INVESTMENT MANAGEMENT ASSOCIATION

PENSION FUND DISCLOSURE CODE

Second Edition

March 2005

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(Second Edition – March 2005)

Revised Code to Incorporate Comparative and Enhanced Disclosure

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INVESTMENT MANAGEMENT ASSOCIATION

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(Second Edition)

Revised Code to Incorporate Comparative and Enhanced Disclosure

1 Introduction

This Code of Practice has been drawn up by a Joint Working Party of Members of the Investment Management Association ("IMA") and the National Association of Pension Funds ("NAPF"). The Code has been adopted by the IMA after full consultation with its Members and is strongly endorsed by the NAPF Investment Council.

The objective of the Code is to promote accountability of fund managers to their clients through increased transparency and to assist pension fund trustees' understanding of the charges and costs levied on the pension fund assets for which they have responsibility. The Code provides a comprehensive, clear and standardised form of disclosure that will allow trustees and their advisers to monitor and compare all costs incurred during the management of their fund's assets.

The Pension Fund Disclosure Code was first adopted in May 2002. This second edition of the Code provides pension fund trustees with additional information on how their investment managers make choices between trading counterparties and trading venues, more detailed information on how the resulting commission spend is built up, and what services are met out of commission spend, in particular such execution and research services as permitted by the FSA. It also provides a comparison of client specific information on costs and trading with similar fund management firm-wide information.

These changes promote a strengthening of the incentives for fund managers to make efficient decisions about trade execution and purchase of ancillary services such as investment research by enabling increased oversight, and provide full accountability to pension fund clients for those decisions and the consequent expenditure of client money.

For managers who already abide by the current Pension Fund Disclosure Code the major additional disclosures are:

- A breakdown of trading volumes and commissions between those undertaken at the full service negotiated rate, those at other rates, and those traded net.
- An allocation of commission between the execution component of the service provided and other components.
- Comparable firm wide information on the pattern of trading and commission spend on behalf of all clients
- A comparison of the client's average commission rate with the firm wide commission rate in the asset class is also required.

The Code sets out minimum standards, and managers can only claim compliance with the Code if they meet all the required disclosures – they do not have the option to select the sections of the Code to which they wish to adhere. A manager may, however, still be deemed to have complied with the Code in the event that particular provisions of the Code are not relevant to the business that the manager undertakes, and the manager has clearly stated and justified this position.

The IMA has no legal authority to impose standards or reporting requirements on its Members. Neither would it wish to propose aspirational standards that few managers would be able to attain without significantly increased operational costs, or that would provide relatively little additional benefit for trustees. In some areas the Code does not set out absolute standards, but sets out minimum standards to determining the information needs of trustees and their advisers. These needs will, of course, not be the same for every scheme. The Code also proposes a common format, which may be expanded, to suit users and providers.

2 Background

The original Disclosure Code was developed in 2001/2 as it became apparent that, in the pursuit of their fiduciary obligations, trustees and their advisers were increasingly looking for numerical disclosures on costs from which they could draw conclusions as to the manner in which their assets were being managed.

In drawing up the original Code, the Joint Working Party was conscious of the issues raised in the Myners Review and sought to address specific questions where appropriate. In the interests of promoting transparency, however, that Code extended beyond the disclosure of transaction costs to disclosure of all costs incurred by client portfolios, directly or indirectly, during the fund management process. The revised Code goes further with respect to the breakdown of how commission monies are spent by fund managers and how that compares with the firm's total commission spend.

To ensure that statistics are put into appropriate context, it is necessary for trustees and their advisers to understand the rationale behind, and justification for, different costs and how these are accounted for. Consequently, there is also a need for disclosure of certain aspects of managers' trading processes, and not just of numbers alone that might otherwise be taken out of context.

Not only are costs different for varying investment strategies, but the reliability with which different types of costs can be measured or estimated will also vary. The Code addresses both explicit and implicit costs, but only requires numbers for explicit costs. Level 1 requires disclosure of the manager's policies and procedures for the management and monitoring of total transaction costs, including implicit, opportunity and market impact costs, in order to achieve best execution for clients. This information is valuable in engaging clients and enhancing their understanding of how different trading strategies are employed in different circumstances. Consequently, the Code requires that the various types of transaction costs should be identified and assessed.

