

Date:	10 May 2016
Classification:	General Release
Title:	Pension Fund Benchmarking Costs
Report of:	Steven Mair <i>City Treasurer</i>
Wards Involved:	All
Policy Context:	Effective Control over Council Activities
Financial Summary:	There are no financial implications arising from this report

1. Executive Summary

- 1.1 This report advises the Board of the current position with regard to performance benchmarking of the Fund and in particular the Scheme Advisory Board Key Performance Indicator (KPI) Benchmarking exercise.

2. Key Matters for the Board

- 2.1 The Board note the contents of this paper

3. Background

- 3.1 At the November meeting of the Westminster Local Pension Board members asked for more information on the benchmarking arrangements for the Funds' investments and costs.
- 3.2 This report will cover the response to the Scheme Advisory Board KPI Benchmarking exercise and provide further analysis of the investment returns and scheme costs.

4. Scheme Advisory Board KPI's

- 4.1 As part of its work over the last two years the LGPS Scheme Advisory Board (in shadow prior to April 2015) has sought to improve the quality and comparability of data associated with the LGPS following criticism from the Hutton Commission Final Report in 2012.
- 4.2 There has also been considerable discussion around the ability to identify and compare the financial health of individual LGPS Funds. This led to the establishment of a working party which was tasked with creating a range of meaningful performance indicators to show those funds who were in a stronger or weaker position. This assessment is not necessarily a reflection of the current governance and administration arrangements but will highlight where improvements are required following decisions made over a number of years.
- 4.3 The Guidance issued by Scheme Advisory Board which sets out the rationale for the exercise and explains the range of KPI's was reported to the Board in October 2015. The KPI's are split into 4 core and 14 supplementary indicators where the core KPI's are classed as "alarm bells" to identify under-performing funds.
- 4.4 Officers have completed the KPI Proforma attached at Appendix 1 which was reported to the Pension Fund Committee meeting in November 2015.
- 4.5 A summary of all responses is expected in early 2016. The 2015 exercise was mainly a feasibility study and the intention in future years is that those funds identified with significant issues are likely to be contacted directly regarding establishing an action plan to make the necessary improvements.

5. Investment Performance Benchmarking

- 5.1 The Pension Fund Committee receive reports every quarter which analyse the investment performance between asset classes, fund managers and various time periods all against pre-determined benchmarks. These benchmarks are largely market related i.e. FTSE indices' and give an indication of the success of the investment strategy and individual mandates/fund managers.
- 5.2 Due to the long term nature of the Fund's liabilities the Pension Fund Committee is able to take a long term approach in its investment strategy and will make strategic allocations to different asset classes such as equities and bonds based upon the expected returns and risk appetite and will have less regard for short-term market fluctuations. Table 1 below shows the Fund's investment returns at

March 2015 over one and three year periods and compares them to the benchmark target.

Fund Manager	Asset Type	Value at 31/03/15	Asset allocation 31/03/15	One Year Net Return	One Year Benchmark	Three Year Annualised Net Return	Three Year Annualised Benchmark
		£m	%	%	%	%	%
Majedie	UK Equity	£256.5	23.5	6.9	6.6	16.0	10.6
Legal & General	Passive Global Equity	£277.3	25.4	13.7	13.9	n/a	n/a
Baillie Gifford	Global Equity	£179.2	16.4	18.9	19.0	n/a	n/a
Longview	Global Equity	£109.6	10.0	n/a	n/a	n/a	n/a
Insight	Index Linked Gilts	£17.9	1.7	6.6	6.8	2.6	2.7
Insight	Bonds	£156.6	14.4	9.8	9.8	8.1	7.5
Hermes	Property	£45.7	4.2	19.1	16.9	12.1	9.5
Standard Life	Property	£47.9	4.4	9.4	16.2	n/a	n/a
TOTAL		£1,090.7	100.0	12.5	12.9	13.3	12.0

Table 1: Westminster Pension Fund Investment Returns

- 5.3 In order to better understand the performance of the fund relative to other LGPS funds, officers have recently subscribed to the WM Local Authority Performance League tables. These tables are produced annually and provide comparisons on the level of returns across asset classes as well as overall returns achieved by individual funds. The results from the 2014/15 Local Authority Universe are shown at Appendix 2.
- 5.4 Whilst there may well be particular circumstances which determine individual fund returns, such as level of risk taken, this remains a helpful indication of where an individual fund's returns sit when compared to their peers and the overall range of results achieved. It also provides an insight into the drivers for success such as the investment strategy adopted and the success or otherwise of particular fund managers.
- 5.5 Compiling data from almost all LGPS Funds also provides the opportunity to carry out wider analysis and hence the ability to draw out specific conclusions. Each year an Annual Review of Local Authority Funds is produced which

discusses a range of topical issues in relation to LGPS investments such as asset allocation, individual asset classes and comparisons to corporate funds.

