



20<sup>th</sup> August 2020

**DWP Consultation Co-ordinator**  
**4<sup>th</sup> Floor**  
**Caxton House**  
**Tothill Street**  
**London**  
**SW1H 9NA**

Submitted via email to: [caxtonhouse.legislation@dwp.gov.uk](mailto:caxtonhouse.legislation@dwp.gov.uk)

To the DWP Consultation Co-ordinator

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

BlackRock<sup>1</sup> is pleased to have the opportunity to respond to the Review of the Default Fund Charge Cap and Standardised Cost Disclosure, issued by the Department for Work and Pensions.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of the DWP on any issues that may assist in the final outcome.

We look forward to further discussion on any of the points that we have raised.

Yours faithfully,

**Alex Cave**  
Head of UK Defined Contribution distribution  
[alexander.cave@blackrock.com](mailto:alexander.cave@blackrock.com)

**Antony Manchester**  
Head of UK Public Policy  
[antony.manchester@blackrock.com](mailto:antony.manchester@blackrock.com)

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<sup>1</sup> BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

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## Executive summary

**Auto-enrolment in the UK has so far been a great success** in meeting what it aimed to achieve, **allowing ever more people to save for their retirement through Defined Contribution (DC) pension schemes**. Employees from various backgrounds and circumstances are now investors, which makes control of and transparency over associated costs all the more imperative. **BlackRock therefore supports the charges cap as a guard against excessive fees, and the drive towards greater transparency and competition in the DC market.**

As a society, we have chosen to rely on DC pension schemes to provide adequate incomes to individuals in retirement. The purpose of auto-enrolment is to ensure people are preparing for their retirement in this way. **The ultimate goal of industry and Government should therefore be to make DC pension schemes a viable means for individuals to secure comfort in retirement, even where a DC scheme is their only savings vehicle. However, significant challenges remain in closing the gap between individuals' expectations for basic retirement comfort** (typically a salary replacement rate of two thirds), **and what they can realistically achieve.**

**One approach to closing the gap is to increase contribution rates.** While we recognise that the current financial environment is challenging for individuals, companies, and the Government, we would strongly urge taking a long-term perspective and further reviewing mandated contributions with a view to increasing them over time. A proposal from The Investing and Savings Alliance (TISA) for a 12% contribution rate (6% employer + 6% employee/HMRC) is one constructive suggestion that, if phased in, would make a meaningful improvement to individuals' retirement prospects, without causing them significant financial difficulty today.

**Another approach to closing the gap, pertinent to this consultation, is increasing investment returns for DC scheme members.** To do this, it is essential that DC schemes have access to a wider range of increasingly sophisticated default investment options that suit their members' long-term horizons, improve risk-return prospects, and reflect savers' views and preferences. BlackRock therefore welcomes recent cross-Government efforts to both lower barriers for DC access to longer-term 'patient capital' investments; and to integrate Environmental, Social, and Governance (ESG) considerations into trustee decision-making processes.<sup>2</sup> As more and more DC savers begin to retire, it will become ever more important to ensure retirement income solutions are effective – and we therefore support measures being taken to improve the transparency of fees and to also facilitate cost-efficient mass-market drawdown strategies.

**We encourage a holistic approach to policymaking for DC pension schemes, which ensures that different policies do not conflict with one another and are ultimately focused on delivering better outcomes for individuals saving for their retirement.** The introduction of the charges cap has ensured fees incurred by scheme members are not excessive and should remain in place. However, further reduction in the level of the cap, or expansion to cover a wider range of costs, would undermine the progress being made in other areas to provide investment solutions that provide better outcomes for end-investors. In order for schemes to access a broad range of return-enhancing investments that can help savings grow over time – including sustainable investment strategies – fees should not be reduced to levels that prohibit DC schemes from competing with other asset owners for access to these strategies (e.g. renewable energy investments, venture capital, or impact investments). Further, a more onerous charges cap would risk intensifying a

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<sup>2</sup> BlackRock engaged with the Financial Conduct Authority's consultation on changes to permitted links rules for unit-linked schemes, which expanded the range of less liquid investments permitted; and the Department for Work and Pensions' 'Investment Innovation and Future Consolidation' consultation, which considered the status of performance fees within the charges cap. Our responses can be found [here](#) and [here](#), respectively.

