FOR PROFESSIONAL CLIENTS ONLY

PENSION FUND INVESTMENT FEES AND COSTS: MAKING THE MOST OF YOUR SHOPPING LIST

The topic of pension investment costs and charges is increasingly at the forefront of industry debate. On one hand, trustees and pension fund executives increasingly need to understand the implicit and explicit costs of managing their investments in greater depth. On the other, institutions ranging from regulators to the investment industry, and institutional investors themselves, are progressing initiatives to help drive further transparency in these areas.

Against that backdrop, Aon and Northern Trust have worked together to research and produce this briefing paper. Our aim in doing so is to help inform ongoing debate and support these efforts.

We aim to do that in three ways. Firstly, by setting out, and helping readers understand more of the various layers of costs applicable during the lifecycle of investing pension fund money. Secondly, by highlighting several areas of cost that the reader may find it most useful to focus on initially as they seek a closer understanding of their investment fees and costs. And thirdly, by providing the reader with questions they may ask of their asset managers and service providers in order to better equip themselves for these discussions.

We hope you find this paper a useful and interesting read.

Aon and Northern Trust have worked together to develop this briefing paper about the implicit and explicit costs of managing pension investments.

EXECUTIVE SUMMARY

Trustees and those overseeing pension funds need to know the cost to their members of managing their investments

Trustees and pension executives work to assess whether they are receiving value for money by comparing the costs with the returns achieved. However, the information required to do this is not always available, and like-for-like comparisons are rarely straightforward.

They should decide what level of cost transparency is meaningful for them and work to achieve it. As they do this, they should be aware of the potential costs of hiring or changing managers as well as the implicit costs of trading and executing investments.

Investment costs and fee disclosures are at the forefront of industry debate

A number of ongoing industry initiatives have the aim of helping schemes achieve clarity over their investment costs, including those by the UK's Financial Conduct Authority and the European Securities Market Authority.

Considerations when hiring an investment manager

When hiring a manager for the first time, trustees can use this opportunity to drill down on costs and operating expenses, and examine any charges that investors pay to access the fund, the costs of dealing and the effects of any performance fees. Trustees should note the style of management employed by their manager and ensure they understand the underlying assets in which they are investing.

Transitioning between managers can be challenging

Trustees should be aware of the potential costs, including opportunity costs, financial transaction taxes and other fees, of changing managers or adjusting fund strategy. Liquidity can be regularly monitored to build metrics for understanding the potential costs of replacing a manager.

Achieving transparency over transaction costs is crucial

Trustees should be aware of the implicit costs of trading and the effects of different methodologies used to calculate the cost of executing transactions. Costs may also arise from anti-dilution and box management practices.

Many cost details are unavailable, unless you know what questions to ask

If trustees understand the full range of costs within their investments, they will be better placed to assess whether their members are receiving appropriate value for money. The areas discussed in this paper are intended to help trustees develop a framework for discussions.

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AON

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

NORTHERN TRUST

Northern Trust's asset servicing business provides solutions to leading institutional investors including pension schemes, corporate and financial companies, insurance companies and fiduciary managers. We remain closely aligned with their evolving requirements – supporting their needs in areas ranging from liquidity management, increasing operational efficiency and data solutions for greater transparency and oversight over their investment assets.

NORTHERN TRUST ASSET MANAGEMENT

Northern Trust Asset Management is a leading global asset manager with the investment expertise, strength and innovation that has earned the trust and confidence of investors worldwide. With $1.2 trillion in total assets under management[1] and a long-standing history of solving complex investment challenges, we believe our strength and stability drive opportunities for our clients.

MAKING THE MOST OF YOUR SHOPPING LIST

Imagine you are a pension fund trustee seeking a new investment manager. Instead of using requests for proposals, consultants, and research to make your decision, imagine if you could find the solution in a supermarket. Are you in need of an active US equity manager? Check out Aisle 6. What about an emerging markets fixed income specialist – there is a 'buy one, get one free' offer on Aisle 9?

There is, of course, a reason why investment products are not sold in supermarkets. These products are specialised, complex and multi-faceted. But while that complexity might be necessary from an investment perspective, it can make assessing scheme options – particularly fees and costs – challenging for a pension trustee.

