



Charges, returns and
transparency in DC:
what can we
learn from other
countries?

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Executive Summary

Value for money from workplace pensions is an important UK policy issue and pension fund charges, as an important component of value, have been the subject of particular scrutiny as around 10 million new members have been automatically enrolled into workplace schemes since October 2012.

These charges are generally compared nationally in order to assess whether they are reasonable. However, an international comparison could help further contextualise UK workplace pension charges and allow analysis of whether, on a global level, UK charges are high or low, transparent and offer good investment returns.

This report compares data for Defined Contribution (DC) workplace pensions from Australia, The United States (US), The Netherlands and Sweden to explore this question. It looks at the level of disclosed costs and charges in each country in the context of the country's pensions system, the investment returns achieved and also the transparency and effectiveness of the governance oversight of charging.

Making international comparisons is inevitably challenging given the differences in pensions systems and wider society and economy. As far as is possible, the report sets out these differences but conclusions need to be seen in this wider context.

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UK pension fund charges are generally toward the lower end of those in the countries studied

UK's benchmark levels of 0.5% Annual Management Charge (AMC), as the typical charge for the largest UK master trust schemes, 0.75% AMC cap for active members and 1% AMC for legacy workplace schemes, look towards the bottom of the international range.

Table Ex1 below selects some reference points from the charges data collated in the report for each country. Selecting the data as reference

points in isolation is open to criticism – these are not direct equivalents, mixing some average statistics with individual schemes. The intention is to illustrate what might be a typical level and structure of charge. It also helps to highlight that scale and fund style are components in determining charges.

However, as the data in the report show, there are wide variations in charges within markets as well as across markets and so averages and reference points can only show a part of the picture.

Table Ex1:¹ A comparison of reference point pension fund charges between countries

Country	Reference Point	Investment Charge (AMC)	Admin Charge	Total expressed as AMC ²	Default Fund Style
Australia	MySuper – average fees	0.50%	0.31% + \$74	0.96%	Active + direct investment
US	Large 401(k) (>\$250m) fund average	0.45%	0.05%	0.50%	Traditionally active, passive and target date increasing
Netherlands	PPI average charge	0.40%	€50 (employer paid)	0.90%	Passive, lifestyle
Sweden	IIP /Folksam default fund	0.19%	1% of contributions	0.34%	Insured fund with minimum guaranteed annual return
UK	Large Master Trust average	N/A	N/A	0.48%	Passive, lifestyle

US charges are competitive with UK charges

Mid-sized US plans (>\$25m) are, on average, operating at the level of the UK cap at 0.75% AMC and larger schemes (>\$250m) average around 0.5% AMC or lower. The largest schemes (>\$1bn) charge less than 0.40% AMC on average. It is possible that this understates the costs slightly as some employers pay for administration fees that are not required to be disclosed.

Dutch and Swedish member charges look competitive but overall charges are more complex

Dutch figures also look competitive with those for the UK as regards the fees levied direct to members but when the relatively high level of administration fees (borne by employers in Holland) are taken into account, the total costs are probably significantly higher.

1. Sources: Rice Warner (2018);Blanchett & Ellenbogen (2017); LCP (2018); DWP (2016); Provider website information
2. We have used the DWP equivalence table to estimate these, as set out elsewhere in this report except for the Australian fees where we have used the APRA standard basis of fees per \$50,000 balance. If we used the DWP equivalence guidance basis the total charge would be around 1.30%.

Fund costs for Swedish DC look very competitive as a result of the buying power exerted by the four occupational schemes in the market, but these are combined with contribution charges and/or fixed fees. Also the default investments are typically in insured funds with minimum income guarantees but lower expected returns. This produces a more complex picture.

But it demonstrates how the scale created in a small market through this social market structure can deliver internationally competitive fee levels.

Australian charges are relatively expensive in this group though reforms and disclosure regulations are pushing prices down

The Australian market does look relatively expensive in this comparison group, with the wide variation of retail and wholesale pricing dragging average levels up to around 1%. This is also a market that has traditionally offered more services, such as life and disability insurance and financial advice bundled in.

The introduction of MySuper and further reforms and disclosure regulations are perceived to be having an effect in pushing down pricing in the retail sector and consolidating smaller funds into larger.

The UK does not exhibit a 'long tail' of high charging schemes

As well as having lower fees overall, the UK also does not exhibit a 'long tail' of high charging schemes, such as those seen in Australia and the US. In Australia, the number of funds significantly in excess of 1.5% AMC – dubbed the 'long tail' – represents around 15% of scheme members and 10% of assets.

The UK charge cap of 0.75%AMC for automatic enrolment schemes is the key factor but regulatory action on older non-qualifying schemes combined with increased governance, for example, through the introduction of Independent Governance Committees (IGCs) for contract workplace pension schemes with larger providers is also a contributory factor.

Charge levels are reducing at around 2% pa. long-term in Australia and the US

Time series data from Australia and US suggest that DC costs are reducing at a long-term rate of around 2% per annum.

Key factors driving down fees have been attributed in Australia to increases in average individual pension pot sizes, reducing provider margins, other operating scale benefits and larger investment mandates.³

Key factors driving down fees have been attributed in Australia to increases in average individual pension pot sizes, reducing provider margins, other operating scale benefits and larger investment mandates.

The analysis of US 401(k) fee data by scheme size also shows the inverse relationship between scale and fee levels and mutual fund data shows the reducing trend in expense ratios within asset class. These support the view that economies of scale are reducing costs, although the trend from active to passive investment⁴, with the consequent structural reduction in asset management costs, may also be a contributory factor in both markets.

This observed rate of reduction could provide a rule of thumb figure to assess how quickly charges might be expected to move in a growing DC market, such as the UK. This might help inform decisions about changing the UK charge cap. A reduction from 0.75% AMC to 0.50% AMC, for example, would represent a 33% reduction, equivalent to over 15 years' worth of scale and efficiency change, based on the Australian and US experience.

3. Rice Warner (2014b)

4. Passive funds invest in indices or assets automatically reflecting the overall returns from a group of assets whereas active funds rely on fund managers selecting which individual assets to hold within a group of assets and making active decisions about when to change their holding based on their view of likely future returns.

Understanding the underlying economies of scale in the UK could help improve outcomes

The way in which the economies of scale play out will be important to understand as part of the charges debate as they are likely to follow different paths for asset management and administration. In the UK, a scale jump in the overall DC market has been already been achieved for administration as a result of auto enrolment but asset growth will accelerate with the incremental staging of contributions rates and consolidation of traditional single employer schemes now taking place.

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An extended period is expected to repay the level of investment made by the sponsors and providers of UK schemes to deliver automatic enrolment at the current level of pricing, as illustrated by the finances of NEST. Recovery of costs in the UK DC system typically bears down on members, rather than employers, through member charges. Analysis of Australian charge changes also shows how costs of change can reduce, at least temporarily, the effect of economies of scale and efficiency on charges.

Current UK disclosure does not facilitate direct examination of how costs are changing as it does in the Netherlands or Australia – there is no current requirement to break down the charges made between investment and administration. It may be important for all stakeholders in the UK market to have access to this data and to facilitate attribution analysis to manage outcomes better as scale grows in UK DC.

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The countries explored vary in investment approach

There is a range of approaches to investment across the comparison countries with Australia having probably the greatest commitment to traditional active and alternative and/or direct investments, the US transitioning slowly from active to passive investment management for DC, whilst the Swedish and the Dutch are still committed to guarantees in their pensions through insured (Sweden) or shared-risk (Dutch CDC) approaches. The UK is further down the road than the US toward passive investing for default funds.

Overall UK pension fund investment returns generally compare favourably with those from other countries

At the level of the OECD global data, overall UK Pension fund returns compare reasonably favourably with those in the country group with real net returns of 7.3% over the last 5 years.⁵ However, these statistics conflate returns on both Defined Benefit (DB) and DC funds which have significant differences in investment strategies and are targeting different outcomes.

Drawing conclusions regarding DC return comparisons is challenging given the complexity and diversity of individual DC fund performance. A 2017 survey of nine UK DC pension provider default funds reported wide variations in the structure of default funds with three year returns ranging from 6.5% - 12% and exposure to equities ranging from 45% - 85%.⁶

5. OECD (2017b)

6. Punter Southall Aspire (2018)

Fee transparency initiatives can be successful when industry works closely with regulators

The difficulties with the implementation of the new Australian (RG97) disclosure regime,⁷ which have experienced both technical data issues and presentational problems, contrasts with the experience of the Dutch with greater fee transparency. The Dutch approach to drive forward voluntary proposals with regulator backing has ended up in a practical system that has improved the transparency of charges and is credited with impact on industry behaviour.

The UK approach, with the recent launch Institution Disclosure Working Group initiative (IDWG), can be seen as working down a similar path, albeit behind the timeline of the Dutch. It will be important to monitor the impact of fee disclosure in the UK asset market as trustees and IGCs gather and analyse the data now becoming available under the IDWG disclosure template.

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Transaction costs data disclosure is patchy but developing

Transaction cost data disclosure is emerging for all countries studied with the exception of the US. These costs are not levied directly but are charged within the fund being reflected in the reduced value of the assets.

Disclosure of investment transaction costs is most developed in the Netherlands, having introduced a voluntary disclosure regime in 2011 as part of the wider disclosure of pension fund costs. Australia is introducing statutory disclosure of transaction costs as part of its wider RG97 disclosure reforms but this is on-going and incomplete. In the UK more data is becoming available under the new EU PRIIPs and MIFID II disclosures, the FCA's rules on disclosure to IGCs and trustees of DC schemes under PS17/20, and DWP's regulations for publication and reporting of costs and charges by DC schemes. However, there is little analysis of this data so far. This may accelerate with the introduction of new voluntary investment fund disclosure sponsored by the FCA. There is no transaction data currently available for the US or Swedish funds.

7. This is discussed in more detail in Chapter one

Introduction

Pension fund management charges are generally compared nationally in order to assess whether they are reasonable. However, an international comparison could help further contextualise UK charges and allow analysis of whether, on a global level, UK charges are high or low, transparent and offer good returns.

International pension fund charges are affected by the economic environment, institutional operation, governance trends and regulatory structure within their country of residence. Therefore, any comparison of international fund charges requires an analysis of the characteristics of the country in which the fund operates.

This report explores what international data is available and to consider these in their own national context to set out:

- A presentation of the range of pension fund management charges (including transaction and administration costs if available) in Australia, the United States (US), the Netherlands and Sweden;
- An analysis of what is included in the charges of different schemes (so that comparisons can be made, as far as possible, on a like-for-like basis) and how transparent such charges are;
- An assessment, where possible, of the relationship between charges and performance so that some idea of the return can be identified;
- An exploration of the economic, operational, governance and regulatory structures in each country and any additional relevant factors; and
- An analysis of the implications arising from the research to ask:
 - How do UK charges compare to those of other countries?
 - Are UK pension funds low, high or within range of other countries?
 - What might account for the differences between the UK and other countries in charges and performance - factors such as scale, maturity or regulation?
 - Are there particular lessons which can be learned from how international pension funds charge that would be relevant in the UK?
 - Are there ways that UK funds could alter their practices which would lead to lower charging and/or better value being delivered?

