For Official Use **DAF/AS/PEN/WD(2017)5**

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development **26-Apr-2017**

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
INSURANCE AND PRIVATE PENSIONS COMMITTEE

DAF/AS/PEN/WD(2017)5
For Official Use

Working Party on Private Pensions

ANALYSIS OF POLICY MEASURES TO CONTAIN COSTS OF RUNNING FUNDED PRIVATE PENSION PLANS

19-20 June 2017

This document is circulated for discussion under the agenda of the WPPP meeting to be held on 19-20 June 2017.

For further information please contact Ms. Emmy Labovitch [Tel: +33 145 24 74 55, Email: emmy.labovitch@oecd.org] or Mr. Pablo Antolin [Tel: +33 1 45 24 90 86; Email: pablo.antolin@oecd.org]

JT03413174

English - Or. English

ANALYSIS OF POLICY MEASURES TO CONTAIN COSTS OF RUNNING FUNDED PRIVATE PENSION PLANS

Introduction

1. Funded private pensions rely on the performance of an investment portfolio to provide future retirement income. Any reduction in the amount of assets in the portfolio means that less money is available for investment and so to pay future benefits.

2. Retirement income from defined contribution (DC) funds is heavily influenced by the level of deductions from the investment portfolio made by the pension provider or other parties. An annual deduction of 100 basis points on assets under management (AUM), assuming productivity growth of 1%, inflation of 2%, contributions of 10% of wages for 40 years and a 4.56% return on portfolio investment, can reduce pension benefits for a life expectancy of 16 years at 65 by as much as 20%. Halving the deduction to 50 basis points can raise pension benefits by just over 10%.[1]

3. Although retirement benefits from defined benefit (DB) funds are not directly impacted by such deductions, it is in the interests of the sponsor and the governing bodies of DB plans that portfolio performance meets expectations to avoid the risk of underfunding. Keeping costs under control contributes directly to portfolio performance.

4. Scrutiny of the charges applied by pension providers has increased as DC pensions have taken on a bigger role in providing income in retirement and automatic enrolment schemes have brought more low-paid workers within the scope of private pension provision. Charges levied on members’ contributions or on their assets directly reduce the returns made on the money that members pay into their plan. In addition to these charges, other deductions are made from members’ assets to cover costs such as fees to investment managers, custodian banks and accountants. These deductions may not be transparent to plan participants and governing bodies. Regulators need to consider both charges and costs in order to capture the full range of deductions made from members' portfolios, which we refer to as “total member reductions”.

5. In efficient markets, both charges and costs should be subject to competitive forces that push them to reasonable levels. However there appears to be a lack of competitive pressure on pension providers in both mature and immature markets. The primary policy tool used by OECD and IOPS members to encourage competition and reduce charges is enhanced disclosure, but other measures have been implemented, such as encouraging new providers (Mexico) and introducing an auction system (Chile). Policymakers have also tried to strengthen the buy-side, by making charges more transparent and comparable (Italy) and simplifying charging structures (Costa Rica). Some jurisdictions have imposed structural changes on the industry, such as charge caps (UK) and consolidation (Sweden). While measures to control charges have been primarily been implemented in DC systems, efforts to control the costs of managing investment portfolios have largely focused on DB schemes. Some of the policy measures and the actions taken by DB funds themselves can provide useful information for DC systems as well.

1. OECD Pensions Outlook 2012, Chapter 6

6. The WPPP and IOPS have decided to undertake a joint project to assess the effectiveness of measures taken to encourage competition among private pension providers and reduce total member reductions from pension portfolios. The objective of this analysis is to develop evidence-based guidelines on what measures work, what conditions are necessary for their success and how best to implement such measures in order to maximise their effectiveness.

7. At the WPPP meeting held on 5-6 December 2016, Delegates approved the current project, including the following analysis:

- identification of policy measures that countries have implemented to reduce total member reductions
- assessment of whether or not these policy measures have been successful
- quantification of any resulting improvement in total member reductions
- determination of conditions that contributed to the success of such policy measures
- consideration of country-specific dynamics that help to explain their effectiveness

8. This preliminary review looks at where deductions might occur in funded private pensions and considers some of the reasons why market failures might lead to total member reductions being too high. It discusses the approaches taken in selected OECD and IOPS member jurisdictions to overcome market failures and control the level of deductions. It also examines topics relevant to the understanding of private pension plan costs and charges such as value for money and economies of scale. It draws on previous IOPS research on trends in the charge ratios and operating expenses of funded private pension plans in a number of jurisdictions in light of policy measures to contain total member reductions. The authors highlighted the difficulty of comparing measures of costs and charges across countries and the current project will not attempt to do so.[2]

9. The structure of this document is as follows:

- Section I provides an overview of the different types of total member reductions that can impact the growth of pension assets
- Section II considers why market mechanisms might not be effective in controlling total member reductions
- Section III describes policy measures implemented in selected OECD and IOPS member jurisdictions in response to market failures
- Section IV concludes and presents preliminary findings on the implementation of different policy measures to contain total member reductions

10. Subject to the WPPP's approval of the current document and its approach, the Secretariat proposes to present a second, more detailed interim report at the WPPP meetings scheduled for 4-5 December 2017 which will examine the success of different country specific policy measures in reducing total member reductions. The analysis will be conducted within and not across countries. Consequently, Delegates are requested and encouraged to contribute data to support this analysis. A final report with main conclusions and policy guidance will be presented for approval at the WPPP meetings scheduled for June

2 . Hinz R. et al, (2010) reached a similar conclusion.

2018. This final report will be published, after authorisation from the WPPP, in the OECD Pensions Outlook 2018.

11. Delegates are invited to provide their views on the following questions:

- Do delegates agree with the proposed scheduling?
- Do delegates have any views on the specific costs areas discussed in this paper?
- Are there any particular issues delegates would wish to emphasise, add, or see addressed differently?
- Could countries provide additional examples of policies aimed at reducing total member reductions?

Section I: Overview of total member reductions

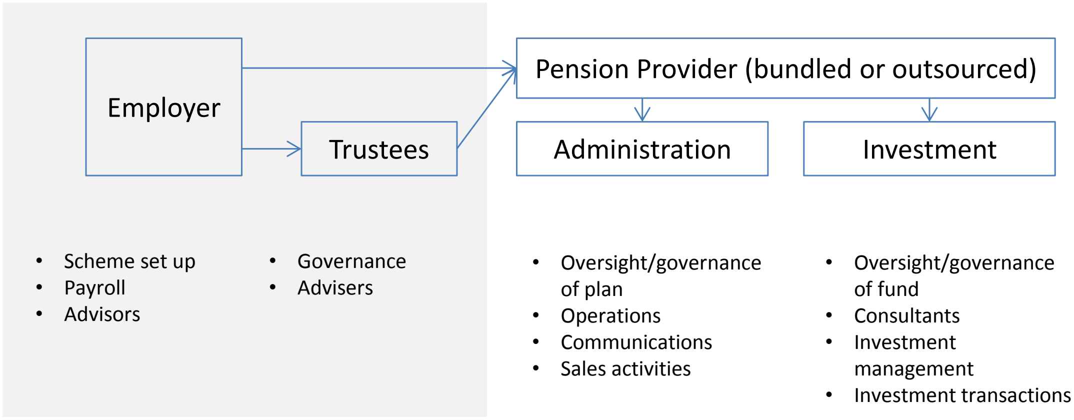
12. Policy measures to contain the costs of private pension provision need to look beyond charges and address the cost structures of pension plans. The charges levied by pension plan providers on plan participants may not reflect the true cost of the pension plan from the member's perspective, as not all payments made to the pension provider or their suppliers are transparent or included in the "headline price" of a pension plan.

13. We define total member reductions as any reduction in the build-up of the plan participant's pension portfolio that is the result of a payment to either the pension provider or a third party. This includes deductions that are made before contributions are invested, such as a fee on contributions, deductions that are made from the assets in the portfolio, such as annual management charges or performance fees, and deductions that are made for specific transactions, such as switching fees.