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3 Members of the IMA and NAPF Joint Working Party

Kenneth Ayers (Chairman) Russell Investment Group	NAPF
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INVESTMENT MANAGEMENT ASSOCIATION

PENSION FUND DISCLOSURE CODE
March 2005

This revised edition replaces that first issued in May 2002.

1 Scope

The Code is designed to:

- be adopted by the managers of UK pension fund mandates.

- be applied to portfolios, or portions of portfolios, consisting of listed securities (including suspended securities previously listed), derivatives (where the underlying instruments are securities, financial indices, interest rates, dividends or foreign exchange), cash and pooled funds/collective investment schemes that invest in any of the above assets.

- address all explicit costs incurred by client pension funds, including broker commissions, fund management and custody fees, foreign exchange charges, bank charges, taxation (stamp duty, VAT etc) and any other costs.

- explain the management of implicit execution costs

In respect of those pooled funds/collective investment schemes managed by the manager or an associate, the Code provides that managers should disclose the costs incurred at the fund level. Attempts to attribute portions of costs to individual pension funds would impinge on decisions that relate to unit trusts and have therefore been deferred to a later stage. The disclosure of costs should be accompanied by appropriate commentary to put the statistics into context, e.g. where the size of the pooled fund has changed significantly during the period. Where managers use third-party funds these costs should also be disclosed at the fund level. This information may only be available annually, however. The Code requires prominent disclosure of any proportion of the portfolio that is invested in assets that are not compliant with the Code and an explanation of why the manager believes it is appropriate to use such vehicles.

2 Disclosure Requirements

The Code requires quantitative disclosure of investment management costs. For implicit costs which cannot be measured with certainty e.g. transaction costs, a description of the manager's approach to handling them is required. The Code seeks to encourage disclosure of all such costs without advocating any particular measurement methodology as to how this is achieved.

There is, however, a requirement to state key aspects of methodology, so that informed readers can draw their own conclusions as to the usefulness of the narrative information presented.

It is both permissible and desirable that different house fund management styles, products and specific client requirements result in varying types of reporting. If any particular costs addressed by the Code are on occasion not relevant, or are perhaps more clearly explained by narrative rather than quantitative reporting, this should be noted in the relevant reports.

There are two distinct types of disclosure covered by the Code:

- Level One: house policies, processes and procedures in relation to the management of costs incurred on behalf of clients (see Appendix 1).

- Level Two: client-specific information (see Appendices 2 and 3). The most important requirement here is for disaggregation of transactions by counterparties and for the disclosure of amount of commissions generated on those transactions and the services received in exchange for these commissions. Additional commentary should be provided where this helps to put numerical disclosure into context. It also requires managers to disclose, in percentage terms, the firm wide pattern of trading and sources and uses of commission for **all** clients in that asset class and to compare that to the specific client.

The Code represents a minimum standard, and managers can only claim compliance with the Code if they meet all the required disclosures that are relevant to the business that the manager undertakes. Managers may also, however, wish to produce additional information which they believe is helpful for their clients e.g. information on turnover.

The Code envisages that the frequency of client reporting will vary according to the type of disclosure. Level One disclosure should be updated annually, while the quantitative client-specific Level Two disclosure should be made at least six-monthly. In the event of any material Level One changes, these should be reported promptly to clients, not left until the next annual reporting date. These frequencies mirror FSA rules that require certain transaction reports to be made at minimum six-monthly intervals. More generally, clear, consistent, consolidated reporting is regarded as crucial (see Guidance in Appendix 4): it will not be helpful to trustees if managers disclose the various costs listed in the Code, in a number of different reports or with different reporting dates.

Managers responsible for mandates of a number of different portfolios or asset classes for one scheme, should carefully consider whether it would be more helpful to the trustees if reporting were at portfolio or asset class level.

