Royal Bank of Scotland Group Pension Fund – CTI case study

Author: Maggie Williams

"Our whole industry needs to be transparent – it is important to know how much it really costs to run a pension scheme," says Robert Waugh CEO & CIO The Royal Bank of Scotland (RBS) Group Pension Fund. "In the past, fund management supply chains have not shared the true cost of managing asset classes."

In recent years, RBS has worked hard to bring more transparency to its scheme costs, so that it can quantify the value being added by its fund managers and determine future investment strategy.

"We split out the total cost of running the scheme, dividing it into fund management fees and other costs, such as custody and adviser fees, as well as implicit and explicit transaction costs," says Waugh. "That enabled us to identify our costs both in monetary value and in basis points."

Waugh says that by having a clearer picture of total costs, it has become easier to manage them and to renegotiate fees based on the data. "We've been able to half our fund management fees from 53 bps in 2010, through to 23 bps in 2018. That is a significant saving especially when you compound it over more than fifty years, with a scheme worth £50bn."

RBS now has eight years' worth of granular cost data to draw on. As a result, the scheme can explore longer term trends, such as whether managers and asset classes are outperforming RBS's benchmarks – and whether the fees the scheme is paying for that outperformance are justified.

Waugh explains: "when we looked at our hedge fund investments, for example, we could see that any outperformance was being completely wiped out by the fees we were paying. In contrast, we retained around 80% of the value added by our quoted equities portfolio."

As a result, RBS has been able to establish some internal guidelines for value and cost. "If you are paying away a lot of your outperformance back to the fund manager, you have to ask, is that investment still worth it? With this data, we can start to discuss realistic performance and no-performance fees with our managers. We expect to keep 70 per cent of the value added by the fund manager."

RBS publishes its costs and performance every year in its accounts, bringing transparency not just for scheme members, but for its asset managers as well. "The fund managers can see this and will then expect a conversation on fee negotiations, if appropriate."

This year, RBS used industry-standard Cost Transparency Initiative (CTI) templates rather than its bespoke process for the first time. Waugh says that there were a number of advantages in using the CTI method: "A process that used to take us two weeks now takes around two hours. It also gives us the ability to benchmark our fund costs accurately against other schemes. That's common practice in the Netherlands and doing this in the UK could also add value."

In the future, Waugh can see further improvements to the CTI process. “We need to further improve analysis of transaction costs, as these costs needs to be assured by a third party.”

Waugh believes that the CTI approach benefits all schemes. “You wouldn’t run a business without knowing your costs, so why would you run a pension scheme that way? Asset owners can determine if they are getting value for members. And, for asset managers CTI creates a level playing field on which to compete. Less scrupulous asset managers cannot gain advantage by hiding costs because CTI’s approach is transparent and open.”