Updates on Fees and charges

IOPS Secretariat

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1. Project Background

- At the IOPS AGM in Hong Kong, China in November 2016, the Members decided to follow up on the IOPS research into fees and charges as part of the IOPS Programme of Work for 2017-2018
  - Delegates agreed to develop a **joint project** with the **OECD Working Party** on Private Pensions aimed at **analysing good practices** and **effects** of **policy interventions to lower costs of funded pensions**
- The project will be accomplished through the following two streamworks:
  - This paper which provides an **update of the IOPS work in the area of costs and fees;**
  - A series of three papers developed by the WPPP with close collaboration of IOPS:
    - Analysis of policy measures to contain costs of running funded private pension plans (discussed at the WPPP meeting held on 19-20 June 2017)
    - Cost of running private pensions: focus on 'Value for Money'"(discussed at the WPPP meeting held on 4-5 December 2017) and
    - Pension costs in the accumulation phase: policy options to improve outcomes in funded private pensions (discussed at the WPPP meeting yesterday, 4 June 2018)

2. Purpose of the project

- **Costs and fees** related to the process of saving for retirement are one of the **most important factors** affecting the **final value of retirement income**

- **Proper information** about **level** and **structure** of **costs and fees** is crucial for **effective governance of pension plans**
  - Such information also has a great value to the members of pension schemes, particularly the DC and hybrid ones where members face investment risks and need to take various decisions related to their retirement saving process

- The **goal** of this paper is twofold:

  1) Provide an **update** of the **current situation** with regard to the structure, level and types of fees and charges present in the surveyed jurisdictions (follow-up of the IOPS Working Papers No. 20 (April 2014) and No. 6 (June 2008))

  2) Gain more understanding of the nature of costs. In particular, to learn more about the **total member reductions** of their **pension savings**, i.e. the types of costs/expenditures that are covered by the existing fees charged directly to the members and the other costs that are charged indirectly

3. Fees charged in the surveyed jurisdictions

1) Current market average fees

- Amongst **88 different pension schemes** in 45 selected jurisdictions,
  - **Majority charge fees on assets**: 41 jurisdictions, 79 schemes (**90%**)
  - **Contributions**: 23 jurisdictions, **47%** of schemes
  - **Returns** (performances fees): 10 jurisdictions, **23%** schemes
  - **Salaries** 5 jurisdictions, **8%** of schemes

- 40 schemes (i.e. **45%** of the sample) charged fees on **one component** only
  - Two components: 35 schemes (**40%**)
  - Three components: 12 schemes (**14%**)
  - Four components: none

* In one scheme (Iceland, occupational plans) the number of fees can vary depending on the fund, which makes it hard to classify them to any of these groups

3. Fees charged in the surveyed jurisdictions

2) Legal caps on fees

- Many jurisdictions (31) introduced **legal caps** on fees
  - In most cases, the **average fees do not equal the legal cap**, which can be explained as a positive effect of market competition
- However, the **difference** between the cap and the actual level may be **insignificant**
  - Average fees were lower than the legal caps by at least 10% in 70% (i.e. 26 out of 37) of schemes

→ In **30% of the cases**, pension providers tended to adhere to the legal maximum values stipulated by governments

** The data on fees charged in 2016 / 2017 is presented in Table 1 (pages 5-10) of the paper*

3. Fees charged in the surveyed jurisdictions

3) Summary of changes since 2014

- All **22 jurisdictions** who participated in both 2014 and 2017 exercises **maintained** their **ways of charging fees**

- The major tendency is that **average fees decreased in 2017** compared to 2014
  - Amongst various pension schemes from 14 jurisdictions, average fee **clearly increased** in **only two cases**

- With regard to the change in **legal maximum fees:**
  - **9 lowered** (Bulgaria, Costa Rica, Czech Republic, FYR of Macedonia, Lithuania, Poland, Slovak Republic, Spain, and U.K.)
  - **3 increased** (Columbia, Hungary and Serbia)
  - **4 unchanged** (Albania, Ghana, Israel, and Romania)

* *The data on fees charged in 2016 / 2017 compared to 2014 exercise is presented in Table 2 (pages 11-12) of the paper*

4. Total member reductions of pension savings

1) Costs/expenditures covered by fees

- **Direct comparison** of fees and charges across jurisdictions may lead to **inaccurate conclusions**
  - The fee figures reported by different pension systems might not cover all cost and fee elements paid by members either directly or indirectly
  - Need to analyze the extent to which cost and fee elements are covered by fees charged from the pension plan members

- Jurisdictions are therefore presented by **clusters**, i.e. by groups of countries with **identical** or very **similar items** already **covered by pension fees**
  - From **Cluster A** (the most comprehensive) to **cluster E** (the least comprehensive), of the extent to which the underlying data incorporate the full range of fees, charges and expenses that ultimately affect member benefits

4. Total member reductions of pension savings

1) Costs/expenditures covered by fees

- **Cluster A**: 15 jurisdictions (17 schemes)
  - fees covering all or almost all of the following elements: administration fees, investment management fees, custodian fees, investment transaction costs, guarantee fees and others
- **Cluster B**: 8 jurisdictions (8 schemes)
  - fees coverage similar to A but without investment costs of the underlying funds (i.e. without including the cost of indirect investment)
- **Cluster C**: 6 jurisdictions (6 schemes)
  - coverage similar to B but without custodian fees. Some of these jurisdictions include investment transaction costs and guarantees in fees charged to the members
- **Cluster D**: 3 jurisdictions (4 schemes)
  - fees, as compared to cluster C, do include custodian fees and investment transaction costs but do not cover administration costs

** The data on cost and fee elements covered in fees charged to the members in each jurisdiction is presented in Table 3 (pages 14-15) of the paper*

