# Transaction cost disclosure in workplace pensions

NATIONAL EMPLOYMENT SAVINGS TRUST

Response from NEST Corporation

## About NEST

NEST is a trust-based defined contribution (DC) pension scheme that UK employers can use to meet the workplace pension duties set out in the Pensions Act 2008. NEST is designed to be an easy to use, low charge scheme. It was set up by government and has to accept all employers of any size that want to use it to comply with their duties. At the time of publication NEST is working with over 240,000 employers and has over 4 million members. It's delivered at no cost to the employer, in line with the original policy intent. A key aim of the scheme is to provide members the benefits of a good value, quality workplace pension scheme, whoever their employer and however much they save.

NEST's members are low to moderate earners and are often saving for the first time. This is a new market of savers who have not been well-served by the pensions market to date and have a history of very low engagement with retirement savings. The scheme has a lot of members, most with small or very small pension pots. The scheme also has a low median age, with the majority of our members being under 40. Their contribution rates are largely low as this is a function of the low initial contribution rates set at the start of auto enrolment, currently 2 per cent of qualifying earnings, rising to 8 per cent in 2019.

## Overview

NEST welcomes the Financial Conduct Authority's (FCA) proposed rules and guidance to improve the disclosure of pension costs in workplace pensions. We believe it's right that the FCA should seek to support a process by which trustees and independent governance committees (ICGs) are able to obtain a standardised disclosure of the transaction costs that pension investments incur.

We recognise that, in the main, this consultation will largely impact on the way in which asset managers undertake their business, but have chosen to respond as we place a high value on transparency. It's absolutely vital that pension scheme trustees and IGCs are able to make good, evidence based decisions about their scheme membership. We see an increased and welcome drive towards greater transparency as vital in achieving this.

In our response we'd like to draw particular attention to:

- **The chosen slippage cost methodology**. We're broadly supportive of this approach and consider it to be both pragmatic and a step in the right direction for pension scheme trustees seeking to gain transparency and consistency of transaction cost disclosure. We recognise that the data required to support the 'slippage cost' methodology is widely available, can be applied across different asset classes and crucially, can be calculated 'in house'.

  However, as you've noted in this consultation paper, the slippage cost methodology cannot be applied when intraday prices are not available for assets such as corporate bonds and property. This may create some issues in that different fund managers may arrive at different numbers despite having the same inputs. As a result, any level of clarity gained though slippage cost should be treated with caution and carefully communicated to trustees. We'd welcome further clarity from the FCA on how it proposes that calculations should be made in these cases.

- **Amalgamating transaction costs in fund of fund structures.** We believe that this is a specific issue which could create some complexity for capturing costs for NEST. Given the structure of our investment approach, complexity arises when NEST buys and sells units in the underlying fund where a transaction has not been initiated by a member but by NEST.

The cost of these transactions will need to be included in our overall reporting of transaction costs. Currently volumes of these transactions are low and most changes are implemented using member flows or internal crossing. However, it's possible that the volume of this type of transaction may rise in future. Under the regulations proposed in the consultation, in addition to the trading price, NEST would need to capture the mid-price of all funds in order to calculate transaction costs appropriately. We're currently discussing this issue with our fund administrator but believe that in the first instance we may have to calculate the costs on a fund of fund basis in-house.

More broadly, NEST believes that savers ought to reasonably expect that the governance body choosing investments on their behalf should understand the transaction costs of their fund managers. Standardisation of disclosure methods will be helpful in simplifying this process in some cases. However ultimately it's important that those responsible for the governance of schemes are sufficiently knowledgeable to make value judgements around transactions costs based on a range of information, which will encompass more than the costs themselves. Transaction costs need to be looked at in the context of the total offer the saver receives as a result of a particular investment and whether the overall investment strategy is appropriate for the needs of the membership.

A move towards standardisation is a welcome step in gaining consistency towards the way in which transaction costs are calculated. However it's also important that as an industry we continue to find ways to build standards of governance and ensure trustees and IGCs are equipped to consider these complex issues in the round.

## Questions

### Q1: Do you agree that our proposed rules will enable information on transaction costs to reach governance bodies? If not, what alternative(s) would you propose?

Yes.

### Q2: Do you agree with the approach set out for calculating transaction costs? If not, what alternative(s) would you propose?

We'd appreciate clarity from the FCA on the totality of the methodology proposed, but in the main remain supportive of this proposal.

### Q3: Do you agree with the proposals in this chapter? If not, what alternative(s) would you propose?

We don't have any comments to make because, as a recipient of the data, we don't believe these proposals to be relevant for NEST at this time.

### Q4: Do you agree that our proposed rules will enable pension arrangements and funds that invest in other funds to amalgamate the total transaction costs from underlying funds?

Yes.

### Q5: Do you agree that transaction costs should be amalgamated on the assumption that underlying funds that invest in other funds to amalgamate the total transaction costs from underlying funds?

In principle we're supportive of this proposal but, as above, would note that this will present some operational difficulty for NEST. In the first instance we believe that in order to calculate costs on a fund of funds basis we'll have to do so in-house. We already do this to an extent but would need to modify our current model to calculate the costs of our own trading into funds we invest in, where the trading was due to rebalancing or asset allocation changes.

### Q6: Do you agree that the approach set out in this chapter is adequate to provide governance bodies with sufficient information to access transaction costs? If not, what alternative(s) would you propose?

We understand that there have been significant moves across the industry to seek clarity and uniformity on the way in which transaction costs are presented. We think this is a key aspect of transaction cost disclosure. We await further developments from the industry on how transaction costs may be disclosed to trustees in the future.

### Q7: Do you have any comments on our analysis of the costs and benefits of introducing rules on transaction cost disclosure?

We don't have any comments to make on this issue but look forward to assessing how this impacts NEST once the proposals have been implemented.

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