Transaction cost disclosure in workplace pensions

This briefing note provides background information for ABI members on the FCA rules on transaction cost disclosure in workplace pensions, which took effect on 3rd January 2018. The ABI strongly supports the disclosure of costs and charges, and view this as essential for maintaining trust in automatic enrolment and long-term savings more broadly.

The ABI has been working closely with the Investment Association (IA) on this issue, as the new rules place regulatory obligations on both providers and asset managers, and will require a coordinated approach between providers and asset managers. The IA has produced its own Q&A document which addresses some asset management specific questions and is available on the IA's website.

Background to the new regulations

On 6 April 2015 rules came into force imposing a duty on the governance bodies of DC workplace pension schemes (IGCs or trustees) to request and report on the level of charges and transaction costs, to inform their value for money assessments. Since this date, providers have supported governance bodies by providing transaction cost information, where available, whilst awaiting rules specifying the items for disclosure as well as the calculation methodology from the FCA.

On 20 September 2017 the FCA published PS17/20, which confirms the final rules and methodology for calculating and disclosing transaction costs. As of 3 January 2018, regulated firms (predominately asset managers) will be obliged to provide transaction cost data following a request from a relevant pension scheme operator. This information needs to be provided within a reasonable time, in a reasonably acceptable format and with appropriate contextual information.

Transaction cost data provision

In line with the proposals set out in CP16/30, the FCA has opted to use 'slippage cost' as the primary measure of transaction costs. Slippage cost seeks to capture the loss of value when an investment is bought or sold. It combines explicit costs such as brokerage commission and transaction taxes, with implicit market costs.

The FCA rules require the calculation of the implicit slippage cost to be based on a comparison of the price at which a transaction is executed and the mid-market price at the time the order is placed in the market (the arrival price). The arrival price as defined by the rules has not been captured as a specific data point by asset managers in the past, so requests for pre-2018 data are unlikely to be available using the new methodology.

The rules also require that data is disclosed for fund administration charges and anti-dilution mechanisms.

The final FCA rules do not specify the period over which pension scheme operators can request data nor the period for which firms are obliged to provide data. However, governance bodies will want this data to inform their value for money assessments, and requests will be made to inform annual trustee chair statements (which will align to specific pension scheme reporting periods) or IGC chair statements.

Response times in relation to a data request are likely to vary, and requests made early in 2018 could take longer than those made later in the year, as elements of the rules are new and untested.

Format of data provision from asset managers

The ABI is aware that providers may have already been working towards delivering transaction cost data in respect of funds that are covered by the European PRIIPS and/or MiFID II regulations. Asset managers affected by these sets of EU regulation have developed common data capture templates in the form of the European PRIIPS Template (EPT) and European MiFID Template (EMT).

In addition, in March 2017 the IA consulted on a new Disclosure Code with the aim of providing a standardised framework for disclosing costs and charges. It included a template designed to enable governance bodies to obtain cost data in a consistent way and it is now included as part of the LGPS Code of Transparency.

ABI

Briefing

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In response to the release of PS17/20, the ABI and IA have worked together to develop a data capture template specifically aligned to the new FCA rules for UK DC pensions. Following consultation with both ABI and IA members, this 'DC Pensions Template' (DCPT) is now available for use on the ABI and IA's websites, and it is hoped that it will be widely adopted to enable consistent data sharing between pension scheme operators and asset managers.

The format of the DCPT has largely been based on the EPT and adapted where necessary to reflect the specifics of these FCA rules.

Please note that the use of the DCPT is not mandatory and it may therefore be the case that data from asset managers is requested and received in a variety of formats, particularly in the early days following the coming into force of the rules.

The FCA's Institutional Disclosure Working Group (IDWG) is aware of the ABI and IA's work on workplace pensions. In the supplement to the IDWG's terms of reference, the revised completion date for the Group to report to the FCA on industry templates is 31st July 2018. Given the implementation timescales for PS17/20, there was a more immediate demand from both ABI and IA members for the delivery of a template covering workplace pensions. We also understand that this group is more focused on reporting to pension fund trustees, whereas the DCPT is about ensuring the flow of information from asset managers to pension scheme operators.

Availability of transaction cost data

There may be a number of scenarios which mean that providers may not be able to respond fully (or in a reasonable time) to requests for transaction cost data. Providers will generally be reliant on a number of third parties to provide them with the necessary data in order to fulfil their obligations.

Providers should take reasonable steps to obtain the required information, but the regulations (COBS 19.8.7R) do allow for situations where firms are unable to provide a full data set and set out the steps that should be followed. In addition, the DCPT follows the regulations by including a field to allow firms to explain why a full set of data has not been supplied.

Calculation of transaction costs at the arrangement level

There are a variety of fund types/arrangements that providers may be required to report on depending on the specific way in which workplace pensions propositions have been established. The main types are:

- **Unit-linked funds**: life company funds that invest directly in a single internal or external investment vehicle (e.g. OEIC, unit trust, TTF, other life funds). Non-UK domiciled funds (e.g. SICAVs) may not be required to provide data as they are not FCA-regulated.

- **Blended unit-linked funds**: life company funds that invest in more than one internal and/or external investment vehicle.

- **Lifestyle strategies**: lifestyle strategies which are often used as default options for workplace pension schemes are typically made up of a number of investment funds and may therefore constitute an 'arrangement' as defined in the regulations. Providers will need to decide how best to approach the reporting of the strategy (as distinct from the individual funds).

- **With-profits**: PS17/20 confirms that with-profits are within the scope of the regulations and transaction costs will need to be disclosed.

Disclosure of transaction cost data

The format for the onward disclosure of transaction cost data to governance bodies (and/or their advisors) will be a matter for providers to decide themselves. It is likely that there will be a range of requests received. Firms will be expected to provide appropriate contextual information alongside the data and may need to provide support and education to governance bodies to help them to meet their obligations.

Onward disclosure of data to members was considered for occupational schemes within the DWP's October 2017 Consultation Paper 'Disclosure of costs, charges and investments in DC occupational pensions.' This consultation paper stated that the FCA intends to consult on corresponding rules for contract-based workplace schemes in Q2 2018.

Treatment of anti-dilution mechanisms

PS17/20 confirms that anti-dilution mechanisms are to be included in the calculation of transaction costs for workplace pensions. The specific data points required to perform this calculation (i.e. 'fair value mid-price' or 'unswung price') are not currently widely captured or disclosed. Both the ABI and IA have raised concerns with the FCA, DWP and TRP about the challenges of obtaining data in the short term and of calculating the dilution effects on a relevant scheme-by-scheme basis. As set out above, providers should take reasonable steps to obtain the required information, but the rules (COBS 19.8.7R) do allow for situations where firms are unable to provide a full data set. Firms should provide a written explanation, the percentage of investments in the arrangement for which information cannot be obtained, and the category of investments involved.

If you have any questions please contact lucy.forgie@abi.org.uk