomes can access good value pension products; and ensuring the reforms do not result in extra costs to the state.

However, McTernan describes the Budget as a “disaster” and urges Labour to vigorously fight the proposals. “Labour should oppose this disaster in every way shape or form they can,” he says.

“It’s what I’ve advised them to do and will continue to do so. They shouldn’t accept the Budget, they should oppose it in the House of Commons and commit to changing it when they come in.”

He adds: “All pension reform should be done through consultation and be bipartisan. This was a tacky, showy, politically partisan little trick in the Budget and if it is ever implemented it will unravel.”

Tom Watson, the Labour representative for West Bromwich East and an influential party figure, has branded Osborne’s pensions revolution a “tax bribe” and a “one-sided charter for tax avoidance”.

Writing on his blog after the Budget, he said: “The special deal between the state, the individual and the market will be eroded. Massive lump sums will be in the hands of individuals with all the everyday temptations and risk-taking that we all know so well.

“Labour, with its collective values and belief in mutualism, must oppose these proposals at all costs.”

Policy review

Dr Blake, professor of pension economics at Cass Business School, will play a major role in shaping future Labour policy.

He told Money Marketing: “The biggest beneficiaries [from the Budget changes] will be well off people like the Chancellor who are rich enough never to need an annuity. They can use the new flexibilities to both maximise the tax relief they get and minimise the subsequent tax they pay on the cash they withdraw. They can also plan to avoid tax on any death benefits.”

Blake says Osborne could have fixed decumulation problems in other ways but instead chose to target older voters. “This was a political decision a year before an election,” he says. “He could have also allowed annuities with more flexible payment terms much sooner - he has been Chancellor for four years.”

Guidance concerns

Other Labour MPs, such as Treasury select committee members Andy Love and Pat McFadden, have expressed concern over aspects of the reforms such as the guidance guarantee.

Love supports the idea of pensioners having greater access to their pots but wants to see reforms sensibly implemented. He says: “I do accept some of the concerns people have expressed about many potential retirees falling through the net. The guidance guarantee may not be enough if it doesn’t signpost where people can get more advice. There are genuine concerns because we want this to be a success with a wider choice. We don’t want savers taking a wrong and hasty choice.”

Practical problems

Scottish Widows head of pensions market development Ian Naismith says reversing the policy, or even introducing additional safeguards such as a minimum income requirement, would create a huge headache for the industry.

“Any change will present issues and taking a step backwards would be very complicated,” he says. “Change of any substance will be expensive for the industry in terms of IT adjustments although how much that will cost depends on what they decide to do. We are also in the process of developing the functionality to offer flexible drawdown in April next year, which again is a significant investment.”

Naismith also warns rowing back on the reforms will cause confusion for savers. He says: “We would need to change all our communications to customers yet again, which is not ideal. People would get very confused and the industry would have to provide extra support for both advisers and direct customers.”

MGM Advantage pensions technical director Andrew Tully adds: “The industry has had to cope with constant change over the last 10 years, so it would be more of the same for us.

“The result of that is huge costs and confusion for our members. We are well underway with development of new products, so to launch them and then be told a

month later things will be changing again would be very frustrating and very expensive.”

Electoral gamble

Despite concerns about the Budget reforms permeating Labour party thinking, none of the experts Money Marketing contacted expect proposals to reverse or amend the changes to feature in the party’s pre-election manifesto.

Tully says: “It would be a brave political move to take away flexibility just after people were given it. There would be many unhappy customers and voters if the Government opens Pandora’s box and then immediately looks to close it.”

Independent regulatory consultant Richard Hobbs agrees the chances of Labour pledging to overturn the Budget changes in their manifesto are “remote”.

He says: “The Labour party will fret that these freedoms for working class to lower middle class households will have a bad effect. So their instinct will be to protect these households.

“But there are other bits of the equation that go the other way, including the popularity of the reforms. So reinstating compulsory annuitisation, for example, will inevitably hinder Labour’s ability to get elected. The political calculus is against a reversal of Osborne’s reforms. But I suspect Labour has a real itch on this but will not scratch until they are in their second or third year of government.”

Whether a future Labour government will have either the stomach or the political capital to object to pension reforms that have been widely lauded remains open to debate. But with a general election now less than eight months away, the only certainty for savers appears to be perpetual uncertainty.

The alternative: What would Labour do differently on pensions?

Pot follows member: Labour would scrap the Government’s pot follows member scheme to stop the build up of multiple small pension funds when people change jobs. Instead it favours an aggregator model, where small pots are transferred to a central third-party scheme and then distributed.

Charge cap: The DWP is imposing a 0.75 per cent charge cap on all auto-enrolment schemes from next April. Labour says it would go further with a 0.5 per cent cap for schemes that wish to be eligible for transferring stranded pots.

Nest restrictions: Labour says it would lift the £4,600 annual contribution limit and ban on transfers immediately if elected next year. The Government is currently proposing to end them in 2017. Pensions minister Steve Webb says doing it sooner would spark a flurry of legal challenges from providers over EU state aid rules.

Pensions tax relief: All three major parties have tax relief under review with Labour expected to unveil proposals in its manifesto. Pensions minister Steve Webb has

proposed a new flat rate of less than 30 per cent while the Conservatives are considering changes to the taxation of savings too.

Adviser Views

Bloomsbury Private Wealth senior partner Jason Butler



I can't see Labour peeling back the thrust of the changes as they are too popular with voters. But the more uncertainty and drama there is the better it is for business as people need advice. I just feel sorry for people paying for advice.

Facts & Figures Financial Planning managing director Simon Webster



It would be extremely helpful if the Labour party clarified its position. Any changes could hurt people on small pots and would be not be helpful or constructive.

Expert view



Without consultation, the entire structure of the British pension settlement was torn up by the Chancellor. We saw the death of the pensions settlement. It was not perfect but it should have been built on and not blown up. Labour should oppose this disaster in every way. It is what I have advised them to do and will continue to do so.

They should not accept it, they should oppose it in the House and commit to changing it when they come in.

It is the death of private pensions, it is the death of occupational pensions in the medium term and the death of pensions in their totality. There is no justification for the preferential tax treatment of savings into pensions that can be accessed with the ease with which the Government is suggesting.

All pension reform should be done through consultation and be bipartisan. This was a tacky, showy, politically partisan little trick in the Budget and if it is ever implemented it will unravel. As far as I understand, the Labour position it is pretty straightforward: they thought there were problems with annuities but did not think the whole system had to be blown up, just reformed.

What has been killing returns on annuities is quantitative easing so the villain is the Bank of England. QE was required because the Government drove the country into a deeper and longer recession than was required so in the end it comes back to George Osborne.

John McTernan is the former political secretary to Tony Blair

A way to fix Australia's longevity problem, by Marion Williams, Financial Publications Australia, September 03, 2014

As the financial system inquiry (FSI) mulls how to make the superannuation system work for retirees and the absence of retirement income products, academics offshore may have the answer.

The FSI's interim report asked if government should increase its provision of longevity insurance as it considers ways to encourage innovation in retirement income products.

Commonwealth Bank of Australia (CBA) responded that most of Australia's retirement benefits are paid as income streams, albeit only 1.9 per cent of retirement benefits in the retail market are invested in lifetime annuities that provide longevity protection, citing independent researcher and consulting actuarial group Plan for Life.

CBA believes the private sector should retain responsibility for retirement income products. Public sector involvement in addressing longevity risk would only add to existing market and longevity risk on the government's balance sheet, crowd out the private sector and stifle product innovation.

Government involvement could result in poorer households with shorter life expectancy subsidising wealthier households that will likely live longer.

Furthermore, unlike the private sector, it may be harder for government to differentiate pricing based on factors such as gender, smoking status and medical history.

Transfer risk to capital markets

Academics in the UK however encourage government issuance of longevity bonds to establish reliable longevity indices and price points.

They regard this as an essential step to developing a transparent, liquid capital market in longevity risk with associated derivatives that would facilitate the transfer of that risk to the capital markets.

David Blake and Tom Boardman of the City University London's pensions institute and Andrew Cairns of Heriot-Watt University in Edinburgh, believe government-issued longevity bonds efficiently and fairly share longevity risk between generations.

By paying the government a longevity risk premium for the longevity bond, the current retired population pays future generations an insurance premium to hedge the nation's longevity risk.

The coupons payable on longevity bonds move as the percentage of people in a certain age group move. So the coupon payable 10 years after bonds were issued to 65-year old retirees will reflect the proportion that has survived to the age of 75.

Private sector lacks a hedge

Like Australia, the UK has a defined contribution (DC) pension system although there's an effective requirement to buy life annuities as part of UK DC plan provision.

DC plans have to work effectively if people are made responsible for their own pension savings but a growing weakness in DC schemes is the inability of annuity providers to hedge the systemic longevity risk. As DC schemes become the norm, more countries will face this problem.

The private sector can hedge specific longevity risk, namely that some people die before they're expected while others don't. What it can't hedge is trend longevity risk arising from medical advances or unanticipated changes in lifestyle.

This makes trend longevity risk a systemic risk that can't be diversified away by pooling. Like inflation, it requires an appropriate hedging instrument.

Furthermore, as demand for annuity-type products increases, there's a risk of unhealthy risk concentration in a few annuity providers. Critically, there's insufficient capital in the insurance and reinsurance industry to bear total global private sector longevity risk.

Private sector can't deal with credit and tail risk

They disagree that the private sector is best equipped to deal with longevity risk, partly because of the credit risk associated with private sector issuance of longevity bonds.

Governments have a natural interest in ensuring an efficient annuity market to limit their age pension liabilities and want efficient capital markets to transfer longevity risk and reduce concentration risk.

Over time government issuance of longevity bonds could be substantially reduced to just deferred tail longevity bonds.

These would hedge the tail risk that would otherwise result in prohibitive capital requirements for a risk without a close-matching asset.

The concept has support from bodies including the International Monetary Fund, World Economic Forum and Organisation for Economic Cooperation and Development.

Extend income drawdown, says Which? By Josephine Cumbo, Pensions Correspondent, *Financial Times*, July 11, 2014 6:52 pm

The government is being urged to develop ways for income drawdown to be made widely available through company pension schemes to reduce the risk of savers investing in unsuitable or expensive products.

In a report to be published next Monday, consumer group Which? argues that allowing workers not only to save for retirement in a company pension but to draw an income from that scheme could help them achieve a better deal in retirement.

Income drawdown is typically taken out by investors with larger pension pots. But the market is expected to become broader-based from April next year when new reforms. giving savers full freedom over how they take their pension, come into effect.

Debbie Harrison, visiting professor at The Pensions Institute and co-author of the Which? report, said: "The current market for drawdown is not ready for the tens of thousands of consumers who will now use some form of drawdown – not ready in terms of the regulated advice they will need to understand their complex choices and not ready in terms of low-cost, well-run drawdown arrangements.

"The report argues that the only rational solution to drawdown in the mass market is for auto-enrolment schemes to make this available. It is a natural extension of the new trust-based model developed to deliver defined contribution accumulation on a low-cost basis."

However, income drawdown providers argued that Which's vision was "fraught with risk".

Tom McPhail, head of pensions research at Hargreaves Lansdown, said: “There is a real risk that investors will be rolled over into inappropriate retirement income products and services.

“More often than not this is likely to be at the hands of the institution that has helped them to accumulate their retirement pot over the preceding years.”