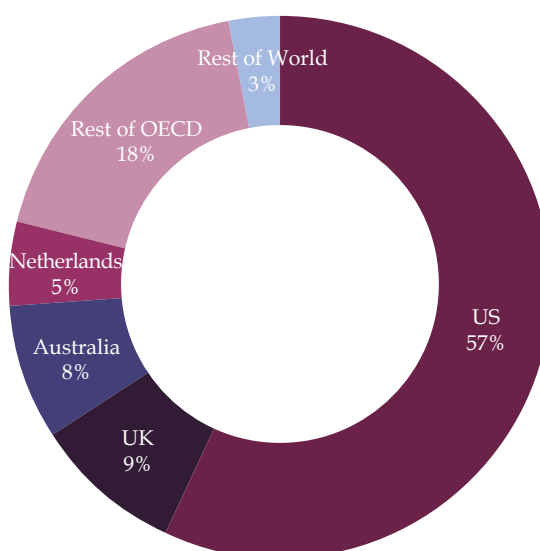
These countries were chosen because:

- They have large assets in funded pension schemes – together with the UK, they are reported to cover in excess of 75% of worldwide funded pensions assets (Chart 1).
- Occupational pensions form a significant part of the overall pensions architecture and are strongly incentivised by government policy and the employment environment.
- They all have significant Defined Contribution (DC) infrastructure and modern DC scheme designs as an important component of their occupational pensions landscape.
- They share a broadly similar approach to investment based on an appropriate mix of equity, debt, cash and, where possible, other assets to match the risk capacity of scheme members.
- The use of ‘lifestyling’, referred to as ‘lifecycling’ in the US, or other similar approaches (such as target date funds) to reduce the risk of shocks to expected retirement income for members drawing their funds around retirement by progressively and automatically switching assets into lower risk asset classes such as bonds and cash.
- There are similarities in the approach to governance and regulation of pensions savings and globally they are seen as having high standards (all but the US being rated A for integrity by the Melbourne Mercer Index⁸).
- The Swedish model received considerable attention during the development of UK pensions policy to deliver automatic enrolment.
- Data is available and accessible in the public domain.
- The PPI have strong contacts with English-speaking experts familiar with these markets.

Chart 1:⁹ Total Investment of pension funds and all retirement vehicles by Country 2016 (occupational and personal, mandatory and voluntary, public and private sector, DB and DC)

US, UK, Australia and Holland hold most of the world’s pension assets

Total investment of pension funds and all retirement vehicles, 2016



8. Mercer (2018)

9. OECD (2017a)

The UK DC system shares similarities with those in other countries included in the scope

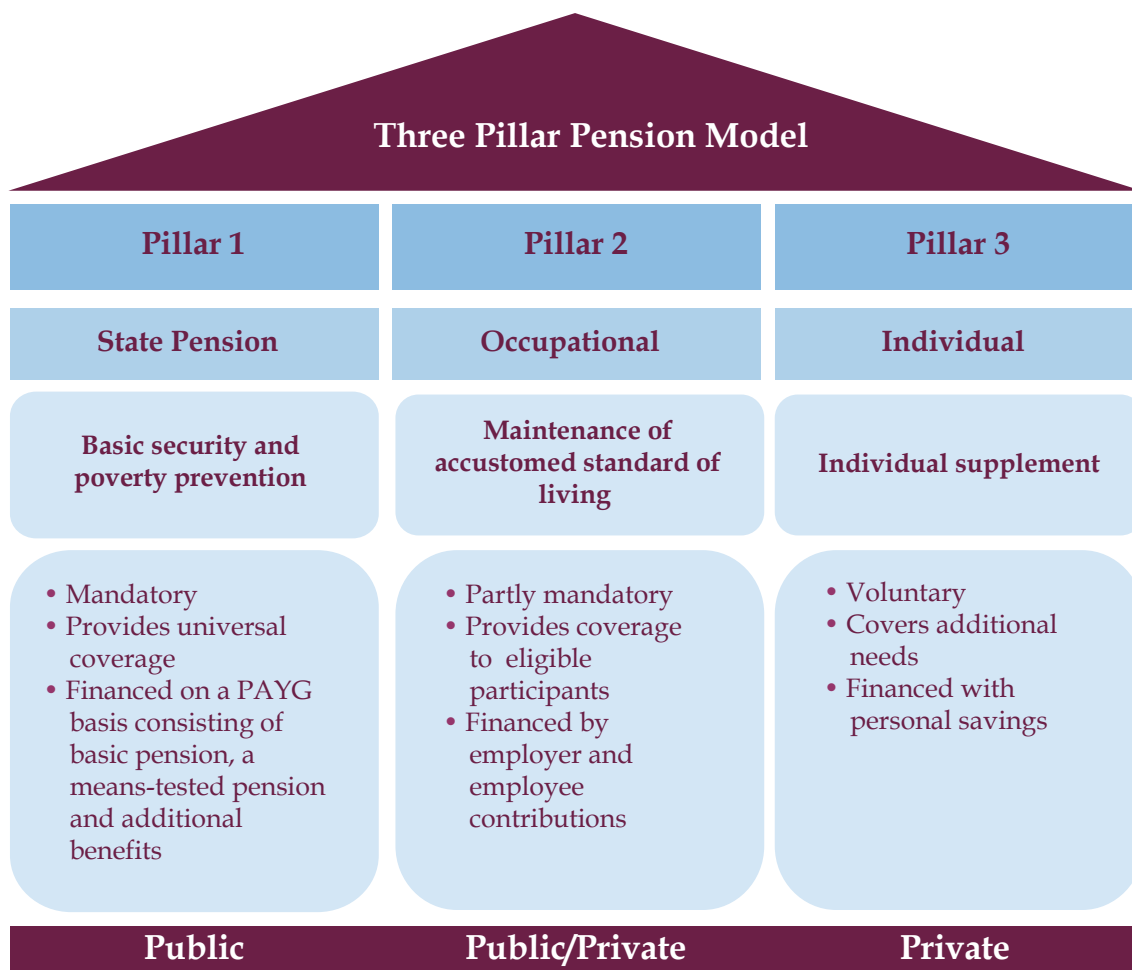
The UK DC pensions system shares a number of similarities with those in the US, Australia and the Netherlands, though not as much with Sweden, which is dominated by four schemes

negotiated in collective labour agreement, but uses funded DC as a significant part of the benefit structure with some degree of choice in its architecture.

The three pillar model is a common way to think about the structure of a country’s pension system as set out in Figure 1.

Figure 1: The Three Pillar Pension Model

The three pillars of pension systems



For all these countries, the Tier 2 (Workplace Pensions) form a vital part of retirement income entitlement, especially for those on median or higher incomes. The employer is central to provision as they usually make the choice of scheme and provider. Even in Australia,

where many employees can contribute to any compliant Super, the employer is still responsible for nominating the default fund.

The following analysis sets out an overview of the pension systems components in each of the countries examined.

	UK	US	AUSTRALIA	NETHERLANDS	SWEDEN
PILLAR 1	<ul style="list-style-type: none"> • New and basic State Pension, provided by the state on PAYG basis • Consists of a flat-rate pension income • National Insurance contributions and credits count towards entitlement, a minimum of 10 qualifying years is required • Intends to provide a basic pension to low earners and an incentive to save in a private pension 	<ul style="list-style-type: none"> • Social Security, a PAYG earnings-related pension benefit • Financed through social security taxes paid by employers and employees • Aims to partially replace income lost due to old age, death of spouse and/or disability 	<ul style="list-style-type: none"> • Age Pension, provided by the state • A means-tested pension scheme, which takes into account an individual's income and assets • Aims to act as a safety net for pensioners and supplements the retirement for those with lower levels of private savings 	<ul style="list-style-type: none"> • Age pension • Provided by the state • Funded on a PAYG basis and consists of flat-rate basic retirement income which is linked to the statutory minimum wage and subsistence level • Aims to provide a basic income in treatment and protect against poverty in old age 	<ul style="list-style-type: none"> • National retirement pension system • Consists of a PAYG notional account system, mandatory funded DC pension and a DB pension income-tested top up • Aims to provide adequate earnings-related retirement benefits with universal coverage and a safety net for the elderly
PILLAR 2	<ul style="list-style-type: none"> • Provided by private pension arrangements, not directly funded by the state • Consists of DB and DC pension schemes, including pensions arising from automatic enrolment • Funded by employer and employee contributions • Aims to redistribute income across an individual's lifetime 	<ul style="list-style-type: none"> • Private pension arrangements employers may offer to employees • Consists of occupational DB, DC or hybrid schemes • Provided by employers, but can also be sponsored by states and municipalities • Aims to provide retirees with multiple distribution options, as well as maintain accustomed standard of living 	<ul style="list-style-type: none"> • Superannuation Guarantee • Provided by the private sector • Consists of mandatory employer contributions to an employee's superannuation fund • Superannuation funds operated by employers, industries association and financial services • Intends to be a compulsory means for saving for retirement 	<ul style="list-style-type: none"> • Consists of occupational DB, CDC and DC pension schemes • Pension schemes are required to be separate from employers and are administered by a pension fund or an insurance company • Pension funds broadly divided into industry-wide, corporate and independent professionals. Aims to allow pensioners to maintain the standard of living of their working careers 	<ul style="list-style-type: none"> • The additional professional retirement plans of company based systems • Consists of occupational DB and DC pension schemes • There are four main pensions schemes: <ul style="list-style-type: none"> • STP – blue-collar workers • ITP – white collar workers • PFA – local govt. office workers • PA-03 – civil servants • Aims to be a compulsory means for saving for retirement
PILLAR 3	<ul style="list-style-type: none"> • Provided by private pension arrangements • Consists of individuals taking out a pension contract with a pension provider • Includes personal savings • Aims to provide for additional needs 	<ul style="list-style-type: none"> • Individual saving arrangements • Most common individual retirement accounts are individual retirement annuities (IRAs) • Aims to cover additional needs 	<ul style="list-style-type: none"> • Provided by voluntary superannuation and other private savings • Self-managed • Aims to provide for additional needs 	<ul style="list-style-type: none"> • Individual arranged private pension products • Primarily used by self-employed and employees in sectors where there is no industry-wide arrangement • Also used to top up retirement savings 	<ul style="list-style-type: none"> • Voluntary pensions and individual pension plans • Aims to provide for additional needs

The UK benefits from having a large existing pension infrastructure which has been leveraged by the new DC schemes

In the UK, there is a diverse market for DC schemes with the employer able to sponsor their own scheme or select schemes from an insurance company or Master Trust. The UK benefits from having a large existing pension infrastructure and whilst DC schemes are still relatively immature, many DC schemes are able to leverage off the scale of existing DB schemes, particularly through possible economies of scale in asset management.

The UK has a distinctive feature in National Employment Savings Trust (NEST), created by the UK government as a key part of the automatic enrolment architecture, to ensure that all employers can provide access for employees to a pension scheme at institutional pricing regardless of the broader market's appetite to supply.

Nevertheless, the significant investment in new DC architecture will need to be recouped in the system medium term and largely direct from members as few employers are willing to pick

up administration and governance costs. This also powers a continuing and growing move¹⁰ from individual trust based schemes to master trust or contract schemes, especially in medium sized firms.