Costs - getting a full picture

14. Pension plan providers offer plan administration services and investment management services. The pension provider may undertake all of these activities itself (bundled provider) or outsource some of them (unbundled). The governance of the pension plan may be assured by external trustees (possibly appointed by the employer) or by internal committees established by the pension provider. Figure 1 illustrates the type of administration and investment costs that can be incurred within a DC plan; the shaded area includes the additional costs that may be faced by the employer if it is responsible for selecting and implementing the plan.

Figure 1. Costs incurred in operating a private pension plan



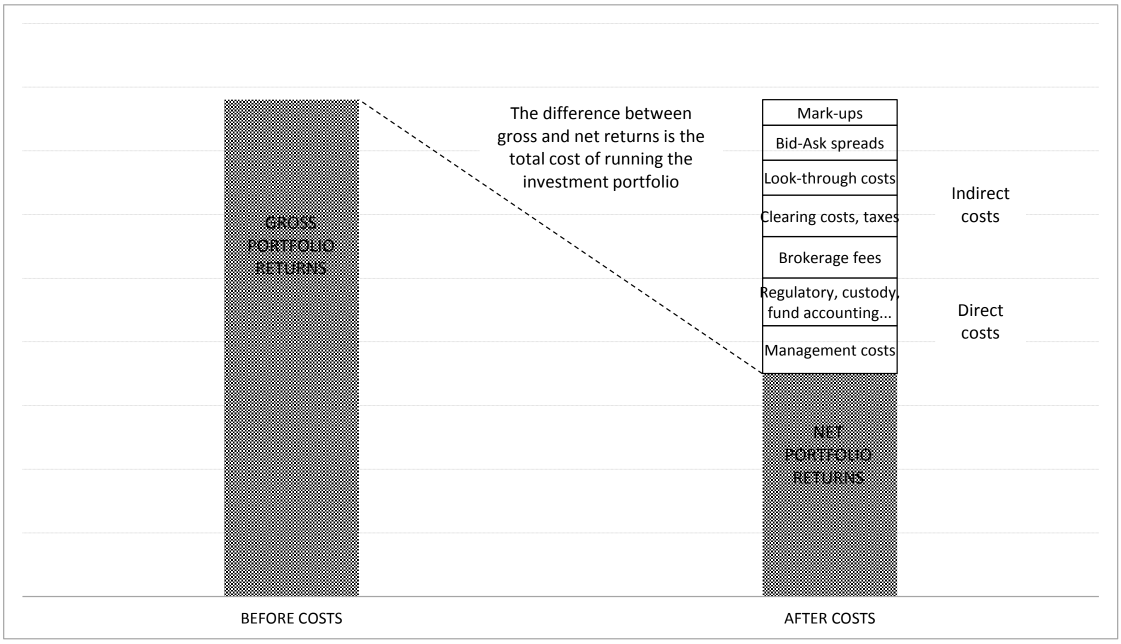
Source: OECD

15. The pension provider is responsible both for administering the plan - collecting contributions, paying benefits, keeping members informed of their situation, record-keeping, meeting regulatory requirements etc. - and for investing the members' assets. Investment costs include the costs of making and implementing investment decisions - asset allocation, stock selection etc. - and the costs of maintaining the portfolio - custody costs, audit fees etc.

16. The costs incurred by pension providers can be direct or indirect. Most administration costs are direct - the provider will either incur operating expenses itself or receive an invoice from an external service provider. Some investment costs are direct, for example compliance and regulatory costs, which are levied at the level of the pension fund. However a number of the costs within the pension plan, especially investment costs, are indirect. An example of indirect costs is transaction costs, i.e. the costs of trading underlying securities in an investment portfolio such as commissions to brokers, clearing and settlement fees to custodians, and applicable taxes. These different costs are usually covered through a reduction in the returns to the portfolio as the transaction takes place, rather than through a separate billing procedure. Figure 2 illustrates the types of direct and indirect costs that can affect the net returns to an investment portfolio.[3]

3 . Note: we only consider cash costs here, so exclude other indirect costs such as market impact or out-of-market costs.

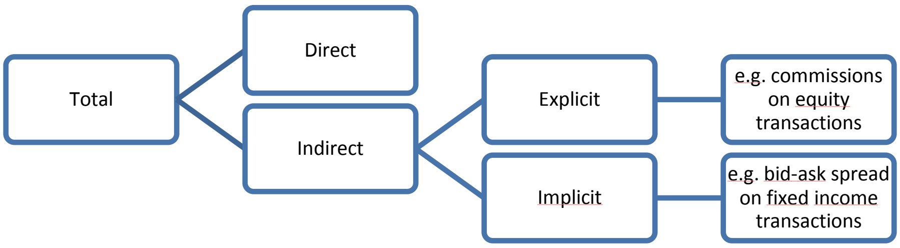
Figure 2. Direct and indirect investment costs



Source: Novarca (note: not to scale)

17. Getting a full picture of investment costs is further complicated by the fact that some indirect costs are "implicit", as illustrated in Figure 3. Transaction costs for equities are "explicit": brokers' commissions are contractually agreed, stamp duty rates are known and so on. Transaction costs for fixed income are "implicit": commissions and other costs are embedded in the bid-ask spread. As Figure 2 shows, the impact of transaction costs will ultimately be revealed in the net returns of the investment portfolio, however there is an argument that transaction costs should be made transparent to ensure that investment managers have an incentive to control their own costs and to avoid excessive "churning" of the portfolios (unproductive transactions), especially by vertically-integrated investment houses that might benefit from broker fees.

Figure 3. Explicit and Implicit Costs



18. The total cost of running the investment portfolio will vary considerably according to the asset allocation, investment style (for example, passive or active management) and fund structure. However indirect costs will generally be a significant part of overall investment cost. Edelen et al. (2013) analysed

1758 US mutual funds invested in domestic equity and found that average cash costs were 27 basis points per trade (one way), while average annual trading volume was well over 150% of net assets. This meant that the funds had on average annual indirect cash costs of approximately 75bp on top of their reported direct costs of 119bp (mean expense ratio). This gives an indication of the potential magnitude of indirect costs in actively managed pension investment portfolios.

19. Table 1 provides an overview of the various different costs that could be incurred by private pension providers and would be recouped from members, whether in the form of charges or in the form of a reduction in the net asset value of their portfolios. Different institutional arrangements will incur different types and levels of costs, depending on factors such as the number of intermediaries, the services offered and the asset classes included in the investment portfolio so not all cost items are applicable or material to all providers, however Table 1 illustrates how a focus on headline fees may obscure the full picture of the deductions that impact members' ability to build up retirement assets.

Table 1. Overview of pension plan costs

Administration Costs		**Investment Costs**	
Cost item	Description	Cost Item	Description
Oversight/governance of plan	Trustee board or other committee, insurance	Oversight/governance of fund	Board, committees e.g. audit committee
Regulator/supervisor costs	Fees to pensions regulator/supervisor	Regulator/supervisor costs	Fees to investment regulator/supervisor
Legal and accounting	Legal advice, auditors' and actuaries' fees	Legal and accounting	Costs of establishing investment funds, bookkeeping, reporting, appraisal
Operations/IT	Collecting contributions, calculating entitlements and paying benefits	Consultants/advisers	Fees to external advisers (e.g. for asset allocation advice)
General business expenses	Premises, other costs	General business expenses	Premises, operating costs
Communication	Annual statements and other required reporting to participants; educational activities (e.g. to encourage higher contributions)	Custody/depositor	Costs of safekeeping the assets
		Internal asset management	Costs of internal teams (salaries, research…)
Sales activities	Commissions to agents	External asset management	Fees to external teams for managing part or all of the investment portfolio
Platform	Creation and maintenance of platform for accessing underlying funds, plan participants can choose between funds on the platform	Look-through costs	If the portfolio is invested in vehicles with various layers of investment management (e.g. a fund-of-funds structure), total costs include the investment costs of the underlying vehicles
Initial charge	Deduction from contribution before it is invested	Performance fees	Variable fees to external asset managers
Additional features/benefits	Cost of providing additional features e.g. guaranteed annuities, minimum rates of return, incapacity insurance	Additional costs of alternative asset classes	e.g. set-up costs for a private equity investment or maintenance costs for a property portfolio
		Transaction costs	Broker commissions, spread, processing, hedging
		Entry/exit costs	Subscriptions and redemptions from underlying funds

Charges - how well do they reflect costs

20. In order to understand whether the charges levied by a pension plan provider are reasonable, it is necessary to know which of the potentially large number of different administration and investment costs are included in the charge, and which are covered by other deductions that are less transparent to members. For example, the fees of external asset managers or advisers are likely to be paid by the pension fund (via a reduction in NAV) rather than by the provider.

