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UPDATE OF IOPS WORK ON FEES AND CHARGES

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ABSTRACT

A primary objective of the paper was to update the charge ratios for the countries that originally participated in the 2008 exercise, while looking at the historic trends of both fees charged by pension funds to members and the operating expenses of pension funds.

The paper also attempts to bring a fresh view on the issue of international fees comparison. Previous work tried to explain fees variation across different jurisdictions by taking into consideration factors such as GDP, ratio of total pension assets to GDP, the mandatory or voluntary nature of the retirement system, etc. However, the results of such research have not been conclusive, in part because of the data challenges of cross-country comparisons.

This paper tries instead to explain the evolution of fees within countries, comparing the level in 2012-13 to that of six years ago by taking into consideration the reforms that jurisdictions have enacted since 2008, the year of the previous research.

Keywords: charge ratios, fees and costs, pension funds, regulation, government policy

JEL codes: G23, G28

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UPDATE OF IOPS WORK ON FEES AND CHARGES[1]

I. Introduction

The growing role of private pension systems and the ongoing shift from defined benefit (DB) to defined contribution (DC) have turned fees and charges into a major concern for pension supervisory authorities. This is because these fees and charges have a significant impact on the amount of retirement income delivered to individuals.

In the past, when DB plans were widespread, management costs did not impact plan members directly, as they had a promise on the level of pension they would receive. Members were not expected to pay for the running costs of the plans. However, costs still held a high level of importance, particularly to the plan sponsor, who would in most cases be responsible for meeting the costs. In DC (and some hybrid) plans, where each individual saves for his or her own pension, members are typically charged a fee for administration and asset management services, although in some occupational arrangements employers bear management costs. These costs can have a substantial negative impact on future retirement income.

Comparing fees and charges across jurisdictions is a difficult task for a number of reasons:

- one challenge in such comparisons is the different reporting methods for fees and costs across jurisdictions, and the extent to which reported fees, costs and expenses include the same elements (e.g. fees charged by investment funds in a pension fund portfolio).

- the structure of fees differs across jurisdictions. Pension funds may charge fees on assets under management, fees on flows, fees on contributions, fees on returns, fees on salaries etc. These expenses may be chargeable by differing parties (the fund, the administrator, other service providers) and paid by either the pension fund, the contributing member, an employer or out of underlying investment capital.

- since the designs of pension systems are different from one another, pension funds may be required to perform quite different tasks. Hence, fees and charges may be used to finance different services and/or products. This means that even where data may be comparable, raw figures might not accurately reflect whether fees are high or low. A higher fee could be explained because it is used not only to provide asset management services, but also collection, recovery and payment services, unemployment or disability benefits, insurance, etc.

- the maturity of the pension system in question – the structure of pension managing companies' income in a newly established market may be substantially different to the fees structure in the developed market. For example, upfront fees in the former and management fees in the latter may have the biggest importance.

The diverse charges and the specific details involved in every single case make it difficult to directly compare pension fund fees and charges internationally. Such comparisons are particularly challenging and the caveats need to be carefully understood.

A primary objective of the research undertaken here was to update the charge ratios[2] for the countries that originally participated in the 2008 exercise (Hernandez and Stewart, 2008), while looking at the historic trends of both fees charged by pension funds to members and the operating expenses of pension funds. The research also attempts to bring a fresh view on the issue of international fees comparison. Previous work, which we reference further on, tried to explain fees variation across different jurisdictions by taking into consideration factors such as GDP, ratio of total pension assets to GDP, the mandatory or voluntary nature of the retirement system, etc. But the results of such research have not been conclusive, in part because of the data challenges of cross-country comparisons. This paper tries instead to explain the evolution of fees within countries, comparing the level in 2012-13 to that of six years ago by taking into consideration the reforms jurisdictions have enacted since 2008, the year of the previous research.

The paper contributes to the literature by providing updated information about the pension funds fees level, their structure and recent developments. The key findings of this paper are as follows:

- complicated fee structures impede the ability of pension fund members to compare the costs of pension funds;

- the proper design of the pension system assures a high level of transparency of fees and of the quality of the pension services so that the members can properly compare pension fund providers;

- imposing fee caps aimed at lowering the costs can have unintended effects;

- some innovative approaches towards better transparency and lower fees may employ the fee auction mechanism (pioneered by Chile) or mandated cost indicators;

- charge ratios can help in cross-country cost analyses, however, a generalized comparison of charge ratios across countries, without taking into consideration numerous differences (outlined in section III), would lead to substantially misleading conclusions.

The paper is structured as follows: section two puts fees in the context of 'value for money' and provides a history of previous work on comparing fees across different jurisdictions. Section three, based on the data submitted by members, looks at the nominal charges and their underlying components reported by members to be in place. Section four briefly explains the methodology of the charge ratio (detailed methodology is referenced in the previous version of this paper). Section five provides a summary on the historical trends that fees charged to members have followed over the years. The detailed information about these trends as well as changes in pension funds' operating expenses is presented in the Annex at the end of this paper. Section six presents and analyses the 2012/13 calculations of charge ratios, done for three time horizons of accumulation period (40, 30 and 20 years, respectively). The last part concludes.

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[2] **Charge ratio** measures the impact of administrative fees on the final balance of investment. It can be defined as **1 – Y/N** where Y is the actual value of the retirement account (with all charges/fees borne by the saver) and N is the final value of the same retirement account assuming there are no charges/fees at all. See more in paragraph 26.

II. Fees and 'value for money'

1. How do charges influence the final retirement balance?

Depending on how they are set, fees can reduce the net contribution paid into the individual account or the assets accumulated. As noted by Whitehouse (2001), an increase in the annual management charge of 1% of funds under management can reduce accumulated assets by as much as 20% (over a 40 year period). Therefore, the impact of fees can be substantial. Seeking to ensure that costs are not excessive and are fully and transparently disclosed is therefore an important aspect of DC supervision.

Inevitably, in DC pension systems, an argument can be made that one should not look at fees in isolation but rather compare costs, performance and quality of service indicators jointly. A provider could charge fees above its peers but if it also achieves a better investment performance or delivers a higher quality service, the extra costs could be warranted. For instance, as argued by Tapia and Yermo (2008)[3], asset allocation affects the level of charges. Investment in interest-bearing assets, such as deposits and bonds, are generally cheaper than investment in equities, while passive investment is cheaper than active investment. The cost of domestic and foreign investment may also differ. Fee comparisons between providers and across countries need to ultimately take into account the possible links between these three indicators: fees, performance and quality, leading to a measure of 'value for money' of the DC provider.

IOPS WP No. 15 asks the question whether higher costs signify a 'better' pension – either in terms of higher returns being delivered to members, or in terms of quality of service, but it concludes "studies have not shown that to be the case" and argues for "publishing compliance on a net return basis[4]".

Administrative and other charges are not always explained clearly to pension fund members. Even if they were, the impact might not be fully understood as people tend to be relatively unsophisticated when it comes to analysing costs and returns over the long term[5].

On the other hand, competition should drive costs and hence charges down. That is, it should be possible for market forces to allow fund contributors to choose the best option (which will probably involve a combination of costs and returns). However, this does not happen in many jurisdictions given the reasons outlined above.

2. Previous work on charges

A small number of publications have previously compared fees across different jurisdictions.

One such publication is Tapia and Yermo (2008), which focuses on the fees that are charged to individuals in the accumulation stage of mandatory, defined contribution pension systems. In making a cross-country comparison, the paper measures the ratio of annual fees to assets under management and focuses on the experience of Latin America, Central and Eastern Europe (CEE), Australia, and Sweden. The indicator used is a simple cost measure, 'a purely accounting figure that does not involve any projections'. The results of the analysis show that the structure of fees adopted in the countries under study

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[3] Tapia, W. and J. Yermo (2008), "Fees in Individual Account Pension Systems: A Cross-Country Comparison", OECD Working Papers on Insurance and Private Pensions, no. 27, OECD Publishing.

[4] See IOPS WP No 15 (2011), "Comparative Information Provided by Pension Supervisory Authorities".

[5] They tend to use so-called "hyperbolic discounting", i.e. show preference for results that arrive sooner rather than later, irrespective of their true real value.

is fairly complex. Fees are influenced by many factors, including the size and the maturity of the system, market structure, competition, investment strategy and regulations.

A 2001 paper written by Edward Whitehouse compares charges for funded pensions and it uses the concept of charge ratios, a concept that is used in this paper and in its 2008 previous version.

According to this author, the empirical evidence showed very different charge levels between countries with relatively similar systems, namely those based on individual accounts with individual (or, in some cases, employer) choice of provider. The average charge varied from less than 15% to more than 30% of the value of the final pension savings. The countries with the most liberal policies on charges (i.e. with no restrictions on level of fees) did seem to have relatively high mean charge levels, but the evidence was far from definite[6].

In the exercise of comparing fees internationally, undertaken in the current paper, the IOPS analyzed several sets of data consisting of:

- <u>nominal fees and expenses</u> that are in place in different jurisdictions and their underlying components;

- <u>historical trends of the fees</u> that pension funds charge to members or are charged by providers to the funds – collected by the IOPS in order to highlight the dynamics incurred by these fees in different countries;

- <u>operating expenses</u> – collected by the OECD/WPPP to update the Global Pensions Statistics;

- <u>charge ratios – collected by the IOPS with the aim of providing a relevant comparison among countries</u> and to update WP No. 6.

III. Charges in different countries – overview and explanations

Recognising the limitations in cross-country comparisons, Table 1 summarises maximum fees (where prescribed by law) and average fees for member countries. A third category, described in Table 1 as 'others', provides information on country-specific exceptions.

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[6] For further details see Whitehouse (2001).

Table 1. Fees charged by pension funds in various jurisdictions

Country	Report Year	MAXIMUM fees on (%)					AVERAGE fees on (%)					Notes
		Contributions	Salary	Assets	Returns	Other	Contributions	Salary	Assets	Returns	Other	
Albania	2013			3.00					2.40			Market average fee by assets.
Botswana	2010			0.60								
Bulgaria (2nd pillar)	2012	5.00		1.00		BGN 20	4.97		1.00			Other: transfer fee.
Bulgaria (3rd pillar)	2012	7.00			10.00	BGN 20	2.75			9.43		Other: transfer fee, entry fee, early withdrawal fee and additional information fee.
Chile	2012		N/A					1.42			1.26	Other: Insurance as a percentage of salary for independent and voluntary worker. Average weighted by number of contributors.
Colombia	2012		1.31			1.70						Other: Insurance as a percentage of salary.
Costa Rica	2013			1.1 (2017: 0,35)								
Croatia (2nd pillar) (1)	2012	0.80		0.65 (2013: 0.45)		0.80						Other: exit fee (for mandatory funds charged only if changing funds when having less than 3 years of membership).
Croatia (3rd pillar) (2)	2012						8.00		2.00		10.00	
Czech Republic (3)	2013			0.60	15.00				0.60	15.00		
Dominican Republic	2012		0.50		30.00	1.00						Returns: over local bank average rates, Other: Insurance as percentage of salary.
El Salvador	2012		2.20					1.10			1.11	Other: Insurance as a percentage of salary.
Estonia (4)	2011			1.20 / 2.00					1.49			
Ghana	2011			2.50								
Greece (5)	2011								0.90			
Hong Kong (6)	2013								1.70			
Hungary	2013	0.90		0.20								The Central Bank of Hungary calculatees charge ratios (fee components related to assets).
India	2013	0.25		0.25		Rs 225						(In Rupee) Opening charges: 150; Record keeping: 225.
Israel	2012	6.00		0.50			3.80		0.33			
Kazakhstan	2011				15.00							
Kenya	2010								0.36			
Latvia (7)	2012								2.00			
Lithuania (8)	2013	2.00 (2016: 0)		0.65 / 1.00		0.05	1.86		0.65 / 0.99			Other: fee on transfers. Simple average fee.
Macedonia	2013	4.00 (2020: 2.00)		0.54 (2020: 0.36)		EUR 15	4.00		0.54		EUR 15	Other: transfer fee for people switching earlier
Mexico	2012			1.50					1.38			
Namibia	2011								0.85			
Panama (SUMEVAL)	2012			2.50					2.50			
Panama (SIACAP)	2012			0.30					0.30			
Peru	2013							1.62			1.23	Other: Insurance as a percentage of salary.
Poland (9)	2011	3.50		0.60			3.50		0.46			
Romania (2nd pillar)	2012	2.50		0.60		5.00	2.50		0.60			Other: transfer fee for people switching earlier
Romania (3rd pillar)	2012	5.00		2.40			4.58		1.79		0.21	Other: transaction fees, audit fees, depositary
Russia	2010			0.40								

Country	Report Year	MAXIMUM fees on (%)					AVERAGE fees on (%)					Notes
		Contributions	Salary	Assets	Returns	Other	Contributions	Salary	Assets	Returns	Other	
Serbia	2012	2.27		2.00								
Slovak Republic (2nd pillar) (10)	2013	1.25		0.30	10.00		1.25		0.30	10.00		
Slovak Republic (3rd pillar) (11)	2013			0.90 - 1.80	10.00	5.00			0.90 - 1.80	10.00	5.00	Other: fee on transfers.
South Africa	2010								0.39			
South Korea	2011								0.70			
Spain (occupational)	2012			2.00		0.50			0.21			Other: custodian fees.
Spain (personal)	2012			2.00		0.50			1.39			
Turkey (12)	2013	2.00		1.09 - 2.28		10.0	N/A		2.00		N/A	Other: exit fee (charged only for a maximum period of 10 years) and entrance fee; the cap for these types of fees is 10% of the monthly gross minimum wage.
United Kingdom (13)	2011			1.50					N/A			
Uruguay	2012		1.77			1.40						Other: Insurance as a percentage of salary.

Notes:

1. In the mandatory system, exit fees are equivalent to 0.8% of the individual account for exiting in the first year of membership, 0.4% for exiting in the second year of membership and 0.2% for exiting in third year of membership.

2. In the voluntary system, the contribution based fee and exit fee depend on the number of years of membership or the amount of contributions. Open voluntary pension funds can charge a sum of up to HRK 1500 for the first contribution and up to 8% of every contribution, thereafter with a maximum HRK 400 annually. The asset management fee amounts to a maximum 2% of the total pension fund assets. Closed voluntary pension funds charge up to 2% of every contribution, but no more than HRK 400 annually. The asset management fee amounts to a maximum 1.6% of the total pension fund assets.

3. The figures correspond to the maximum statutory fees for transformed funds from January 2013.

4. The value of 1.20% refers to conservative funds, while the value of 2.00% refers to all other funds.

5. These fees are fixed and contain only entry fees. The provided figure represents an average for the occupational pensions in Greece.

6. The figure refers to the average Fund Expense Ratio ("FER") of MPF constituent funds as of December 2013.

7. The composition of fees and charges varies significantly between different pension schemes. Some of the schemes provide charges deducted from contributions, while others use average assets as a basis for calculation. Also, sometimes 'assets under management' charges are deducted from return on assets. Therefore each scheme has its own structure and these are not comparable. The average fee provided is calculated at the level of the whole pension system.

8. The value of 0.65% refers to conservative funds, while the value of 1.00% refers to all other funds.

9. 0.8 percentage points out of the fee on contributions is charged by the Social Insurance Agency.

10. 0.25 percentage points out of the fee on contributions is charged by the Social Insurance Agency.