Charges pay for a wide range of services

Pension charges in the UK are typically presented as a single Annual Management Charge (AMC) figure but they pay for a wide range of services. In other comparison countries, the charge is typically split into separate charges made for 'investment' and 'administration' or 'record keeping'.

It is worth noting the range of services that are covered by these headings as they include a number of components. Each can have an important impact on outcomes and value for the member in terms of the quality of scheme offered and the ability of members to engage with choices available to them.

A list of typical components is set out in Figure 2.

Figure 2:¹¹

List of typical investment and administration services

'Investment' and 'admin' cover a wide range of services

- **Investment:**
 - Fund design and oversight
 - Purchase and sale of assets
 - Fund management
 - Fund administration and valuation
 - Fund reporting and communication
 - Custody
 - Fund audit and compliance
- **Administration:**
 - Scheme design and authorisation
 - Contribution collection
 - Record keeping
 - Participant communication
 - Participation education and tools
 - Audit and regulatory compliance
 - Governance and oversight

Ancillary services such as life and disability insurance or financial advice may also be included in schemes which may also have an effect on overall scheme design, communication, audit and governance costs, even though the direct cost of these services will usually be charged for separately. Our comparisons have sought to exclude separate charges for ancillary services.

Making fair and reasonable comparisons raises a number of challenges

To address the challenge of making fair comparisons across different countries the research adopted a number of strategies:

- Focus on group pensions provision in the workplace, sponsored or facilitated by employers, as the closest equivalent to the

10. Kaveh (2018)

11. Holden, Duvall & Barone Chism (2018)

predominant provision in the current UK DC market under automatic enrolment. Such workplace provision is often referred to as 'Pillar 2' provision when describing a national pension architecture;

- Where possible, gain an understanding of the scale and maturity of the DC schemes as two of the key metrics influencing the pricing of asset management and administration services;
- Focus on the investment fund design most often delivered to members, whether this is a default or not, and how closely this compares with typical UK default design;
- Identify what ancillary benefits and services may be bundled for members – for example, life or disability insurance or financial advice – and seek out pricing for the core offers of retirement fund investment management and account administration; and
- Look also at the chain of supply – the decision makers, intermediaries and providers - in the market and how this compares to the UK market structure and what this might suggest about comparative efficiencies and delivery of value to members.

There are issues comparing different shapes of charges

Asset manager charges are universally quoted as a percentage of the fund per annum, a form usually referred to as an AMC. In addition to AMCs, administration charges can also be levied as a flat fee per annum or as a percentage charge on contributions. All of these forms of charge are present in the UK DC market.

To aid comparison they are commonly converted into a broadly equivalent AMC. It should be noted that for individual members and for providers, the form of charge has important implications, but this report makes comparisons where possible using AMC and uses the UK Department for Work and Pensions (DWP) guidance as a base to compare. It is also worth noting that the DWP guidance does not consider transaction costs as a component of charging.

In Table 1, each of the rows is assessed by the DWP as an equivalent level of charge. So, for example, a 0.5% AMC combined with a £15 flat fee or a 1.8% contribution charge, is deemed equivalent to 0.75% AMC only charge.

Table 1:¹² DWP charge equivalence guidance

AMC	+ only one of these ...		Equals a total AMC of
	Flat fee (p.a.)	% of contribution	
0.75%	£0	0%	0.75%
0.60%	<£10	<1%	0.75%
0.50%	£10-£20	1%-2%	0.75%
0.40%	£20-£25	2%-2.5%	0.75%

From these, we can assess £15 fee¹³ as broadly equivalent to around a 0.2% AMC – as you would need to reduce the AMC by around 0.20% (interpolating between the second and third lines of the table) to make the total AMC 0.75%. Similarly a 1.8% contribution charge could be assessed as equivalent to just under 0.25% as an AMC.

Structure of the Report

Chapter one considers charges, returns and transparency and governance in Australia.

Chapter two considers charges, returns and transparency and governance in the United States.

Chapter three considers charges, returns and transparency and governance in Europe looking at the Netherlands and Sweden.

Chapter four draws some comparisons from the preceding chapters with the current UK DC market.

12. DWP (2016)

13. When required to assess in a UK context, we have converted using the following currency rates: £1=€1.15; £1=\$1.3; £1=A\$1.85; £1=SEK12

Chapter one: Australia

This chapter explores charges, returns and transparency and governance in the Australian superannuation market.

Charges

Concern about the high level of Super fees

In 2014, the Australian Financial Systems Inquiry (FSI) published a report detailing average charges for Superannuation Schemes

(Supers) based on 2013 data as set out in Table 2. The FSI were concerned that fees had not reduced significantly over the previous 10 years despite the increase in assets in the system in that period.

Table 2:¹⁴ Average fees by Superannuation segment – year to 30 June 2013

Sector	Segment	Operating	Investment management	Operating and investment management	Advice	Total fees
Wholesale (Workplace)	Corporate	0.26%	0.49%	0.76%	0.02%	0.78%
	Corporate Super Master Trust (large)	0.22%	0.45%	0.67%	0.19%	0.86%
	Industry	0.41%	0.62%	1.03%	0.04%	1.07%
	Public sector	0.2%	0.52%	0.72%	0.04%	0.76%
Retail	Corporate Super Master Trust (medium)	0.58%	0.48%	1.06%	0.24%	1.3%
	Corporate Super Master Trust (small)	1.04%	0.5%	1.53%	0.16%	1.69%
	Personal Superannuation	0.84%	0.53%	1.37%	0.36%	1.73%
	Retail Retirement income	0.55%	0.62%	1.17%	0.54%	1.71%
	Retirement Savings Account	0.6%	0.1%	0.7%		0.7%
	Eligible Rollover Funds	1.97%	0.46%	2.43%		2.43%
Small funds	Self-Managed Super Funds	0.26%	0.54%	0.8%	0.15%	0.95%
Total		0.4%	0.55%	0.95%	0.17%	1.12%

14. Rice Warner (2014b)

- This data show that, at that time, the overall average AMC charge for asset management was 0.55% and for administration 0.4%, a total of 0.95% AMC.
- If retail funds are excluded, then the ranges for average corporate and public sector occupational schemes are around 0.5% AMC for asset management and 0.2 – 0.25% AMC for administration.
- Industry funds had significantly higher charge levels but also much lower average funds per member - industry funds in 2017¹⁵ having A\$45,000 per member (A\$168,000 for corporate, A\$162,000 for public sector), little more than one quarter of the size.

More than a million Super members use Self-Managed Super Funds (SMSFs) - where the members are also the trustees and are restricted to a maximum 4 members. These funds hold over 25% of total Super assets (A\$700bn). Whilst large fund SMSFs are broadly competitive with institutional funds in terms of net returns, smaller ones (<A\$1m) perform worse due to higher average costs.¹⁶

Over the period June 2004 to June 2013, overall Super funds grew by just under A\$ 1tn, from A\$625bn to A\$1,617bn – a compound growth rate of 11.1% p.a.

Over the same period, average fees (excluding SMSFs) fell by 20 basis points.¹⁷ The analysis in Table 3 below shows the attribution of the changes in fee levels, with the key factors driving down fees being:

- increasing average balances (i.e. individual pension pot sizes);
- reducing provider margins;
- scale benefits in operating expenses; and
- larger investment mandates.

This suggests that the increasing size of Super funds are bringing economies of scale, offset by a number of change costs.

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Table 3:¹⁸ Attribution Analysis of Super AMC fee changes 2004-2013

	Driver	Change in fees
Market forces	Margins	-0.15%
	Market shares	0.1%
	Corporates shift to MEFs	-0.03%
	Pensions	0.01%
Operating expenses	Marketing	0.05%
	Reform implementation	0.04%
	Advice	0.02%
	Average balances	-0.19%
	Scale benefits	-0.14%
Investment expenses	Larger mandates	-0.09%
	Higher direct management costs after GFC	0.08%
	Asset allocation	0.03%
	MDI	0.02%
	Higher performance fees in 2013	0.02%
Other	Interaction and others	0.11%
Total		-0.2%

15. APRA (2018)

16. Australian Government Productivity Commission (2018)

17. A basis point is one hundredth of one percentage point, so one basis point = 0.01%

18. Rice Warner (2014b)

Analysis of expected future trends in 2014 predicted that increasing passive investing along with the upcoming reform package, 'Stronger Super' would also be drivers of cost reduction.

Analysis of expected future trends in 2014 predicted that increasing passive investing along with the upcoming reform package, 'Stronger Super' would also be drivers of cost reduction.

More recent data shows that overall total average Super fees have fallen by 26 basis points from 1.26% AMC to 1.00% AMC in the period 2006- 2017 - just over 20% in 10 years or 2% per annum.¹⁹

Case Study: 'MySuper'

In June 2013, the Australian Government implemented significant reforms in the system, under the banner 'Stronger Super'.

A key part of these reforms was the introduction of 'MySuper' to replace the previous default funds system with a new default system using low cost and simple products for the 80% of employees deemed to be disengaged from their superannuation fund.

Mandated features include:

- a single, default investment choice;
- standardised fees for all members;
- basic default life and total permanent disability insurance; and
- no commission or advice charges.

Since 2014, employers have been required to make default contributions on behalf of employees to a MySuper product.

Rice Warner comment that this resulted in a significant compression of margins as average fees converged around a figure of 1%AMC whilst implementation costs of these and other reforms have pushed up costs short term by up to 10 percentage points. At launch, the average total MySuper fees by sector ranged from around 0.8% AMC in the public sector to 1.1% AMC in the retail sector.

Alongside this, other Stronger Super reforms sought to:

- facilitate account consolidation and improve the efficiency of collecting and allocating funds through the application of data standards and e-commerce for funds and employers under the 'SuperStream' initiative; and
- ban the use of commission and volume-related payments in the distribution and advice of retail financial products under the Future of Financial Advice (FoFA) package of legislation.

MySuper impact felt on retail products but not large occupational schemes

Looking specifically at the movement of charges on default funds, Table 4 shows a reduction in the average default fund AMC from 0.92% in 2011 to 0.81% in 2017 – a reduction of 11 basis points or 12% over 7 years. But they also report

a slight increase in the average per member fees from A\$61 to A\$74. The AMC drop was largest in the retail funds from 1.59% - 0.97% whereas average fees for corporate and public sector funds increased marginally as shown in Table 4.

19. Rice Warner (2018)

Table 4:²⁰ Default options and MySuper product fees – average fee by segment 2011-17

	2011 Default Option		2017 MySuper	
	Average A\$ per member fee	Average % of assets fee	Average A\$ per member fee	Average % of assets fee
Corporate	A\$103	0.68%	A\$81	0.76%
Retail	A\$62	1.59%	A\$75	0.97%
Industry	A\$65	0.83%	A\$75	0.79%
Public Sector	A\$27	0.53%	A\$57	0.73%
Total	A\$61	0.92%	A\$74	0.81%

Large funds have continued to invest actively with the introduction of MySuper although some smaller industry funds have increased the proportion of passively managed funds. These funds also invest in a wider range of assets with around 20% of funds allocated to non-listed assets (direct property, infrastructure and other alternatives). MySuper is also reported to have led to an increase in the number of funds offering lifestyle investment options.²¹

Australian pension fund charges are not considered competitive in the global market

The Australian market does look relatively expensive in the comparison group with higher average fees and the wide variation of retail and wholesale pricing dragging average levels up. This market that has traditionally offered more as part of its DC pensions offer, with additional benefits such as life and disability insurance and financial advice bundled in.

