

PF

Federation of the
Dutch Pension Funds

Recommendations on Administrative Costs

Revised version 2016

DENSIOEN
FEDERATIE

Federation of the Dutch Pension Funds

On behalf of approximately 240 Dutch pension funds, the Federation of the Dutch Pension Funds represents the interests of 5.5 million members, 2.9 million pensioners and 8.3 million deferred members.

Roughly 85% of all working people in the Netherlands are members of a group pension fund. The pension funds affiliated with the Federation of the Dutch Pension Funds collectively manage approximately 1200 billion in funds.

Contact information

Prinses Margrietplantsoen 90
NL-2595 BR The Hague
The Netherlands

P.O. Box 93158
NL-2509 AD The Hague
The Netherlands

T +31 (0)70 7620220
info@pensioenfederatie.nl
www.pensioenfederatie.nl

© Making use of the text of these recommendations (or parts of it) is possible after permission has been obtained from the Federation of the Dutch Pension Funds. No rights can be derived from the content of this publication.

Federation of the Dutch Pension Funds,
The Hague, February 2016

Foreword

Much has happened since the *Federation of the Dutch Pension funds* first issued Recommendations on Administrative Costs in 2011. The Dutch pensions sector has taken rapid action to make all costs transparent. At international level too we see developments reflecting a pressing concern for cost transparency, notably in asset management. The *Federation of the Dutch Pension funds* applauds these moves and warmly supports such action wherever possible.

This revised version of Recommendations on Administrative Costs replaces three earlier publications:

- Recommendations on Administrative Costs (November 2011)
- Further elaboration of asset management costs (2012)
- Further elaboration of asset management costs, revised version with supplements (October 2013, digital version only)

This present document addresses many considerations pertaining to administrative costs. There is no need for every pension professional to be familiar with all of these. Chapters 1 to 3 deal in turn with legal and regulatory requirements, communication, and policy choices affecting administrative cost levels. Chapters 4 to 7 are primarily of interest to those responsible for assessing and reporting administrative costs. Chapter 4 presents generic recommendations, while chapters 5 to 7 deal with the three types of administrative costs: pension management, asset management and transaction costs.

PF

Recommendations on Administrative Costs (2016)

Summary	6
Introduction	8
Chapter 1. Communication on administrative costs	10
1.1 Presentation of administrative costs in annual report	11
1.2 Communication resources and target groups	13
1.3 Comparability of administrative costs	14
1.4 Explanatory notes in annual report	16
Chapter 2. Legal and regulatory requirements 2012-2015	19
2.1 Amendment of the Pensions Act (Implementation) Decree	20
2.2 Pension Communications Act	21
2.3 Pension Fund Code of Governance	23
2.4 Reporting to DNB	23
2.5 DNB/AFM studies	24
2.6 Guidelines for annual reports	25
2.7 International developments	25
Chapter 3. Determinants of administrative costs	27
3.1 Consequences of choices	28
3.2 Pension policy	28
3.3 Investment policy	31
3.4 Administration method	34
3.5 Costs deriving from legal and regulatory requirements	37

Chapter 4. Generic recommendations	41
4.1 No offsetting of costs against revenues	42
4.2 Look-through principle	43
4.3 Matching principle	43
4.4 Nonrecurrent costs	44
4.5 Practical feasibility and use of estimates	44
4.6 Taxation	46
4.7 Currency	47
4.8 No limitative summary	47
Chapter 5. Pension management costs	48
5.1 Integral costs of pension administration	49
5.2 Pension administration and communication	49
5.3 General pension fund costs	50
5.4 Calculating participant numbers	52
Chapter 6. Asset management costs	53
6.1 Asset management structures	54
6.2 Average invested assets	58
6.3 Types of asset management costs	59
Chapter 7. Transaction costs	69
7.1 Types of transaction costs	70
7.2 Subscription and redemption fees for investment funds	70
7.3 Calculating internal transaction costs in investment fund	71
7.4 Costs on buying and selling investment titles	72
7.5 Acquisition costs	74
Appendices	77
Appendix 1 Overview of cost type breakdown	78
Appendix 2 Different forms of reporting	82
Appendix 3 Examples from annual reports	83
Appendix 4 DNB reporting form	90
Appendix 5 Guidelines for Annual Reports	97
Appendix 6 Reporting standards for specific investment categories	99
Appendix 7 Literature	104

Summary

Recommendations on Administrative Costs were first issued in 2011. They can be summarised as follows:

- 1 Report pension management costs in euros per participant.
The number of participants is the combined number of active participants and pension beneficiaries.
- 2 Report asset management costs as a percentage of average assets under management. Review these costs also in relation to:
 - a the chosen investment mix and relevant benchmark costs;
 - b the return over a longer term, also relative to the benchmark return.
- 3 Report transaction costs (or estimates thereof) as a percentage of average assets under management.

These three key recommendations relate primarily to transparency on administrative costs for external stakeholders like pension fund participants and affiliated employers. Alongside these key recommendations this revised version sets out a number of recommendations that pension funds may adopt voluntarily. Here the pension fund may/will distinguish between communicating with fund participants and reporting to the executive board or other internal governance bodies.

The objective of this revised version of the Recommendations is to achieve greater uniformity in methods for calculating and presenting administrative costs. Besides promoting transparency its aim is to make costs more readily comparable. In that context it is important to account precisely for total costs, while paying due regard to proportionality. Although costs should be made verifiably transparent, it is not intended to spend a disproportionate amount of time on achieving precision and transparency down to the last euro.

All recommendations are subject to the 'comply or explain' principle, except in the case of legal provisions and regulatory requirements. It

should be noted that pension funds are required by law to state the above three key figures in annual reports from the 2015 financial year onwards.

This version of the Recommendations includes a number of generic recommendations as guidelines for calculating administrative cost levels. These are as follows:

- no offsetting of costs against revenues;
- use the 'look through' principle for investment funds;
- use the matching principle: allocate costs and revenues over identical time periods;
- nonrecurrent costs are part of the administrative costs;
- practical feasibility is a relevant factor. Use estimates if necessary;
- taxes (VAT and transaction tax) are integral part of the costs they relate to;
- all costs are denominated in euros;
- the Recommendations do not give an exhaustive summary of costs to be reported. But they clarify cost definitions.

These generic recommendations are further explained in chapter 4.

These revised Recommendations on Administrative Costs are applicable to annual accounts from the 2016 financial year onwards. Application of the look-through principle for transaction costs is effective from the 2017 financial year.

Appendix 1 gives an overview of all types of cost, broken down under the three key figures. That overview is intended as an aid to identifying all costs. It is emphatically not intended as a reporting format.

Introduction

The Recommendations on Administrative Costs (hereafter: 'the Recommendations') of 2011 were a form of self-regulation. The *Federation of the Dutch Pension funds* (hereafter: 'the Federation') called on its pension fund members to present transparent accounts of administrative costs in annual reports and in communications to stakeholders through the appropriate channels. Administrative costs encompass all costs incurred by the pension fund, whether for pension management or asset management.

Since 2011 we have built up the requisite experience with cost transparency. That has prompted a need to elaborate on some points. This revised version of the Recommendations responds to that need.

The Recommendations have furthermore been tightened up to provide a more effective basis for market players to draw up comparable figures. Definitions of costs have been clarified and calculation methods further explained.

All Recommendations are subject to the 'comply or explain' principle, except where compliance is mandatory under legal and regulatory requirements (such as the requirement to state the three key figures in annual reports).

The recommendations are printed in bold type. If a pension fund decides not to adopt a recommendation, it must insert a note in its annual report explaining its motivation for that choice. There may be a diversity of reasons for rejecting a recommendation, such as disproportionately high costs incurred in obtaining the required information.

Chapter 1 discusses transparency requirements, forms of communication and the stakeholders.

Chapter 2 explains a number of recent developments. For example, the Pension Communications Act that came into force on 1 July 2015 also applies to the communication of administrative costs. The Act explains briefly how the central bank of the Netherlands DNB (*De Nederlandsche Bank*) and the financial markets authority AFM (*Autoriteit Financiële Markten*) deal with cost transparency. For that reason DNB recently amended its standard annual statement reporting form for submission by pension funds. AFM has drawn up its own recommendations on administrative costs relating to transparency and accountability.

Chapter 3 explains the factors that determine the level and composition of pension fund costs. Costs should not be seen in isolation but in relation to choices made by the pension fund.

The Recommendations are based on a number of generic principles. These are defined in chapter 4. Administrative costs and the impact of the Recommendations on pension management costs, asset management costs and transaction costs are discussed in chapters 5 to 7.

This version of the Recommendations replaces the Recommendations for Administrative Costs issued by the Federation in 2011 and the 'Further elaboration of asset management costs' (revised version with supplements) of 2013. The present revised Recommendations come into effect on 1 January 2016. They are thus applicable to the 2016 financial year unless otherwise indicated in subsequent chapters, as for instance in the case of 'look through' for internal transaction costs in investment funds for which the starting date is 1 January 2017 (the 2017 financial year).

Questions have arisen in the sector concerning good practice in the treatment of costs in directors' reports. Texts and tables in the attached appendices may serve as examples of how pension funds can clarify administrative costs in their annual reports. The Board remains responsible for aligning information with the users of the annual report and for their own way of treating administrative costs.

1

Recommendations on
Administrative Costs

Communication on administrative costs

In seeking to make costs transparent the pension sector acknowledges its obligation to respond to concerns being voiced about cost levels by pension fund participants and the general public. The question is essentially quite simple: what does it cost? The present Recommendations define the constituent elements of costs and explain how pension funds deal with the issues they encounter in practice. They stress the need for pension funds to assess asset management costs in conjunction with investment risks and returns. Such conjunction must also be clearly set out in communications.

This version of the Recommendations clarifies a number of definitions and types of costs.

This may require pension funds to amend some figures, depending on choices made in the past. Year-on-year figures are thus less readily comparable, and that will require an explanatory note.

1.1 PRESENTATION OF ADMINISTRATIVE COSTS IN THE ANNUAL REPORT

Administrative costs encompass diverse elements. Every figure must be seen in its own specific context: why has a specific accounting method been used and what are the related costs? Administrative costs can be presented in greater or lesser detail depending on the target group. A directors' report treats cost considerations in great detail, whereas a newsletter for participants gives only a broad outline.

The Recommendations consistently distinguish between pension management costs, asset management costs and transaction costs.

Administrative costs can be reported in many different ways: as total costs in euros, for instance, or euros per participant, or as a percentage of either annual premium revenue or total assets. In the interests of comparability all pension funds should report the same three key figures. This does not detract from the importance of underlining the correlation between costs, return and risk.

1.1.1 Key figure pension management costs

Report pension management costs in euros per participant.

The number of participants is the combined number of active participants and pension beneficiaries.

This is a legal requirement from 2015 onwards, alongside mandatory reporting of total pension management costs.

A pension fund may choose to report the pension management costs in a different way, alongside the definition mentioned above.

1.1.2 Key figure asset management costs

Report asset management costs as a percentage of average assets under management.

This is a legal requirement from 2015 onwards, alongside mandatory reporting of total pension management costs.

Recommendation: present the key figure for asset management costs as a percentage with two decimal points.

More detailed information on asset management costs and transaction costs can also be presented in basis points.

Recommendation: examine these costs also in relation to:

- the chosen investment policy and relevant benchmark costs;
- the return over a longer term, also relative to the associated benchmark return.

An explanatory note on this point may be both qualitative and quantitative. The benchmark figure is important as both costs and return are considered in relationship to investment policy.

1.1.3 Key figure transaction costs

Report transaction costs (or estimated transaction costs) separately as a percentage of average assets under management.

This is a legal requirement from 2015 onwards, alongside mandatory reporting of total transaction costs.

Recommendation: present the key transaction costs figure as a percentage with two decimal points.

1.2 COMMUNICATION RESOURCES AND TARGET GROUPS

Most people find pensions a complex subject. That also holds true for administrative costs. It is the job of the pension sector to make these crystal clear. One advantage of a pension fund is after all its shared, and low, costs.

The question always to be kept in mind when communicating on administrative costs is: what can or should the recipient do with this information? This means a huge range of information must be distributed to differing target groups. Information presented to the Board in a quarterly report will differ from that given in an explanatory note in the annual report.

The level of administrative costs is the outcome of a great many decisions in the area of pension management and asset management.

Recommendation: information on administrative cost levels should be accompanied by information on policy choices.

A number or percentage pertaining to administrative costs is meaningless without a knowledge of policy choices.

Transparency should go hand in hand with communication that is comprehensible to the recipient. Recipients must be able to make out what the message means for themselves in person.

Recommendation: participants must be kept informed of administrative costs in broad outline.

Decision-making bodies on policy (the Board, the accountability body and internal supervision) must have detailed information on administrative costs for the purposes of their deliberations.

The Federation therefore advises pension funds to distinguish between various target groups for the purposes of information provision. In concrete terms this means that key figures are not stated in the uniform pension statement (*UPO*) or in layer 1 of *Pensioen 1-2-3*, but are all included in information available to participants via the website or the annual report. Decision making bodies must have access to all relevant information on costs in order to arrive at a balanced opinion and to change course if need be.

1.3 COMPARABILITY OF ADMINISTRATIVE COSTS

Users of information on administrative costs need to have access to comparable data for specific periods in order to identify trends.

They also need comparable data from various pension funds in order to assess their relative performances. For that reason it is important that explanatory notes on administrative costs are dependable, and that all pension funds report consistently. Benchmarking depends entirely on comparable data being available. Uniform definitions and a generic model are indispensable.

Information users need to know the substance (accounting principles/definitions) of administrative costs. Comparability is improved by adhering to the Recommendations, including an explanatory note on 'the substance'.

When providing information on administrative costs the challenge is to prevent faulty conclusions. Pension funds with a portfolio of marketable securities may well incur higher administrative costs than pension funds with a portfolio of interest-bearing negotiable paper. Linking costs to risk and return improves comparability, but makes for a more complex substance.

1.3.1 Different forms of presentation

Transparent and unambiguous reporting of asset management costs is important. But what are 'asset management costs' precisely? Pension funds currently have a diversity of reporting conventions using varying definitions.

Differing forms of reporting have differing points of departure and underlying rules or accounting principles. The translation table in Appendix 2 provides a broad understanding of the chief differences between some reporting conventions. It is not intended as a medium of communication and it is not advisable to use this table in an annual report. The translation table encompasses the DNB 402 annual statement form, the accounting standard RJ610, the Pensions Act (Implementation) Decree and the presentation requirements set out below in the Recommendations.

Costs in the annual accounts

RJ610 is the standard for drawing up the annual accounts of a pension fund. The only costs reported in the statement of assets and liabilities are costs for which the pension fund has received an invoice. Costs charged directly to an investment fund by asset managers (thus not charged to the pension fund) fall under indirect investment revenues. Transaction costs fall under buy and sell investment transactions. These too are designated as indirect investment revenues.

1.3.2 Benchmarking

Pension funds should use benchmarking to put their costs into perspective. A benchmark figure is the most straightforward way to put costs into context, while making allowance for specific characteristics of the pension fund and its investment policy.

The relevant factors for benchmarking administrative costs are the various service levels, the number of pension schemes and their complexity, the number of value transfers, and communication strategy.

The important factors in the case of asset management costs are the investment mix at the level of the various investment categories, the

returns associated with these asset classes, the composition of costs, and matching cost definitions.

Pension funds can make use of various benchmarks offered by different market players. These compare the costs and returns of a participating individual pension fund with those of a comparable group, and submit reports on their findings.

In the case of transaction costs it will be sufficient for the present to report 'transaction costs' that are partially based on estimates. The insight these give will contribute to a further improvement in the accuracy of reported costs in years to come. Comparison of transaction costs will eventually be possible at a later stage. No benchmark for transaction costs is currently available on the market. It is nonetheless important to be able to explain the level of transaction costs on the basis of investment policy or changes therein.