11. The figures correspond to a maximum that pension funds can charge. Fee of 0.90% and 1.80% can be charged out of the average net annual value of pay-out and contributory supplementary pension fund´s assets, respectively.

12. The values 1.09% and 2.28% refer to the maximum fees on assets of liquid funds and stock funds respectively. The maximum fees on assets of other funds are included in this range.

13. This represents a statutory cap on annual management charges for one type of personal pension arrangement, the stakeholder pension plan. Other than for stakeholder pension plans, there is no statutory limit or cap on charging in the UK. Average figures are not available as TPR does not collect information from schemes.

Source: Supervisory authorities' data, IOPS, OECD, World Bank.

The numbers show the variety of charges applied in different jurisdictions. While there is a tendency of countries from a same region (i.e. Latin America, Central and Eastern Europe, etc.) to have comparable ways of charging individuals because they have a comparable structure of the pension system, these particularities can vary greatly across wider geographical regions.

The information contained in the table clearly shows that in many situations where a legal cap on fees exists, the market average coincides with the legal maximum fees. This shows that these legal requirements are not very efficient in incentivising market competition. One can observe this especially in the mandatory systems, while in voluntary systems, there seems to be some degree of competition or at least some variation from the legal maxima.

A further complication in both domestic and cross-country fee comparison is that some types of fees and charges are levied directly against the contributing member (out of salary), some are deducted against the contribution (contribution-based charges) and some are indirect, deducted out of the assets of the pension fund itself, thus reducing the value of the fund to members. This means that ultimately these fees are borne by members as well, but cannot be attributed for each and every single member, making the international comparison even more difficult. The table below reflects what underlying components are included in the data upon which charge ratios were calculated. This exercise clearly shows the challenges involved in the international comparison of fees, and is also useful for identifying similarities and differences across systems.

Table 2.   Cost and fee elements incorporated in charge ratio (CR) calculation process and ascending degree of underestimation of the final CR numbers

Country	Plan/scheme administration fees	Investment management fees, for:		Custodian fees	Investment transaction costs	Guarantee fees	Other	Under-estimation of CR
		primary funds only	underlying funds					
Albania	●	●	●	●	●		●	
Israel	●	●	●	●	●			
Hong Kong	●	●	●	●		●	●	
Bulgaria	●	●	●	●			●	
Turkey	●	●	●					
Panama	●	●		●	●			
Peru	●	●		●	●	●	●	
Chile	●	●		●	●	●	●	
Romania	●	●		●	●	●		
El Salvador	●	●		●	●			
Czech Republic	●	●		●	●		●	
Hungary	●	●		●		●	●	
Macedonia	●	●		●			●	
Mexico	●	●		●			●	
Colombia	●	●		●			●	
Spain	●	●		●				
Croatia	●	●			●		●	
Costa Rica	●	●					●	
India	●	●					●	
Poland	●	●					●	

Notes: A cell marked with '●' means that the fee component **is included** in the charge ratio calculations.

A **blank** cell means that the fee component **is not included** in the charge ratio calculations.

A **crossed** cell means that the fee component **is not applicable** in the jurisdiction.

Other types of fees: audit fee, marketing fee, legal fee, etc.

For the following countries: Bulgaria, Croatia, Poland, and Romania, the table above refers to the second pillar only.

Source: Supervisory authorities' responses.

The table has been tentatively sorted in the descending order of the extent to which the underlying data incorporate the full range of fees, charges and expenses that ultimately affect member benefits. Obviously, the ordering in this table must be somewhat discretionary as it is subject to subjective assessment. Due to the diversity of cost positions in the countries, it seems impossible to design a more 'scientific' approach. In this way Albania has the most inclusive estimation of the charge ratio and we can assume that the charge ratio is an accurate reflection of how much the assets accumulated by a member of the Albanian pension system would be reduced by the totality of fees, charges and expenses compared to a scenario where no fees would apply. On the other hand, the group of countries at the bottom of the table have the least inclusive estimations of the charge ratio because fees related to outsourced management (underlying funds), custodian fees and investment transaction costs were not taken into account when calculating the charge ratio.

As a general rule, if a certain cost does not constitute an explicit fee and is paid from the net asset value[7] of pension savings, then we considered it as not included in the explicit fees used in calculating the charge ratio. This is because in such a case, the member will bear the cost indirectly, by having this charge deducted from the net asset values of his or her fund. This cost cannot be attributed individually for each member or (in case of individual accounts) it can be attributed but such an operation would require some detailed data and calculations. On the other hand, in some jurisdictions, it is the pension company (administrator of the pension fund) that pays some of the fees listed in the table above such as custodian fees, transaction costs, audit fees, etc. In such cases, we considered that these fees are included in the explicit fees because, from the member's point of view, he or she does not suffer a further diminishing of assets by paying indirectly for these services.

Having entirely comparable data is not possible, as demonstrated by the summary table above. The table helps, however, to understand the limitations associated with the data collected. For example, in the overwhelming majority of cases, the data used to calculate the charge ratio include plan administration fees and investment management fees for primary funds. On the other hand, the only jurisdictions where investment management fees for underlying funds are included in the charge ratios are Albania, Israel, Hong Kong, Bulgaria and Turkey. When it comes to custodian fees and transactions costs, in most of the jurisdictions which declared these types of fees to be included, they are paid by the pension companies. All these differences can influence the final calculations of the charge ratio, so **that is why it is important not to compare all charge ratios altogether, but rather to compare the numbers for these systems (''clusters'') that have the same or similar characteristics**, or as a basis of identifying changes in overall fee trends over time within individual jurisdictions.

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[7] Net asset value (NaV) is understood here as the value of a fund's assets less the value of its liabilities.

IV. Methodology of the charge ratio

The charge ratio is an indicator of the fees charged on individual retirement accounts and has proven to be quite useful in making cross-country comparisons. It measures the impact that any type of charge can have on the final balance of an individual retirement account compared to the hypothetical balance that could be obtained if no fees were charged at all[8].

The first step to calculate the charge ratio is to estimate the asset accumulation in the individual retirement account for an average worker on an annual basis. This is done by taking an average wage as given and calculating the contribution flow into the retirement account according to the current legislation in each country, as well as applying a fixed rate of return (same for all countries), and all of the fees that a worker who enters the workforce today is expected to pay during the period before he retires. The typical period for such calculation is 40 years, but it can be adjusted to reflect the fact that for some workers the contribution period may be shorter.

The equation below is the general formula used to estimate the asset accumulation in the individual retirement account in each period. It determines the accumulated balance at the end of a working life for an average worker in a given country taking into consideration the fees charged by a particular pension manager which operates in that country. For doing this, the calculation is repeated i times, where i is the number of years of contribution period, i.e. 40 times for a contribution period of 40 years.

$$Sf = \left\{ [Si * (1 + i') * (1 - \beta)] + \left[(Fi * (1 - \alpha) + cs) * \left(1 + i' * \frac{1}{2} \right) * \left(1 - \beta * \frac{1}{2} \right) \right] \right\} * (1 - \gamma)$$

where:

S_f = balance in the individual retirement account at the end of period i.

S_i = balance in the individual retirement account at the beginning of period i.

F_i = Flow contribution to the individual retirement account in period i, including all contributions from employers, employees and the government.

cs = Any fixed contribution which is not subject to charges on flows or a fixed charge on flows (in which case it would be a negative number).

α = Proportional charge on flows (as a percentage of F_i).

β = Proportional charge on assets under management.

i' = Real rate of return net of charges on returns.

γ = Proportional exit fee.

The formula used to calculate the charge ratio is the following:

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[8] Although the process of calculation is briefly mentioned here, a more detailed description of the methodology can be found in the previous paper. See Appendix 1, page 30 in: Gomez Hernandes and Stewart (2008).

$$Charge\ ratio = \frac{S_f\big|_{No\ Commissions} - S_f\big|_{With\ Commissions}}{S_f\big|_{No\ Commissions}}$$

The calculations use annual data. This is a theoretical exercise since the future cumulative balance is projected as if the current commissions are maintained during a 40-year period. The only exception for the latter is when a country has set a timetable to reduce fees in the future by means of an approved legislation (such as in Costa Rica, Macedonia and recently Poland). The real rate of return refers to a standard (yet not necessarily unquestionable) assumption of what a DC pension scheme should yield on average in the long run. As a convention, the rate is set, as an assumption, at 5%. This does not represent necessarily the historical rate of return for any specific national system. The exercise assumes a 100% contribution density and a zero account balance to start with. The result is independent of the wage level.

The caveats of the charge ratio should be spelt out clearly. Firstly, as mentioned in the previous section, the charge ratio is not a perfectly accurate calculation of how much any one member's savings would diminish as a result of fees and charges in a given jurisdiction. This is because, aside from the fees that he or she is charged directly, there are other costs that a member bears indirectly and which are charged to the overall assets of the pension fund. In this way, the charge ratios calculated are actually underestimated for some jurisdictions, as indicated in Table 2. Secondly, the fee structure varies greatly from country to country, and that is why cross-country comparison should be handled carefully. It may not reflect reality closely without the kind of proper analysis represented in Table 2. Thirdly, the effect of (absolute fees) may vary depending on the rate of return assumed. Finally, it is worth remembering that the level of fees is somehow related to the asset allocation profile. Thus a 'cheap' system (expressed either in terms of low fees or charge ratios) does not necessarily imply that the absolute value of the retirement pot at the end of accumulation savings will be higher than in an 'expensive' system that offers much higher rates of return. While comparing the costs/charges, some caution must be exercised in making assumptions about the outcomes.

V. Summary of historic trends in fees

The detailed presentation of recent changes in pension funds' fees and operating expenses are provided in the Annex. Table 3 contains a summary of this discussion and shows the different mechanisms countries have adopted in order to make fees decrease.

Table 3.   Measures taken to decrease fees in various IOPS countries

Country	Imposing fee caps	Changing or simplifying fee structure	Improving transparency	Others
Chile		✓	✓	Auction mechanism
Costa Rica	✓	✓	✓	System maturity, merger of schemes/funds
Hong Kong			✓	Competition, enhanced disclosure, consolidation of member accounts, system maturity, merger of schemes/funds, investment education for members, automating and streamlining administration
Hungary	✓			System maturity
Israel				Competition
Macedonia	✓			
Mexico	✓	✓	✓	Merger of schemes/funds
Peru		✓		Auction mechanism
Poland	✓			
Romania	✓			Financial education for members, merger of schemes/funds
Turkey	✓	✓		System maturity

Source: Own compilation based upon IOPS members' input.

The following conclusions can be drawn based upon the analysis of the historical trends:

- transparency is in most cases a legislative requirement for pension funds and will always help, but if different types of fees are allowed, comparison becomes a difficult task for individual members. To assist, the regulator could require providers to publish a synthetic cost indicator and communicate it to members in an accessible manner (for instance, in the annual pension statement or in their pay statement)[9];

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[9] In addition to Mexico and Hong Kong, the Italian regulator, COVIP, introduced new regulation in 2006 requiring pension funds to calculate a synthetic cost indicator so as to increase transparency to members and facilitate the comparison of costs applied by different kinds of pension funds. The indicator displays all costs paid by a member (in the accumulation phase) as a percentage of the assets of his/her individual account. This indicator is now widely used in the Italian specialized press, while in Hong Kong the Fund Expense Ratio (FER) is always used as the basis for debate/discussion while comparing cost information from different DC providers. For further information on the synthetic cost indicators used by Italy and Hong Kong, see IOPS (2011).

- introducing a single type of fee (either on contributions or on assets under management) makes comparisons between providers much easier[10] and in this way facilitates choice by members of the lowest cost provider, leading to increased competition and lower fees charged to members;

- introducing an auction mechanism which declares as default option the lowest-cost providers[11] – members are automatically assigned to these funds in case they do not make a choice;

- setting price caps may result in some undesirable consequences. As previously mentioned in the earlier research on this topic (Tapia and Yermo, 2008), one problem with setting maximum limits on fees is the risk that authorities set the wrong ceiling. Setting the limit too high might not have the desired effect – pension funds may converge towards the ceiling level and thereby actually lowering the competition. Setting a ceiling that is too low may prevent fund managers from covering operational costs and in the short term, might go as far as inhibiting competition by discouraging new pension funds to enter the market. In CEE countries, the cap was set at the start of the system and has not been reviewed regularly. On the other hand, in Mexico it was introduced after a period of liberalized fees, when the gap between maximum and minimum fees charged by commercial providers was quite significant. With the introduction of the fee caps by CONSAR, the pensions regulator in Mexico in 2010, the maximum fees dropped significantly and the spread of fees diminished accordingly;

- while policy reforms can contribute to lowering fees, it is often difficult to disentangle their impact from other factors, such as the natural tendency for costs indicators like 'fees as percentage of total assets' to decline as the pension fund industry matures and the assets accumulated grow (reaping efficiency gains from economies of scale).

Pension authorities are clearly looking for ways to improve the transparency of costs. Although this should be accompanied by financial education and increased awareness, studies have shown that financial education is not a "panacea" and "whatever the level of financial understanding, the pensions market cannot be effective without transparency in a clear and understandable [language]" (Pitt-Watson and Mann, 2012). Members should be aware of what they are buying, and how much it costs, in order for them to become more interested in making choices and actively managing their benefits.

At the same time, providers in some countries are becoming more engaged towards the customer. In the UK for example, the National Association of Pension Funds, in association with groups representing consumers, employers and employees, has launched a Code of Conduct to help employers understand the impact of charges when choosing a pension scheme for their employees. According to the Code, its scope is to "provide information about charges to employers in a form they can understand, as part of good transparent practice" and "allow a more ready comparison of charges and services so that employers and trustees are able to act as well informed customers".

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[10] Assuming, of course, that providers offer a similar type of investment portfolios.

[11] One might also impose some additional minimum requirement on funds' historical returns (for example that their results are above some minimum threshold such as inflation).