21. IOPS (2014) assessed the "charge ratio" in different IOPS and OECD private pension systems. The charge ratio represents the difference between the actual final balance in an individual's retirement account and the hypothetical final balance if no charges had been levied. Table 2 is reproduced from that document and shows the underlying components of the charge ratio calculation in each jurisdiction.[4]

Table 2. Cost and fee elements incorporated in charge ratio (CR) calculation process and ascending degree of underestimation of the final CR numbers

Country	Plan/scheme administration fees	Investment management fees, for:		Custodian fees	Investment transaction costs	Guarantee fees	Other	Under-estimation of CR
		primary funds only	underlying funds					
Albania	●	●	●	●	●	/	●	
Israel	●	●	●	●	●	/		
Hong Kong	●	●	●	●		●	●	
Bulgaria	●	●	●	●		/	●	
Turkey	●	●	●			/		
Panama	●	●	/	●	●	/		
Peru	●	●		●	●	●	●	
Chile	●	●		●	●	●	●	
Romania	●	●		●	●	●		
El Salvador	●	●		●	●	/		
Czech Republic	●	●		●	●		●	
Hungary	●	●		●		●	●	
Macedonia	●	●		●		/	●	
Mexico	●	●		●		/	●	
Colombia	●	●		●			●	
Spain	●	●		●				
Croatia	●	●			●	/	●	
Costa Rica	●	●				/	●	
India	●	●				/	●	
Poland	●	●				/	●	

Notes: A cell marked with '●' means that the fee component **is included** in the charge ratio calculations; a **blank** cell means that the fee component **is not included**; a **crossed** cell means that the fee component **is not applicable** in the jurisdiction; other types of fees: audit fee, marketing fee, legal fee, etc.
Bulgaria, Croatia, Poland, and Romania: the table above refers to the second pillar only.
Source: Supervisory authorities' responses.

22. There are various types of charging structure across jurisdictions: flat rate, proportion of contributions, proportion of assets, share of investment performance, with loyalty discounts, or a

4. It should be noted that the methodology for calculating the underlying components was not standardised (for example, transaction costs may be measured differently in different jurisdictions).

combination. In the early phases of implementing private pension plans, contribution-based charges might help to encourage new entrants as they will bring in revenues faster than asset-based charges (since participants will not have had time to build up significant assets). However as plans mature, the number of inactive members tends to rise; under a contribution-based structure inactive members would no longer pay anything to the plan provider although they would still generate both administration and investment costs. Asset-based charges will generally bring in more revenue for the provider over the lifetime of the plan, but they can create perverse incentives - for example, an asset manager who charges an ad valorem fee might be more interested in growing assets than in outperforming the market (if the market rises by 10% and the fund by only 8%, the manager can charge his normal fee on the 8% of additional asset value, even though he has underperformed the market). On the other hand, performance-based fees for investment services could lead asset managers to take excessive risks.

Summary

23. Measures to contain costs must consider total member reductions. Private pension plans incur several different types of administration and investment cost, some of which are not easily observed or measured; the charges imposed by private pension plans on their members may not accurately reflect all the payments that are made by members to the plan provider or third parties and therefore create a drag on portfolio returns. Different charging structures may be appropriate for different cohorts and providers' costs will evolve as plans mature.

Section II: Weak competitive pressures in private pension markets

24. In a competitive pensions market, total member reductions will be contained. However studies in a number of jurisdictions point to a lack of competitive pressures on private pension providers. Schwartz (2008) found that "noise" in the Mexican pension fund market prevented workers from accurately interpreting market signals - instead of responding to price incentives, they were prompted to switch providers by intensive sales efforts. The Financial Conduct Authority's (FCA) 2016 study of the UK asset management industry, which manages over GBP 2 trillion of pension assets,[5] found that "The evidence suggests there is weak price competition in a number of areas of the asset management industry. This has a material impact on the investment returns of investors through their payments for asset management services." Australia's 2014 Financial System Inquiry determined that "the superannuation system is not operationally efficient due to a lack of strong price-based competition."[6]

5 . Source: Investment Association annual survey 2015-2016

6 . Financial System Inquiry (Murray) final report

25. The United States' view, by contrast, is that competitive pressures are effective in keeping total member reductions in defined contribution to a reasonable level, as long as the information is available to plan sponsors and members to make suitable choices.[7] Sponsors face legal sanctions if they breach their fiduciary responsibilities to members. Plan costs as reported in regulatory filings have fallen from 1.02% of assets in 2009 to 0.97% of assets in 2014 on a plan-weighted basis and from 0.65% to 0.55% on a participant-weighted basis; a fall in reported investment costs as larger plans move into lower-cost mutual funds has helped to drive this trend.[8]

26. There are a number of reasons why private pension markets might be uncompetitive:

- Lack of engagement by plan participants
- Complex and opaque charging structures
- Weak governance
- Barriers to entry/switching
- Failure to exploit potential economies of scale

Lack of engagement by plan participants

27. The problems that individuals have in engaging with and understanding financial products are well documented.[9] The problems are particularly acute with pension products, as neither the benefits themselves nor the reduction in benefits caused by excessive deductions will be felt immediately. This means that they do not respond to high total member reductions by pressuring their provider to reduce deductions or by switching plans.

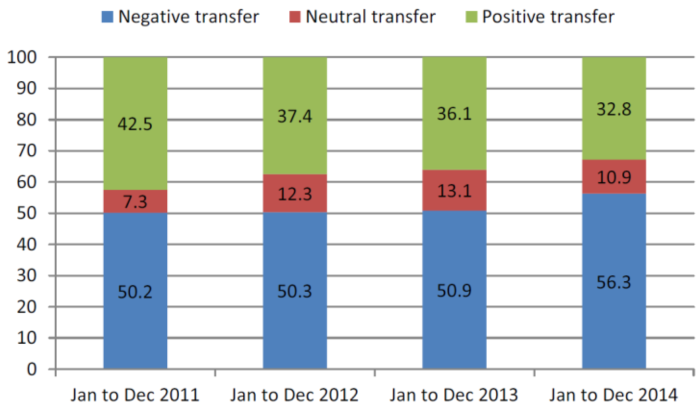
28. Plan participants and - where relevant - plan sponsors may be ill-equipped to select the appropriate plan, monitor its performance and switch plans where appropriate. Figure 3 shows the quality of account transfers in Mexico over the period 2011-2015: over half of transfers were made into providers offering a lower net return than the current provider. OFT (2013) described the buyer side of the UK DC workplace pensions market as "one of the weakest that the OFT has analysed in recent years." Their comment referred not only to plan members, but also to employers that were involved in selecting plan providers; they were concerned that smaller employers might lack the knowledge to select the most suitable provider for their employees and the resources to buy in expertise.

7 . References to the United States apply to ERISA-regulated 401(k) plans.

8 . Brightscope (2016)

9 . See for example OECD/INFE International Survey of Adult Financial Literacy

Figure 4. Quality of account transfers in Mexico (% of all transfers)



Notes: A negative transfer is one to an AFORE offering a lower net return. A neutral transfer is one to an AFORE offering the same net return or a net return less than 5% higher than the one offered by the previous AFORE. A positive transfer is one to an AFORE offering a net return at least 5% higher than the one offered by the previous AFORE.

