

**PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION**



MANAGING YOUR MANAGERS AND COSTS

Christopher Sier

Chair, FCA IDWG

Fintech Envoy for the North

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Headline sponsor

ALLEN & OVERY



I'VE BEEN DOING THIS FOR A LONG TIME – OVER 10 YEARS

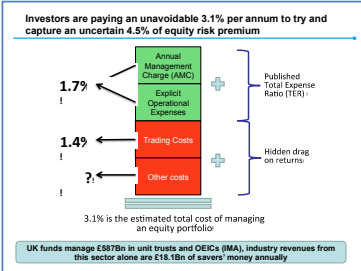
- ▶ Started in 2007, over 10 years ago, as Director of the FSKTN
- ▶ **“What is the total cost to the consumer of interacting with capital markets through the wrapper of a long-term savings product?”**
- ▶ Amazingly, and with all of my experience as a management consultant to asset managers, I found I couldn't answer it and still cannot
- ▶ First Paper 2007-9: “Complexity and Intermediation in Equity Fund Management”

Complexity and Intermediation in Equity Fund Management

- Dr Christopher Sier, Director, Financial Services Knowledge Transfer Network (FSKTN)
- Dr Jez Bezzant, Independent Consultant
- Mr David Collins, Strategic Solutions, SuperDerivatives,
- Mr Dominic Hobson, CEO COOConnect
- Dr Ian Hunt, Buy-Side Industry Consultant
- Mr David Norman, Founder Director, TCF Investment

The ISA Layer Cake

1. The ISA investment is recommended to the end investor by a financial adviser, such as a FA or a pension bank, which takes a commission.
2. The financial adviser passes it to a funds distribution platform (such as Citifund) which may add a variety of charges, including initial or trail commission, which may be charged to the investor.
3. The funds distribution platform uses subordinated technology, for which it is charged a fee.
4. The fund distributor delivers passes the investment to a trustee agent, which charges fees for subordinated expenses, maintaining the account, updating the register of investors and passing the subscription on to the fund manager.
5. The fund manager pays the investment to a subcustodian bank which charges an annual fee and admin fees plus fees for confirmation of transactions in the underlying assets, plus sub-custodial expenses.
6. The fund manager appoints an independent fund accountant to take the investment fees to the portfolio. Charges are not taken from the value of the assets under management (but transaction charges and custody charges for assets and tax reporting).
7. Relationships between fund managers, trustee agents and fund distributors such as Plurix are made via Managed Investor Services such as BOK, Calleva, Fidelity, Vestra and SIF, which levy service fees and per message charges.
8. The investment process and the charges are recorded and reported on by the intermediary bank or trustee – then the same information on the distribution bank which charges an annual fee.
9. At this point, the promoter of the fund may take an initial charge from the client for the investment. This can be a substantial amount, but is not a commission, because it does not change as attributable from the fund.
10. The fund manager opens the fund's (asset) cash to invest in the market. The manager charges an annual percentage fee on assets under management and possibly a performance fee.
11. The fund manager assess a dealer the market to invest the new cash. This may involve paying a spread if the trade is placed directly in the market, or a commission to a broker-dealer.
12. If the trade is subject to bid-ask spreads (as in equity markets) then this is taken from the fund as an adjustment to the trade commission.
13. The broker-dealer may make a payment back to the fund manager as an inducement to trade with them. This is called 'soft commissions'.
14. The fund manager settles the trade (often with the broker-dealer) through a trade matching service, such as those supplied by Citifund or SIF, which may further fees.
15. Settlement instructions are exchanged between the custodian banks, the issuer and the dealer for the usual 'cut-off' time, which are exchanged for securities on electronic book entries of a central securities depository (CSD), which charges a settlement fee.
16. Cash is paid and received to accounts maintained at the central banks by the custodian banks, which charge settlement fees.



