Regulatory Policy Committee

Transaction cost disclosure in workplace pensions

Financial Conduct Authority

RPC rating: validated

Description of proposal

The Financial Conduct Authority (FCA) introduced a requirement for asset managers to disclose transaction costs and administration charges when this information is requested by certain pension schemes (essentially workplace defined contribution (DC) pension schemes). The rules for asset managers are an FCA initiative, to align with the required disclosure of transaction costs by pensions schemes under s. 44 of the Pensions Act 2014.

The rules require asset managers, managing money on behalf of a workplace DC pension scheme, to respond to a request for information about transaction costs and administration charges from the governance bodies of those pension schemes.

To enable firms to do this, the FCA decided to set out a standard methodology to calculate costs and place this requirement on the managers of the assets held within pension schemes. This particular qualifying regulatory provision submission by the FCA relates to this aspect of the measure.

There are three different types of arrangement the FCA states will be covered by the requirement (estimated number of schemes of each, in brackets):

- Trustees of a stand-alone scheme (6,700);
- Trustees of a master-trust (50), and
- Independent Governance Committees (IGCs) of a contract-based pension provider (30).

Impacts of proposal

The FCA makes the following assumptions to assess the benefits of standardising transaction cost disclosure:

- Each standalone pension scheme uses a single insurer/asset manager. The FCA assume this is an underestimate and that each pension scheme offers around 10 investment options.
- Each master-trust offers a wide range of products, in a similar way to a contract-based scheme.

- A contract-based scheme offers around 150-250 different investment options from multiple asset managers.

The FCA estimates the *baseline* annual cost to an asset manager of responding to *ad hoc* queries from standalone scheme clients to be around £1,000. The regulator estimates that master-trust and contract-based schemes offer around 20 times the number of funds offered by a stand-alone scheme, therefore estimating a cost of around £20,000 for responding to *ad hoc* queries. Although not clearly stated by the FCA, it appears that the cost of compliance increases with the number of fund options, presumably due to the larger range of information potentially covered.

Benefits

Benefits of standardising disclosure

The FCA considers that standardising cost disclosure will provide a benefit to asset managers by eliminating the need for them to produce information pertaining to transaction costs on an ad hoc basis. These data are currently requested annually by each scheme. The regulator estimates the annual benefits of this to be £8.3 million, which consists of £6.7 million for standalone schemes (6,700 x £1000) and £1.6 million for master-trusts/contract-based schemes (80x £20,000).

Costs

Costs of standardising disclosure

The regulator estimates the costs of a standardised solution in two parts:

i) Costs of calculating transaction costs

The FCA's rules will require asset managers to calculate the transaction costs they are incurring on relevant portfolios.

The FCA estimates that, at most, 50 asset managers manage money that will put them in scope of the rules. Based on information that the regulator has received from firms and its 'understanding of the market', the regulator estimates that 40 of these firms are buying systems from third-party providers, 5 have in-house systems, and 5 currently have no transaction cost analysis capability. The FCA explains that third-party providers of transaction cost analysis indicate that their systems will be capable of producing reports on the proposed standardised basis with limited amendment.

The regulator also estimates the calculation cost for a firm buying a system from a third-party provider will be around £10,000 per annum, for a firm with an in-house system, a one-off cost of £25,000, and a firm with no system currently will incur a cost of £75,000.

On this basis, the regulator estimates that the market will incur one-off costs of £125k. They also estimate that the market will incur £775k per annum on an ongoing basis.

ii) Costs of reporting transaction costs to clients

Based on industry responses to FCA information requests, the regulator estimates that reporting costs will be around £150,000 per independent asset management firm and £250,000 per insurance firm. The regulator multiplies this by its estimate for the number of each respective type of firm that is operating in the workplace DC pensions market.

This gives an estimate of one-off costs associated with reporting of £13.5m.

Quality of submission

The FCA provides a breakdown of both the one-off and ongoing costs/benefits of the new requirement to business. The analysis is concise, but some areas require an understanding of both the industry and the existing regulatory landscape. The assessments could have been improved had the FCA presented its assessment in terms that are likely to be understood by the general reader.

The FCA also provides evidence of having consulted with industry, including DC pension providers and transaction cost analysis firms, to understand the implications of the new requirement on industry. The RPC believes that the regulator has taken a reasonable and proportionate approach in this case and is able to validate the measure.

The RPC suggests that the quality of the submission could have been improved in the following areas:

1. *Lack of clarity concerning what informs underlying assumptions.* The assessment makes various references to assumptions being 'based on supervisory knowledge' or 'our understanding of the market'. Where such anecdotal support for its assumptions is used, the assessment would benefit from more clearly outlining what evidence has informed their knowledge base.

2. *Familiarisation costs.* The assessment makes no explicit reference to the familiarisation costs or transition costs which will be incurred by business within scope of this new requirement. While it may be inferred that this component is part of the one-off costs of the requirement's cost to business, the assessment would benefit from explicitly clarifying these costs.

3. The assessment would benefit from more clearly explaining what businesses are expected to do with to meet the requirement, compared to what they did previously. For example, whether they will still have to send the same number of communications, and will they have to send them with a set frequency.

4. The assessment would also have benefited from providing more detailed explanation of the requirements of the existing regulations, and a comparison between the 'ad hoc' and standardised approaches.

5. Whilst the assessment discusses the main benefits of the requirement, is it not clear whether other potential benefits could have been considered (e.g. informing those not currently informed, improving customer and firm choices, strengthening competition). The assessment would have benefited from considering such potential impacts.

6. The regulator's estimate for the total market costs of calculating transaction costs could have been clearer. The regulator should have more clearly identified how many businesses it has assumed are likely to opt for more expensive alternative methods.

Departmental assessment

Classification	Qualifying regulatory provision OUT
Equivalent annual net direct cost to business (EADNCB)	-£5.5 million
Business net present value	£51.1 million

RPC assessment

Classification	Qualifying regulatory provision OUT

EANDCB – RPC validated[1]	-£5.5 million
Business Impact Target (BIT) Score[1]	-£27.7 million

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[1] For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.