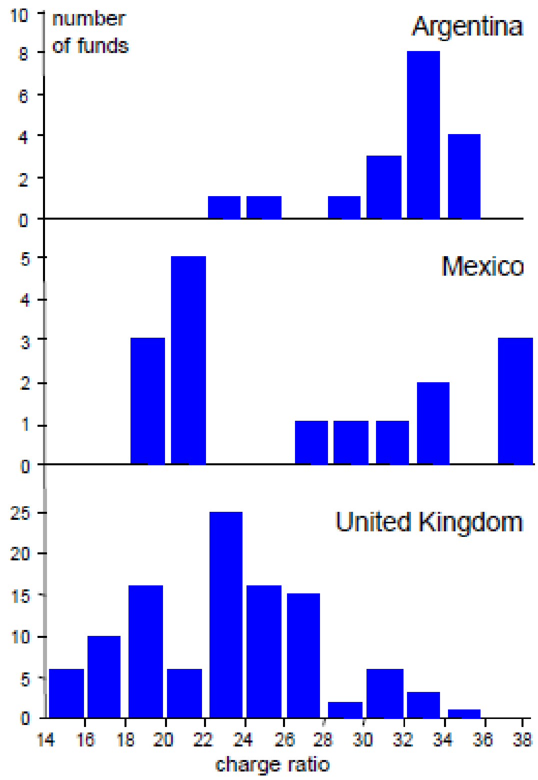
Source: OECD (2015)

Complex and opaque charging structures

29. Non-standardised charging structures and unclear communications around features and charges make it even harder for plan participants to understand what they are being charged by the plan provider and whether this charge includes all the deductions that will impact their portfolio accumulation. Clearer communication of explicit plan charges, such as expressing the charge in cash terms rather than as a percentage of assets, can help members to compare plans. Where charges are deducted from contributions after they have been transmitted to the provider, members may not take note of the level of the charge – this could be tackled by imposing charges on top of the contribution so that the impact on disposable income is felt immediately, as is the case in Chile.

30. Complex charging structures may lead to wide variations in charges within a single jurisdiction. World Bank (2005) found "a huge range of different charge levels between different providers", as illustrated for Argentina, Mexico and the United Kingdom in Figure 4.

Figure 5. Different providers' charges



Source: World Bank (2005)

31. There may also be information asymmetry between plan providers and their suppliers. RailPen, which manages pension assets of over GBP 20 billion, calculated that the actual costs of external investment management were up to four times the GBP 70 million that they were paying annually in direct fees, and in response started to bring more investment management in house.[10] Investment managers might charge different fees for segregated accounts to different clients and impose non-disclosure agreements so that pension providers cannot compare the fees they are paying to those being paid by their peers. This has led to a wide range in the fees paid by institutional investors for similar services (Table 3).

Table 3. Cost range in basis points for selected asset classes

	Externally-managed passive global fixed income	Internally-managed active real estate	Externally-managed active global equity
90th percentile	8.5	60.2	83.3
75th percentile	7.8	41.2	62.7
Median	7.1	27.3	49.2
25th percentile	4.0	15.8	38.8
10th percentile	1.6	7.1	24.0

Source: CEM Benchmarking presentation to World Bank Global Pension and Savings Conference, April 2014. The CEM global universe covers around 360 DB funds, SWFs, buffer funds and DC platforms with almost USD 7 trillion of assets.

10 . Source: Financial Times, 24 August 2014.

Weak governance

32. Weak governance can result in a failure to identify and contain total member reductions. Smaller schemes in particular may lack the resources for effective oversight of costs and may be in a weak position to negotiate with their suppliers. Governance failings could also arise from conflicts of interest, from agency problems, or from lack of clarity as to different suppliers' responsibilities towards plan participants. Conflicts of interest may weaken governance. External trustees of small plans might vote against scheme consolidation if it would put their jobs at risk, while the internal governance committees of bundled providers might hesitate to take action in areas such as investment costs that are a source of revenue for the provider.

33. Governance issues have been suggested as one of the reasons why retail funds were significantly more expensive than industry funds within the Australian superannuation system in the early 2000s. Industry funds typically levied a flat-rate administrative fee of around AUD 45 a year plus a fund management charge of around 0.4-0.5% of assets. Retail funds were more expensive, with flat-rate fees averaging AUD 70 a year and fund management charges up to 1.9%. There was also a charge of around 4.5% of contributions. However differences in marketing costs or service levels could also account for the difference – retail funds did not have a captive client base and offered greater product choice.[11]

34. The responsibility of governing bodies in relation to total member reductions is not necessarily to minimise cost, but to ensure that members are getting good value for money from their plans (Box 1). Assessing value for money is more complicated than understanding costs and charges. It involves comparing total member reductions to both quantitative indicators, such as portfolio return and risk, and to qualitative indicators such as service levels and member satisfaction. Addressing "value for money" avoids the danger that focusing on costs alone might create a perverse incentive to invest only in low-cost products that are unlikely to build an adequate pension pot, such as a passive bond fund.

Box 1. Value for money

There is a strong argument that pension plan costs should not be looked at in isolation. Costs are a function of the quality of the plan administration and the design of the investment strategy and each of these plays an important role in ensuring that plan participants receive adequate retirement benefits.

- Plan administration; regular communications can increase member engagement and raise contribution levels; efficient processing of contributions means that out-of-market risks are minimized; paying for training for trustees may protect members' interest better. Administration requirements will vary according to the characteristics of plan participants - those close to retirement will require different services from those just joining the plan.

- Investment strategy: plans require different strategies according to their membership profiles and liabilities; higher-cost investment strategies may generate higher returns.

Extra costs eat into portfolio returns but may bring valuable services. LCP (2015) found that while members of DC plans in the UK could pay up to 20 bp more to select an underlying investment product for their portfolio through a platform rather than directly from the manager, there were advantages to platforms such as access to a wider range of underlying products, easier switching between products and the ability to customize and simplify DC propositions.

35. In the USA, plan sponsors must ensure that their plans offer value for money. Department of Labor Regulation 408(b)(2), which took effect in July 2012, sets out the information that sponsors must collect - and service providers must make available - to determine the "reasonableness" of their

[11] World Bank (2005)

arrangements with their providers. This includes information not just on fee levels but also on the extent and quality of service and the investment options selected for the plan.

36. However, value for money is a qualitative concept and so can create additional governance problems. In the UK, all providers of contract-based pension schemes have been required to establish an Independent Governance Committee (IGC) since April 2015, and the IGCs are required to produce an annual report demonstrating the value for money delivered by the scheme so that members can compare providers across the market. To date, the IGCs have been unable to come up with common definitions, measurement techniques or benchmarks for determining value for money. To the extent that costs are certain but administration quality and investment performance are not, prioritising attention to costs is more likely to reap immediate and durable benefits to plan participants.

37. The long chain of intermediaries involved in delivering a pension plan can give rise to agency problems, especially where the intermediaries do not have an explicit duty of care towards plan participants. Employers are likely to focus on minimising costs to themselves (such as integrating contributions into payroll systems) rather than to their employees. Fund platforms that provide participants with access to underlying investment strategies might not use their bargaining power to reduce entry and exit costs for members. Investment consultants could be tempted to increase their billings by proposing complex investment strategies or frequent changes in strategy. Advisers who benefit from built-in adviser commissions (an implicit charge, not directly visible to participants) are less likely to recommend switching plans. Investment managers who are not required to report on indirect costs might not try to control them.

Barriers to entry/switching

38. Competition between plan providers should be strongest when a new plan is being set up or when participants are thinking of switching plan. Barriers may exist at the level of the provider or at the level of the plan participant.

39. Providers may face barriers to entry due to the high proportion of up-front costs in setting up a new plan - fixed costs such as IT are incurred before significant pools of assets are collected. This may make it especially difficult to attract new providers for automatic enrolment schemes targeting smaller employers and lower paid workers. New plan providers and external asset managers might be at a competitive disadvantage from lower brand recognition or a shorter track record. Bundled providers might limit access to their platforms by external asset managers or benefit from lower switching costs through crossing trades within their platforms (if a plan participant decides to switch from one underlying investment product to another, a bundled provider might be able to match that trade with an equivalent trade by another participant). On the other hand, if it is too easy for new providers to enter the market there is a risk that they will not achieve sufficient scale and be forced to increase charges or reduce the quality of the plan, or withdraw from the market completely.

