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By email to: reinvigorating.pensions@dwp.gsi.gov.uk and dp15-02@fca.org.uk

Dear Sirs,

Call for Evidence on Transaction Costs Disclosure

ShareAction welcomes the DWP and FCA's joint Call for Evidence on Transaction Costs Disclosure. We are pleased to see the DWP and FCA's commitment to ensuring consistency of approach across the different types of pension schemes.

ShareAction is a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors. We are a member organisation and count amongst our members a growing number of NGOs and trade unions, as well as over 35,000 individual supporters.

We are conscious that this is a complex area in which different approaches may have unintended consequences. However, we hope that our short submission will be helpful in highlighting the areas we see as key to the project of increasing transparency in this area.

Transparency is important

ShareAction fully supports the Government's commitment to increasing transparency in the pensions sector generally, including in relation to transaction and administration costs. Greater transparency is needed in order to address the weakness of the buy-side in the pensions market. There is too little scrutiny of the agents investing ordinary savers' money and this lack of oversight has led to a culture of rent-extraction. Greater disclosure of costs, if properly managed, will send helpful messages to the market that intermediaries' decisions will be scrutinised.

Rules need to be accompanied by principles

The Call for Evidence flags the risk of intermediaries transferring costs to avoid having to disclose them. It is frustrating that this "waterbed effect" exists. Agents subject to fiduciary duties and FCA rules on treating customers fairly should not attempt to "game" the system in this way. However, in our experience, unfortunately, the FCA and DWP are right to be concerned about this. We suggest that one way to avoid this risk would be to include with the new rules on costs a general overarching duty/principle for agents to provide costs information honestly and fairly in the best interests of customers and their customers, that is the ultimate savers.

Complexity now may prompt future simplification

Disclosure of costs may be a complex, time-consuming and costly exercise in itself. This should not, however, be an argument against requiring further disclosure given the wider systemic costs of the current lack of visibility. In fact, the costs of compliance may well fall as reporting becomes embedded and standardised.

It is also worth reflecting on whether the complexity and scale of costs at the moment reflects a bigger problem about the nature of investment by pension funds, which may actually be solved by greater disclosure. Transaction costs are increased where investors pursue "trading" style investment strategies with high levels of portfolio turnover. However, it is not clear that these strategies are appropriate for pension funds, given their long-term investment horizons. This type of risky, short-term behaviour was identified by Professor John Kay as a contributory factor to the latest financial crash, which caused significant damage to the value of pension funds' holdings.

Furthermore, greater clarity on the costs associated with active management strategies and investment in alternative structures and funds of funds may help trustees and IGCs assess whether it is appropriate to invest in this way at all. If it is too difficult to discover the full costs of these investments, then that in itself should raise a question as to whether trustees and IGCs can confidently say that these represent good value for money in the interests of members.

In its initial phases, disclosure of costs may be a time-consuming activity for managers, but the process may lead to simplification of investment strategies and thus simpler disclosures. For this reason, ShareAction does not believe that a standardised model based on assumptions rather than actual costs (as set out a page 37) is the best way forward. Governance bodies need to see the real and full costs of investment strategies in order to assess their value. We also believe that reporting of portfolio turnover is very important.

What information do savers need

IGCs and trustees need sufficiently accurate information to assess value for money in the interests of savers. To a lesser degree of granularity, employers need to be able to assess whether or not they have selected a scheme which provides value for money.

For savers, it is important, on principle, that they are aware of the impact of costs on their pension savings. However, it may not be realistic to expect them to engage with the same level of detail as other recipients. It may be better to present savers with higher level information which they can digest than to aim to capture every possible cost broken down across fund and asset class and to risk alienating or confusing them. This is not to say that savers are not interested in their pensions. It is a convenient myth that people have no interest in their money: in reality, most people simply do not understand how their money is used and very little is done by the pensions sector to improve this situation. Until real effort is made to engage savers on terms they understand, it is not possible to say that they have no interest.

In practice, it is likely that savers will understand best one aggregated figure setting out the costs incurred and the impact on their savings. It would also be helpful for this to be accompanied by a statement from the IGC or trustees, as appropriate, as to whether or not they believe this represents value for money or whether they have raised concerns about costs incurred. This statement should be in line with that produced for the annual reports. More detailed information could be flagged as available on request.

Many savers will not take action based on these disclosures. However, a significant number may be spurred to action where they see a large chunk of their savings proportioned to costs. Such action may involve speaking with their employer about the choice of pension scheme, asking trustees or managers for further justification of high costs, reconsidering whether they are invested in the best fund and/or engaging with consumer groups. Any of these actions would help to strengthen the buy-side of this dysfunctional market.

The impact of Europe

Our understanding is that IORP II may introduce new requirements around communications to savers on costs. Under the Commission's proposal, institutions will have to produce a standardised 'Pension Benefit Statement' which will include, amongst other jargon-free information, the sum of costs deducted from the gross contributions', broken down into: (i) costs of administration of the institution; (ii) costs of safekeeping of assets; (iii) costs related to portfolio transactions; and (iv) other costs (which shall be briefly explained where they account for 20% or more of the total charges).[1] ShareAction is supportive of this measure, and sees the current consultation as an opportunity for the UK to set the standard for the European Commission to follow.

[1] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52014PC0167, Art 49