The Which? report will also call on the Financial Conduct Authority to use its product intervention powers to prevent a “flood of unsuitable products” entering the market ahead of the reforms. It also recommends the government consider a “national clearing house” to help savers get a better annuity deal.

“Too many consumers have received a raw deal from annuities in the past,” said Richard Lloyd, Which? executive director.

“It is of paramount importance that the government, industry and regulators work together now to put in place a consumer-friendly system that builds on the benefits of auto-enrolment and ensures that people get a good deal throughout their retirement.”

OECD criticises UK pension reforms, By Chris Flood, FTfm, June 20, 2014

The OECD has criticised the UK government’s recently announced plans to end the obligation to buy an annuity at retirement.

Anyone aged 55 or over will be able to take their entire pensions savings pot as cash from next April instead of buying an annuity that would guarantee an income for life.

Pablo Antolin, chief economist and head of the OECD’s private pensions unit, said he was concerned the UK government’s proposals would lead to pensioners running out of money in old age.

“An annuity is the only instrument that provides complete protection in retirement and which safeguards individuals against the danger that they exhaust their savings before death,” he said.

Mr Antolin said the proposed UK reforms were driven by the high costs of buying an annuity, but he argued that savers were unlikely to achieve better incomes in retirement simply as a result of scrapping mandatory annuitisation.

Mr Antolin is expected to say at the Investment Innovation & the Global Future of Retirement conference in New York on Monday that partial annuitisation should be encouraged as an integral part of direct contribution retirement plans offered to savers across the OECD.

With investors likely to be faced with an environment of low yields and low investment returns for some time, the only way to ensure adequate income in retirement is for workers to save more for longer, said Mr Antolin.

He also criticised private pension providers for marketing annuities as investments, rather than insurance products.

“Buying fire insurance is not an investment. That is how an annuity needs to be looked at, as insurance against outliving one’s resources,” he said.

The OECD’s intervention echoes similar criticisms by the Pensions Institute, a UK research centre, which this week condemned the government’s plans as “reckless”.

A lifetime annuity was “an essential component” of a well-designed defined contribution pension plan, said Professor David Blake, director of the Pensions Institute.

He added “the chancellor [George Osborne] has forgotten the definition of a pension scheme, which is to provide retirement income for however long the member lives”.

Almost every professional investor fails to outperform the wider market over 10 years, academics find, By Richard Evans, Daily Telegraph, 17 June 2014

Ninety-nine per cent of fund managers fail to beat the stock market, according to a 10-year study by a respected academic body.

The study, by the Pensions Institute at Cass Business School, part of City University London, found that actively managed funds returned an average of 1.4pc less than the market each year between 1998 and 2008 once fees were taken into consideration.

The institute examined the monthly returns of 516 funds (unit trusts and Oeics) focused on British shares.

Professor David Blake, the director of the Pensions Institute, said: “Based on the findings, just 1pc of fund managers are ‘stars’ who are able to generate superior performance in excess of operating and trading costs. But they extract all of this for themselves via fees, leaving nothing for investors.

“A typical investor would be 1.4pc a year better off by switching to a low-cost passive UK equity tracker.”

“Tracker” funds, which automatically buy the holdings in a particular stock market index in order to mimic its performance, have become increasingly popular in recent years, partly because their charges are much lower than those on funds managed by professional stock pickers.

But the institute said active management remained “the dominant investment strategy” as investors put their faith in finding “star” fund managers.

It also released a second paper showing that large funds tended to underperform smaller ones.

“This is because funds which attract inflows scale up their existing investment, driving up asset prices and pushing down yields,” it said.

Professor Blake said the findings suggested that funds should consider splitting when they reach a critical size.

Pensions Institute warns on ‘reckless’ retirement reforms, By Judith Ugwumadu, The Actuary, 16 June 2014

The Pensions Institute has warned that the government’s ‘reckless’ pension reforms risk turning private sector defined contribution funds into a savings scheme that will not provide an income for life.

In a highly critical report, the institute today claimed that the March Budget, which removed the requirement to purchase an annuity, was likely to lead to thousands of retirees running out of money in their old age.

It called for the development of a decumulation product – where accumulated assets during an employee’s working life is used to fund their retirement income – to be integrated into auto-enrolment.

Pensions Institute director Professor David Blake said there was an urgent need to move away from retail decumulation products, such as individual drawdown and retail annuities, due to high costs and poor governance.

‘It is essential that the decumulation stage of a DC is institutionalised in the same way that auto-enrolment has institutionalised the accumulation stage, rescuing pension savers from the high charges and poor investment strategies of retail personal pensions,’ Blake stated in *The consequences of not having to buy an annuity* report.

‘In a similar way, economies of scale need to be exploited in the decumulation phase to enable good value drawdown products to be designed for the early stage of retirement and good value annuities to be designed for the later stage.’

The report went on to demonstrate the complexities involved in estimating life expectancy and highlighted that, across all age groups, individuals significantly underestimate their remaining years.

‘Without longevity insurance in later retirement the scenario is stark,’ Blake continued. ‘Even with the best planning, men will outlive their pension pot by five years and women by three.’

The report raised concerns that thousands of pensioners could end up ‘double dipping’, spending their pension savings quickly and falling back on state support. However, some individuals were likely to do the opposite and take excessive precautions by hoarding their pension savings, forfeiting a higher standard of living than they could have enjoyed.

In both cases, the report argues that annuities would help pensioners manage their spending better.

‘The chancellor has forgotten the definition of a pension scheme, which is to provide retirement income for however long the member lives,’ Blake added.

‘In his bid to offer freedom of choice, he fails to recognise the key risk associated with every pension scheme. The optimal running down of assets in retirement is

extremely complex. A minority of individuals might be able to manage some of these risks on their own, but this is a risky and high-cost strategy.

‘Importantly, the chancellor must understand that it is impossible for an individual to manage longevity risk, except in extreme cases of terminal illness.’

<http://www.theactuary.com/news/2014/06/pensions-institute-warns-on-reckless-retirement-reforms/#sthash.TvyIAJ3O.dpuf>

Reforms risk taking the 'pension' out of DC, Actuarial Post, 16 June 2014

The Pensions Institute at Cass Business School has warned the government that it risks turning private sector defined contribution pensions into a savings scheme that will not provide an income for life.

In a highly critical report, the research centre claims the “reckless” reforms could lead to thousands of retirees running out of money in their old age.

The white paper calls for the decumulation stage of defined contribution pension schemes to be “institutionalised” in the same way that auto-enrolment has institutionalised the accumulation stage and helped to provide good-value low-cost savings products.

*“The Chancellor has forgotten the definition of a pension scheme, which is to provide retirement income for however long the member lives,” said **Professor David Blake, Director of the Pensions Institute**. “In his bid to offer freedom of choice, he fails to recognise the key risks associated with every pension scheme. The optimal running down of assets in retirement is extremely complex. A minority of individuals might be able to manage some of these risks on their own, but this is a risky and high-cost strategy. Importantly, the Chancellor must understand that it is impossible for an individual to manage longevity risk, except in extreme cases of terminal illness.”*

The paper demonstrates the complexities involved in estimating life expectancy and shows that at in all age groups individuals significantly underestimate their remaining years. *“Without longevity insurance in later retirement the scenario is stark,”* Professor Blake said. *“Even with the best planning, men will outlive their pension pot by five years and women by three.”*

The report raises concerns that thousands of pensioners could end up “double dipping” – spending their pension savings quickly and falling back on state support. Some may actually do the opposite and take excessive precautions by hoarding their pension savings, thereby forfeiting a higher standard of living than they could have enjoyed. In both cases, annuities help pensioners manage their spending better. To avoid fallout from the reform, Prof Blake calls for the development of a “decumulation product” that can be integrated into auto enrolment. He said there was an urgent need to move away from retail decumulation products, such as individual drawdown and retail annuities, due to the high costs and poor governance.

“It is essential that the decumulation stage of a DC scheme is institutionalised in the same way that auto-enrolment has institutionalised the accumulation stage, rescuing pension savers from the high-charges and poor investment strategies of retail personal pensions. In a similar way, economies of scale need to be exploited in the decumulation phase to enable good value drawdown products to be designed for the early stage of retirement and good value annuities to be designed for the later stage.”

How would a new decumulation product that can be integrated into auto-enrolment look?

The interim findings of a research study being conducted at Pensions Institute by Professors Debbie Harrison and David Blake are that ‘scheme drawdown’ would:

- Benefit from institutional design, governance, and pricing
- Deliver a reasonably consistent income stream (i.e., with minimal fluctuations)
- Maintain the annuity-purchasing power of the fund
- Is simple to understand, transparent and low-cost
- Require minimal consumer engagement
- Benefit from a low-cost delivery system
- Offer the flexibility to purchase a lifetime annuity at any time (or at regular predetermined intervals) to hedge interest rate and longevity risk

<http://www.actuarialpost.co.uk/article/reforms-risk-taking-the-----039pension----039-out-of-dc-6359.htm>

Cass Business School warns Govt on ‘reckless’ pension reforms, By Tessa Norman, Money Marketing, 16 June 2014

The Government’s “reckless” pension reforms risk thousands of retirees running out of money in their old age as it is “impossible” for individuals to manage longevity risk, a report by Cass Business School warns.

In a paper published today, Cass Business School’s Pensions Institute director David Blake - who is leading a Labour pensions policy review - is calling for a decumulation product to be developed to avoid a fallout from the radical changes to pension taxation announced in the Budget.

Blake says: “In his bid to offer freedom of choice, the Chancellor fails to recognise the key risks associated with every pension scheme.

“The optimal running down of assets in retirement is extremely complex. A minority of individuals might be able to manage some of these risks on their own, but this is a risky and high-cost strategy.

“The Chancellor must understand that it is impossible for an individual to manage longevity risk, except in extreme cases of terminal illness.”

The report says individuals tend to significantly underestimate their life expectancy, with men outliving their pension pot by an average of five years and women by an average of three years.

Blake says there is a need to move away from retail decumulation products, such as individual drawdown and retail annuities.

He says: "It is essential that the decumulation stage of a defined contribution scheme is institutionalised in the same way that auto-enrolment has institutionalised the accumulation stage, rescuing pension savers from the high-charges and poor investment strategies of retail personal pensions.

"In a similar way, economies of scale need to be exploited in the decumulation phase to enable good value drawdown products to be designed for the early stage of retirement and good value annuities to be designed for the later stage."

<http://www.moneymarketing.co.uk/news-and-analysis/pensions/cass-business-school-warns-govt-on-reckless-pension-reforms/2011330.article>

Pensions Institute warns against leaving savers to go it alone, by Natasha Browne, Professional Pensions, 16 Jun 2014

The decumulation phase of defined contribution (DC) pensions should be institutionalised to prevent savers from splashing their pots, the Pensions Institute (PI) has said.

A report from the PI described George Osborne's Budget decision to abolish mandatory annuitisation or drawdown for DC members as "risky".

Professor David Blake said: "The Chancellor has forgotten the definition of a pension scheme, which is to provide retirement income for however long the member lives."

Blake warned that the majority of individuals would be unable to manage longevity risk, and that men would outlive their pension pots by five years and women by three.

"It is essential that the decumulation stage of a DC scheme is institutionalised in the same way that auto-enrolment has institutionalised the accumulation stage, rescuing pension savers from the high-charges and poor investment strategies of retail personal pensions," Blake said.