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Pension fund trustees need to know the total cost of managing their members' investments. And in order to assess whether members are getting value for money, trustees should also compare the costs with the results achieved. Obtaining clarity in both areas is important in ensuing good governance.

1. INTRODUCTION: UNDERSTANDING YOUR SHOPPING BILL

Trustees should understand how their costs fit into the wider context of their investment programme, and adopt a holistic approach to understanding them. Whether they are looking to either hire or change investment managers, or understand the transactions within their funds, it is important to be aware of the costs involved. This paper provides ideas that may help in such circumstances.

But they also need to know what questions to ask of providers and what is most relevant: there is little point in worrying about the cost of 5p shopping bag, for example, when they could be focusing on their £500 shopping bill.

Yet many trustees do not have the information required to make that analysis. In this respect, trustees may feel as though they are standing outside the supermarket with a full cart, belatedly scrutinising numerous items on their shopping bill and trying to understand the all-important total. While the big-ticket items have been printed out clearly on their receipt, the bottom of the list may be smudged, making it harder to read. What are the full charges included in the fund's total expense ratio (TER), for example? How about its ongoing charge figure (OCF?)

Trustees may not know where to look for this required data, and in many cases, do not have access to it at all. And even when this data is available, it is frequently calculated using varying methods and presented in multiple formats. This means like-for-like comparisons are far from straightforward, and are often themselves open to interpretation and further estimates.

Many headline investment costs are obvious. Less obvious are the implicit costs around hiring and changing managers, and the myriad costs associated with trading and executing investments.

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WHAT'S VISIBLE ON THE SHOPPING BILL?

In their prospectuses and other documents, fund managers include details of the fees they charge, which can include depositary, administration and custody-related fees. The documentation also sets out fees included within each specific share class and fees related to distribution.

Yet significant complexity exists around some of these costs. For example, regulatory fees could include listing fees for the local stock exchange, agent fees that enable certain investors to access the fund from their country or region, audit fees and legal fees. Without further information, trustees will not know what is covered and what is not.

These sometimes contentious costs, and those that are harder to quantify, are implicit. They could include custodian fees, stamp duty, turnover costs and market spreads. These costs vary depending on the liquidity of the underlying asset or stock, and are not always included in the information provided to trustees or their consultants.

While regulatory initiatives such as MiFID II[2] now require managers to disclose costs to clients, the absence of consistent guidance on how these costs should be calculated and reported means the methodologies used may vary significantly – adding complexity and making it difficult to make meaningful comparisons between various available investment options.

The disclosure debate

This issue has come to the fore in recent months. Many pension funds are publically discussing the challenges they have faced. Four years ago, a UK pension scheme with more than £11 billion in assets adopted the Chartered Institute of Public Finance and Accountancy's updated accounting standard, significantly broadening the scope of costs reported. Subsequently, it saw its reported costs rise from £11.3 million in 2013/2014 to £87.3 million the following year as these costs on the bottom of the 'receipt' became clearer.[3]

The fund decided it needed to better understand and challenge its costs, and it is not alone. There are several initiatives ongoing to assess costs, and the issue has equally come under significant wider industry and regulatory scrutiny.

In September last year, the UK's Financial Conduct Authority (FCA) published new rules requiring asset managers to disclose total transaction costs to their clients from January 2018. The Institutional Disclosure Working Group (IDWG), chaired by Dr Chris Sier, was set up by the FCA and is supported by various stakeholders in the asset management industry.[4] The IDWG has the objective of improving the transparency of costs across the institutional market.

The IDWG is expected to launch an industry standard template for asset managers to disclose all costs incurred in managing investment funds by summer 2018. Investors can expect to receive a standard set of cost information from any provider when requested to allow a comparison between providers and market norms.

Asset managers have been represented in the template's development and there is broad and increasing support for its adoption. Managers are also required to provide information about administration charges and to offer appropriate contextual information to help clients understand their costs.[5]

Placing the onus firmly on trustees, the UK Department of Work and Pensions (DWP) has announced following consultation that defined contribution (DC) occupational schemes will need to disclose costs and charges to their members, beneficiaries and recognised trade unions on an annual basis. The consultation outcome[6] and corresponding guidance[7] published in February 2018 make clear any trustee board that fails to provide the relevant information could be fined up to £50,000.