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tendency to focus on costs over outcomes, storing up problems for future generations, and potentially widening the gap between those in default DC strategies and others with access to a wider range of investment strategies.

As such, we believe **transaction costs should not be brought within the scope of the cap or subject to a separate one**. An investment strategy may undertake transactions as part of active security selection; active asset allocation decisions; or rebalancing portfolios to achieve a target allocation. Transaction costs are also incurred through hedging strategies, securities lending, managing market volatility, or anti-dilution measures. All these activities are undertaken with the aim of achieving better outcomes for scheme members. As such, **placing a regulatory limit on transaction costs will reduce the sophistication of default investment options available to DC schemes, undermining the potential retirement outcome benefits for scheme members**.

Transaction costs are not a charge to investors, they are a cost associated with transacting in markets, and reflected in investment performance. Asset managers acting on behalf of clients have a duty to transact as efficiently as possible, in line with their investment guidelines; and to justify to governance bodies how and why transaction costs have been incurred and managed. **The best way to ensure transaction costs remain reasonable is through disclosure of reliable information** allowing scheme governance bodies to assess the costs of the relevant strategy against the outcomes delivered and facilitating comparison.

We also believe **the impact of lowering the overall level of the cap would be to reduce the prospect of improved retirement outcomes for end-investors over the long term**, as a result of diminished ability to provide more sophisticated investment solutions. While the cap thus far has successfully ensured fees are not excessive, it has also encouraged price competition on relatively homogenous products instead of outcomes in the DC market. The relatively fixed costs associated with administration have meant downward pressure on total costs tends to result in a lower amount of the fee budget being allocated to investments, and generally less sophisticated default investment options. **Reducing the level of the cap is likely to hamper a move to more sophisticated default investment solutions providing access to a wider range of asset classes and strategies**.

The model of DC pension schemes as the predominant vehicle for retirement savings is in its infancy, and sophistication of default investment options is limited, especially relative to other types of pension scheme. Good progress is being made towards increasing the range of investment options for DC schemes, and widening the scope or lowering the level of the charges cap risks undermining these efforts. A stable policy framework would, we believe, encourage the take-up of well-designed default solutions.

## **Responses to questions**

### **Including transaction costs within the charge cap**

#### **1. What are the advantages or disadvantages of extending the cover of the charge cap to include some or all transaction costs?**

We believe transaction costs should not be brought into the scope of the charges cap. This is primarily because doing so will significantly hamper the asset management industry's ability to provide effective and increasingly sophisticated investment solutions for DC schemes. In addition to this, there are several conceptual, methodological, and practical challenges that need to be noted when considering transaction costs.<sup>3</sup>

<sup>3</sup> BlackRock has set out these issues in full in our ViewPoint: [Disclosing Transaction Costs – The need for a common framework](#).

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It is important to distinguish between ‘charges’ and ‘costs’ associated with investment management. Generally, ‘charges’ or fees are paid to the fund manager and other service providers as compensation for managing or selling a fund. ‘Costs’ can be thought of as the payments necessary to deliver an investment strategy. Put differently, charges are something that can be viewed and controlled ex-ante. Costs are more difficult to control beforehand, without hampering the process of investment management or introducing operational issues. Charges will – all else equal – reduce the net performance received by investors but costs are often incurred with the aim of delivering increased performance or managing against risk and so may contribute to enhanced performance.

Transaction costs are not a separate charge to investors. They reflect the cost of investing in markets, and performance of investments is always reported net of transaction costs. Across the spectrum of investment strategies, transaction costs can vary within different asset classes – influenced by market structure and depth of trading; or approach to portfolio management – which may involve more or less turnover of holdings, depending on investment objectives.