He added: "In a similar way, economies of scale need to be exploited in the decumulation phase to enable good value drawdown products to be designed for the early stage of retirement and good value annuities to be designed for the later stage."

The PI study argued that scheme drawdown products would deliver a consistent income, and benefit from institutional design, governance and pricing.

It also said it would maintain the annuity-purchasing power of the fund, while being transparent, low cost and easy to understand.

According to the PI, such products could also hedge interest rate and longevity risk by offering the flexibility to buy a lifetime annuity at any time.

The PI also criticised the Treasury and the Department for Work and Pensions (DWP) for taking opposing directions on private pensions, with the former opting for individualism and the later pushing collectivism.

Previous research from Hargreaves Lansdown found 58% of scheme members delayed buying an annuity in the wake of the Budget in March (*PP Online, 30 May*).

Drawing on evidence from the global pension system, the Pensions Policy Institute (PPI) said the ability for savers to take their pensions as cash would not necessarily lead to the end of annuities, however (*PP Online, 12 May*).

New research slams active management, are fee cuts the answer? From PA Analysis, Jun 17 2014, By Geoff Candy , News Editor , Portfolio Adviser

New research by the Pensions Institute at London's Cass Business School demonstrates that 99% of fund managers are unable to beat the benchmark and, of the 1% that do, luck cannot be ruled out as the reason.

According to research forthcoming in the Journal of Econometrics by David Blake, Tristan Caulfield, Christos Ioannidis and Ian Tonks, when 'time effects and the non-normality of fund returns' are considered, "there is no evidence that even the best performing fund managers can significantly out-perform the augmented benchmarks after fund management charges are taken into account."

The research, which uses two new methodologies to improve the inferences that can be made when evaluating fund performance also found that fund size has a significant negative impact on performance.

Looking at the monthly return data for 561 open-ended UK domestic equity funds between the period January 1998 to September 2008, sourced from Lipper, Morningstar and Defaqto, the researchers took account not only of the so-called 'panel nature' of the data set, but also the possibility of both time and fund effects on the nature of returns.

Apart from demonstrating that most managers are unable to beat the benchmark, Blake et al found that once fund size was accounted for "the average fund manager's alpha for both gross and net returns is insignificantly different from zero".

The researchers added: "This implies that if better qualified managers do manage the largest funds in the largest fund families – which is entirely plausible – they do not appear to deliver outperformance: in other words, the size of the fund overwhelms any superior skills they might have, as predicted by Berk and Green (2004)".

In plainer English, even the so-called 'star' fund managers are unable to beat the benchmark because the size of their funds works against them.

Taking this point even further, Blake et al wrote: "Since the most likely explanation for the negative relationship between fund size and performance is the negative

market impact effect from large funds attempting to trade in size (Keim and Madhavan, 1995), this suggests that funds should split themselves up when they get to a certain size in order to improve the return to investors.”

While the research and the methodologies are new, the findings are by no means ground breaking. That most active managers fail to beat the benchmark, is now widely accepted. That bigger funds tend to struggle to outperform is likewise fairly common knowledge.

What is perhaps more interesting is how this knowledge is slowly filtering down into the market place.

Speaking to the Financial Times, Blake was pessimistic that the market would change, despite people recognising that investors in the end seldom see a benefit. It is, indeed, unlikely that this research will see the demise of the active manager, no matter what the numbers show.

But, what you have already seen is that the market is no longer willing to pay as much for manager skill as it once was. And, while the data demonstrates that active managers do not always justify their fees, those fees have fallen a long way since 2008.

Head of financial planning at Hargreaves Lansdown, Danny Cox, agrees that the large majority of fund managers do not outperform the benchmark, but maintains there are some managers that have demonstrated over many years that they can outperform.

But, he added: “Costs in the active management space have come down much more than they have in the passive space, these days you can get an active fund for the same sort of fee passive funds were charging just a few months ago.”

Indeed, even the Neil Woodford, right now the starriest of star fund managers, whose new fund launches later this week has come to market at much lower rates than any would have imagined even a few years ago.

At the same time passive fund providers are being forced to drop their charges as well, especially if one can now get a manager like Woodford for .60% AMC.

The question now becomes, how much lower can the charges really go? And, importantly, will it be enough?

99% of equity mutual funds fail to outperform - research

Funds Europe - 16 June 2014

http://www.funds-europe.com/index.php?option=com_content&view=article&id=13942:99-of-equity-mutual-funds-fail-to-outperform-research&catid=121:latest-news&Itemid=414

Only 1% of fund managers are “stars” who are able to generate superior performance in excess of operating and trading costs, according to decade-long study of UK equity funds –

and even these talented individuals “extract all of this for themselves via fees, leaving nothing for investors”.

The Pensions Institute at Cass Business School, part of City University London, says 99% of all UK equity fund managers fail to deliver outperformance from stock selection or market timing.

Led by David Blake, director of the pensions institute, the researchers calculated that a typical investor would be almost 1.44% a year better off by switching to a low-cost passive UK equity tracker.

The researchers evaluated monthly returns of 516 UK domestic equity mutual funds between 1998 and 2008, and found that almost all active fund managers failed to outperform the market once fees were extracted from returns.

Nevertheless, active management remains the dominant investment and the researchers found evidence of a “star” fund manager culture.

Blake adds that large funds tend to underperform small ones because funds attracting inflows scale up their existing investment, which drives up asset prices and pushes down yields. He says funds should consider splitting when they reach a critical size.

The studies were conducted using bootstrapping, a statistical technique allowing the researchers to construct a distribution of returns, which a fund manager could achieve by luck alone.

Pensions Institute: ‘Almost all’ active managers fail to beat the market, By Jack Jones, Professional Pensions, 16 Jun 2014

Almost all active fund managers fail to outperform the market once fees are extracted from returns, according to research from the Pensions Institute (PI).

The Cass Business School department studied monthly returns of 516 UK domestic equity (open-ended) mutual funds between 1998 and 2008.

It found an annual post-fee alpha return of -1.44%, meaning a typical investor would be better off switching to a low-cost equity tracker.

The study found that just 1% were able to generate returns above operating and trading costs, but added that these managers “extract all of this for themselves via fees, leaving nothing for investors”.

The remaining 99% of equity mutual fund managers were unable to deliver outperformance from stock selection or market timing.

In a second paper based on the same data set, the Pensions Institute found that fund size had a strong negative effect on benchmark-adjusted performance.

The authors found that a 1% in funds under management led to a nine basis point drop in alpha each year.

It said this was because funds which attract inflows scaled up their existing investment, driving up asset prices and pushing down yields.

Pensions Institute director Professor David Blake said "The most likely explanation for the negative relationship between fund size and performance is the negative market impact of large funds attempting to trade in size," he said.

"This suggests that funds should split themselves up when they get to a certain size in order to improve returns for investors."

The studies were conducted using bootstrapping, a statistical technique allowing the researchers to construct a distribution of returns which a fund manager could achieve by luck alone.

Active management branded costly and futile, By Sophia Grene, FTfm, June 15, 2014

End investors usually do not see any benefit even from 'star' managers such as Warren Buffett

Most active fund managers cannot beat the market, while those that can simply pocket their added value in the form of fees, according to research from the Pensions Institute at London's Cass Business School.

The research found "a typical investor would be almost 1.44 per cent a year better off by switching to a low-cost passive UK equity tracker", according to Professor David Blake, director of the Pensions Institute. Although the analysis also found that one in a hundred managers appears to be a "star" who can beat the market, even taking operating and trading costs into account, the end investors do not see any of the benefit.

"It is always going to be like this," says Prof Blake. "There are enough of us willing to believe the new investment strategy is going to be the winner, that the smart-suited fund managers with their fancy haircuts can give us the extra return they promise."

Prof Blake, with colleagues Tristan Caulfield, Christos Ioannidis and Ian Tonks, have published two papers* using a particular statistical method known as bootstrapping to evaluate the performance of mutual funds.

The research replicates the findings of a number of other research projects, but Prof Blake is pessimistic about its chances of changing the situation, as active managers "do not accept it".

"They don't believe it, they come back with 'new strategies' that are old wine in new bottles – smart beta, systematic alpha, diversified growth," he says.

Prof Blake recognises that active managers have a role in identifying which companies are putting capital to most efficient use and allocating more capital to them, and so optimising aggregate growth, but believes managers reap all the rewards of that for themselves at the moment.

“The extra returns should accrue to the investor,” he says, adding that the current situation where fund managers extract rents from the market is unlikely to change.

Although passive investment has made huge headway in recent years with the growth of exchange traded funds (low-cost tracker funds with intraday liquidity), active management is still alive and well.

Over the past decade, ETF assets have experienced compound annual growth of about 27 per cent a year. At the end of May 2014, roughly \$2.5bn was held in these products. This is still less than a tenth of the asset management industry in total (estimated at \$33tn in 2012), but these products are growing at a much faster rate.

The research also found size has an impact on performance – bigger is not always better in the world of fund management. The reverse is true, in fact, as a 1 per cent increase in funds under management leads to a nine basis point drop in alpha per year, according to the analysis.

“Since the most likely explanation for the negative relationship between fund size and performance is the negative market impact effect from large funds attempting to trade in size, this suggests that funds should split themselves up when they get to a certain size in order to improve the return to investors,” says Prof Blake.

But not everyone has a problem with active management; none of the big investment consultants recommend switching entirely to passive, although they do advise caution in selection.

Stephen Miles, head of manager research at Towers Watson, says: “You cannot beat active management for delivering when it is done by a skilful manager whose mandate is aligned with the investor, notably on fees. We are not against high fees per se, as long as they are very well aligned and you get good value for money.”

The Pensions Institute research uses data from US and UK domestic equity mutual funds, two of the most liquid, and by implication most efficient, markets in the world. Many commentators are prepared to accept that active management can add little value in these markets, while maintaining the worth of using active managers in less easily accessible markets, where it may be possible to exploit either asymmetries of information or illiquidity.

*New evidence on mutual fund performance: a comparison of alternative bootstrap methods by David Blake, Tristan Caulfield, Christos Ioannidis and Ian Tonks

*Improved inference in the evaluation of mutual fund performance using panel bootstrap methods by David Blake, Tristan Caulfield, Christos Ioannidis and Ian Tonks

How fund managers spend your money, By Norma Cohen, Financial Times, June 6, 2014

In Turney Duff's account of his drug-addled and alcohol-soaked days picking shares for a hedge fund, recounted with great relish in *The Buy Side*, a broker pitching for trade asks Mr Duff what he can do to get more of his business.

"Well, you can start by taking me to Vegas," he responds. So they do. Not just Las Vegas, but Florida too. They charter private jets and attend sporting events where the thrill of the match is amplified by cocaine and parties where sex is on call.

Why are brokers falling over themselves to offer such expensive inducements to Mr Duff? The answer is simple: each block of shares the hedge fund buys or sells carries a commission. That commission does not come out of Mr Duff's pocket, nor does it come out of the pocket of his employer. Ultimately, it comes out of your pocket.

Amid all the debate about what investors should be told about fees, transaction costs are the elephant in the room. They are not part of the two most commonly-used cost disclosures, the annual management charge (AMC) or the total expense ratio (TER, sometimes also known as the ongoing charges figure or OCF). But by some estimates, they may account for as much as a third of what leaks from investors' portfolios in fees and costs.

"There's a lot of evidence that about 30 per cent of the cost of running a pension fund is lost through trading and other costs," said Richard Balarkas, who runs an independent consultancy that analyses market structure and execution services. "Transaction costs are the murky, murky part of the industry."