VI. 2012/2013 Charge ratios in IOPS member jurisdictions

The results for the 2012/2013 calculations are the following (Table 4):

Table 4.   Charge ratio calculations for average fees reported in Table 1

% Assets Under Management	40 Years Charge Ratio		30 Years Charge Ratio	20 Years Charge Ratio
Jurisdiction	**2008**	**2012/13**	**2012/13**	**2012/13**
Albania	n/a	45.12%	34.92%	23.83%
Botswana	n/a	14.70%	10.44%	6.69%
Bulgaria (2nd pillar)	26.51%	26.51%	20.86%	15.31%
Bulgaria (3rd pillar)	n/a	13.44%	10.47%	7.67%
Chile	17.40%	14.20%	14.20%	14.20%
Colombia	12.73%	12.70%	12.70%	12.70%
Costa Rica	21.07%	9.05%	6.66%	4.49%
Croatia (2nd pillar)	22.21%	11.74%	8.71%	5.85%
Croatia (3rd pillar)	n/a	44.47%	35.88%	26.80%
Czech Republic	38.14%	28.51%	21.28%	13.99%
Dominican Republic	19,35%	23.76%	18.77%	13.90%
El Salvador	11,97%	11.00%	11.00%	11.00%
Estonia	n/a	31.56%	23.69%	15.68%
Ghana	n/a	46.40%	36.03%	24.66%
Greece	n/a	20.67%	15.19%	9.84%
Hong Kong	36.42%	35.01%	26.48%	17.64%
Hungary	22.57%	5.93%	4.50%	3.17%
India	n/a	6.35%	4.58%	2.93%
Israel	13.67%	11.71%	9.49%	7.41%
Kazakhstan	n/a	16.84%	12.29%	7.91%
Kenya	n/a	8.96%	6.45%	4.09%
Latvia	n/a	39.59%	30.25%	20.36%
Lithuania	n/a	22.72%	16.88%	11.20%
Macedonia	20.24%	11.65%	9.35%	7.34%
Mexico	31.56%	29.67%	22.19%	14.62%
Namibia	n/a	19.75%	14.49%	9.37%
Panama (SUMEVAL)	n/a	46.40%	36.03%	24.66%
Panama (SIACAP)	n/a	7.50%	5.39%	3.41%
Peru	15.01%	15.80%	15.80%	15.80%
Poland	18.74%	14.35%	11.35%	8.50%
Romania (2nd pillar)	n/a	16.10%	12.29%	8.67%
Romania (3rd pillar)	n/a	38.47%	30.05%	21.34%
Russia	n/a	9.86%	7.11%	4.52%
Serbia	37.51%	29.31%	22.56%	15.86%
Slovak Republic (2nd pillar)	19.03%	19.17%	14.36%	9.70%
Slovak Republic (3rd pillar)	n/a	43.48%	33.52%	22.78%
South Africa	n/a	9.56%	6.89%	4.37%
South Korea	n/a	16.53%	12.06%	7.75%
Spain (occupational)	n/a	5.32%	3.81%	2.40%

Spain (personal)	n/a	29.84%	22.32%	14.72%
Turkey	45.88%	39.59%	30.25%	20.36%
United Kingdom	n/a	31.73%	23.83%	15.77%
Uruguay	12.39%	14.10%	14.10%	14.10%

Source: Own calculations based upon the average fees data from Table 1.

Calculations to make projections of retirement income are usually run on a 40-year time span (see for example OECD, 2011). However, it may be the case that in some countries such a period may not be very representative of actual contribution patterns. Therefore, the same calculations were run for a 30-year and 20-year working life. Obviously the accumulation period being shorter, the charge ratio is smaller (less is paid as fees and charges over a shorter period of time).

There are a number of countries in Latin America (i.e. Chile, Colombia, El Salvador, Panama, Peru, and Uruguay) where the charge ratio is substantially the same, regardless of the time horizon. This happens because these pension systems only allow fees on inflows and not on assets under management, so the charges paid by an individual do not depend on how much is accumulated over the working-life period.

Some explanations on a country basis are set forth below.[12] It is important to reiterate that a superficial and generalized comparison of charge ratios across countries would not be relevant, for reasons outlined earlier in the paper. Readers wishing to make cross-country comparisons should do this cautiously, at least taking into consideration the input data differences outlined in Table 2.

As described in the section on fees trends, the reforms in the Turkish private pension system also touched on the fee structure. These reforms clearly had an impact on the charge ratio. We can see an important decrease in the new charge ratio calculated in 2012 compared to 2008.

The charge ratio for Hong Kong shows a decrease compared to its 2008 value, with some more reforms having commenced in the second part of 2012, which will likely continue the trend in the following years. As previously observed, it is important to note that the FER used as a basis for calculating the charge ratio incorporates elements that are not taken into account in the data for other systems[13].

The different changes in legislation have led to a decrease in Mexico's calculated charge ratio for 2012. In line with this indicator, the Mexican pension system is still quite expensive, but according to CONSAR, the targeted effect has been partially reached due to the reduction in the average fee by almost one-third between 2008 and 2012. Furthermore, a roadmap is in place to reduce the cap to 1% by 2015. On the other hand, CONSAR fears that imposing a fee cap may force the exit of those pension providers that have not yet reached economies of scale. It may also put limits on investment strategies and services differentiation among companies that manage pension funds and it may hinder incentives for financial innovation and risk management policies.

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[12] Some of the 2008 calculations in the previous paper have been revised to standardize the calculations to a 40-year span (e.g. Mexico).

[13] This includes incorporation of all fees of any underlying investment structure, the impact of fee rebates and guarantee fees. Service providers often rebate an amount of fees back to individual members (for example, as a way of reducing the effective level of fees to employees of larger employers). Such a rebate (which in effect lowers the total fee impact) is not reflected in the calculated figure. It is not possible to quantify precisely the overall impact, but the estimated effect may reduce the FER by around 10%. In addition, about 2% of the Hong Kong FER figure represents guarantee fees, i.e. the amount paid to a guarantor to provide the guarantee in such funds. In total, these impacts might materially impact the relativity of the Hong Kong figures compared to other jurisdictions presented in Table 4.

Chile's charge ratio has seen an important reduction. This could be explained by the reforms put in place starting 2008, which led to the elimination of the fixed fee and the possibility of charging only a fee on salary, could have had a big impact by making the issue of comparing costs for members much easier. In addition, the auction mechanism has also been an important reform for diminishing the fees charged by pension funds. The new pension fund that entered the market after the auction (AFP Modelo) has gradually increased its market share and has influenced the charge ratio and the weighted mean of fees. In 2010, AFP Modelo started with a share of 0.57% of the market and by December 2012, after a second auction it won, its market share increased to 7.67%. In December 2012, AFP Modelo had already surpassed a couple of the other pension funds in terms of members and/or contributors. However, one can see that the spread between the fees charged by AFP Modelo and its peers is still large, so it is possible that other pension funds feel pressure from the competition and lower their fees. On the other hand, the market has seen little mobility of members between entities that manage pension funds. Indeed, the latest auction mechanism (carried out in January 2014) resulted in success for the AFP with, until now, the highest fee. During the January 2014 auction, this AFP made an offer of 0.47% of salary (vs. an average system's fee of 1.42%). This new lowest fee level will be applied from August 2014 and will benefit both new entrants to the pension system and all previous members of the AFP that won the recent auction.

In 2012 there was a reform in the pension law in Peru aimed at increasing competition between pension managing companies. The reform provided for more flexibility for transfers among administrators, and introduced the auction mechanism for new entrants. It also initiated a transition from fees based on salary towards fees based on asset under management (AUM)[14]. A mixed fee (salary and AUM) structure was created for a period of ten years over which the fees based on salary will decline and ultimately disappear in 2023. The impact of this transition (mixed fees) will be seen over the coming years. At the moment, as a result of the above measures, the fees based on salary have reduced from an average of 1.91% in July 2012 to 1.62 % in December 2013.

Israel's charge ratio has not changed much compared to 2008. Nevertheless, a new regulatory framework for setting a lower ceiling for management fees in life insurance policies and provident funds, which came into force in 2012, may contribute to the future decrease of the charge ratio.

Romania's charge ratio (for the mandatory system) ranks around the middle of the chart. Although it is a young system, with only six years of functioning, one might consider it as positioning itself as a reasonably cost-effective pension system. Further developments to address transparency issues could ensure a larger portion of members 'shopping' for good fees and thus increasing their market power.

There are several countries whose charge ratio has dropped significantly: Slovakia, Costa Rica, Poland, Hungary and Czech Republic.

Slovakia's 2012 charge ratio slightly increased from 19.03 (2008) to 19.17 in 2013[15]. There was the significant decrease in the fee cap imposed through legislation by the National Bank of Slovakia. In 2008, all pension funds charged the same amount for assets under management (0.78%), but starting June 2009, it was lowered to 0.3%. However, the average fee on returns has been equal to 10%, which as a result counterweights the effect of lower management fees. Further changes were adopted starting from April 2012, when each pension provider was required to manage a new "index fund" which tracks a major equity

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[14] As this is a gradual process, this structural change has not yet been accounted for in Table 1 that shows the average market fees.

[15] As was specified in footnote 10 to Table 1, 0.25 percentage points of the 1.25% fee on contributions is charged by the state Social Insurance Agency. If taking into account only the fee charged by managing companies, equal to 1%, the charge ratios for 40-, 30- and 20- years' horizons would be equal to 18.96%, 14.14% and 9.47%, respectively.

index. As of 1 January 2013, the pension fund managing companies are no longer obliged by the relevant legislation to manage the index funds; however they are allowed to do so if they should wish.

Costa Rica has experienced one of the most significant decreases of the charge ratio, from 21.07 to 9.05. According to the supervising authority (Superintendencia de Pensiones of Costa Rica), this may be explained by the progressive lowering of fee caps on assets under management. These were programmed to go from over 2% when this gradual decrease started, to 0.35% in 2020. The cap is now at 1.1% and will reach 0.7% in 2014. Nonetheless, the Costa Rican market has seen a decrease in the number of private fund administrators from nine participants at its inception in 2000 to six today.

Poland's charge ratio also fell dramatically from 2008. This and the substantial decline in 2010 can be explained in view of the new legal limit (3.5% maximum) on upfront fees, which fell by almost 40%. In 2011, the rate of contribution to open pension funds was reduced, and this caused a further decline. One may expect further reductions in charges ratio after legislative changes, scheduled for 2014, have taken place. The details of the 2014 pension reform are presented in the Annex.

Hungary's charge ratio has decreased dramatically from 2011. In the 2008 exercise, the 40-year charge ratio was 22.57%, whereas currently it is only 5.93%. The underlying force for this change was a drastic reduction in the fees charged on both contributions and assets. Further details of these changes are presented in the Annex.

The significant decrease in the Czech Republic may be explained by the important structural reforms adopted in the pension system starting in 2013: introduction of the second pillar, some changes in parameters of the third pillar, but the main influence is the important restrictions in total fees chargeable by pension funds.

VII. Conclusions

The paper provides an important database of the fees, charges and expenses charged in different jurisdictions, for both some IOPS members and non-members. The database contains the maximum fees allowed by law (where such fee caps exist) as well as the average market fee per type. This gives the reader a first idea of the different fee-charging structures and levels across pension systems internationally.

One key lesson that emerges from the country experience surveyed in this paper is that the more complex the fee structure in a retirement system is, the harder for members to compare across pension funds. They find it difficult to get a clear image of the way these fees can reduce their future retirement benefit. In some countries in Latin America, allowing only one type of fee has had a positive impact on fee levels, as it has become easier for members to make comparisons between different pension providers. This is the case of Mexico where commercial pension fund managers (AFOREs) can charge only fees on assets under management, while in Chile Administradoras de Fondos de Pensiones (AFPs) can charge only a proportional fee as a percentage of salary for every contribution made to the system.

Although reducing fees remains a major policy concern, it is worth emphasizing that the quality of service of pension funds is also important for supervisors. Thus, when designing or improving a particular pension system, a key characteristic should be a high degree of transparency and comparability both for the fees charged and the quality of service providers, which then allows members to increase their 'shopping power'.

The paper also identified a series of policies which were put in place by the surveyed jurisdictions and which had different impacts on the fee levels.

Some jurisdictions have introduced fee caps in their systems, and the outcome has not been the same for all. While sometimes it can be an effective policy for reducing fees, it can also prove to be less productive in triggering a fee decrease. Fee caps may even cause a different set of problems (such as reduced incentives on pension providers for enhancing operational efficiency).

Chile's innovative policy approach towards fees was to introduce an auction mechanism for pension funds' managing companies. All new members are automatically assigned to the pension fund with the lowest fee. This has made it possible for a new pension fund operator to enter the market and even win a second auction by further reducing its fees.

These reforms had an impact on cost levels. Both in Chile and in Mexico a downward trend in fees can be observed since the implementation of the latest reforms.

There are other jurisdictions, like Italy and Hong Kong, where the problem of transparency has been addressed by imposing a legal requirement for pension funds to publish a synthetic cost indicator. Although in Hong Kong the average FER of MPF constituent funds in the mandatory system has declined, further reforms are being implemented to make the system more cost-competitive: launching low-fee funds, facilitating trustees to merge smaller scale or less efficient schemes/funds, facilitating trustees to further automate and streamline their administration process, and encouraging members to consolidate their personal accounts.

The CEE countries, amongst other countries surveyed, have quite a complex fee structure which makes it difficult for members to fully compare costs between pension funds. In these jurisdictions the sole legal requirement for pension funds to publish all the fees that they can charge to members does not meet the intended purpose. Consumers would benefit from a move towards greater clarity of pension charges, in addition to the cap on fees that is quite common in these jurisdictions.

There are several countries in which the charge ratio dropped dramatically, such as Costa Rica, Poland, the Czech Republic and the Slovak Republic. Costa Rica is gradually lowering the cap on fees on assets under management. A similar reform – important restrictions on different fees charged by pension funds – has been adopted in the other three countries.

The paper uses the concept of 'charge ratio' for the cross-country comparisons of fee structures. In addition, it adds to the literature of international comparison of fees by collecting data from some jurisdictions in which fee components have been included in the charge ratio calculations. In this way the reader can get a better idea of what limitations are involved in international comparison of fee levels and charge ratios, as well as the extent to which charge ratios are a more or less inclusive estimate. **It is important to reiterate that a generalized comparison of charge ratios across countries, without taking into consideration the differences outlined in section III, would lead to substantially misleading conclusions.**

ANNEX: Historical trends in fees

While analysing the 2012/13 charge ratios, it may be useful to understand the trends in fees and charges that have occurred over time in various jurisdictions. This annex provides some description of legislative developments or market changes that influenced the fee levels in various IOPS members' jurisdictions.

It is also interesting to see what trends have emerged in the operating expenses of pension funds. The data presented in this respect are the data collected and compiled by the OECD. Furthermore, the evolution of charge ratios between 2008 and 2012/13 may be well influenced and explained by the above-mentioned trends.

Chile

Since the introduction of the mandatory fully-funded defined contribution pension system in 1981, both the services offered by pension fund managers and the fees charged for these services have changed in several ways. The latest policy initiative took place as part of the 2008 pension reform, which has led to noticeable downward adjustments to the fees allowed. Most importantly, it has also stoked cost competition between providers. This growing competitiveness is likely to lower fees further in the future. Taking into account the latest auction run in January 2014, the AFP that had so far has been charging the highest prices offered a new fee of 0.47%, which by August 2014 will decrease the system's average fee to almost 1.2%.

Figure 1. Chile: Evolution of total fees as a share of total assets since the inception of the system (%)
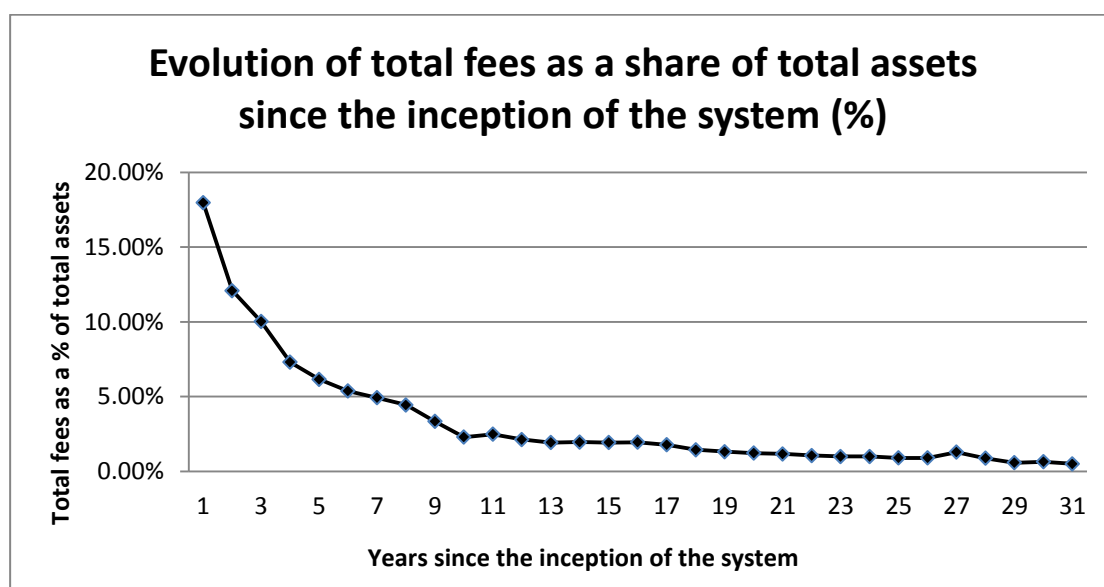
Source: Superintendence of Pensions, Chile.