3 Appendices

1. Level One Disclosure requirements
2. Level Two Disclosure requirements
3. Disclosure Table
4. Guidance for Completion of Table
5. Glossary

APPENDIX 1

LEVEL ONE DISCLOSURE

MANAGER'S POLICIES, PROCEDURES AND CONTROL PROCESSES

Reporting Period to which Disclosure Relates:

Selection Processes:

- Dealing Venues and Methods

Disclosure should address the following:

- Description of the various dealing venues used with reasons e.g. brokers, crossing networks, direct market access etc.
- Description of trading strategies e.g., net trading, execution only, agency trading, principal trading, internal crossing and programme trading
- Description of the decision making process in the choice of venue and the relevant factors influencing that decision, i.e. the investment decision, the choice of venue and how that is informed, the delegation of the trade, the assessment of anticipated explicit and implicit costs, and the quality assessment of the trade after execution
- Description of how the manager ensures best execution for clients

- Broker Selection

Disclosure should address the following at the firm level:

- The manager's broker selection process, how often it is conducted, the relevant factors involved in the assessment and controls put in place to address counter-party risk
- Description of how targets are established for future levels of business, and how this is allocated between commission bearing and net business

- Broker Review

Disclosure should address the following:

- The frequency and content of broker reviews
- Description of the firm's negotiation process with counterparties when arriving at an ex-ante "At Full Service" commission rate for agency trades
- Description of the firm's negotiation process with respect to agreeing on an ex-ante basis the execution component of the "At Full Service" rate of commission and to agreeing on services received for the residual
- Monitoring process of business transacted against targets and how outcome may differ from original targets, either in monetary terms, in trading patterns or in the commission split

It is to be expected that the process of broker selection and review will be different between different firms, reflecting the differing size and complexity of the investment management firm.

Variations in Rates of Commission:

Disclosure should address the following:

- The range of commission rates paid (in basis points) across asset classes at the firm wide level
- Description of how different trading strategies affect the firm wide rate(s)

Commission Recapture/Directed Commissions:

- Managers should disclose participation in commission recapture and/or directed commission programmes
- Managers should disclose whether the programme is run in-house or whether it is the client's progamme. Where it is the latter, managers should disclose, if possible, whether it is a client/broker arrangement or whether it is a client/third party/broker arrangement. Managers should also disclose whether they have contracted out of best execution as a result of such an arrangement

Dealing Efficiency Monitoring:

Disclosure should address the following:

- Policies and procedures for monitoring transaction costs
- Assessment of the impact of implicit costs e.g. bid/offer spread, market impact and opportunity costs
- Any use of third party transaction cost analysis services and how the results are used
- How often dealing effectiveness is formally monitored

Conflicts of Interest:

Disclosure should include the following:

- Procedures for identifying conflicts of interest e.g. fair treatment of client orders and allocation of trades
- Description of how conflicts of interest are managed and monitored
- Description of how the effectiveness of controls is assessed

Purchase of Research:

Disclosure should address the following:

- The firm's policy on using external research, including third party research
- Description of how external research is assessed (reference back to Broker Selection)
- Description of the process whereby research is purchased

Derivatives:

- Where appropriate, managers should disclose how and in what circumstances they use derivatives as a fund management tool
- Managers should describe the different types of derivatives used

Access to and allocation of Initial Public Offerings and Underwriting:

- Manager's policy plus procedures for complying with relevant FSA regulations and the extent to which securing allocations of IPOs and underwriting influences trading patterns.

Custody Services:

- Where the manager appointed the custodian, an outline of the manager's selection, monitoring and review processes

Placing of Deposits:

- Manager's policy on spreading deposits, in particular as regards placing deposits with associates, policy on credit ratings and counter-party risk, use of money market funds

Foreign Exchange Transactions:

- Manager's policy in spreading foreign exchange transactions, in particular as regards placing these through associates and policy on credit ratings and counter-party risk

APPENDIX 2

LEVEL TWO DISCLOSURE

Reporting Period to which Disclosure relates:

Percentage of portfolio at period end not covered by the Code

e.g. direct property, private equity, or commodities.

Fund Management fees and any other income derived by the manager and associates
In the case of pooled funds with multiple fee scales, the fee scale borne by the particular client.

Custody costs borne directly by the fund, and to whom paid

Comparative Disclosure of trading volumes, commissions generated and how they have been spent

- Analysis of trading for the reporting period by top 10 counterparties and of total trading
- Analysis of commissions generated at various commission rates
- Analysis of how commissions generated have been spent i.e. how much on execution and how much on other services, and what has been retained by the executing broker and what has been paid to third parties
- Total commissions generated for the fund
- Firm-wide comparison of the fund's trading, commissions generation and how they have been spent, and of average commission rate paid

Guidance for Completion of the Disclosure Table is set out in Appendix 4 on Page 14