40. When plan participants consider changing plan provider, they may be put off from doing so by regulatory barriers, such as taxes, or by commercial barriers such as explicit charges. They may also be unwilling to spend the time and effort researching a new plan, resulting in inertia and the failure to switch out of poorly performing plans. However, excessive churning of investment portfolios can create additional administration expenses for providers and unnecessary trading costs for members.

Failure to exploit potential economies of scale

41. As noted in OECD (2016), there has been a significant decline in the number of private pension funds and plans since 2005 in several OECD member jurisdictions. A number of countries with mature pension systems, such as Canada, the Netherlands and Australia, are actively encouraging further consolidation of funds. Pension plan size varies considerably across OECD and IOPS members and it is not clear that there is an "optimal" plan size, but the existence of high fixed costs in pension plan administration implies that larger plans will be more efficient. They could also benefit from better governance. The decrease in the number of pension funds in the Netherlands since 2005 from 800 to under 400 has been accompanied by tougher qualification requirements for trustees.

42. Administrative costs include a number of items with a substantial fixed element and there is evidence that scale economies can be captured relatively quickly. Di Gialleonardo and Marè (2015) found that the administrative costs per participant of supplementary closed pension funds in Italy fell from EUR 31.43 for funds with 10-50 000 members to EUR 19.63 for funds with over 50,000 members.[12] Furthermore, there were no diseconomies of scale for bigger funds. Bikker (2013) reached similar conclusions for Dutch pension funds and found also that the size at which funds could continue to reap scale economies was increasing over time, suggesting that "average administrative costs per participant now decline without limit", in part because of more expensive technology and more complex regulation.

43. Both studies found that the evidence for economies of scale in investment costs was less conclusive. Di Gialleonardo and Marè suggest that the relatively low level of management fees for closed funds in the Italian market might leave fewer opportunities for further cost reduction and that larger funds implement more complex and so more costly investment strategies. Bikker found that larger funds used more expensive asset classes and that scale economies were exhausted at an asset size of EUR 690 million. However, Broeders et al. (2015) found significant and sustained economies of scale for all pension funds with assets over EUR 20 million, driven by the ability to spread fixed investment costs such as compliance and reporting, risk management and the cost of trading facilities, as well as the greater bargaining power of larger funds. They did not conclude that DB plans have greater scope to use bargaining power than DC funds, although their DC sample size was low.

44. Deloitte (2014) found that size was a key driver of the "all-in fee" of 401(k) plans, incorporating both administration and investment costs. Data from the USA suggests investment economies of scale are available to DC plans. Brightscope/ICI find "larger [401(k)] plans, measured by assets or participants, [tend] to have concentrated assets in mutual funds with lower expense ratios ".[13] This is true across all asset classes and results partly from larger plans paying lower fees than smaller plans for actively-managed mutual funds, and partly from a bigger allocation to passively-managed or low-cost mutual funds by larger plans. Figure 6 shows a sample of the findings.

12 . "Closed" pension funds include single company and industry funds.

13 . Brightscope (2016)

Figure 6. Distribution of Mutual Fund Expense Ratios Paid by 401(k) Plan Participants*

10th percentile, median and 90th percentile asset-weighted mutual fund expense ratios as a percentage of plan assets

Source: Brightscope (2014)

45. Economies of scale in investment costs can come from negotiating power with asset managers and other suppliers such as custodians, spreading semi-fixed costs such as research on external managers, and bringing investment management in house, especially for complex asset classes. However, there may be diseconomies of scale arising from concentration risk (investors may have limits on the proportion of an underlying asset that they can own, or of the share of an individual manager's business that they can represent), from market impact (market delays or adverse price movements from passing large trades) or from the temptation to go into riskier asset classes. Larger DB plans may find it difficult to implement Liability Driven Investment (LDI) strategies because there are fewer counterparties for large derivatives trades. Reducing the number of plan providers too far could stifle innovation by both providers and external investment managers.[14]

46. To the extent that economies of scale are driven by bargaining power, both DB and DC pension providers might be able to exploit these economies through co-operation rather than consolidation. Schemes have different objectives and funding levels, so may need to maintain individual investment strategies. The UK's Local Government Pension Scheme (LGPS) is undertaking an asset pooling exercise, with the 89 individual funds being grouped into eight Common Investment Vehicles (CIVs). Between them, the 89 funds manage over GBP 200 billion, but the range of fund sizes is wide with the largest individual fund at GBP 25 billion and the smallest at GBP 400 million. Cost savings are expected to come from negotiating down investment management and custody fees, lower procurement costs, and greater efficiency (there are currently over 950 separate asset management contracts maintained by the LGPS).[15]

Summary

47. Market incentives to contain total member reductions are weak in most private pension systems. The impact of deductions on benefits is not felt in the short term, deductions may be made indirectly through reductions in portfolio returns, and even explicit charges may be difficult to understand and compare. Plan participants and oversight bodies may therefore fail to notice the full extent of costs and charges or to respond to high levels of deductions by putting pressure on their plan provider to reduce costs or by switching providers. Understanding whether total member reductions represent good value for members is especially complicated in the absence of agreed standardised methodologies or benchmarks.

---

14 . Axa (2013)

15. Unison (2016)

Section III: Policy responses

48. Policymakers have responded to market failures in private pension systems with various measures designed to strengthen competitive pressures on plan providers, to restrict their pricing options, or to introduce structural changes that will encourage or oblige pension providers to contain or reduce total member reductions. Most OECD and IOPS members have employed a combination of these approaches.

- Disclosure-based initiatives are the principal policy tool for strengthening competitive pressures. Transparency has been a key objective of policy in all jurisdictions, with measures to improve reporting, communication and benchmarking of investment costs and plan charges. Such measures target market failures arising from lack of engagement by plan participants; complex and opaque charging structures; and weak governance.

- Pricing regulations include charge caps (Costa Rica, Turkey, UK) or controls (Canada, Australia) and changing the basis for charges (Australia, Netherlands, UK),

- Structural solutions include increasing the number of providers (Mexico), introducing auction mechanisms (Chile, New Zealand); creating centralised institutions (UK, Sweden); encouraging scale (Netherlands, Australia, Sweden); and strengthening governance requirements (Australia, Netherlands, UK).

Disclosure-based initiatives

49. Regulators in every jurisdiction under review have highlighted transparency as a key element of encouraging competition. In the Netherlands and Denmark transparency measures were primarily aimed at changing the behaviour of pension plan providers. Plans are required to provide granular information on administration and investment costs and this has led to greater cost awareness, resulting in better outcomes for members (see Box 2). Both countries require pension providers to report on their costs to a level of detail similar to that in Table 1, using proxies for implicit costs such as look-through and transaction costs in some instances in order to simplify and standardise the data collection process. The Dutch National Bank benchmarks plans' performance on cost, return and service criteria and calls "expensive" plans to account.

Box 2: The Netherlands Recommendations on Administrative Costs

In 2011, the Dutch Authority for Financial Markets (AFM) published a report on pension fund costs that highlighted

- the influence of costs on retirement incomes
- that costs differed markedly among pension funds of similar size
- the potential for economies of scale
- under-reporting of costs by pension funds

The report sparked a considerable backlash in the press and prompted the industry to address the issue of transparency. Over time, the Netherlands has introduced a series of legal and voluntary requirements for pension funds to publish more and more detail on their cost structure, service levels and performance. It is now mandatory for pension funds to report their administration costs, investment costs and transaction costs (the reporting form for individual pension funds to the Dutch National Bank (DNB) is reproduced in Annex 1).

The effectiveness of the Netherlands' cost disclosure framework is demonstrated by the evolution of plan providers' costs since the start of the reforms. Cost data for five of the largest DB funds is shown below.

Costs of asset management (bp)	2010	2011	2012	2013
ABP*	39	64	73	76
PFZW	48	55	57	61
PMT	17	62	54	40
BPF Bouw	52	46	50	58
PME	70	53	37	29

*note ABP restated 2010 figure to 70 bp

The table indicates that pension providers had an incomplete picture of their costs before reporting requirements were introduced: ABP and PMT understated their 2010 costs. The data also shows that pension funds were able to take action on the basis of the new information - PME and PMT both reduced their costs over the period 2011-2013. (It should be noted that the other funds took similar action, but made other changes that mean that overall costs did not decline).