1.4 EXPLANATORY NOTES IN ANNUAL REPORT

The aim of the Recommendations is to establish a uniform method for calculating and presenting administrative costs. Although the annual report is not the only channel for disclosing administrative costs, this section deals explicitly with that context on grounds of the legal requirement to publish the key figures in the annual report.

Pension funds are advised to publish explanatory notes on the three key figures. These notes should refer to the correlation between cost levels and risk and return. Cost levels may furthermore be put into perspective by including a benchmark figure that takes account of investment policy, scale and other factors impacting on costs. Appendix 3 gives some examples of how to explain costs in qualitative terms in the annual report.

A second consideration that needs explaining is any divergence between figures in the annual accounts and the directors' report. Because the annual accounts are intended to provide insight into the overall costs charged directly to the pension fund, which do not necessarily include

'look through' costs, the figures in the annual accounts may differ from those cited in the directors' report.

In the explanatory notes the Board may also express their opinion on cost levels, their trend and potential targets.

Costs relative to return over the longer term

Performance fees are often pegged to a multi-year period. By presenting figures over a five-year period, for example, a better assessment can be made of the relationship between performance fees and extra return. Extra return is the additional return generated relative to an agreed benchmark, and is also referred to as an outperformance.

Because performance fees are agreed per portfolio or per asset manager, there can be a question of aggregate performance fees without any question of an outperformance at aggregate level, since the outperformance of a number of portfolios may be offset by the underperformances of others. This underlines the importance of assessing performance fees over a longer period.

Gross and net returns

The return on investment is a significant component in funding future pension liabilities. Pension funds state the return in the directors' report. It is not always clear which return is referred to: gross return or the net return after deducting costs.

It is important to state clearly which return figure is referred to. A diagrammatic presentation showing gross return, net return and costs gives a clear picture of the quantitative relationship between these components. An explanatory note on this relationship makes things even clearer.

Recommendation: The report from the executive board gives notice of costs and return, making explicit whether the figure cited is the gross return (before deduction of costs) or net return (after deduction of costs).

Transaction costs relative to transaction volumes

Given that transaction volumes (in either number or value) are often the decisive factor for cost levels, cost levels can be made more transparent by comparing them with transaction volumes. This is notably the case with liquid investment categories, and to a lesser extent with alternative investment categories.

2

Recommendations on
Administrative Costs

Legal and regulatory requirements 2012-2015

Recent years have seen the requisite steps taken to promote the transparency of administrative costs. In 2011 the process was given a clear impetus in the form of self-regulation, when the Federation called on all Dutch pension funds to report their pension management costs, asset management costs and transaction costs in a uniform manner. A large number of pension funds responded. Each year sees a growing percentage of funds giving a transparent account of administrative costs in their annual reports.

The trend that began in 2011 with self-regulation was followed by legal and regulatory measures. These are discussed below in sections 2.1 to 2.4. Other countries too are calling for greater transparency on costs, a trend that is discussed in the final section of this chapter.

2.1 AMENDMENT OF PENSIONS ACT (IMPLEMENTATION) DECREE

Article 45a was added to the Pensions Act with effect from 1 January 2015, making it mandatory for pension funds to include information on their administrative costs in their annual report. Further legal requirements concerning the presentation of administrative costs were enacted in article 10a and 10b of the Pensions Act (Implementation) Decree. The explanatory note on this Decree expressly refers to the Recommendations drawn up by the Federation in 2011, and is aligned to these recommendations as far as possible with a view to limiting the administrative burden on pension funds.

The legislation makes it mandatory for pension funds to include a statement of administrative costs in their annual report from the 2015 financial year onwards. Article 10a of the Pensions Act (Implementation) Decree distinguishes between administrative costs, asset management costs, and transaction costs. Costs not falling under any of these headings should be allocated proportionately to the three types. The Pensions Act refers to 'administrative costs' whereas the term used in the Recommendations is 'pension management costs'.

The legislation gives a non-limitative summing up of specific costs falling under each of the three cost types. That summary is also in alignment with the Recommendations.

Article 10b of the Pensions Act (Implementation) Decree stipulates how costs should be presented. The headings are as follows:

- administrative costs: total costs and costs per participant or pension beneficiary;
- asset management costs: total costs and costs as a percentage of average assets under management;
- transaction costs: total costs and costs as a percentage of average assets under management.

2.2 PENSION COMMUNICATIONS ACT

The Pension Communications Act came into force on 1 July 2015. This legislation amends the Pensions Act and lays down new requirements for communication with participants. It also sets out new rules for providing information on administrative costs.

The new communication requirements are based on two underlying principles: information may be presented digitally and should be layered. This is not yet compulsory, but digital communication on pensions can now be expected to take off in a big way. An advantage of digital presentation is that it then becomes possible to publish information in smaller 'chunks' that the participant can click on to in turn. This is termed a layered presentation of information.

The Pensioen 1-2-3 (*pensioen123.nl*) is an important tool for communicating with pension scheme participants, giving basic information on the scheme. It replaces the mandatory printed introductory letter to participants. Layer 1 outlines the substance of the scheme. The Layer 1 presentation is identical for each individual pension fund and leads participants smoothly on through links to the following layers in turn. Layer 2 gives more detailed information on each component in Layer 1, while Layer 3 contains formal documents like the annual report, articles of association

and the pension scheme regulations. In Layer 1 pension funds must tell their participants that costs are incurred, that is to say administrative costs and asset management costs. At this point no amounts or percentages are stated. In Layer 3 participants are referred to the annual report for information on costs.

Pension funds are legally obliged to post information on administrative costs on their website under Article 46a of the Pensions Act. Article 9b of the Pensions Act (Implementation) Decree of 24 June 2015 adds to the requirements in Article 46a. That brings these provisions into alignment with the Decree of 12 December 2014 (see paragraph 1.1) and with the Recommendations. This means pension funds are now legally obliged to state administrative costs (= pension management costs) in euros per participant, and asset management costs and transaction costs as a percentage of average assets under management.

Information on costs must be published on the pension fund website. If the information presented in the annual report complies with the above requirements, it is sufficient for the information to be accessible through a website link to the appropriate section of the annual report.

Article 204 of the Pensions Act authorises the Netherlands central bank DNB to publish information concerning individual pension funds. Article 40a of the Decree on the Implementation of the Pensions Act of 24 June 2015 elaborates on this. DNB will publish a large volume of data on pension funds on its own website. From mid-2016 onwards the administrative costs of individual funds will also be published on the DNB website. These too will be in alignment with the Recommendations as far as the three key figures are concerned. Since the central bank is not authorised to process regulatory information on any specific fund before it has been publicly disclosed, DNB has amended its standard annual statement form such that the three key figures are provided via annual statement J402.

2.3 PENSION FUND CODE

The new Pension Fund Code of Governance came into effect on 1 January 2014. The Code was drawn up by the joint labour council STAR (*Stichting van de Arbeid*) in collaboration with the Federation (*PensioenFederatie*), and is now enshrined in law. The standards set in the Code are supplementary to legal and regulatory requirements. Like the Recommendations, all standards in the Code are subject to the comply-or-explain principle. That means pension funds must either comply with the Code or in each case explain the motivation for its failure or partial failure to do so in their annual report. The following standards relate to administrative costs. Code standard 20 stipulates: the executive board reports on the costs of implementing the pension scheme in the annual report. Code standard 37 stipulates: each year the executive board evaluates the quality of implementation and the costs incurred, and calls on service providers to account for any complete or partial failure to fulfil an agreed performance.

2.4 REPORTING TO SUPERVISOR DNB

On grounds of the amendment to the Pensions Act DNB has made some changes to its standard annual statement form for submission by pension funds. DNB will conduct a trial to verify whether the cost data reported to DNB are in alignment with key figures published by the pension fund in question in its annual report in compliance with the Pension Communications Act and governmental Decree. For this purpose DNB calculates the key figure itself on the basis of the data submitted in annual statement form 402, and if the figures diverge asks the fund in question to explain those entered in the statement.

In addition to checking the consistency of key figures submitted in annual statement forms and key figures as assessed by the pension fund, DNB is now authorised by virtue of the published data Act to publish the figures provided by the fund itself.

The amended 402 reporting form for annual statements, including instructions, can be found in Appendix 4.

2.5 DNB/AFM STUDIES

In March 2015 DNB published¹ the results of a study conducted in collaboration with AFM of asset management costs reported by pension funds. This study revealed that reports of these costs published by pension funds in 2014 were much improved by comparison with 2013. DNB and AFM see room for further improvement.

Of the 21 funds whose figures were further examined, 15 were required to submit revised figures on grounds of implausible reporting. These 15 funds had apparently failed or partially failed to report the costs of underlying tiers of asset management. An asset manager under contract to a pension fund may in turn outsource some activities to other parties. Pension funds need to know the costs incurred by such underlying parties in order to assess whether these are appropriate. After questioning these funds DNB concluded that most make an attempt, but often find it impossible to obtain a complete 'look through' on costs of all underlying asset management tiers because the necessary data are not made available.

The study also revealed that performance related costs are regularly overlooked in reports, although they are readily identifiable in the annual reports of the investment funds concerned.

DNB and AFM found that many types of costs had been stated either under the incorrect heading or under the investment category 'other', or that some cost elements had been overlooked. Some pension funds were unable to submit any contractual information on costs.

Although the submission of costs pertaining to buy and sell transactions for investment titles is optional in annual statements filed with DNB, DNB and AFM strongly advise pension funds to consider including these costs in their annual statements, all the more since the legislator has added a provision to the Pensions Act stipulating that pension funds must include information on administrative costs, and more specifically transaction costs, in their annual report (Pensions Act, Articles 45A and 56A).

1 DNB press release, March 31, 2015

DNB and AFM expect pension funds to verify whether their reporting of costs is accurate and comprehensive, and to report any adjustments in their annual report. The regulatory authorities also expect pension funds to outsource their asset management to firms that provide full transparency on the asset management costs incurred, and to have drawn up prior agreements. DNB and AFM also believe pension funds ought to appraise their asset managers yearly, including their service provision costs.

2.6 GUIDELINES FOR ANNUAL REPORTS

The 2014 issue of Guidelines for annual reports (applicable to financial years starting on or after 1 January 2015) introduces changes relating to explanatory notes on asset management costs and transaction costs in the annual accounts (RJ610.314) and annual report (RJ610.503). The RJ texts can be found in Appendix 5.

2.7 INTERNATIONAL TRENDS

The growing concern among pension funds for transparency and insight into costs is not confined to the Netherlands. Pension funds worldwide are under increasing pressure to understand and report their total costs - including transaction costs, all private asset management fees and performance fees, and other offset costs.

The Netherlands is a forerunner in the reporting of such costs, but other European countries are similarly active in this area. Pension funds in Switzerland are obliged to publish a Total Expense Ratio (TER) in their annual reports. A TER embraces all costs, including pooled fund look-through and the underlying transaction costs of fund-of-fund investments. In the United Kingdom the Financial Conduct Authority recently announced its intention to discuss how DC funds should report and compare costs.

Full cost transparency has recently become an important issue in the United States. This applies notably to private equity, where most costs are not explicit. South Carolina Public Employees Retirement System was one

of the first pension funds in a position to report its private equity fees in full. The efforts of South Carolina PERS attracted worldwide interest and the Securities and Exchange Commission and US supervisory authorities have recently put increasing pressure on pension funds to give more insight into private equity costs.

Institutional investors in private equity worldwide are collaborating with the Institutional Limited Partners Association ILPA to identify and quantify all costs relating to private equity. A reporting standard developed by ILPA for that purpose is due for publication in January 2016.

Although complete cost transparency will not be achieved for some time yet, pension funds worldwide are making increasing efforts to identify all their implicit and explicit costs and make them transparent.

3

Recommendations on
Administrative Costs

Determinants of administrative costs

3.1 CONSEQUENCES OF CHOICES

Administrative cost levels hinge on choices about how pension provision is organised. Such choices are made at different levels. Social partners determine not only the substance of the pension scheme, but also how the scheme is implemented. Is the fund that implements the scheme a company pension fund, an industrywide pension fund or an occupational pension scheme? And how are transitional regulations treated if the pension scheme provisions are amended?

The social partners set out the framework within which the Board of the pension fund has decision-making authority. The Board thus decides on the implementation of pension administration, including the organisation of asset management, risk management and communication.

3.2 PENSION POLICY

Scale is a significant determinant of pension fund management costs. The social partners determine the scale of the collective. They also dictate the complexity of the scheme. These two key determinants for the costs of pension fund management are given factors for Boards, who will seek to optimise costs within this framework. Another significant determinant is the composition of the participant group. Active participants, deferred participants and pension beneficiaries all have different service needs.

3.2.1 Scale

A number of studies have been conducted in recent years on the administrative costs of pension funds and insurers. The published results all agree that scale is beneficial in terms of administrative costs per participant. Figure 1 shows administrative cost levels in pension fund management (vertical axis) relative to participant numbers (horizontal axis). Dutch pension funds vary greatly in scale, from a few hundred participants to over a million. Their administrative costs vary in parallel. In the interests of readability the figures exclude pension funds with over 100,000 participants. For all these funds management costs are below 120 euros per participant per year.

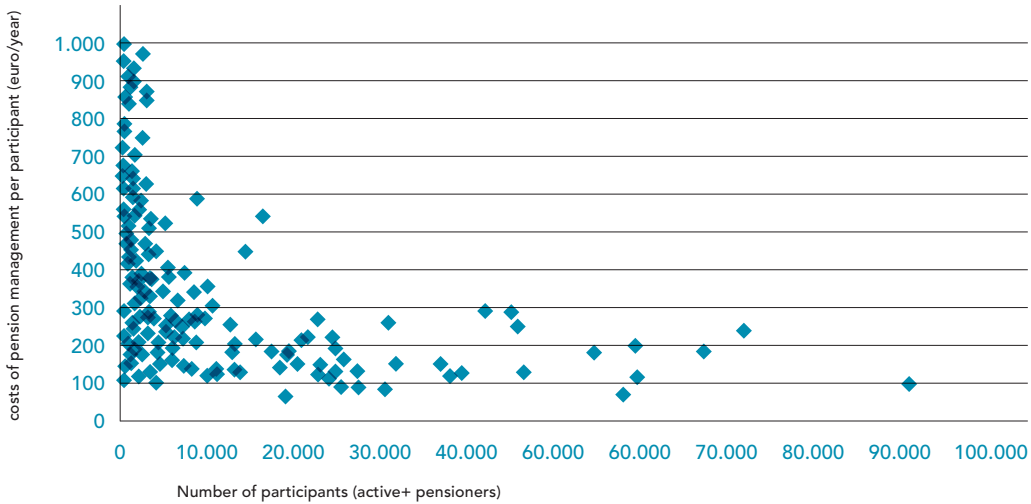


Figure 1 – Administrative costs of pension management per participant relative to total participant numbers.

Source: unpublished figures from annual statements submitted to DNB.

The executive board of a pension fund has only limited influence on the scale of the fund. The company, or the industry or the occupational group with which the pension fund is associated has after all a given scale. It is moreover the social partners or the company or the fund management that determine which organisation administers the pension scheme. That choice is thus dictated by circumstances. Independent professions are destined to participate in an occupational pension scheme, while companies and social partners in industrial sectors can choose between a company pension fund, an industrywide fund or a collective contract with an insurer. For fund management, whatever choice has been made is a given. New forms of administration, such as a 'general pension fund' or *APF*, can allow for greater advantages of scale.