The introduction of MySuper and further reforms and disclosure are perceived to be having an effect in pushing down pricing in the retail sector and consolidating smaller funds into larger. But the sense of political frustration with these continuing higher charging levels is evidenced by the tone of commentary in the AGPC's latest publications and the search for new policy interventions to improve efficiency and drive competition.

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Despite the 'Stronger Super' reforms of 2013, the AGPC believe there is little effective competitive pressure in the Australian market and the potential benefits of the increasing scale of Super assets are not resulting in lower fees for Super members. They advocate changes to the

20. Rice Warner (2018)

21. Rice Warner (2014)

choice architecture to direct members to ‘best in show’ contracts to improve outcomes. They are also concerned about the number of funds with charges significantly in excess of 1.5% AMC - dubbed the ‘long tail’ - representing around 15% of both scheme members and assets. They

conclude that “the costs incurred by Australian superannuation funds are some of the highest in the OECD” and ask whether “the Australian system can ‘do better’ for members through lower fees, and ultimately higher net returns”.²²

Returns

Australian returns are towards the bottom of the comparison group

Data from the OECD shows that the average net real returns on all Australian Pensions Assets were 6.1% in the 5 year period 2011-2016.²³ This figure is toward the bottom of the comparison group, 1.2% less than the UK.

More recent data shows that these returns have edged upwards. Figures to June 2018, set out in Table 5 show 5 year real returns at 7.0%.²⁴

Table 5:²⁵ Australian Super Fund investment returns to June 2018

Period (%pa)	Nominal Return	Real return
1 year	9.1	6.8
5 years	9.0	7.0
10 years	6.5	4.3

The AGPC has reviewed net 10 year annualised investment returns to 2017 in the Super system and concluded that “funds on average perform close to or above benchmark” in all asset classes except unlisted infrastructure which underperformed. They also comment that occupational schemes outperformed retail schemes in key asset classes. They concluded that Australian funds performed better on average than international peers in cash, fixed income and unlisted assets but worse for domestic listed equity, private equity and listed property.^{26, 27}

Transparency and Governance

Greater transparency is a work-in-progress in Australia

Most Australian Supers are administered by not-for-profit entities which are set up as trusts. Since 2006, all superannuation trustees

are required to register with the Australian Prudential Regulatory Authority (APRA). The market conduct of super funds is regulated by the Australian Securities and Investment Commission (ASIC) who also supervise disclosure to members via Product Disclosure Statements (PDSs).

The standards for PDSs were enhanced in 2017 with the implementation of the RG97 measures. Intended to create consistency and transparency in the disclosure of fees and costs that make up the net investment return, including transaction costs, the implementation has been problematical with, for example, no methodology prescribed to calculate the implicit costs embedded in the price paid for an asset. This has proven particularly problematic for non-traded assets – such as property, infrastructure and private equity. In the UK, high level approaches to calculating transaction costs for illiquid assets were included in

22. p131, Australian Government Productivity Commission (2018a)

23. OECD (2017b)

24. The figures to June 2018 drop the particularly poor year of 2012 for Australia at 0.6% real return

25. ASFA (2018)

26. The domestic equity shortfall was particularly significant as in this key component Australian funds underperformed US DC funds by around 3%p.a.

27. Australian Government Productivity Commission (2018b)

the FCA's rules for disclosure to DC scheme trustees in September 2017.²⁸ In addition, specific, separate schedules have been designed for these assets as part of the IDWG's disclosure proposals to elicit meaningful data for trustees and advisers.

ASIC indicated that additions to disclosed fees and indirect costs range from a few basis points to nearly 1%. As a result, the system is yet to reach the desired level of consistency of data and ASIC continues consultation on this issue. Rice Warner estimate that disclosed Super costs may have risen by around 25 bps under the new basis (RG97).²⁹

A further aspect of the 2017 changes was the requirement to disclose of total fees in A\$ amounts to members.

An independent review, commissioned by ASIC, has concluded that the comparison tools available to consumers "contain numerous limitations that severely inhibit" this role and that comparing products using the PDS of each would be too laborious for most consumers. The review recommends ASIC look into developing a searchable consumer-facing facility that compares fee and cost information extracted from PDS.³⁰

28. PS17/30

29. Rice Warner (2018)

30. Hurley (2018)

Chapter two: The United States (US)

This chapter explores charges, returns and transparency and governance in US DC, focusing on 401(k) plans.

401(k) plans are employer-sponsored DC schemes - the name 401(k) derives from the section of the US tax code that governs them. 401(k) plans were originally created as supplementary plans for Defined Benefit (DB) schemes in the 1980s. But with the shift to DC, they are now the main vehicle for occupational pensions.

Larger schemes in the US operate at around 0.50% AMC or less

The effect of scale is clearly shown in the US 401(k) market. Larger US schemes tend to charge an average AMC of around 0.5%, while smaller ones tend to average around 0.75%.

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Morningstar in the US have created a benchmarking system for DC plans, piecing together data from that required to be disclosed on Department of Labor (DoL) 5500 forms by employee benefit plans, SEC disclosures and other sources.

This data has become more important in the market with the introduction in 2017 of DoL's "best interest" standard, requiring an evaluation of "in-plan" portfolios relative to "out-of-plan" portfolios in Individual Retirement Accounts (IRAs), including an estimate of plan expenses, in providing fiduciary advice. Through this tool, Morningstar have provided a set of 10

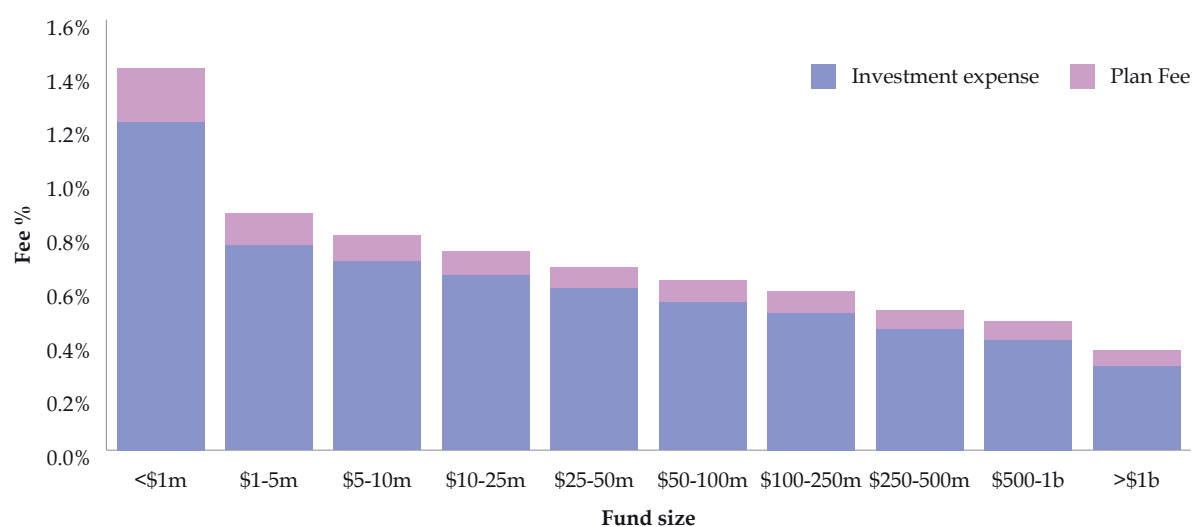
benchmarks based on DC plan size, to be used when actual plan cost data is unavailable to the investor or their adviser.

These benchmark figures are set out in Chart 2 below, showing that mid-sized plans (>\$25m) are on average operating at the level of the UK cap at 0.75% AMC and larger schemes (>\$250m) around 0.5% or lower.³¹

Chart 2:³² Benchmark US DC scheme costs by fund size

Large US schemes operate at 0.50% or less

Benchmark US DC scheme costs by fund size



The 2016 Plansponsor Defined Contribution Survey shows a similar level of charges from respondents but also shows the range of charges across different fund sizes. The data, set out in Chart 3, suggest that of those respondents sure of their charges levels, 70% of all schemes have charges less than 0.75% and for larger schemes (\$200m+) the majority are under 0.5%. But it is worth noting that overall around a third (32%) of respondents said they were unsure of their charge levels and were biased heavily toward the smaller schemes.

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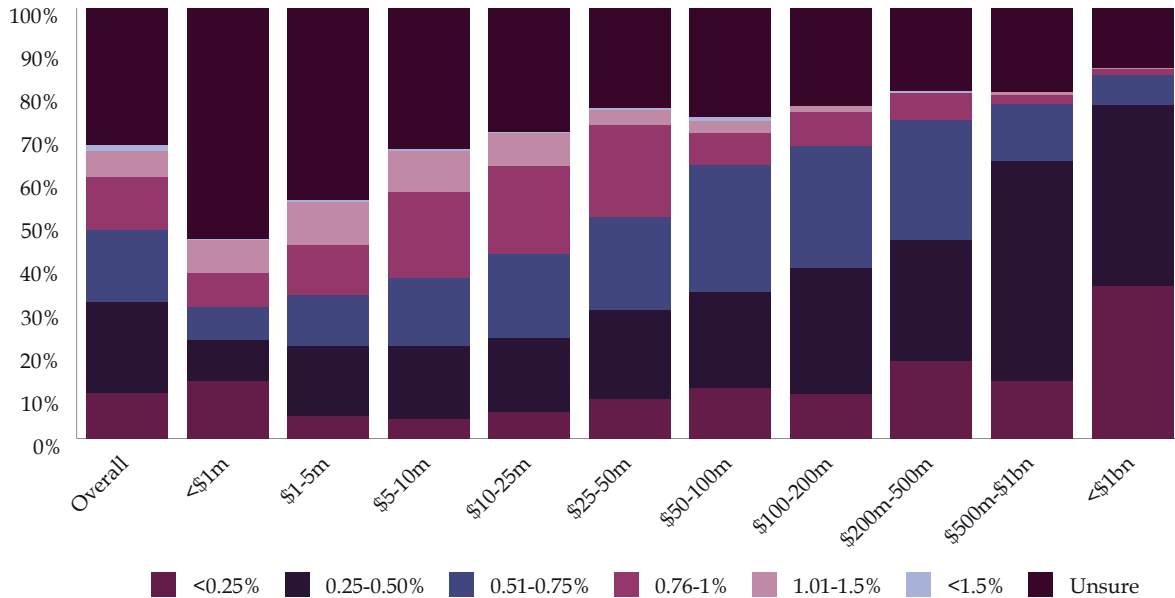
31. By way of comparison, in 2017 there were 120 UK DC trust schemes with 1000-4999 members with assets of £6.7bn, an average of £56m per fund and 70 UK DC schemes with 5,000+ members with assets of £28bn or £401m per fund according to The Pensions Regulator DC trust returns data 2016-17 accessed at <https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-presentation-of-scheme-return-data-2016-2017/#f74e09212c524f7e86989ad30cc0e6a7>

