

Institution: University of Leeds		
Unit of Assessment: 17 - Business and Management Studies		
Title of case study: Increasing transparency of costs and fees in asset management to improve pension fund performance		
Period when the underpinning research was undertaken: 2010-2019		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	Role(s) (e.g. job title):	Period(s) employed by submitting HEI:
Professor Iain Clacher	Professor of Pensions and Finance	01/09/2007 - present
Period when the claimed impact occurred: 2017-2019		
Is this case study continued from a case study submitted in 2014? No		
1. Summary of the impact (indicative maximum 100 words)		
<p>The development of a new industry standard for institutional investment cost data, based on research by Clacher, has been instrumental in transforming how UK pension fund trustees make decisions when investing pension fund assets. As a member of the Institutional Disclosure Working Group of the Financial Conduct Authority, Clacher was responsible for the design of a User Template for the collection and reporting of standardised and aggregated costs and fees. This was accepted by the Financial Conduct Authority and subsequently adopted by the Cost and Transparency Initiative of the Pensions and Lifetime Savings Association as the industry standard. The standard has a broad range of benefits for the pensions industry. An industry expert confirms that Clacher's research contributed to overall market cost savings of approximately GBP3bn in 2018/19. These and future savings compound and persist and are estimated to reach GBP2tn over the next 35 years through a combination of cost savings and improved decision-making by trustees.</p>		
2. Underpinning research (indicative maximum 500 words)		
<p>The costs and fees that are charged by the asset management industry are extremely complex and lack transparency. UK pension fund trustees are responsible for GBP2tn of pension fund assets, equivalent to 105% of UK GDP¹, and most of this is invested through the asset management industry. Even a small percentage saving on these costs has the potential to have a significant impact on the pension outcomes of millions of UK citizens, because of the scale of pension investments and the significant lifetime compounding effects. Research by Professor Iain Clacher has addressed pension fund management issues over the past decade, including a focus on the lack of transparency in the costs associated with pension fund management [1, 2 and 3].</p> <p>The lack of transparency in asset investment costs and fees has historically raised industry-wide concerns about pension fund trustees' ability to make the best or optimal investment decisions. This can have a detrimental effect on the performance of some funds and ultimately the level of pension individuals receive in retirement. Due to these concerns and a perceived lack of competition, the Financial Conduct Authority (FCA) undertook an investigation of competition in the asset management industry (The Asset Management Market Study – report published June 2017). This study led the FCA to set up the Institutional Disclosure Working Group (IDWG), with</p>		

¹ OECD data shows that UK pension fund assets are the second largest amount of assets in all OECD countries, exceeded only by the United States.

a remit to address the transparency problem and create disclosure templates which could be applied to the different types of investments that trustees make for pension funds (e.g. equities, bonds, and property). **Clacher's** research expertise on asset and pension fund management and governance led to him being appointed as a member of the IDWG.

The body of research led by **Clacher** formed an evidence-base for the policy considerations of the IDWG and established the key criteria for **Clacher** to design a User Template for cost and fee disclosure. The foundations of the research began in 2010 with a study by **Clacher** with collaborators in Australia on the investment behaviour and style of portfolio fund managers using data from 174 Australian mutual funds for the period January 1990 to June 2005 [1]. This was followed by a study with collaborators at Leeds, Loughborough and Strathclyde (i) that developed and tested a new approach to assess Defined Benefit pension plan solvency risk in the presence of extreme market movements. It found that the standard assumption of constant discount rates leads to dramatic underestimation of future projections of pension plan solvency risk. The results have important implications for those with responsibility for balancing risk against expected return when seeking to improve the current poor funding positions of Defined Benefit pension schemes [2].

