



# The AMBACHTSHEER Letter

Sustainable Pension Design • Effective Pension Management

June 2023

## DO YOU KNOW HOW MUCH IT COSTS TO RUN YOUR PENSION ORGANIZATION?

*“Many pension organizations around the world have expressed the need for a clear, comprehensive, and accessible set of guidelines for reporting organizational performance, including costs. **CEM Benchmarking** is working with a growing group of thought-leading pension organizations and industry associations to address this challenge. The goal is to create an integrated set of principles and standards we are calling the **Global Reporting Standards for Institutional Investors (GRSii)**.”*

CEM Benchmarking, May 2023

*“We treat cost management as a central tenet of our public accountability as we seek to maximize long-term investment returns.”*

CPP Investments, 2023 Annual Report

### Fostering Trust and Credibility

Stating the obvious, effective communications helps build a pension organization’s trust and credibility with its stakeholders. This publication has long been promoting the *Integrated Reporting Framework* as an effective tool to that end, most recently in the [April 2023 Letter](#) titled: “From *Integrated Reporting* to Value-Creating Organizations: How The Medium Is (Slowly) Becoming the Message”. The *Integrated Reporting Framework* guides pension organizations to regularly update their stakeholders through a 5-part narrative: Purpose, Governance, Business Model, Performance, and Strategy. This *Letter* digs more deeply into one of these five components: Performance.

Specifically, we report on the status of the *Global Reporting Standards for Institutional Investors (GRSii)* project being managed by *CEM Benchmarking*, and how your fund can participate in it. We also examine how *CPP Investments*, the top-rated fund in the 2022 *CEM-TOP1000FUNDS Global Pension Transparency Benchmark* protocol, actually dealt with reporting on Performance in general, and cost management in particular in its just-released 2023 Annual Report.

### The GRSii Project

*CEM* has working relationships with over 400 pension funds worldwide. In its own words, it provides “objective, actionable insights into how to maximize value for money in pension investments and administration”.<sup>1</sup> In that context, it is ideally-placed to play a leading role in creating “a clear, comprehensive, and accessible set of standard global guidelines for reporting organizational performance, including costs”. It notes that while some regions already have reporting standards for pension organizations, they are often limited in scope and non-comparable. Despite the fact that these regional standards make for a strong starting point for building the *GRSii*, further harmonization is needed to develop effective global standards for reporting and contextualizing performance.

To that end, the *GRSii* project is already underway:

- A 7-member Advisory Board drawn from thought-leading pension organizations has been formed.
- First drafts of the two cost modules (i.e., one for investing and one for pension benefit administration) already exist.
- Drafting the standard for the third module, investment performance, is next on the list, scheduled for completion in 2024.
- The drafting of these global reporting standards draws on already-existing regional and asset-related standards.<sup>ii</sup>
- Global standardization/integration of these reporting standards will enhance comparability, reporting synchronization, and the improvement of standard definition/calculation processes.<sup>iii</sup>
- The more rapidly pension funds around the world engage in this project, the sooner and greater the positive impact *GRSii* will have in benchmarking ‘value for money’ creation in the global pension sector in the years ahead.<sup>iv</sup>

While it is not possible to cram all the ‘work’ implications of bringing the *GRSii* project to a successful conclusion in this *Letter*, a listing of the 10 foundational principles on which the Investment Management Costs Module is based is instructive: 1. Timely Disclosure, 2. Estimate Missing/Implicit Costs, 3. Include Taxes Borne by Investors, 4. Include Non-Recurring Costs, 5. Convert to Local Currency, 6. Include Related -Party Costs, 7. Include Gross Management Fees, 8. Include Netted Costs, 9. Look-Through Investment Costs, and 10. Match Costs With Revenues. Some of these principles are aspirational, and will take time to fully implement. *CEM* is currently engaging institutional investors globally for feedback.

To facilitate this feedback process, *CEM* has provided an example in Table 1 of the differences between how investment costs are typically being reported by Funds in their Annual Reports today, versus how they are being calculated for the *CEM* benchmarking process, versus how they would be reported under the proposed *GRSii* standard. The Table 1 example is based on the experience of an actual Fund, with the actual \$ amounts proportionally adjusted to maintain Fund confidentiality.

**TABLE 1 Three Versions of Fund X Investment Costs in \$Millions**

	Annual Report	CEM	GRSii
Asset Management Costs			
• Base fees and Costs	\$500	\$665 <sup>v</sup>	\$675
• Performance fees	\$250	\$325	\$325
• Total AM costs	\$750	\$990	\$1000
• Transaction costs	\$125	Excl <sup>vi</sup>	\$250
Total Investment Costs	\$875	\$990	\$1250

Source: *CEM Benchmarking Inc.*

The message of Table 1 is clear. Many pension funds and other institutional investors are materially under-reporting their total investment costs today, and the *GRSii* initiative is warranted to address this problem. To learn how your Fund can participate in the *GRSii* project, please contact Chris Flynn or Edsart Heuberger at *CEM*.<sup>vii</sup>

## Cost Disclosure at CPP Investments

To study where the leading edge of cost and investment performance disclosure is today, we turned to the just-released 2023 138-page Annual Report of the organization that ranked #1 in last year's *Global Pension Transparency Benchmark* protocol: *CPP Investments*. The Report dealt with costs in two places. The Strategy section of the Report explains how the organization thinks about cost management, and the Performance section of the Report provides a detailed description of what its FY2023 costs actually were, why they were what they were, and how the outcome compares to the previous year.