This means when looking at transaction costs it is important to bear in mind the portfolio investment objective, and its net-of-fees performance. Lower transaction costs do not necessarily translate into lower overall costs or better performance. Indeed, there are different reasons an investment strategy may undertake transactions: for example as part of an active security selection strategy; making active asset allocation decisions; or rebalancing portfolios to achieve a target allocation. All these activities may be undertaken in the course of portfolio management for a DC pension scheme in order to achieve better outcomes for scheme members.

Securities lending is another activity asset managers can employ to unlock additional value in a fund and collect higher returns for clients than would otherwise be achieved. Investors can benefit from securities lending in the form of better fund performance, because a fund can generate additional income through the fee that it charges for loaning securities, but will incur transaction costs as part of this – for example costs related to counterparty oversight and collateral management. Securities lending is always additive to performance, as additional returns are generated from fees paid by the borrower.<sup>4</sup>

As such, we believe the impact of extending the charges cap to include some or all transaction costs will be to reduce the sophistication of default investment options and restrict asset managers’ trading on behalf of clients, to the detriment of investors’ long-term retirement outcomes.

There are several channels through which this could happen:

- Firstly, it will tend to limit the range of assets it is feasible to invest in, resulting in portfolios that are more concentrated in highly liquid listed equities and bonds – which have generally lower transaction costs – and less exposure to areas like higher-yielding fixed income securities or private investments.
- Secondly, it will deter the use of strategies that make active security selection or asset allocation decisions to improve risk-return outcomes: An index-tracking portfolio will have lower turnover and therefore lower transaction costs than an actively managed portfolio that seeks to deliver outperformance or reduce exposure to market risk – this is particularly important as individuals approach retirement and DC default options will need to ‘de-risk’ their portfolios.

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<sup>4</sup> We set out a description of the benefits that long-term investors such as pension schemes can derive from participating in securities lending programmes in a recent *Policy Spotlight: [Securities Lending Viewed Through the Sustainability Lens](#)*.

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- Finally, it will limit the ability to continually review portfolio building blocks, to improve the sophistication of investment approaches and better manage risk through to retirement. This is particularly important in the context of default investment options, where the general aim will be for higher risk exposure and return generation early in the retirement savings journey, before gradually de-risking over time often referred to as the 'glidepath'.

## Case study: illustration of transaction costs for index and active equity funds<sup>5</sup>

The following example highlights the challenges that arise from setting a cap on transaction costs and from the measurement associated with such caps. We consider two types of funds, an equity index fund with a broad benchmark and diversified holdings; and an active equity fund with a narrower investment universe and more concentrated holdings. The active fund trades frequently to achieve its investment objective while the index fund rebalances to stay aligned with the reference index. The active fund will have a higher net-return target than the index fund.

Fund	Investment Style	Turnover of fund AUM	Average t-cost	Total t-cost	OCF	t-cost + OCF	1Y return
Equity Index Fund	Broadly diversified	10%	10bp	1bp	10bp	11bp	6%
Active Equity Fund	Active positioning	200%	40bp	80bp	160bp	240bp	10%

In line with average transaction costs BlackRock uses for disclosures and internal oversight, we assume transaction costs of 10 bps for a broadly diversified equity index mandate and an average transaction cost of 40bps for a more concentrated active fund.

The broadly diversified index fund incurs a cost of 1 bps of fund AUM, and the active fund 80 bps. While it may appear that the active fund is 80 times as expensive in transaction cost terms, this overlooks that these costs are incurred to build up active positions and generate higher net investment returns. Furthermore, if, in the context of a transaction cost cap, a fund would be judged based on the transaction costs and its management fee (OCF) combined, the 'cost' of the active fund would be significantly inflated, making it less likely to be included in a DC default option.

Moreover, there is significant variability in transaction costs, particularly when measured using the 'slippage' methodology. The index fund's transaction costs could rise to 20 bps or fall to 0bps in the next year; and the active fund's could double to 80 bps per trade or fall to 0 bps. If the fund costs were refreshed based on those higher levels of slippage cost, the index fund would report 2 bps and the active fund 160 bps, at fund level.

