How to start thinking about your cost transparency exercise.

Cost transparency is not just about fulfilling reporting requirements and a means to lower costs – it's an important pillar for defining and striving for value for members. The process of improving cost and data transparency sets the foundations for stronger sustainable governance. The compounding effects of costs and charges are well established, and having a complete and detailed understanding on costs adds more control – and eventually better outcomes – for members.

COST TRANSPARENCY IS AN IMPORTANT SOCIAL RESPONSIBILITY TOOL FOR PENSION SCHEMES, GIVEN THE LONGER TERM IMPACT OF COSTS ON PENSIONS SAVINGS AND RETURNS.

DEFINING YOUR OBJECTIVE FROM THE BEGINNING

You may want stronger oversight of your costs, for example. A cost transparency exercise provides tangible, transparent information on costs – and if it's your first time considering such an exercise, the initial data-set is a good starting point. By undertaking the exercise every year, you can track your progress on how your pension costs are being managed.

Seeking to reduce your costs could be another objective. The greater implementation of cost transparency by UK pension schemes is helping drive costs lower. For example, we've seen a gradual fall in management, performance and transition costs since 2016, which has had an important impact on pension saving and returns. Having greater insight of your costs will help in your discussions with asset managers.

WHAT ARE THE COSTS OF MANAGING A PENSION SCHEME?

A first step when undertaking a cost transparency exercise is to understand the total costs of running a pension scheme. Some of these may not be obvious from the outset. We've summarised these below and it's always useful to run through the list of these costs to assess how you are collecting this information today. If there are gaps in knowing how much these individual costs are, a cost transparency exercise will help you understand your total cost of ownership.

PENSIONS MANAGEMENT COSTS

- Administration and processing costs, which are associated with communication, staff and systems costs
- Advisory costs related to services such as actuarial, audit, legal and consultancy work
- Executive costs and any rent

Investment costs – these are associated with any activity relating to the management and monitoring of a scheme's investments.

- Transaction costs, which occur in the process of buying and selling stocks or bonds. These are broken down into explicit and implicit costs
- Explicit costs relate to areas such as stamp duty tax or brokers' commissions
- Implicit costs relate to the difference between the buying and selling price of a security. These can be higher if the turnover rate of a fund or mandate is high.
- Management costs that are incurred by the asset manager
- Ongoing charges related to administration, custody, audit and legal expenses
- The performance costs which are incurred
- Borrowing and lending costs relating to stock borrowing
- Property expense relating to property mandates such as property management fees, leasing costs and maintenance

THE START: UNDERSTANDING WHAT DATA YOU NEED TO COLLECT AND HOW

The starting point when undertaking a cost transparency exercise is to complete the Cost Transparency Initiative (CTI) templates, which are designed to create a standardised way of collecting costs from asset managers. Today, around 85% of asset managers we work with use the CTI template to submit costs.

You have to complete one CTI template for each pooled fund or mandate. For the average pension scheme, this can amount to several templates, which all need to be aggregated at the end to provide the scheme level cost and charges analysis. The data you will need to collect includes:

- Account information
- Portfolio investment activity
- Portfolio transaction costs
- Ongoing charges
- Incidental costs
- Lending and borrowing costs
- Property expenses
- One off costs, like foreign exchange
- Performance information
- Stock lending

STEP TWO: CONTEXT IS IMPORTANT

Looking beyond the data is key when undertaking any cost transparency exercise. When you collect the different CTI templates from your managers, you'll have to sift through large volumes of data, analyse it and make sense of what you are seeing. The goal is to ensure the findings lead to the right outcomes. Some of this context is embedded within the CTI templates and it's key to pull out before you begin to analyse any of the cost data. Important areas of context include:

- Turnover rates –indicates the volume of trading carried out over the period. We typically find that higher turnover leads to higher transaction costs.
- Flows – if a fund has been recently set up or starting to go into liquidation, the costs reported may be higher than usual. Looking at the flows helps determine what stage of life the fund is at.
- Asset values - similarly the asset values can help determine the maturity of the investment by looking at the invested capital.
- Asset values by asset class - the type of asset class invested will impact costs. Certain asset classes are known to be more expensive. A larger allocation in more expensive asset classes can ultimately bring total costs up.

STEP 3: THE COLLECTION PART OF THE PROCESS

Once you have submitted the CTI templates to your asset managers, you'll then need to project-manage the process, which involves reviewing the timeliness and delivery of the information.

The next part of the process is reviewing all the submissions for completeness and accuracy of the data that has been provided. This might mean managing additional requests for missing information.

Once this is done you can begin aggregating all the data you've received across the CTI templates into one cost report, so you have an overall top level view of your scheme's total costs, segmented by type. This usually requires plenty of hands-on analysis and is one of the more challenging steps in the cost transparency process.

> "Did you know: In the data we collect, only 12% of CTI templates are complete at the first time of asking. This means a lot of hands-on work is required with asset managers when going through such an exercise."

USING THE INFORMATION FOR GOOD GOVERNANCE

The final step in the process is using the data you have collected to drive good governance. We've summarised this below:

What you need to collect	How will it help you	Governance: What you need to ask of your asset manager
Investment costs Understand how total investment costs change year by year and get the full picture on transaction costs	Full transparency on all investment costs gives you more insight so you can have informed discussions with your investment managers and suppliers	How do you control your explicit costs? How do you control your transaction costs?
Total cost of ownership It's important to collect total costs if you want to get a clear picture	Total costs put you more in control of decision-making and in assessing value for money in order to focus on member outcomes	Do you capture every single cost? Are you looking beyond the data to understand how we are delivering value for money?
Other costs Develop a clearer understand of your costs for custody, reporting and fund administration	You can determine if the services you are getting reflect the costs you are paying. It provides a good starting point to have a dialogue with your service provider	What type of reporting can the scheme expect? How will this change when market dynamics are challenging?
Data It's important that the data you are collecting and analysing is as robust as possible. The integrity of cost reports is key	It's important that in the data collection process and validation, the data is as accurate and robust as possible, so you can get a true picture of your scheme's costs	How do third-party cost transparency specialists validate and review the data they are receiving?