Of course, those buying investment funds do "see" transaction costs, in the form of a lower investment return than they might have otherwise had. But because this is rarely spelt out clearly, most investors – even professionals running large corporate pension schemes – are in the dark about it.

A 2013 survey of fund managers by actuaries Lane, Clark & Peacock, whose clients are large UK pension schemes, found that only a third of fund managers disclose transaction fees. LCP noted that managers of funds of hedge funds were particularly unwilling to disclose these extra costs. "It seems that such providers would rather keep investors in the dark about the true cost incurred to manage assets."

What are transaction costs?

Even defining what constitutes transaction costs can be a challenge, but experts broadly divide these into two categories: explicit and implicit costs. Among the explicit costs are things such as stamp duty, exchange fees and brokerage commissions. Some explicit fees, such as charges for custody (holding investments in ringfenced accounts, to protect investors in the event of the provider getting into financial difficulty) and legal and audit services, are included in the TER.

Brokerage fees, which provided the fuel for Mr Duff's hard partying, are easy to define but far from easy to measure. That's partly because their cost does not just reflect the price of buying and selling shares or bonds, but a whole range of other things, such as research or preferential access to corporate clients.

And brokerage commissions are only part of trading costs. "It's not talked about much, but implicit costs can be much more significant than explicit costs," said Yossi Brandes, head of European analytics research at ITG, a company that specialises in measuring them.

Brokers act as introducers for new companies coming to the stock market. A fund manager who puts a lot of business their way is more likely to secure a large tranche of new stock in an IPO. A 2008 study by academics at Babson College and the Universities of Georgia and Missouri found clear evidence that fund managers engage in "churning" – unnecessary stock trading – to gain a leg up on broker allocations of initial public offerings.

Implementation shortfalls

Implicit costs are not only harder to see and measure, but also harder to define. Broadly, the implicit cost is the gap between the price of a security – shares, bonds, traded funds – at the time the investment decision to buy or sell is made and the price change over the course of fulfilling an order. For securities in foreign currencies, it also includes the difference between the rate at which that currency is bought and sold.

One of the trickiest issues is "implementation shortfall". Typically, as an order is executed, other market participants will adjust the price at which they are offering that security to reflect either the rising demand as shares are bought or falling demand as they are sold. There is often a time lag between the point at which a manager decides to buy or sell a share and the time the transaction is complete. That price change is called the implementation shortfall and is almost impossible to measure accurately.

"If you are a large institution and you need to buy a stock, it will drive the price up," Mr Brandes said, adding that such moves can be long-lasting. In that case, investment returns are lower than they might be otherwise.

In trying to understand some of these hidden costs, some broad rules of thumb apply. For example, fund managers buying less liquid securities will see a bigger adverse price movement when they trade than they might when buying more widely traded shares, and securities purchased in less liquid currencies will also prove more expensive than those denominated in, say, US dollars.

Another rule of thumb is that fund managers who buy and sell shares within a portfolio frequently will lose more of their investment returns to frictional trading costs than a manager who trades infrequently.

So-called “portfolio turnover” can vary widely between funds. It can be very low at long-only equity funds, but tends to be higher for bond funds, which must continuously replace maturing holdings.

But size matters, too. “Portfolio turnover matters less for big funds that can negotiate lower transaction costs,” says Hugues Gillibert, chief executive of Fitz Partners, a consultancy. He says a big fund with high turnover but low transaction charges could cost investors less overall than a small fund with low turnover.

But portfolio turnover is one reason investors in “passive” funds that track an index are far less likely to be adversely affected by hidden charges than those investing in actively managed portfolios.

Actuarial consultants Hymans Robertson recently sought to quantify the difference in cost between managing various investments in index trackers versus having them actively managed. Its report prompted the Department of Communities and Local Government to urge switching almost half the £178bn Local Government Pension Fund into index trackers.

Even for the highly liquid UK market, the cost differential is huge. The scheme has roughly equal sums of about £25bn invested in trackers and active management. But total fees on the actively managed portion are nearly four times those on the passive portfolios, and there is no evidence that their returns are any better. One factor eating into returns of the actively managed funds are the hidden transaction costs.

Regulators shine a light

Regulators and the industry are moving to require that some of these hidden costs be shown to investors. The main driver for that is the fact that, increasingly, households will have to rely on their own investment decisions for their retirement income. It is becoming more important to ensure that as much as possible of each pound invested is working for the saver.

“We have a huge, looming pensions crisis in Europe and this is an effort to address a problem that is spiralling out of control,” said Rebecca Healey, senior research analyst at Tabb Group, a consulting firm specialising in trading market analysis.

The second part of the EU’s markets in financial instruments directive (Mifid) will require fund managers to spell out some of these soft costs. “The information on all costs and associated charges must include information relating to both investment and ancillary services, including the cost of advice, where relevant . . .” the directive states. It will be implemented from the fourth quarter of 2016.

Investors can be heartened by the fact that regulators are moving towards illuminating the darker corners of the market, and curtailing the apocryphal golf days and Test match tickets. But for those paying unseen costs today, those moves may still seem rather too slow.

The price of research

Many fund management groups market themselves on the depth of their in-house research, the cost of which is incorporated in their charges. But investment banks also employ analysts to produce research for distribution to clients. This is paid for indirectly via trading commissions.

The Financial Conduct Authority estimates that funds spent £1.5bn a year on external research and £500m on preferential access to senior company managers. Both costs are met through brokerage commissions.

Many experts feel the cost of external research – while legitimate – should be borne by the fund manager and incorporated into the TER, rather than paid for indirectly via opaque commissions.

The regulator agrees; in November 2013, it announced a crackdown on “cash for access” in particular.

A separate report in December 2013 suggested that much of the research that investment bank analysts produce is not even read by fund managers.

A common standard on disclosure

How much information should be disclosed to investors, and in what format, has become a hot issue for the funds industry.

The Investment Management Association, which represents open-ended fund providers in the UK, says it is “absolutely” in favour of better disclosure.

“We have huge sympathy with someone who wants to know how much of the money that they invest is actually put to work,” says Guy Sears, director of risk, compliance and legal affairs. The difficulty is agreeing a uniform method for measuring and disclosing costs that is comparable across the market. “We’re interested in making sure that the disclosure is uniform and there is clarity on methodology.”

Campaigners such as Alan and Gina Miller, who initiated the True & Fair Campaign, say that only a single all-encompassing figure in pounds and pence will do, while the City regulator has urged managers to use the same figure across all marketing literature.

The IMA has committed to provide a standard framework for implicit costs, which would result in a “pounds and pence” figure, but its critics argue that the proposals do not go far enough and that details of the all-in cost will only appear in a fund’s annual report – a document most investors don’t bother to read.

While fund management groups may protest that it is too difficult to provide costs data to consumers in a consistent format, that does not mean they are not measuring it themselves.

Mr Sears says a very large number of providers are using some form of transaction cost analysis software which constantly monitors the cost of trading for internal purposes. But he adds that there is no standardised methodology across clients or vendors for what is measured and how.

“There is a risk of ‘apples to oranges’ problems if comparing asset manager A with B.”

Many in the funds industry argue that transaction costs of fractions of a per cent are very minor, and that what really matters is performance net of fees. But across an industry where average performance is barely any better than what could be delivered by an index tracker, costs matter – especially over the long term.

A recent report by the Pensions Institute noted that up to 85 per cent of investing costs may be hidden.

And advocates of better disclosure are unmoved. “The question to ask the manager of your fund is ‘What would the investment return have been at the end of the year if you did not trade a single share?’” Mr Balarkas says.

He recalls a regulator posing just that question to a room full of fund managers – and being greeted with silence.

The UK's political consensus on pensions is alive and well, By Mark Cobley, Financial News, 30 May 2014

Rachel Reeves, the shadow work and pensions minister, set out some interesting ideas for what a Labour government would do with pensions policy yesterday. But the striking thing is just how little they would really change.

The proposal that made headlines yesterday was Reeves' pledge to automatically enrol an additional 1.5 million low-paid workers into company pension plans, in addition to the 10 million already either signed up or due to join in the next four years.

Cue protestations from the Confederation of British Industry about extra costs being loaded on business - but this is reasonable reform. It just isn't that radical.

In proposing it, Labour are going back to the original ideas of the Pensions Commission chaired in 2003-4 by Adair Turner -- now Lord Turner -- the former Financial Services Authority chairman.

In practical terms, it's do-able. Many of these 1.5 million people will likely be employed by large companies, who have already built HR, admin and payroll systems to cope with 10 million new pension savers. They can take in a few extra.

But by the same token, the reform isn't one to set the pensions industry's hearts a-flutter either. The total new money set to flow into funds from these 1.5 million low earners is just £14 million a year, according to government figures, quoted by Labour. That is very small beer compared to the annual £1.4 billion extra that auto-enrolment is already set to bring in to pension funds.

Thinking about the same figures from the individual's perspective, for the lowest paid this means annual pension contributions of just a few pounds. Sure, they get tax relief on that, despite paying very little tax in the first place, and sure, their boss pays in - but when the amounts are so small will anyone thank Labour for this?

Ros Altmann, the independent pensions expert, says extending auto-enrolment in this way "could fulfill an important social need", but she also points out that allowing these people to use their pension savings to pay off debts first might be more productive.

In her speech yesterday, Reeves also attacked her political opponents in the Coalition for "unpicking" the political consensus that has existed in pensions policy in the UK over the past few years.

This is something of a red herring. As we approach the 10th anniversary of the Turner Commission's report in October 2004, it's remarkable how much of it still underpins what government is doing.

The differences between the parties on pensions policy are ones of degree and emphasis, rather than philosophy. Labour might cut a little more from tax relief, or screw the fee-cap lid down from 0.75% of pension assets to 0.5%, as Reeves threatened yesterday. Then again, neither of these are firm pledges as yet.

The reforms announced by George Osborne in his Budget in March, overhauling the tax code so that savers are no longer incentivised to buy annuities, were truly radical, and unexpected. But amid much cautious language yesterday, Reeves did not say she planned to undo any of that.

Her choice of David Blake, professor of pensions economics at Cass Business School, to lead a taskforce looking at policy options for the post-retirement market will be well-received. Especially as she's also made clear this review group will have CBI representation.

A by-now familiar call to lift commercial restrictions on Nest, the government's not-for-profit pensions provider, is something the industry has been preparing itself for. And Reeves' advocacy of collective defined-contribution pensions (where individuals join a collective fund), as practised in the Netherlands, may yet be gazumped by proposals on the related defined-ambition agenda from Coalition pensions minister Steve Webb next month.

Business-people in other sectors, such as energy, may feel that Labour leader Ed Miliband deserves his 'Red Ed' tabloid tag. But the pensions industry won't be overly worried by anything Reeves had to say yesterday.

Cass paper calls for 'full disclosure' of costs, Global Investor Magazine, 28 May 2014

Pensions Institute says ongoing charges figure does not go far enough to reveal all hidden fees of active asset management

Asset managers should be made to reveal the full costs of active fund management to help investors see the total drag on their returns, according to a report *On the Disclosure of the Costs of Investment Management* by the Pensions Institute at Cass Business School.

The paper cites research that suggests that up to 85% of a fund's total transaction costs can consist of concealed costs. These are made up of cash costs such as bid-ask spreads, transaction costs in underlying funds and non-cash costs associated with the active management of an investor's portfolio.