- ▶ Nth Paper 2015: “The Drive towards Cost Transparency in UK Pension Funds”
 - ▶ FSCP commissioned paper
 - ▶ A proposed standard for the UK, with suggestions for implementation
 - ▶ Subsequently adopted by LGPS. A £250bn ‘lobby’

THE FCA MARKET STUDY (2017) AND THE IDWG

- ▶ The ‘Why’:
 - ▶ The Financial Conduct Authority’s (FCA) Asset Management Market Study identified that institutional investors find it difficult to get the necessary cost information to make effective decisions
 - ▶ Remedy? A stakeholder working group with an independent Chair – the IDWG
 - ▶ The objective is to gain agreement on disclosure templates for asset management services provided to institutional investors
- ▶ You need a granular approach to manage down costs – bottom up coupled with top down
- ▶ It’s not just about templates. It’s about building awareness and understanding:
 - ▶ Having a framework for data collection is one thing. Not knowing there’s a problem in the first place is another. DWP survey: “.....some trustees admitted they were not clear what transaction costs were”
- ▶ But I still hear the mantra ‘net performance’ is all you need
 - ▶ Nearly always from Asset Managers, often from Trustees and most recently a Consultant

(FACEPALM)

THERE ARE SOME BIG UPSIDES TO GETTING THIS RIGHT

- ▶ A bp saved is a bp earned, and this creates a real uplift in performance through the magic of compounding. A Dutch audience doesn't need convincing on this point!
 - ▶ LGPS: A voluntary, proactively offered, 15% headline cost reduction...£125mn per annum saving. Just the THREAT of transparency has changed the market
 - ▶ Railpen: 1 FTE junior accountant yielded £100mn fee reduction per annum
 - ▶ West Midlands LGPF. Identifying incremental £90mn of costs allowed negotiation of £10mn reduction
- ▶ The market will be more honest, open and transparent. In an environment where trust in money managers and pensions is at all-time low this is a good thing
- ▶ The UK will be a better place to manage money: Tom Tugendhat “Real investment charge transparency...will supercharge the City” (The Telegraph article, 19/08/17)

REMEMBER THIS – If your manager (or other SP) either won't or can't get the full cost data for your investment you need to pick one that can – consider how 'reasonable' you are being.

- ▶ There IS an upside for investment managers too! Those that are willing and able to declare costs will gain clients from those who are unwilling and/or unable
 - ▶ Just look at the LPGA transparency code signatories if you don't believe me

IDWG – THE ‘WHO’

Members

| | | | |
|--|-------------|--|-------------|
| ▶ Dr Christopher Sier – Chair | INDEPENDENT | ▶ David Hutchins (Alliance Bernstein) | MANAGER |
| ▶ Jeff Houston – Co-Deputy Chair, LGA | ASSET OWNER | ▶ Piers Lowson (Baillie Gifford) | MANAGER |
| ▶ Gregg McClymont – Co-Deputy Chair, Aberdeen Asset Management | MANAGER | ▶ Thomas Mercier (Invensys Pension Scheme) | ASSET OWNER |
| ▶ Stewart Bevan (Simplitium) | ASSET OWNER | ▶ James Mowat (Majedie Asset Management) | MANAGER |
| ▶ Richard Butcher (PTL, Chair PLSA) | ASSET OWNER | ▶ Mark Rowe (Partners Group) | MANAGER |
| ▶ Dr Iain Clacher (Leeds University) | INDEPENDENT | ▶ Mark Sherwin (Investment Association) | MANAGER |
| ▶ Ralph Frank (Cardano, Transparency Taskforce) | ASSET OWNER | ▶ Sarah Smart (LGPS, TPR) | ASSET OWNER |
| ▶ Teresa Fritz (Financial Services Consumer Panel) | INDEPENDENT | ▶ Dr Ali Toutounchi (Independent) | INDEPENDENT |
| ▶ Joanne Getty (BlackRock) | MANAGER | ▶ Graham Vidler (PLSA) | ASSET OWNER |
| ▶ Tim Giles (Aon Hewitt) | ASSET OWNER | | |
| Ex-officio Member: Financial Conduct Authority (FCA) | 4:8:7 | | |

Observers: Department for Work and Pensions (DWP), Organisation for Economic Co-operation and Development (OECD), Trades Union Congress (TUC)CFA Institute (CFA)