The European Securities Market Authority (ESMA) is following suit, embarking on a large-scale study to assess the reporting of costs and past performance of retail investment products. Its goal is to help investors understand the net returns of the products and the effects of fees and charges.[8] As ESMA points out, the implementation of regulations such as MiFID II and PRIIPs,[9] which increase the transparency around costs and charges, demonstrates that now is the right time to embark on such a study.

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Templates for transparency?

Pension schemes have also been undertaking their own initiatives. The £217 billion[10] UK Local Government Pension Scheme (LGPS) has launched a voluntary Code of Transparency that creates a standard template of costs and charges.[11] Managers signing up for the transparency code agree to supply certain sets of information, using templates launched last year by the Investment Association.[12] The LGPS has recently announced that it will be adopting the costs template developed by the FCA's IDWG for its' own cost-transparency initiative.

These templates include not only details of direct and indirect trading costs, but also 'net return' and summary details of turnover within the portfolio for the year. They include details of payments charged for research, fees paid within the segregated mandate of any holdings in pooled funds and a split of stock lending fees.

From a pooled fund perspective, the templates provide an underlying pension scheme with the ability to calculate costs in relation to their average holding, which includes their share of any related performance fees.

DISSECTING YOUR SHOPPING BILL: THE TER AND OCF

For many years, The Total Expense Return (TER) was used widely throughout the investment industry as a way of measuring the total costs involved in managing and operating an investment fund. It includes the manager's annual charge and the fees paid to the trustee, depositary, custodians, auditors and registrar. Collectively, these are known as 'additional costs'.

More recently, managers in Europe have moved away from the TER, believing more accurate information is provided by the Ongoing Charges Figure (OCF) imposed by UCITS V,[13] which is located in a fund's Key Investor Information Document. ESMA defines the OCF figure as "payments deducted from the assets of a UCITS where such deductions are required or permitted by law and regulation, the fund rules or instrument of incorporation of the UCITS or prospectus."[14]

Unfortunately, even detailed fund prospectuses often do not provide information about either the TER or the OCF. For pension scheme trustees who want to know what they are being charged for, that is unhelpful.

Both the OCR and TER should include the following fees in its calculation:

- Fund accounting fees
- Transfer agency fees
- Custody fees
- Depositary fees
- Management company fees – including any fees paid to advisors of the funds (e.g. lawyers and auditors)
- Trustee fees
- Directors fees
- Documentation fees

In continental Europe, this discussion is most advanced in the Netherlands, where pension funds have been obliged to report on their costs for more than a decade. For several years, the Dutch regulator has required details of transaction costs, and has recently extended this to include full 'look-through' reporting.

This includes a requirement to report on the expenses associated with buying and divesting securities, in place since the 2017 accounting year began, in pension funds' annual reports. But while this data may be readily available for listed equity and fixed-income transactions, the requirement will likely present challenges for more illiquid or opaque instruments such as closed-end funds, private equity and property .[15]

Challenges include the multiplicity of internal reporting processes used by providers, particularly by alternative managers who usually employ highly specialist, sector-specific accounting, and disclosure processes that may not easily confirm to standard fee templates.[16]

For several years, the Dutch regulator has required details of transaction costs, and has recently extended this to include full 'look-through' reporting.

TOTAL COST OF OWNERSHIP: BEYOND THE TER AND OCF

In 2012, the Netherlands Authority for the Financial Markets (AFM) proposed the 'Total Cost of Ownership' (TCO) concept as a solution for gaining oversight of the direct and indirect costs of investing, for pension funds. This concept has since become the 'standard' model in the Dutch market.

The TCO includes the costs of buying, holding and selling securities. When totalled, it may be higher (or occasionally lower) than the figures in the TER or OCF. It offers advantages in capturing not only direct, but also indirect costs, and thus providing a more complete picture of the true costs associated with investing.

2. HIRING A MANAGER (OR BUYING A READY MEAL?)

The initial hiring of a manager provides an opportunity for trustees to drill down on costs and operating expenses. While the TER and OCF can provide insight into the cost of managing investments, they do not include charges that investors pay to access the fund, the costs of dealing, or the effects of any performance fees.