3.2.2 Complexity of pension schemes and transitional provisions

The social partners make choices concerning the scope and quality of a pension scheme. The complexity of the scheme impacts directly on

administrative costs. Pension schemes have become more complex in course of time. That trend derives from efforts to establish the broadest possible terms-of-employment package for participants. Alongside provisions for retirement pension and dependants' pension, pension schemes may also cover other risks like incapacity for work. Some schemes offer the possibility of high/low constructions that add to complexity and costs.

Differences in cost levels also derive from the type of pension scheme in question: final salary, average salary or defined contribution. However, it is specifically transitional rights and the fact that previous entitlements remain valid after a change of system that add to complexity and push up costs. Higher pension management costs are not invariably bad for participants, who are often recompensed in the form of greater flexibility and better risk insurance cover. Costs should always be viewed in relationship to the product that participants are given or can choose.

Establishing uniform entitlements may offer a solution. Pension funds would then no longer need to continue administering transitional regulations for years on end.

Another option is to commute the entitlements of early leavers up to the legal buy-off limit. That would relieve pension funds of the need to administer pensions for which they receive no contribution.

3.2.3 Service level

The executive board determines pension administration service levels. Examples are the speed with which complaints are handled and the accessibility of the customer contact centre. The Board determines the appropriate service level for each of the target groups: active participants, pensioners and employers. These choices lead to cost differentiation and possibly varying levels of customer satisfaction.

Apart from the service level, the basic features of service provision also play a role. Some pension funds deal with complaints online as far as possible. At the other end of the scale is a service to employers and

participants that is directly person-to-person, for example in a personal consultation to discuss a prospective pension.

Recommendation: cost differentiation derives from the basic features of service provision. Pension funds should explain this fully in their annual report.

Pension funds also decide what kind of service it should provide. How broadly does the Board perceive its own role? Does it free up capacity for an active approach to public affairs, or does it focus exclusively on its own fund? Does it obtain a second opinion on the advice it receives from consultants, or does it do that itself?

And how much concern does a fund show for communication? Is it satisfied simply to comply with minimum legal requirements? Or is it more ambitious, investing actively in fostering awareness of pensions among its participants?

The Pensions Act stipulates a number of requirements for communication between pension funds and their participants. Examples are: the *Pensioen 1-2-3* and the annual uniform pension overview (*UPO*) statement. Many pension funds opt for more comprehensive communication with participants, for instance through newsletters, brochures, websites and social media. Many offer a pension planner with which individual participants can check their pension accrual and the financial impact of early or later retirement. Whatever the communication medium chosen, it impacts directly on administrative costs.

3.3 INVESTMENT POLICY

‘Pennywise and pound foolish’ and ‘no pain no gain’. These classic sayings indicate that a judgment based purely on curtailing costs (= costs as low as possible) is inadequate. That is specifically the case with asset management. Pension funds must assess costs in relation to risk and return.

Five aspects of investment policy are the chief determinants of asset management costs (in random order):

- 1 investment mix;
- 2 the degree of active or passive management;
- 3 the degree of internal or external management;
- 4 direct or indirect investment;
- 5 scale.

The impact of these five factors on costs are discussed below.

3.3.1 Investment mix

Professional asset managers submit bills for costs. The size of their management fee depends on the type of investment. The management of a portfolio of Netherlands government bonds incurs lower costs for example than the management costs for an equally large investment in property. Asset management costs are thus related to the composition of assets. The fees charged by asset managers can also vary as demand and supply dictate. Complexity and liquidity are significant factors in this differentiation. Publicly listed shares are low in complexity. The investment title is known to a wide public, and price formation on stock markets is highly transparent. Investment in hedge fund strategies demands a deeper knowledge of structuring, valuation and the composition of the underlying investments. Liquidity (the degree of marketability of the investment) is another significant factor. Generally speaking, the greater the liquidity of an investment product, the greater the number of parties trading on the market in that product and the more efficiently and transparently price formation takes place. With illiquid investments more effort is needed to find a suitable market player to trade with and to negotiate the appropriate valuation.

3.3.2 The degree of active or passive management

The essential features of management are a contributory determinant of cost levels. The aim of active asset management is to generate a higher average return over a specific period than a previously defined benchmark. Choices made in active management are based on analyses, thus requiring greater effort. For that reason active management is more costly than passive management, which is based on tracking the market index.

3.3.3 The degree of internal or external management

Asset management can be implemented either by the pension fund itself (internal management) or by an administrative organisation (external management). The degree to which assets are managed internally or externally is largely dependent on the expertise and/or scale of the pension fund.

Internal management can be less costly. However an important factor in opting for internal management is whether the fund can enlist the knowledge and expertise required, given the envisaged investment mix.

The pension fund pays a fee for external management. Asset management contracts should be checked to verify which costs are payable by the pension fund and which are deducted directly from investment revenues. Both components should be reported as asset management costs.

Internal management

In the case of internal asset management the costs should be stated in the annual accounts. These often comprise payroll costs and the costs of internal facilities like business premises and ICT.

External management

External asset management means the pension fund outsources the management of its investment portfolio to an implementing organisation and/or external asset managers. The implementing organisation and/or external manager may be the direct holder of investment titles registered in the name of the pension fund, but may also hold positions in investment funds it has selected for itself.

Fee percentages in external asset management are generally based on the scale of the managed assets, depending on the investment category.

Implementing organisations may contract out a portion of the assets they manage to third-party asset managers.

3.3.4 Direct or indirect investment

A pension fund may hold investment titles in its own name in a discretionary mandate. It may also choose to participate in an investment pool or an investment fund of an asset manager. This latter can offer economies

of scale and help to constrain costs, through exemption from VAT among other things. On the other hand the party offering the fund may charge a fee for fund management. It is important that in addition to costs, the pension fund should also consider the advantages and disadvantages of structuring through an investment fund, such as the extent of voting rights.

In the area of hedge funds and private equity, but equally in property, pension funds may make use of an external manager to select appropriate investments. The asset manager may in turn appoint an underlying manager to manage individual investments. That is an indirect or 'fund-of-fund' investment. The costs associated with a structure of this kind are generally higher than the costs of direct investment. The 'intermediate' external manager obviously charges an additional fee.

3.3.5 Scale

Management fees are payable for the services of professional asset managers. Management fee percentages generally fall as the level of managed assets rises. However that does not mean that scale brings only benefits. Perceivable cost advantages are offset by constraints that are less easily measurable. The management of an extremely large volume of assets may for example clash with the marketability of investments on financial markets.

Studies by DNB and AFM² have shown that advantages of scale in the costs of asset management (excluding performance fees) are found most notably in liquid investment categories.

3.4 IMPLEMENTATION METHOD

3.4.1 Type of pension fund

Social partners place pension schemes with an industrywide pension fund, a company pension fund or an insurance company. Independent professional groups, like doctors, have their own occupational pension funds.

² AFM study *Vermogensbeheer- en transactiekosten pensioenfondsen in beeld*, May 2015

Employers affiliated to an industrywide pension fund belong to a specific branch of industry. A company pension fund is tied to a single company or a group of closely related businesses.

These three categories of pension fund have most of their activities and responsibilities in common. So too the associated costs. There are some areas where they diverge, and these are reflected in higher or lower costs. For instance debt collection charges are usually lower for a company pension scheme than for an industrywide fund. Industrywide funds have to deal with a large number of employers, while a company pension fund serves only one or a handful of employers. An industrywide fund also incurs costs for the enforcement of mandatory participation, that is to say compulsory affiliation applying to all businesses in the industry concerned. Company pension funds have no such costs.

A company pension fund that is administered inhouse can make use of the company's own payroll and salary administration. This can have synergetic benefits and deliver an advantage in terms of costs. Industrywide and occupational pension funds do not have this potential. On the other hand a company pension fund may have participants who are based abroad, which can add to costs in a number of processes.

Occupational pension funds have specific costs that other types of fund do not incur. An occupational pension fund does not deal with employers, but with a group of independent members of a profession. This has an impact that can add to costs:

- occupational pension funds are legally obliged to organise and finance an occupational pension scheme association. The association functions as the support base for the pension scheme to which affiliation is mandatory;
- occupational pension funds have no employer in the chain between pension fund and participant. Queries from active participants are addressed directly to the fund itself, not to the HR department of an employer. Because of this direct relationship between participant and pension fund, occupational pension funds for the professions, with their higher than average contributions (in euros), and highly educated participant base, have to deal with many individual queries;

- the earnings of independent members of a profession vary from year to year. So too their pension contributions. An occupational pension fund has to verify contribution levels yearly;
- the regulator DNB regularly conducts studies based on a theme, in which a limited number of funds take part. There are 11 occupational pension funds in the Netherlands. For that reason individual occupational pension funds are relatively often involved in a study. The costs of these theme-based studies are for the account of the fund.

Based on currently available figures the above costs represent a substantial portion of the administrative costs incurred by occupational pension funds.

A new type of pension fund is the general pension fund or 'APF' (*Algemeen Pensioenfond*s). Company pension schemes or pension schemes for occupational groups or industries that are not subject to mandatory affiliation to an industrywide fund can be placed with an APF. They can thus benefit from advantages of scale, deriving from joint asset management or joint procurement of services in a shared administrative system for instance. An APF is jointly controlled. That means the required expertise, whether for the Board or other pension fund bodies, can potentially be organised more efficiently than on an individual basis.

The Recommendations do not apply to individual pension schemes in the third pillar, such as those offered by pension administration organisations, banks and insurers.

3.4.2 Administrative model

Pension funds may implement pension management in the following ways:

- self-administration;
- contracted out to an administrating organisation;
- administration partially or wholly by the company (company pension fund);
- reinsurance.

A self-administered pension fund conducts all activities under its own management. The executive board has direct control over the administra-

tion of pension management and consultancy on policy. Asset management may be partially outsourced.

A pension fund may also contract out all its activities to a service organisation (pension administration organisation or an insurer). A characteristic of this model is that policy is separated from implementation.

In the case of self-administered company pension funds the company may implement the scheme either wholly or partially. This occurs primarily in relatively small funds; the company will then correlate the administration of the pension scheme with its salary administration. Asset management may be wholly or partially outsourced.

A reinsured pension fund has contracted its activities out to an insurer. The insurer then assumes the financial and administrative risks, and contribution payments fall under a contractual agreement.

The pension fund Board chooses the administrative model. That choice has an impact on administrative cost levels.

3.5 COSTS DERIVING FROM LEGAL AND REGULATORY REQUIREMENTS

3.5.1 Costs of supervision

Dutch pension funds are under the prudential supervision of the Dutch central bank DNB and of financial markets regulator AFM in the area of professional conduct. In the event of a merger between large pension funds, the merged fund is also regulated by the consumer and market authority ACM (*Autoriteit Consument en Markt*). DNB and AFM pass on a portion of their regulatory costs to the pension funds under their supervision.

The contribution of pension funds to regulatory costs is based on their premium receipts and their assets, whereby an additional payment by the company is deemed to be premium.

A new and less visible consideration relates to supervisory costs: the costs incurred internally by a pension fund in responding to queries from DNB. DNB began thematic supervision in 2011. That means a limited number of pension funds are required to take part in studies focusing on one specific aspect of pension administration. This type of in-depth study involves participating pension funds in substantial costs.

Pension fund Boards have no influence on costs relating to supervision.

3.5.2 European regulations

A number of new regulations relating to asset management have come into effect since 2008. The following sections explain the most important of these, together with their impact on asset management costs.

Alternative Investment Fund Managers Directive (AIFMD)

The AIFMD is intended to provide greater transparency for investors and regulators and promote financial stability. Changes deriving from the AIFMD apply to investment funds that are not UCITS. That means they also apply to property funds, hedge funds, private equity investments and other institutional funds. Managers of these investment categories must comply with AIFMD requirements relating to risk and liquidity management, administrative organisation, valuation, remuneration policy and professional conduct. At fund level, asset managers must appoint an independent custodian with responsibility for supervisory activities like cash monitoring, custody of assets and specific 'oversight functions' in respect of procedures or processes carried out by the manager. Alongside the costs referred to thus far, this may involve an additional cost item: supervisory costs incurred by the custodian for instance.

European Market Infrastructure Regulation (EMIR)

The objective of EMIR is to curtail the risks attaching to derivatives. Derivatives are associated with risks, whereas pension funds actually use derivatives to hedge risks. EMIR makes it mandatory for parties to a derivative contract to work with a central counterparty clearing house or CCP, which makes the market more transparent. EMIR effectively adds to costs, as the CCP has to be paid and collateral has to be deposited.

EMIR entered into force in 2012. Pension funds were initially granted temporary exemption, which was extended in 2015 to 2017. The motive for exemption is that depositing collateral in cash involves pension funds in costs and liquidity risks, leading to a lower pension outcome. Different ways for pension funds to comply with the collateral requirement are currently being sought.

Financial Transaction Tax (FTT)

The financial transaction tax (hereafter: FTT) proposed by the European Commission is aimed at coercing the financial sector into contributing towards the costs of the financial crisis, preventing a double tax levy on financial transactions and discouraging 'high-risk transactions' on financial markets. Broadly speaking, financial institutions that are party to a financial transaction are taxed at a rate of 0.1% of the value of the traded securities (equities and bonds), and at 0.01% on the underlying value of traded derivatives. Some 11 EU member states are currently working on the FTT proposal within the framework of an 'enhanced cooperation procedure'. The Netherlands is not a member of that group, and the Dutch government's coalition agreement even contains a passage to the effect that it would only consider joining in on condition that pension funds were granted exemption. The administrative costs of pension funds would effectively rise if they had to pay the FTT in order to optimise their strategic and tactical investment policy, and manage risks and collateral.

Markets in Financial Instruments Directive (MiFID II)

The MiFID directives are intended to bolster the competitive strength of European financial markets by creating a single internal market for investment services and activities. That would give better protection to investors in financial instruments like bonds, equities, derivatives and a number of structured products. For pension funds, however, the pre-trade and post-trade transparency created by MiFID II has a converse impact. Pension funds then find it difficult to shift large positions without being perceived as High Frequency Traders. That may have the effect of driving up prices, and thus costs. This happens primarily in the case of less liquid but more transparent markets, such as the longer end of bond markets, where pension funds trade. Trading costs may therefore rise.

3.5.3 VAT

On 1 January 2015 exemption from VAT for umbrella organisations was curtailed by law. From that date onwards pension administrators must charge VAT (21%) over their administrative services to funds affiliated to the umbrella organisation. This levy is payable by the pension funds concerned, which represents a permanent substantial increase in administrative costs.

In the first year VAT is payable pension funds are advised to publish a note in their annual report explaining this cost increase clearly and making its impact transparent. The impact of VAT should be explicitly visible in comparisons with previous years.

The pensions sector is still in consultation with the government concerning the legitimacy of curtailing exemption from VAT for umbrella organisations. The outcome was not yet known at the publication date of these Recommendations.

Exemption from VAT may also occur in the case of a fiscal entity or a ruling from the tax department. Whether exemption can be granted hinges to some extent on the possibility of demonstrating that the fund can be designated as a joint investment fund, thus qualifying for VAT exemption. That does not alter the fact that for pension funds, liability for VAT adds to administrative costs.

4

Recommendations on
Administrative Costs

Generic recommendations

The Recommendations are based on a number of generic recommendations. In the case of situations that are not specifically defined, readers can base their decisions on the following recommendations.

The Recommendations are subject to the comply-or-explain principle. That means pension funds are expected to comply with the Recommendations. If pension funds fail to comply with certain recommendations they are expected to explain their motivation for noncompliance in their annual report.

4.1 NO OFFSETTING OF COSTS AGAINST REVENUES

Cost transparency entails a line of approach unlike the treatment of costs in the annual accounts. The principle applying in the directors' report is: 'where you have revenues, you don't do setoffs'. In the annual accounts certain costs may be set off against revenues in accordance with RJ 610, whereas that is not the case under these Recommendations. The directors' report must explain the impact of setoffs, making their relationship with costs reported in the annual accounts transparent.

