COSTS & CHARGES INDEPENDENT ADVISORY BOARD

13:30 6 SEPTEMBER 2016

CAMOMILE COURT, 23 CAMOMILE STREET, LONDON, EC3A 7LL

BOARD ATTENDEES

Mark Fawcett	NEST (Chair)
Yvonne Braun	ABI
Teresa Fritz	FSCP
Jeff Houston	Local Government Association
David Hare	Phoenix Life IGC
Graham Vidler	PLSA
Thomas Mercier	PLSA DB Council
Richard Butcher	PTL
Chris Hitchen	RPMI
David Will	The Society of Pension Professionals
Andy Agathangelou	Transparency Task Force

INVESTMENT ASSOCIATION ATTENDEES

Jonathan Lipkin
Imran Razvi
Mark Sherwin

APOLOGIES

Alex Pocock	The Society of Pension Professionals

PROCEEDINGS

1. Independent Advisory Board closed session

The Board held a closed session without IA attendance prior to the main meeting.

2. Discussion on draft disclosure material

At the Chairman's invitation the IA provided some background to the Board on how the draft disclosure code sent to the Board in August was arrived at. This included a short description of the IA's work with the LGPS Scheme Advisory Board (SAB), emphasising that the SAB approach was similar both to the Financial Services Consumer Panel template and to earlier IA thinking on a new Code. The IA emphasised sequencing challenges given different timings of UK initiatives and regulation (both UK and EU).

Following this introduction the Board also received a more detailed briefing on the process the LGPS had gone through in creating its own cost template, which currently was the same one that formed the core quantitative element of the IA draft code. The IA emphasised that the use of this template in the IA code was a starting point for discussion and that the Independent Advisory Board could choose to take a different approach. The IA also noted that the proposed Disclosure Code would be far wider in scope than SAB template, covering areas such as pricing policy and best execution, as well as providing wider narrative support.

The Board was then invited to provide the IA with feedback and comments on the initial draft of the code. Attention was focused on the template with a mixture of general and more technical points raised:

- When the IA publishes its code it should be explicit in stating that the code will evolve over time as regulation and client demands evolve and data becomes more readily available.

- Benchmarking of data (both to the past for a given manager but also industry-wide figures) would be important in helping to contextualise the quantitative data and to assess 'value for money'.

- Benchmarking should definitely exist in relation to costs but views on whether it was necessary in relation to performance were mixed. Where it was felt that performance should be contextualised in this fashion, performance in relation to formal benchmarks and targets/objectives as well as tracking error[1] were suggested as possible data points for inclusion.

- Independent auditing of the data would help ensure confidence in it. In this vein it was suggested by the Board that asking the investment manager to commit to a statement in advance confirming that the information was full and complete would be a helpful demonstration of integrity. The IA noted that this was a fair point upon which it would reflect.

- Was there a risk of the 'waterbed effect'? I.e. were there any costs not in the template? The IA explained that the investment manager only gets their fees, which are all disclosed in the template. Scrutinising manager fees doesn't mean that cost in other areas, for example custody, automatically increases.

- A consistent approach to calculation and presentation of costs across managers would be important in allowing clients to compare managers.

- In the segregated mandate template, presentation of the transaction cost figures in basis points in addition to monetary amounts would be helpful in aiding comparison and providing a sense of proportion to the levels of transaction costs generated.

- In the notes to the templates:

    - The language around management fees 'including' certain items suggested that some items were excluded. The IA explained that management fees covered all fees paid to the investment manager for the service provided. In response it was suggested that the language in the notes should refer to management fees 'comprising' any income derived by the manager or associates as this was a more accurate characterisation.

    - What constituted 'observable spreads' in the context of market spread costs needed further clarification.

- On implicit transaction costs it was noted that opportunity costs[2] and delay costs[3] were not in the template. It was recognised within the Board that there was a

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[1] The standard deviation of a fund's return relative to its benchmark. It indicates how far a fund is deviating from the benchmark return.
[2] Orders are closed either filled or partially filled. Where the order is partially filled there is an opportunity cost – this is the price change in respect of the unfilled portion of the order.
[3] The change in the price from order initiation (when the manager enters the order into an Order Management System) to the point the order is placed in the market.

debate to be had in this area because people had different views about the extent to which these metrics constituted costs that should be part of a standardised disclosure framework, not least because they did not represent an economic value stream to an individual agent. The IA agreed, noting that it had drawn its line at the PRIIPs measure of implicit costs which covered both spreads (required by LGPS) and market impact[4].

- For DC strategies that were typically unit-linked contracts with multiple underlying components (both pooled funds and directly invested) the IA confirmed that asset managers will report the costs and charges of the underlying investment process to the unit-linked product provider. However, aggregation of component costs and charges would need to be done by the product provider[5] as only the provider will have full sight of all the components of the strategy. It was noted that it would be important for providers to be aware of this point and signed up to it.

- Other points for consideration in relation to life fund disclosures: tax treatment, single swinging pricing policies, costs of direct and indirect property holdings.

- On stock lending it was suggested that more detail could be provided in this area – for example, what about accounting for the returns on collateral received for lending securities?

- On turnover calculations it was queried why the IA recommended using the lesser of purchases or sales in the calculation. It was also explained that in order to properly understand how turnover related to trading costs, clients needed to be able to separate the purchases and sales of assets due to subscriptions and redemptions from those due to trading activity driven by investment decisions. The IA explained that it had set out its thinking on PTR in some detail in its February 2015 costs and charges position paper (see chapter 2). It was suggested that the Board read this material and that the next meeting should devote some time to discussing issues around turnover.

  Action: IA to circulate to the Board a copy of its 2015 position paper.

- The template did not include financing costs related to funds borrowing in order to buy assets as part of an investment strategy. Pooled LDI was cited as an example of such a strategy. The IA noted that while the costs of borrowing to leverage returns are not a management fee they are costs that should be accounted for. The IA agreed to consider how these costs could be captured in the templates.

Following the end of the technical discussion the IA was asked if it considered the code comprehensive. Notwithstanding the points discussed during the meeting, the IA explained that in its view the Code was comprehensive. The IA had not included opportunity and delay costs due to its view – and the regulators' current view – of what constituted quantifiable implicit costs appropriate for a standardised disclosure framework. The management fee was comprehensive in quantifying what the investment manager receives for the service provided. However, it was stated that the code was not, nor was intended to be, a comprehensive analysis of what goes through a manager's P&L.

The IA invited the Board to send directly to it any further questions or comments on the draft code. These would be answered in writing for all Board members to see. In addition, the IA would be available to meet on a bilateral basis with any Board member to discuss

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[4] The difference in the price at which a trade is executed and the market price at the time the trade was placed in the market.
[5] Insurer, trustees (both master trust and single employer trust), investment consultants or a mixture of these parties, depending on the segment of the market.

particular points of interest or detail. Further questions could also be discussed at the next Board meeting in October.

3. Next steps

The IA agreed to provide the Board with a plan of what they will receive in the next couple of meetings.

Action: IA to circulate to the Board a plan of what material they will receive and by when.

The meeting was closed promptly at 3:30.

Date of next meeting: TBC October