The success of the framework reflects a number of factors:

- Regulatory pressure: although the development of reporting standards was led by the industry, there was a clear message from the DNB that it would intervene if progress was too slow (public pressure also contributed).
- Industry leaders: the biggest funds adopted the voluntary Recommendations on Administrative Costs quickly; the Recommendations are burdensome for smaller funds but compliance is now close to 100%
- A gradualist, pragmatic approach: reporting requirements have become stricter and more detailed over time. For example, look through costs will only have to be reported from 2017. The usefulness of data is set against the cost of collecting it.
- Benchmarking: the data is intended to enable participants to understand the relative performance of their plan on a number of criteria. Standard definitions and calculations are therefore used.
- Explaining cost drivers: pension plans' costs are heavily influenced by the choice of investment strategy, the scale of the fund, the complexity of the membership base, and service quality. Pension plans are benchmarked against plans with similar characteristics and annual reports contain detailed information about investment strategy and about service levels (for example, query handling).

The Netherlands framework relies on co-operation by pension providers and their suppliers to provide transparency, and on trustees and participants to make informed choices based on the data they receive. It has been successful in focusing pension providers' attention on costs and value for money, with leadership provided by the biggest schemes.

Source : PF (2016), Novarca

50. Enhanced disclosure should also encourage plan participants to react to differences in total member reductions. The Danish government-backed site www.pensionsinfo.dk provides individuals with comprehensive information on their own pension accounts including direct and indirect administration and investment costs, and past returns, and the 2015 Communications Act in the Netherlands requires schemes to provide standardised information. Individual pension statements in Mexico include information on fees paid by the worker and compare net-of-fees returns across AFOREs. In the USA under participant disclosure regulation 404(a), plan sponsors must ensure that participants and beneficiaries receive sufficient information on fees, expenses and performance to make informed investment decisions.

51. Regulators in several jurisdictions provide comparison websites for plan costs and charges. In order to overcome the problem of opaque and complex charging structures that make comparisons difficult, they have imposed a degree of standardisation on the information collected and displayed. In Hong Kong, China, funds that are part of the Mandatory Provident Fund (MPF) must disclose their Fund Expense Ratio (FER) according to a fixed formula:

FER (%) = direct expense (%) + underlying funds costs (%) +/- any adjustments permitted or required by the supervisory authority in any individual case

52. In Italy, a synthetic cost indicator covering both costs and projected returns is available. The disadvantage of such methodologies is that they are not directly applicable to all individual circumstances, but the inclusion of return projections means that the broader issue of "value for money" as opposed to just "costs" is addressed in a simple format.

53. In several countries, including Israel and the Netherlands, transparency initiatives have been spurred by demands from the public or the press for better disclosure of costs. However a clear signal or intervention from the Regulator has been the decisive factor in ensuring that disclosure is to a high standard and the information is presented in such a way as to be useful to participants.

54. Greater transparency and more straightforward comparisons make it easier for plan participants to switch providers. This is expected to increase market discipline in Hong Kong, China where MPF contributions are transferable under the Employee Choice Arrangement; an Investment Education Campaign was also implemented to support members in making informed decisions about their plans. By contrast, policy in Mexico and Poland aims to discourage switching, since it leads to additional costs for both the plan provider and the plan participant and does not necessarily lead to a better pension outcome.

Pricing regulations

55. Pricing regulation can contribute to disclosure efforts by making it easier for participants to understand what services they are paying for and exactly how much they are paying. Simplifying fee structures is one way of achieving this: Mexico stopped the use of fees on contributions in 2008, so that AFORES can only levy a charge on assets under management (which was also capped). However, unless the charge in question captures a significant part of total member reductions, including indirect and implicit costs, this may not be sufficient to deliver better pension outcomes. Therefore more direct controls over pricing, such as charge caps, may be introduced.

56. The UK introduced a charge cap of 0.75% of funds under management to be applied to workplace default funds from April 2015. The cap applies to all direct and indirect administration and investment costs, but does not include transaction costs. Charge caps set a clear and simple standard for member charges but can have unintended consequences. If the cap is set too high, charges tend to rise to the level of the cap, as was seen earlier in the UK market when stakeholder pensions were introduced with a maximum charge of 1%, which quickly became the market price for all similar retirement savings

products. In a similar manner, the German government's estimated total charge for Riester products of 10% has become the de facto standard charge.[16] If the cap is set too low, plan providers might try to cut costs by offering lower-quality plan designs or by reducing the number of transactions they undertake, even when the trades would be in the best interests of members. On the other hand, if the cap does not include total member reductions, then providers might have an incentive to exaggerate uncapped costs in order to compensate for any lost profits in areas that do fall within the scope of the cap. For example, there are concerns that UK providers will raise the level of portfolio turnover so that total member reductions will exceed the level of the cap.

57. Establishing the correct level of the cap is complicated in markets where both bundled and unbundled providers offer pension plans. Bundled providers can benefit from lower costs thanks to vertical integration, for example they can reduce transaction costs when members buy and sell underlying investment funds for their portfolios through crossing trades on their internal platforms. Setting the cap in line with the cost structure of bundled providers might squeeze out unbundled providers. A low cap can also discourage new entrants. However a relatively high cap could enable lower-cost providers to generate excessive profits if they choose to price at the level of the cap, unless there was pressure from participants or other stakeholders to reduce charges. In the UK, Legal and General responded to the charge cap by capping its default fund charges at 50 basis points.

58. Turkey reduced its charge cap quite significantly in 2013 (Table 4). The new charging structure consists of a capped ad valorem fee that varies by asset class (ranging between 1.09% and 2.28%), a 2% fee on contributions and a small fixed on-boarding fee. The cap takes into account all fees that pension providers can earn from participants, putting the onus on providers to cut costs in order to increase profits – although as assets grow, ad valorem fee revenues will increase. Turkish providers must offer discounts to large employers, so the cap does not mean that economies of scale are lost, and loyalty rebates to members, which should discourage churning. Costa Rica replaced its mixed fee structure (with charges on both assets and on contributions) with a single, asset-based fee in 2011. The fee was initially capped at 1.1% and this will reduce to 0.35% by 2020, so that members share in the benefits from economies of scale.

Table 4: Charge cap in the Turkish pension system (%)

As of 31.12.2012	Fees on (%)							
	Contributions	Salary	Assets	Returns	Entrance Fee	Exit Fee (0-5 years)**		
Turkey (Maximum)	8	-	3.65	-	470 TL			
Turkey (Average)	3.52	-	1.80*-2.55	-	N/A			
From 01.01.2013	Fees on (%)							
	Contributions	Salary	Assets	Returns	Entrance Fee	Exit Fee ***		
						0-3 years	3-6 years	6-10 years
Turkey (Maximum)	2	-	1.09*-2.28	-	102 TL	766 TL	511 TL	255 TL
Turkey (Average)	N/A	-	2****	-	N/A	N/A	N/A	N/A
* Depends on fund type								
**No exit fee is charged after indicated period								
***Covers all other costs (transaction, switching etc;, i.e. Total Costs)								
****As of 30/06/2013								

Source: IOPS (2014)

59. Other forms of price control include restricting the types of charge that can be levied. Member-borne commissions have been banned in UK DC schemes; similar measures have been introduced in

16. Better Finance (2016)

Australia and the Netherlands. Mexico changed the incentive structure of sales agents to limit negative-yielding transfers.

Structural solutions

60. Structural solutions entail efforts to overcome market failures by intervening in the structure of the market. These can include measures to strengthen market mechanisms or alternatively to circumvent them by imposing new organisational structures.

61. Mexico and Chile provide examples of policies designed to strengthen market mechanisms. In Mexico, the number of providers (AFOREs) in Mexico increased from 11 to 21 between 2003 and 2008 as the Regulator encouraged new entrants in order to stimulate price competition. However because of weak member engagement and understanding, this led instead to increased expenditure on commercial activity that did not benefit plan participants.

