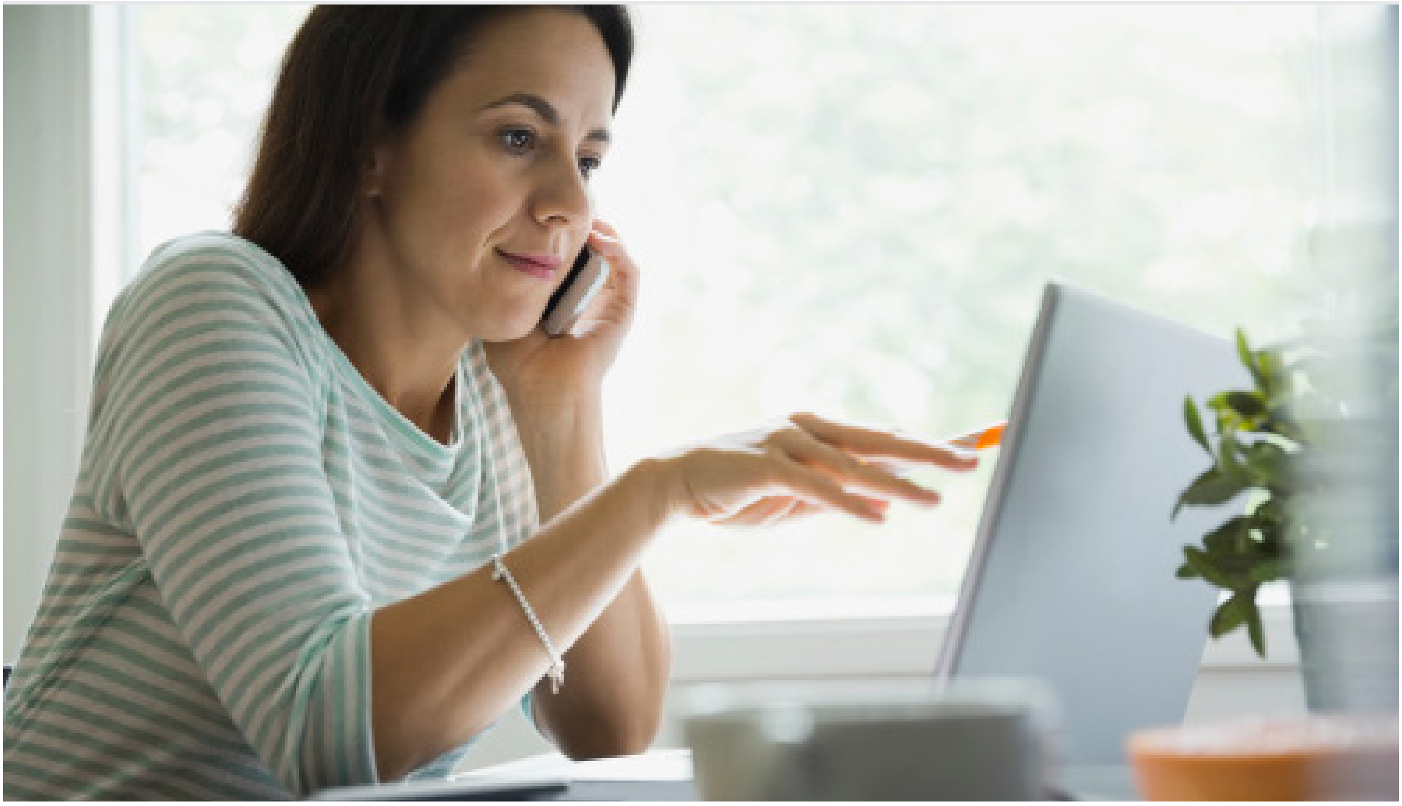
DC TRANSACTION COSTS DISCLOSURE

THE ONE CLICK SOLUTION



Under current UK regulation,* DC governance bodies need to access transaction cost data. This data should inform trustees' value for money assessments, and be shared with members.

Sourcing, compiling and understanding the data can be laborious and complex. But should trustees simply resign themselves to more drudgery? AllianceBernstein's (AB's) David Porter suggests there is a smarter way to good governance.

THE REGULATIONS

The Financial Conduct Authority's (FCA's) 2018 Policy Statement and the Department for Work and Pensions' (DWP's) regulations are the first steps towards ensuring governance bodies get a better understanding of the underlying costs they are incurring on behalf of members. This is both an important and a substantial undertaking because, as we will see, transaction cost analysis is complex and multi-layered. That complexity creates a significant governance and cost burden – particularly if the underlying investment solution is unnecessarily complicated.