Style of management is also a factor. For example, an index fund regularly rebalanced to reflect stock value or market capitalisation changes will attract different types of costs than a high-conviction manager employing buy-and-hold strategies.

In this respect, hiring a manager is somewhat like adding a ready meal to your shopping basket. You know what the basic ingredients are, but may not be aware of the additional preservatives or flavourings that have been added. Even apparently simple chilled meals may contain surprising numbers of ingredients.

As per the ESMA guidelines,[17] investors need to understand:

- Entry or exit charges or commissions
- Performance fees payable to the management company or advisor
- Interest charges on borrowing
- Payments to third parties
- Payments incurred from holding financial derivative instruments
- Transaction costs
- Fee-sharing arrangements, such as broker transaction costs or custodian fees on stock-lending income
- Subscription or redemption fees for acquisitions or disposals

Diversified growth funds – comparing apples and pears?

Trustees must also take a holistic approach to their costs. How important are costs if a high-performing strategy is returning value? For a product designed to deliver outperformance, how active is the portfolio, and how much is portfolio turnover costing? And when trustees are choosing between managers, are they really comparing them on a like-for-like basis, or are they comparing apples and pears?

One example of this dilemma is a diversified growth fund (DGF). DGFs are multi-asset funds aiming to achieve their return objectives with significantly less volatility than would be incurred through an investment in equities alone.

How important are costs if a high-performing strategy is returning value? For a product designed to deliver outperformance, how active is the portfolio, and how much is portfolio turnover costing?

To achieve this objective, the DGF manager has a degree of freedom in how it works toward a prescribed return target. DGF funds can be set up in various different ways, ranging from fund-of-fund multi-manager structures to direct investment in separate strategies. They may also have multiple layers of fees. The wide variety of DGF investment approaches and strategies mean those running pension funds should understand and be comfortable with the investments they hold within these funds.

Trustees could find themselves choosing between two different DGFs that appear comparatively similar, with similar management charges and return objectives, but in reality are quite different.

One fund may be more active, for instance, or have a more dynamic strategy that results in more asset turnover. While the approach may be required to deliver outperformance, trustees nonetheless need to understand what they are paying for.

In this type of instance, trustees need to know:

- Exactly what assets do they have invested within the fund?
- What is the liquidity of the underlying investments?
- Is the turnover high, medium, or low?
- Is there full transparency on costs?
- What efforts have been taken to manage costs appropriately?

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Costs relating to the management of a fund may include:

- Index fees
- Price vendor fees
- Research costs
- Broker fees
- Stamp duty
- Implicit costs of trading
- Local market taxes
- Financial transaction tax
- Stock lending fees and splits of revenue

3. REPLACING A MANAGER (TIME TO CHANGE YOUR MIND?)

What happens if you have already made your purchase – but now something has changed? Perhaps your experience was not as expected, circumstances have changed, or potentially more suitable products have been discovered?

In such cases, you may need to go back to the supermarket. Can you give your ready meal away? Do you include it with what you are serving? Or do you start from scratch because that meal is not appropriate anymore? In the same way, pension schemes appoint and change managers for a variety of reasons; this may be for performance-related reasons, or it may be that the pension scheme itself is changing strategy.

But when transitioning between managers, multiple considerations have the potential to add costs and affect value. A change in strategy may require switching exposures from a daily-priced fund to one with a monthly or quarterly dealing cycle, for example. If the new fund deals less frequently, there may be implications for redemption, resulting in a loss of investment opportunity for any time that your assets have been out of the market.

Trustees should consider other factors, particularly when transitioning into or out of pooled vehicles. In some countries, these transfers incur substantial market fees. In France, for example, under its financial transaction tax regime, moving assets into pooled vehicles will generally cost 20 basis points. In the UK, this rises to 50 basis points and to 100 basis points in Ireland and Poland.[18]

Trustees should also consider the following risks:

- Execution slippage: when the same execution price is not achieved for buys and sells.
- FX opportunity cost: when local cash cannot be moved between accounts, and sub-custodians need to execute FX trades, potentially at different times for buys and sells.
- Settlement error: when strict market rules around matching and buy-in lead to expensive settlement charges.[19]

Trustees should also be conscious of structural issues within their own organisations, or within the organisations of their appointed providers. For example, sometimes the decision to change a manager is made before the cost of doing so is taken into consideration.