32. Blanchett, D and Ellenbogen, P (2017)

Chart 3:³³ Proportion of funds reporting different charges by scheme fund size

70% report scheme charges under 0.75%

Proportion of funds under different AMC charges by scheme size



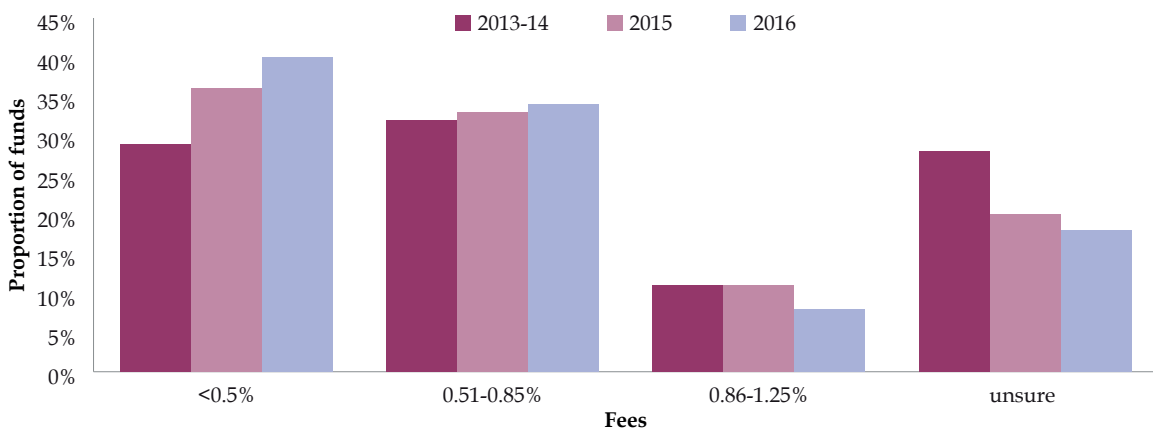
Data from Deloitte’s DC benchmarking survey³⁴ does not analyse by size of scheme but groups by charge level allowing us to further assess the range of charges. Chart 4 shows that by 2016, for those schemes able to assess their weighted charges, over 90% report them as

less than 0.85%, although it is worth noting that nearly 20% were unsure of their number. Data from the Plansponsor Survey suggest that ‘unsure’ respondents on charges are weighted to the smaller schemes with higher charge levels.

Chart 4:³⁵ Proportion of US DC funds under different charges

US fund charges declined between 2013/14 and 2016

Proportion of US pension scheme funds under different charges by year



33. Plansponsor (2016)

34. Deloitte (2017)

35. Deloitte (2017)

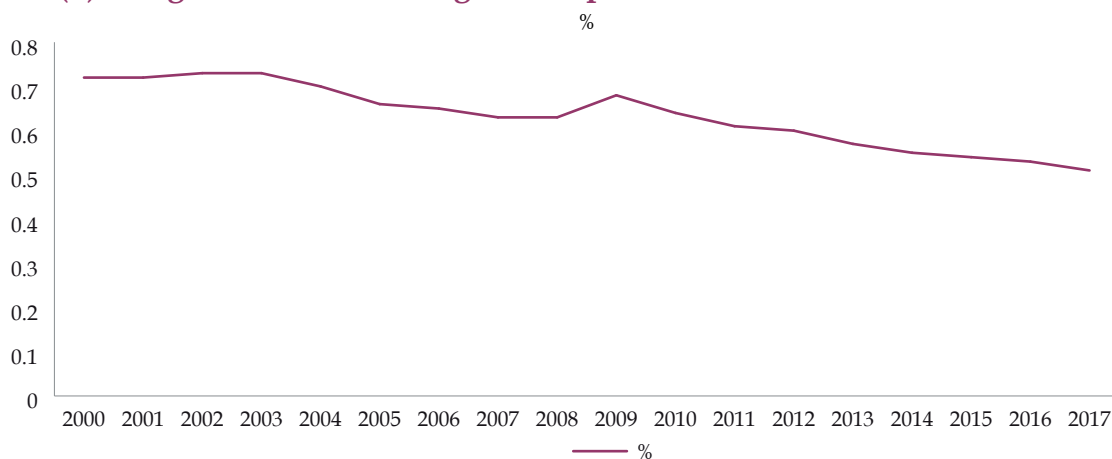
US 401(k) charges have reduced at about 2% per annum over the last decade

The Deloitte survey provides a time series that shows how charges have been on a declining trend in the period 2013-2016. Data from the

US Investment Company Institute (ICI) shows a steady declining trend since 2000 across equity, bond and hybrid mutual funds. The data series for hybrid funds – mixed asset funds broadly similar to the typical UK default fund investment strategy - is shown in Chart 5.

Chart 5:³⁶ 401(k) asset-weighted average expense ratio for hybrid mutual funds

401(k) charges have been falling at c.2% pa



In the period 2008-2017, the average expense ratio has reduced from 0.63% - 0.51%. This is a reduction of 12 percentage points, just under 20% in 10 years, or about 2% per annum.

US 401(k) schemes offer a mix of active and passive balanced funds

Data from the Plansponsor Survey shows that the most prevalent type of DC pensions contract offered is the 401(k) with over 85% of employers offering these plans and that target date funds (77%) and balanced funds (70%) are the most offered investment options. There is a mix of investment approaches with 48% offering target date index funds and only 11% of plans offering no index funds. These are predominantly delivered through mutual fund structures (91% offer overall).

Data from the US ICI reports that in 2017, two thirds of 401(k) assets were invested in mutual funds, with 60% of those in equities, 27% in hybrid funds (which include target date funds) and 10% in bonds.³⁷

US schemes are becoming more likely to invest in cheaper passive funds

Discussions with key experts suggest that whilst traditionally 401(k) investment has been active, cheaper passive funds are an increasing part of the market with Vanguard – the leading passive 401(k) provider and third largest 401(k) administrator by assets³⁸ - being evidence of the progress of the passive approach in the market. Analysis of this trend is complex, however, as US pensions statistics record target date or lifecycle funds generically as active management, even if they invest in passive funds.

Detailed analysis across all US mutual funds reported that by 2017, 42% of target date assets were in passive funds (up from 24% in 2008 and 35% in 2014) and that nearly 95% of net flows into target funds in 2017 were into predominantly passive funds.³⁹ In the same period, the expense ratios for target date mutual funds has fallen by 34% to 0.44% AMC in 2017.⁴⁰

36. Holden, Duvall & Barone Chism (2018)

37. Holden, Duvall & Barone Chism (2018)

38. Based on Plansponsor data cited at <https://blog.runnymede.com/401k-providers-2017-top-10-lists>

39. Holt & Larsen (2018)

40. Duvall & Mitler (2017)

‘Leakage’ of funds to Individual Retirement Accounts (IRAs)

Data from 2013 show that while 401(k) plans serve as the gateway for retirement saving, more than half of the money collected now resides in IRAs, where balances come in large part from 401(k) rollovers.⁴¹

This presents potential issues as the investor is moving from an employer-sponsored plan to an individual account with a broker, leaving the protection of the employer as fiduciary and also likely to face more fees, typical of retail mutual fund sales networks.⁴²

Administration costs may be under reported in fees

There is a mix of methods by which administration (or ‘record keeping’) costs are charged in 401(k) funds. For just under half (47%) of schemes, these are recovered through investment revenue, or a wrap or additional AMC charge. For the balance (53%), the administrator charges a direct fee. Of these 53%, around 25% are paid direct by the employer and a further 17% are part paid by the employee and part by the member, with 58% paid solely by the member.⁴³

Fees paid direct by the employer are not captured in the 5500 form disclosures and so administration fees are likely to be under-reported for over 20% of schemes. The effect of this may be greater as larger employers are more likely to pay fees direct.

Returns

US 401(k) target fund returns are better than global OECD data suggests

Data from the OECD shows that the average net real returns on all US Pensions Assets were just 3.8% in the 5 year period 2011-2016.⁴⁴ This figure is at the bottom of our comparison group, 3.5% less than the UK. The series contains a negative real return of 2.2% in 2015.

It is possible that these figures are significantly influenced by DB scheme investment strategies and returns, as an analysis of US 401(k) target fund data by Morningstar⁴⁵ shows that long dated target-date funds have achieved an average annual nominal return over the period 2013-2017 of just under 10% for long date funds and 6.5% for short date funds.

This suggests that US 401(k) default returns have the potential to be significantly higher than the global pension return figures reported by the OECD statistics and look competitive with international DC returns.

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Transparency and Governance

US disclosure is inconsistent and does not aid transparency

The regulation of private pension plans in the US is based mainly on the Employment Retirement Income and Security Act, 1974 (ERISA) and the labour laws relating to pensions are administered by the DoL.

ERISA specifies the standards and fiduciary duties of plan sponsors and requires that the assets be held in trust. It also specifies annual reporting requirements (via the Form 5500 series) on plan sponsors and civil enforcement and remedial provisions, including authority to investigate plans and initiate law suits against sponsors.

41. Munnell (2014)

42. Rosenbaum (2013)

43. Holden, Duvall & Barone Chism (2018)

44. OECD (2017b)

45. Holt & Larsen (2018)

The Form 5500 information was designed as a supervisory tool and is inadequate for disclosure purposes. Form 5500 data is often incompatible with Securities and Exchange Commission (SEC) filings about the underlying investments and the 5500 form fails to capture the full cost to an individual of participating in a plan. Considerable collation, analysis and assumption is required to yield any summary information and major improvements are required to provide useful information to aid governance and transparency for regulators, plan sponsors and advisers.

ERISA also specifies the requirement for participant plan and investment fee private disclosures (often called 404a-5 disclosure) to participants. The most recent DoL participant fee disclosure rules were issued in 2012. These rules require quarterly statements of dollar charges and an annual fee notice detailing general information about the plan, potential administrative and individual costs and a comparative chart of key information about plan investment options. Indirect fees are incorporated into a fund expense ratio but are listed separately in the comparative chart. These disclosures are not widely available or required to be filed with the DoL.⁴⁶

Discussions with our expert respondents confirm that there is no current disclosure of transaction fees or 'trading costs' in US fund reporting. Statistics on annual fund turnover are typically used as a proxy to assess how active the fund is in managing its portfolio.⁴⁷

46. Szapiro & Mitchell (2018)

47. See also Wasik, J (2017)

Chapter three: Europe

This chapter explores charges, returns and transparency and governance in two contrasting European countries with occupational DC schemes.

The Netherlands

Charges

Member charges appear low

Member-borne charges in Dutch individual DC schemes appear low compared to those in other countries, many with AMCs in the range of 0.30% - 0.55%. These schemes benefit from the scale of the Dutch pensions market but the charges also reflect that employers, not members, typically pay for administration costs.