The visible costs, which make up the remaining 15%, include commissions, taxes and custodial costs.

"No good reasons have been put forward for why all the costs of investment management should not be fully disclosed. They are after all genuine costs borne by the investors," said director of the Pension's Institute and author of the paper, Professor David Blake.

"The size of these indirect costs depends on the asset classes involved and the extent to which the client's assets are actively managed, but they could be material, even when investments are passively managed."

The paper rejects the ongoing charges figure (OCF) that has been supported by the Investment Management Association (IMA) and says even with the new information, the OCF will incorporate, further hidden costs will remain unreported. These include the indirect transaction costs for which investors pay via lower-net returns.

Instead Blake argues that all costs should ultimately be disclosed in the form of a rate of cost, which could be deducted from the gross rate of return to give a net rate of return, and as a monetary amount, which could be compared with the monetary value of the investor's portfolio. This would include estimates for non-cash costs that stem from market impact, information leakage, market exposure, missed trade opportunity and delay, once investment management firms have the right IT systems in place.

The paper calls for further work to require disclosure of non-cash costs. It also recommends that the UK government should announce the investigation of non-cash costs within a set period and that proposed solutions be subject to a cost-benefit analysis at the end of that period.

The IMA has defended the OCF as a "forward thinking" alternative to the annual management charge (AMC) and that it is only the first step in a four-stage process to tackle transparency within the industry.

The second stage will be disclosure of pounds and pence per unit, the third will look further at how to account for indirect costs and create a consistent standard across the industry and the fourth is ongoing review of disclosure codes.

Daniel Godfrey, CEO of IMA said that these three stages will all be based on historic accountability, in other words looking backwards to explain costs incurred.

"The IMA has already implemented a programme to improve transparency, working with both government and regulators. While our work focuses on investment funds, it could be transposed to the pensions environment," he said.

Report: No justification for lack of full disclosure on investment fees, By Taha Lokhandwala, Investments and Pensions Europe, 28 May 2014

Asset managers hide more than four-fifths of costs, with no reasonable justification given for why full disclosure is not being provided, a think tank has claimed.

Research published by The Pensions Institute, part of the Cass Business School in London, found that visible costs from asset managers only account for 18% of the total cost borne by investors.

The remaining hidden costs include the bid/ask spread, transaction costs, undisclosed revenue and other market-implied costs during transactions.

The Institute said that, even where asset managers aimed to increase cost disclosure, there remained hidden costs, and that full-disclosure was paramount.

"These are the indirect transaction costs for which investors pay via lower net returns," the report said.

It said all good investment managers should have an estimate of the size for cash-costs relating to the efficiency of the investment management, such as commissions, taxes, bid/ask spread costs, transaction costs and undisclosed revenue.

The Institute did accept that non-cash costs, still borne by the investor through lower returns, would be more difficult. These costs include market impact, information leakage, market exposure and missed trade opportunities.

However, it did argue specialist advisers could obtain this information for investment managers, allowing them to disclose the impact to investors.

With regards to the cash-costs, managers argued the IT systems required to provide full disclosure would be expensive to implement.

But the Institute rejected this point.

For non-cash costs, it suggested configuring fund manager systems to generate similar information as can currently be provided, or periodic audits by consultants.

David Blake, author of the study and director at The Pensions Institute, said: “I would argue the principle of full transparency is paramount. Further, there is little point in requiring transparency where the reported measure for ‘costs’ does not include all of the costs, or, in the short term, as many as could currently be reported on a cost-effective basis.”

He added: “No good reasons have been put forward for why all the costs of investment management, both visible and hidden, should not ultimately be fully disclosed. They are, after all, genuine costs borne by the investor.”

The Investment Management Association (IMA), a lobby group for fund managers, argued it had already set out plans to increase transparency, including replacing the annual management charge and having a more basic charge structure.

Daniel Godfrey, chief executive of the IMA, said: “The third stage is to look further at how to account for indirect costs, and also to reach a consistent basis for the calculation and disclosure of portfolio turnover rates so clients can better understand the relevant investment processes.”

However, the True & Fair Campaign, which champions fee transparency, hit back at the IMA and said these were excuses for delay.

Co-founder of the campaign, Gina Miller, said: “This research proves the latest attempt to disclose all costs by the IMA, whilst dulcet in tone, is a pure farce.

“The IMA must act immediately to stop the abuse of people’s hard earned money and must interrogate and audit existing proposals and bring in total fee transparency by the end of this year.”

The report also argued that costs, which are provided to clients, may not be as simple as they look, such as declared commission on the purchase of assets.

“Investment managers often get ‘free’ services in exchange for this commission, such as broker research, market data or corporate access (to company managers),” the report said.

“But these ‘free’ services are actually paid for by the client. Investment managers frequently aggregate different clients’ trades to get the best price.

“The aggregated trades will go through a particular broker, which means some of these clients will be indirectly paying for research from which they get no benefit.”

More light, please, by Neil Collins, Financial Times, May 31, 2014

David Blake at the Pensions Institute reckons that the disclosed fees on pooled funds can be as little as 15 per cent of the true cost to the investors. He is pressing for better, if not full, disclosure of the real amounts that punters pay to have their money managed by others.

This is a thoroughly laudable aim, and the Retail Distribution Review has already forced reductions in management fees, but claiming that 85 per cent of the true cost remains hidden requires some heroic assumptions about the return on spare cash, the bigger spread on large trades and the rate of churn in the portfolio.

The RDR has turned the spotlight on to a dark, and highly lucrative, corner of the City, while the Financial Conduct Authority's push for fuller disclosure continues. The true rewards enjoyed by those managing other people's money, often for mediocre performance, are only starting to become apparent, and as they do, more individual investors are likely to decide that they can (mis)manage their own affairs just as well, and save themselves the fees.

Labour backs coalition plans for 'collective pensions', By Jim Pickard and Josephine Cumbo, Financial Times, May 29, 2014

Labour has thrown its weight behind coalition plans for "collective pensions" which could increase pensioners' income by up to 30 per cent.

Rachel Reeves, the shadow work and pensions secretary, announced a new task force on pensions, chaired by Professor David Blake, director of the Pensions Institute. The review will look at "boosting savers' retirement income" with a mandate to examine how to replicate the collective pension schemes that are operated in Canada and the Netherlands.

The move comes as Steve Webb, the Liberal Democrat pensions minister, has drawn up his own plans for pooled pension schemes, with legislation widely expected in the imminent Queen's Speech.

The attraction for savers is that a large, pooled fund should have substantially lower charges because of economies of scale. It could also put money into higher-yielding long-term assets such as infrastructure.

The plans have received a mixed response from the industry, however, and a paper by the Department for Work and Pensions in 2009 cast doubt on the benefits.

Ms Reeves said too many people lost retirement savings through poor-value schemes. "We need to do much more to boost the value of those savings. In the Netherlands and Canada, new forms of collective pensions have increased the value of pension pots by up to 30 per cent," she said.

She told the Financial Times that the idea was popular with both employers and employees. Acknowledging that the government was already examining it, she said: "We are still waiting for the results of that consultation."

David Pitt-Watson, a finance expert at the London Business School and an advocate for pooled funds, said these schemes would have a "better outcome" than individual saving. "They aren't perfect, they do have issues, but they have been seriously successful in Holland for 70 years."

Michael Johnson, a pensions expert from the Centre for Policy Studies think-tank, said that in Australia the number of workplace schemes had shrunk from 700 to 210 since 2004. "They are heading to 10 or 20, and I wish we could do the same here," he said.

Mr Johnson said that pooled funds were not risk-free, but it was better to hedge risks as a collective than an individual. He added: "This may be the least worst option."

Ms Reeves also announced that Labour would like to lower the threshold for pensions auto-enrolment to bring another 1.5m people into the system.

However, her plan to cut the eligibility from £10,000 to £5,772 prompted warnings from business groups that it would add costs and red tape to companies, without any great benefit for many workers.

Up to 85 per cent of fund charges are hidden, by Rebecca Jones, Money Observer, May 27, 2014

A white paper published by Cass Business School's Pensions Institute has revealed that up to 85 per cent of indirect fund costs are hidden from investors and calls on asset managers to disclose the full cost of active management.

According to the author of the paper, director of The Pension's Institute Professor David Blake, indirect fund charges fall into three categories: visible cash costs, hidden cash costs and hidden non cash costs.

Visible cash costs include commissions, taxes and management fees and account for 18 per cent of total costs. Hidden cash and non-cash costs include transaction fees like the bid-ask spread that a broker charges a manager to buy and sell a security as well as more complex costs including those associated with not executing a transaction at the best possible price.

According to Blake, these hidden costs account for an average 82 per cent of the total cost of owning an investment fund. As such, he claims that these costs should be disclosed to investors.

'No good reasons have been put forward for why all the costs of investment management should not be fully disclosed. They are after all genuine costs borne by the investors,' he says.

Commenting on the Financial Conduct Authority's (FCA's) recent paper on fees and charges, which was backed and endorsed by the Investment Management Association (IMA), Blake says that the Ongoing Charges Figure (OCF) that the two bodies recommend fund managers use in place of the Annual Management Charge (AMC) does not go far enough in revealing hidden costs.

'The FCA recommended the use of the OCF which, in addition to the investment manager's fee, includes recurrent operational costs, such as keeping a register of investors, calculating the value of the fund's units or shares, and asset custody costs.

'Unfortunately, even with the new information reported, there will remain costs that are hidden. These are the indirect transaction costs for which investors pay via lower net returns and could be material,' he says.

Responding to the report, Daniel Godfrey, chief executive of the IMA says: 'The IMA has already implemented a programme to improve transparency, working with both Government and regulators.

'The initial stage was our voluntary guidance published in 2012 which included a recommendation that IMA members should use the OCF rather than the AMC. This is forward looking, uses a standardised methodology and provides the best indicator of the charges a consumer will pay for the fund. We would encourage the entire market, including the media, to refer to the OCF.'

However, Gina Miller, co-founder of the True & Fair Campaign which lobbies for transparency of fund charges, argues: 'This research proves that the latest attempt to disclose all costs by the IMA, whilst dulcet in tone, is a pure farce at the consumers' expense. Contrary to the hyperbole emanating from Mr Godfrey, the proposed new accounting standard for fund costs excludes 85 per cent of transaction costs, all initial charges, all exit charges, all adviser charges, all wrapper charges and all platform charge,' she says.

As an alternative and solution to the OCF, Blake suggests a staggered approach could be taken in the lead up to the full disclosure of all transaction costs.

In the initial stage, fund managers should be required to report all visible cash costs involving commissions, taxes, fees, custodial charges and acquisitions costs, together with the hidden cash costs of bid-ask spreads, transaction costs and undisclosed revenue.

'All these indirect costs relate to the efficiency of the investment management process and all good investment managers should have an estimate of their size,' says Blake.

In the final stage, once fund houses have the right reporting systems in place, managers should be required to reveal the more complex hidden non-cash charges such as the costs incurred from price movements in the market following block sales of securities.

Blake does admit that the disclosure of the hidden non-cash costs would be more challenging to calculate, however he adds that it is not impossible and there are already a number of consultancies that specialise in advising investment managers on the efficiency of their investment, including Novarca, a Swiss-based consultancy.

As an immediate measure he calls on fund managers to publish their portfolio turnover rate - a percentage that expresses how much buying and selling a manager has done in any 12 month period - as the extent of the transaction costs are 'highly correlated' with the number of transactions.