TWO EXAMPLE APPROACHES

To explain the complexities better, let's contrast two approaches.

Firstly, we examine a familiar lifestyle arrangement. Here, our example scheme uses several third-party managers, plus an administrator to oversee each member's account and step them through the different phases of the lifestyle glide path.

For our second example, we turn to AB's target-date fund (TDF) range. In this approach each member is invested in one fund from the AB range whose target date corresponds with their intended retirement window. This way, the member can use a single fund from a single provider, for the whole of their career lifetime. The administrator oversees the members' accounts but isn't responsible for the switching of the underlying funds, as they would be in lifestyle funds. Because each TDF has its own internally managed glide path, there is no need for the administrator to carry out any changes to the members' asset mix, making it immediately more efficient to run, with fewer complicated moving parts to administer or reconcile.

OPTION 1

DOING THINGS THE HARD WAY

With the familiar lifestyle arrangement, the trustees themselves need to seek data from their administrator and all the individual third-party managers.

Each of the underlying managers' funds will have its own range of explicit charges, which will include the asset management fee, fund charges (e.g. for audit, custody and directors) and transaction costs. Each manager will also account for the implicit costs of trading in each fund. The FCA has prescribed a specific approach to measuring transaction costs – the 'slippage cost' calculation methodology – and other regulatory and industry bodies have also provided guidance. However, this may be interpreted in different ways by the various third-party managers.

The trustees should also seek the data for costs in respect of buying and selling the managers' pooled funds. This could be disclosed in any one of three different ways: a bid-offer spread; a single "swing" price in which the costs are apportioned to reflect the balance between buyers and sellers; and an anti-dilution levy, a single standard charge which can be triggered depending on the size of the trade.

Lastly, the trustees will need the provider/administrator charges data. Again, these will break down into different categories – implicit costs that are included in the fund fees, and explicit costs in terms of member charges or costs paid by deduction of units. Similarly, the breakdown could vary depending on the individual investment manager's fund setup. As costs and charges data are typically based on historical averages and annualized computations, trustees will need to interpret the numbers with care and make various assumptions, based on historical comparators.

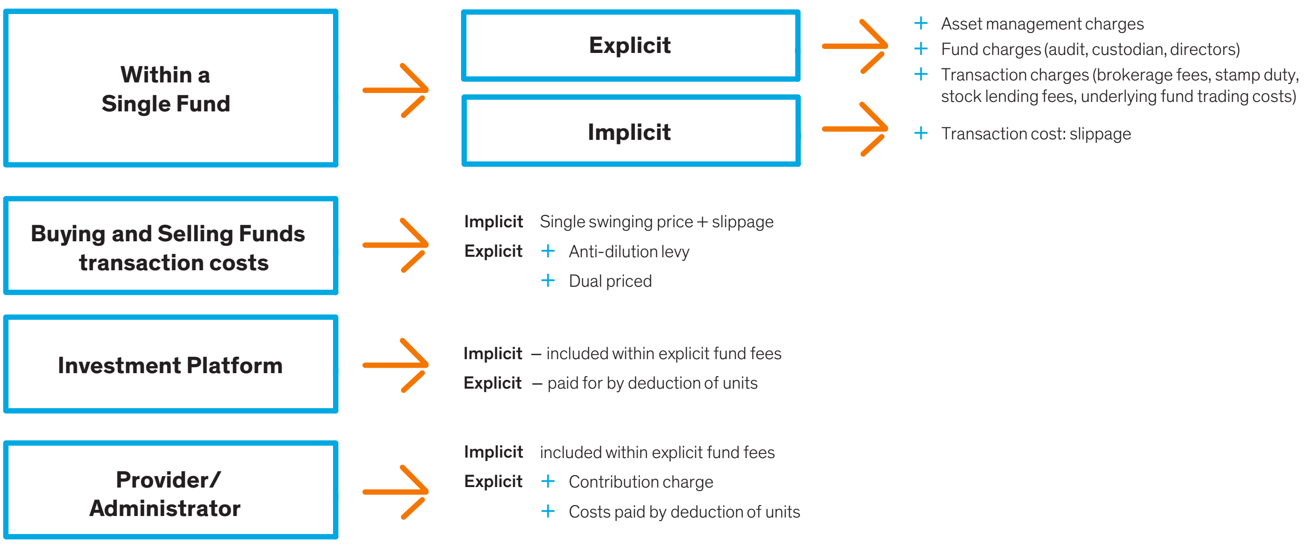
At this stage, there is no universally agreed format for setting out the complete range of costs and charges. So the trustees could be faced with several data sets from the various managers, each compiled in different ways.