These examples are illustrative but demonstrate the wider point that capping transaction costs will effectively rule out particular asset classes or investment strategies for inclusion in a default option, to the detriment of outcomes for end-investors.

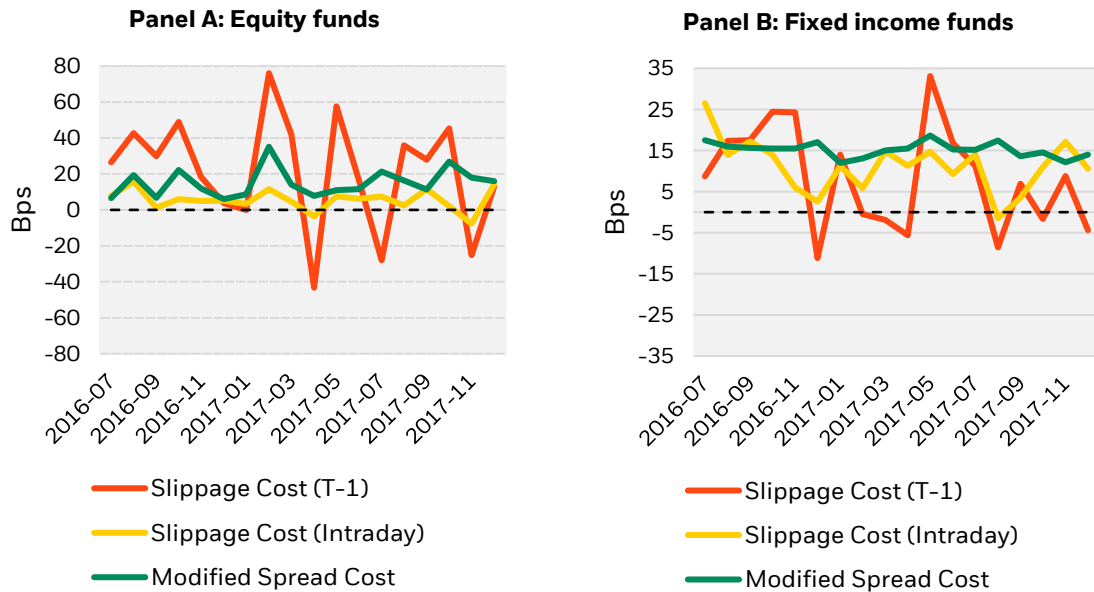
There are also interrelated practical difficulties with the measurement and restraint of transaction costs. As the DWP's consultation paper notes, there is 'no unarguable methodology' for measuring the implicit portion of transaction costs. Indeed, there are many difficulties associated with doing so that would mean a cap on transaction costs would bring significant complexity. The 'slippage' methodology, which is noted as the preferred approach of the FCA and the Government, ascribes highly variable and often negative values to the implicit transaction cost measure. As we set out in a *ViewPoint*

<sup>5</sup> The figures in this case study are based on cost and performance figures indicative of two index and active equity funds. Transaction costs are in line with internal assumptions. As such the data here should be taken as indicative and illustrative.

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published in 2018, we do not believe that (as it is often argued) over time negative costs will average out to a positive and more stable figure.<sup>6</sup>

**Figure 1: Monthly fund transaction cost disclosure data**



Source: BlackRock (2018) *ViewPoint: Disclosing Transaction Costs – The need for a common framework*; BlackRock proprietary data.

This variability makes it hard to limit transaction costs in advance and means reported transaction costs for the same investment strategy may differ from year to year. The DWP’s consultation document notes that “a recent study [by LCP] found that the majority of ... total transaction costs fall within the range of  $-0.1\%$  to  $+0.1\%$ ”: this is the case for index investments in UK equities or global corporate bonds, but LCP’s data also shows much higher average transaction costs and much higher variability in other asset classes, such as infrastructure, emerging market equity or debt, or absolute return strategies.<sup>7</sup> As we discuss further under questions 3 and 4 below, this would generate significant difficulties for trustees should they be responsible for complying with a cap; alternatively an asset manager designing an investment product with capped transaction costs may face a situation where trading must stop mid-way through a year to avoid a breach – potentially in conflict with the product’s investment objectives or the manager’s duty to act in the best interests of the product’s investors.