The Report explains that, strategically, it is a matter of establishing the minimum base costs of operating an organization like *CPP Investments*, and then assessing the value-adding potential of various active strategies the organization could choose to pursue. Such strategies would consider choices such as private vs. public markets, developed vs. emerging markets, insourcing vs. outsourcing, leverage vs. non-leverage, and the structure of base vs. incentive compensation.

Table 2 below sets out *CPP Investment's* actual cost experience for FY2022 and FY2023. Note there are three broad expense categories: Operating (includes people and other internal expenses), Investment-Related (includes external fees, transaction costs, taxes), and Financing (includes interest costs on leverage, swaps gains and losses). Relating all this back to the *GRSii* project, we noted that its intent is to get all Funds to use the same expense categories and calculation methods, thus enhancing comparability and the power of benchmarking.

**TABLE 2 CPP Investments Total Expense Disclosure FY2023 and FY2022**

	FY 2023	FY 2022
Operating Expenses	\$1540M	\$1428M
Inv-Related Expenses	\$3826M	\$4539M
Financing Expenses	\$2355M	-\$16M
Total Expenses	\$7721M	\$5951M

Source: *CPP Investments* Annual Report, 2023

It is essential to also express these expense disclosures in relation to the dollar value of the assets being managed. So, for example, *CPP Investment's* FY-end asset value was \$570B, and hence its full expense/assets ratio was 1.35%, and the expense ratios for Operating, Investment-Related, and Financing were 0.27%, 0.67%, and 0.41% respectively.<sup>viii</sup> By way of comparison, the most recent median total investment expense ratio in the *CEM* database was 0.70%, with the 10%/90% range spanning from 0.28% to 1.41%. However, as noted in Table 1 above, the *CEM* cost numbers do not include transaction and financing costs, and hence understate total investment expenses. Once again, this demonstrates the need for an agreed-upon *GRSii* standard.

## Beyond Cost Benchmarking

We noted earlier that standardizing the calculation of investment expenses is only part of the *GRSii* project. A standardized approach to the calculation of investment performance is also needed. How can we assure that calculated investment performance results are truly comparable? The *GRSii* project has some way to go before it addresses this follow-on question. Meanwhile, we can have a look and see how *CPP Investments* addressed the investment performance disclosure question in its FY2023 Report.

The *CPP Investments* Report explains that the intent of its investment program is to outperform a simple passive implementation of its investment policy, net of the expenses that will be incurred implementing it.

The explanation begins with an assertion that a simple 50% global equities-50% Canada bonds investment policy is an appropriate starting point, given the intent and design of the *Canada Pension Plan*. However, the organization also believes that targeting a higher-risk 85-15 mix would likely generate additional investment return without subjecting Plan participants to undue risk.<sup>ix</sup>

The Report lists two additional strategies that the organization believes would increase the long-term return above that of a passively-implemented 85-15 asset mix, net of expenses: 1. Diversification/leverage strategies that improve the Fund’s reward/risk ratio, and 2. Active strategies related to investing in both public and private markets across the globe. Table 3 sets out the five-year results reported in the FY2023 Report.

**TABLE 3 CPP Investments 5Yr Investment Performance Results**

Actual Fund Return net of Expenses	7.9%/yr
50-50 Reference Portfolio Return	4.6%/yr
Total Net Value-Added	+3.3%/yr
Net Value-Added from Higher Risk (85-15) Decision	+2.5%/yr
Net Value-Added from Active Strategies	+3.0%/yr
Net Value-Added from Diversification/Leverage Strategies	-2.2%/yr

Source: *CPP Investments* Annual Report, 2023

Once again, it is interesting to look at the most recent 5yr Total Net Value-Added results in the *CEM* database. The median value was +0.4%/yr, with the 10%/90% range spanning from -0.4%/yr to +1.5%/yr. The most comparable *CPP Investments* result is the combined net value-added impact of its Active and Diversification/Leverage Strategies: 3.0%-2.2% = +0.8%/yr.

**In Conclusion**

We started this *Letter* by posing the question “do you know how much it costs to run your pension organization?” We close by suggesting that until we have a Global Reporting Standard for Institutional Investors that all Funds adhere to, the only really honest answer to the question is: ‘no, not really’.

*Keith Ambachtsheer*

Endnotes:

- i. I was a CEM (short for Cost Effectiveness Measurement) cofounder in 1991 and continue to be a CEM shareowner and Board member today.
- ii. These already-existing regional/asset class reporting standards are extensive: GIPS, IFRS, UK (CIPFA, CTI), EU (EIOPA), NL, AUS (RG97), PRIVATE EQUITY, REAL ESTATE.
- iii. There is an assessment rubric that allows Funds to self-assess rather than hire outside auditors.
- iv. The implementation time is purposely staged to give Funds a chance to adapt.
- v. Excludes certain investment vehicle costs which are not provided on a consistent basis.
- vi. Transaction costs are excluded from CEM’s core analysis as few Funds provide them on a consistent basis.
- vii. [Chris@cembenchmarking.com](mailto:Chris@cembenchmarking.com), [Edsart@cembenchmarking.com](mailto:Edsart@cembenchmarking.com)
- viii. The *CPP Investments* Annual Report reports a slightly higher 0.286% cost number for operating expenses because it used slightly lower average Fund asset value over the course of FY2023 rather than the year end value of \$570B.
- ix. The decision to enhance CPP benefits has complicated these calculations, as *CPP Investments* has chosen to institute a different investment policy for the accruing assets related to the additional CPP benefits.

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