Most DC schemes in the Netherlands are not comparable to UK individual DC schemes

Individual DC, comparable to that in the UK, US or Australia, is a small part of the market in The Netherlands. So while disclosure of fees is good in the Dutch market (and the central bank, DNB, is both a diligent regulator and publisher of data), the focus of most analysis is on traditional DB and the hybrid 'collective' DC (CDC) schemes. These scheme designs dominate the occupational market, supported by strong employer/union agreements.

Dutch CDC scheme are categorised as DB schemes, offer fixed benefits and must maintain solvency buffers but qualify as DC for accounting purposes as there is no compulsory plan sponsor covenant. Disclosed data for all schemes are available via the DNB website.⁴⁸

Whilst CDC arrangements are not directly comparable with current UK pension structures, the scale of overall provision and the supporting infrastructure for asset management administration does mean that the individual DC that is in the market can benefit from the economies of scale and expertise of the wider Dutch pensions system.

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48. Table 8.19, De Nederlandsche Bank (2018)

There are two types of individual DC pension schemes in the Netherlands

Individual DC exists in two specific pockets in the Dutch market:

- supplementary schemes; and
- new occupational individual (as opposed to collective) DC schemes.

Supplementary schemes, for those on high incomes, sit atop of large corporate DB or CDC arrangements. The data for these is not broken out in and, even if it were available, it is likely to provide a very different profile or membership to compare with DC in the UK.

New occupational individual DC schemes are for those companies and industry-wide schemes who have established their principal schemes as individual DC, either for new members

or for all future accruals. Two designs exist in the market that facilitate decumulation in different ways:

- decumulation through insurers by the purchase of an annuity or via drawdown (permitted since 2016) similar to that in the UK; and
- decumulation through more complex mechanisms including grouped conversion of assets to retirement income over a 10 year period.

Table 6 lists the four schemes identified to us by expert respondents. *Personeelsdiensten* is a company specialising in contracting temporary labour and *True Blue* is an IT industry scheme. In addition to administration and asset management costs, transaction costs are also quoted.

Table 6:⁴⁹ Disclosed data for identified Dutch IDC occupational schemes

Scheme	IBM Netherland	Personeelsdiensten	Shell Netherland	True Blue
Total Members	13,950	1,252,323	6,522	8,052
Total Contributions (€)	€42.7m	€245m	€40.1m	€22.5m
Admin costs / member (€)	€398	€46	€307	€601
Asset management costs (AMC)	0.54%	0.30%	0.38%	0.32%
Transaction Costs	0.12%	0.09%	0.07%	0.13%

The most striking aspect of this small sample is the wide variation in administration costs. Comparing this with the total number of members and contributions suggests inverse correlations with scale and contribution levels.

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As far as charges levied directly on members, only the asset management costs are paid by members and administration costs are typically borne by the firms.

Individual DC is a fast growing segment and is estimated to represent around 5% of the Dutch pension market, particularly in the individual occupational scheme segment that accounts for an estimated 40% of the Dutch market.⁵⁰

Individual DC schemes are offered by existing individual pension funds and APFs (General Pension Funds), insurers and by the new and the growing sector of Premium Pensions Institutions.

Premium Pensions Institutions, broadly equivalent to master trusts, were created by Dutch finance ministry legislation outside of the main pensions regime in 2011. Their aim was to introduce more competition and

49. Table 8.19, De Nederlandsche Bank (2018)

50. Expert commentator estimate.

innovation in pension provision and to reduce costs. Their initial success suggests that they are now setting a benchmark for DC cost and charges in the individual Dutch DC sector.

The actuarial consultants, LCP, conduct a survey of Premium Pensions Institutions.⁵¹ Their analysis indicates a range of asset management fees from 0.2% - 0.6% with an average of 0.4%. Investment solutions are lifestyle-based and passive. Our expert respondents advise us that administration costs levied by PPI schemes are in the range €30 - €60, with an average charge being around €45-50 per member per annum. This would equate to a 0.50% AMC or more based on the DWP equivalence tables but as Dutch contribution levels are much higher than the UK (typically 10% or more) the effective rate in the Netherlands may be much lower.

Returns

Overall Dutch pension returns are very close to the UK

Data from the OECD shows that the average net real returns on all Dutch Pensions Assets was 7.0% in the 5 year period 2011-2016.⁵² This figure is near the top of our comparison group, just 0.3% less than the UK.

Dutch DC data is not readily available

Perhaps given the recent adoption of and small proportion of assets in pure DC, summarised investment returns for typical Dutch DC funds are not readily available.

However, the LCP survey of PPI funds reports nominal returns on long target dated default funds at between 6.5% and 10% p.a. in the period 2014-17 with an average of around 8.25%⁵³ which is broadly consistent with global OECD Dutch figures and US 401(k) target date analysis discussed earlier.

Transparency and Governance

Dutch governance and its transparency regime is driving fees down

The Dutch central bank, the DNB, authorises and regulates Dutch pension funds and the financial markets authority, AFM, deals with conduct regulation.

Case Study: Dutch Voluntary Cost Disclosure

In 2011, under pressure to increase its cost transparency from the Dutch government and central bank, the Federation of Dutch Pension Funds (PF) produced a recommended disclosure format for costs as follows:

1. Reporting on pension management costs in euros per participant. The number of participants is the sum of the active participants and pension beneficiaries
2. Reporting asset management costs as a percentage of average assets under management
3. Report transaction costs (or estimates) as a percentage of average assets under management.

The PF recommendations called on its pension fund members to present transparent accounts of administrative costs to stakeholders in annual reports and communications to stakeholders.

In 2015, the Pension Act was changed to make cost disclosure in the annual report mandatory using a previously voluntary format developed by the PF in 2011.

Data is submitted to and tabulated by the DNB, using the standardised costs dataset developed by the industry. Web-based tools are available from the market to assist trustees in comparing their costs and benchmarking against other providers using this data. These can quickly compare administration costs, size, asset management costs and transaction costs allowing the user to input the data for the scheme they are assessing and see graphically how these compare with the market.

51. LCP (2018)

52. OECD (2017b)

53. LCP(2018)

Greater transparency associated with lower asset management costs

The introduction of this greater cost transparency is associated with a decline in asset management costs across the Dutch pensions systems as shown in Table 7. It is worth noting that this data are overwhelmingly for DB and CDC schemes.

The introduction of this greater cost transparency is associated with a decline in asset management costs across the Dutch pensions systems

Table 7.⁵⁴ Dutch pension asset management fees 2012-2016

	Management Fee	Transaction Costs	Cost of asset management
2012	0.53%	0.13%	0.66%
2013	0.54%	0.10%	0.64%
2014	0.52%	0.09%	0.61%
2015	0.47%	0.08%	0.55%
2016	0.46%	0.08%	0.54%

This represents a reduction of 7 basis points in asset management fees and a further 5 in transaction costs, an overall reduction of 12 points or 18% in 4 years – a rate of over 4% per annum.

The scale of reduction in transaction costs is particularly striking, possibly suggesting a change in investment process to reduce transaction activity, but the Dutch Pensions Federation (PF) ascribes the reductions in asset management costs to a combination of factors including cost transparency, consolidation of funds and an increase in internal asset management.⁵⁵ This would suggest that there are significant scale and efficiency gains available from the explicit costs elements within the transaction cost figure such as broker

and other service fees and spread costs. LCP calculate that the largest Dutch pension funds spend less proportionately on investment transaction costs.⁵⁶ It will be interesting to see how this data series for transaction costings might be effected as the Netherlands transitions into the new methodology specified under the 2018 EU PRIIPs and MIFID II regulations.⁵⁷

No data is available to assess any changes in administration costs in the same period, so changes to overall costs may be significantly lower.

Dutch regulation also specifies disclosure by pension funds and insurers to members using a standard format – the Universal Pension Overview.

54. Committee on Workers Capital (2018)

55. Committee on Workers Capital (2018)

56. LCP (2013)

57. This will require disclosure under the same 'slippage methodology' as being implemented in the UK. There is some commentary around the transitional arrangements being implemented by the Dutch AFM which might suggest that like-for-like comparisons may not be immediately available. See Flood, C (2018) for example.

Sweden

Charges

There are very few DC schemes in Sweden

Pensions in Sweden reflect the social democratic politics of the country with a key role for the state and large pan-industry schemes in the pension system, underpinned by strong labour agreements.

There are two potential comparison points for UK DC pensions. The first are the four large occupational industry DC schemes for private sector white-collar (ITP) and blue-collar (SAF-LO) employees, central (PA-03) and local government (KAP-KL/AKAP-KL).

These schemes are designed and administered by four not-for-profit organisations, referred to as social partners, – one for each scheme - and provide a wide range of individual choice of provider, product type (traditional insured or unit-linked), retirement benefits and insurance covers. The social partners are both procurers of services, administrators and, in some cases, own the insurers who provide pension products.

Traditional insured benefits are an important part of the market and are the typical default investment. ITP, for example, require that 50% of contributions are directed to the insured option.

Charges for funds in the schemes are set out in Table 8.

Table 8.⁵⁸ Member fees for Swedish Occupational Schemes

		Private - White Collar	Private - Blue Collar	Central Government
Traditional Pension Insurance	Default Fund	0.13-0.29% AMC (+0-85SEK/yr)	0.2%AMC (+65 SEK/yr)	0.1% - 0.2% AMC (+ 6 or 75 SEK/yr)
Unit-linked	'Entry Solution'			0.3-0.4% AMC (+65-75SEK/yr)
	Balanced Fund			0.3-0.5% AMC (+65-70 SEK/yr)
	Minimum	0.16% AMC	0.1% AMC (+65 SEK/yr)	0.1% AMC (+65SEK/yr)
	Maximum	0.30% AMC	0.5 – 1.0% AMC (+50-65 SEK/yr)	0.7%AMC (+75SEK/yr)
Administration Fee	% of contributions	1.0%	1.5%	14SEK/yr

Charges initially look competitive but are more complex than in the UK

The initial impression is the low cost of the investment options, with AMCs for default options in the range of 0.1-0.2% and unit-linked balanced fund options in the 0.3-0.5% range. But there are multiple levels of charges with both a fixed fee for the investment fund of perhaps 65-75SEK (around £5.50-£6.00) and also a contribution fee for administration of 1.0-1.5% of contributions. The combined effect of these additional charges, if we use the DWP equivalence table as an approximation, would be of the order of 0.35-0.40%.

The second potential comparator is the state run premium pension. Whether this is an appropriate comparator is questionable, as it is part of the first pillar (state run) Swedish pension and is universal in nature. However, in other respects it is a traditional DC scheme with choice for the member as to the investment of over 830 mutual funds but with a state-run lifestyle fund (AP7) as the default. The investment strategy of the AP7 fund employs derivatives to enhance equity returns. The Swedish Pensions Agency's Orange Book⁵⁹ gives details of the fixed and performance-based fees charged to members after rebates have been returned. From 2015, the maximum fees charged are shown in Table 9.

58. Websites and direct enquiry to schemes by the author

59. www.pensionsmyndigheten.se/other-languages/en/en/publications0

Table 9:⁶⁰ Maximum Fees by Fund type in Swedish Premium Pension

Fund type	Maximum Fee (AMC)
Equity	0.89%
Bond	0.42%
Mixed (including default fund)	0.62%

The Orange Book also quotes overall transaction costs for the premium pension as SEK 519m and management fees as SEK 2,466m. From this data, we could estimate that transaction costs are around 20% the level of management charges which would suggest that they might be of the order of 0.10-0.15%.