When transitioning between managers, multiple considerations have the potential to add costs and affect value.

Switching managers should be seen as an implementation decision as much as an investment one. In fact, pension funds could regularly monitor their liquidation costs in order to build reliable metrics to understand what it could cost them to replace a manager.

Trustees should consider:

- Whether cost/benefit analysis has been undertaken to ensure that switching managers is worth it
- Any redemption implications
- Whether market opportunity costs exist and should be considered
- Whether it is worth hiring a transition manager
- Whether they have been informed of all taxes and market fees

Pension funds could regularly monitor their liquidation costs in order to build reliable metrics to understand what it could cost them to replace a manager.

Fund structuring expenses can include:

- Management company fees
- Trustee fees
- Director's fees
- Company secretarial and administration fees
- Legal fees
- Documentation fees
- Audit fees
- Regulatory reporting fees
- Financial accounting and submission fees

4. TRANSACTION COSTS: MOVING TO CHECKOUT (BUT WHAT'S IN THE BASKET?)

For many people, buying groceries online can be a liberating experience, but may cost more than expected at the point of sale. Prices of goods can fluctuate from the day that an order is placed to the day they are received, resulting in higher prices.

In this respect, transaction costs can become lost in the checkout 'basket' – those costs that trustees do not always have access to, or that can change between placing an online order and receiving grocery delivery.

The implicit costs of trading, and the potential impact of different methodologies, are issues trustees need to take into account. There are also other costs that do not always appear on trustees' radars.

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Anti-dilution levies and swing pricing

One of these costs is dilution. When an investor invests new money into a fund or withdraws money out of a fund, the resulting flows may result in transactions with potentially significant accompanying costs. In response, many asset managers impose an 'anti-dilution levy' on the investor whose activities trigger these transactions – the aim is to direct those costs to them, rather than other investors. This charge will affect that investor's total return.

To work out these costs, managers tend to use complex calculations based on varying assumptions. The costs may be disclosed by managers to their investors in various ways – sometimes before transactions occur and sometimes afterwards.[20]

Some of the ways in which dilution may impact investors' total returns include:

- Buying securities at a higher offer price than anticipated
- Selling securities at a lower bid price than purchased
- Executing transactions that incur brokerage fees, taxes and other costs
- Market effects as a result of purchasing or selling down securities due to the effects on the supply and demand curves of those securities in the market [21]

'Swing pricing' is another way that investment managers and their administrators attempt to protect existing investors in a fund from the effects of new subscriptions or redemptions.

Swing pricing has two distinct forms:

- The 'full' swing method, when net asset value adjusts up or down every day based on the direction of net capital activity. This calculation occurs regardless of the size of the shareholder dealing.
- A 'partial' swing method, which is only invoked when the net capital activity is greater than a pre-determined percentage threshold. This can be based on an absolute monetary value, or a mixture of both.

Asset managers use different methods depending on market conditions, the volume of shareholder activity, the size of the fund and how much cash is normally held. Trustees should find it useful to know whether the price has indeed been swung, and what methodology was used – particularly as it could affect performance fee calculations and risk and performance reporting issued in the sub-fund.

Again, the process of determining if the price should be 'swung' and by how much can be complex. Managers should have appropriate internal policies on the rules of implementation, on governance, and around transparency on the results and the frequency of application.

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Fund operating expenses may include:

- Dilution levies and swing pricing at the point of investment
- Fund accounting/investment accounting fees
- Transfer agency fees
- Custody fees
- Depositary fees
- Distribution fees

Box management

Institutional investors are also concerned about transparency in so called 'box management' practices. These occur when the difference between the spread in a fund's offer price (at which investors buy in) and the bid price (where the provider can buy units back) can be kept as profit by fund managers.

In its study, the FCA concluded that some sources of revenues associated with buying and selling funds are not transparent to investors. Many asset managers are benefiting from significant risk-free box profit revenues, as they could profit from matching the buyers and sellers in fund units.[22] The FCA is seeking to end this practice by 2019. [23]

When it comes to understanding transaction costs better, trustees should know:

- How swing pricing is applied to the fund, whether at the fund level or share class level.
- How active the manager is in buying and selling stocks.
- How dynamic asset allocation activity translates into costs.
- What percentage of the fund they constitute, in order to understand the effects of market movements on their holding.
- Whether box management is occurring.