It is nonetheless important that transaction costs are not excessive relative to trades made and overall investment outcomes. We believe a better way of achieving this is to have proper transparency and disclosure of transaction costs, accompanied by robust best execution standards and practises. This will allow trustees to make a broader value for money assessment against performance, and facilitate switching into more competitive or efficiently managed strategies, as a means of improving end-investor outcomes.<sup>8</sup>

<sup>6</sup> See BlackRock’s 2018 *ViewPoint: Disclosing Transaction Costs – The need for a common framework*.

<sup>7</sup> See *LCP Investment Management Fees survey, August 2019*, p. 15.

<sup>8</sup> We also note that under MiFID II the focus on execution quality and best execution under MiFID II increased, leading to a reduction in overall trading costs since the start of the decade. However, in times of market volatility dealing costs can spike as liquidity falls and market impact from trading increases. These conditions are not possible to predict in advance.

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

It is important to keep in mind that lower transaction costs do not necessarily translate to better returns. It may be that a particular investment strategy has both higher transaction costs *and* higher returns than another. Indeed, more transactions may be incurred in order to achieve higher returns

As mentioned under question one, the likely effect of capping transaction costs will be to reduce the sophistication and ability to trade for default investment options in terms of asset class diversification, active security selection, active portfolio construction, or ongoing management and rebalancing. Each of these are undertaken with the objective of improving returns or achieving specific objectives – for example reducing volatility or targeting consistency of income.

From the perspective of an end-investor in a DC scheme, the end-goal is to generate a sufficient pot of assets to meet their income expectations at retirement. The lower the prospective returns for default DC investment options, the higher individual contributions will need to be to attain a given replacement income at retirement. This is especially so earlier on in the retirement savings journey, when the focus is on accumulation, and investment options tend to allocate more to higher-return products, often with higher portfolio turnover.

Another implication of reducing the sophistication of investment options available to some DC schemes will be the discrepancies it introduces between other types of less constrained pension scheme. Defined Benefit schemes, for example, tend to face less restrictions on costs or investment options. Indeed, being only a few years into auto-enrolment, the DC model of providing retirement savings is relatively new. Most default investments are heavily index-based and concentrated in public equity and fixed income markets. In the future, there could be scope to introduce other features beneficial to the end-investors, such as deferred annuities. This will become increasingly difficult to achieve if the scope of the charges cap is widened, and its overall level lowered.

In all, the end result could be regressive: individuals whose only savings vehicle is their DC pension scheme will have access to a limited range of investment options; by contrast those with other investment vehicles or access to financial advice will face fewer restrictions and possibly better investment outcomes in the long-term.

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

### **4. Who should be responsible for complying with a transaction cost cap?**

Questions 3 and 4 raise interrelated issues and we answer them together here.

For the reasons outlined above, we believe there should not be any form of cap on transaction costs. Indeed, the questions of how to cap transaction costs and who should be responsible for complying highlight the difficult set of issues any cap – combined or separate – would bring.

At present, governance bodies are responsible for ensuring compliance with the charges cap. As mentioned under question one, doing so is manageable when the fees for administration and investments are visible ex-ante, and trustees can pick service providers consistent with a fee budget. If transaction costs became another component of the cap, and trustees were responsible for complying, the variability associated with them would likely require a highly conservative approach to ‘budgeting’ for transaction costs – in effect leaving a wide margin of error to ensure realised transaction costs do not result in the cap being exceeded. Given administration costs are generally fixed, the effect of this will be

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exert further downward pressure on budget allocated to investment products. LCP's August 2019 *Investment Management Fees Survey* shows the range of transaction costs for different asset classes, and the significant variance within asset classes. Median transaction costs for listed infrastructure, for example, are approximately 45bp, but vary from around 20 to 70bp; meanwhile active global equity strategies have median costs of around 20bp, but vary from 10bp to 50bp.<sup>9</sup> Indeed, a high-turnover product that incurs 40bp annual transaction costs on average could have realised costs of 0bp one year and 80bp the following.