Recommendation: When making costs transparent, costs should not be set off against revenues. Separate reporting of costs is a fundamental principle.

That means for example that transaction costs in investment funds are reported separately and not incorporated into movement in investment fund valuations.

Here are two specific examples:

Administrative organisation forms a participating interest of the pension fund

A number of pension funds in the Netherlands are shareholders in their administrative organisation. That relationship means that a share of the administrative organisation's profit is allocated to the pension fund. But administrative costs charged to the pension fund by the administrative organisation are not set off against these revenues.

Securities lending income with custody fee

It is not unusual for revenues generated from securities lending to be deducted directly from the custody fee. In conformity with the 'no offsetting' principle, income deriving from securities lending should be designated as revenues and custody fees reported in full as asset management costs.

4.2 LOOK-THROUGH PRINCIPLE

For the purposes of calculating asset management costs and making them transparent the structuring involved should be irrelevant. In other words: if a fund chooses to invest through investment funds or 'funds of funds' these various investment tiers should form no impediment to the transparency of total costs incurred.

Recommendation: Where a pension fund invests through investment funds the asset management costs and transaction costs of these investment funds are incorporated into total costs.

This recommendation applies to all structural tiers. Costs incurred by enterprises in which the fund invests are not incorporated into total costs.

This recommendation means that asset managers must clearly disclose all costs to the tier above. This recommendation is increasingly widely accepted at international level, a factor that should make it easier to obtain the required information.

4.3 MATCHING PRINCIPLE

On grounds of legal and regulatory requirements the data relating to transactions and other events such as movements in valuation are stated in the accounting period in which the event occurs (and not the period when money is received or paid).

Recommendation: Revenues and costs are attributed to the accounting period to which they relate, and costs are stated in the accounts for the same period as the related revenues.

Performance fees are thus stated in the accounts for the period in which the associated performance occurs. This ensures the greatest possible transparency of the relationship between costs and outperformance.

4.4 NONRECURRENT COSTS

Unavoidable changes to administrative systems can have a severe impact on pension management costs. It can become imperative to adapt systems on grounds of new legislation as well as the simplification or increasing complexity of a pension scheme.

Recommendation: Nonrecurrent costs are incorporated into the assessment of management costs.

This recommendation relates to project costs or other nonrecurrent costs. Given that nonrecurrent costs occur at fund level in most years, these are incorporated into the assessment of pension management costs.

Recommendation: Nonrecurrent costs are explained in the directors' report.

This may take the form of stating the reason for investments, including a forecast of cost trends deriving from the investment in question. Under general financial reporting guidelines (BW2 and RJ) these costs can be capitalised and allocated to the result over a number of years.

Nonrecurrent costs may also be incurred in asset management. Take for example transition costs deriving from changes in investment policy or other changes with material impact in portfolios.

4.5 PRACTICAL FEASIBILITY AND USE OF ESTIMATES

One basic principle is that implementing the recommended action must be practically feasible. An estimate suffices if costs cannot be directly identified from pension fund records or data provided by third parties. In that case it is important that the estimate and the applicable underlying assumptions can be verified, by an external accountant for example.

In practical terms 'implementable' means that costs are calculated or estimated as far as possible on the basis of models that are simple to use. A clear understanding of administrative costs can be obtained without the use of a labour-intensive calculation based on a complex model.

Recommendation: Pension funds report costs transparently in line with this Recommendation and add an explanatory note on the accounting principles applying. If cost transparency is still insufficient or unobtainable on grounds of existing contractual provisions for instance, an estimate of costs should be stated in the annual report together with an explanatory note concerning the circumstances.

In that case it is advisable to indicate which portion of costs with notional surcharges or percentages are estimates, and which are known precisely, for example on grounds of an agreement.

For the purpose of reporting asset management costs pension funds should have access to reports from external managers in good time. Timely submission of costs over the previous quarter is not always possible, notably in the case of alternative investments that are managed externally. It is thus essential that the external manager or asset manager draws up and submits estimates of costs on time. In some cases reports or estimates over the fourth quarter of the current financial year are not available from the external manager or asset manager. If the pension fund believes that the cost figure stated for the fourth quarter of the previous financial year is a good estimate for the fourth quarter of the current financial year, that figure will suffice. This should be appropriately clarified in a note.

Special attention should be paid to performance related remuneration. If precise performance fee figures are not available, these should be estimated.

4.6 TAXATION

Taxes adding to cost price levels

Also known as indirect taxes, these are taxes that are implicit in the price of a product or service and are thus payable by the client pension fund or investment fund. Examples are value-added tax (VAT) and transfer tax.

Recommendation: Taxes that add to cost price are stated in the accounts as costs in the category where the tax in question applies, thus the VAT on asset management costs under asset management costs, and so forth.

Taxation is therefore not a separate heading, but is stated under the relevant cost categories.

VAT comes into the picture if the fund has outsourced some activities. If the contracted service provider is based in a different country the VAT transfer regulations become applicable. The pension fund can then claim a portion of its VAT liability as a deductible item, on condition that the fund itself carries out activities subject to VAT. The pension fund can claim tax relief for a percentage of VAT equivalent to taxable revenue relative to total revenue.

Transfer tax on direct transactions in property is attributed to transaction costs.

Taxation on returns

These taxes are levied on the investment return of pension funds or investment funds. This often relates to foreign taxes, which can include withholding tax on dividends and interest (levies on direct return) and levies on book profits (capital gains tax). Pension funds, and to a lesser extent investment funds, are partially exempt from these levies under various taxation treaties between the Netherlands and other countries.

Recommendation: Taxes on returns are not stated as costs, because these levies do not add to cost price.

Compare this with corporation tax: companies do not normally report this tax liability under the heading of costs.

4.7 CURRENCY

Recommendation: All costs should be denominated in euros.

Costs denominated in a foreign currency should be converted at the exchange rate applying at the date the costs were incurred. If these foreign exchange rates are not available or the required separate administration of costs (in investment funds, for example) would add to administrative complexity, alignment with the customary processing method of the administrator or asset manager can suffice.

4.8 NO LIMITATIVE SUMMARY

The Recommendations do not give specific consideration to all investment categories. In practice there are innumerable variations of categories as well as other, possibly new, investment categories that are not dealt with here. Should any doubt arise concerning the scope of costs the following question may be considered:

'What are the total costs incurred (directly and indirectly) in enabling pension funds to invest in the related investment category?'

In its 402 reporting form for annual statements DNB uses a limitative summary in alignment with its K201 quarterly statement form. These categories do not necessarily align with the composition of the pension fund's established investment mix. It is important to be able to clarify the relationship between the fund's own presentation format and that of DNB. That guarantees adherence to the same cost information.

5

Recommendations on
Administrative Costs

Pension management costs

Pension management costs comprise all costs associated with pension management activities. These can be the administration of pension entitlements, communication with participants and the Board, and consultancy & auditing. Project costs attaching to these activities also fall under pension management costs. This chapter deals with specific elements of pension management costs.

5.1 INTEGRAL COSTS OF PENSION ADMINISTRATION

In the interests of comparability it is important that pension funds account for total costs, irrespective of which costs are payable by which party. This applies specifically to company pension funds, where a portion of costs is payable by employers and not charged to the pension fund.

Recommendation: All costs are taken into account when assessing pension management costs. If a material portion of pension management costs is permanently payable by the employer and not by the pension fund, that portion is nonetheless taken into account when assessing pension management costs with a view to promoting comparability with other pension funds. Any costs not taken into account that are of material significance for cost transparency are disclosed separately in an explanatory note in the annual report.

Pension administration costs are normally booked in financial accounts and can then be stated as such in the annual accounts. That may differ only in the case of wholly reinsured funds.

5.2 PENSION ADMINISTRATION AND COMMUNICATION

Pension management costs consist specifically of costs incurred for pension administration and for communication with participants. Activities such as collecting contributions, paying out pension benefits and the administration of pension entitlements also fall under this heading. Pension funds moreover incur costs for communication with participants and employers.

Industrywide pension funds also incur costs deriving from the enforcement of mandatory participation legislation. In other words the costs involved in ensuring that all employees subject to mandatory participation are indeed participants in the fund.

5.3 GENERAL PENSION FUND COSTS

5.3.1 Types of general costs

Some costs incurred by pension funds are not specifically attributable to pension management or asset management. These are termed general costs. Because general costs are not treated separately they should be divided between pension management costs and asset management costs. The chief general costs are:

- **Board and committee costs**
Various internal bodies and committees are involved in the management of a pension fund. As well as the executive board there is often an audit committee, an accountability body and an investment committee. Holiday pay and the costs of external officers like supervisory board members and other external advisors are designated as governance costs.
- **Board office costs**
If a fund has a Board office, costs will be involved. Alongside staff salaries these include the costs of premises, computerization, administration and so on. If the Board office (of a company pension fund) makes use of the company's own premises and facilities, estimates of the associated costs should be stated in the accounts.
- **Costs of external consultancy & auditing**
In support of policy the fund may recruit expertise externally, or the service may be provided by the administrative organisation as part of the SLA. These costs are designated as general costs because they often cannot be split between pension management costs and asset management costs.
- **Costs of Supervisory bodies and Pension Register**
Depending on the size of the fund concerned and other factors, pension funds are required to contribute to the costs of supervision. Both regulators (central bank DNB and financial markets authority AFM)

receive remuneration for their supervisory activities. The Pension Register has a statutory basis and requires pension funds to pay an annual contribution based on active participant numbers.

5.3.2 Splitting general costs between pension management and asset management

Article 10a of the Decree on the Implementation of the Pensions Act stipulates that the costs of the executive board and supervisors fall under administrative (= pension management) costs. However the official Policy Document on the decree allows scope for allocating costs to asset management by defining asset management costs as internal costs incurred by the pension fund (or its Board office) for asset management.

It is often difficult to apportion general costs specifically to asset management or pension management.

Recommendation: Pension funds make their own estimate of general costs attributed either to pension management or asset management, and substantiate that estimate. An explanatory note on the substantiation of the estimate is published in the annual report.

There are a different ways of attributing total costs of the Board, Board office, consultants and regulators to either pension management or asset management. The pension fund can make its own decision on a reasonable apportionment of general costs.

If a transparent assessment of costs incurred by the Board office for asset management activities is available, for instance, these can be attributed to asset management costs. Other costs incurred by the Board office that cannot be directly attributed fall under pension management or are attributed pro rata to the costs incurred. Costs relating to the Pension Register fall under pension management costs.

It is important that the pension fund attributes costs specifically either to pension management or asset management as far as possible, and gives a plausible explanation for its chosen allocation of unattributable costs.

5.4 CALCULATION OF PENSION FUND PARTICIPANT NUMBERS

Recommendation: Pension management costs are divided between the number of active participants and pension beneficiaries taken together.

Ignoring early leavers in the participant count is an express choice. Leaving out early leaver numbers has virtually no impact on the mutual comparability of costs. Including full early leaver numbers gives a misleading picture. The above definition was preferred for that reason. The Decree on the Implementation of the Pensions Act similarly defines the number of participants as the sum of active participant and pension beneficiary numbers.

A limited number of pension funds have a relatively high number of early leavers. In that case the total participant number including early leavers can be stated alongside the number of participants as defined by the Federation. This should be explained in a note in the annual report.

Some funds use a norm participant number in the denominator. That does not comply with the definition stipulated above, but may be stated as a separate figure alongside the stipulated key figure.

Recommendation: The number of active participants and the number of pension beneficiaries that together make up the denominator total are identical to those reported to DNB in the J701 annual statement.

Alignment with the DNB definition is the best way to prevent double counting.

Practical experience has shown that for most pension funds, using averages involves no meaningful divergence from stating year-end levels. If any essential movement in participant numbers has occurred over the year whereby a year-end total gives a divergent figure, that divergence can be explained separately from the stipulated key figure.



Asset management costs

6.1. ASSET MANAGEMENT STRUCTURES

Pension funds can invest their assets (or have them invested) in different assets. The way they do that has a direct impact on the types of potential costs incurred in any specific situation.

Figure 2. shows a number of situations that involve different relationships between a pension fund and asset manager.

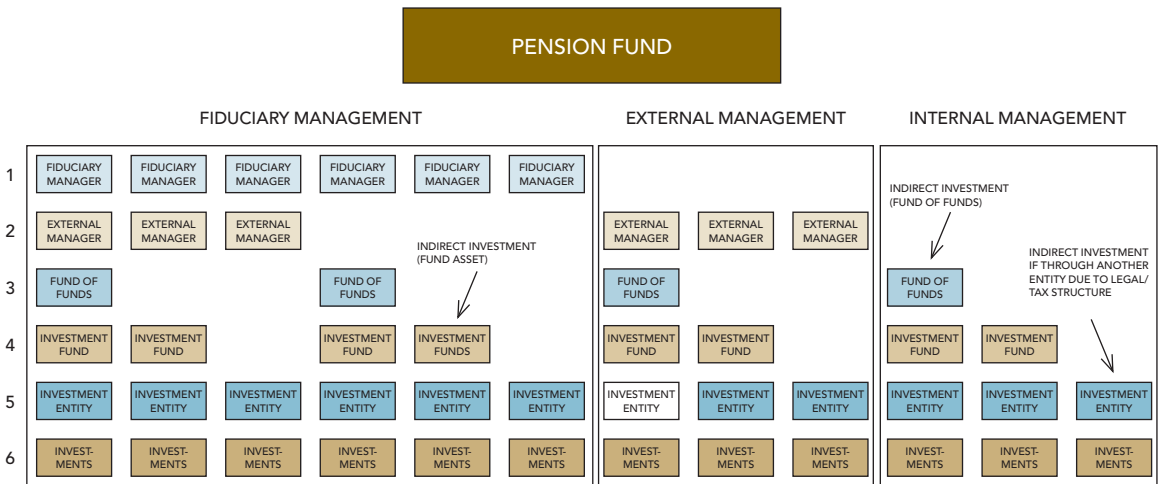


Figure 2 – Structuring variants (asset management is often a combination of variants)

A pension fund may manage its investment portfolio internally (figure 2, right-hand block). Within internal management the fund can opt to invest directly in securities or indirectly through investment funds. Funds of funds (investment funds that invest in other investment funds) are a separate category. Asset management costs comprise the remuneration, IT costs, accommodation costs, and so on, of the pension fund itself, but also include the costs of investment funds and funds of funds.

A pension fund may also outsource its asset management to a fiduciary manager (left-hand block). The fiduciary manager takes over a number

of asset management activities such as the selection and monitoring of external managers. Costs related to fiduciary management are treated as asset management costs.

Other types of relationships may also occur.

Figure 2 shows 11 (not limitative) potential forms of investment structures.

Recommendation: Compliance with the look-through principle means that all asset management costs from tier 1 up to, and including, tier 5 must be made transparent.

An important point is that when attributing investment fund costs to the pension fund, the pro rata participation of the pension fund in that investment over the period to which the costs relate should be taken into account.

Alternative investments

By comparison, the average asset management costs for alternative investment categories are higher than traditional investment categories like equities and fixed income securities. Because of the diverse legal entities involved, it is difficult to obtain transparency of all asset management costs, and for the moment estimates of these costs should be used, if need be. For the purposes of reporting asset management costs, the entire (legal) structure should be assessed. The aim is to report these costs up to the tier at which investments are accounted for at regulatory level.

In practice, there are innumerable varieties of the structures set out in figure 2, and other (possibly new) investment categories. If doubts arise about the scope of the costs, the following question may be asked:

“What are the total costs (direct or indirect) of enabling the pension fund to invest in the investment category concerned?”

Real estate and infrastructure

There are various ways to invest in real estate and infrastructure. An asset manager or pension fund may invest in these categories:

- by purchasing publicly traded shares;
- by participating directly or indirectly in a partnership;
- by developing a project directly under its own management and operating it, possibly employing a manager to carry out maintenance, and so on.

