The Need To Lift The Lid On Cost

The Financial News

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09 Mar 2012

There’s no denying that pension funds all over the world have taken a battering from the ongoing financial crisis. Defined-benefit plans have become gold dust, with sponsors offloading their liabilities or closing their schemes to future accruals at a rate of knots.

At the same time, employers, the government and the media have shifted their focus to defined contribution, despite the fact that these schemes, too, have been hit by turbulent markets.

It’s incredible, then, that there are still pension fund sponsors and trustees who choose not to fully understand the costs they can control and who fail to demand more transparency from their managers and custodians. Many funds are allowing the charging structures for services, such as general transaction costs, foreign exchange and transition management, to remain opaque.

But who should take responsibility for shining a light on costs?

Some custodians and managers that should be entrusted by pension funds to manage or help out with fringe activities, such as foreign exchange and transition management, have been accused of not delivering best execution for their clients.

But it is clear from conversations with industry players that fund managers and custodians are not deliberately setting out to obfuscate the matter, despite a few cries of foul play in the US, but rather that there is ambiguity over how and when costs should be presented.

Do currency managers have to give their clients the best intra-day price, as well as the best daily price, when executing FX trades? Should fund managers disclose every detail of the costs that lie behind their funds?

This is a grey area that should be set out in black and white in advance in mandate contracts. It falls to trustees, consultants and lawyers to thrash out the details of exactly how much information is required.

Arguably, pension funds have had a good decade to consider the need for transparency. In 2001, Paul Myners, then chairman of Gartmore Investment Management, produced a report on the matter for the UK government.

Part of Myners’ task was to look into transaction fees for UK pension funds, and he concluded that most schemes had very little awareness of what they were charged for share trading. The report led to a Financial Services Authority survey, which found that institutional investors had paid a total of £2.3bn in fees to brokers in 2000 alone.
One of Myners’ recommendations focused on increased openness on trading costs for pension funds. However, more than 10 years later very little has changed.

There have been several initiatives along the way. In 2007, the T-Charter was launched as a voluntary code of practice for the transition management industry, and even some of the custodians have put their weight behind calls for clear performance data when portfolios are transitioned between asset managers.

Efforts to improve transaction cost analysis services have also been proposed, ranging from performance analytics to forex transaction cost analysis. But a survey last year by trade body the Investment Management Association showed that despite 80% of UK asset managers including transaction cost analysis as part of their internal assessment, only 42% provided this service to institutional clients on a regular basis.

There’s still a lot of work to be done, and as long as investment returns fail to reinvigorate portfolios, keeping tabs on costs remains essential. It is the pension funds that scrutinise and apply pressure to their cost base and fund managers and custodians that can deliver lower, transparent fees that will ultimately prosper.