Trustees may instead decide to set a limit for transaction costs and require that asset managers comply with it. Indeed, this would be the likely approach if transaction costs were either within the existing cap or subject to a separate one. A hard limit on the transaction costs that can be incurred by a particular fund or strategy would lead to skewed incentives for asset managers, and serious operational complexity. If a limit on transaction costs were constructed on an annual basis, this may lead to situations where asset managers would no longer be permitted to transact on behalf of a strategy in order to avoid a breach of the cap, to the detriment of end-investors. It may also mean many higher-turnover strategies, such as active investment strategies, become untenable. And, if – as is often the case – a default strategy is constructed from a range of funds provided by different asset managers, the transaction cost limit would need to be apportioned between them accordingly. Moreover, if transaction costs associated with transitioning scheme assets from one fund to another were to be counted, this could disincentivise replacing one asset manager with another, or changing the risk profile of a scheme by moving between asset classes – to the ultimate detriment of scheme members.

## The level of the charge cap

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

We believe the impact of lowering the cap would be to reduce the prospect of improved retirement outcomes for end-investors over the long term, as a result of diminished ability to provide more sophisticated investment solutions aimed at enhancing them.

We recognise the point, put forward in the consultation paper, that there is evidence to suggest DC schemes are on average incurring fees well under the cap. While it may therefore be tempting to conclude that this justifies a further reduction in the cap, we believe there are several factors that explain current arrangements, and that there will be adverse consequences from lowering the cap.

The charges cap has been successful in ensuring fees incurred by end-investors are not excessive. However, at present the cap is one factor behind an intense focus on costs over outcomes in the DC market: placing an obligation on trustees to comply with a charge cap has led to a reluctance to increase costs, even within the cap, on investment strategies. Given the relatively fixed costs associated with administration, downward pressure on fees tends to result in a lower amount of the fee budget being allocated to investments – indeed experience suggests this is the case, with investment fee expenditure being lower than that of administration. This limits the range of investment strategies it is possible to include in defaults, with competition among investment propositions tending to be based heavily on price, rather than on outcomes; and means the most common approach to investments are using lower-cost index investment products as building blocks for portfolios.<sup>10</sup> Given the

<sup>9</sup> See [LCP Investment Management Fees survey, August 2019](#), p. 15.

<sup>10</sup> The DWP's consultation paper notes "some industry stakeholders have raised concern that the shift to passive strategies could impact on price discovery and market efficiency, and contribute to market volatility". These claims are based on misconceptions about how index investing and ETFs operate, which we have addressed variously in the following papers: [Index Investing Supports Vibrant Capital Markets](#) (October 2017); [A global](#)



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reliance for retirement provision society is placing on DC pension schemes, this focus on costs instead of outcomes is worrying, and further market interventions that may, in the short term, look appealing could undermine the adequacy of pension provision in the longer-term.

As discussed above, bringing transaction costs into the scope of the cap would be a de-facto reduction in fee budget available for administration and investments. As such, reducing the level of the cap is likely to have many similar impacts, hampering a move to more sophisticated default investment solutions providing access to a wider range of asset classes.

Strategies that make long-term investments in private markets, such as unlisted equity or infrastructure, tend to have higher fees – reflecting the need for closer active management and the resources required to source investments. Such investments can be favourable for long-term investors given their lower correlation to publicly traded assets, and portfolio diversification assets. We note the UK policymaking community has also been keen to reduce barriers to DC investment in these areas, recognising the potential economic benefits of doing so.<sup>11</sup> A number of initiatives stemming from HM Treasury’s ‘Patient Capital Review’ have made good progress in this regard, which a reduction in the charges cap would risk undermining.<sup>12</sup>

Likewise, the DWP has recently introduced a set of policies encouraging greater focus from trustees on reflecting scheme members’ environmental, social, and governance preferences in their approach to manager selection and investment strategies. This is a welcome development, particularly as the range of sustainable investment options offered in the market increases with growing attention on how better management of these long-term investment risks will help improve return. However, some ‘sustainable investment’ strategies may come at a higher cost if they make use of intellectual property to optimise a portfolio on ESG metrics (although this is not at all universal, and many sustainable investment products do not differ in cost); as can private market investments with a sustainability focus – such as renewable energy or other sustainable.