Recommendation: In case of a direct investment in a publicly listed entity, management costs are included in the market price. Because of their inextricable link with the profit and loss account of the listed entity, these costs do not qualify as asset management costs and are not assigned as such.

Private equity

In principle, there are five basic private equity structures. Within these five, sub-structures exist. The selection of one of the five structures is primarily based on the extent to which the pension fund is able and willing to be engaged in the investment. This often depends on the total size of the investment portfolio, for example because of relative economies of scale, and the degree to which the fund has experience with the investment category concerned.

Except for when a pension fund itself decides to invest or co-invest directly, the investment takes place through a general partner (private equity manager) and a limited partner (pension fund) structure, possibly through an intermediary. In concrete terms this means that the pension fund participates in the investment concerned as a limited partner and that its role is effectively confined to providing the required investment capital. The liability of the pension fund is limited to amount of assets under management. In many cases, the general partner is the private equity manager who invests the pension fund's capital, and who is also responsible for the day-to-day management of the investments.

If a pension fund opts for a 'Managed Account', an asset manager sets up a separate structure directly with a private equity manager, without involving other investors. This type of structure provides the pension fund with maximum control, risk management and flexibility, but is also costly.

Through a fund-of-funds, a pension fund can invest in a spread of private equity funds, whether or not through its external asset manager. The fund-of-funds selects private equity managers who directly invest in individual companies, and is responsible for the day-to-day management of the investments. This type of investment is appropriate where the pension fund or the external asset manager wish to invest in private equity but cannot (or prefer not to) actually select the private equity manager; has no access to specific popular managers; or when doing so independently would make no sense due to (loss of) economies of scale.

In the classic situation, the pension fund or external asset manager selects a private equity manager with whom it then participates as limited partner in a fund, together with other investors.

In some cases, a pension fund may co-invest in a company together with a private equity fund. In these circumstances it is the private equity manager who takes the lead in identifying and managing the investments, while the pension fund has a more subordinate role. This arrangement is mainly used for large investments, in which the private equity fund is keen to have a co-investor. Because investment proposals all have to be assessed individually, this arrangement requires a high level of expertise from the pension fund or external asset manager.

If a pension fund or external asset manager has sufficient in-house expertise, the preferred course may be to invest directly in companies, thereby replicating the private equity model.

In addition to the situations referred to above, another possibility is investing in a 'publicly listed' private equity fund, whether or not through a fund-of-funds structure. The advantage of such investments is their

greater liquidity, although this advantage is also discounted in the price. Moreover, the supply of listed private equity managers or funds is relatively limited.

Hedge funds

Various types of strategies can be chosen in the hedge funds category, which are often operated by (niche) managers.

Many of the investment structures, like managed accounts, funds-of-funds and investment funds (or partnerships), are identical to private equity structures.

The hedge fund manager sets up an investment fund that is accessible to institutional and other investors: the 'master fund'. A feeder entity may be set up for institutional investors, either for fiscal reasons or in the interests of limiting liability, often in partnership with the hedge fund manager. Investment in the master fund takes place through such a feeder entity. The managers have often outsourced their administrative services to an organisation specialised in hedge funds, which generally will be audited by an external accountant.

That means that if an external administrator is involved, these costs should also be accounted for.

6.2 AVERAGE ASSETS UNDER MANAGEMENT

The Recommendations state that costs should be expressed as a percentage of average assets under management (including that related to third-party investments). There are various definitions for assessing average assets under management.

The Guidelines for annual reports stipulate that negative positions in derivatives should be stated as liabilities. As a result, the balance sheet total rises. The balance sheet total may also increase as a result of direct investments in long-short strategies. The recommended procedure is to base the assessment of key figures on net invested capital.

For investment categories like private equity, real estate and infrastructure, and also commodities, commitments are generally involved. For the moment, the average invested capital is derived from the total invested capital.

The point of departure for assessing averaged invested capital is the net asset position, excluding outstanding commitments.

Recommendation: Average assets under management is calculated on the basis of end of month values:

$$\text{Average assets under management} = \frac{0,5 * \text{dec} + \text{jan} + \text{feb} + \dots + 0,5 * \text{dec}}{12}$$

This diverges from the DNB definition of average assets under management in its J402 annual statement reporting form. For its verification of key figures DNB uses annual statement form 301, applying an average of the start of year and year-end figures. That approach is less accurate, however, than proposed in the above formula. An average based on more frequent measurements is recommended.

6.3 TYPES OF ASSET MANAGEMENT COSTS

The Recommendations distinguish between the types of asset management costs (excluding transaction costs, which are dealt with separately in Chapter 7) presented below. Costs are presented in table 6.1. It should be noted that the various types of costs should not be stated separately in the annual report.

- remuneration for fiduciary management;
- management costs for asset managers;
- custody fees;
- other costs;
- performance-related remuneration.

This approach diverges from that used by DNB in its 402 annual statement form instructions. In that form, custody fees that cannot be assigned to

a specific investment category are classified as management costs. It is important for pension funds to know which costs are considered a specific type of costs.

6.3.1 Fees for fiduciary management

The costs of fiduciary management can consist of fees for strategic advice, risk management, and the costs of portfolio implementation and management. Given the ultimate aim of stating costs over a full reporting year as asset management costs, it is important to be thoroughly acquainted with the contract between the pension fund and its service provider(s).

In 2012, DUFAS revised its Principles of Fiduciary Management. In this document, the following activities are listed as fiduciary management.

Core activities of fiduciary management:

- proposal for strategic investment policy, in relation to an (ALM) study;
- advice on risk management, balance sheet management and its potential implementation;
- proposal for portfolio composition, dynamic portfolio management;
- selection, implementation and monitoring of operational asset managers;
- communication with and reporting to the pension fund on the implementation of the various activities, and offering support to the pension fund through exchange of knowledge;
- performance measurement and attribution of performance (internal or external).

Optional secondary activities of fiduciary management:

- ALM study;
- selection, instruction, monitoring, evaluation and termination of commissions, of or to prime brokers, clearing brokers, execution brokers, counterparties in OTC derivatives transactions and entering into ISDA contracts (including Credit Support Annex) with counterparties, and providing for adequate monitoring of counterparty risk and prudent collateral management activities;
- issuing instructions to and terminating commissions to operational asset managers;

- administration of and interaction with custodian(s);
- supporting pension fund management in board meetings, annual reports, reports to the regulator, etc.

6.3.2 Management costs asset managers

Management fees can be calculated in various ways, notably:

- a fixed management fee irrespective of the magnitude of managed assets;
- transaction fees (not the same as transaction costs);
- a fee based on assets under management (AUM);
- a fee based on asset commitment.

A fixed fee for asset management is stipulated in the contract, and often includes remuneration for the investment administration. This agreed fee should then be reported as management fee costs for the reporting year in question.

Costs per transaction may be charged, for overlay management for instance. It is important to report a fee for all transactions as at the balance sheet date.

An additional variable fee may be awarded, based on the average AUM in the related investment category. If necessary, these costs can be based on an estimated average of managed assets over the reporting year, for example where a final settlement has not yet been received.

Depending on the amount, asset managers (and administrative organisations) may charge differing fee percentages for the same investment category for individual clients. In other words: discounts may be offered. Such discounts need not be made transparent separately.

Definition of asset management costs related to real estate

In the case of a direct investment in real estate, the pension fund is directly responsible for the operational management of that investment and for taking it into operation. These expenses may include costs of land purchases, architects, required permits and costs of the various building and installation contractors.

After an investment has been taken into operation, costs will be

incurred for maintenance and depreciation of installations, etcetera. These real estate management costs are aimed towards generating an optimum operational result to compensate for real estate management activities (commissioned internally or externally), to be specified later. Costs are calculated in compliance with the provisions of the relevant management contract, as well as agreed additional work to be paid separately on an ad hoc basis. These real estate management costs are not designated as asset management costs.

Failure to state real estate management costs can lead to a discrepancy with the annual accounts when the pension fund has invested directly in real estate or in case a real estate fund, in which the pension fund has majority voting rights, has been consolidated. Annual Reporting Guideline 610.315 can be taken to mean that these costs should be stated in the annual accounts as asset management costs. The pension fund should clarify this discrepancy in an explanatory note. If pension funds and/or asset managers invest in real estate or infrastructure through an investment fund or entity, they are not directly involved in the day-to-day operational management of the investment. Operational management is the responsibility of the fund manager and rests with the management team of the underlying enterprise (in infrastructure investments, for example).

The asset manager receives a management fee and possibly a performance fee for managing the investment portfolio. These portfolio management costs are designated as asset management costs. The relevant contracts can be consulted to verify whether management costs for real estate investments cover all management costs involved.

Fee structures

In the area of private equity and real estate in general, differing methodologies are used to assess management fees, e.g. a fee calculated over the committed capital or a fee calculated over the cost price of or (if lower) the current value of the investments.

A management fee is calculated over the committed capital at that point in time at which the asset manager starts to look for suitable investments. Generally, the manager is remunerated for 'seeking' suitable investments.

From the moment an investment has been purchased, the investor is

charged a fee for regular management activities. A period is often agreed during which the management fee is calculated over the committed capital, after which the fee is calculated over the cost price or current value of the investment.

The private equity manager may also charge the company in which the investment is placed for e.g. consultancy costs, as well as for management costs and monitoring fees. If receipts of the charges from private equity manager (general partner) are shared with the investor (limited partner) they should also be designated as receipts for the pension fund and not deducted from previously agreed costs. For accounting purposes the management fee is equal to the gross management fee.

6.3.3 Custody fees

Remuneration of custodians

Individual listed investment titles are deposited with a custodian for safekeeping. The custodian charges a fee for safeguarding these assets. The fee depends on the nature of the items deposited. Custody fees for assets invested in emerging markets are generally higher than for equities that are publicly traded in developed countries.

Custody fees are based on the market value of the securities under custody. The fee is equivalent to an agreed percentage of their market value (the percentage depends on the nature of the investment).

The custodian may execute additional services. In calculating custodial costs it is important to verify what services have been agreed in the relevant contract.

A few examples of additional services:

- arrangements for cash sweeps;
- processing all corporate actions in liquid securities;
- compliance monitoring;
- accounting;
- opening of accounts in other countries;
- filing dividend claims with local authorities;
- pre-financing of refundable withholding taxes.

Custodians present invoices periodically. Pension funds should consult their contract with the custodian to verify the percentage fee and the intervals at which custodial costs are assessed.

To obtain complete transparency custodial costs should be reported as a gross sum, before deduction of any revenues from securities lending.

Bills from custodians may include charges for services that are not covered by custodial fees:

- Costs per trade and/or cash movement. These should be designated as transaction costs.
- Costs relating to proxy voting. These should be designated as 'other costs'.

Depositary fees

Since the introduction of AIFMD through its incorporation in the Act on Financial Supervision (*'Wet Financiële Toezicht, Wft'*), investment fund providers are required to appoint an independent depositary to execute activities relating to the investment fund, such as: cash flow monitoring, safeguarding of individual publicly listed investment titles, establishment of ownership rights, verification of valuation and valuation policy, and the correct marketing of participatory interests in the investment fund.

Costs incurred for these services should be designated as costs incurred for the investment funds and stated under costs payable by the pension fund.

Given that depositary functions for individual publicly listed securities are services already provided by a custodian, the custodian and depositary are often affiliated parties. A contract for depositary services may thus be a subcontract to the contract concluded with the custodian.

6.3.4 Other costs

There can be a diversity of 'other costs' in the realm of asset management. Statements from asset managers do not always distinguish clearly between activities clustered under 'other costs' and costs designated

as management fees. Pension funds need to be alert in identifying the service provided to them. One example is administrative costs, which are often incorporated in management fees. Another example is that some management costs in real estate investments are designated as 'other costs'.

Other costs are often not based on the amount of invested or deposited assets, but on separate agreements and contracts for the provision of specific types of services, for which invoices are received. Some of the more frequently occurring other costs will be discussed below.

Set up costs

These are the costs of setting up alternative investments funds.

In order to be able to invest in less liquid alternative investments, general partners set up special funds for investors to investment in. Advisors such as accountants, legal advisors, appraisers and tax consultants are involved in the process of setting up such funds. Depending on the relevant reporting rules, these costs are deducted from the results either as a lump sum or spread out over a specific period.

These costs should be designated to set up costs under the related investment category.

Administrative costs of asset management

Pension funds and/or asset managers may have outsourced their investment accounting to specialist companies. Any such contract should be consulted to verify whether or not the entire fee has been assigned in the relevant reporting year. Different methods may be used for assessing the fee. It may be a fixed fee, or it may be calculated on the basis of services. A combination of these two methods is also possible. These administrative costs are reported as 'other costs'.

Hedge funds and other market players use external specialised accountancy firms. These costs are also recognised to be administrative costs.

Accountancy and consultancy costs

Assets may be invested through an investment fund. Here too, the administration may be wholly or partially outsourced. For the sake of trustworthiness, an external accountant audits the annual accounts and/or records of the administrative subsystem. The related costs are stated under 'other costs'. These are therefore not auditing costs of the pension fund, but auditing costs of investments.

Valuation costs

On grounds of legal and regulatory requirements, investment entities that are not traded on a regulated market should also be assessed at fair value. In such cases the costs incurred by appraisers should be charged to the funds.

This generally applies to investments in real estate and infrastructure.

6.3.5 Performance fees

Performance fees can play a role in active investment strategies, and also in specific investment categories. Performance fees are typically awarded as remuneration for asset managers' exceptional performance.

Opting for an active investment strategy is generally aimed at generating a higher return. The pension fund can verify whether the choice of an active strategy was appropriate by comparing its return increase with the performance-related contribution to profit. This assessment generally takes place over a multiyear period.

Specific agreements between pension fund and asset manager are stipulated in a contract. For an adequate assessment of costs it is essential to be aware of the specific contractual provisions stipulating the time interval and benchmark as well as the assessment method.

Performance fees can play a role in every investment category. Assessing performance fees can be complex, due to unusual contractual provisions such as hurdles, clawbacks and catch-ups. The degree of complexity varies per investment category, as well as the timeframe of realisation and pay out. For regular equity mandates, performance fees can be realised

earlier than for private equity investments, where realisation takes place at end of the investment. Complexity increases because investments can be direct or indirect, and it is difficult to obtain the required transparency regarding performance fees, in particular with indirect investments.

Performance fees can fluctuate strongly, notably where high returns are generated. This may lead to complexity in communication since these high costs should be considered in relation to the higher return.

Agreements on provided services

Pension funds and asset managers can draw up agreements in various ways. Such agreements often relate to different types of investment categories. A few examples:

- benchmark: a public and independently calculated benchmark is selected as the reference point for measuring performance, notably in liquid categories like equities and fixed income securities. The performance fee is awarded if the asset manager outperforms the benchmark over a period of, for example, three years;
- high watermark: where the performance fee assessment is only awarded after the asset manager has made up for past underperformance;
- hurdle rate: an absolute and predetermined percentage return (or 'preferred return') must first be matched before a performance fee is considered. Granting a performance fee only comes into the picture after the preferred return has been exceeded, whereby in many cases the return made over several years is taxed in a year in which a performance fee is awarded;
- catch-up (notably with private equity): if the absolute return is achieved over several years, the agreed additional return is first allocated to the performance fee. This is done up to the point at which the asset manager has achieved its contractual portion of the total return over the same period, after which the remainder of the additional return is divided between pension fund and asset manager in the agreed proportion.

Allocation of performance fees to the report year (matching principle)

Performance fees generally have a duration of more than one year, and a period of six years or longer is no exception. The performance fee cannot finally be assessed until the end of the duration.

