

Investment Management Association  
Pension Fund Disclosure Code  
May 2002

Endorsed by the National Association of Pension Funds





# Investment Management Association Pension Fund Disclosure Code

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# Investment Management Association

## Pension Fund Disclosure Code

### Introduction

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This Code of Practice has been drawn up by a Joint Working Party of Members of the Investment Management Association ("IMA") and the National Association of Pension Funds ("NAPF"). The Code has been adopted by the IMA after full consultation with its Members and is strongly endorsed by the NAPF Investment Council.

The objective of the Code is transparency in order to assist pension fund trustees' understanding of the charges and costs levied on the pension fund assets for which they have responsibility. This will be facilitated by comprehensive, clear and standardised disclosure that will allow trustees and their advisers to monitor and compare all costs incurred during the management of the fund's assets.

The IMA has no legal authority to impose standards or reporting requirements on its Members. Neither would it wish to propose aspirational standards that few managers would be able to attain without significantly increased operational costs, or that would provide relatively little additional benefit for trustees. Instead, the Code takes a differentiated approach. In some areas the Code does not set out absolute standards, but is an approach to determining the information needs of trustees and their advisers. These needs will, of course, not be the same for every scheme. The Code also proposes a common format to suit users and providers.

Two important factors have been identified as likely to encourage compliance with the Code:

- the practicality of the Code for managers. Most of the reportable items specified are already available to managers, as FSA requirements or as information that managers need to demonstrate compliance with FSA Rules. It is recognised, however, that disaggregation of costs on a scheme-by-scheme basis has not hitherto been a requirement.
- the positive attitude of trustees. Trustees have an important role in compliance, by requiring information from managers that trustees need in order to carry out their responsibilities effectively.

The Code sets out minimum standards, and managers can only claim compliance with the Code if they meet all the required disclosures – they do not have the option to select the sections of the Code to which they wish to adhere. A manager may, however, still be deemed to have complied with the Code in the event that particular provisions of the Code are not relevant to the business that the manager undertakes, and the manager has clearly stated and justified this position.

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### Background

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It has become apparent that, in the pursuit of their fiduciary obligations, trustees and their advisers are increasingly looking for numerical disclosures on costs from which they can draw conclusions as to the manner in which their assets are being managed. Equally clear is that currently there is no comprehensive, common format of numerical reporting that meets this need and that, taken out of proper context, numerical comparisons can be misleading.

In drawing up the Code, the Joint Working Party was conscious of the issues raised in the Myners Review and sought to address specific questions where appropriate. However, in the interests of promoting transparency, the Code extends beyond the disclosure of transaction costs to disclosure of all costs incurred by client portfolios, directly or indirectly, during the fund management process.

To ensure that statistics are put into appropriate context, it is necessary for trustees and their advisers to understand the rationale behind, and justification for, different costs and how these are accounted for. Consequently, there is also a need for disclosure of certain aspects of managers' trading processes, and not just of numbers alone that might be taken out of context.

Not only are costs different for varying investment strategies, but the reliability with which different types of costs can be measured or estimated will also vary. In fact, it appears that the significance of different types of transaction costs and the reliability with which they can be measured vary inversely. Transaction costs can be categorised in increasing order of significance and decreasing order of reliability of measurement/estimation as follows: commissions, spread, market impact and opportunity costs. Consequently, the Code requires that the various types of transaction costs should be identified and assessed to the extent they can be reliably measured or estimated. Although the Code does not recommend one particular methodology above others, it does draw attention to areas where figures can be potentially misleading.

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## Pension Fund Disclosure Code

### Scope

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The Code is designed to:

- be adopted by the managers of UK pension fund mandates.
- be applied to portfolios, or portions of portfolios, consisting of listed securities (including suspended securities previously listed), derivatives (where the underlying instruments are securities, financial indices, interest rates, dividends or foreign exchange), cash and pooled funds/collective investment schemes that invest in any of the above assets.
- address all explicit costs incurred by client pension funds, including broker commissions (direct, soft and directed or recaptured), fund management and custody fees, foreign exchange charges, bank charges, taxation (stamp duty, VAT etc) and any other costs.
- consider also the impact of implicit execution costs, e.g. the bid/ask spread, market impact and also opportunity costs.

The Code is limited to those custody costs borne directly by the fund, where the manager undertakes custody or has appointed custodians on behalf of clients. Withholding taxation on income is outside the scope of this Code.