62. Chile followed a different approach, introducing an auction process in 2008. Providers bid for the right to enrol new members of the mandatory DC system, their bids cover administration costs and internal investment costs. As shown in Table 3, this appears to have been effective in reducing fees charged by Chilean providers (AFPs) and incumbents do not appear to have had a competitive advantage or benefited from scale: the first auction in 2010 was won by a new entrant to the market with a bid of 1.14% of salary; it won again in 2012 with a lower bid of 0.77%. As a result, another pension fund decided to lower its fees from June 2012, the first reduction by any of the incumbents since 2009. In 2014, the auction was won by the provider that had until then been the most expensive, with a bid of 0.47%. It should be noted that Chile introduced other reforms in 2008 to help drive competition, such as the elimination of fixed fees and including comparative fee information on members' account statements.

Table 4. Fees charged by Chilean AFPs 2005-2012 (% of salary)

AFP	2005	2006	2007	2008	2009	2010	2011	2012*
Bansander (1)	1.67	1.67	1.91	-	-	-	-	-
Capital (1)	-	-	-	1.70	1.44	1.44	1.44	1.44
Cuprum	1.78	1.78	1.78	1.99	1.48	1.48	1.48	1.48
Habitat	1.48	1.48	1.33	1.74	1.36	1.36	1.36	1.27
Modelo (2)	-	-	-	-	-	1.14	1.14	0.77
Planvital	1.77	1.77	2.04	2.31	2.36	2.36	2.36	2.36
Provida	1.55	1.69	1.69	1.6%	1.54	1.54	1.54	1.54
Santa Maria (1)	1.29	1.62	1.62	-	-	-	-	-
Mean	**1.54**	**1.64**	**1.63**	**1.74**	**1.49**	**1.49**	**1.48**	**1.42**

Source: IOPS (2014)
(1) AFP Santa Maria was a subsidiary of AFP Capital, property of the ING group. In March 2008 AFP Santa Maria and AFP Bansander merged and from this merge AFP Capital was created.
(2) AFP Modelo entered the market in August 2010 after winning the first auction.

63. In some pension systems, regulators expect improved governance to help to create the conditions for market mechanisms to function. Australia and the Netherlands have imposed tougher qualification requirements on members of governing bodies and the UK Regulator is asking for more detailed reporting from the oversight boards of DC schemes. These reforms are in each case part of a much larger package of measures to improve outcomes for DC plan participants. In the USA, the fiduciary duties of plan sponsors (backed up by legal sanctions) are viewed as the most effective driver of competition among plan providers.

64. Where enhanced market mechanisms are not expected to be sufficient to control total member reductions, policymakers may consider measures to influence the operational set-up of pension providers or the organisational set-up of the market in which they operate. Policy makers in several jurisdictions are encouraging the development of bigger and more efficient plans through mergers or other organisational

changes in order to reap economies of scale. In Hong Kong, China the Regulator is discussing with trustees of MPF schemes how to streamline operations; the Australian Prudential Regulation Authority can apply a scale test to Superannuation funds. Fund mergers can be mandatory, as in Sweden, or a voluntary response to other regulatory pressures such as increased scrutiny of costs, as in the Netherlands and Switzerland. Canada's Pooled Registered Pension Plan system is designed to pool individual accounts in order to benefit from scale economies and participating providers must ensure that total member reductions are no more than they would be for a plan with 500 members.

65. Measures to encourage fund consolidation indicate that policymakers consider that the anticipated gains from scale offset any concerns that such moves could create entry barriers that favour established providers and prevent innovative competitors emerging. However additional regulation, such as sliding fee schedules, may be needed to ensure that the gains from scale are shared with plan participants.

66. Australia's Stronger Super reforms announced in 2011 (see Box 3) impose a number of structural requirements on providers of MySuper products, including simplified product specifications and investment strategies, streamlined back office functions and fund mergers. These in turn support other policy measures such as enhanced disclosure and standardised pricing to create greater transparency and clarity for both plan participants and employers.

Box 3: Australia's Stronger Super reforms

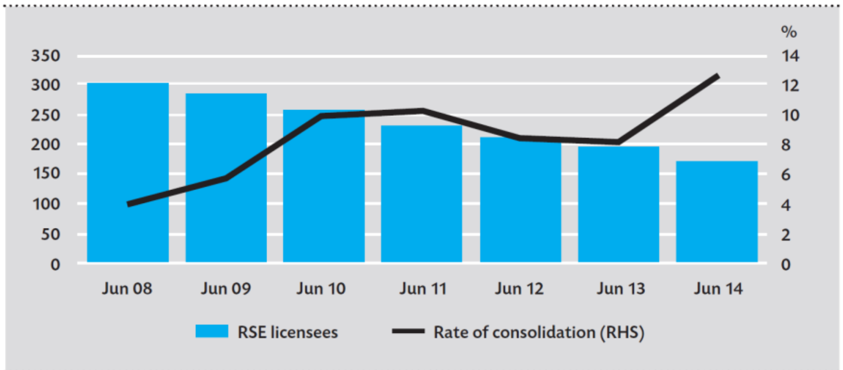
The Stronger Super reforms include a variety of measures designed to tackle different competitive weaknesses in the Australian superannuation market. Together, they are expected to reduce the average fees paid by members by up to 40%.

Key elements of the reforms are:

- The introduction of MySuper, a simplified, cost-effective default product
- Super Stream introduces new administrative and processing protocols based on standardised data
- Tighter governance procedures and clearer duties for trustees
- Measures to improve the integrity of the self-managed superannuation funds sector

Improvements in total member reductions are expected to be achieved through structural reform in conjunction with disclosure based initiatives and pricing regulation.

Structural reforms include simplified investment strategies that are lower-cost for members and more efficient back-office functions. Consolidation is encouraged, both by individual members (it will be made easier to locate and consolidate lost accounts) and at the provider level (compulsory mergers of smaller firms). The chart below shows the number of Registrable Superannuation Licences and the percentage decline in that number.



Source : Stronger Super Information Pack issued 21 September 2011, APRA Insight Issue 1 2015

MySuper products have a limited range of fees and the components of fees must be clearly disclosed and consistent across funds; standardised comparative information is available on the MySuper dashboards. Trustees must disclose "indirect costs", defined as any cost that they can be reasonably certain will reduce the return to members and that is not charged as a fee. Dashboards will also contain information on risk and return, giving an indication of value for money.

67. Rather than try to change the cost structure of pension providers, policymakers may change the structure of the market by establishing new, centralised institutions. Centralised institutions can help to control total member reductions in a number of ways. They can provide additional competition to plan providers – the UK's NEST competes with other providers for auto-enrolment business. They can offer low-cost solutions directly to underserved populations – NEST has an obligation to take on smaller accounts. They can ensure that scale economies are available to all participants – Sweden's PPM clearinghouse offers very low platform fees to plan providers. However it could be argued that centralised institutions have an unfair marketing advantage and can price in scale economies before they are realised thanks to government support. Furthermore, centralised institutions face the same governance issues in

demonstrating value for money as private sector plans: NEST's annual management charge of 0.3% is low relative to the UK market, but it also charges employers a fee on contributions of 1.8% that makes comparisons with other providers more difficult (Now Pensions has a monthly charge of GBP 40 and People's Pension charges a one-off set up fee of GBP 500 or GBP 300 if the employer comes via an intermediary).

Summary

68. Policy to contain total member reductions has largely focused on simplifying charges and making them more transparent, so that plan participants have the information they need to put pressure on their providers. Such policies have generally been supplemented by measures to control pricing or structural measures to influence the set-up of the private pension market or of the providers themselves.

Section IV: Conclusion and Preliminary Findings

69. A variety of different measures have been introduced in order to contain the costs of running private pension plans, as summarised in Table 4. IOPS (2014) indicates that charges, as measured in each individual jurisdiction, have reduced in response to these policy measures. We note, however, that charges are not always a good proxy for total member reductions.