The 2008 reform made four main changes related to fees:

- it eliminated fixed fees charged on contributions (pension fund providers (AFPs) now only charge proportional fees as a percentage of salary for every contribution made to the system);

- the disability and death insurance premium was separated out from the variable fee charged;

- the personal statement sent to each affiliate three times a year was modified to take into account the changes regarding the fee structure. Further, the new statement provides a cost-comparison for each AFP in the system, including the one into which the individual is enrolled;

- an auction mechanism was introduced for new members who enrolled into the system. The auction applies to the fees charged for the management of the individual accounts for new members. New members are automatically enrolled in the AFP which charges the lowest fees and they are required to remain in this AFP for 24 months. After that, members can freely transfer their accounts to other AFPs.

The first three changes have improved the comparability between AFPs' fees, making comparisons clear and straightforward, and also improved the visibility of cost information.

There have been three auctions since the reform was enacted. The first auction took place in 2010 and it allowed a new AFP to enter the market starting from August of that year, offering the minimum fee of the system equal to 1.14% of salary. The same AFP won the second auction in January 2012, decreasing the fee offered to 0.77% of salary. As a result, another AFP decided to lower its fees from June 2012, the first reduction by any of the incumbents since 2009. During the third auction, carried out in January 2014, the AFP previously with the highest fee won the auction by lowering it to 0.47% of salary.

Below one can see the fees charged in the past seven years in Chile, as of December of each year:

Table 5.   Fees charged by Chilean AFPs in the period 2005-2012 (% of salary)

AFP	2005	2006	2007	2008	2009	2010	2011	2012*
Bansander (1)	1.67	1.67	1.91	-	-	-	-	-
Capital (1)	-	-	-	1.70	1.44	1.44	1.44	1.44
Cuprum	1.78	1.78	1.78	1.99	1.48	1.48	1.48	1.48
Habitat	1.48	1.48	1.33	1.74	1.36	1.36	1.36	1.27
Modelo (2)	-	-	-	-	-	1.14	1.14	0.77
Planvital	1.77	1.77	2.04	2.31	2.36	2.36	2.36	2.36
Provida	1.55	1.69	1.69	1.6%	1.54	1.54	1.54	1.54
Santa Maria (1)	1.29	1.62	1.62	-	-	-	-	-
Mean	**1.54**	**1.64**	**1.63**	**1.74**	**1.49**	**1.49**	**1.48**	**1.42**

Source: Chilean Centre of Statistics, Superintendence of Pensions webpage.

(1) AFP Santa Maria was a subsidiary of AFP Capital, property of the ING group. In March 2008 AFP Santa Maria and AFP Bansander merged and from this merge AFP Capital was created.

(2) AFP Modelo entered the market in August 2010 after winning the first auction.

The mean is weighted by the number of contributors to each AFP as of December of each year for 2005–2012. One can see an increasing trend in fees from 2005 until 2008 and then, after the reform, the mean decreases to a level of a weighted average of 1.42% in September 2012.

The following figure shows the pattern of the average proportional fee weighted by number of contributors of each AFP from December 1988 to December 2012.

Figure 2. Average proportional charges on flows in the Chilean pension system: 1988-2012
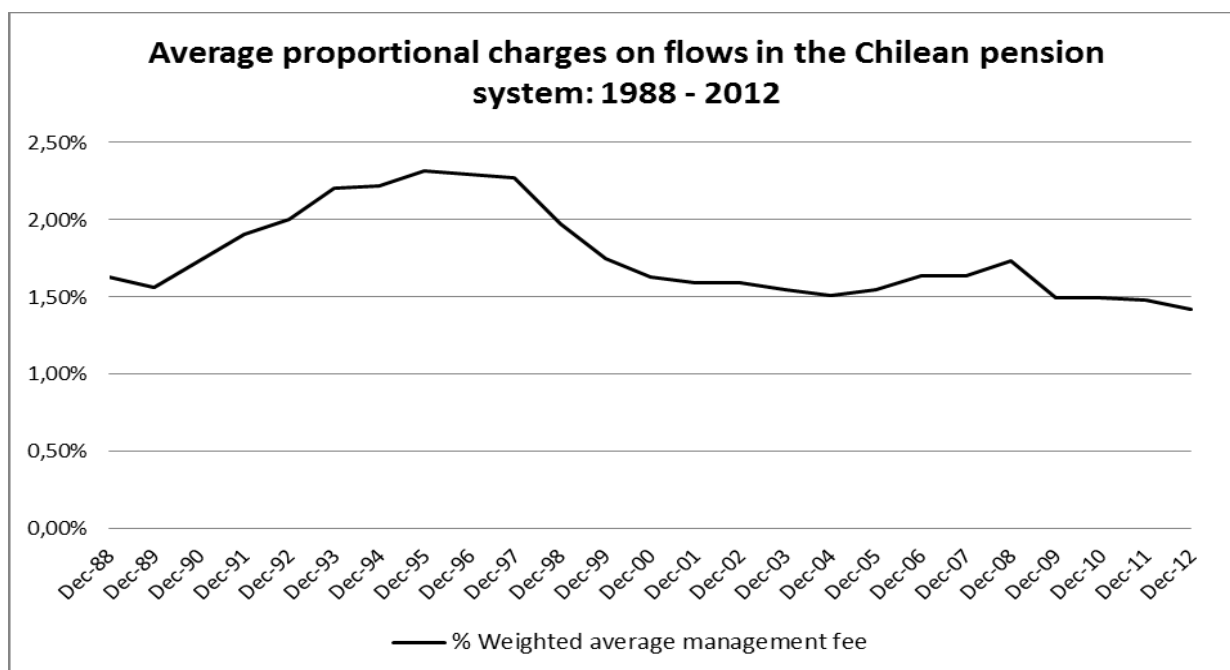
Source: Superintendence of Pensions, Chile.

The graph shows that although in the beginning of the 1990s there was an increase in the average charges on flows, a series of mergers and acquisitions in the market a few years later brought the average management fee down. In the years prior to the 2008 reform, the average management fee picked up. Since the reform, the average management fee has been gently falling over time in accordance with the introduction of the auction mechanism of new members which is meant to increase competition between providers.

In Figure 3 below one can see a comparison between how proportional charges on flows and the operating expenses of pension funds in Chile have evolved, according to OECD calculation and methodology (expressed as a percentage of total assets).

Figure 3. Chile: Average proportional charges on flows (% of salary) and operating expenses (% of assets)

Average proportional charges on flows and Operating Expenses
(2002 - 2012)

— % Weighted average management fee   — Operating expenses / total assets
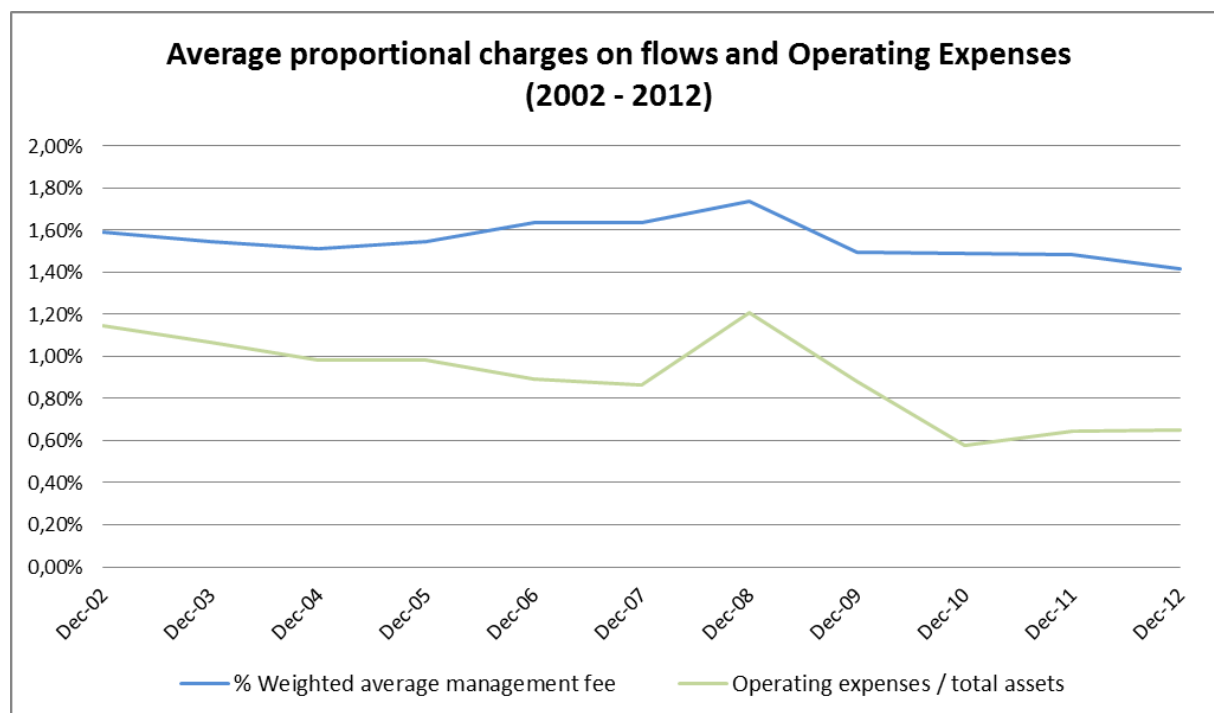
Source: Superintendence of Pensions, Chile.

In general, the operating expenses of pension funds in Chile have followed a similar path to the fees charged to members. There is a temporary increase from 2007 to 2008 which is explained mainly by the reduction in pension funds because of the financial crisis in 2008. Since then, however, a growing gap between fees and expenses can be observed, which effectively translates into a higher profit margin for the AFPs. It remains to be seen whether this gap will start shrinking again as the effect of the 2008 reform progresses.

Costa Rica

The complementary pension regime in Costa Rica (second pillar) was created in 2000 and started to operate a year later. This regime is a DC structure and was built on top of the basic DB regime. The individual accounts are managed by pension administrators, known as OPCs. In the beginning, there were 10 pension administrators: five of them owned by governmental institutions, four of them by private firms, and the last one is affiliated to a teachers´ association, which by law is also considered to be a private provider.

The regulation of this DC scheme set up a default allocation for participants if they do not choose an administrator on first entering the workforce. In this way, such workers are affiliated to the same specific OPC (belonging to a governmental bank) or to the teachers´ OPC if the worker belongs to the education sector.

The fees are regulated by the national pensions supervisor, which determines the base and the cap of the fees charged by the administrators. In the initial years, the OPCs were only allowed to charge fees on the fund´s returns, with a maximum of 10% per month. However, it was noted after a few years that these fee caps were not working well for the system, since the portfolio was only being invested locally, and due to the volatility and immaturity of the small Costa Rican financial market, this was affecting the income of

OPCs. This became critical for the OPCs because if returns turned negative during a specific period, they did not receive any fees, but nevertheless had to cope with the usual costs. With such variable incomes and short-term fixed costs, the OPCs´ earnings were not high enough for their owners and for their clients, limiting the investment and the improvements in the industry.

By 2004, the DC regimes had accumulated high balances and the returns began to be important, resulting in a considerable increase in the incomes of the OPCs. At this point the regulator decided to change the fee structure to a mixed scheme. The fee was a combination of a percentage on contributions (4% maximum) and a percentage on returns (8% maximum). This scheme was maintained until December 2010. Beginning 2011, a new fee scheme began, now based only on assets under management (AUM). It began with a 1.10% annual cap of AUM, with a gradual decline until reaching a cap of 0.35% in 2020. Figure 4 shows the evolution of total fees as a percentage of AUM since the inception of the scheme.

Figure 4. Costa Rica: Evolution of total fees as a share of AUM
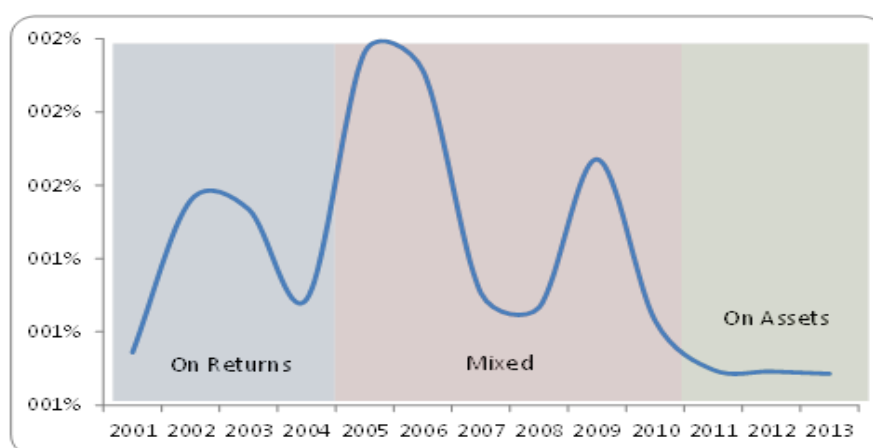
Source: Superintendencia de Pensiones, Costa Rica.

The change in the fee structure in 2011 was the result of 10 years of observation of the evolution of the DC pensions market. The reform was aimed at:

a. making fees of OPCs easily comparable for workers;

b. controlling the income growth of OPCs. As AUM grew, OPCs' profits were growing exponentially. Clearly, there was a trade-off between the OPC gains and the accumulation of individual account balances, which were being reduced by the fees. Therefore, it was necessary to have a balance between the capital return to the OPCs´ owners and the need for balance accumulation to give a fair pension to the participant;

c. stopping the criticism that fees on contributions were not encouraging the managers to obtain better returns;

d. reducing the administrative cost of inactive accounts. Immigration is a relevant issue in Costa Rica and many people work for short periods, leave the country and stop contributing (only 44% to 50% of members contribute regularly). This makes inactive accounts very expensive to administer under a fee system based on contributions.

The pensions industry has increased its concentration to exploit the economies of scale associated with larger managed assets. By 2013, the number of OPCs had dropped to six. The default OPC has experienced greater growth in AUM because it purchased one of the private OPCs. Currently this OPC

manages more than 36% of the system assets. The other five OPCs are promoting competition to attract members and reduce spending to make the business more profitable. However, the difference in participation is noticeable, as can be seen in Figure 5.