In 2018, Aon, a global professional services firm in the field of risk, retirement and health, commissioned **Clacher** to conduct a research project on pensions working with colleagues from the Centre for Decision Research at Leeds. The aim of the research was to investigate whether trustees were able to make more effective decisions if they were given more complex and enhanced disclosures of the costs of asset management. The research was relevant to Aon's core business as well as being beneficial for the wider pensions industry. An online survey, which generated just under 200 responses from pension trustees of schemes of all sizes, was the first systematic investigation of whether trustees can select the best investment when presented with increasingly granular and complex combinations of costs and fees, and whether trustees understood the indirect costs of asset management. The findings from this research, published in an industry report: *Costs, fees, and trustee decision-making* [4], demonstrated that trustees understood explicit net of fees options i.e. selecting the best fund when presented with explicit cost and performance data. However, trustees of smaller schemes did not perform as well as trustees of larger schemes. A crucial research finding was that trustees were less familiar with hidden fees, and that this lack of understanding was much worse for trustees of small schemes. These findings were important as they revealed that many trustees struggle with more complex cost and fee disclosures [4] and this had implications for the design of interventions aimed at assisting the investment decision-making process.

Clacher's contribution to the IDWG included his leadership of a sub-group that was set up to design a User Template, which aggregates complex granular data into a more useable format for trustees to make effective decisions. To build this template **Clacher** undertook further research on trustees, in collaboration with Aon, to empirically validate the optimal structure of the User Template, which was tested with different formats e.g. adding costs back to net performance to arrive at gross performance vs deducting costs from gross performance to arrive at net performance. **Clacher's** recommendations for the design of the final User Template included the cost categories, the order and structure of the template, and crucially, the presentation of both the absolute value of costs and fees as well as the percentage charge against assets, because the absolute value of the costs incurred increases their salience to the trustees.

Subsequent research, funded by the Institute and Faculty of Actuaries (ii) and (iii), with Aon as an industry partner, showed empirically that the core issues examined in the design of the User Template around the format and presentation of information to trustees is critical, as the format and presentation of information impacts the quality of trustee decision-making. This research moved from the action-research approach taken for the IDWG to a more scientifically rigorous experimental approach that tested the influence that extraneous non-financial information can have on the financial decisions of trustees, by manipulating the presentation of choice menus. Trustees were influenced by changes to the menu item mix, context, and layout. It was found that these subtle variations in the presentation of options influence decisions and can lead to poor-quality decisions, impacting on pension fund performance [3].

3. References to the research (indicative maximum of six references)

- [1] Holmes K, Faff R, and **Clacher** I., (2010). Style analysis and dominant index timing: An application to Australian multi-sector managed funds. *Applied Financial Economics*. 20(4), pp. 293-301. <https://doi.org/10.1080/09603100903459915> [Examines the investment style of portfolio fund managers using data from 174 mutual funds with complete data for the period January 1990 to June 2005.]
- [2] Abouraschi N, **Clacher** I, Freeman M, Hillier D, Kemp M, and Zhang Q., (2016). Pension plan solvency and extreme market movements: A regime switching approach. *European Journal of Finance*. 22(13), pp. 1292-1319. <https://doi.org/10.1080/1351847X.2014.946528> [Finds that the standard assumption of constant discount rates leads to dramatic underestimation of future projections of defined benefit pension plan solvency risk.]
- [3] **Weiss-Cohen** L, **Ayton** P, and **Clacher** I., (2020). Extraneous menu-effects influence financial decisions made by pension trustees. *Economic Letters*. 187, 108895. <https://doi.org/10.1016/j.econlet.2019.108895> [Three experiments tested 252 pension scheme trustees for the influence of manipulations to the menu of options on investment decisions. Trustees were influenced by changes to the menu item mix, context, and layout.]
- [4] **Clacher** I, **Hodgett** R, and McNair, S (2017) Costs, Fees, and Trustee Decision-Making. Report: https://www.aon.com/unitedkingdom/attachments/aon_hewitt/i/Costs-Fees-And-Trustee-Decision-Making-July-2017.pdf. [Examines in detail the salience of costs and fees with respect to investment decision making, and considers both the explicit and implicit costs and fees associated with fund management.]