Returns

Overall Swedish returns are in the middle of our comparison group

Data from the OECD shows that the average net real returns on all Swedish pensions assets was 6.5% in the 5 year period 2011-2016.⁶¹ This figure

is in the middle of our comparison group, 0.8% less than the UK.

Swedish returns: DC default funds are good performers

In the occupational system, the default funds of the 4 occupational schemes are traditional insured funds with guarantees and lower expected returns and so are not directly comparable with investment linked funds.

However, a study at Stockholm University tabulated combined weighted nominal returns of the underlying investments for the 4 default funds for the period 2004-13 as set out in Table 10.

Table 10:⁶² Value weighted return of the combined Swedish default options

Year	Return %
2004	10%
2005	14.9%
2006	8.5%
2007	4.2%
2008	-6.6%
2009	12.7%
2010	9.5%
2011	0.3%
2012	9.9%
2013	9.8%

The AP7 default fund within the Swedish premium pension system has been regarded as a top performing fund. The fund returned 14.4% in 2017 (compared to 11.3% average

return by private providers in the premium pension system) and 13.9% in 2016 (private providers average, 9.5%).⁶³ Bloomberg quotes the AP7 5 year return currently as 16.3%.⁶⁴

60. Pensions Myndigheten (2017)

61. OECD (2017b)

62. Malgerud & Stenholm (2014)

63. Fixen (2018a)

64. Accessed 23/10/18 at www.bloomberg.com/quote/AP7ASEK:SS

Transparency and Governance

Swedish pension fund governance is under reform

The Swedish regulator (FI) made changes in 2017 to require standalone Swedish occupational pension funds, which historically have constituted as friendly societies, to become either insurance companies – regulated under Solvency II or as occupational pension associations – regulated under IORP.⁶⁵

Reforms are also being implemented in two stages between 2018 and 2020 by the Swedish

Pensions Agency to strengthen the supervision of Premium Pension funds following a series of scandals where members funds invested in certain external funds were embezzled.⁶⁶

Swedish disclosure focusses on member information

The Swedish state pension discloses costs in its annual statement to members known as the Orange Envelope. For the Premium Pension this shows the fund fee by fund and as an average and also provides a comparator of ‘the average pension saver’ to frame the figures as shown in Figure 3.

Figure 3:⁶⁷ Extract from Swedish ‘Orange Envelope’ communication

Your premium pension

In the table you can see the development of your premium pension during 2010 and the fees that you pay for fund management. You can compare this with the information for the average pension saver. New premium pension credits are invested according to the breakdown of your latest choice.

Premium Pension Account 2010-12-31	Value SEK	Change in value per cent	Fund fee per cent	*Chosen allocation per cent	Current allocation per cent
Equity Fund Sverige	29 895	18	0,19	30	35
Equity Fund Global	22 286	14	0,35	25	26
Interest Fund Sverige	7 087	2	0,14	10	8
Generation Fund	20 812	11	0,19	25	24
Medical Products Fund	6 550	1	0,50	10	7
Total	86 630	13	0,26	100	100
<i>The average pension saver</i>		12	0,32		

Keep in mind that high fees can entail a less change in value for you as a saver.

65. Williams (2015)

66. Fixen, R (2018b)

67. US Government Accountability Office (2012)

Case Study – The Swedish Orange Envelope

In 1999, there was a major reform of the Swedish state pension with a switch from a defined benefit (DB) to a defined contribution (DC) system. This change required a change in the way members thought about the role of the state pension and the benefits it offered. Whereas before the state pension was considered a social right that promised a specified replacement rate of wages prior to retirement, under DC retirement income would be a function of savings and returns during working life.

To convey this change to members, and to inform them better as to what to expect in retirement, the Swedish Pensions Agency created a new communications strategy. The centre piece of this is the ‘Orange Envelope’. The brightly coloured Orange Envelope contains the annual statement for members of their state pension entitlement covering:

- pensionable earnings;
- contributions during the year;
- expected pension at retirement;
- pension growth during the year;
- details of the value, growth, costs and charges for the PPM component (as in Figure 3); and
- an analysis of how their pension might change with a later retirement date.

The Orange Envelope is part of an integrated campaign, designed to have impact through an eye-catching, instantly recognisable design and colour which is distributed at one time in the year to all members to generate media and social interest to raise awareness.

Care was taken to keep the information simple, numerical and impactful and incorporates the use of behavioural tools in the inclusion of ‘the average pension saver’ item to act as an anchor or frame for comparison and to engage in assessment.

A survey, conducted every year when the envelope is sent out, found that around three quarters of the envelopes are opened by members and around half are read in some part, but self-assessed member knowledge of the pension system has not increased.

The Orange Envelope has become a brand, an effective trade-mark for pensions in Sweden. It is used by the media to signify pensions and by financial providers in sales campaigns and has generated high levels of public trust in the information.

The Orange Envelope is partnered by the annual Orange Report, issued by the Swedish Pensions Agency, which discloses the economic status of the system primarily for expert commentators and media to further support transparency and wider social engagement.

The Swedish state has since co-sponsored a joint venture, ‘Minpension’, with industry scheme providers which provides on-line access to more than 90% of occupational scheme members and the Orange Envelope service is now moving on-line also.^{68,69}

A survey, conducted every year when the envelope is sent out, found that around three quarters of the envelopes are opened by members and around half are read in some part, but self-assessed member knowledge of the pension system has not increased.

With a limited role for choice in the Swedish pensions system and close state and social partner control of scheme design and quality, the focus of transparency is on member engagement and addressing the question of pension adequacy.

68. Paulson (2006)

69. Pugh (2018)

Chapter four: Comparisons with the UK

This final chapter draws out some comparisons with the UK DC market looking in turn at charges, returns and transparency and governance.

Charges

UK charges look competitive in this comparison

To see charges play out in the UK market, the Department for Work and Pensions (DWP) costs and charges survey from 2016 (following the introduction of the charge cap in April 2015) provides some insight.

In the light of the international comparisons above, UK charges are low, particularly for those schemes that qualify for automatic enrolment. Data in Chart 6 show that in the default arrangement of schemes used for automatic enrolment:

- **Contract schemes**, typically used by smaller and medium sized firms, have an average charge of 0.54% AMC (the smallest schemes (1-5 members) average 0.72%, the largest (1000+members) 0.45%);

- **Master trusts**, dominated by the big new automatic enrolment schemes such as NEST, The People's Pension and Now: Pensions, have average charges at 0.48% AMC; and
- **Trust-based schemes**, typically used by larger sized firms, have average charges around 0.38% AMC (smallest schemes 0.72%, largest schemes 0.37%).

These charge levels are significantly below those 5 years previously in 2011. The average for all trust-based schemes at that time was estimated at 0.71% and for contract-based schemes at 0.95%.⁷⁰

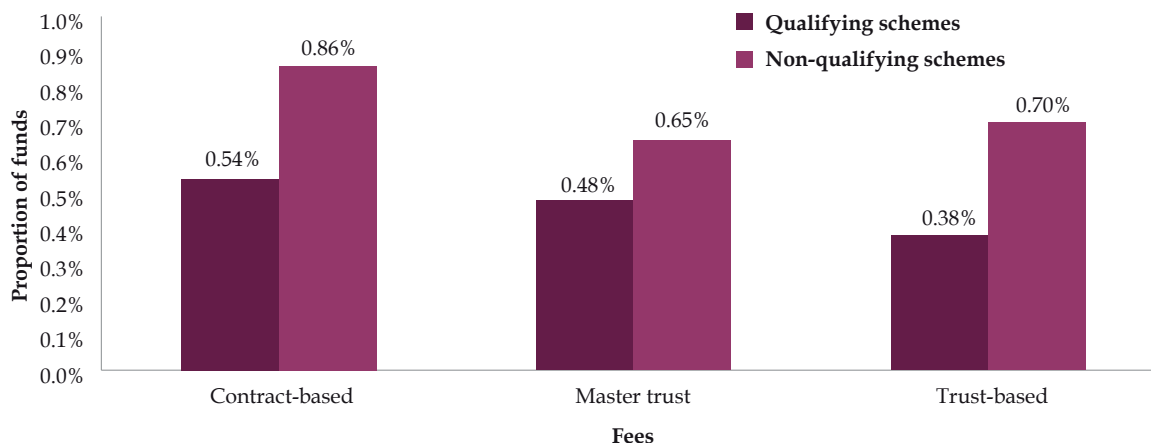
It is worth noting that the market has moved on further in the last two years as automatic enrolment has brought more members into the market and the Financial Conduct Authority's (FCA) and the Department for Work and Pensions' (DWP) review of past business has born down on charges in non-qualifying contract schemes.

70. DWP (2014)

Chart 6:⁷¹ Average scheme charge paid by members of UK DC pension schemes, 2016

UK DC qualifying scheme charges are low

Average scheme charges paid by members of qualifying and non-qualifying UK DC pension schemes, 2016



The UK has quite clear charge benchmarks which the system and regulatory action bring to bear on the market:

- De-facto benchmark price:** Scheme trustees and the chairs of Independent Governance Committees (IGCs) are required to assess value for money for members. The three largest master trust schemes – NEST, The People’s Pension and NOW: Pensions - provide a clear benchmark of value available to all in the market. Whilst each has a different charging structure, all three equate to around 0.5% as an Annual Management Charge (AMC). Most large schemes with mature profiles and stable employment, especially those with higher salaried workforces, would expect to operate below this level (at around 0.4%) and some significantly lower, although smaller schemes or those with low paid and/or transient workforces will need to charge more (and justify the value to members).
- The Charge Cap:** The automatic enrolment legislation brought in with it a charge cap for a qualifying default fund of 0.75% (or its equivalent). This provides a legislative ceiling for the 98%⁷² of active UK members accepting the default investment solution.
- The past business review reference point:** For those members with accrued pensions in older workplace contract schemes and/or those who do not qualify for automatic enrolment, the regulator now effectively requires the major providers, via their IGCs, to charge no more than 1% (which was also the charge cap under previous stakeholder pension schemes) or to explain why higher charges provide value for money, for example, via the provision of additional or more expensive services. In practice, this has now resulted in a 1% charge on all contracts from the major providers except where an active choice is made by the member to save in a specialist investment solution.

So the UK’s benchmark levels of 0.5% as the ‘de facto’ price, 0.75% cap for members of schemes used for automatic enrolment and 1% for legacy workplace schemes that are not used for automatic enrolment, look towards the bottom of the range. US benchmark figures compete with these numbers for the larger schemes. This is as might be expected in a significantly larger pensions market when compared to the UK, with 91% of US companies with more than 500 workers offering a retirement benefit scheme.⁷³ Nevertheless, those in the US in small schemes can experience high charging levels as our data show.

71. DWP (2017)

72. DC scheme return 2017

73. Bureau of Labor Statistics, 2017

The UK's benchmark levels of 0.5% as the 'de facto' price, 0.75% cap for members of schemes used for automatic enrolment and 1% for legacy workplace schemes that are not used for automatic enrolment, look towards the bottom of the range.