Underwriting/sub-underwriting commissions received

Stocklending **(**if the manager undertakes stocklending on behalf of the client)

Income to the fund and fees paid

Taxation

- VAT
- Stamp duty paid on purchases
- Any other transaction taxes or levies

Other de minimis costs, e.g. PTM levy on transaction contract notes need not be disclosed**.**

APPENDIX 3

IMA COMPARATIVE DISCLOSURE TABLE
How commissions paid have been generated and how they have been used
Report for: Client A
Asset type:

Analysis of Trading in period

Counterparty	**Total (£)**	**Of which:**		
		% Net	**% with Commission**	
			At Full Service Rate	***At Other Rates***
1 2 9 10 Other				
ALL				
	(a)	*(b)*	*(c)*	*(d)*

Sources of Commissions Paid(£) **Uses of Commissions Paid (£)**

			Of which:			
			For Execution (£)		**Other[1] (£)**	
At Full Service Rate (£)	***At Other Rates(£)***	***Total Paid Out (£)***	***Retained by Executing Broker***	***Paid to Third Parties***	***Retained by Executing Broker***	***Paid to Third Parties***
(e)	*(f)*	*(g)*	*(h)*	*(i)*	*(j)*	*(k)*

Firm-Wide Comparators				
All Equity Trading	**100%**	**%**	**%**	**%**
Client A Trades	**100%**	**%**	**%**	**%**

%	**%**	**100%**	**%**	**%**	**%**	**%**
%	**%**	**100%**	**%**	**%**	**%**	**%**

Average Firm-Wide Commission Rate (bp)	**XXbp**
Client A Average Commission Rate (bp)	**XXbp**

[1] **Other is research.**

APPENDIX 4

GUIDANCE FOR COMPLETION OF COMPARATIVE DISCLOSURE TABLE

Level II disclosure is intended to provide information to an asset manager's client on the following:

- An analysis of the trading on his portfolio by counterparty and by type of trade. Some managers may wish to break down the column "At Other Rates" further in order to disclose their use of various trading systems e.g. DMA, crossing networks, programme trading
- An analysis of the sources, and amount in £s, of commission generated by those trades by counterparty, and the total generated by counterparty
- An analysis of the uses which those commissions, in £s, have been put to with respect to purchasing execution and other services, both those commissions retained by the executing broker and those paid to third parties
- A comparison of the above with the asset manager's **total** pattern of trading in the specific asset class for **all** clients, and a comparison of the client's average commission rate with the firm

Pooled Funds - For pooled funds, separate disclosure should be made at the fund level and not the client level.

Asset Class - As a minimum, managers should complete the table for equities and for bonds. Managers may, however, wish to break asset classes down further depending on client requirements. Bond trading volumes should be disclosed in order to inform the client of trading pattern by counter-party.

Derivatives - Managers who use derivatives should treat these as a separate asset class where inclusion would distort disclosure of other numbers. The consideration paid should be disclosed, not the economic exposure.

Currencies - Currency trades should be treated as a separate asset class with reference as to which asset class they relate.

Commission Recapture - Where the manager arranges and operates the commission recapture programme and agrees the level of rebate, the commissions disclosed in the table should be net of any rebates to the client. For those programmes organised by the client, but where the manager nominates trades in accordance with client instructions, the manager may wish to disclose the value of participating trades and commissions by counterparty, and if known the sharing of commissions between broker, agent and client. If the manager is aware of the programme but not the relevant trades, he may wish to provide a footnote to that effect. Disclosure should also be made if best execution is signed away as a result of a particular programme.

Table Definitions

- **Counterparty:** Trading venue, which may be a broker, a crossing network, an alternative trading platform, or other venues

- **Trading Volume for period:**

  Col. (a) – Total (£):
  - purchases plus sales plus IPOs plus secondaries to include programme trades, derivative trades (futures, options etc. by consideration paid, not economic exposure) and to include investment/disinvestment of cash flows. In-specie transfers excluded but to be identified by value as a footnote
  - internal crosses to be identified separately if in the top 10, or put in "Others"

  Col. (b) - % Traded Net:
  - trades done with no commission paid, including IPOs, secondaries, internal crosses, other securities and instruments which are traded net, and business transacted on a principal basis, as a percentage of total transactions by value