5. CONCLUSION: UNDERSTANDING COSTS: MAKING THE MOST OF YOUR SHOPPING LIST

From regulators to asset managers, consultants to custodians, the finance industry is working to meet new standards and for heightened transparency and less complexity. But for many trustees, gaining a thorough picture of the factors behind their scheme's fees and costs will continue to be a complex undertaking.

Unfortunately, a standard agreement does not exist across the investment industry about what constitutes a 'cost' and how it is reported. In addition, while regulatory measures are being undertaken to help create standardisation, trustees are not always equipped with clear definitions of best practice for understanding costs. The situation is also made more challenging by the volume of data that trustees must often sift through in order to decide what is relevant.

Knowing what questions to ask of providers – and building a framework for that discussion –can be key to understanding these costs and help build an appropriate 'shopping list.' Once trustees understand the contents of their shopping bill, they will also be better-placed to assess whether they and their members are receiving value for money.

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UNDERSTANDING INVESTMENT FEES AND COSTS

- While the task of standardising investment fees and costs may appear daunting, regulators, asset owners, the investment industry and others are taking steps such as the FCA's IDWG costs template to standardise information in different ways.
- Obtaining high levels of transparency is achievable, but drilling down in significant detail may incur additional costs to the pension fund and its members. Trustees should seek to develop a level of insight and transparency into their costs that is meaningful for them and their underlying members.
- Trustees should take a holistic approach to understanding investment costs. Pricing should not be considered in isolation, but as part of the broader value anticipated from their purchases. Specific areas to prioritise may depend on factors such as the strategy being pursued or the asset class in which their pension fund is investing.
- Making changes or adjusting strategy will be likely to have variable accompanying costs. Be aware of the range of potential outcomes before proceeding.
- Many costs are simply not available to trustees – unless they know what questions to ask.
- Some charges are unavoidable – and some may be relatively inconsequential when placed in the broader context of overall costs. But trustees should be aware of them.

GLOSSARY

Explanations of the costs highlighted and financial terminology used in this whitepaper.

Audit fee

A fee paid to an external auditor for performing an examination of books, accounts, or other statutory records.

Broker fee

A fee charged by a broker to execute transactions such as the buying or selling of shares. Fees may also be charged for other services, such as for consultations on projects.

Company secretarial fee

A fee charged in order to ensure a company's compliance with its company secretarial obligations. A solicitor or other service provider may charge these fees for tasks such as filing an annual return each year and for keeping certain statutory registers complete and up-to-date.

Custody fee

A fee charged to an investor by a financial institution for keeping their assets safe and secure, or for other activities related to their role as custodian (e.g. settling trades).

Director's fee

A fee paid to an individual for their services as a director to a company.

Distribution fee

A fee paid to meet an investment manager's costs of marketing and selling fund shares. This charge is usually paid out of the fund's assets.

Diversified growth fund (DGF)

A fund that aims to provide exposure to a variety of different asset classes within a single fund. Many different types of DGF exist and they can be structured in numerous ways.

Documentation fee

A charge for the production of documents required for a fund to exist, such as a prospectus, fund contract, factsheet, or other type of document used for client reporting.

Entry or exit fee

A charge paid by an investor when investing into a fund for the first time, or when moving investments out of a fund respectively. These charges are explicitly detailed within fund documents. Entry or exit fees are also sometimes referred to as subscription or redemption fees respectively.

GLOSSARY *(continued)*

Financial accounting and submission fee

A fee paid to facilitate the preparation and or submission of company accounts for a fund and any associated regulatory filings.

Financial transaction tax

A charge, usually placed by a regional financial authority on specific types of transactions, such as the buying or selling of securities.

Fund accounting/investment accounting fee

A charge for accounting services relating to the valuation and reporting of the net asset value for the fund in line with the agreed valuation cycle.