For the entire duration, a sum equivalent to the performance fee accrued up to that point should be reserved at all reporting dates. If an additional return has been achieved in any reporting year, the related performance fee should be attributed to that same year (matching principle). Depending on contractual provisions and investment performance, a previously acknowledged fee commitment may be negated in later periods.

During the course of this possibly lengthy period a performance fee may be awarded (possibly at a future date) in year one, or on the other hand, be settled or even refunded by the manager in question, in year two.

When determining an reservation for costs, the recommended procedure is to assume that the contract will expire at the end of the reporting year.

It is inherent to performance fees that the reservation may vary during the duration from 0 to 15-25% of the additional generated return.

6.3.6 Use of existing reporting standards

In recent years, partially reflecting a growing allocation of assets to alternative investment vehicles, organisations have emerged that have established reporting standards for that, and other, investment categories. In order to avoid the need for new additional reports, these organisations are used as much as possible. A key requirement is to ensure the use of correct definitions. Please refer to the appendices for cost definitions and reporting standards.

The DNB annual statement form J402 requires reports of management costs, performance fees and transaction costs for each investment category. The J402 form can be found in the appendices. DNB uses the same cost definitions as those set out in the Recommendations.

7

Recommendations on
Administrative Costs

Transaction costs

Transaction costs are the costs necessarily incurred in realising and implementing any (investment) transaction. They are not the costs paid to asset managers, but rather stock market fees and brokers' commissions, for instance.

Transaction costs are a troublesome category, as such costs are often implicit in an agreed 'net' transaction price and therefore hidden. The regulator requires asset managers to comply with the principle of 'best execution'. In that context, the way costs are defined already helps to keep costs per transaction low. Next to aiming to execute transactions at the lowest possible cost, pension funds' boards should seek to obtain a clear picture of total costs.

7.1 TYPES OF TRANSACTION COSTS

Transaction costs are directly related to the execution of a transaction. They can be split into the following three categories:

- 1 subscription and redemption costs for investment funds;
- 2 buy and sell costs for direct holdings in investment funds;
- 3 acquisition costs.

This definition relates only to buying and selling investments and/or participatory interests in investment funds. For example, in accounting for transaction costs the processing of corporate actions (dividend receipts, coupon payments) is not covered.

7.2 SUBSCRIPTION AND REDEMPTION FEES FOR INVESTMENT FUNDS

A large share of pension funds' invested assets is allocated to investment funds. By issuing participatory interests in these funds, investment funds provides asset managers with a simple and efficient procedure for investing the assets of numerous pension funds.

Pension funds 'pay' subscription and redemption costs when they allocate to or withdraw assets from these investment funds. Subscription and redemption fee rates (percentages) vary per investment category.

The percentage serves to cover the actual costs (estimated if needed) of executing transactions for allocation or withdrawal purposes.

7.3 CALCULATION OF TRANSACTION COSTS INCURRED IN INVESTMENT FUND

As already noted, 'a look through' must also be applied with respect to transaction costs incurred for investment funds. These costs relate to buying or selling of securities, acquisition costs within investment funds or, in fund-of-funds structures, subscription and redemption fees for the underlying investment funds. This recommendation applies from the 2017 financial year onwards. Earlier application over the 2016 financial year is recommended, and in that case this should be explicitly clarified in an explanatory note.

For 'look through' purposes, a correction is required for investment fund subscription and redemption fees. These fees contribute to the return of the investment fund. The 'look through' principle therefore requires a pro rata portion of these returns to be discounted against subscription and redemption fees already paid by the pension fund. The pro rata portion of the transaction costs will then have to be attributed to the pension fund.

An example: upon subscription into the investment fund on 1 January, a pension fund pays an subscription fee of 100. After entry, the pension fund holds a 20% participating interest in the investment fund, for the remainder of the reporting year.

In the same period, the investment fund carries out investments, paying 1600 in transaction costs. Total profit from subscription and redemption fees is 1000.

For the pension fund the pro rata portion of the returns and costs relating to the transaction are as follows:

Subscription fee	100
Returns on subscription (20%*1000)	(200)
Transaction costs investments (20%*1600)	<u>320</u>
Total transaction costs	220

This is a simplified example. In practice there are complicating factors such as fluctuation in the pension fund's participating interest in the investment fund or a failure to match subscription and redemption to underlying transactions (timing differences).

Another factor is that a precise attribution adds to the administrative burden of pension fund management. In fund-of-fund structures, the various tiers and allocation to the right period pose a further challenge, as costs have to be calculated several times.

It should also be noted that transactions executed in investment funds need not necessarily arise from the subscription or redemption of participating investors. They could also arise from changing the index that is being tracked, or from active trading in financial instruments. The costs related to these transactions are also allocated pro rata to the pension fund based on the 'look through' principle.

A simplified calculation method is possible, using a periodic rather than an individual transaction basis. In that case, the starting point is the average participation of the pension fund over a specific period.

If the fund's management cannot obtain reliable data because of administrative complexity or lack of available data, the pension fund may resort to mentioning the subscription and redemption fees. In that case the 'comply or explain' principle applies: the pension fund will be obliged to explain this in its presentation of transaction costs.

7.4 COSTS ON BUYING AND SELLING SECURITIES

Equities

In equities trading it is general custom that brokers invoice for transaction costs. These invoices relate to the actual costs to be paid on the broker's completion of a transaction. It is important to state the full costs of transactions in the appropriate financial year. Stamp duty should be included when assessing the total costs of equity transactions.

Transaction costs for mandates executed by external asset managers should also be stated under transaction costs.

Exchange traded funds (ETFs)

Exchange traded funds are baskets of securities designed to offer investors the same return as the underlying market. When an index appreciates, the value of the exchange traded fund follows suit. Here too, the buy and sell (transaction) costs should be taken into account. Brokers present periodic invoices for these costs.

Commodities

Commodities are customarily traded as derivatives. The transaction costs comprise the actual costs of Total Return Swaps and Future Index.

Fixed income securities

Generic formula

No costs are charged for transactions in fixed income securities; the costs are already incorporated into the transaction price (spread) and therefore have to be estimates.

An indication of transaction costs can be obtained using a formula that is relatively simple for pension fund's administrative organisations to apply.

The spread between buy and sell prices is divided by two and then multiplied by the transaction value.

As a formula:

transaction value * ((spread)/2) = estimated transaction costs.

The spread depends on the type of product and can be determined in three different ways:

- 1 the actual spread recorded per individual transaction;
- 2 on the basis of the average spread over the last complete quarter;
- 3 on the basis of a standard spread (market information).

Method 1 is the preferred way to calculate costs, i.e. by using the actual spread at the time of the transaction. To account for this efficiently, the required data should be accessible either in the records of the external

asset manager or in the internal systems. The methods used to establish total costs must then be clearly verifiable. If the cost of adapting administrative systems would be unreasonably high, the pension fund may decide to use a standard spread for the relevant investment type. It is recommended to indicate clearly which method of cost calculation has been used. Deviation between pension funds may result from the differences in their use of methods.

Interest rate derivatives

This heading relates to transaction costs on interest rate swaps and zero coupon inflation swaps. An average spread is calculated on the basis of the spread for the duration of the contract. The outcome is then multiplied at transaction level by the nominal value and the duration.

As formula: $\text{nominal} * (\text{spread}/2) * \text{duration} = \text{estimated transaction costs}$

FX contracts

Costs on concluding an FX (spot and swap) contract can be based on market data such as quoted spreads, or obtained on request from the counterparty or broker. Estimates may be used if necessary. These are based on the estimated number of basis points (bp) of costs for the relevant type of FX contract, multiplied by the nominal value and possibly the FX rate. The calculation is executed at transaction level.

The formula:

$\text{nominal value Euro 'foot'} * \text{bps} = \text{estimated transaction costs.}$

If no euro foot is applied to the FX transaction, the formula becomes:
 $\text{nominal value of one FX 'foot'} * \text{FX rate (at time of transaction)} * \text{bps} = \text{estimated transaction costs.}$

7.5 ACQUISITION COSTS

Generic calculation method

An extended process precedes direct transactions in illiquid investments. Advice and research by various recruited consultants, external or other-

wise, play a role. Here the acquisition costs (or 'transaction costs') include the costs of:

- Appraisers: appraisal/valuation of different investment entities that have to be assessed at current market value on the transaction date;
- accountants: examination of financial administration and annual accounts to verify the presence or otherwise of extraordinary items to be addressed;
- tax consultants: due diligence, focused on potential fiscal considerations related to the transaction;
- legal consultants: costs of legal consultants for assessing the structure and drawing up contracts.

This process does not invariably end in a transaction. But whatever the case the costs incurred are reported as transaction costs (broken deal costs).

Private equity

Next to the above-mentioned costs, distribution fees and discounts on management fees (voluntary fee waivers) are also recognised as transaction costs insofar as they result from transactions.

If costs are incurred for a transaction that is eventually called off, these costs are also accounted for as transaction costs (broken deal fees).

In private equity transactions a discount on management fees is not unusual, for example if a company preparing for a public offering on the stock market incurs costs (e.g. for investment in periodic reporting, organisational restructuring). The general partner who advises the company concerned may charge a fee for its own role in the process. This fee is credited to the general partner and in many cases will be entirely or partially offset against the management fee payable by the limited partners. These discounts (also known as management fee offsets) should be reported separately as transaction costs. In other words, the transaction costs are arguably reduced by these 'returns'.

Real estate and infrastructure

Real estate and infrastructure investments also come with specific costs attached. In addition to the costs referred to above, designated transaction costs in buy and sell transactions include:

- costs of the estate agent;
- costs of registration in land registry;
- costs of transfer tax.

B

Recommendations on
Administrative Costs

Appendices

Appendix 1 | Overview of cost type breakdown

The further breakdown of cost types and associated definitions in the table below can be an aid to securing uniformity. Pension funds may find it helpful when verifying whether they have identified the full range of administrative costs. The table is not intended as a communication tool.

Chapter allocation	Cost types	Costs	Definition
Pension management costs (chapter 5)	Administration	Collections	Activities on behalf of premium collection
		Payments	Pension payments
		Entitlement administration	Administration of accrued pension rights, value transfers
	Communication	Participant communication	Activities relating to legal commitments and other pension communication
		Employer communication	Communication with associated employers/sponsors
	Oversight & advice	Externe accountant	Remuneration of auditor
		Externe actuaris	Remuneration of certifying actuary
		Other advice	Financial, legal, or actuarial advice. Advice relating specifically to asset management are not included here.
	General costs	Administration Board	Administration of Board and committee fees
		Administration Office	Costs for an administrative office (if any)
		Supervisory costs	AFM and DNB expenses
		Other general costs	Memberships, conference attendance
	Asset management costs (chapter 6)	Fiduciary fees	Remuneration strategic advice
Risk management fee			Advice regarding risk management, balance sheet management, and potentially execution thereof; not pertaining to specific products such as mandates or investment funds.
Remuneration for fiduciary advice			Charges for the compilation of the portfolio, dynamic portfolio management, and the selection, implementation, and monitoring of asset managers.
Manager's base fees		Asset management fee	Remuneration to external asset manager for management of (discretionary) portfolios. Services covered by the asset management fee can include strategic inputs, investment advice, the management of assets and liabilities, the appointment of third party service providers, and reporting. The composition of the fee may vary per manager. The remuneration is largely based on the asset levels invested in a specific investment fund or discretionary portfolio.
→	→	→	→

Chapter allocation	Cost types	Costs	Definition
Asset management costs (chapter 6)	Manager's base fees	Fund management fee or Asset servicing fee	Remuneration paid to the external asset manager for the management of the investment funds. Services covered by the fund management fee include the day-to-day management of investment funds and portfolios, the administration thereof, reporting and communication with investors. The composition of the fee may vary per manager.
		Internal management costs	All expenses incurred for the internal management of assets. Among other things, this relates to personnel costs allocated to the asset management and facility costs of the internal apparatus.
	Custody & depositary fees	Custody fee	Fee charged by the custodian (the custodial company) for safekeeping of securities in a fund, payable by the fund.
		Depositary fee	In accordance with AIFMD appointed depositary. Fees for additional services by this depositary, next to safekeeping of securities.
	Other asset management costs	Incorporation expenses	Fees incurred for the establishment of funds or partnerships (entity in which is invested). Usually part of asset or fund management costs, although individual assessment of the fees is necessary if these are not transaction related.
		Auditing fees	Costs incurred for the auditing of financial statements or the issuance of a different type of assurance. The auditing expenses of the pension fund are not reported here; the auditing costs of the investments are.
		Administration costs	Remuneration paid to an administrator for the administration of assets and liabilities in the fund, and for other bookkeeping and reporting activities. Execution of administration of the investments may be outsourced to specialist companies by the pension fund and/or asset manager.
		Fiscal and legal consultancy fees	Fees for fiscal and legal advice not related to transactions.
		Other consultancy fees	Fees for services by external advisors that are unrelated to transactions.
		Bank fees	Fees charged by the bank for their services. This includes financing fees.
		General expense allocation	Regarding the allocation of general costs to asset management. Fees in connection with reimbursement to committees (audit committee, accountability body, investment committee), Board members, etc. Fees associated with the oversight of supervisory (internal) bodies or external organisations (such as AFM and DNB) relating to asset management.
		Other costs	Other costs that do not fall under the "other cost" categories, or are categorized as such. Also costs of small expenditures, such as petty cash. This also includes Other Fees and Fund Level Expenses of real estate funds.
	→	→	→

Chapter allocation	Cost types	Costs	Definition
Asset management costs (chapter 6)	Other asset management costs	Lending compensation	Compensation for the implementation of the securities lending activities to lending agent/custodian, and/or agent/asset manager.
		Technology costs	Expenses relating to the purchase and maintenance (or in-house development) of hardware and/or software (such as trading platform, risk management system).
		Market data costs	Costs for obtaining market data, or subscription fees for a databank.
		Research costs	Fees for research data, including attendance at research conferences.
		Management and/or secretarial fees	Management costs paid to members of the Board, including costs for secretarial support. (applicable to consolidated investment management entities).
	Appraisal costs	Fees for the estimation of investment objects by appraisers (primarily applicable to investments in property and infrastructure); not transaction-related.	
	Performance fees		The remuneration a service provider receives for outperformance. Carried interest provisions, such as those that apply to private equity, are also included.
Transaction costs (chapter 7)	Subscription and redemption fees charged by investment funds		Amounts charged to investors at the entry into or withdrawal from a fund (allocation or withdrawal of monies to an investment fund), in favour of the fund, the manager, and/or the already existing investors. The fee percentage is periodically established per fund.
	Fees arising from the purchase and sale of investments	Broker fees	The broker's fees for processing the transaction.
		Spread costs	Difference between the bid price and ask price with respect to the broker's various costs and profit margins. The fees are defined as half of the spread.
		Registration fees	Fees for processing and registering the transactions in the asset manager's administration.
		Transactional taxation	Tax levied over transactions of financial instruments. This includes Stamp Duty and the Financial Transaction Tax (FTT / dependent upon implementation: tax on all transactions in financial instruments that are traded between parties, in which at least one party is based inside the EU).
	Acquisition costs	Broken Deal expenses	An extensive deal process does not always lead to a transaction. The expenses incurred are nonetheless reported as transaction costs.
		Appraisal fees	Appraiser's fees for the assessment/implementation of valuations of different investment objectives which must be estimated against market value on transaction date.
Auditing fees		Audit fees for financial administration research and annual accounts, with the objective of ascertaining the existence of any particular focus points relevant to the deal.	
→	→	→	→

Chapter allocation	Cost types	Costs	Definition
Transaction costs (chapter 7)	Acquisition costs	Fiscal and legal consultancy fees	Tax consultancy fees for due diligence, with a focus on possible fiscal considerations attaching to the potential transaction. Legal consultancy fees for assessment of structure, as well as drafting contracts. This also includes the Acquisition and Disposition Fee for property.
		Other acquisition costs	Other consultancy fees, such as the expenses for technical advisors for regulation, traffic flow, wind studies, insurance, pensions, and (in most cases) a financial advisor working on a success-fee basis.
		Bank fees	Fees charged by banks for services relating to transactions or deals. This also includes the Financing Fee for property deals.
		Participation fee	Fees charged by the bank for participation in the underwriting of a loan.
		Bank/Broker fees	Charges for processing the transaction via bank or broker.