  Cols. (c), (d) - % With Commission:
  - transactions subject to commissions

  Col. (c) – At Full Service Rate:
  - transactions which bear commission at the standard rate negotiated ex-ante with the counterparty on a firm wide basis, as a percentage of total transactions by value

  Col. (d) –At Other Rates:
  - transactions which bear commission at all other rates, such as direct market access, agency programme trades, alternative trading platforms, execution only, algorithmic trading etc. , as a percentage of total transactions by value

- **Sources of Commissions Paid during Period (£):**

  Col. (e) – At Full Service Rate:
  - commissions paid on trades in Col (c)

  Col (f) – At Other Rates:
  - commissions paid on trades in Col (d)

  Col (g) - Total:
  - total of Cols. (e) and (f)

- **Uses of Commissions Paid during Period (£):**

  Col (h) – For Execution – Retained by Executing Broker:
  - the amount of commission retained by the executing broker which is for execution, in £s

  Col (i) – For Execution – Paid to Third Parties:
  - the amount which is used to pay for services from third parties to support execution, in £s

  Col (j) – Other – Retained by Executing Broker:
  - the amount which is used to pay for non-execution related services from the executing broker as agreed ex-post (with reference to the ex-ante split), in £s

Col (k) – Other – Paid to Third Parties:

- the amount which is used to pay for third party research, in £s

These amounts, the sum of columns (h) to (k), must sum to the total commission that has been paid in column (g). "Other" refers to non-execution related services, i.e. research. The total amount paid in respect of other services is essentially determined as the excess over that required for execution i.e. the residual.

- **Firm Wide Comparators:**

  All Trading by Asset Class:

  - to include all trades in the discrete asset class for **all** clients (including those not subject to the disclosure regime), as a percentage, for each column

  Client A Trades:

  - as above by client, as a percentage, for each column i.e."ALL" line above in percentages

  Average Firm-wide Commission Rate (bp):

  - the firm's average commission rate in that asset class

  Client A Average Commission Rate (bp):

  - specific client's average commission rate in that asset class

APPENDIX 5

GLOSSARY

Algorithmic Trading – the use of a broker's proprietary tools to allow a manager to run trading strategies for his orders (such as matching VWAP or a percentage of volume) without additional execution services from the broker such as sales trading overlay or capital commitment.

Best Execution – well-informed trade execution decisions made with the intention of maximising the value of client portfolios in the particular circumstances at the time.

Bid/ask Spread – the difference between the market price quotations, for buying and for selling particular securities.

Commission Recapture – the process whereby a client directs a manager to place trades for his account through a specific broker, in exchange for which the client will receive a rebate of a portion of the total commission in addition to execution services. This arrangement can be managed by a third party, such as an investment consultant, or managed by the client's fund manager.

Counterparty – trading venue which may be a broker, a crossing network, an alternative trading platform, direct market access or other venues.

Crossing Network – an electronic execution venue for fund managers that enables them to match buying and selling orders in securities directly with other fund managers. Commissions are typically lower while market impact and bid/ask spreads are removed altogether. Liquidity is often a constraint to order completion.

Direct Market Access (DMA) – direct access to the market floor by managers who wish to deal anonymously in the market, without the use of execution services provided by a broker.

Directed Commissions – the process whereby a client directs a manager to place trades for their account through a specific broker, in exchange for which the client may receive benefits from the broker.

Execution Services – those services related to trade execution that meet the criteria laid down by the FSA for payment out of commission.

Internal Crossing – a manager's decision to match a selling order of one client with a buying order of another client, or vice versa, without placing the orders through the market, thereby saving both clients the cost of the bid/ask spread and broker commissions.

Market Impact - the difference between the actual execution price for a transaction and the market price that would have prevailed had the manager not sought to trade the security in question.

Net Transactions – trades placed directly with brokers and where no broker commission is paid. The broker is remunerated by making a turn on the bid/ask spread.

Opportunity Cost - the loss (or gain) incurred as a result of delay in completion of, or an inability to complete in full, a transaction following a portfolio manager's initial decision to trade.

Programme Trades – bulk trades for multiple securities placed through a single broker at a significantly reduced commission rate.

Research Services – those services that meet the criteria laid down by the FSA for payment out of commission, irrespective of whether the actual costs are met that way.

Stocklending – the process by which a portfolio lends securities to a counterparty, subject to an obligation for return of the securities at a future date. The lender is remunerated by way of a fee.