Figure 5. Costa Rica: OPC participation in the pension industry:
assets (USD thousand, vertical axis) and affiliates (m, horizontal axis)
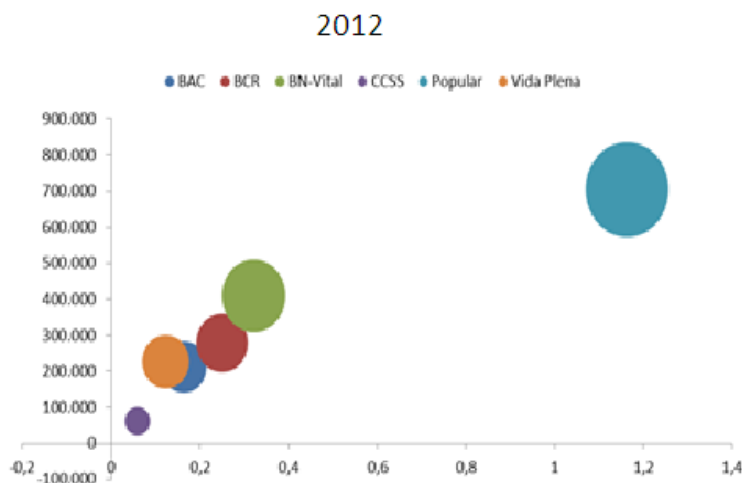
Source: Superintendencia de Pensiones, Costa Rica.

In respect to new affiliates, the new fee scheme introduced in 2011 will represents an improvement of 11.6% (Table 6) in the assets accumulated, considering a period of 20 years and a real rate of return of 4%. The regulator is satisfied with the reform and continually monitors the earnings of OPC to verify that the profit margins are attractive and promote competition.

Table 6.   Costa Rica: Increase in pensions (%) to new affiliates

Number of years	Real returns			
in the Fund	1%	2%	3%	4%
5	4,10	4,35	4,60	4,85
10	5,12	5,60	6,10	6,61
15	6,53	7,29	8,09	8,92
20	8,18	9,26	10,41	11,64

Source: Superintendencia de Pensiones, Costa Rica.

With regard to the profits of the industry, as shown in Figure 6, since 2010 these have been relatively stable and growing, making margins for future projects to the benefit of competitiveness and participants.

Figure 6. Costa Rica: Revenues and expenses of OPCs
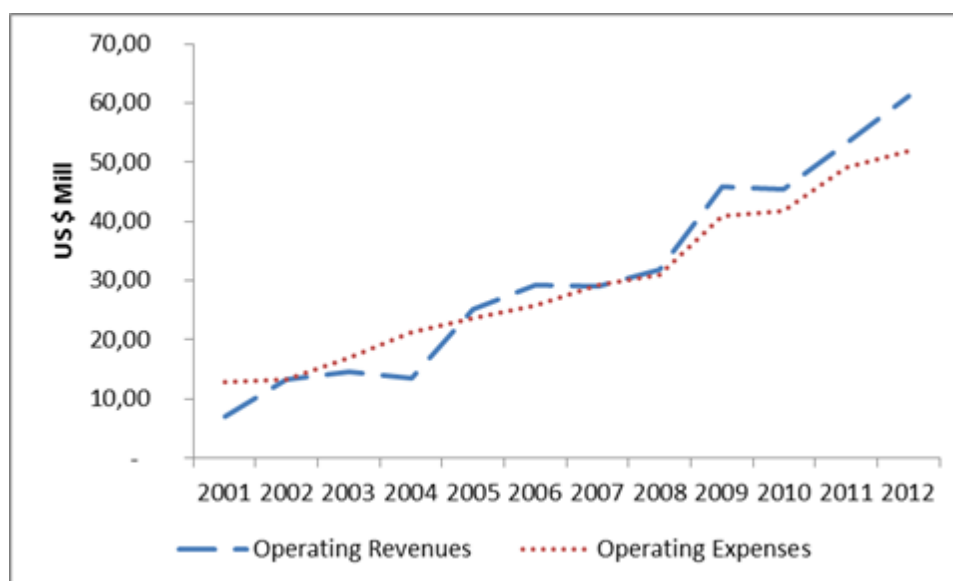
Source: Superintendencia de Pensiones, Costa Rica.

Hong Kong, China

The Hong Kong Mandatory Provident Fund (MPF) System is a pension jurisdiction where funds are obliged to report to members and the regulatory authority a synthetic indicator to enhance transparency of fees and expenses. Under the MPF, fees and expenses paid to trustees and other service providers are taken out of the underlying funds into which contributions are invested. Generally, no fees are charged directly to members or deducted from contributions. Accordingly, in the MPF context, fees and expenses relate to amounts charged to funds rather than to members.

To enhance transparency of fees and expenses, the trustee of an MPF scheme is required to calculate and disclose the Fund Expense Ratio (FER) of each constituent fund provided under the scheme. The FER expresses the expenses of the fund (including fees charged by the trustees and other service providers, etc.) as a percentage of the fund size. The FER is provided in the Fund Fact Sheet of a scheme and has reduced otherwise complex fee disclosure to a single percentage figure. The FER should be calculated to two decimal places in the following manner:

FER (%) = direct expense (%) + underlying funds costs (%) +/- any adjustments permitted or required by the supervisory authority in any individual case[16]

The FER, as a synthetic figure, has its own uniqueness when compared to the fee figures in some other pension systems. For the FER, as one can see from the formula above, fees and expenses are rolled into a single figure, which provides a measure of the total level of expenses incurred in investing through a fund, including the costs incurred by underlying investment vehicles. In addition, since transfer fees are not allowed in the MPF system, the administrative cost associated with transfers is effectively aggregated into administration or trustee fees and therefore reflected in the FER. Other systems may not have such a

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[16] For further details on methodology of the FER, please see IOPS (2011), "Comparative Information Provided by Pension Supervisory Authorities".

restriction and may allow transaction charges. If they are not charged to the fund, these charges might not be included in the aggregated data about the fees and expenses of funds under these systems.[17]

The average FER of MPF constituent funds as a whole generally showed a downward trend for the period of December 2007 to December 2013. The overall average FER of MPF constituent funds fell from 2.10% as of December 2007 to 1.70% (Figure 7) as of December 2013, a decrease of 19.0%.

Figure 7. Hong Kong: Average Fund Expense Ratio (FER) of the MPF funds
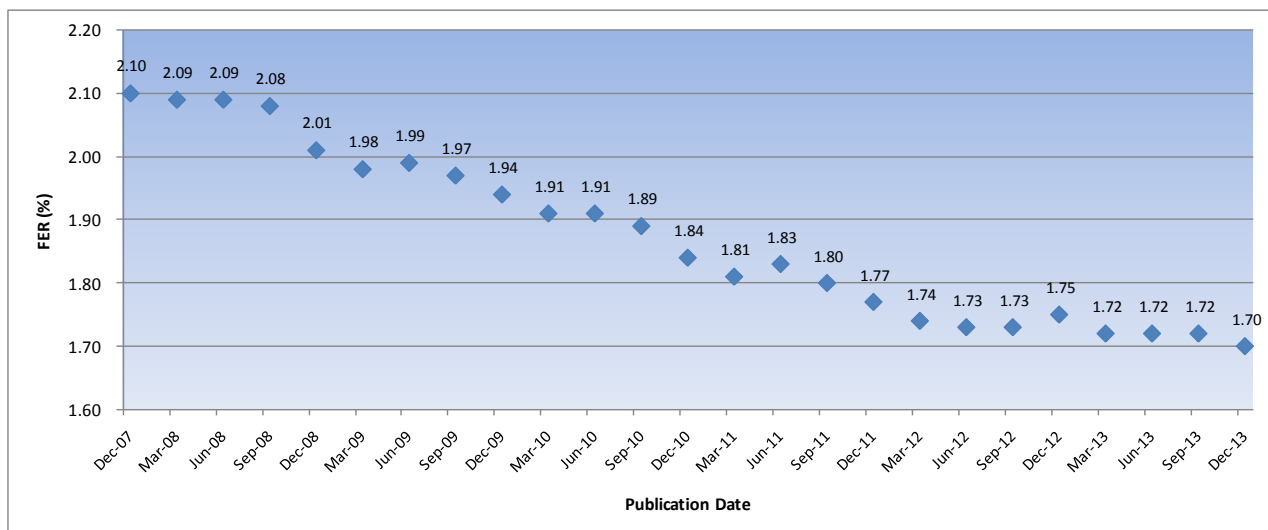
Source: MPFA, Hong Kong.

The downward trend is attributed to a number of factors, on both the demand and supply sides.

On the demand side, MPF trustees have been facing intensified competition. On the one hand, the enhanced disclosure of fees and expenses of funds – mainly through the "Fee Comparative Platform" on the MPFA website[18] – has given rise to increasing pressure from the public on MPF trustees for fee reduction. On the other hand, Employee Choice Arrangement (ECA), a reform to provide employees with greater autonomy of choices of trustees and scheme, has been implemented. According to the supervisor, ECA has changed the demand landscape of the MPF market, due to the fact that after the implementation of the reform, both employee mandatory contributions and mandatory contributions accrued during former employment have become transferable, so employees will be encouraged to manage their MPF investments more actively. Consequently, trustees have adjusted their marketing strategies for better competiveness, including reducing fees of existing funds and introducing schemes or funds with lower fees. The MPFA has also been pursuing an Investment Education Campaign to equip members with the basic knowledge for making informed decisions, including the impact of fees on their MPF benefits.

On the supply side, the MPFA has been discussing with trustees ways to streamline the operation of their MPF schemes so as to lower the costs of scheme administration and thereby allow more room for reduction of fees. In addition, as the asset size of MPF funds grows larger in future, MPF funds could benefit from economies of scale, making further room for lower fees. Reforms are also being implemented to make the system more competitive, which include launching low-fee funds, facilitating trustees to merge

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[17] Gomez Hernandes and Stewart (2008), and Mandatory Provident Fund Schemes Authority.

[18] http://cplatform.mpfa.org.hk/MPFA/english/index.jsp.

smaller scale or less efficient schemes or funds and to further automate and streamline their administrative process, and encouraging members to consolidate their personal accounts.

Hungary

Figure 8. Fees (% of assets) charged by pension funds in Hungary (mandatory and voluntary)
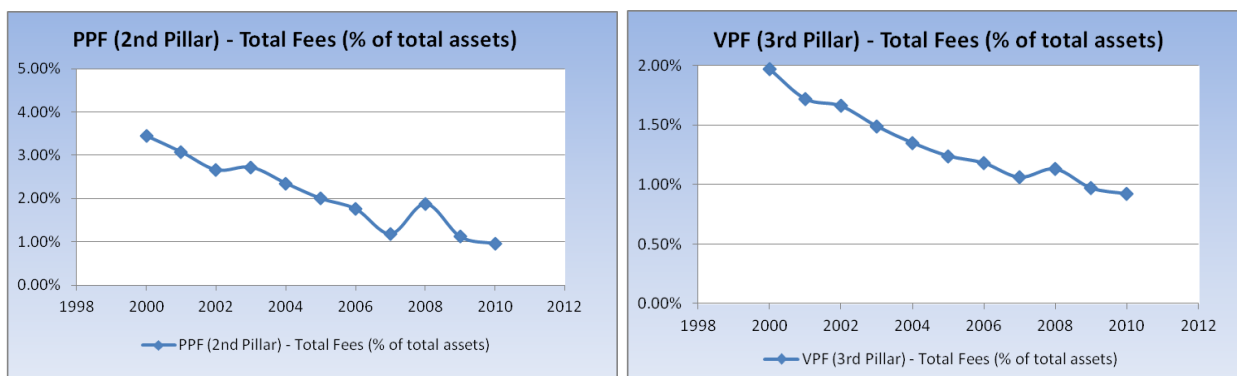
Source: Central Bank of Hungary.

In the Hungarian pension fund industry, in both the second and third pillars, total fees as a percentage of total assets have decreased continuously (Figure 8), with one exception – from 2007 to 2008, the period of the peak of the financial crisis when assets dropped dramatically, thus affecting the ratio.

The national legislation provides a cap on fees on contributions and asset management. In the period 2008-2011 the limits were the following (Table 7):

Table 7.   Cap on fees in the Hungarian pension system

Private pension funds	2008	2009	2010	2011
max deduction on contributions	5,50%	4,50%	4,50%	0,90%
max asset management fee	0,80%	0,80%	0,80%	0,20%
Voluntary pension funds	2008	2009	2010	2011
max deduction on contributions*	6,00%	6,00%	6,00%	6,00%
max deduction on contributions up to 10,000 forints per annum*	10,00%	10,00%	10,00%	10,00%
max asset management fee	0,80%	0,80%	0,80%	0,80%

*Funds may derogate from this provision in connection with the first two payments following the date of admission of a new member subject to the provisions laid down in specific other legislation.
Source: Central Bank of Hungary.

Regarding the fees on contributions in the private pension funds system, as of 2011 the funds had to credit to the safety reserve at least 99.1 per cent of the membership contributions and the donations for membership contributions. Between 1 November 2010 and 31 December 2011 funds were entitled - after the operating and liquidity reserves were exhausted - to deduct 265 forints each month, on the last day of the month, from the profits made on the investment of the member's individual account, and credit it to the

operating reserve. Funds may depart from this provision with respect to the first monthly membership payment subject to the provisions laid down in specific other legislation.

With respect to management fees in the private pension funds system, if the fund manages all or part of its own assets, the annualized pro-rata costs of investments managed by the fund may not exceed 0.8 per cent of the mathematical average of the daily gross market values of the assets (or any part thereof) that the fund manages during 2009 and 2010, 0.2 per cent in 2011 and thereafter (Table 7).

It is important to emphasize that the legislation on private pension funds changed radically in 2010, when a pension reform led to the transfer of most of the assets that the mandatory pension funds had accumulated to the government. Since November 2010 private pension funds charging a membership fee became optional. Therefore, the maximum level of fees was reduced significantly.

With regard to fees on contributions, voluntary pension funds must credit to the safety reserve at least 90 per cent of the payments made by a member or employer member, up to 10,000 forints per annum, and 94 per cent of the sum above this amount limit. Funds may derogate from this provision in connection with the first two payments following the date of admission of a new member subject to the provisions laid down in specific other legislation.

Voluntary pension funds may charge an annual fee payable for asset management services as contracted, exclusive of trading expenses (commissions), up to 0.8 per cent of the mathematical average of the daily gross market values of the assets (or any part thereof) entrusted for management. Any clause of the contract stipulating a higher fee shall be null and void. If the pension fund manages all or part of its own assets, the annualized pro-rata costs of investments the fund manages by itself may not exceed 0.8 per cent of the mathematical average of the daily gross market values of the assets (or any part thereof) the fund manages by itself.

The post-2010 trend was not taken into consideration in any of the charts because the second pillar system was practically wound up and this would distort the calculations and the trends.

Figure 9. Operating expenses of pension funds in Hungary (% of assets)
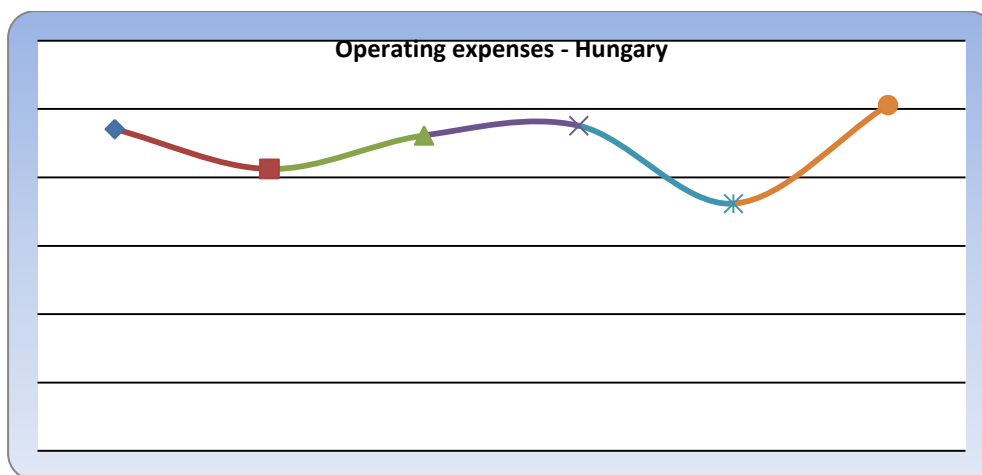

Source: Global Pensions Statistics, OECD.