Finally, we note that the model of using DC schemes as the primary vehicle for retirement income is still in its early stages, and sophistication of default investment options is limited, especially compared to the options available for Defined Benefit schemes. It is possible that in future other solutions, such as integration of deferred annuities, could be offered to end-investors as part of their default investment option (currently growing in traction in the US 401k market); however this will necessarily involve higher fees, and therefore become more difficult to achieve following a reduction in the charges cap.

## **6. 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)?**

As noted above, the introduction of the charges cap – while a necessary and important way of protecting end-investors from excessive fees – has led to DC market conditions where cost is the overriding criterion for selecting default investment options. The increasing availability of low-cost index investment products, particularly for liquid public equity and

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[perspective on market-on-close activity](#) (July 2020); and [Lessons from COVID-19: ETFs as a Source of Stability](#) (July 2020).

<sup>11</sup> See Bank of England (July 2020): [Protecting economic muscle: Finance and the Covid crisis – speech by Alex Brazier](#)

<sup>12</sup> Following the Government’s Patient Capital Review, the FCA consulted on the ‘permitted links’ to expand the range of alternative asset classes available to particular types of DC scheme; and DWP consulted on possible alterations to the charge cap to facilitate use of performance fee-charging investment products by DC default options. BlackRock’s responses to these consultations can be found [here](#) and [here](#), respectively.

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fixed income markets, allows the development of ‘building blocks’ portfolios for default investment options that fit within cost constraints.

As such, the introduction of the cap has seen a shift away from ‘traditional’ active investment management into indexed equivalents. Similarly, there has been a shift away from tactically managed multi-asset ‘diversified growth funds’ using actively managed funds as building blocks and towards strategically managed funds using index funds to achieve exposure to different asset classes.

DC schemes tend to incorporate additional asset classes or different approaches to glidepath design as they increase in size, but in general the level of sophistication in terms of asset allocation and glidepath design is still not where it could be – for example in take-up of portfolio optimization techniques based on strategic asset allocation insights – and limiting charges further will reinforce this.

Another change that has taken place in parallel to the implementation of the charges cap is the growth of flexible drawdown strategies, where individuals’ assets remain invested into retirement – rather than the traditional option of holding high quality bonds and cash – and portfolios may benefit from continued changes to asset allocations over time to deal with the investment challenge.

One area that has not seen strong take-up in DC default options is alternative asset classes or private markets – such as unlisted or early-stage equity, infrastructure, and real estate. From an investor perspective, these assets are well suited to the long-term investment horizon for most DC scheme members and bring obvious diversification benefits. Government has also recognised the potential of DC schemes as a source of capital for companies and infrastructure projects and has begun reviewing potential regulatory barriers to its deployment. However, as noted above, product offerings in these areas tend to have higher management fees and often make use of performance fees, which may not be viable in the context of the relatively small amount of the charge cap budget allocated to investment fees. In response to DWP’s 2019 consultation on this issue, BlackRock recommended a more flexible application of the fee cap that would, with specific conditions, allow DC schemes to exclude performance fees from the charge calculation in certain circumstances.<sup>13</sup> Such a change would ensure investors continue to be protected from excessive fees, without inadvertently being prevented from being offered investment strategies with fee structures appropriate to their investment needs.

## **7. Have schemes changed administrator or asset manager in response to the cap?**

At implementation, the introduction of the cap naturally drove many changes in scheme administrator and investment provider in order to comply with the cap. Subsequently, however, compliance with the cap and review of overall costs have simply become one of the factors in the decision-making process.

The decision to re-allocate to index funds or other low-cost investment solutions, incentivised by the cap, has resulted in switching from one asset manager to another – however this switching reflects the specific product offerings available from different managers and is a function of decisions about investment strategy and style, rather than individual managers. These decisions are usually strongly based on advice from investment consultants.

