

20 August 2020

State Street Global Advisors
20 Churchill Place
Canary Wharf, London
E14 5HJ
T +44 20 3395 6000
ssga.com

Department for Work and Pensions
Policy Group
Private Pensions and Arm's Length Bodies Directorate
Third Floor South
Quarry House
Leeds
LS2 7UA

Submitted via email: pensions.charges@dwp.gov.uk

Dear Sir / Madam

Re: Review of the Default Fund Charge Cap and Standardised Cost Disclosure

State Street Global Advisors (SSGA) welcomes the opportunity to comment on the Department for Work and Pensions call for evidence on the review of the Default Fund Charge Cap and Standardised Cost Disclosure.

For four decades, SSGA has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of active and index strategies to create cost-effective solutions. Through our pioneering approach, SSGA has become the world's third largest asset manager, with nearly \$3.05 trillion¹ under our care. We manage over \$500bn of assets on behalf of defined contribution (DC) pension schemes globally, including over \$50bn in the UK.

In summary, our response covers the following main points:

- We note that the DC market is competitive, and on average, default investment strategies in DC schemes are priced below the current charge cap level. We therefore do not believe it necessary to amend the charge cap level and that to do so would potentially restrict the investment strategies used by schemes.
- Transaction costs should not be included in the charge cap due to the effect this potentially will have on asset managers' ability to trade in response to changing market conditions.

¹ Assets under management as of June 30, 2020 includes approximately \$67 billion of assets with respect to which State Street Global Advisors Funds Distributors, LLC (SSGA FD) serves as marketing agent; SSGA FD and State Street Global Advisors are affiliated.

- The DC market has achieved transparency of costs under the DC standardised templates, in line with COBS 19.8, and we do not believe there is a need for further legislation to mandate disclosure.

Our views are broadly in line with the response submitted by the Investment Association (IA). However, we believe it may be helpful to provide further details on specific questions, which we have set out below.

Should you wish to discuss any aspect of our response further, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Alistair Byrne', with a stylized, cursive script.

Alistair Byrne, CFA

Head of Pensions and Retirement Strategy, EMEA
State Street Global Advisors

Detailed Comments on Specific Questions***Chapter 2: Potential changes to transaction costs*****Q1. What are the advantages or disadvantages of extending the cover of the charge cap to include some or all transaction costs?**

We do not believe that extending the charge cap to include transaction costs, both explicit and implicit, will be beneficial to the DC market or scheme members. The only potential advantage of including transaction costs in the charge cap is that it could indicate to savers a single fee level which their costs won't exceed.

The call for evidence however highlights the main disadvantages of including transaction costs in the charge cap, which we agree with:

- Firstly, including transaction costs in the charge cap will potentially limit an asset manager's ability to trade securities in response to changing market conditions. In these circumstances, asset managers will face a perverse incentive not to trade, despite trading being intended to benefit the scheme members. This limitation will be to the potential detriment of the members' returns and retirement outcomes.
- Secondly, capping transaction costs may limit the investment universe to assets and investment strategies that are cheaper to trade, irrespective of whether this is beneficial to risk-adjusted returns. For example, it may hamper investment in property and other illiquid private markets assets.
- Finally, implicit costs, as stated in the call for evidence, are inherently difficult to calculate accurately and there is a variety of metrics for calculating these costs, adding a degree of subjectivity to the cap.

As the call for evidence states, there is no evidence of asset managers benefiting from inflating transaction costs. Since the rules in COBS 19.8 have been introduced, asset managers are transparent with transaction costs and disclose them in an itemised format. We also note that asset managers are subject to best execution obligations with respect to transaction costs.

Q2. What would be the impact on scheme member returns/industry if some or all transaction costs were covered by the cap?

Please see our response to Q1 above. If transaction costs are included in the charge cap, there will be a potential detrimental impact on returns for savers for two reasons:

1. An investment manager may not be able to trade in line with a certain investment strategy or in response to prevailing market conditions, for the benefit of the portfolio.

2. Investment managers may be restricted insofar as they cannot invest in assets that are more expensive to trade, but which may improve risk-adjusted returns and match the schemes investment horizon.

Q3. Should there be a combined transaction cost and charge cap, or should these be separate?

As stated above, we believe there should not be a cap on transaction costs, whether combined with the charge cap or otherwise. If a cap on transaction costs were to be introduced it should be separate to the main charge cap, given the different nature of the charges and cost estimates involved.

Q4. Who should be responsible for complying with a transaction cost cap?

The trustee or provider would need to be responsible for any transaction cost cap at the default strategy level. This illustrates one of the challenges, given that most default strategies will be comprised of a number of underlying investment funds all incurring transaction costs independently in pursuit of their agreed investment strategy. It is not clear how a cap could be managed at the aggregate level without compromising other investors in those funds.

Chapter 3: The level of the charge cap

Q5. If we lowered the cap, what would be the impact on (a) scheme member outcomes (b) industry?

As the evidence presented in the call for evidence indicates, the DC market is competitive, with the average charge on DC default strategies being well below the current charge cap level of 0.75%. We therefore do not believe it is necessary to lower the level of the charge cap.

While it is clear that on average there is ‘headroom’ between current charge levels and the existing cap, bringing the cap down could restrict decisions schemes might make in relation to investment strategy and quality of service deemed appropriate for their members.

Q6. How have investment approaches altered as a result of the introduction of the cap? What changes have there been in asset allocation, management style (active, passive, factor based)?

Most DC default strategies make significant use of index tracking funds in public equity and bond markets. It is not clear the extent to which this is driven by the charge cap, rather than wider competitive and investment strategy considerations.

Q7. Have schemes changed administrator or asset manager in response to the cap?

We do not have any direct evidence on this.

Q8. What links have you found between cost and performance?

We would endorse the proposal to update the 2016 survey of DC charges and suggest that the new survey be widened to include information on investment performance to enable an analysis of the link between cost and performance. We would note, though, that some schemes will have bundled costs of investment and administration and the link between total cost and investment performance will be less clear.

Q9. How much notice should be given for any reduction in the cap?

As our response states above, we do not believe there should be a reduction in the charge cap. In the event that the charge cap is reduced, we believe there should be significant time allowed (say 2-3 years) for the market to respond to the change, given the potential need for schemes to change investment strategies and administration arrangements.

Chapter 5: Standardised cost disclosure templates**Q14. Is legislative intervention required to support the uptake of the CTI templates?**

We fully support transparency of costs and charges in the DC market and believe that the existing regime recently put in place is effective. Managers are required to make disclosures in line with FCA COBS 19.8 and the industry has adopted relevant templates to capture and communicate the required information. These rules are fairly recent and should be allowed to bed down without further changes.