The operating expenses of pension funds in Hungary have been stable with little variation (Figure 9), in contrast to the trend shown by the fees on assets under management. At first sight this suggests that the cap on fees imposed by the HFSA[19] worked well for the Hungarian pensions market by lowering expenses to members.

Israel

Figure 10.   Average fees on contributions and on assets under management (in percentage points) for the new pension funds in Israel
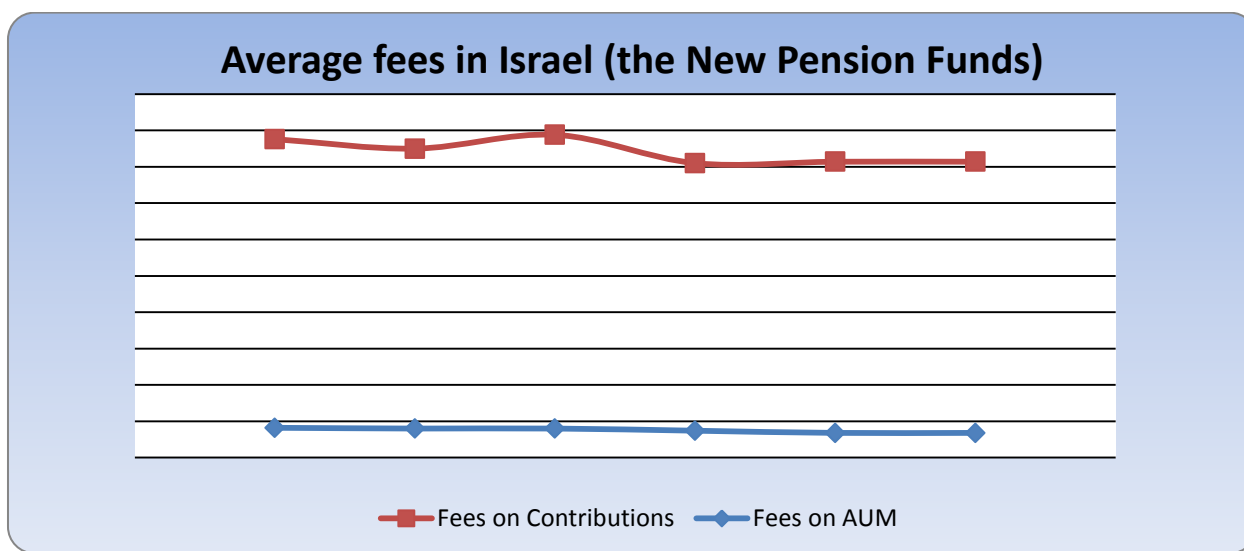
Source: Capital Markets, Insurance and Savings Division, Ministry of Finance.

The decrease in fees on assets and contributions (Figure 10) in the Israeli pension market can be explained by increasing market competition and improvement of the bargaining power of Israel's long-term savers, mainly because of the global financial turmoil and its consequences.

In explaining the increasing market competition, it is important to note that public's dissatisfaction with the level of the service it received from the institutional providers mounted on the back of the global economic crisis. This public pressure obliged the institutional bodies to provide a higher level of service, one measure being to reduce or at least to keep steady their management fees.

In respect of the rise in bargaining power, it is worth mentioning that in 2007, a significant proportion of the salaried employees in Israel were not under the retirement pension coverage. To address this issue, the government published a legislative proposal early 2007 with regard to mandatory retirement savings. At the end of the same year, what was just an agreement between a governmental body and the biggest trade union in Israel, ended up being applied to all salaried employees in the country. Data show that more than 70% of salaried employees, who had not saved for their retirement until 2007, were now saving.

A rise can be seen in 2007/2008 for the average fee relative to total assets, sharing the same experience as other countries during the financial crisis. After 2008, the same ratio had a substantial drop,

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[19] As of 1 October 2013, the Hungarian Financial Supervisory Authority (HFSA) has been merged into the Central Bank of Hungary.

of around 10%. However, the average fee on AUM had a more stable route, decreasing moderately over time.

Figure 11. Operating expenses of pension funds in Israel (% of assets)
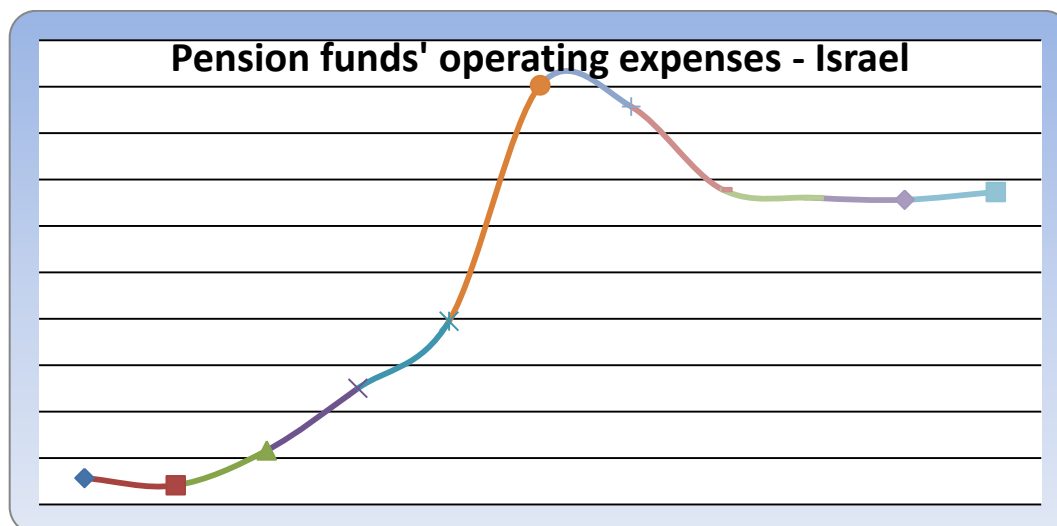
Pension funds' operating expenses - Israel

Source: Global Pensions Statistics, OECD.

The operating expenses of pension funds in Israel increased between 2003 and 2006 (Figure 11). The explanation is that during this period a new long-term savings vehicle, the new pension fund, was introduced. After 2006, operating expenses began to decrease, but still remained at a high level, much higher than in the period of 2001-2003, suggesting that the implementation of the new pension funds raised significantly their expenses.

Macedonia

The Macedonian pension system was designed (among other priorities) to have low costs, but at the same time to protect interests of members as well as to take care of the commercial interest of pension companies. There is a centralized contribution collection for pension insurance (including contributions for second pillar) to lower the costs. Currently, there are two pension companies managing one mandatory and one voluntary pension fund each (four pension funds in total). The election of pension companies was done through public tender based on the lowest fees. The default allocation formula to pension funds for mandatory members of the second pillar that did not make their choice is based on the formula directly related to fees and return.

At the beginning of the operation of the second pillar, the levels of fees on contributions were set on a public tender and the other two types (on assets and transfer fee) were set by national legislation. The Agency for Supervision of Fully Funded Pension Insurance (MAPAS) and the Ministry of Labour and Social Policy have continuously followed and analysed the development of the level of fees. They took measures to decrease the level of fees. Fees charged to the pension companies by public institutions (MAPAS, the Pension and Disability Insurance Fund, and the Central Bank as a custodian) decreased over the first four years (2006-2010) of the system's functioning, which consequently was followed by the decrease of fees charged by the pension companies themselves.

Figure 12. Fees (% of assets) charged by pension funds in Macedonia (mandatory and voluntary)
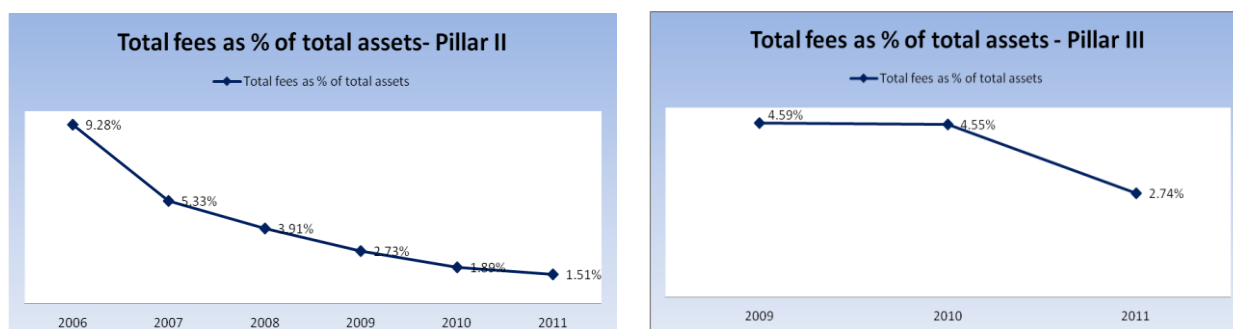
Source: MAPAS.

A further decrease in the level of fees has been accomplished by MAPAS' decision to set every year a maximum level of fees on contributions during the period 2007-2010. From 2010 onwards, the maximum level of these fees has been set up in the law. During the first six years of functioning of the Macedonian second pillar, the fees expressed as percentage points of total assets have been continuously decreasing. Nevertheless, as a result of the rising number of members and their assets, the absolute value of the fees charged has been continuously growing.

The main reason for the reduction of fees on AUM is the decrease of the maximum levels set by the legislation, as well as the growth of assets. Also, fees have dropped due to a number of decreases in fees charged by the public institutions and due to single time voluntary decision of pension companies to lower their fees as well.

Mexico

In respect of the fees charged by pension fund managers (AFOREs) to members, the policy of the regulating authority in Mexico (CONSAR) has changed several times since the inception of the system in 1997.

Between 1997 and 2003, there was a hands-off approach to fees. AFOREs were allowed to charge the performance fee (as an annual percentage of the investment performance) as well as two other types of fees or a combination of both:

- flow fee: charged to every contribution flow to the individual account. The charge was expressed as a percentage of the wage;

- stock fee: annual percentage of the assets under management (AUM) in the pension funds (SIEFOREs).

During this period, most companies that manage pension funds applied the flow and the stock fee while only two used the performance fee. According to CONSAR, during this period account holders had a very limited understanding of the total fees that being levied. They also had a great difficulty comparing fees among AFOREs, and switching between AFOREs was not driven by differences in fees.

A second period was between 2004 and 2008, when, in order to promote market competition and reduce fees, the law was amended to favour AFOREs that charged the lowest fees, but without considering returns. Account holders were allowed to switch before the one-year minimum permanence period so long as they chose an AFORE that charged a lower fee. CONSAR also developed an equivalent fee indicator, a

regulatory tool to allow members to compare the different fee levels across AFOREs. According to the supervisory authority, some reductions in the level of fees were observed, but due to a sizeable volume of switches, the commercial costs of the system increased significantly.

By 2007, the fee system faced serious drawbacks that required immediate attention. The equivalent fee was not very accurate, as it required several assumptions to calculate. Some AFOREs charged higher fees on contributions (up to 25%) to compensate for the reduction of other fees. Switches between pension funds did not follow rational behaviour and as returns were not considered in the regulation, some AFOREs with higher net returns were losing members.

Finally, starting 2008, new regulations were introduced which allowed only one type of fee (on assets under management). This eliminated a lot of confusion and provided members with more simplicity, transparency and comparability when choosing a pension fund manager. The main competition driver became the *net return indicator* (i.e. the difference between the return of the fund and the fee it charges on assets under management), again calculated by CONSAR and reported on its website.

According to CONSAR, since the beginning of the system in 1997, AFOREs' fees show a clear downward trend. According to the figure below, implicit fees have decreased from 14.95% in 1997 to 1.33% in 2012.

Figure 13.   Mexico: Implicit fees[20] charged by AFOREs (% of assets)
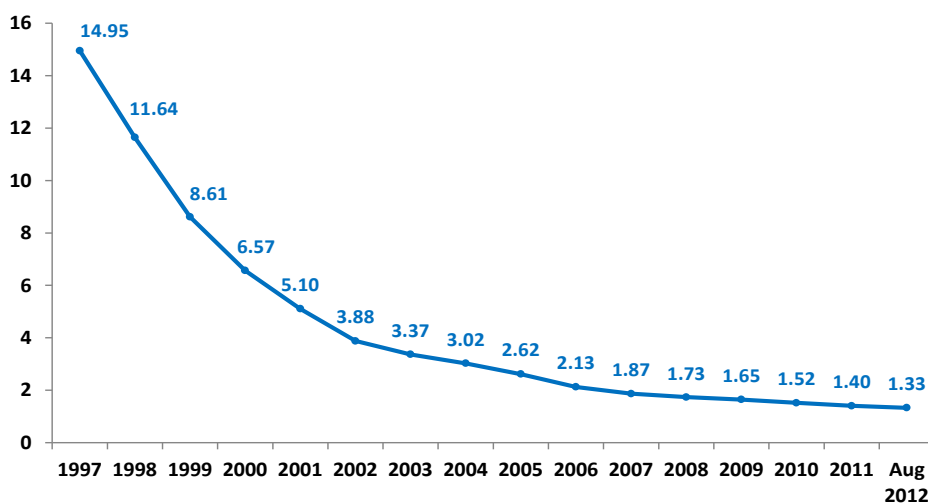
Source: CONSAR presentation at the OECD/IOPS Global Forum on Private Pensions, Chile, 2012.

This trend will continue since pension funds have to present to the governing board of CONSAR on a yearly basis their proposals of fees for the following year for the Board to authorize.

Therefore, an incentive scheme was introduced to foster fee reduction:-

- if a pension fund does not submit their fees on time, it will have to charge a fee equal to the minimum of the authorized fees;
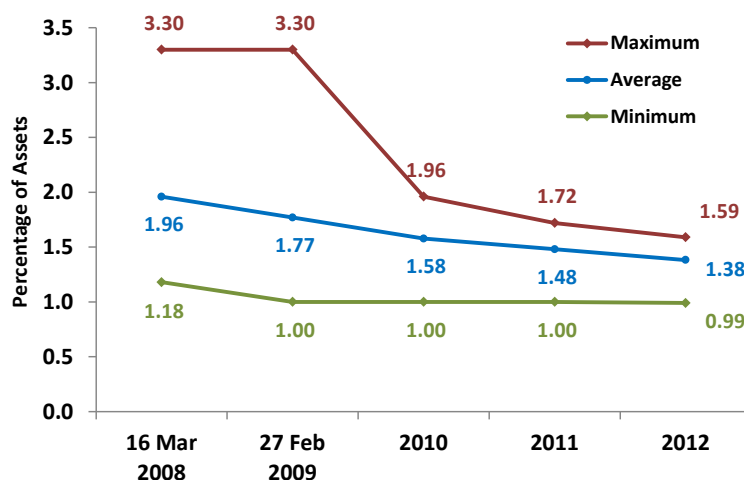
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[20] Implicit fee is calculated as a ratio between income from fees and average assets under management.