Unlike in the US, UK fund managers are not required to publish their portfolio turnover rate. The IMA previously recommended that managers publish this rate,

however this has been removed from the draft IMA Statement of Recommended Practice (SORP) 'Financial Statements of Authorised Funds'.

Fund Costs Explained:

Visible cash costs

- Commissions
- Taxes
- Fees
- Custodial charges
- Acquisition costs

Hidden cash costs

- Bid-ask spread - of the hidden costs, the simplest to understand is the bid-ask spread that a dealer or market maker charges to buy and sell a security or an investment bank charges for, say, a currency hedge. The total spread costs incurred during the year will be related to the annual portfolio turnover.
- Transactions costs in underlying funds - if the investment manager buys funds on behalf of the investor, the transaction costs incurred by these funds are not reported even to investment managers, but are still paid by the investor in terms of a lower return.
- Undisclosed revenue - the investment manager might also benefit from undisclosed revenue, such as retained interest on underlying cash balances or retained profits from stock lending.

Hidden non-cash costs

- Market impact - refers to the reaction of the market price to a large transaction, such as a block sale of securities. The market price will fall in the process of selling the securities and the average execution price will be below the pre-sale price. If the investment manager attempts to execute a large transaction in smaller batches - e.g., by advertising trades to attract buyers or seeking indicators of interest - this will lead to information leakage and will have broadly the same effect as market impact.
- Market exposure - refers to the fact that an investor is exposed to what is happening in the market during the period that the transaction is taking place. Suppose the investment manager is planning to buy securities for a client. The client is exposed to the risk that the market price rises before the transaction is executed.
- Missed trade opportunity or market timing costs are the costs associated with not executing a transaction at the best possible price. Finally, there are delay costs associated with waiting for transactions to complete (e.g., holding the purchase price in a zero-interest account). Some of these non-cash costs can be hedged against - e.g., those relating to adverse market movements - but the cost of the hedge then becomes an explicit measure of the hidden cost.

New paper urges full transparency from fund managers, by Stephen Durham, Asset Servicing Times, London | 27 May 2014

The Pensions Institute at Cass Business School has called for asset managers to reveal the full costs of their fund management business.

Investor returns are being damaged by hidden costs that are at least as big as the visible costs in actively managed funds, according to a report by the institute.

Research cited in the paper suggests that concealed costs, such as bid-ask spreads and transaction costs in underlying funds, can make up to 85 percent of a fund's total transaction costs. The remainder is taken up by visible costs such as commissions, taxes and fees.

A staggered approach could be taken in the lead up to the full disclosure of all transaction costs, according to the paper.

Director of the Pensions Institute, Professor David Blake, said: "No good reasons have been put forward for why all the costs of investment management should not be fully disclosed. They are after all genuine costs borne by the investors."

"There is little point in requiring transparency where the reported measure for 'costs' does not include all of the costs, or in the short-term, as many costs as could currently be reported on an efficient basis."

Costs could be reported in the form of a 'rate of cost', which could be deducted from the gross rate of return to give a net rate of return, and as a monetary amount, which could be compared with the monetary value of the investor's portfolio.

The paper concludes that, in the initial stage, investment managers should be required to report all visible cash costs involving commissions, taxes, fees, custodial charges and acquisitions costs, together with the hidden cash costs of bid ask spreads, transaction costs underlying funds and undisclosed revenue.

"All these indirect costs relate to the efficiency of the investment management process and all good investment managers should have an estimate of their size," said Blake.

IMA hits back at claims it allows costs to remain hidden, By Emma Ann Hughes, FT Adviser, May 27, 2014

The Pensions Institute publishes a white paper calling for asset managers to disclose all visible and hidden costs that are ultimately borne by investors.

New fund charge requirements set to be brought in by the Investment Management Association will not "cover every penny spent by a fund", the Pensions Institute at Cass Business School said in a white paper published today (27 May).

The institute's paper comes despite the Financial Reporting Council accepting the IMA's proposal to report not only the ongoing charges figure, but also all the dealing costs and stamp duty paid when an investment manager buys and sells assets in the fund's portfolio.

Yet today (27 May) the Pensions Institute has hit back at the IMA's assertions that charges will be made clear under these new requirements and claims even with new information reporting rules "there will remain costs that are hidden".

But Daniel Godfrey, chief executive of the IMA, said the recommendation for his organisation's members to use the OCF rather than the annual management charge was only the first stage of improving transparency.

He said the OCF was "forward looking, uses a standardised methodology and provides the best indicator of the charges a consumer will pay for the fund."

Mr Godfrey said: "We would encourage the entire market, including the media, to refer to the OCF.

"The second stage has been the pounds and pence per unit disclosure of all costs paid by a fund, including all direct transaction costs, in the context of performance.

"The third stage is to look further at how to account for indirect costs, and also to reach a consistent basis for the calculation and disclosure of portfolio turnover rates so that clients can better understand the relevant investment processes.

"The fourth stage is an ongoing review of existing disclosure codes to ensure that specific, costed disclosure is made to clients of the split in dealing commissions between execution and research.

"These three stages are all based on historic accountability (ie. looking backwards to explain costs incurred)."

This follows a FCA review into fund management charges, published earlier this month, which found that the majority of firms in the industry are still not communicating charges clearly enough to investors.

The FCA reviewed 11 asset management firms from a variety of backgrounds, such as independent asset managers, banks and insurers.

It found that many firms were still using the annual management charge in marketing material, using different charges in different documents and making it difficult for investors to understand the full costs and compare those costs with other funds.

Research cited in the Pensions Institute paper suggests that concealed costs - such as bid-ask spreads and transaction costs in underlying funds - can make up to 85 per cent of a fund's total transaction costs.

The remainder is taken up by visible costs such as commissions, taxes and fees.

Professor David Blake, director of the Pension's Institute, said: "No good reasons have been put forward for why all the costs of investment management should not be fully disclosed. They are after all genuine costs borne by the investors.

“There is little point in requiring transparency where the reported measure for ‘costs’ does not include all of the costs, or in the short-term, as many costs as could currently be reported on an efficient basis.

“If total investment costs are not ultimately disclosed in full, how can there ever be an effective and meaningful cap on charges, and how can active investment managers ever assess their true value added?”

Costs could be reported in the form of a ‘rate of cost,’ the reports claims.

The ‘rate of cost’ could be deducted from the gross rate of return to give a net rate of return - and as a monetary amount, which could be compared with the monetary value of the investor’s portfolio.

The paper suggests a staggered approach could be taken in the lead up to the full disclosure of all transaction costs.

In the initial stage, the institute argues investment managers should be required to report all visible cash costs involving commissions, taxes, fees, custodial charges and acquisitions costs, together with the hidden cash costs of bid ask spreads, transaction costs underlying funds and undisclosed revenue.

Pensions Institute calls for full disclosure of ‘hidden’ active investment management costs, By Matt Ritchie, Pensions Age, 27/05/2014

The Pensions Institute at Cass Business School has called for active asset managers to disclose all “visible and hidden” costs ultimately borne by investors, citing research showing up to 85 per cent of a fund’s total transaction costs can be concealed.

The research centre argues in a white paper that visible and hidden cash costs could be relatively straightforward to disclose, while hidden non-cash costs could be more challenging to calculate.

A staggered approach to revealing all costs is therefore suggested, with the indirect, non-cash costs to be disclosed once IT systems capable of capturing the data are put in place.

Director of the Pensions Institute and author of the white paper David Blake said no good reasons have been put forward for why all the costs of investment management should not be fully disclosed.

“There is little point in requiring transparency where the reported measure for ‘costs’ does not include all of the costs, or in the short-term, as many costs as could currently be reported on an efficient basis,” Blake said.

“If total investment costs are not ultimately disclosed in full, how can there ever be an effective and meaningful cap on charges, and how can active investment managers ever assess their true value added?”

Last week Local Government Minister Brandon Lewis argued active management is not delivering value for money for local government schemes, and they could save up to £790m a year in fees by using passive strategies.

The Pensions Institute's white paper divides costs into visible explicit costs, and hidden implicit costs. Quoted research from the Plexus Group identified commissions, taxes, fees, custodial charges, and acquisition costs as explicit costs accounting for 15 to 20 per cent of overall charges.

Implicit costs such as bid-ask spread, transaction costs in underlying funds, undisclosed revenue, market impact, information leakage, market exposure, market timing costs, and delay costs could account for 80 to 85 per cent of costs, the research found.

The report states that initially investment managers should be required to report all explicit costs.

Blake said the government should announce implicit costs will be investigated within a set period with proposed solutions subject to a resulting cost-benefit analysis.

Investment Management Association chief executive Daniel Godfrey said the IMA has already worked with government and regulators to implement a programme to improve transparency. While the work focuses on investment funds, he said, it could be transposed to the pensions environment.

Voluntary guidance published in 2012 comprised the first stage of the programme, recommending IMA members use the Ongoing Charges Figure rather than the Annual Management Charge.

“This is forward-looking, uses a standardised methodology and provides the best indicator of the charges a consumer will pay for the fund. We would encourage the entire market, including the media, to refer to the OCF,” Godfrey said.

Further work has focused on pounds and pence per unit disclosure of all costs paid by a fund, including all direct transaction costs, in the context of performance.

“The third stage is to look further at how to account for indirect costs, and also to reach a consistent basis for the calculation and disclosure of portfolio turnover rates so that clients can better understand the relevant investment processes. The fourth stage is an ongoing review of existing disclosure codes to ensure that specific, costed disclosure is made to clients of the split in dealing commissions between execution and research. These three stages are all based on historic accountability,” Godfrey said.

Pensions Institute attacks 'still hidden' fund manager charges, Corporate Adviser, 27 May 2014

<http://www.corporate-adviser.com/news-and-analysis/latest-news/pensions-institute-attacks-still-hidden-fund-manager-charges/2010635.article>

Concealed costs can make up to 85 per cent of a fund's total transaction costs, according to a paper published today by the Pensions Institute at Cass Business School.

The Pensions Institute has published a white paper calling on asset managers to reveal the full costs of active fund management to help investors see the full drag on their returns. It says the Financial Reporting Council and Investment Management Association's moves to offer greater transparency around charges fall short of giving a complete picture of charges levied on consumers.

The paper cites research that suggests concealed costs - such as bid-ask spreads and transaction costs in underlying funds - can make up to 85 per cent of a fund's total transaction costs. The remainder is taken up by visible costs such as commissions, taxes and fees.

The Pensions Institute says costs could be reported in the form of a 'rate of cost' - which could be deducted from the gross rate of return to give a net rate of return - and as a monetary amount, which could be compared with the monetary value of the investor's portfolio.

The paper suggests a staggered approach could be taken in the lead up to the full disclosure of all transaction costs. It proposes that initially investment managers should be required to report all visible cash costs involving commissions, taxes, fees, custodial charges and acquisitions costs, together with the hidden cash costs of bid ask spreads, transaction costs underlying funds and undisclosed revenue.

Once investment management firms have the right IT systems in place, non-cash costs should also be reported comprising of market impact, information leakage, market exposure, market timing costs and delay costs, says the Pensions Institute.

On 13 May 2014, the Financial Conduct Authority criticised the investment management industry for not reporting charges to investors sufficiently clearly. In particular, it criticised the annual management charge (AMC) as failing 'to provide investors with a clear, combined figure for charges'. Instead, it recommended the use of an ongoing charges figure (OCF) which, in addition to the investment manager's fee, includes recurrent operational costs, such as keeping a register of investors, calculating the value of the fund's units or shares, and asset custody costs.