Implicit costs of trading

A cost that has already been occurred through the process of buying or selling investments but has not necessarily been reported as an expense. Best understood if compared to the more broadly known ‘opportunity cost’ described in business terms to denote an often intangible cost of choosing one course of action over another. For example, if buying shares from a broker for a certain price, the implicit cost could reflect the opportunity lost (if any) of going with broker A instead of broker B. Or, in MiFID II terms, takes account of any ‘slippage’ in the price of a share between order and execution. Implicit costs will therefore not always be negative.

Index fee

An index fund is set-up to closely match or track (benchmark) the components of a market index (e.g. The Financial Times Stock Exchange 100 Index), as a lower-cost way of investing compared to more ‘active’ styles of asset management. The index fee is the cost (licence cost) from a benchmark provider to an asset manager or fund to use it as the benchmark.

Legal fee

A payment to lawyers or other advisors for any legal work required by an investment manager in the course of managing an investment fund and the preparation of fund legal documents.

Management company fees

Fees for the establishment, licensing or running of a company vehicle through which investments are managed.

Ongoing Charges Figure (OCF)

Represents the total ongoing costs to the funds, which includes the Annual Management Charge (AMC) and other charges for services. According to the Investment Association's[24] definition, the OCF should already cover all operating costs, including management fees (not including performance fees), custody, administration, auditor fees, regulator fee, and depositary fees.

Performance fee

A fee typically issued by an investment manager to its investors when it outperforms a benchmark or beats a specified return target.

Regulatory reporting fees

A fee charged by an investment manager or service provider for undertaking any reporting services that may be required under the law, or by another regulatory body.

Research fees

A fee charged by a brokerage firm for research activities, typically into markets or securities, often for the purposes of generating investment ideas for its clients.

Stamp duty

A tax levied by a government on the buying or selling of certain securities.

Stock lending fees and splits of revenue

Fees charged to the fund by a service provider for carrying out securities lending activities. Securities lending involves transferring bonds or equities (lending) temporarily to a borrower. In return, the borrower transfers other shares, bonds or cash to the lender as collateral and pays a borrowing fee.

Total cost of ownership

A concept and approach to understanding the 'true' cost of investing; originally proposed by the Netherlands Authority for the Financial Markets, as a means of gaining oversight for pension funds of all the direct and indirect costs associated with investing.

Total Expense Ratio (TER)

A means of expressing the costs and charges that apply to an investment fund or pension scheme. It includes the manager's annual charge and the fees paid to the trustee, depositary, custodians, auditors and registrar. However, and despite the name, the TER does not include all fees that may have been charged to an investor.

GLOSSARY *(continued)*

Transaction costs

Costs incurred by an investment manager through the process of buying or selling investments. Transaction costs may include a number of implicit and explicit costs.

Transfer agency fee

A fee paid to a transfer agent for providing and keeping records of who owns a publicly-traded company's stocks, bonds and other securities.

Trustee fee

A fee paid to a company or individual in return for their services as a trustee.

END NOTES

1 Represents total assets managed by the subsidiaries of the Northern Trust as of 31 March, 2018

2 "MIFID II" refers to the European Union's Markets in Financial Instruments Directive II

3 *Professional Pensions "How West Midlands Saved Millions of Pounds Through Cost Transparency Drive"* Last Updated: 30 May 2017

4 *Investments & Pensions Europe "Chris Sier appointed to lead UK cost transparency push" 2 August 2017*

5 The Financial Conduct Authority Policy Statement *"Transaction Cost Disclosure in Workplace Pension Funds"* September 2017

6 HM Government, "*Disclosure of costs, charges and investments in DC occupational pensions: government response",* February 2018.

7 HM Government, *"Cost and charge reporting: guidance for trustees and managers of occupational schemes",* February 2018

8 European Securities and Markets Authority "*ESMA Receives Mandate on Fund Performance from European Commission"* 19 October 2017

9 PRIIPs: refers to the European Union's Packaged Retail and Insurance-based Investment Products regulation.

10 Last triennial valuation of the LGPS assets and liabilities (as at May 2017) was at 31st March 2016

11 The Local Government Pension Scheme Advisory Board *"Code of Transparency-Introduction"*

12 Investments & Pensions Europe "*UK Public Pensions Launch Investment Cost Transparency Drive"* 16 May 2017

13 UCITS refers to the European Union's Undertakings for Collective Investment in Transferable Securities funds framework

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