In respect of those pooled funds/collective investment schemes managed by the manager or an associate, the Code provides that managers should disclose the total costs incurred by each pooled fund, in monetary terms or as a percentage of the size of the fund, whichever is the more meaningful. Attempts to attribute portions of costs to individual pension funds would be onerous and the results would not be meaningful. Although this "global" information is not currently disclosed in collective investment scheme reports and accounts, it should be readily obtainable for "in-house" managed funds and should be accompanied by appropriate commentary to put the statistics into context, e.g. where the size of the pooled fund has changed significantly during the period. The Code recognises, however, that it may not be possible for managers to obtain this level of detail from third-party funds and from investment trusts which, although they may be managed "in-house", are the responsibility not of the manager but of the relevant boards of directors. In such circumstances, the Code requires prominent disclosure of any proportion of the portfolio that is invested in assets that are not compliant with the Code and an explanation of why the manager believes it is appropriate to use such vehicles.

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### Disclosure Requirements

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The Code only requires quantitative disclosure of costs that can be measured with certainty. For the other costs listed in Appendix 1, a description of the manager's approach to handling them is required. The Code seeks to encourage disclosure of such costs without advocating any particular methodology as to how this is achieved. However, there is a requirement to state key aspects of methodology, so that informed readers can draw their own conclusions as to the usefulness of the narrative information presented.

It is both permissible and desirable that different house fund management styles, products and specific client requirements result in varying types of reporting. If any particular costs addressed by the Code are on occasion not relevant, or are perhaps more clearly explained by narrative rather than quantitative reporting, this should be noted in the relevant reports.

There are two distinct types of disclosure covered by the Code:

- Level One: house policies, processes and procedures in relation to the management of costs incurred on behalf of clients (see Appendix 1).
- Level Two: client-specific information (see Appendix 2). The most important requirement here is for disaggregation by counterparties to transactions, to the extent and level of detail that provide meaningful information for clients. Additional commentary should be provided when this helps to put numerical disclosure into context.

The Code sets out minimum standards, and managers can only claim compliance with the Code if they meet all the required disclosures that are relevant to the business that the manager undertakes.

The Code envisages that the frequency of client reporting will vary according to the type of disclosure. Level One disclosure should be updated annually, while the quantitative client-specific Level Two disclosure should be made at least six-monthly. In the event of any material Level One changes, these should be reported promptly to clients, not left until the next annual reporting date. These frequencies mirror FSA rules that require certain transaction reports to be made at minimum six-monthly intervals and, in the case of soft commissions, at least annually. More generally, clear, consistent, consolidated reporting is regarded as critical: it will not be helpful to trustees if managers disclose the various costs listed in the Code, or comply with FSA requirements, in a number of different reports or with different reporting dates.

Managers responsible for mandates of a number of different portfolios or asset classes for one scheme, should carefully consider whether it would be more helpful to the trustees if reporting was not fully consolidated but reported at portfolio or asset class level.

### Appendix 1

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#### LEVEL ONE DISCLOSURE

##### MANAGER'S POLICIES, PROCEDURES AND CONTROL PROCESSES

**Reporting period to which disclosure relates:**  to

**Dealing venues and methods** – description of the various dealing venues used, e.g. different types of brokers, dealing for commission and dealing net, programme trading, internal crossing, crossing networks etc. How the manager decides between these alternatives and the impact that these decisions have on client transaction costs.

**Broker selection and transaction volume allocation process** – manager's processes, policy on credit ratings, how brokers' relative competence is established with regard to execution, research, etc. How this results in business level targets for each broker/dealing venue, how this is split between commission bearing, soft commission and net dealing and how progress towards and variations from these targets are monitored on an ongoing basis. Cross-reference to Level Two Disclosure, based on Appendix 2.

**Variations in rates of commission** – manager's processes for negotiating commission rates and the impact on rates of commission in different markets, e.g. UK/overseas, bond/equity, liquid/illiquid.

**Soft commissions** – manager's internal policy, justification (i.e. against potential lower commissions) and control processes to ensure compliance with current FSA regulations. Any change in this policy since the last report. Cross-reference to Level Two Disclosure, based on Appendix 3, and to the manager's annual soft commission disclosure.

**Commission recapture** – if applicable to the particular client, a description of the process. Cross-reference to Level Two Disclosure, based on Appendix 3.

**Dealing Efficiency Monitoring** - manager's policy and procedures designed to maximise the value of client portfolios and to control transaction costs while still trading effectively. This will include policy, procedures and assumptions for assessing execution costs, including bid/offer spreads, market impact and opportunity costs, whether the manager measures these and how the results are used.

**Conflicts of interest** - procedures for complying with FSA requirements for fair treatment of clients in the execution of orders and allocation of trades, and procedures to identify and manage actual and potential conflicts of interest (including dealing through associates). How the manager complies with current FSA regulations on inducements. An approximate number, type and overall value of inducements logged over the period.

**External and internal research** – manager's policy on using external research, how the benefit of that research is assessed and how it is funded.

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***Access to and allocation of Initial Public Offerings and underwriting*** – manager’s policy plus procedures for complying with relevant FSA regulations and the extent to which securing allocations of IPOs and underwriting influences trading patterns.

