If you can not measure it, you can not improve it!

Sikko van Katwijk

Amsterdam, November 25, 2014
Agenda

1. Cost transparency: growing demand by institutional investors

2. Cost benchmarking: threat or opportunity?
Cost transparency: growing demand by institutional investors
Question 1

What were the operating expenses (as a share of total investments) of Dutch Pension funds, according to OECD in 2011?

A. 0.6 bp  
B. 0.5 bp  
C. 0.3 bp  
D. 0.1 bp
Onderzoek

Pensioenbeheer veel duurder

Pensioenfondsen gaven vorig jaar € 1,5 mrd meer uit aan vermogensbeheer

Kostenplaatje

<table>
<thead>
<tr>
<th>Kostenpost</th>
<th>Kosten vermogensbeheer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vermogensbeheer</td>
<td>€ 4,5 mrd</td>
</tr>
<tr>
<td>Administratie</td>
<td>€ 0,7 mrd</td>
</tr>
<tr>
<td>Transactiekosten</td>
<td>€ 0,9 mrd</td>
</tr>
<tr>
<td>Overige kosten (a.a. advies, control)</td>
<td>€ 2,3 mrd</td>
</tr>
<tr>
<td>Verdelingskosten pensioenfondsen</td>
<td>€ 1,0 mrd</td>
</tr>
</tbody>
</table>

Kamervragen over kosten pensioenfondsen

Pensioen is jackpot voor bankiers

Door Arno Reekers

Zakenbankiers uit de hele wereld hebben afgelopen jaar dik verdiend aan onze pensioenfondsen. Behalve de gebruikelijke vergoedingen voor hun werk zijn er miljarden overgemaakt voor buitengewoon goede beleggingsresultaten.

Alleen al de twee grote fondsen ABP en Zorg&Welzijn betaalden vorig jaar gezamenlijk €1,2 miljard aan bankiers en vermogensbeheerders naar aanleiding van "gerealiseerde extra rendementen". Dit bedrag van €1,2 miljard komt boven op de miljarden euro’s die pensioenfondsen sowieso betalen aan banken voor het beheer van aandelen, de transacties, adviezen en dergelijke.
Costs are inevitable

Cost breakdown

Execution costs
The difference in value between an ideal trade and what was actually done:
• Broker commissions
• Taxes
• Exchange fees

Middle office costs
Information technology resources:
• Performance measurement and attribution
• Collateral management
• Investment risk reporting

Backoffice costs
Administration and supporting resources:
• Clearing & settlements
• Investment Accounting
• Data management
• Corporate actions processing
• Proxy voting
Statement 1

What are your thoughts?

The risk of no transparency will result in a loss of (public) confidence
Recommendations for reporting costs

Cost transparency

Report the cost of pension management in euros per participant. The number of participants is the sum of the number of active members and pensioners.

Report the cost of the asset as a percentage of the average investments. Relate these costs to:

- the selected asset mix and the corresponding cost benchmark;
- returns over a longer term.

Report (possibly estimated) transaction costs separately as a percentage of the average investments.
Reporting in three cost types

Cost transparency

- Pension management costs
- Asset management costs
- Transaction costs
  - Transaction costs are part of the asset management costs
What are transaction costs?

Transaction costs = broker costs
Research costs are part of the broker costs and are charged to the end investor!
What are transaction costs?

Purchasing bonds of OTC-Derivatives

- Seller
- Bank
- Buyer

Price A ➔ Spread ➔ Price B
Question 2
What are your thoughts?

1. What are transaction costs for bonds or OTC-Derivatives? Half of the spread?
2. How to measure these costs?
3. What about bid/ask spread for equities?
Cost benchmarking: threat or opportunity?
Question 3
What are your thoughts?

How do you compare yourself with your competitors?
Do not compare apples and oranges

Cost benchmarking

Benchmarking

Create a benchmark (‘Universum’) that allows parties to compare their own costs with their peers on different levels:

- Peers
  - Based on size, type, number of employees or turnover
- Active/ passive
- Asset classes
- Financial instruments
Question 4
What are your thoughts?

Which Dutch province has, according to KAS BANK's own research, the lowest total cost?

A. Limburg
B. Utrecht
C. Groningen
D. Overijssel
Budgeting as the next step in cost benchmarking

Budgeting

Preparing budgets with cost targets (max.):

- Asset classes
- Adjustments of investment guidelines and implementation
- Procurement and reductions
- Increase predictability
Analyzing costs based on benchmarking results

Cost benchmarking

Analysis

Cost analysis focusing on specific themes. Examples include the following research themes:

- Research costs (brokers)
- Mutual funds vs. direct investments
  - Swaps vs. LDI-pools
- Best execution policies
First result of analyses
Cost benchmarking

Currency overlay mandate (before)

- Month based Fx Forwards
- EUR/USD
- Hedge ratio 100%
- Bandwidth 0%

Results:
- Approximately **300** transactions!

Currency overlay mandate (after)

- 3-Month based Fx Forwards
- EUR/USD
- Hedge ratio 100%
- Bandwidth +/- 10%

Results:
- Approximately **40** transactions
Statement 3
What are your thoughts?

The risk of complete transparency is a race to the bottom
More information

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