The OFC measures costs that an investment manager would pay in the absence of any purchases or sales of assets and if asset markets remained static during the year.

The next day, on 14 May, the Financial Reporting Council accepted the Investment Management Association's (IMA) proposal to report not only the OFC, but also all the dealing costs and stamp duty paid when an investment manager buys and sells assets in the fund's portfolio.

The Pensions Institute says even with the new information reported, there will remain costs that are hidden.

Pensions Institute director Professor David Blake says: “No good reasons have been put forward for why all the costs of investment management should not be fully disclosed. They are after all genuine costs borne by the investors.

“There is little point in requiring transparency where the reported measure for ‘costs’ does not include all of the costs, or in the short-term, as many costs as could currently be reported on an efficient basis.

“If total investment costs are not ultimately disclosed in full, how can there ever be an effective and meaningful cap on charges, and how can active investment managers ever assess their true value added?

“All these indirect costs relate to the efficiency of the investment management process and all good investment managers should have an estimate of their size,” said Professor Blake.

“The hidden non-cash costs would be more challenging to calculate, since they involve the analysis of information that might not necessarily be automatically captured by the investment manager’s own systems. Nevertheless, the issue is whether fund manager systems could be configured to generate similar information on a cost-effective basis.”

IMA chief executive Daniel Godfrey says: “The IMA has already implemented a programme to improve transparency, working with both Government and regulators. While our work focuses on investment funds, it could be transposed to the pensions environment.

“The initial stage was our voluntary guidance published in 2012 which included a recommendation that IMA members should use the Ongoing Charges Figure (OCF) rather than the Annual Management Charge (AMC). This is forward looking, uses a standardised methodology and provides the best indicator of the charges a consumer will pay for the fund. We would encourage the entire market, including the media, to refer to the OCF.

“The second stage has been the pounds and pence per unit disclosure of all costs paid by a fund, including all direct transaction costs, in the context of performance. The third stage is to look further at how to account for indirect costs, and also to reach a consistent basis for the calculation and disclosure of portfolio turnover rates so that clients can better understand the relevant investment processes. The fourth stage is an ongoing review of existing disclosure codes to ensure that specific, costed disclosure is made to clients of the split in dealing commissions between execution and research. These three stages are all based on historic accountability, that is, looking backwards to explain costs incurred.”

Hidden cash costs

- **Bid-ask spread** – of the hidden costs, the simplest to understand is the bid-ask spread that a dealer or market maker charges to buy and sell a security or an investment bank charges for, say, a currency hedge. The total spread costs incurred during the year will be related to the annual portfolio turnover.

- **Transactions costs in underlying funds** – if the investment manager buys funds on behalf of the investor, the transaction costs incurred by these funds are not reported even to investment managers, but are still paid by the investor in terms of a lower return.
- **Undisclosed revenue** - the investment manager might also benefit from undisclosed revenue, such as retained interest on underlying cash balances or retained profits from stock lending.

Hidden non-cash costs

- **Market impact** - refers to the reaction of the market price to a large transaction, such as a block sale of securities. The market price will fall in the process of selling the securities and the average execution price will be below the pre-sale price. If the investment manager attempts to execute a large transaction in smaller batches – e.g., by advertising trades to attract buyers or seeking indicators of interest – this will lead to information leakage and will have broadly the same effect as market impact.
- **Market exposure** - refers to the fact that an investor is exposed to what is happening in the market during the period that the transaction is taking place. Suppose the investment manager is planning to buy securities for a client. The client is exposed to the risk that the market price rises before the transaction is executed.
- **Missed trade opportunity** or **market timing costs** are the costs associated with not executing a transaction at the best possible price. Finally, there are delay costs associated with waiting for transactions to complete (e.g., holding the purchase price in a zero-interest account). Some of these non-cash costs can be hedged against – e.g., those relating to adverse market movements – but the cost of the hedge then becomes an explicit measure of the hidden cost.

Pressure grows on fund managers over fee disclosure, By Josephine Cumbo, Pensions Correspondent, Financial Times, May 24, 2014

Asset managers are coming under further pressure to reveal their full fees after a new study suggested that up to 85 per cent of fund management charges are hidden from investors.

A new report from the Pensions Institute, the London-based research centre at Cass Business School, said that investors were only seeing 15 per cent of a fund's total transaction costs.

While commissions, taxes and fees were visible to investors, research cited in the report said concealed costs such as bid-ask spreads and transaction costs in underlying funds could make up to 85 per cent of a fund's total expenses.

“No good reasons have been put forward for why all the costs of investment management should not be fully disclosed, as they are, after all, genuine costs borne by investors,” said Professor David Blake, director of the Pensions Institute.

“If total investment costs are not ultimately disclosed in full, how can there ever be an effective and meaningful cap on [workplace pension] charges?”

The report suggests that asset managers could take a phased approach towards full disclosure of all transaction costs.

“In the initial stage, investment managers should be required to report all visible cash costs involving commissions, taxes, fees, custodial charges and acquisition costs, together with the hidden cash costs of the bid-ask spread, transaction costs on underlying funds and undisclosed revenue,” said Prof Blake.

“All these indirect costs relate to the efficiency of the investment management process and all good investment managers should have an estimate of their size.”

The research follows a recent review by the Financial Conduct Authority which found some fund managers were not providing investors with a clear, combined figure for charges in their marketing materials.

Seven of the 11 companies reviewed by the FCA used the annual management charge (AMC) as the headline cost figure on marketing material.

Following the review, the regulator said it would “continue to work” with the Investment Management Association (IMA), which has produced a voluntary industry guidance on enhanced disclosure of charges and costs.

The True & Fair Campaign, which has been campaigning for greater transparency in fund charges, welcomed the Pensions Institute’s report and said it should spur the regulator to take tougher action.

“The research highlights one new fact which the IMA has always ignored – that the bid-ask spread and transaction costs in underlying funds can make up to 85 per cent of a fund’s total transaction costs,” said Gina Miller, co-founder of the True & Fair Campaign.

“Maybe someone at the FCA [Financial Conduct Authority] and Financial Reporting Council should wake up to this basic fact as they are just about to approve a shoddy fund disclosure which will exclude both elements from the aggregated cost.”

The IMA said that it did not agree with the suggestion that 85 per cent of costs were hidden, but added that it was working to improve charge disclosure.

In 2012 the body issued voluntary guidance for its members to use an ongoing charges figure (OCF) rather than the AMC, on the basis that the OCF provides a common standard for “all the known” costs and charges that a fund would bear.

“The IMA has already implemented a programme to improve transparency, working with both government and regulators,” said Daniel Godfrey, chief executive of the IMA.

“While our work focuses on investment funds, it could be transposed to the pensions environment.”

Median value of annuity pots, By Josephine Cumbo, Financial Times, January 31, 2014

Definition of 'average' annuity makes a material difference

The insurance industry has been accused of “playing clever” with figures to inflate the value of annuities achieved by most savers.

As the debate grows over whether annuities are good value, the Association of British Insurers (ABI) has been challenged over the use of a measure to describe the “average” fund used to buy an annuity at retirement. The figure is significant as larger pension funds enjoy better rates and more choice.

Recent annuity sales data from the ABI suggested that the average pension pot was £33,455 in 2012. But analysis of annuity sales data for 2012 by the Pensions Institute, a London-based research centre, says most sales were at below half this figure.

“A fairer reflection of the typical pot used to buy annuity is the median value, not the mean or ‘average’ which takes into account the distortions caused by the very small number of high-value annuities purchased,” says Professor David Blake, Director of the Pensions Institute at Cass Business School.

“The median value is closer to £15,000. The use of the mean is masking the reality that most people don’t have anywhere near the average often quoted by the industry.” According to the Pension Institute’s analysis, three-quarters of sales were for sums below the mean.

Prof Blake argued that the ABI and its members should use the more realistic median figure – which represents the point at which half of all sales were made – when framing public discussion about value from annuities. The benchmark pot size used currently for the ABI’s “annuity window” or snapshot of rates offered by providers, is £32,000.

“The industry is playing clever with figures,” added Prof Blake. “The number of insurers offering competitive quotes is lower the smaller the size of your fund, so using quotes at the median, rather than the mean, would give a fairer reflection of value for money for most people.”

Annuity brokers said pension savers with funds of less than £20,000 are “more adversely affected by poor rates”.

“For those savers with less than £5,000 there is effectively no open market for standard rate annuities and these savers are therefore stuck with taking an annuity through their existing provider and receive even lower rates,” said James Auty, a director of the Annuity Bureau.

The ABI conceded that the mean figure used “can fail to be a fair representation of ‘average’.” However, it added: “We provide average figures to illustrate the point that people are not saving enough for retirement and, contrary to Prof Blake’s assertion, point out both the mean and median averages.

“In the case for annuity purchase price data there are a small number of large pots purchased each year, which place an upward bias on the mean pot size.” The association added that industry commentators “usually choose to use the mean, using our aggregate annuity sales data”.

The ABI said it would support any reforms designed to ensure that people with small pots did not annuitise in a way that would be disadvantageous to them.

DC pension market value to expand six-fold to £1.7trn by 2030, by Natasha Browne, IFAonline, 16 Jan 2014 | 16:13



The defined contribution (DC) pensions market will rocket to six times its 2012 value of £276bn assets under management (AUM) by 2030, according to the Pensions Institute (PI).

In its latest report the institute said the DC market would be worth £1.7tn within the next 16 years.

Report author and visiting professor at the PI at Cass Business School Debbie Harrison (*pictured*) said: "The stakes are high and the battle to secure market share between now and 2018 is going to be bloody."

"The government and regulator must ensure that in a market where competition is weak, due to lack of expertise of smaller employers, then the schemes that emerge as victors do so because they offer genuine member value for money."

The report said the auto-enrolment (AE) market would be dominated by about five or six multi-employer schemes over the coming years, despite there being an estimated 50 or more currently active in the market.

As such, the question remains over what would happen to members in these periphery schemes if they went bust, as well as the impact it could have on overall industry confidence.

In December, the Pensions Regulator (TPR) and the Institute of Chartered Accountants of England and Wales (ICAEW) published a draft assurance framework to help ensure high standards in master trusts.

Under the framework, it is expected that master trusts should obtain independent assurance annually.

TPR also proposed to develop a separate regulatory framework which recognises the "inherent complexities" within the master trust sector.

However, the PI report called for a clear and consistent regulatory regime across contract and trust-based schemes to avoid "regulatory arbitrage" making a "mockery" of the private sector pension system.

It also called for DC contract law to be relaxed, allowing members in contract-based arrangements to be easily moved into schemes that would deliver better value.

The People's Pension head of policy Darren Philp said: "We need wholesale regulatory reform if we are to get people saving into decent pensions.

"The PI isn't the first organisation to call for a single regulator for workplace pensions, and the weight of support behind this idea means that the government needs to give it serious consideration. Scheme quality and innovation should first and foremost be built on a strong regulatory footing."

Now Pensions chief executive Morten Nilsson welcomed the report as it highlighted a range of factors that impact on value for money.

He said: "At the moment, very few schemes have all the characteristics of a value for money scheme. This needs to be urgently addressed otherwise the long term success of AE could be seriously undermined."