***Custody services*** - where the manager appointed the custodian, an outline of the manager’s selection, monitoring and review processes.

***Placing of deposits*** – manager’s policy on spreading deposits, in particular as regards placing deposits with associates, policy on credit ratings, use of money-market funds.

***Foreign exchange transactions*** – manager’s policy in spreading foreign exchange transactions, in particular as regards placing these through associates, and policy on credit ratings.

## Appendix 2

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### LEVEL TWO DISCLOSURE

**Reporting period to which disclosure relates:**  to

#### **Percentage of portfolio at period end not covered by the Code**

e.g. in third-party collective investment schemes, investment trusts, direct property, private equity, or in commodities. An explanation as to why the manager is using such vehicles.

#### **Fund Management fees and any other income derived by the manager and associates**

In the case of pooled funds with multiple fee scales, the fee scale borne by the particular client.

#### **Custody costs borne directly by the fund, and to whom paid**

#### **Transaction values/commissions paid** (see example of analysis at Appendix 3)

- Transactions traded net without commission, as percentage of total transactions
- Transactions subject to commissions and fees, as percentage of total transactions
- Transactions subject to soft commissions, as percentage of total transactions
- Transactions subject to directed or recapture arrangements, as percentage of total transactions
- Total commissions incurred for the period

#### **Underwriting/sub-underwriting commissions received**

**Stocklending** (if the manager undertakes stocklending on behalf of the client)

Income to the fund and fees paid

#### **Taxation**

- VAT
- Stamp duty paid on purchases
- Any other transaction taxes or levies

**Other de minimis costs**, e.g. PTM levy on transaction contract notes, need not be disclosed.

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## Appendix 3

### An example report

#### SUMMARY OF TRADING VOLUMES, COMMISSIONS AND FEES

Reporting period to which disclosure relates:  to

Counterparty	Trading volume for period			Commissions and fees paid during period			
	Total	Traded net	Subject to commissions	Total	Under softing arrangements	Under directed or recapture arrangements	Other
	£000	£000	£000	£000	£000	£000	£000
1							
2							
:							
9							
10							
Others > 5%							
:							
Others (total)							
Total							
% age	100%	[ ]%	[ ]%	100%	[ ]%	[ ]%	[ ]%

Disclosure is required of volumes undertaken through, and also commission paid to, different counterparties during the period. For each of these two categories, the top ten counterparties, plus any others representing over 5% of the overall total, should be listed. In this regard, counterparties include brokers (any associates of the manager being clearly noted), crossing networks and as a distinct category, the total of trades internally crossed by the manager. Clearly, different counterparties may feature in the table for different disclosure elements. The proforma will need to be customised accordingly.

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### Appendix 4

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#### GLOSSARY

**Best execution** – well-informed trade execution decisions made with the intention of maximising the value of client portfolios under the particular circumstances at the time.

**Bid/ask spread** – the difference between the market price quotations, for buying and selling particular securities.

**Counterparty** – for the purposes of the Code, is a market maker with whom a manager places trades directly rather than through the agency of a broker. Associated counterparties are distinct organisations that also have mutual relationships through equity ownership, management or regulation.

**Crossing network** – an electronic execution venue for fund managers that enables them to match buying and selling orders in securities directly with other fund managers. Commissions are typically lower while market impact and bid/ask spreads are removed altogether.

**Directed commissions** – the process whereby a client directs a manager to place trades for their account through a specific broker, in exchange for which, the client may receive benefits from the broker.

**Internal crossing** – a manager's decision to match a selling order of one client with a buying order of another client without placing the orders through the market, thereby saving both clients the cost of the bid/ask spread and broker commissions.

**Market impact** - the difference between the actual execution price for a transaction and the market price that would have prevailed had the manager not sought to trade the security in question.

**Net transactions** – portfolio trades placed direct with market makers and consequently where no broker commission is paid. The market maker is remunerated from making a turn on the bid/ask spread.

**Opportunity cost** - the loss (or gain) incurred as a result of delay in completion of, or an inability to complete in full, a transaction following a portfolio manager's initial decision to trade.

**Programme trades** – bulk trades for multiple securities placed through a single broker at a significantly reduced commission rate.

**Recaptured commissions** – the process whereby a client directs a manager to place trades for their account through a specific broker, in exchange for which the client will receive a rebate of a portion of the total commission in addition to execution services.

**Soft commissions** – an arrangement whereby a manager directs transactions to a broker, in exchange for which the broker provides the usual execution services and also purchases certain goods or services for the benefit of the manager.

**Stocklending** – the process in which a portfolio lends securities to a counterparty, subject to an obligation for return of the securities at a future date. The lender is remunerated by way of a fee.

# Investment Management Association Pension Fund Disclosure Code

## Contact Details

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