Table 5. Summary of policy measures in selected jurisdictions

	Lack of engagement	Opaque charging structures	Weak governance	Barriers to entry/switching	Failure to exploit economies of scale
Australia	Dashboard of costs, risk, returns	Low-cost plans; some charges prohibited	Tougher qualifications	Easier consolidation of "lost" pots	Back-office efficiencies; consolidation; scale test
Canada	Comparative website for PRPP	Low-cost plans			PRPP must offer same costs as for 500-member plan
Chile	Cost comparisons on individual statements	Auction system; simplified charge structure			
Costa Rica		Charge cap; simplified charge structure			Declining scale on charge cap
Denmark	Individualised dashboards	Detailed cost reporting			
Hong Kong, China	Fee comparative platform; education campaign	Fund Expense Ratio calculation		Employee Choice Arrangement	Regulator encourages administrative efficiency/mergers
Italy	Synthetic cost indicator				
Mexico	Net-of-fees return comparisons on individual statements	Regulator can reject fee proposals and force AFORE to charge the industry average; simplified charge structure		Policies to encourage new entrants and switching scaled back	Declining scale on charge cap
Netherlands	Information on plan policy in annual report	Detailed cost reporting; benchmarking; some charges prohibited	Tougher qualifications		Reduction in number of funds
Turkey		Charge cap			Discounts for larger employers
UK		Charge cap; some charges prohibited	IGCs introduced	Centralised low-cost provider	Pooling
USA	Participant disclosure requirements	Focus on "reasonableness"/value for money	Fiduciary duties of plan sponsors		

70. There are a number of preliminary conclusions that can be drawn from the experience of different jurisdictions in tackling competitive failures in the private pension market:

- No single measure is effective in isolation. All the jurisdictions under review employed a combination of measures to enhance market mechanisms, regulate pricing and influence the structure of providers and markets.

- Transparency is a pre-requisite for containing total member reductions, but is not sufficient in itself:

    - For transparency to be effective, plan participants and oversight bodies must be able to access standardised information and compare it across plans, and be prepared to act upon that information

    - Several jurisdictions have backed up transparency measures with efforts to improve governance standards, to ensure that greater transparency on costs leads to action to deliver better value for money

    - The information must be accurate: headline charges do not necessarily reflect the true cost of a plan from the member's perspective.

- To ensure better outcomes for plan participants, policy measures must address value for money rather than costs alone.

    - The examples of the Netherlands and Denmark demonstrate that it is possible to get sufficient information on different cost categories and on the investment policies and service levels that are the other components of value for money. However smaller plans might struggle both to deliver and to act upon such data

    - Where progress on prioritising value for money considerations is slow, it could be more beneficial for members to focus on costs in the interim. Cutting costs can lead to immediate gains (which will become significant over time)

- Measures aimed at stimulating market mechanisms work best when they are reinforced by pricing regulation and structural solutions.

    - Measures such as charge caps, the introduction of low-cost products and forced pooling can overcome the issues of low member engagement and weak incentives for plan providers to lower their charges, although they can also create distortions in participants' behaviour.

- Different policies and different charging structures may be appropriate for different plans and systems. Policy measures may therefore need to evolve over time

    - The maturity of the system affects the cost structure of pension plans. Participants build up more assets over time but may also become more expensive to administer. Providers benefit from economies of scale as asset values and member numbers increase.

  - An auction system may be more effective in systems with fewer plan providers and lower assets in legacy products; a centralised institution may be required in systems where newly-enrolled members are likely to be unprofitable for plan providers

  - Gaining full transparency on total member reductions is complex. Transparency improvements can be made incrementally, as plan providers and their suppliers build the operational capacity to deliver more and more detailed information

- For both relatively mature and relatively new private pension systems, the role of the Regulator is critical – neither plan providers nor plan participants will take action on costs and charges independently of regulatory action.

REFERENCES

Axa (2013), “Is Big Better?”, Axa Investment Managers, September 2013

Better Finance (2016), Pension Savings – the real return, 2016 edition

Bikker, J. (2013), "Is there an optimal pension fund size? A scale-economy analysis of administrative and investment costs", *DNB Working Paper* No. 376

Brightscope (2016), "The Brightscope/ICI Defined Contribution Plan Profile: A Close Look At 401(k) Plans, 2014", December 2016

Broeders, D. et al; (2015), "Scale economies in pension fund investments: A dissection of investment costs across asset classes", *DNB Working Paper* No. 474

Deloitte (2014), "Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013: A Study Assessing the Mechanics of the "All-In" Fee, August 2014

Di Gialleonardo, L. and Marè, M. (2015), “The Efficiency of Italian Pension Funds: Costs, Memberhip, Assets”, Siep Working Paper No. 687

Edelen, R. et al. (2013), "Shedding Light on 'Invisible' Costs: Trading Costs and Mutual Fund Performance", *Financial Analysts Journal* Vol. 69, No. 1

FCA (2016), Asset Management Market Study Interim Report, November 2016

Forsikring &Pension (2014), "Cost Recommendation - updated version", Danish Insurance Association LP Information 49/154

Hinz, R. et al (2010), "Evaluating the Financial Performance of Pension Funds", World Bank 2010

ICI (2016), "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2015", ICI Research Perspective July 2016

IOPS (2014), "Update of IOPS Work on Fees and Charges", IOPS Working Paper No. 20

Johnson, M., “The LGPS: a Lost Decade”, *Centre for Policy Studies,* February 2017

LCP (2015), LCP Investment Management Fees Survey 2015, https://www.lcp.uk.com/

OECD (2015), OECD Reviews of Pension Systems: Mexico

OECD (2016), Pension Markets in Focus

Office of Fair Trading (2013), "Defined contribution workplace study", OFT1505 DC workplace study

PF (2016), "Recommendations on Administrative Costs", revised version, Pensioen Federatie

Schwartz, M. et al. (2008), "Consumer Confusion: The Choice of AFORE in Mexico", IMF Working Paper WP/08/177

Unison (2016), "Local government pension funds guide", September 2016

World Bank (2005), "Administrative charges: Options and arguments for controlling fees for pension funds", *World Bank Pension Reform Primer series*

ANNEX 1: DNB REPORTING FORM

Annual statement 402, applicable from 2015 financial year

Specification income and expenditure account Amounts x 1,000						
		Gross payments	Frequency			
	Pensions paid					
1.1	Periodic pension payments					
1.2	Commutation					
1.3	Other lump sum pension payments					
1.4	Total					
		Internal costs	Procured from third party	Total		
	Costs (excluding asset management)					
2.1	Executive costs					
2.2	Administrative costs					
2.3	Consultancy & auditing costs					
2.4	Rental (incl. attributed rent premises in ownership)					
2.5	Total					
2.6	Active participants					
2.7	Pension beneficiaries					
2.8	Administrative costs as euros per participant					
2.9	Does you calculation align with amount under 2.8?					
2.10	What amount does your calculation give?					
2.11	Note on the difference					
3	Note on 'other income' and 'movement other provisions'					
	Asset management costs					
4.1	Have estimate methodologies been used?					
4.2	Note					
				Transaction costs		
		Management costs	Performance related costs	Transaction costs excl. buy & sell costs	Buy & sell costs	Total
	Costs per investment category					
5.1	Property					
5.2	Equities					
5.3	Alternative investments					
5.4	Fixed income securities					
5.5	Hedge funds					
5.6	Commodities					
5.7	Other investments					
5.8	Total costs attributable to categories excl. overlay					
5.9	Costs overlay investments					
5.10	Total costs attributable to categories incl. overlay					
	Other asset management costs					
5.11	Asset management costs pension fund and executive office					
5.12	Fiduciary management costs					
5.13	Custody fees					
5.14	Asset management consultancy costs					
5.15	Other costs					
5.16	Total other asset management costs					
5.17	Total costs asset management					
6.1	Average invested assets					
6.2	Asset management costs (excl. transaction costs) as percentage of average invested assets					
6.3	Does your calculation align with the percentage given at 6.2?					
6.4	What percentage does your calculation give?					
6.5	Note on the difference					
6.6	Transaction costs as percentage of average invested assets					
6.7	Does your calculation align with the percentage given at 6.6?					
6.8	What percentage does your calculation give?					
6.9	Note on the difference					
7.1	Note on asset management costs					
7.2	Note on divergence from income and expenditure account					

J402 Specification income and expenditure account
To be completed by: all pension funds
Last amendment to statement form: 2014
Last amendment of designation 1 January 2015

Source: PF (2016)