UK regulatory action has addressed the issue of very high charge levels

Only Sweden, out of the countries researched, has applied charge caps apart from the UK in their system and this is in the Premium Pension, part of the first tier, rather than in the occupational tier 2 of the system.

The effect on the range is significant as other countries, the US and Australia in particular, exhibit 'long tails' of charges. In the US, around a quarter of plans charge over 0.75% and the Productivity Commission's analysis in Australia shows 15% of Supers charge fees over 1.5% (although these may reflect some costs from wider services such as advice and insurance). Australia, where employee choice of Super is part of the architecture, is considering measures to direct choice towards 'best in show' funds to attempt to address this.

Charge levels are reducing at around 2% p.a. long-term in Australia and the US a possible rule of thumb

Time series data from Australia and the US suggest that DC costs are reducing at a long-term rate of around 2% per annum.

Key factors driving down fees have been attributed in Australia to increases in average individual pension pot sizes, reducing provider margins, other operating scale benefits and larger investment mandates.⁷⁴ The analysis of

US 401(k) fee data by scheme size also shows the inverse relationship between scale and fee levels and mutual fund data the reducing trend in expense ratios within asset class. These support the view that economies of scale are reducing costs, although the trend from active to passive investment, with the consequent structural reduction in asset management costs, may also be a contributory factor in both markets.

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This observed rate of reduction could provide a rule of thumb figure to assess how quickly charges might be expected to move in a growing DC market, such as the UK. This might help inform decisions about changing the UK charge cap. A cut from 0.75% - 0.50%, for example, would represent a 33% reduction, equivalent to over 15 years' worth of scale change based on the Australian and US experience.

Understanding the underlying economies of scale in the UK could help improve outcomes

The way in which the economies of scale play out will be important to understand as part of the charges debate as they are likely to follow different paths for asset management and administration. In the UK, scale has already been achieved for administration in more schemes as a result of automatic enrolment but asset growth will accelerate with the incremental staging of contribution rates now taking place.

74. Rice Warner (2014a)

The way in which the economies of scale play out will be important to understand as part of the charges debate as they are likely to follow different paths for asset management and administration. In the UK, scale has already been achieved for administration as a result of automatic enrolment but asset growth will accelerate with the incremental staging of contribution rates now taking place.

UK DC schemes and providers have absorbed the upfront costs of attracting business from over 1 million employers and enrolling around 10 million new members,⁷⁵ many in schemes which will not recover initial costs for 8-10 years.

An extended period is expected to repay the level of investment made by UK schemes to deliver automatic enrolment at the current level of pricing. Although NEST tends to serve a lower income lower contribution demographic, they illustrate this point. NEST have estimated that it will not break-even until 2026 and will have accumulated a total of £1.22bn in loan funding from the UK government.⁷⁶

Recovery of costs in the UK DC system typically bears down on members, rather than employers, through member charges. Analysis of Australian changes show how the cost of changes designed to improve outcomes

for members can increase charges, at least temporarily. This can delay or diminish the effect of economies of scale and efficiency on charges.

Until recently, UK disclosure did not facilitate direct examination of how costs are changing as it does in the Netherlands or Australia. It may be important for all stakeholders in the UK market to have access to this data to manage outcomes better as scale grows in UK DC.

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Returns

Investment comparison challenges

In the previous chapters, an assessment of the returns from DC funds in the relevant countries was approached by looking both at the global levels of investment returns for pension assets from OECD data⁷⁷ and by looking for data from each of the countries under review. It feels like this topic would benefit from a more systematic review to supplement our work. As a result, this report seeks only to see if there are marked differences in returns related to the design or asset management of DC schemes within the countries examined compared to the UK.

75. DWP (2018)

76. Fernyhough (2017)

77. OECD (2017b)

Fees will be influenced by investment strategies and returns

It is worth noting that investment returns interact with fees in a number of ways:

- The choice of asset to invest in will have an impact on the cost of management and the expected return. Also, traded assets (such as equities and bonds) are cheaper to manage than untraded ones (such as real property and infrastructure).
- The style of asset management will affect the costs. Passive management, where investment returns track an index are typically much cheaper than active management where asset

managers seek excess returns by investing in certain assets over others based on future expectations of returns.

- For charges on the basis of an annual management charge or performance fees, higher returns will also yield higher fees for the manager than 'flat fees'.

Net returns overall on UK private pensions over the last 5 years have been broadly in line or slightly better than those in the other countries

The OECD data for all four countries studied and for the UK is set out below in Table 11.

Table 11:⁷⁸ Real annual net investment rates of return of funded and private pension arrangements (%), 2007-2016

	Australia	Netherlands	Sweden	UK	US
2007	12.9%	0.6%	..	0.7%	-0.8%
2008	-11.4%	-17.3%	..	-15.9%	-26.6%
2009	-10.2%	11.5%	..	14.3%	9.5%
2010	5.6%	8.9%	..	11.7%	5.5%
2011	5.3%	4.3%	-1%	9%	-4.1%
2012	0.6%	9.5%	7.9%	9.2%	5.2%
2013	10.3%	1.6%	6.7%	5.5%	10.4%
2014	8.9%	15.1%	10.6%	5%	3.2%
2015	7.8%	0.9%	2.7%	4.4%	-2.2%
2016	3.3%	8.6%	4.6%	12.7%	2.6%
2011-16 average	6.1%	7%	6.5%	7.3%	3.8%

This data suggest that net returns overall on UK private pensions over the last 5 years – 8.9% nominal and 7.3% real – have been broadly in line or slightly better than those in our comparison set.

It should be noted that this data cover all funded private pensions arrangements and so include returns for DB funds as well as DC. These include a very wide range of investment strategies and will be influenced by the liabilities in DB schemes as well as asset choices and the use of active or passive management styles. Nevertheless, the figures do provide an overall broad benchmark to compare with figures for sectors and/or funds within the territories although as noted previously the low US figure does not appear to be reflective of returns in DC 401(k) funds.

There is a range of investment approaches across the countries studied

Our discussions with expert respondents indicated that there is a range of approaches to investment across the comparison countries. Whilst comparative data between countries is not readily available, Australia was characterised as having probably the greatest commitment to traditional active and alternative and/or direct investments, the US transitioning from slowly active to passive for DC, whilst the Swedish and the Dutch are still highly committed to guarantees in their pensions through insured (Sweden) or shared-risk (Dutch CDC) approaches.

78. OECD (2017b)

The spread of investment philosophies and capabilities is an important backdrop when considering charges. Active, alternative and direct investments have higher costs both in asset management and transaction costs whilst offering the potential for enhancing risk-weighted returns, if executed well, through diversification of risk and better management of investment shocks.

One key aspect of the UK approach is the new requirement on trustees and IGCs, as part of the better workplace pensions initiatives, to monitor and review the performance and appropriateness of their default as part of their statutory duties. The difficulties of this comparison suggest this may not be a straightforward task for them and one where better comparative data not only on performance but also fund structure and inherent risk may be needed.

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Transparency and Governance

The UK is rated relatively highly for integrity in regulation

The integrity of the UK pensions system is strong, with important safeguards being added as part of the pension reform process that brought in automatic enrolment, mainly under the 'better workplace pensions' policy. This is evidenced by being graded 'A' with only Finland, Norway, the Netherlands, Australia and Switzerland being rated higher for integrity in the Melbourne Mercer Global Pension Index.⁷⁹ Sweden is also graded 'A' but the US is graded only 'C+'.

Nevertheless, there is a slightly stronger sense of consistency in the regulatory framework of pensions in Australia, the Netherlands and Sweden without the complexities of the UK split of responsibilities between the FCA (who regulate the conduct of contract-based DC schemes) and The Pensions Regulator (who regulate the conduct of trust-based DC schemes and the automatic enrolment system). This can result in the UK system having inconsistencies or gaps between contract and trust based regime in disclosures, conduct and governance as well as additional effort for the regulators and policy makers to minimise the opportunity for regulatory arbitrage.

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79. Mercer (2018)

The US takes a more free market approach and more pressure is put on scheme governance through litigious action in the courts, especially for large schemes, than via direct regulatory action.⁸⁰

UK transparency and disclosure going down the right path but needs to accelerate

The difficulties with the implementation of the Australian RG97 regime contrasts with the experience of the Dutch with greater fee transparency. The Dutch approach to drive forward voluntary proposals with regulator backing has ended up in a practical system that has improved the transparency of charges and had impact on industry behaviour.

The UK approach, with the recent launch of the Institution Disclosure Working Group (IDWG) initiative, can be seen as working down a similar path, albeit behind the timeline of the Dutch. It will be important to drive forward and monitor the impact of fee disclosure in the UK asset management market as trustees and IGCs gather and analyse the data now becoming available under the new EU PRIIPs and MIFID II disclosures, the FCA's rules on disclosure to IGCs and trustees of DC schemes under PS17/20, and DWP's regulations for publication and reporting of costs and charges by DC schemes and the IDWG disclosure template.

Consideration needs to be given to greater disclosure of administration costs to ensure proper governance of all costs borne by members.

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Transaction costs data disclosure is patchy but developing

Disclosure of investment transaction costs is most developed in the Netherlands, having introduced a voluntary disclosure regime in 2011 as part of the wider disclosure of pension fund costs. Australia is introducing statutory disclosure of transaction costs as part of its wider RG97 disclosure reforms but this is on-going and incomplete.

In the UK more data is becoming available but there is little analysis of this data so far. The levels currently being disclosed for default funds do not, so far, appear to be creating any immediate concern amongst scheme trustees and IGCs.⁸¹ A settled view should become clearer as more data becomes available and with the introduction of new voluntary investment fund disclosure sponsored by the FCA. Care is needed to ensure that this data are used to understand and challenge the value and efficiency of the underlying investment processes. There is a risk that a simple drive to reduce transaction costs could lead to unintended outcomes by hampering managers' actions in managing funds and so exposing the funds to greater risks and reduced risk-weighted returns.

80. Qualitative interviews

81. See, for example, Royal London and Zurich IGC, NEST reports 2017-18

Appendix: research methodology

Evidence gathering was largely in three parts:

- Desk-based search of publically available papers, data sources and commentary for the four countries and the UK by the Pensions Policy Institute (PPI) research team, including reference to the PPI's own resources;
- Informal requests for data from expert contacts with knowledge of the four countries and/or an overview of international pensions, yielding further papers and commentary; and
- Subsequent discussions, over the phone or face-to-face, to explore further the relevance/context around evidence provided, to seek out any further relevant information and to test some initial analysis and findings.

A list of relevant sources and expert contributors is provided in the below. The PPI team would like to thank all those who took time to respond to our requests for evidence and to discuss the study and emerging findings with us.

The PPI has used its standard process of governor review as part of the quality assurance process for the final published report.

Whilst the researchers have taken considerable effort, drawing on the knowledge and experience available to the PPI, to ensure the validity and accuracy of the findings of this report, the methodology is reliant on a UK-based interpretation of publically available secondary data and comment. As the research objectives are to provide further context and comparison to the UK market, this approach is worthwhile. However, this should not be regarded as a definitive study of DC pension provision in countries covered.

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