- if a fee proposal is rejected by the governing board, the AFORE will have to charge the average of the authorized fees.

The authority publishes each year the maximum fees allowed to be charged by pension funds and this is done before the latter submit their proposals for fees for the next year. Thus they need to abide by the caps imposed by CONSAR, which are calculated on the AUM of pension funds.

Starting 2010, in order to give stability and predictability to the system, CONSAR has established a path for fees to converge to 1% in 2015. However, according to the authority, there may be further room for reduction of fees. This is not only because of the caps introduced by CONSAR, but due to consolidation of the system through mergers and acquisitions between commercial pension fund managers, as well as a result of the growing pool of funds. As shown in Figure 14, the most dramatic drop in fees took place between 2009 and 2010, when the maximum fee charged by any AFORE fell from 3.3% to 1.96%. The dispersion in the fees charged by different AFOREs also fell by over two-thirds between 2009 and 2012 (see Figure 15).

Figure 14.   Mexico: Average, maximum and minimum fees charged by AFOREs (% of assets)
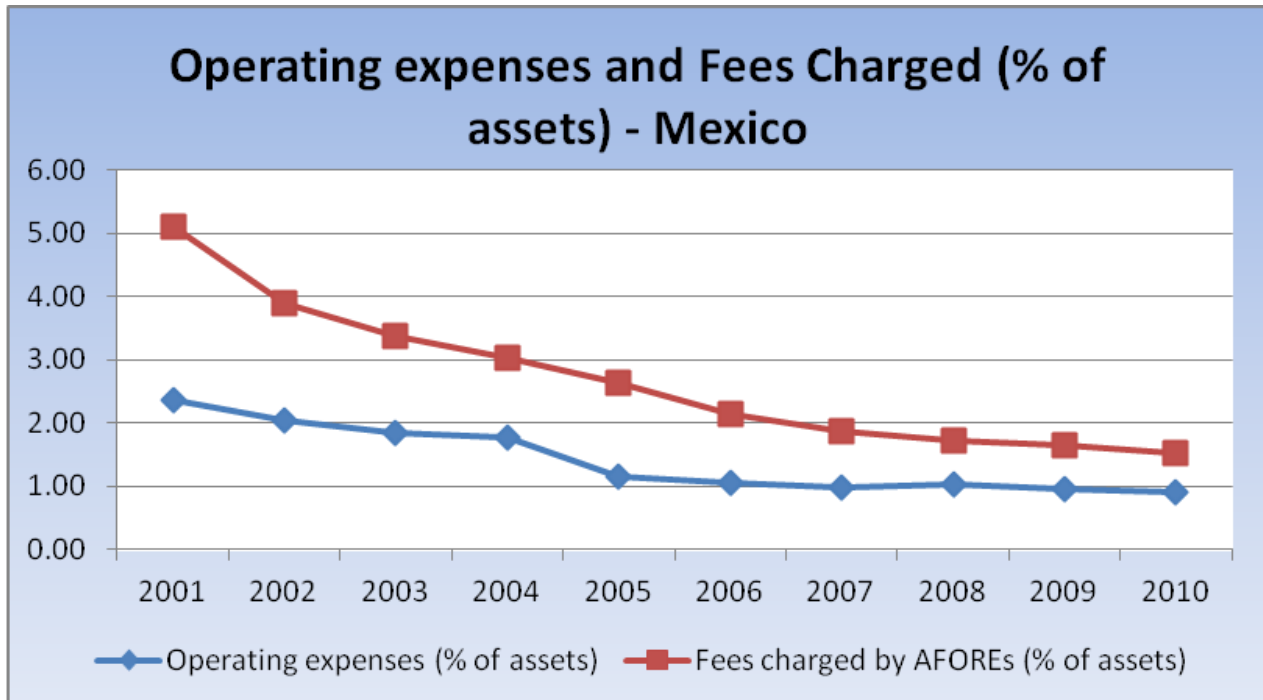

Source: CONSAR presentation at the OECD/IOPS Global Forum on Private Pensions, Chile, 2012.

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Figure 15.   Mexico: Dispersion of fees among AFOREs has diminished since 2008
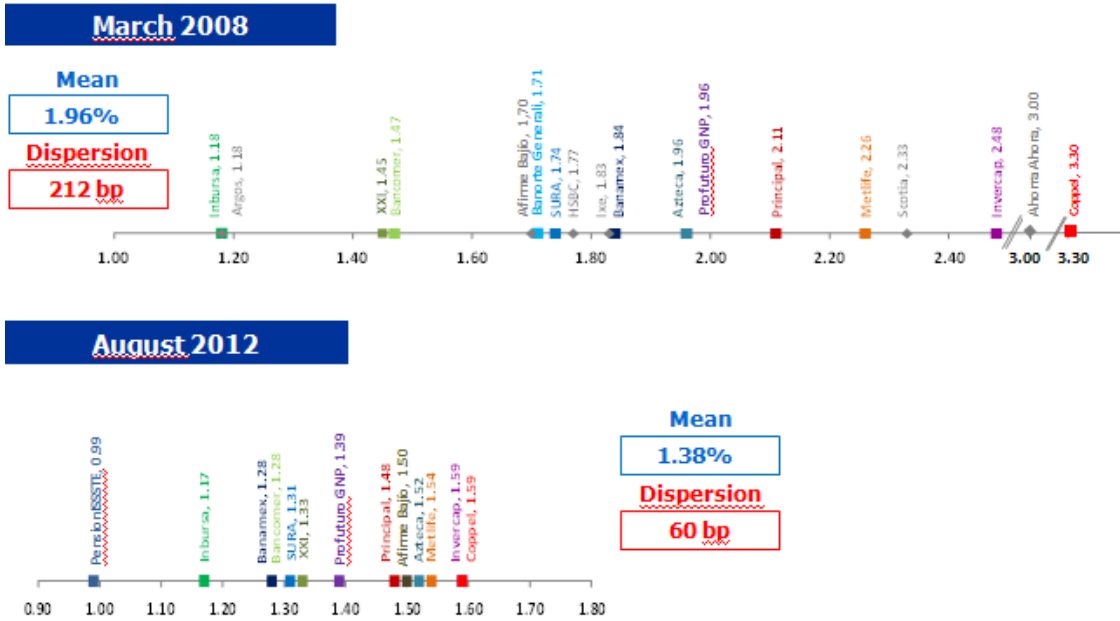
Source: CONSAR presentation at the OECD/IOPS Global Forum on Private Pensions, Chile, 2012.

Figure 16.   Mexico: Operating expenses of pension funds and fees charged (% of assets)

Source: Global Pensions Statistics, OECD.

The operating expenses of AFOREs in Mexico have also continuously decreased from 2001 (Figure 16), although the rate of decrease has slowed down substantially since 2005. The lower expenses are in line

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with the path followed by the fee charged on members. The regulator, CONSAR, has clearly taken into account the evolution of expenses when setting the gradually lower cap on fees each year and targeting convergence to 1% by 2015.

Poland

Currently the pension funds in Poland charge three kinds of fee:-

- Upfront fee on contribution: the maximum level set by pension law is 3.5%. Twelve out of 14 funds charge the maximum fee; one pension fund charges 3.4% and another one 3.45%. From 1 February 2014 the legal maximum upfront fee will be reduced to 1.75%;

- A management fee on assets – based on a regressive algorithm (just like progressive income tax, except the rates fall in step with higher assets intervals) - each interval having a nominal cap. The highest rate charged for the lowest assets is 0.54% annually, while the lowest rate is zero for assets over PLN 45 billion (Polish zlotys). Overall, the maximum annual management fee for a single pension fund could not exceed PLN 186 million.

  - In 2011, the average management fee for the whole pension market was about 0.44%. Some pension funds have already reached the maximum management fee.

  - The algorithm implies that with the growth of pension assets, the rate of management fee will fall. It is estimated that this will be as low as 0.1% when the system reaches its full maturity.

- A so-called "premium account fee" – this is a kind of a success fee, based on the pension fund relative performance against other funds. The maximum rate is 0.06% of assets annually (for the best performing pension fund) the minimum is 0% (for the worst one). On average, one may assume this to be the equivalent of a 0.03% management fee. Unlike the base management fee, the algorithm here is linear (just a percentage of the assets), and without any nominal cap.

The figure below shows the ratio of total fees to assets under management in the recent eight years.

**Figure 17.   Fees (% of assets) charged by pension funds in Poland**
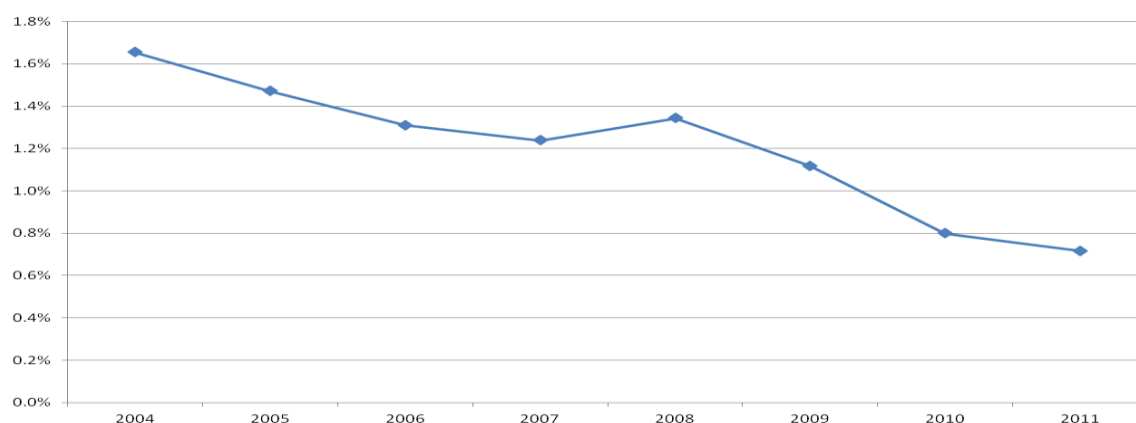
Source: Financial Supervisory Authority, Poland.

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The temporary increase in 2008 was due to the economic crisis and losses in the equity market. The upfront and management fees (for the first three quarters) in 2008 were both relative high, but the final assets increased only by 1% during that year (the investment losses almost matched the value of new contributions) and this is the reason for the temporarily higher ratio.

The general decline is easily explained by the structure of fees – until 2010, the most important fee was the upfront fee subtracted from contributions. The contributions are fairly stable and grow along with the labour market, while assets grow at a much faster rate (accumulation and investment profits). Thus the ratio of fees to assets falls steadily, as the denominator increases quickly in this quotient. However, due to systemic changes that took place in February 2014 it is difficult to predict the development of this indicator in the future, as both the structure of fees have been changed and pension assets themselves reduced (51.1% of assets were transferred to the first pillar on 3 February 2014). As a result, both the numerator and denominator in the formula will be affected.

Figure 18.   Operating expenses of pension funds in Poland (% of assets)
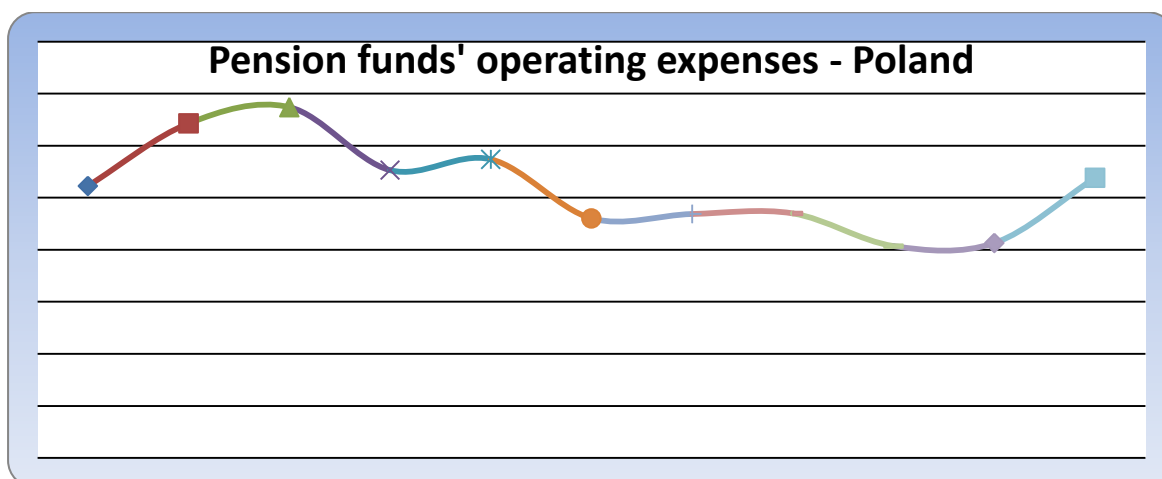
Source: Global Pensions Statistics, OECD.

Unlike the fees charged to members, the operating expenses of pension funds in Poland have been relatively stable (Figure 18). The 2011 increase in operating expenses may be linked to the decrease of the contribution rate from 7.3% to 2.3% that took place in May 2011.

In February 2014 the statutory transfer of 51.5% of the value of assets held by each member of the pension fund (as of 31 January 2014) to the Social Insurance Office took place. The Social Insurance Office is the state administrative entity for the Social Insurance Fund (first-pillar notional accounts). There will also be a slight increase in the rate of contributions allocated to pension funds from the current 2.8% to 2.92% but, on the other hand, contributing to the second pillar itself will become voluntary (with the default option of the whole contribution going to the notional account in the first pillar). The proposed operation will have an impact on the level of operating expenses of the pension fund.
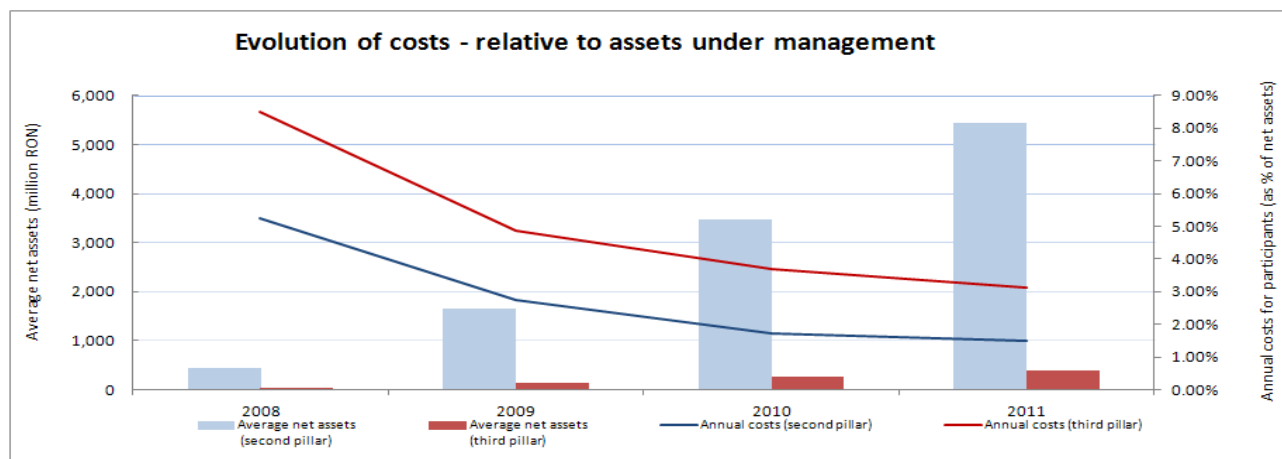
Romania

The Romanian legislation applies a cap on the fees charged by pension funds to individual members, but it is also based on a transparent fee structure.