Appendix 2 | Different forms of reporting

The table below shows how the various forms of reporting relate to each other.

Principles Recommendations	DNB (J402)	RJ/BW2T9	AMvB/PW
Total costs	All asset management costs are included in principle.	Costs stated in annual accounts are identical to costs stated in the financial administration of the fund. Asset management costs comprise all costs incurred by the pension fund for management of investments, excepting transaction costs.	The heading relates to all costs incurred by the pension fund.
Look-through for investment funds	The 'look through' rule applies here.	No look-through applied in annual reports. The directors' report ...	No specific pronouncement.
Presentation of general costs	Costs relating to asset management are incurred by the pension fund (for example for the investment committee) and Board office, if any. These should be allocated to and reported under this heading.	No specific pronouncement.	Board costs fall under pension management in the first instance. Explanatory note states that costs relating to asset management are reported under asset management.
Performance related remuneration	The pension fund reports performance related remuneration (performance fees) separately.	No specific pronouncement.	Stated under asset management costs.
Transaction costs	The pension fund reports transaction costs separately (broken down into direct buy and sell costs for investment titles, and other transaction costs).	Annual accounts: Asset management costs should be verifiably deducted from investment result. Transaction costs may be offset against the related investment revenues. If and insofar as transaction costs can be reliably assessed, these should be clarified. If transaction costs cannot be reliably assessed, the reason and motivation should be clarified in a note.	The pension fund states transaction costs separately.
Costs per investment category	The pension fund breaks down asset management costs into investment categories.	Annual accounts: Investment results (and costs) should be stated under the various investment categories in conformity with paragraph 610.202. Directors' report: explains asset management costs and transaction costs, with specification per investment category. Any divergence with amounts stated in the annual report and annual accounts is also explained.	No specific pronouncement.
Matching principle	No specific pronouncement.	General point of departure in RJ is matching of revenues and income.	No specific pronouncement.
Alignment with Recommendations	DNB indicates that reporting should align with the Recommendations.	No reference to the Recommendations.	Aligns with Recommendations and DNB annual statement form.

Appendix 3

Examples from annual reports

The following passages taken from various annual reports are examples of how administrative costs are qualitatively clarified in explanatory notes. These may provide inspiration for drafting new texts for the directors' report.

Administrative costs of asset management

Asset management costs are currently a prominent issue of public debate. In absolute terms the financial resources involved are indeed substantial. The usefulness and necessity of these costs is frequently questioned. High performance fees in particular are called into question. The Board is well aware of the questions being aired in the public domain and has set itself the task of keeping costs as low as possible relative to the envisaged risk and return. Asset management costs should always be considered in relation to the return or extra return and risk. The Board makes choices along these three axes to arrive at the best risk-return ratio, after deduction of costs. Thus Pension Fund XXX opts for an active style of investment with the aim of achieving a return in excess of the benchmark after costs. The fund pays for this in the form of higher asset management fees and possibly performance fees. After these costs are deducted, Pension Fund XXX has effectively earned an extra YY billion for its participants over the past five years through this style of investment. Hedge funds are another case in point. Cost levels in this investment category are admittedly relatively high, but that is offset by stable returns, thus reducing risk exposure in the portfolio. After deduction of costs Pension Fund XXX booked an annual return of YY % on its hedge fund investments over the past five years.

As in previous years the only costs stated in the annual accounts are those that comply with the Guidelines for Annual Reports 610. Costs have therefore been set off against revenues. That means costs as stated in the annual accounts are lower than costs stated in this directors' report.

As noted earlier, when evaluating asset management costs it is not only the absolute level of reported costs that should be taken into account. Cost levels depend on investment policy, where costs are treated as relative to risk and return in accordance with the economic vision and investment convictions of Pension Fund XXX. The investment policy gives rise to an apportionment between investment categories (the investment mix) and investment style (active or passive).

Asset management costs are also dictated by the level of invested assets and the performance achieved. The cost drivers are explained below.

Level of invested assets

Cost levels relate largely to the total level of invested assets. The higher the assets under management the higher the costs will be in absolute terms. On the other hand higher invested assets can be expected to produce economies of scale. In 2014 Pension Fund XXX saw costs rise in absolute terms due to an upward trend in invested assets. But given the investment style and investment mix, costs fell in relative terms as a result of economies of scale and cost savings.

Investment method

Asset management costs are driven inter alia by the chosen investment style. The board has adopted an active investment style for the majority of its investments, with the aim of achieving a higher return than the benchmark. This investment style involved higher costs than a passive style that simply tracks the benchmark, for example. This may mean that while Pension Fund XXX incurs higher costs than other funds, it can expect to generate higher revenues for its participants. Over 2014 it outperformed the benchmark with a return of YY % (2013: YY %).

Achieved performance

Performance fees of YY million euros represent remuneration to external asset managers in return for an outperformance (possibly multiyear) relative to the agreed benchmark, and are paid from the extra return generated. Performance fees rose by YY million euros. A large portion of the YY basis points in performance fees related to private equity

(YY basis points), reflecting a good return over the 2014 year. For illiquid investments Pension Fund XXX had often drawn up agreements with many external asset managers regarding performance fees above a specific potential multiyear return. Such agreements may be based either on an outperformance relative to an agreed absolute return or to an agreed benchmark. By drawing up agreements on performance the fund creates what is known as an 'alignment of interest' with external asset managers. Costs relating to performance agreements should be considered relative to the extra return generated. Thus the higher performance fees in private equity compared to 2013 should be seen as correlating with the higher return booked on private equity in 2014, to the amount of YY % (2013: YY %).

The administrative costs incurred by a pension scheme are substantially driven by scale, both in terms of invested assets and in terms of total active participant and pension beneficiary numbers. But there are other contributory factors such as the complexity of the scheme and its asset management.

Pension fund XXX has a large number of early-leaver participants ('slapers') relative to active participant and pension beneficiary numbers. Pension fund XXX also performs services for early leavers, such as the administration of their pension entitlements, periodic communication and asset management. Costs incurred for the early leaver group are not included in costs per participant as defined in the Recommendations. That means the fund's costs per participant are pressured by the relatively low number of active participants as well as the continuing declining trend in that number reflecting the fluctuating composition of the XXX participant pool relative to the early-leaver group.

The fund moreover has some 40 different pension schemes, which adds to administrative complexity and thus impacts on cost levels. It also has high aspirations for the quality of its administration and communication, and that too tends to push up costs.

Asset management costs over 2013 at Pension Fund XXX were thus approximately equivalent to the percentage median of all participating pension funds in the Netherlands, but somewhat higher than its peer group median. Comparisons of asset management costs must take account of the policy pursued. In the past five years Pension Fund XXX booked a higher net annual return on average (a higher return after deduction of costs), namely X %, by comparison with either all pension funds in the Netherlands taking part in the study or with its peer group (both categories: X %).

Cost level is important, but not the only criterion. Pension Fund CC C may choose a more expensive asset manager for instance, in anticipation of a likely outperformance. Alternative investments like property and hedge funds are also relatively expensive, but they provide added value in terms of risk diversification and net return.

Pension management costs at Pension Fund CCC represent a relatively high level per participant by comparison with other funds of similar size. That is explained to some extent by the high service level for participants and an administrative organisation of relatively good quality.

Costs incurred in the area of auditing and risk management do not directly translate into higher revenues, but they potentially prevent losses or future recovery costs.

One reason for the possibly divergent cost levels compared with other pension funds is that Pension Fund CCC invests fairly heavily in investment categories like equities, property and hedge funds (alpha mandate) where costs are higher. A large proportion of these mandates are more-over actively managed, and active mandates are more expensive than passive mandates. That will potentially be recompensed by an outperformance. The composition of the Pension Fund CCC portfolio is based on a weighing up of risk, return and costs. Costs always come before revenues, and these costs are to a large extent fixed while revenues are uncertain. By spreading risks and investment categories Pension Fund CCC expects to generate a return even in periods when equities and

bonds underperform. Some of these categories involve higher costs, but if the strategy is successful that pays itself back. Cost comparisons alone do not suffice. Costs must be placed in perspective relative to risk-return profiles.

Alongside these direct asset management costs Pension Fund CCC incurs indirect costs. These derive from investment in private instruments and in funds, which may be invested in turn in other funds. Such undertakings often have complex legal structures. That makes it difficult to obtain clarity on all asset management costs in these categories. Indirect costs are offset against returns. In some cases we have had to make use of estimates to quantify these costs.

The third heading relates to transaction costs. Transaction costs are the costs necessarily incurred in arranging and implementing an investment or any other transaction. They are not the costs payable to asset managers, but rather stock market fees and broker's commission, for instance. This category of costs is difficult to differentiate because they are an implicit part of an agreed 'net' transaction price. These costs have thus also been offset against return.

Benchmarking

Administrative/asset management costs over 2013 at Pension Fund XXX are already known by benchmark party X as € AAA (2012: € AAA) per active participant and pension beneficiary; that is in line with the figure reported in the Pension Fund XXX annual report for 2013. Benchmark party X distinguishes two groups of pension funds with which the performance booked by our pension fund can be compared:

- the Netherlands median:
that is the figure exceeded by half of the pension funds in the Netherlands taking part in the benchmark study (in 2013: 24 and in 2012: 31 pension funds), while the other half obviously failed to achieve the benchmark performance. In 2013 this median figure was € XXX (2012: € XXX) per active participant and pension beneficiary;

- the peer group median:
in 2013 benchmark party X identified eight (in 2012: nine) pension funds deemed to some extent comparable with Pension Fund XXX as a separate (i.e. peer) group in terms of their characteristics and composition (in participant numbers, for example). In 2013 median administrative costs for this peer group were € XX. That compares with € XXX in 2012 for the nine pension funds forming the peer group in that year, consistently expressed as costs per active participant and pension beneficiary.

The tables below are examples of how administrative costs may be quantitatively presented in the directors' report.

Administrative costs	2015		2014		2013	
	x € 1.000	key	x € 1.000	key	x € 1.000	key
Pension management	1.234	€ 123	1.234	€ 123	1.234	€ 123
Asset management	1.234	1,23%	1.234	1,23%	1.234	1,23%
Transaction costs	1.234	1,23%	1.234	1,23%	1.234	1,23%

*) The key figure for pension management costs is expressed as costs per participant. The number of participants is defined as the sum of the average number of active participants and average number of pension beneficiaries in the relevant year. Asset management costs and transaction costs are presented as percentages of average invested assets. Average invested assets are calculated according to the Pension Federation definitions.

Asset management costs, difference between directors' report and annual accounts	2015		2014	
	x € 1.000	in %	x € 1.000	in %
Invoiced asset management costs	1.234	0,00%	1.234	0,00%
Allocated general costs	1.234	0,00%	1.234	0,00%
Costs as reported in annual accounts	1.234	0,00%	1.234	0,00%
Management costs treated as value adjustments in investments (investment)	1.234	0,00%	1.234	0,00%
Performance fees	1.234	0,00%	1.234	0,00%
Total asset management costs	1.234	0,00%	1.234	0,00%

Asset management costs per investment category	2015						2014		
	AIA* x € 1mln	costs x € 1mln	costs in bp	investment style			AIA'* x € 1mln	costs x € 1mln	costs in bp
				% active	% internal	% direct			
Fixed income 1				100%	100%	100%			0,00%
Fixed income 2									0,00%
Fixed income 3									0,00%
Fixed income 4									0,00%
Fixed income securities									0,00%
Investment cat. 1									0,00%
Investment cat. 2									0,00%
Investment cat. 3									0,00%
Etc.									0,00%
Total asset management costs									

Transaction costs	fixed	stated	estimated	total 2015		total 2014	
	x € 1mln	x € 1mln	x € 1mln	x € 1mln	in bp	x € 1mln	in bp
Investment cat. 1							
Investment cat. 2							
Investment cat. 3							
Investment cat. 4							
Etc.							
Total transaction costs							

Appendix 4

DNB reporting form

Annual statement 402, applicable from 2015 financial year

Specification income and expenditure account						
Amounts x €1,000						
		Gross payments	Frequency			
	Pensions paid					
1.1	Periodic pension payments					
1.2	Commutation					
1.3	Other lump sum pension payments					
1.4	Total					
		Internal costs	Procured from third party	Total		
	Costs (excluding asset management)					
2.1	Executive costs					
2.2	Administrative costs					
2.3	Consultancy & auditing costs					
2.4	Rental (incl. attributed rent premises in ownership)					
2.5	Total					
2.6	Active participants					
2.7	Pension beneficiaries					
2.8	Administrative costs as euros per participant					
2.9	Does your calculation align with amount under 2.8?					
2.10	What amount does your calculation give?					
2.11	Note on the difference					
3	Note on 'other income' and 'movement other provisions'					
	Asset management costs					
4.1	Have estimate methodologies been used?					
4.2	Note					
				Transaction costs		
		Management costs	Performance related costs	Transaction costs excl. buy & sell costs	Buy & sell costs	Total
	Costs per investment category					
5.1	Property					
5.2	Equities					
5.3	Alternative investments					
5.4	Fixed income securities					
5.5	Hedge funds					
5.6	Commodities					
5.7	Other investments					
5.8	Total costs attributable to categories excl. overlay					
5.9	Costs overlay investments					
5.10	Total costs attributable to categories incl. overlay					
	Other asset management costs					
5.11	Asset management costs pension fund and executive office					
5.12	Fiduciary management costs					
5.13	Custody fees					
5.14	Asset management consultancy costs					
5.15	Other costs					
5.16	Total other asset management costs					
5.17	Total costs asset management					
6.1	Average invested assets					
6.2	Asset management costs (excl. transaction costs) as percentage of average invested assets					
6.3	Does your calculation align with the percentage given at 6.2?					
6.4	What percentage does your calculation give?					
6.5	Note on the difference					
6.6	Transaction costs as percentage of average invested assets					
6.7	Does your calculation align with the percentage given at 6.6?					
6.8	What percentage does your calculation give?					
6.9	Note on the difference					
7.1	Note on asset management costs					
7.2	Note on divergence from income and expenditure account					

J402 Specification income and expenditure account

To be completed by: all pension funds

Last amendment to statement form: 2014

Last amendment of designation 1 January 2015

Introduction on J402

In this statement the pension fund submits additional information concerning a number of items in its income and expenditure account. If a fund submits a consolidated balance sheet, that is based, as in statement J401, on the consolidated income and expenditure account.

'Asset management costs' in this statement are broken down into the various investment categories. The statement is assumed to incorporate all asset management costs. These may be both invoiced costs and costs withheld from gross returns. The 'look through' rule applies here. The 'look through' principle is that asset management cost tiers should be fully broken down. In the case of investment funds or fund-of-funds vehicles for example, that means the costs of all intermediate investment tiers are identified right up to the ultimate investment.

The statement relates to net asset management costs. That means any discounts granted to the pension fund on costs charged in the investment fund must be netted out.

Reporting of asset management costs aligns with the revised version of the Recommendations (2013) which elaborates on recommendations for asset management costs as set out in the Federation's initial Recommendations of 2011 (*Pensioenfederatie 1*).

The breakdown of asset management costs under the various investment categories and any overlay investments should be aligned with the categories set out in quarterly statements. See the explanatory note in DNB quarterly statement form K201.