Grants

- (i) Freeman, M., Rotman ICPM, Toronto. £27,000. 2010. **Clacher** – Co-investigator. [Project to analyse pension plan solvency and extreme market movements]
- (ii) Freeman, M., The Institute and Faculty of Actuaries. £11,000. 2011. **Clacher** – Co-investigator. [Project to analyse pension plan solvency and extreme market movements]
- (iii) Ayton, P., The Institute and Faculty of Actuaries. £199,893 (Amount to LUBS £9,751). 2018. An investigations of institutional investors' decision making. **Clacher** – Co-investigator. [Project to examine behavioural biases and trustee decision-making]

4. Details of the impact (indicative maximum 750 words)

The research provided more informed choices for pension fund trustees and a heightened awareness of the components of fund returns and specifically cost structures. This has increased awareness in trustee boards of not only fee structures but return measurement overall. This is a major development for the management of savings and investments, with significant economic impacts and repercussions for pension holders and investors.

Development and regulatory adoption of a new industry standard

Clacher's appointment by the FCA to the board of the IDWG **[A]** was a key step in applying his research knowledge to support the development of the new industry standard for disclosure of institutional investment cost data. The Chairman of the IDWG commented:

“The board [of the IDWG] had 32 members from the asset management and pension fund worlds, alongside regulators (both national and international), and various union representatives. All members were senior executives in their relevant companies. Dr Clacher was the independent pension expert and sole academic representative on the Board, and was the only candidate selected by the FCA from a large pool of applicants. Dr Clacher was invaluable to this enquiry and led a team of senior pension consultants to design the User Template, one of the three data standards that were the structured output of the enquiry.” **[B]**

The final set of hierarchical templates, including the User Template, were presented in the IDWG final report **[C]**. This report explains that the User Template was “designed to form the basis of

better and more involved conversations between trustees, their investment consultants, and their asset managers.” It continues: *“The proposed [User] template therefore aggregates data from the Account level template into broad categories of costs and fees for trustees to understand the costs incurred from the running of the overall fund or a specific asset class”* [C]. An advantage of the User Template is that it allows key costs to be clearly tracked over time and if there is a significant change in a cost category then trustees will be able to investigate what caused the shift [C, D]. The results of the testing of the User Template were presented by Clacher to the FCA and an audience from across the asset management industry in January 2018 [B].

A letter from the Interim Chief Executive of the FCA states: *“In July 2018, the FCA endorsed the proposals of the IDWG, including the User Template developed by Dr Clacher, and it is now included in a new industry standard on costs and fees disclosure.”* [E]

The Interim Chief Executive of the FCA confirms that the benefits of the User Template for the industry are that it has improved institutional investors’ access to key data. Furthermore, as a result of the aggregation of data into broad categories of costs and fees and the ability to segment by asset class or manager, trustees are now more likely to achieve their investment goals through better, more informed selection of managers and are in a better position to challenge and hold asset managers to account where costs are out of line with expectations [E].

Subsequently, the User Template has been rolled out as part of the Cost and Transparency Initiative (CTI) of the Pensions and Lifetime Savings Association (PLSA). The PLSA now manages the standards and templates that were built by the IDWG in collaboration with the Scheme Advisory Board (SAB) of the Local Government Pension Scheme (LGPS) of England and Wales and the Investment Association (IA) (the trade body that represents investment manager and asset management firms in the UK) [E].

Industry application and estimated cost savings

The PLSA website on the CTI (the industry standard) provides case study evidence that explains the implementation of the standard and the benefits to pension fund trustees [F]. The website includes four case studies by pension schemes, outlining the benefits of CTI:

- National Grid UK Pension Scheme: Now into the third year of using the CTI framework with an external data provider, they can provide their trustees with much more detailed management information and trend analysis, enabling them to assess and challenge themselves on achieving value for money [F].
- Royal Bank of Scotland Group Pension Fund: The scheme has been collecting cost data for eight years. However, the CEO stated that the introduction of the industry-standard CTI templates, rather than a bespoke process, reduces the time to collect the data from asset managers from two weeks to around two hours and gives the ability to benchmark fund costs accurately against other schemes [F].
- RPMI Railpen: From their own data collection in 2011, they believed their costs to be GBP80m per annum. However, after using CTI disclosure in 2019, they found that there was an additional GBP210m per annum of costs representing 1.8% of asset value. They estimate that they have been able to make a percentage point saving in annual costs with the Finance Director of the scheme advocating the CTI templates as they are now the industry standard for schemes to know what their costs are [F].
- West Midlands Pension Fund: The Director of Pensions states that the CTI has two key advantages over their own earlier in-house approach. First, it captures a broader range of costs, in a standard format. Second, it makes it easier for the investment community to respond (i.e. provide cost data) – reflected in the rate and volume of responses since using the CTI. They now have in-depth information on their asset management costs and fees on over 90% of their assets [F].