Conflicts of interest are expected and managed by the Independent Chair

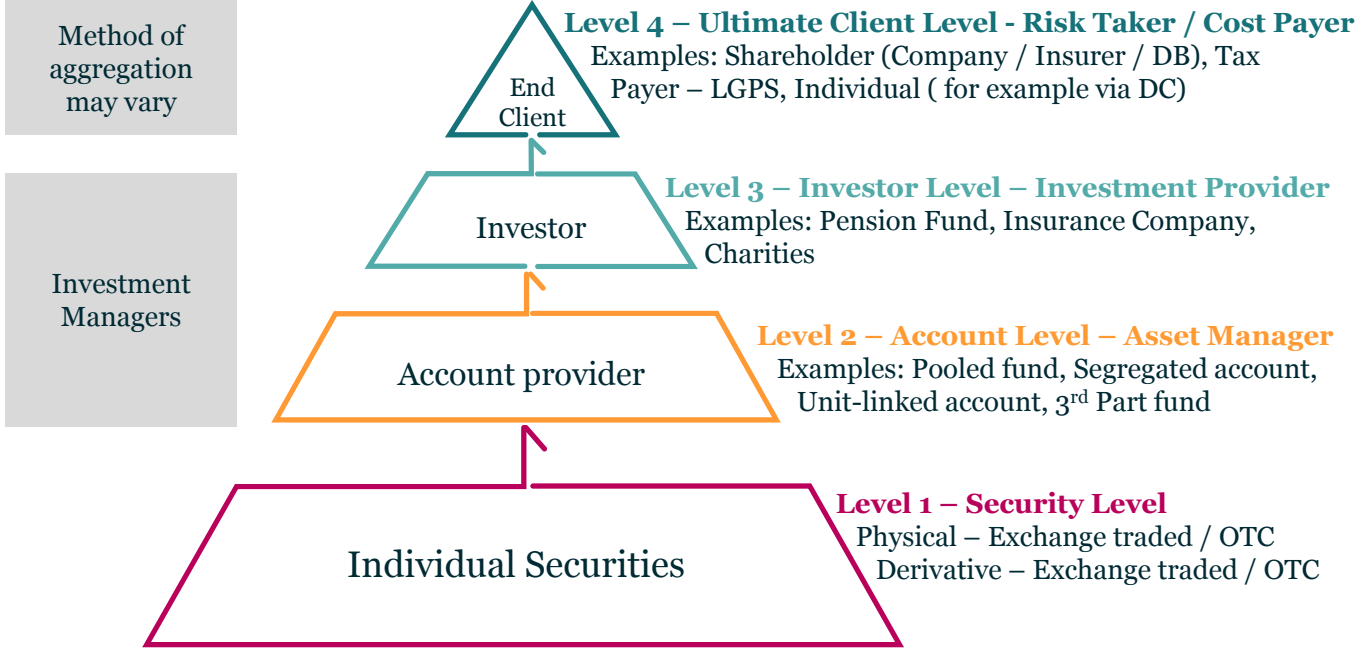
IDWG – THE ‘HOW’

(ToR) Cost and fee disclosure by asset managers to institutional investors is a complex issue and has several dimensions, each of which will be examined by the IDWG:

1. Breadth of coverage and depth of data
 - ▶ Are current templates sufficiently detailed or should they have additional data fields added, and be expanded to other security or vehicle types?
 - ▶ Should separate templates be set for other suppliers in the value chain?
2. Confirming compliance with the data standards set by the IDWG
 - ▶ Are compliance-testing mechanisms needed and, if so, what mechanisms (market or otherwise) should the IDWG recommend for tracking and assessing compliance?
3. Different types of institutional investors have different data requirements
 - ▶ What Institutional Investors should we consider and which should we prioritise for setting templates?
 - ▶ How can the data needs of the different types of pension funds be respected? Are different data-capture mechanisms and data standards needed?
4. Data consistency
 - ▶ What data is actually needed by different types of institutional investor for the purposes of accurate financial reporting and decision-making?
 - ▶ Can the mechanisms alluded to above be used to provide this reporting and analysis?

CONCEPTUAL COSTS AND CHARGES STRUCTURE

Process Should Enable Aggregation of “All Costs” Through to the Ultimate Client Level



CONCEPTUAL COSTS AND CHARGES STRUCTURE

Framework Enables Aggregation Through to End Client

Security Level Templates

- ▶ Consistent high level headings (master template) enable aggregation
- ▶ Bespoke detail for each security type (though many common fields)
- ▶ Responsibility of Asset Manager
- ▶ Internal use only

Security Type A

Transaction costs

- ▶ Explicit
- ▶ Implicit

Ongoing holding costs

- ▶ Explicit
- ▶ Implicit

Account Level Template

- ▶ Single unifying template
- ▶ Responsibility of asset manager (though may be operationally delivered by administrator or fund accountant)
- ▶ Disclosed to Investor

Account A

Investment return + activity

- ▶ Net return v Benchmark
- ▶ Asset reconciliation

Account level costs and charges

- Management fees (inc. stock lending)
 - Regular
 - Performance
- Ongoing costs and charges
 - Custody etc
 - Security level

Investment transaction costs and charges

- Security level transaction costs
 - Implicit
 - Explicit
- Account level transaction costs incurred
 - B/O spreads etc.