Question 5 consists of four columns. The first column relates to the breakdown of asset management costs over different investment categories and the second relates to performance fees. The third and fourth columns relate to transaction costs. Transaction costs excluding the direct buy and sell costs of investment titles should be submitted in the third column, and direct buy and sell costs of investment titles in the fourth column. Reporting buy and sell costs in column four is not obligatory, but is an option for pension funds willing and able to submit these data.

Explanatory notes

Questions 1.1 to 1.4: Pension benefits

The pension fund reports periodic pension payments, the surrender of small pensions and lump sum benefit payments. Reporting of surrender of small pensions should include both volume and frequency, in other words the number of times the fund has paid out a sum in respect of surrender.

Questions 2.1 to 2.5: Specification of costs

As well as reporting total costs (as required in statement form J401 at question 2.7) the pension fund reports a breakdown of costs excluding asset management costs according to the fund's internal functions. The breakdown also applies where activities are wholly or partially outsourced. Costs should be broken down into:

- management costs: costs of management, executive board, etc.;
- administrative costs: all costs relating directly to pension administration, including disbursement costs;
- consultancy and auditing costs: costs of actuary (internal or external), accountant, and any additional auditing and consultancy services;
- rental costs (including rent payable for own premises).

The fund allocates costs to one of the stated categories. Costs should be broken down into internal costs and costs deriving from outsourcing. All costs incurred in the area of outsourced activities (to employer, accountant, actuary and administrator) are reported as 'procured from third parties'. Internal costs comprise such items as costs of personnel directly employed by the pension fund, costs of premises owned by the pension fund and direct executive board costs (e.g. reimbursement of expenses). Any costs for internal activities that cannot be allocated to one of the above categories should be stated as fair estimates.

Question 3: Explanatory note

The pension fund provides explanatory notes on any figures submitted in statement form J401 in answer to questions 1.7 'other income', 2.2. 'movement in other provisions' and/or 2.8 'other charges'.

Question 4.1: Estimation methods

Some costs may not yet be known at the time of submitting the annual statement. In that case the fund states a best estimate and answers 'yes'.

Question 4.2: Explanatory note on estimation methods

If the pension fund has answered 'yes' to question 4.1 the explanatory note should provide data on:

- the categories for which costs reported are estimates;
- which specific items have been assessed on the basis of estimates;
- why these amounts are not (yet) known;
- the estimation methods used.

Questions 5.1 to 5.7: Costs per investment category

The pension fund breaks down asset management costs according to investment category. Allocation to investment categories should align with that applying in quarterly statements of investments (K201). The main categories in these quarterly statements match those in this annual statement form.

Costs per investment category break down into four columns: management costs, performance fees, transaction costs and buy and sell costs.

Column 1: state asset management costs (management fees) including custody fees. All asset management costs relating to investment categories not covered in columns 2, 3 or 4 should also be stated in column 1.

Column 2: state performance related remuneration (performance fees) for investments in each category.

Column 3: state transaction costs excluding buy and sell costs. These include in any event acquisition costs and investment fund subscription and redemption costs. Acquisition costs incurred for an investment category where no investment has actually taken place are stated under the relevant investment category. This heading also covers recruitment of an external transition manager.

Column 4 (optional): state the direct buy and sell costs of investment titles per separate investment category, if these figures are available and the pension fund is willing and able to submit them.

Mixed exposure

Costs incurred for a mixed investment fund and/or mandate should be stated over the various categories in proportion to exposure. Where the pension fund is exposed to no material risk in several investment categories a breakdown of cost types per mandate or investment fund suffices. Costs relating to an equities mandate with 1% of investments allocated to publicly listed property and 2% to liquidities need not be attributed specifically to costs for equities, property or fixed income securities, but may be stated under the relevant categories in proportion to the fund's holdings in these categories. For a mixed fund with 50% of investments allocated to equities and fixed income securities, costs should be attributed specifically to equities and fixed income securities.

Liquid assets

Costs relating to liquid assets held for margin liabilities or exposure to derivatives are stated under the investment category in which they are held. Costs for other liquid assets (such as a strategic allocation to cash) are stated (in accordance with K201) under costs for other investments, at question 5.7. An explanatory note should then be submitted at question 6.1.

Question 5.9: Overlay costs

Costs for overlay investments should - if possible - be allocated to an investment category and thus stated on the appropriate line (5.1 - 5.7). Question 5.9. relates to costs for overlay investments that cannot be allocated to any investment category (e.g. currency hedging costs). If a figure is stated here the pension fund should give further details of the overlay in question in the explanatory note on asset management costs (question 6.1.)

Question 5.11: Cost of asset management for pension fund and Board office

Pension funds (e.g. their investment committee) and their Board office, if any, incur costs relating to asset management. These costs should be allocated under this heading and stated as such on the form.

Question 5.12: Fiduciary management costs

Fiduciary management costs are not attributable to an investment category and should be stated here.

Question 5.13: Custody fees

Custody fees should preferably be reported under the relevant investment category at questions 5.1 to 5.10. If allocation to investment categories is impossible, a figure for total custody fees should be stated here.

Question 5.14: Costs of asset management consultancy

All costs incurred for consultancy services relating to asset management should be stated here. These may relate for example to a risk budgeting study, external asset management consultants or legal advice relating to asset management.

Question 5.15: Other asset management costs

This question relates only to costs that cannot be allocated either to an investment category or stated under other possibly more specific questions in statement form J402. These include costs for liquid assets that are not held against marginal liabilities or derivatives exposure. The area to which these costs relate should be specified in the explanatory note at question 6.1.

Question 6.1: Explanatory note on asset management costs

The pension fund should always submit an explanatory note if figures have been stated as 'other investments' (question 5.7) or 'other asset management costs' (question 5.15).

Similarly if a figure has been stated for 'costs overlay investments' (question 5.9), additional information on the overlay in question should be given here.

The pension fund should furthermore submit an explanation if asset management costs have changed significantly compared to the previous report period. For example: high costs in a new category reflecting non-recurrent start-up costs for investment in that category.

Question 6.2: Explanatory note on non-alignment with income and expenditure account

Total asset management costs may possibly diverge from the figure stated in the annual accounts (as entered in statement J401 at question 1.5), for instance where it is based only on invoiced costs. If total asset management costs stated at question 5.17 diverge from the figure for total asset management costs entered in statement J401 at question 1.5, the fund should submit an explanatory note on the divergence.

Appendix 5

Guidelines for Annual Reports

This appendix explains articles dealing with costs in Guidelines for Pension Funds 610. It is important to note the precise wording: if the article states that something 'should' be done, that is an emphatic instruction. If the verb is 'can' or 'may' it is not an emphatic pronouncement.

Paragraph 314

This states that asset management costs should be transparently deducted from the return on investment.

Transaction costs can be offset against the related investment revenues.

Transaction costs should be explained in detail if and insofar as they can be reliably assessed. Where reliable figures for transaction costs are unobtainable the reason and motivation should be given in a note.

Paragraph 315

Asset management costs encompass all costs incurred by the pension fund for managing the investment of its assets, except transaction costs. In the case of property it is advisable to distinguish between operating costs in property (including depreciation) and other asset management costs.

This is not an emphatic pronouncement.

Paragraph 316

Investment results (and costs) should be specified under the appropriate investment category in accordance with paragraph 202 of these Guidelines. The investment categories are property, equities, fixed income, derivatives and 'other'.

Attribution of costs is essential here.

Paragraph 317

This paragraph states that when specifying investment results (and costs) gross revenues from the various investment categories should be stated where asset management costs have been transparently deducted. If no reliable allocation can be made the reason should be given in an explanatory note.

That means an explanation should be given if reliable cost allocation figures are unobtainable.

Paragraph 503 relates to the Directors' Report

Besides complying with the substance of Guideline 400, the Directors' Report should include information on their conduct of affairs over the report year and their position at the balance sheet date in terms of legal requirements.

This includes a summary and explanatory note on the financial position of the pension fund and its development over the report year.

With respect to costs special attention should be paid to:

- internal and external developments in investments and returns stating the composition of returns before and after deduction of asset management costs and/or transaction costs;
- full clarity on asset management costs and transaction costs, with asset management costs and transaction costs specified per investment category;
- explaining any divergences between figures stated in the Directors' Report and figures stated in the Annual Accounts;
- full clarity on total pension management costs and management costs per active participant and pension beneficiary.

Appendix 6

Reporting standards for specific investment categories

STANDARDS IN THE PROPERTY SECTOR

The European Association for Investors in Non-Listed Real Estate Vehicles INREV

The mission of INREV is to share knowledge in the area of non-listed property. INREV also aims to promote transparency, exchange information on best practices and make non-listed property easily accessible and attractive to investors.

Investors in non-listed property are joining INREV in growing numbers. In a bid to avoid extra work, the terminology used in the Recommendations aligns with that used by INREV wherever possible. This means effectively that the particulars needed for reporting asset management costs and transaction costs can often be obtained from existing reports.

INREV is a European organisation. That means the same particulars should be obtained for investments in non-European countries. In such cases the types of cost recognised by INREV can be deemed reliable.

In the area of reporting INREV has drawn up a Standard Data Delivery Sheet (SDDS) that should be filled in quarterly by property managers.

INREV distinguishes between costs incurred by the investor and costs at fund level. INREV makes no distinction between asset management costs and transaction costs. However the INREV reporting modules cover all types of cost, in other words they comply with the 'look through' principle.

When assessing and reporting asset management costs in line with the definitions used in the Recommendations the following types of cost should be taken into account (adding the code reference on the INREV data sheet, version 3.0, in brackets).

See [https://www.inrev.org/library?task=article&id=2 20%20](https://www.inrev.org/library?task=article&id=2%20%20)).

Asset management costs for property (based on shareholding in the fund)

Investor level

- fund management fee (21.1) → service provision for use by the fund;
- asset management fee (21.2) → in respect of investment management, insofar as not included in the fund management fee;
- performance fee (21.3);
- financing fee (21.8), if unrelated to transactions;
- other fees (21.9).

Fund level

- fund level costs (5.7) → these include fees paid to the manager, and should thus not be duplicated with the investor level costs referred to above;
- set-up costs of the fund (4.2.10);
- contractual fee → fees payable during the term of a contract, often reserved costs (4.2.12).

Total asset management costs for property investments are equivalent to the sum of investor level costs and fund level costs.

Transaction costs for property

To report transaction costs in alignment with the definitions used in the Recommendations the following types of cost should be specified (adding code reference on the IMREV data sheet in brackets):

- acquisition fee (investor level portion: 21.5, fund as a whole 11.5);
- disposition fee (investor level portion: 21.6, fund as a whole 11.6);
- acquisition costs (stated as an asset) (4.2.11).

ROZ/IPD

The ROZ/IPD *Vastgoedindex* is an index of direct investments in property in the Netherlands. These guidelines are primarily intended for calculating returns from the various investment vehicles.

They explain how to treat costs for an adequate assessment of returns. A significant deviation from the Recommendations is that the index does not recognise transaction costs as a cost item.

REPORTING STANDARDS FOR PRIVATE EQUITY

The Institutional Limited Partners Association ILPA

In October 2011 ILPA issued best practices for quarterly reporting and margin calls. ILPA was set up by partners with limited liability (investors in private equity); in other words the general partners are under no obligation to comply with these standards. The underlying rationale was *inter alia* to standardise the diverse reporting practices within the branch in the interests of organising procedures more effectively. Another key motive was to respond to the growing demand for transparency.

These standards contain information that is required for the reporting of asset management costs.

Private equity involves additional types of cost and cost concepts. ILPA makes no distinction between asset management costs and transaction costs.

Asset management costs for private equity (based on shareholding in the fund) are:

- management fee of the fund;
- performance fee (carried interest), both the realised portion and the reserved portion;
- formation costs;
- fund costs (partnership expenses).

The general partner may deduct certain costs from the invoiced management fee; in other words the sum payable in respect of the management fee is reduced on grounds of an agreement that these cost are for the account of the general partner. These costs should include:

- consultancy costs;
- costs incurred for a transaction that ultimately fell through (broken deal costs);
- discounts on management fees;
- fees for supervision (monitoring and directors' fees);
- transaction costs.

These may be costs incurred by the portfolio company (the company in which the investment is placed) for activities carried out by the general partner. The portfolio company pays the general partner a fee for these activities, of which part is passed on to the investor as management fee offset.

In the interest of transparency these costs are reported separately to the pension fund Board. Here a distinction should be made between asset management costs and transaction costs.

ILPA periodically amends its standard reporting guidelines on grounds of trends in the branch. At the time of drawing up this document ILPA's proposed new fee reporting template was still a consultation version (<http://ilpa.org/ilpa-fee-reporting-template/>). The new template gives a more detailed account of cost categories. That can help investors to gain a better understanding of costs.

Invest Europe

Invest Europe, formerly the European Private Equity and Venture Capital Association (EVCA), represents investors in the private equity, venture capital and infrastructure sectors in Europe. Invest Europe has also issued Investor Reporting Guidelines (<http://www.investeurope.eu/media/431779/invest-europe-professional-standards-handbook-2015.pdf>) These guidelines of November 2015 also contain recommendations on the reporting of costs, broken down into the following categories (section 5 paragraph 3.5):

- fund management fee;
- performance fee (with carried interest), both the realised and the reserved portion;
- transaction costs and other costs;
- fund costs (fund operating expenses).

Reporting standards for hedge funds

The London-based Hedge Funds Standards Board published new standards in November 2015 at (<http://www.hfsb.org/sites/10377/files/Hedge%20Fund%20Standards%20-%20as%20at%20November%202015.pdf>). HFSB is

a standard-setting organisation for the hedge fund industry. Standards are a good mechanism for promoting transparency and creating a framework for integrity and good governance.

Hedge Fund managers are in principle obliged to comply with these standards. If compliance is not (yet) possible that should be made known in conformity with the 'comply-or-explain' principle.

Further details of fees and costs for asset management and other such areas can be found in the 'disclosures' section, which sets out the methodology for calculating asset management fees and performance fees, and includes an explanatory note on other costs incurred. Specific details of asset manager's fees are also explained. Fees to service providers and other expenses for the account of the fund are also reported.

Appendix 7

Literature

- Aanbevelingen Uitvoeringskosten, Pensioenfederatie, November 2011
- Aanbevelingen Uitvoeringskosten Nadere uitwerking kosten vermogensbeheer – herziene versie met aanvullingen, Pensioenfederatie, October 2013
- Aanbevelingen Vergoedingen vermogensbeheer, Pensioenfederatie, April 2015
- Kosten pensioenfondsen verdienen meer aandacht, AFM, April 2011
- AFM onderzoek naar jaarverslagen pensioenfondsen inzake kosten van vermogensbeheer en transactiekosten, AFM, July 2014
- Vermogensbeheer- en transactiekosten pensioenfondsen in beeld, AFM, mei 2015
- Uitkomsten onderzoek DNB en AFM naar vermogensbeheerkosten pensioenfondsen, DNB Nieuwsbericht, 31 March 2015
- Scale economies in pension fund investments: A dissection of investment costs across asset classes, Dirk Broeders, Arco van Oord and David Rijsbergen, DNB Working Paper No. 474, June 2015
- Principles for investment reporting, second edition, CFA Institute, 2014
- Guidance to effective investment reporting, CFA Institute, 2014
- Transaction Costs Disclosure: Improving Transparency in Workplace Pensions, Call for Evidence, FCA, March 2015
- Transaction Costs Transparency, Prepared for FCA by Novarca, December 2014
- Principes Fiduciair Beheer, DUFAS, April 2015

PF

Recommendations on
Administrative Costs

COLOPHON

The Federation of the Dutch Pension Funds would like to thank the committee on Accounting and Administrative Costs and Frits Meerdink (PGGM)

Editor

Mirjam Lammerts

Design

PutGootink