On the administration side, we have seen some decisions driven by cost, but they are also influenced by quality of administration and member communications, among other qualitative factors.

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<sup>13</sup> BlackRock’s response to this consultation can be accessed [here](#).

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## **8. What links have you found between cost and performance?**

This question addresses the issue of 'Value for Money' (VfM) of investment products. While costs and performance are significant components, there is an inherent subjectivity in assessing whether an investment product provides VfM. VfM should not be viewed simply as net return relative to a benchmark, nor should lower costs be taken as a proxy. For DC pension schemes, VfM is best assessed based on a range of quantitative and qualitative factors that reflect the scheme's specific objectives, membership, and structure. Overall we believe VfM assessments should take into account how successful the investment strategy has been in delivering against its intended investment objective.

## **9. How much notice should be given for any reduction in the cap?**

For the reasons set out above, we strongly believe that there should be no reduction in the charges cap or expansion of its scope. It is important to recognise that any significant change in the level of the cap will require DC schemes to re-assess their current administration and investment arrangements and make changes accordingly. This may involve switching to new platform providers and/or transitioning to a new default investment option – all of which will need to be communicated with scheme members. At the same time, service providers themselves will need to consider the viability of their product offerings in the new market environment and respond accordingly – which may require some firms to re-configure their business models and resources. Indeed, some asset managers without product offerings that are competitive within a lower cap may be driven to exit the market; as could some scheme administrators, where the market has already seen consolidation and a number of providers exiting the market.

In short, a reduction in the fee cap would necessitate significant change and adjustment across the DC landscape. It is difficult to say in advance how much time would be needed, but anything less than three years would create serious operational challenges.

## **Standardised cost disclosure templates**

### **14. Is legislative intervention required to support the uptake of the CTI templates?**

We support enhanced and comprehensive disclosure for investors as a means of improving transparency and comparability between investment products. BlackRock was an active participant in the Institutional Disclosure Working Group (IDWG) and supports the recommendations the group made.

We do not believe legislative intervention is necessary to increase uptake of the CTI template. Our experience in disclosing according to the CTI template is that take-up has been high and is increasing on a voluntary basis. Many large pension schemes, such as the Local Government Pension Scheme (LGPS), already require reporting on this basis. Beyond this, BlackRock has adopted CTI reporting for all pensions mandates, and will begin reporting on this basis for all non-LGPS clients from Q3 2020.

### **15. How easy is it to request cost information from asset managers?**

This is a question for pension schemes; however, asset managers are subject to regulatory requirements to report costs to their clients as requested.

### **16. Do you believe that scheme members and recognised trade unions should have the right to request the information provided on the CTI template, and that a requirement to disclose this on request is proportionate?**

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This is a matter for pension schemes.

**17. Should DB schemes be required to adhere to the same standards?**

We do not have strong views on this.

**18. What are the barriers to using the information obtained when making decisions?**

One point to note on this issue is that although CTI templates standardise disclosures, some discretion remains over the approach for specific data fields: a pertinent example is implicit transaction costs, where CTI gives discretion to use either the 'slippage' or 'spread' measures meaning in some instances cost disclosures for different investment products will not be perfectly comparable.

## **Conclusion**

We appreciate the opportunity to address and comment on the issues raised in this consultation paper and welcome the opportunity to work with the Department for Work and Pensions on any specific issues which may assist in further work on this topic.

### **Further reading:**

- [ViewPoint – Planning for Retirement: Long-Term Savings and Investment in the UK](#)
- [ViewPoint – Disclosing Transaction Costs – The need for a common framework](#)
- [FCA CP17/18: Consultation on implementing asset management market study remedies and changes to Handbook – BlackRock response](#)
- [FCA: Consultation on Proposed Amendment of COBS 21.3 Permitted Links Rule – BlackRock response](#)
- [DWP: Investment Innovation and Future Consolation: A Consultation on the Consideration of Illiquid Asset and the Development of Scale in Occupational Defined Contribution scheme – BlackRock response](#)