Contract law, regulatory changes recommended to ensure value for money from DC pensions, By Matt Ritchie, Pensions Age, 16/01/2014

A new report has urged changes to contract law and the regulatory structure for pensions, to ensure members get value for money from defined contribution default funds.

The Pensions Institute report estimates the DC market will grow more than six-fold by 2030, when assets under management are expected to reach around £1.7trn.

Fierce competition to capture this new business will see just five or six large multi-employer schemes in the market by 2020, the report said, with the risk that rapid consolidation among providers could lead to market instability and the sale of pension books to uncompetitive consolidators.

Modelling in the report indicated pensions secured by the best funds are 55 per cent higher than the worst over a 40-year working life. Charges were a major factor, with each percentage point increase in the member charge leading to a fall in the expected pension at retirement of about 20 per cent.

Accordingly, the report recommended a change to contract law to facilitate the mass migration of member assets from old high-charge schemes to new low-charge schemes, ensuring member value for money for the remainder of the accumulation period.

Visiting professor at the Pensions Institute at Cass Business School Dr Debbie Harrison said the battle to secure market share between now and 2018 is going to be

“bloody”.

“The government and regulators must ensure that in a market where competition is weak, due to the lack of expertise of smaller employers, that the schemes that emerge as victors do so because they offer genuine member value for money. Otherwise there is a danger that deep pockets, predatory pricing and conflicts of interest might become the hallmark of the dominant auto-enrolment schemes,” Harrison said.

VfM: Assessing value for money in defined contribution default funds recommends reforming the current dual system of regulation, where The Pensions Regulator oversees trust based schemes and the Financial Conduct Authority regulates contract based arrangements. Announcing the report's release, the Pensions Institute warned that without regulatory reform regulatory arbitrage would “make a mockery” of the new pension system for the private sector.

Other recommendations included full disclosure of costs extracted by default funds and schemes, both through reporting to governance boards and regulators and on a central website so they can be subject to independent public scrutiny.

The report recommended defining value for money, taking into account the optimal combination of scheme cost and design over both the accumulation and decumulation periods.

Defining member outcomes in terms of income replacement ratios was recommended, as measuring outcomes in terms of fund size does not take account of annuity-conversion risks.

The People's Pension head of policy Darren Philp said the report is not the first to call for a single pensions regulator, and the market needs a regulatory framework that “protects members, drives up standards, and ensures the market works effectively”.

“We would like to see an OFPEN that brings together those involved in regulating workplace pensions and ensures that the market is working effectively and in the interest of savers. Delivering value for money requires transparency. We need an approach that allows employers and employees to be able to compare easily what different schemes cost,” Philp said.

NOW: Pensions trustee director Chris Daykin said if the report's recommendations are followed scheme members can have greater confidence that their pension will deliver a retirement income that is fair value relative to the contributions paid.

“The consequences of ignoring these warnings will be many disappointed pensioners and an ageing population which simply cannot afford to retire.”

DOD's blog: Are DC default funds value for money?, By Debi O'Donovan, Employee Benefits, 17 January 2014

Yesterday the highly insightful team from the Pensions Institute at Cass Business School delivered its latest report: *Assessing value for money in defined contribution default funds*.

I doubt it will top too many bestseller lists, but if everyone who has ever saved for a pension were to read it, it could incite them to rise up and demand better value for money.

Collectively we, as pensions savers and pensioners, who use defined contribution (DC) pension plans are losing hundreds, if not thousands or even tens of thousands, of pounds due to the way DC default investment funds are priced and sold.

This is going to get worse given that the value for the defined contribution (DC) pensions market is predicted to grow more than six-fold by 2030, from £276 billion assets under management pre-auto-enrolment (2012) to about £1.7 trillion.

It makes me want to wake the sleeping nation and tell them of this horrendous state of affairs. But my fear is that the only message they will hear is ‘pensions are bad’ – which is the complete opposite of what I want. ‘Your pension could be better’ is the message we really want them to hear.

So what is the problem?

Short of reproducing the report (see attached: Assessing value for money in defined contribution default funds), I will restrict myself to one narrow area of findings that caught my eye.

The report points out that pensions providers prioritise their services directly opposite to the old saying ‘He who pays the piper calls the tune’. In pension provider world corporate advisers are top of the pile (because they advise the product to employers). Second comes the employer, which acts as the unregulated agent to the provider.

Bottom of the pile is the employee pension plan member who ultimately pays for the service and has no say over either the piper nor the tune.

This might not matter if everyone was getting good value for their pensions spend. But, as the report, found there is a big gap between those getting a decent deal and those getting a bad deal – all down to the ongoing costs associated with being in a pension.

When the Pensions Institute measured a range of real life pension plans saving an 8% contribution over a 40 year period, it found that the default fund with highest mean replace rate of 23.8% (i.e. ratio of pension paid compared to salary paid in final year of employment) was 55% higher than that with the lowest mean replacement rate (at 15.3%).

The report stated:

- This was largely due to charge differences
- As a guide, each percentage point increase in the total expense ratio (TER) leads to a fall in the expected replacement ratio at retirement of about 20%.

The other finding on the analysis of these real life pension plans that caught my eye was that “While ‘cheapest’ is not synonymous with ‘best’, there is no evidence that

higher charges can ‘buy’ more sophisticated investment strategies that deliver superior performance. Default funds with low charges were consistently among the better performers, while default funds with high charges were consistently among the worst performers.”

The problem is, too often, we do not even know what these charges are for. Even the researchers for this report battled to get full information – so what hope for employers trying to implement good governance and the even poorer employee?

So one of the recommendations of the report is for all plans to have a clear definition of costs and charges, reported in full. All costs extracted by the default fund and the scheme should be reported in full to scheme governance boards and to regulators “so that component parts of the member charge, as well as the total, can be evaluated in relation to member value for money.”

It also recommended that full disclosure data should be published on a central website for independent public scrutiny, because, as Debbie Harrison, visiting professor at the Pensions Institute at Cass Business School, who presented the findings pointed out: Most members will not look at these charges nor understand them. But there are people who will, who can defend consumers.

I whole heartedly endorse this.

Debi O’Donovan
Editor
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Friday Focus: The charge cap and DC value for money, by PLANSPONSOREurope Staff , 17 Jan, 2014

Speculation abounds this morning over when a charge cap will be introduced by Government with reports claiming it may not even occur until after the dissolving of Parliament ahead of next year’s General Election.

In the debate around a charge cap amongst the wailing and gnashing of teeth from the pensions industry emerged the very real concern about whether a cap could actually be to the detriment of, rather than benefiting, DC scheme savers.

A report published this week by the Pensions Institute, has aimed to shed light on this. But what does value for members actually mean? Will a charge cap necessarily result in poor value for scheme members? What level should a cap come in at? How should charges be communicated to members? And how should members transfer out of poorly performing schemes into high performing schemes for better outcomes?

While reports circulating have claimed a charge cap may not happen until the next Parliament, the Department for Work & Pensions has today refused to rule out a charge cap in the on-going legislation.

At the end of November, as the consultation process began, such leading lights in the industry such as Malcolm McLean at Barnett Waddingham warned a cap on charges could stifle innovation with investments. It seems the view from the industry has been a cap should be introduced but not at the expense of members attaining value for money. But what is value for money anyway?

For Dr Debbie Harrison, author of the Pensions Institute's new report into value for money for DC scheme member value for money is inextricably linked with income replacement ratios.

At an event launching the report this week she said: "A good outcome is defined as the income replacement ratio of pension in the first year of retirement and final salary before retirement."

So what difference would more sophisticated investments make to employees achieving their desired income replacement ratio?

Well according to Dr David Blake, co-report author and professor of pension economics at Cass Business School, not much of a difference.

He said: "While cheapest is not synonymous with best there is no evidence that higher charges can buy more sophisticated investment strategies that deliver superior performance – at least on the basis of the schemes surveyed."

But Blake warns charges do have a very real effect on member outcomes. He added: "Each percentage point increase in charges leads to a fall in the expected replacement ratio of about 20% so each 1% point increase in charges reduces the pension by 20%."

So what level should the cap be set at? Well the Pensions Institute calls for a cap on DC schemes' total expense ratios of just 0.5%.

But Harrison warns the introduction of a cap would be pointless if there is not full disclosure on charges.

She adds: "All the costs extracted by the default fund and the scheme should be reported in full to the scheme governance board and to the regulators so that each component parts of the member charge as well as the total can be evaluated in relation to member value for money.

"We're not talking about cheapest but we want to know that what members pay is bringing them benefits.

"We recommend there should be full disclosure on this data published on a website so that it is available for independent public scrutiny. There are not a lot of people and certainly I would not include most employers in that group who will be able to thoroughly analyse this data but there are people who can."

But is a cap on charges the only route to members gaining value for money? Not according to Chris Daykin, trustee director at NOW: Pensions, who says Government

need to make it easier for people with legacy schemes to transfer into more cost effective arrangements.

He said: “We think the market should be much more facilitating the possibility of people to have their funds moved to the more cost effective place both in terms of charges and in terms of good governance and availability of good default funds and good glide path arrangements as they get closer to retirement.

“This is something which the report flags up. It is a need for regulatory change in order to facilitate for contract based pensions can be moved en block to a more effective home and I think that the regulators need to be aware of the importance of giving a new home to people who are stranded in orphan funds which are not coming up to quality standards.”

But such a move brings with it another debate on charges, says Darren Philp, head of policy at B&CE.

He said: “We need to drive down the cost of transfers. The average cost of transfers is something like £50. It needs to be pence. We need to look at the legislation.”

It seems while a cap is inevitable, albeit delayed, how it is introduced will be the most critical issue in terms of true value for money in DC pensions for members.

DC pensions members may not be getting best value, By Robert Crawford, Employee Benefits, 17 January 2014 |



The value of the defined contribution (DC) pensions market is expected to grow to £1.7 trillion by 2030 from £276 billion assets under management pre-auto-enrolment in 2012, according to a report by the Pensions Institute.

But its *Assessing value for money in defined contribution default funds* report found that members of DC schemes are losing thousands of pounds due to the way DC default investment funds are priced and sold.

It also found there was no link between the cost of membership and member outcomes, with higher charges not linked to potential outperformance of a pension scheme.

According to the Pensions Institute, providers are cherry-picking only profitable sections of a workforce, which scuppers many smaller employers’ plans to use an existing scheme provider for auto-enrolment.

The report made a number of recommendations that included:

- Defining member value for money, to deliver scheme cost and design, sustainable over both the accumulation and decumulation periods.
- Defining the members' target outcome.
- To require all costs and charges to be reported in full.
- A revision to DC contract law.
- A reform to regulation that requires a clear and consistent legal and regulatory regime across both contract and trust-based schemes.

Dr Debbie Harrison (pictured), visiting professor at the Pensions Institute at Cass Business School, said: "The stakes are high and the battle to secure market share between now and 2018 is going to be bloody.

"The government and regulators must ensure that in a market where competition is weak, due to the lack of expertise of smaller employers, that the schemes that emerge as victors do so because they offer genuine member value for money.

"Otherwise there is a danger that deep pockets, predatory pricing and conflicts of interest might become the hallmark of the dominant auto-enrolment schemes."

Chris Daykin, trustee director at Now: Pensions, added: "If the report's recommendations are followed, scheme members can have greater confidence that their pension will deliver a lifetime income in retirement that is fair value relative to the contributions paid.

"The consequences of ignoring these warnings will be many disappointed pensioners and an ageing population which simply cannot afford to retire."