In the second pillar at the moment, all pension funds charge the maximum main fees allowed by the law: fee on contributions, fee on AUM, and transfer fee.

In the third pillar, pension funds charge fees on contribution between 2.95% and 5%, the legally-approved maximum; fees on AUM between 0.091% and 0.195% (the legal maximum is 0.2%) and transfer fees of 5%, the maximum again, for a transfer before two years).

Figure 19.   Fees (% of assets, m RON) charged by pension funds in Romania

Source: CSSPP.

Figure 20.   Fees (% of contributions, m RON) charged by pension funds in Romania
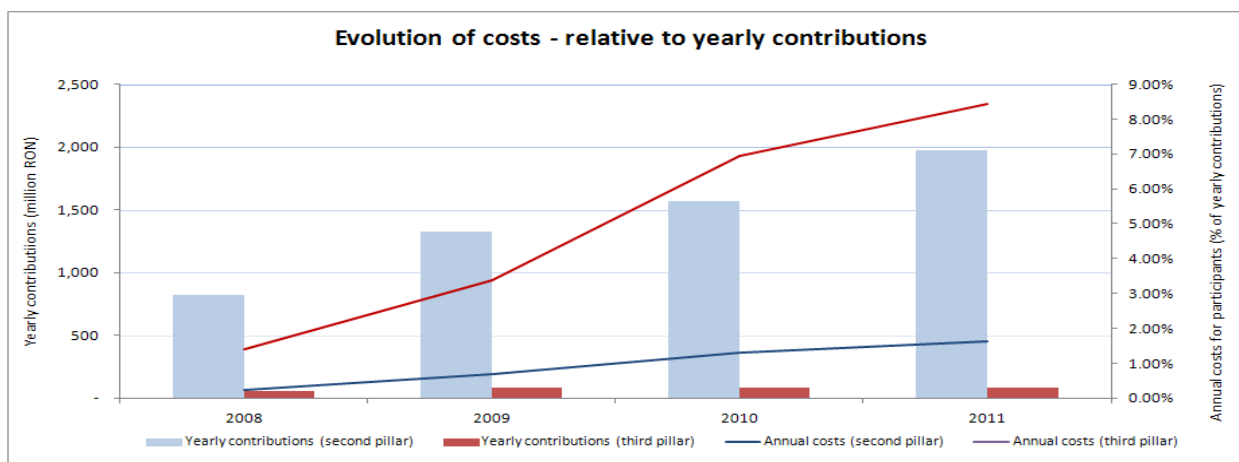
Source: CSSPP.

Another useful way considered by CSSPP, the national regulator, to keep costs under control is their **transparency**:

- there is a legal obligation for pension funds to disclose different information regarding costs and fees publicly, through various ways (the scheme prospectus, an annual written letter, information upon request, information published on website, etc.);

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- CSSPP has its own website[21], where the "Financial Education" page provides an updated comparison of all the main information pension funds should disclose publicly, both for second and third pillars. This information includes the main costs and fees afore mentioned;

- CSSPP provides a web-based system for members to undertake comparison of the returns earned by second pillar pension funds.

The Romanian pension system is only five years old and so pension funds' operating expenses were high during the first three years. When the system was set up there were practically no assets and the pension funds had high administrative costs. Starting 2008, asset growth was rapid (almost doubling annually, Figure 19) and so the operating expenses calculated as a percentage of assets under management went down.

On the other hand, as already mentioned, pension funds charge the maximum fees allowed. This is understandable taking into consideration the tender age of the system while, at the same time, the reduction of operating expenses (as a percentage of assets) is due to the accumulation phase in which the Romanian pension system finds itself. In the future the downward trend in expenses should spell further cuts in the fees levied on members.

Turkey

The Turkish pension system applies a cap on fees.

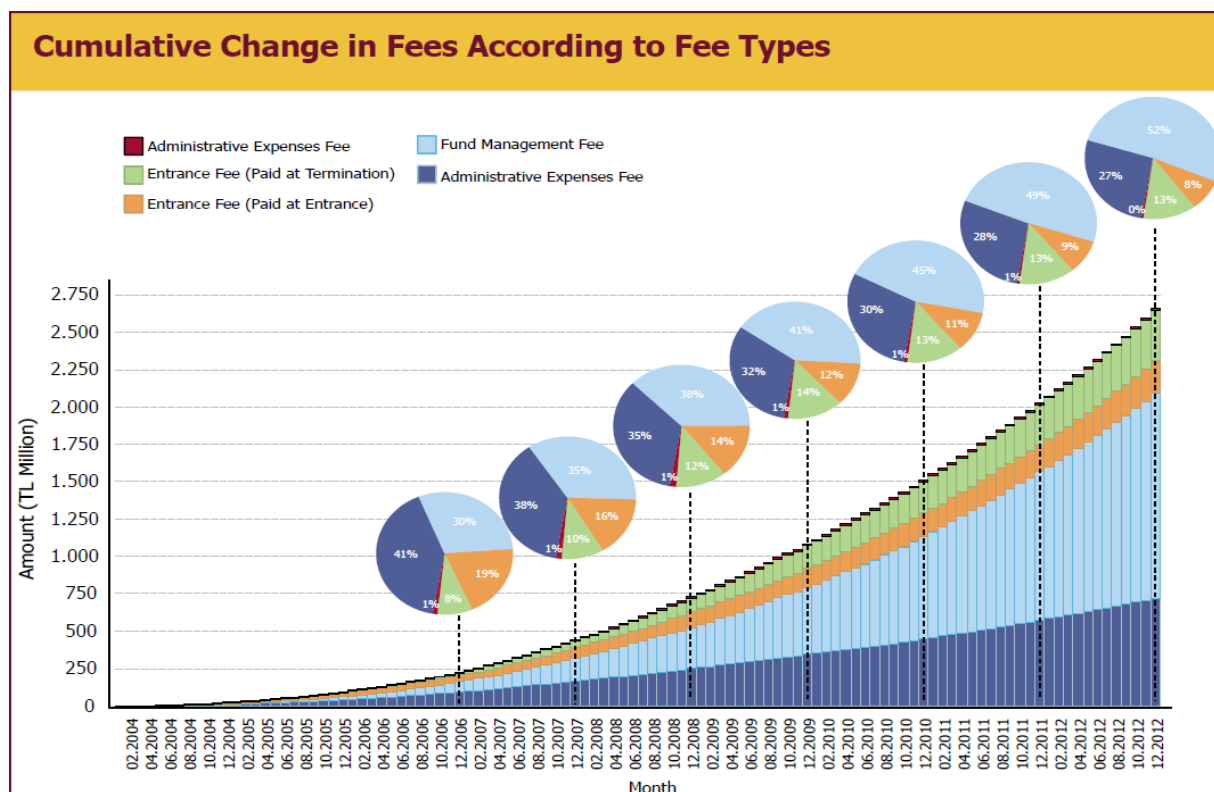**Figure 21.   Change in administrative expenses fee ratio in Turkey**
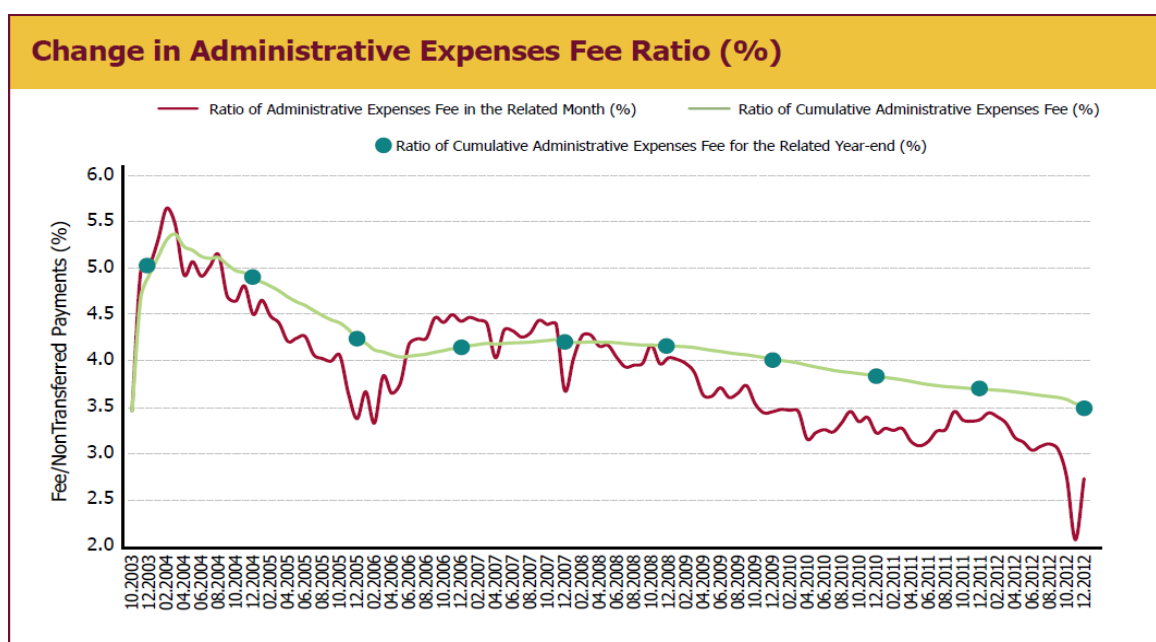
Source: Individual Pension System Progress Report 2012, Pension Monitoring Center.

Figure 21 shows the administrative expenses fee for contracts, deducted from all the payments except the transferred amounts as of 2012 year-end. The ratio of the cumulative administrative expenses fee is

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[21] http://www.csspp.ro/comparare-fonduri.

calculated as 3.52% for the whole market; 4.17% for individual pension contracts; 1.43% for group individual contracts; and 0.25% for non-contributory group contracts as of 2012 year-end. One can see a continuous decrease in the ratio of cumulative administrative expenses fee for the related year-end.

Figure 22.   Cumulative change in fees (in TRY m) according to fee types in Turkey
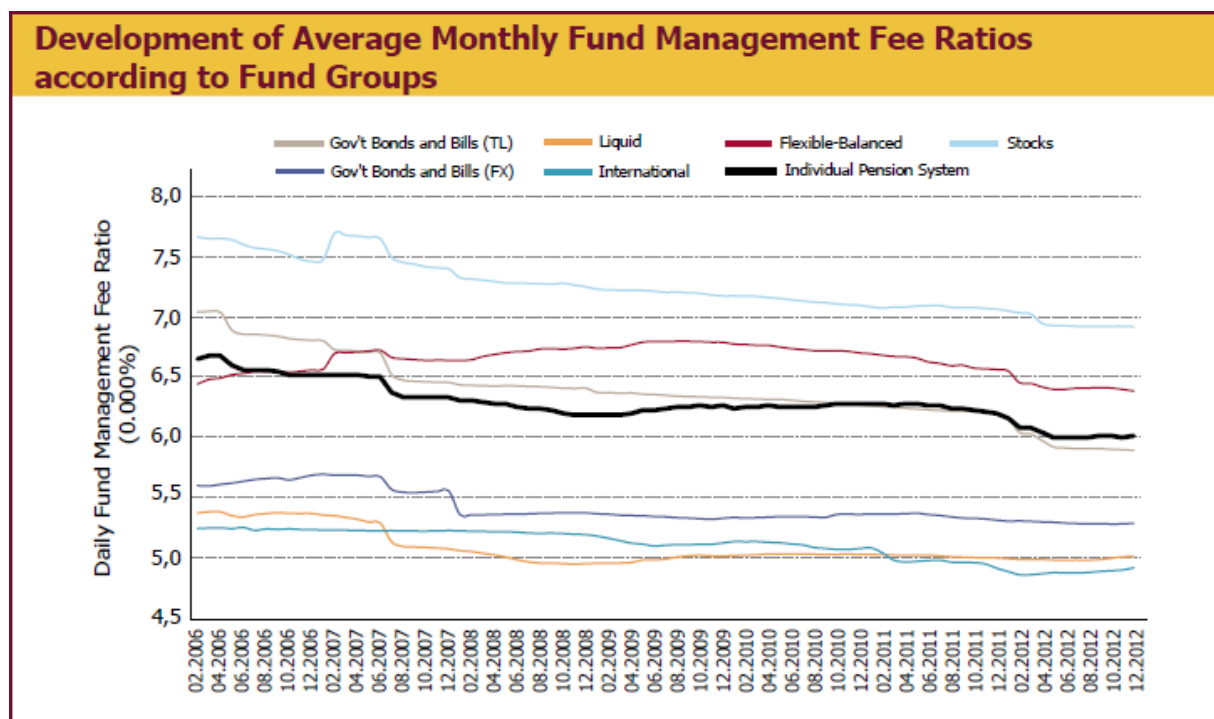

Source: Individual Pension System Progress Report 2012, Pension Monitoring Center.

Figure 22 shows the breakdown of specific fee revenues of the pension companies from the total fee revenues, which amounted to almost TRY 2.66 billion (Turkish liras). The fees are analyzed according to fee type as of 2012 year-end. The pie charts illustrate cumulative distribution of fee types as of year-ends.

A steady trend can be seen for expenses in the Turkish pensions market – the ratio of income from the administrative expenses fee to the total income decreases steadily each year by 3 percentage points, while the ratio of companies' income from fund management fee to the total income increases steadily by 3-5 percentage points each year.

Figure 23 provides change of monthly averages for fund management fees on a fund group basis. Fund management fee rates are calculated by weighting the net asset value of funds. This report disregards bonus implementations related to fund management fees, included in certain pension schemes. All types of funds experience a decrease in the average monthly fund management fee ratio, except for the "Flexible-Balanced" category, where there was an increase of management fees in 2008 and 2009.

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Figure 23. **Development of average monthly fund management fee ratios (in basis points) for pension funds in Turkey**

Source: Individual Pension System Progress Report 2012, Pension Monitoring Center.

In an effort to maintain an 'affordable' pension system for members, new legislation, including the reduction of fee caps, was introduced on 1 January 2013. The new cap for the fee on contributions has been lowered significantly from 8% to 2%, while the fee on assets has decreased from 3.65% to a range of 1.09% to 2.28%, depending on the fund type. The cap was increased to 75% of minimum wage. The duration of minimum stay for the waiver of exit fee was extended from 5 years to 10 years.

A summary of fees before and after the introduction of 2013 legislation is presented below:

Table 8. Cap on fees (in %) in the Turkish pension system

As of 31.12.2012	Fees on (%)							
	Contributions	Salary	Assets	Returns	Entrance Fee	Exit Fee (0-5 years)**		
Turkey (Maximum)	8	-	3.65	-		470 TL		
Turkey (Average)	3.52	-	1.80*- 2.55	-	N/A	N/A		
From 01.01.2013	Fees on (%)							
	Contributions	Salary	Assets***	Returns	Entrance Fee	Exit Fee**		
						0-3 years	3-6 year	6-10 year
Turkey (Maximum)	2	-	1.09*- 2.28	-	102 TL	766 TL	511 TL	255 TL
Turkey (Average)	N/A	-	2****	-	N/A	N/A	N/A	N/A

* Depends on fund type
** No exit fee is charged after indicated period.
*** Covers all other costs (transaction, switching etc., i.e Total Costs)
**** As of 30/06/2013.

Source: Undersecretariat for Treasury, Turkey.

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