Because the lifestyle approach involves pre-determined asset strategy changes for each individual member's account, the level of related member transactions could be substantial. This would generate not only corresponding fund management costs and charges, but also higher administration fees.

Option 1 therefore involves high volumes of cost data that may not be directly comparable, and these are inflated by the multiple transaction and administration costs incurred by each member's account as part of their lifestyle asset strategy. The trustees need to collate and interpret all this cost data to create an overview of their lifestyle costs in total.

Of course, if the trustees are investing via a platform and/or using blended funds, assessing transaction costs becomes even more complicated. For instance, it's less clear which entity is responsible for aggregating the data – or even whether there is adequate data to disclose.

COSTS AND CHARGES



Source: AB

OPTION 2

KEEPING THINGS SIMPLE

With the AB TDF approach, many of these complexities disappear or are hugely reduced.

Each AB TDF is a discrete fund. That means our team at AB have ready access to all the data for the underlying pool of assets, and have all the insights that are necessary to interpret that data correctly. That in turn makes it much more straightforward for AB to create a tailored report for each client and each TDF, using a completely consistent approach and capturing all the underlying transaction costs where they are disclosed. That single report includes the costs of buying and selling the underlying pooled funds, which is an often-overlooked cost item.

As we use an open-architecture approach for the AB TDFs, we select from the best third-party specialist managers in their respective fields. Hiring several different managers has the potential to create extra complexity, which can be challenging in a lifestyle arrangement. But AB's approach and oversight enables the aggregation and harmonizing of the different managers' transaction costs to create reporting that is on a consistent basis.

What's more, AB can provide transaction cost transparency at the individual member level, simply by breaking out each member's share of their chosen TDF's total. And we have also helped our clients frame transaction cost responses in their Chair's annual statement or investment governance report – something we have been doing since 2016 to help meet the increased challenges that trustees face.

Trustees will still need to seek a cost breakdown from their administrator, but as noted above, this will reflect a greatly reduced volume of work relative to a lifestyle approach. In fact, clients tell us that changing to AB TDFs from lifestyle has reduced their investment-related administration hours by 70-90%, and removed the large operational, financial and reputational risk of getting lifestyling wrong.

Our core mission and purpose is to align our TDFs with members' needs, promote good governance and offer exceptional value for money. So it's no wonder that we take cost control and disclosure so seriously, and that we have devoted so much effort to cost management and reporting over recent years. And that's why we have joined PTL's **Clear Funds initiative** to provide independently verified, simple and concise reporting.

DISCLOSE OR DELETE?

We believe that the regulators' drive for improved disclosure will lead trustees to question not only the cost of transactions, but also whether those transactions are necessary. That's because the simplicity of AB TDFs' single fund for life approach can eliminate many unnecessary transactions, slashing both trading and administration costs. Our thoughtful approaches to portfolio management and trading generate further cost saving benefits. It's better, in our view, to estimate and understand the costs first, control and reduce them, then disclose them afterwards.

DC TRUSTEES AT A CROSSROADS

There is only one certainty about financial regulation: over time, it becomes more detailed and compliance becomes more onerous. DC trustees should expect more demanding and prescriptive cost disclosure rules in the future.** The question is, should DC trustees simply wait for the pain, or would it make more sense to adopt a smarter solution now?

WHAT ABOUT THE ONE-CLICK BIT?

That's easy. Simply contact:

Michelle.inskip@alliancebernstein.com or
Katie.weber@alliancebernstein.com

for further details and a demonstration of our AB TDF technology.

* The Pensions Act 2014 s44 places a duty on the FCA to make rules requiring governance bodies to disclose information about transaction costs *to scheme members and to publish it*. The Financial Conduct Authority (FCA) Policy Statement PS17/20, September 2017 (Transaction cost disclosure in workplace pensions) requires that governance bodies request transaction cost and administration charges data from providers. The regulation came into effect from 3 January 2018. Further guidance is set out in the Department of Work and Pensions (DWP) Occupational Pension Scheme Regulations 2018, effective from 6 April 2018.

**FCA PS17/20 s1.15 and CP19/10

IC2019211