Investor Level Template

- ▶ Single unifying template
- ▶ Should be extendable to individual member reporting of DC plans etc.
- ▶ Responsibility of provider
- ▶ Disclosed to End Client

XYZ Investor

Investment return + activity

- ▶ Net return v Benchmark
- ▶ Asset reconciliation

Total provider level fees

Split to be agreed:

- ▶ Administration
- ▶ Governance
- ▶ Consultancy
- ▶ Investment (account level)
- ▶ Other

Investment related transaction costs and charges

- ▶ Security level
- ▶ Account level

EXAMPLES

▶ Security Level - OTC

- ▶ Upfront/purchase costs
 - ▶ Commission fee and/or Bid/offer spread on a notional...
 - ▶ But sometimes zero
- ▶ On-going costs
 - ▶ Life-cycle/Event Management Costs – dividends, coupons, plus settlement fees
 - ▶ Collateral Management as an operational process
 - ▶ Collateral costs – cash vs. eligible securities; interest on cash collateral; netting efficiency
 - ▶ Contract termination/closure costs – contract value and closure

▶ Account level – Hedge Fund

- ▶ SBAI Standard Total Expense Ratio (STER) is assessment of structural costs only
- ▶ Real example from a ‘vanilla’ hedge fund
 - ▶ STER = 1.15% BUT additional cost of carry = 2%. Actual total cost (not including performance fee) = 3.15%
 - ▶ Cost of carry = transactional costs, dividend expense, clearing costs, equity finance, stock borrow costs...in other words, Broker fees
 - ▶ Depending on strategy, CoC can be MUCH higher

HOW MIGHT WE CREATE IMPACT – POSSIBLE LEVERS OF CHANGE

- ▶ LGPS Scheme Advisory Board?
 - ▶ Adopting the first cost collection standard and requiring AMs to comply was the start
- ▶ Pension funds need to flex their muscles?
 - ▶ Case Study: Calpers and California primary legislation. Don't pick a manager unless they are willing to comply with standards
- ▶ Trustees and equivalent need to be sufficiently skilled? ...and/or...
- ▶ Advisors need to do their job?
 - ▶ The gated criteria to Consultant's 'recommendation list' could be adherence to IDWG standards
- ▶ In other words, asset managers may need to be assessed and picked for honesty as a primary characteristic. Building an independent framework for kitemarking to IDWG standards of disclosure might also become important
- ▶ Global impact and harmonisation?
 - ▶ Committee on Workers Capital - working group to look at transparency created
 - ▶ World Bank/OECD

IDWG STATUS UPDATE

We are ahead of schedule

SO WHY DO I ALSO WORK ON INNOVATION AND FINTECH?

- ▶ UK Treasury appointed Fintech envoy, Professor of Financial Technologies at Leeds University, mentored dozens of startups...in fact, I've been involved with almost every UK and global fintech initiative since before the term was coined – 10 years now
- ▶ Why? Originally as KTN Director my mandate was to introduce digital innovation to finance, but no-one was interested
- ▶ So I set out to prove that there was a problem that required innovation as the solution
- ▶ That problem was complexity and intermediation introducing cost and risk, and the best, indeed the only, way to concatenate complex, heavily intermediated value chains is with technology
- ▶ And the technology exists
 - ▶ Distributed ledgers and blockchains concatenate middle/back office processes
 - ▶ AI, machine learning, neurolinguistic pattern matching make sales/front office more efficient/scalable
 - ▶ Scalable intimacy through managed networks builds trust and opens new markets. Trust is fundamental, hence the need for secure digital IDs

**BUT It all starts with PROVING the need for change.
And that's why I ask myself the 'cost' and complexity question**

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TRUSTEE CONFERENCE 2017

Clear decisions; transparent outcomes



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 **#PLSA**