CTI Board member, and Chair of the Association of Consulting Actuaries highlights that the templates are not only beneficial for large schemes but have been even more helpful and significant to smaller schemes. Smaller schemes do not have the governance budget to employ Chief Investment Officers and in-house investment teams. The templates have therefore

enabled trustees of smaller schemes to better explain cost data to clients, improving decision-making [F].

Rather than collect their own data directly, most pension funds use a data service provider that collects large volumes of comparable data from billions of pounds of pension fund assets using the CTI templates. ClearGlass, for example, verifies this data for accuracy and provides additional services e.g., benchmarking. A further benefit of collecting data in the CTI format is the very powerful ability to examine trends over time [F – video with Chairman, Clearglass and Product Specialist, Caceis (collectively holding data on GBP575bn of asset funds)]. Trustees are able to not only understand their costs today, but they can also track them through time to make sure that they remain under control. The Interim Chief Executive, FCA commented:

“More broadly, it [the IDWG templates including the User Template] has been taken up by significant parts of the market through commercial organisations such as ClearGlass, bringing transparency to trillions of pounds of investment in UK pension funds.” [E]

Clacher’s research has contributed significantly to delivering transparency and cost savings to pension fund investments. The industry expert, Chairman of Clearglass (who is also the former IDWG Chair, Chairman of Fintech North, and Fintech Envoy for England for the UK Treasury) estimates the initial savings from the industry standard in the year 2018/19 to be in the range of GBP2tn to GBP3tn. This value is arrived at based on verified cost savings from the Clearglass platform of GBP2bn for their clients and extrapolated, to give a conservative estimate for the whole of market impact.

“As a result of the disclosure [User] template becoming the industry standard, for our pension fund clients, the cost savings amount to GBP2 billion in 2018/19... the overall cost savings to the market are of the order of GBP3 billion in 2018/19. Crucially, these are not one-off savings, these savings compound and persist. The overall cost savings to UK pensions over the next 35 years, the estimated time for defined benefit schemes to be run-off, will in aggregate approach GBP2 trillion through a combination of cost savings and improved decision-making by trustees.” [B]

5. Sources to corroborate the impact (indicative maximum of 10 references)

[A] The terms of reference, membership, and meeting minutes from the IDWG can be found here: <https://www.fca.org.uk/firms/institutional-disclosure-working-group> [accessed 15.02.21] [IDWG background and evidence of Clacher’s membership and contributions]

[B] Letter from Chairman, IDWG. Chairman, ClearGlass Analytics [14.09.20]. [The application of Clacher’s User Template and its associated cost savings]

[C] The final report of the IDWG to the FCA including the user template and recommendations to the FCA: <https://www.fca.org.uk/publication/documents/idwg-report-fca.pdf> [IDWG’s recommendation of Clacher’s User Template to the FCA]

[D] The FCA’s response to the IDWG Recommendations: <https://www.fca.org.uk/news/statements/christopher-woolard-statement-welcoming-idwg-recommendations> [FCA Interim Chief Executive’s statement welcoming the IDWG recommendations, including Clacher’s User Template]

[E] Letter from Interim Chief Executive, FCA [30.09.20]. [The development and adoption of a new industry standard to improve trustee decision-making]

[F] The PLSA webpage on Cost Transparency Initiative: CTI in Practice: with YouTube video explaining the CTI framework (disclosure templates) and the benefits [comments by CTI Board Member (JC) start 9 minutes into the video and comments by Chairman, Clearglass (CS) and Product Specialist, Caceis (SF) start 32 minutes into the video]. In addition, four CTI case studies by pension funds explain the problems of trying to gather data prior to the industry standardisation. <https://www.plsa.co.uk/Policy-and-Research-Investment-Cost-Transparency-Initiative> [accessed 05.01.21 – click on tab ‘CTI in practice’]