

# Trustee toolkit downloadable

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## **How a DC scheme works (2014)/ Investment in a DC scheme**

Extra resource: Costs and charges glossary

The trustee toolkit includes a number of 'extra resources' providing you with practical tools to help you transfer the learning to your own scheme or to illustrate key learning points.

This document includes some of the terms frequently used to describe the costs and charges which may be deducted from members' contributions or pots in occupational DC trust-based pension schemes. Costs and charges, and the names used to describe them, vary between schemes, and trustees should establish all the costs and charges incurred by members in their scheme, both at scheme and fund level.

## **Active member discount (AMD)**

The reduction in the annual management charge for an active member of a scheme. This discount is removed when contributions cease and a member becomes a deferred member. (See 'deferred member charge'). From April 2016, qualifying schemes used to comply with automatic enrolment requirements are no longer permitted to apply an active member discount or similar mechanism that results in lower charges for active members and higher charges for deferred members.

## **Annual management charge (AMC)**

A fee which is charged to cover some of the costs in running an investment fund or a scheme. It is a commonly used headline figure but the AMC is not the only expense incurred by investors, and for pooled funds some of these other charges are included in the Total Expense Ratio (TER).

The AMC is defined differently by different providers, and may either refer to a charge which is applied by the pension scheme or to charges which are applied by the investment funds used by the pension scheme. Trustees will therefore need to look beyond the AMC to obtain a complete picture of the overall costs and charges borne by the members and the employer, as applicable.

The AMC is normally quoted as a percentage of the monies invested, but other pricing options can be used, such as a fixed fee, although this is relatively rare.

## **Auditing/ accountancy fees**

Auditing and accountancy fees incurred by the scheme or investment managers. They are normally included in the TER, but not the AMC.

## **Basis point**

A basis point (also known as bp) is one hundredth of a percentage point (0.01 per cent). For example 50 basis points is 0.5 per cent.

## **Bid price**

The price at which investments are sold by or on behalf of the investor/ member – this is less than the offer price.

## **Bid-offer spread**

The difference between the price of buying investments (offer) and the price of selling investments (bid). It is a way of market makers to charge investors for their management and services.

## Consultancy charge

The cost of advice or services provided to an employer or member, agreed between the adviser and employer but deducted from members' contributions or DC pots.

From 6 April 2016, schemes used as qualifying schemes for the purpose of complying with automatic enrolment requirements are banned from making members cover commission costs paid to advisers for advice or services to members or employers.

## Contribution charge

A deduction made from a member's contribution prior to investment. It may be flat rate or a percentage of the contribution.

## Costs and charges

Deductions from a member's contributions or DC pot. (This does not include costs or charges paid by the employer, or monies transferred out or withdrawn by the member.)

Explicit deductions are sometimes referred to as 'charges'. 'Costs' often refer to those deductions which are not explicit, but which are reflected in the price of units and reduce the value of the contributions or DC pot such as transaction costs (also known as dealing costs) and stamp duty on purchases of investments.

## Custodian fees

Fees charged by a custodian for holding fund investments. They are normally included in the TER, but not the AMC.

## Dealing costs

Costs to an investment manager in buying and selling investments within the fund, including stockbroking commission and stamp duty reserve tax. These are not normally included in the AMC or TER.

## Dealing spread

The difference in the value of an investment between the bid price and the offer price. See also 'bid-offer spread'.

## Deferred member charge

Charges incurred by deferred members. They may be a flat rate amount or a percentage of the fund value. This charge is sometimes called a 'deferred member penalty' (as they can be greater than those incurred by active members). From April 2016, qualifying schemes used for complying with automatic enrolment requirements are no longer permitted to apply a deferred member charge or similar mechanism that results in lower charges for active members and higher charges for deferred members. Also see 'Active member discount'.

<b>Dilution levy</b>	Any cost incurred in a fund in creating or cancelling units to meet purchase or sell requests. Using a dilution charge ensures those buying/selling do not impose a cost on the existing investments of members of the fund.
<b>Initial charge</b>	A charge deducted from each contribution made by members, normally a percentage of the amount invested.
<b>Legal fees</b>	Fees incurred for legal advice by the scheme or investment managers. They are normally included in the TER, but not the AMC.
<b>Offer price</b>	The price at which investments are bought by or on behalf of the investor/member – this is higher than the bid price. See also ‘bid price’ and bid-offer spread’.
<b>Platform fees</b>	A platform is a structure used by investment managers to provide access to funds in a convenient and tax-efficient manner. The platform makes a charge for this service and this may be through a deduction from members’ pots.
<b>Portfolio turnover ratio (PTR)</b>	<p>The PTR (Portfolio Turnover Rate) measures the extent to which investments are changed or ‘turned over’ during a defined period of time – usually a year. It reflects how often the underlying assets or holdings within the fund (or funds) are bought and sold. The PTR therefore gives an indication of what the transaction costs are likely to be, based on the rate at which investments are ‘turned over.’ It can provide trustees with a more complete picture of the likely costs than the TER on its own is able to provide.</p> <p>The PTR can be reviewed to ensure that the buying and selling of scheme assets is consistent with the investment strategy of the relevant product. For example, portfolio turnover costs will often be higher for actively managed investment strategies than for passively managed investment strategies. They may also be higher where members are approaching pension age due to the management of investments away from higher risk categories, such as equities, to lower risk categories, such as bonds, as part of a ‘target date’ approach to pension age.</p>
<b>Reduction in yield</b>	The TER plus initial charges expressed as a percentage reduction in the annualised return over a defined period. This percentage shows the impact of the charges applied to a member’s pot on its potential rate of growth. Dealing costs are not included in this figure.

## Single price

The price used to buy and sell an investment is the same. This price incorporates costs – see ‘swing price’.

## Stamp duty reserve tax (SDRT) (or ‘stamp duty’)

The tax payable on the purchase of UK equities. This is not normally included in the AMC or TER.

## Swing price

Where there is a single price, investment managers have the discretion to change that price depending on whether there are net inflows or outflows in the fund. This single price can therefore be ‘swung’ to a bid or offer basis to account for that in/outflow.

## Total expense ratio (TER)

The TER or Total Expense Ratio is another way of expressing the costs and charges that apply to an investment fund or pension scheme. The TER will normally include the AMC but it is worked out on a historic basis for the previous year and is therefore also able to include other fees and charges such as legal and audit costs, custodial fees and investment management and administration fees which have been applied. However, and despite the name, the TER does not include all the costs that a member has been charged. It does not include the transaction costs incurred when buying and selling investments or the taxes associated with those transactions. Nor does the TER capture other costs such as those associated with exiting from a fund or a scheme. The TER is a more complete measure than the AMC of what the member is paying for the services they are getting, but it does not capture all the costs and charges that apply to members’ pots. The TER is sometimes referred to as the ‘ongoing charge’. However, the ongoing charge will exclude any performance fee for the investment manager meeting agreed performance targets.

## Trail commission

A charge, usually a percentage of the fund value, to pay commission to an adviser. This has not been permitted on contract-based personal pension schemes set up after 1 January 2013, but may be permitted to continue in certain circumstances for schemes set up prior to 2013. There are also restrictions on when commission can be paid on occupational pension scheme investments. From 6 April 2016, schemes used as qualifying schemes for the purpose of complying with automatic enrolment requirements can no longer deduct adviser commission payments from members’ pots. Also see ‘Consultancy charge’.

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