4. Total member reductions of pension savings

2) Charge ratio

- **Charge ratio** measures the **impact** that any type of charge can have on the **final balance** of an individual retirement account **compared to** the hypothetical balance that could be obtained if **no fees were charged** at all
  - For example, a charge ratio for 40-years horizon shows **how much higher pension savings would have been** at the end of 40-year saving period had there been **no fees charged** to the pension scheme member

- The **caveats of charge ratios** should be spelt out clearly:
  - some of cost elements might be **omitted**, leading to charge ratios being actually **underestimated** for some jurisdictions
  - the **fee structure varies** greatly from country to country
  - the effect of absolute fees may vary depending on the **rate of return assumed**
  - the level of fees is somehow related to the **asset allocation profile**. Thus a **'cheap' system** (expressed either in terms of low fees or charge ratios) does not necessarily **imply** that the **absolute value** of the retirement pot at the end of accumulation savings **will be higher** than in an 'expensive' system that offers much higher rates of return

4. Total member reductions of pension savings

2) Charge ratio (40 years, rate of return 3%) – by clusters

- Average charge ratio for clusters (A, B, C, D) are (22.4%, 23.3%, 21.4%, 18.1%)
- Charge ratios for **clusters C and D** tend to be **decreasing**
  - This effect might be related to the fact that fees in these countries are lower as they cover fewer cost elements as indicated in the previous slides
  - Therefore, charge ratios for these less comprehensive clusters are likely to be underestimated

	Cluster A	Cluster B	Cluster C	Cluster D
# of jurisdictions	11	8	4	2
# of schemes	13	19	6	2
Average	**22.4%**	**23.3%**	**21.4%**	**18.1%**
Median	**16.6%**	**21.9%**	**20.4%**	**18.1%**
Range	**10.2% - 39.9%**	**6.9% - 37.0%**	**8.0% - 36.3%**	**7.3% - 28.8%**

** The data on charge ratio is presented in Table 5 (pages 18-19) of the paper*

4. Total member reductions of pension savings

2) Charge ratio (40 years, rate of return 3%) – other classification

- Average charge ratio may have been **affected** by the **number of fee components**
  - But the difference is not considerable taking into account the differences of charge ratios in each type of schemes
- Clearer difference in average charge ratio among different **pension schemes**
  - Occupational DC pension schemes tend to be much more cost effective than personal schemes, especially the ones where there is no direct link with employment

Classification		Average charge ratio
Fee components	One	**20.6%**
	Two	**21.9%**
	Three	**24.2%**
Pension schemes	Occupation DC plans	**19.3%**
	Personal plans L*	**22.8%**
	Personal plans NL*	**27.3%**

Based on the sample of 14 occupational, 13 personal L and 10 personal NL schemes.

* Personal plans, to which access can be linked to employment or professional activity

** Personal plans, to which access is not linked to employment or professional activity

4. Total member reductions of pension savings

3) Historical trend of charge ratios (40 years, rate of return at 5%)

- Charge ratios were compared with 2014 exercise under the same assumed rate of return 5%:
  - Charge ratio has **dropped** in **70%** (14/20) of the cases (schemes)
  - **Average charge ratio** has dropped from **25.7%** to **23.3%**
- This result is in line with the **tendency of decreased average fees** in most of the countries which we analysed in the previous slide

	2018	2014
# of schemes	20	19
Average	**23.3%**	**25.7%**
Median	**20.2%**	**24.3%**
Range	**8.0% - 42.4%**	**5.9% - 46.4%**

** The data on historical trends of charge ratio is present in Table 6 (pages 20) of the paper*

4. Total member reductions of pension savings

4) Sensitivity analysis

- **Four different sets of sensitivity analysis** performed to compare their **impact on charge ratio:**
  - Values for charge ratio increase as independent variable increases
  - **Average impact** on charge ratio is **higher** when **fees increase** because in schemes with low fees, the decrease in charge ratio is limited as fees cannot go below zero
  - The biggest impact is observed when changing **fees on performance**, followed by **fees on assets**

Sensitivity Analysis	Increase	Decrease
Investment return (±2pp)	+ 1.76pp	- 1.95pp
Fees on assets (±0.25pp)	+ 4.36pp	- 4.12pp
Fees on contribution (±0.75pp)	+ 4.05pp	- 2.64pp
Fees on performance (±2.5pp)	+ 5.01pp	- 3.80pp

* *The data on sensitivity analysis is presented in Table 7-10 (pages 21-26) of the paper*

4. Total member reductions of pension savings

4) Sensitivity analysis

- When analyzing **each pension scheme**, the **impact** on charge ratio is **asymmetric**:
  - The impact is **higher** when independent variable **decreases** compared to the case when it increases
  - For example, one can see that in case of Poland, charge ratio increases by 4.9 pp when fees on assets increase by 0.25 pp, but decreases by 5.3 pp when fees on assets decrease by 0.25 pp.
  - This tendency is the same with other fee structures, which can create **higher incentives for jurisdictions to lower fees charged to members**

Country	Sensitivity Analysis	Base	Up	Down
Poland (personal plans L*)	Investment return (±2pp)	12.7%	**+ 1.0pp**	**- 1.1pp**
	Fees on assets (±0.25pp)		**+ 4.9pp**	**- 5.3pp**
	Fees on contribution (±0.75pp)		**+ 0.7pp**	**- 0.7pp**
	Fees on performance (±2.5pp)		**+ 1.5pp**	**- 0.0pp**

* Fees are charged on contribution(1.55%), and on assets(0.51%)

5. Proposed updated time frame

Summer- Autumn 2018	▪ **Final draft of paper – approval to publish it in IOPS Working Paper series**

Thank you!

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