- 5.6 In March 2016, State Street Bank (formerly the WM Company) announced that they were to discontinue the provision of the performance measurement services provided to third party clients from 30 June 2016. Work is on-going to find an alternative provider for this service and the Pension Board will be kept informed of any developments.
- 5.7

6. Fund Management Costs

- 6.1 The focus on the costs of operating the LGPS has increased significantly over recent years with a number of commentators offering views on the comparability and potential savings that could be achieved through greater collaboration. In particular Michael Jonson at the Centre for Policy Studies (CPS) has recently published a report titled LGPS: Unsustainable : <http://www.cps.org.uk/files/reports/original/151215155124-LGPSUnsustainable.pdf>
- 6.2 The management costs for the Westminster Pension Fund have been analysed over the last 5 years and this is included at Appendix 3 (exempt). It is important to note there have been a number of changes during the period which limit the comparability of the figures such as changes in investment strategy and fund managers.
- 6.3 For the first time in 2014/15 CIPFA introduced guidance on accounting for the costs of running pension funds. This included reporting transaction costs in the accounts for the first time (transaction costs are costs associated with the purchase and sale of assets such as stamp duty and Broker commissions). As these costs exceed £1M pa the annual reported costs have increased significantly from 2013/14 onwards.
- 6.4 In order to provide some perspective to these figures and to consider how the Fund compares to other LGPS Funds an independent consultant has carried out a review of management costs. This highlights the degree of compliance with the CIPFA Guidance and shows how Westminster Pension Fund compares across a number of categories. This analysis is included at Appendix 4.
- 6.5 The analysis has been prepared in the context of the CPS report mentioned above and seeks to clarify some of the points raised and challenges a number of the conclusions drawn. In particular, the new CIPFA guidance and the inclusion of transaction costs is an attempt to improve the transparency around costs but has been interpreted as an increase in costs which is simply not the case.

- 6.6 Clearly the size of the Pension Fund will have a major influence on the costs as a percentage of assets and as Westminster is a smaller Fund this will result in a higher figure. In addition, the choice and number of fund managers will have a significant impact and needs to be considered alongside the investment returns achieved.

**If you have any queries about this Report or wish to inspect any of the
Background Papers please contact:**

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BACKGROUND PAPERS:

None

APPENDIX 1:

Westminster Response to the Scheme Advisory Board KPI Exercise

LOCAL AUTHORITY

ANNUAL 2014/2015

The following summary is based on 85 funds with a total Market Value of £199,896m.

FINAL RESULTS

CATEGORY	ASSET MIX (%)		Last 12 Months		3 Year Annualised		5 Year Annualised	
	Latest Year	31/03/2015	Average	Index	Average	Index	Average	Index
	31/03/2014							
TOTAL EQUITIES	63.1	61.5	13.7	19.2	13.2	14.2	9.6	10.0
GLOBAL POOLED INC UK	5.9	7.0	18.3	19.2	14.3	14.2	-	10.0
UK EQUITIES	24.3	21.2	6.3	6.6	11.7	10.6	9.4	8.3
OVERSEAS EQUITIES	32.9	33.3	18.1	20.7	13.8	14.8	9.5	10.3
North America	11.7	8.2	24.8	26.1	18.4	18.1	14.0	14.0
Europe	8.6	6.3	8.8	7.7	14.6	14.2	8.2	7.2
Japan	3.1	2.9	27.3	27.1	13.9	12.7	8.4	6.7
Pacific (ex Japan)	3.2	2.8	16.0	10.6	8.7	7.2	7.1	6.1
Emerging Markets	5.4	3.8	13.5	16.3	6.0	3.7	4.1	2.7
Global ex UK	1.0	9.3	19.2	20.7	16.0	14.8	11.3	10.3
TOTAL BONDS	16.4	17.1	13.0	-	7.1	-	7.9	-
UK BONDS	9.3	9.2	11.8	13.9	7.5	5.3	7.9	7.0
OVERSEAS BONDS	2.4	2.3	8.7	8.4	3.9	4.9	4.3	4.8
INDEX LINKED	3.7	4.2	20.2	18.5	8.5	7.9	10.3	9.6
POOLED BONDS	0.9	1.3	7.6	-	5.5	-	5.8	-
TOTAL CASH	2.9	2.7	1.8	0.3	2.0	0.4	1.8	0.4
ALTERNATIVES	7.0	7.9	12.5	-	8.6	-	7.0	-
Total Private Equity	3.8	4.3	15.7	-	10.9	-	9.6	-
Total Hedge Funds	2.0	2.2	8.6	-	6.5	-	4.9	-
Other Alternatives	1.2	1.4	9.5	-	4.8	-	3.3	-
POOLED MULTI ASSET	3.1	2.8	10.2	-	-	-	-	-
TOTAL EX-PROPERTY	92.6	91.9	13.0	12.5	11.2	10.6	8.8	8.1
TOTAL PROPERTY	7.4	8.1	15.8	18.3	9.7	11.4	8.9	10.3
TOTAL ASSETS	100.0	100.0	13.2	12.9	11.0	10.6	8.7	8.2

APPENDIX 2:

WM UK Local Authority Universe Results 2014/15

APPENDIX 4:

External Analysis of LGPS Management Costs 2014/15

Worth Accounting Solutions Response to CPS Report *LGPS: Unsustainable*

1. The analysis prepared by Michael Johnson is based on the DCLG's data rather than the published accounts for 2014/15. During 2014/15 CIPFA issued new guidance on accounting for the costs of running pension funds. The guidance required:
 - a. All transaction costs to be reported gross (hitherto these have tended to be netted off purchases and sales)
 - b. Report all management fees (i.e. *ad valorem* fees, performance fees and custody fees) gross rather than net these off purchases and sales
 - c. Disclose costs over three categories of expense:
 - i. Administration
 - ii. Investment management
 - iii. Oversight and governance (new category for 2014/15)
2. The guidance was not fully implemented by all pension funds. Nationally only about half the pension fund across England, Scotland and Wales complied with the guidance and within London, less than half of all pension funds fully implemented the guidance. Therefore any inter-fund comparison is probably flawed. Michael Johnson's analysis does not reflect this.

	London pension funds		National position	
	No.	%	No.	%
Fully complied	14	43%	51	52%
Partly complied	6	19%	16	16%
Did not comply	12	38%	31	32%
	32	100%	98	100%

3. Westminster Pension Fund fully implemented the CIPFA guidance in 2014/15.

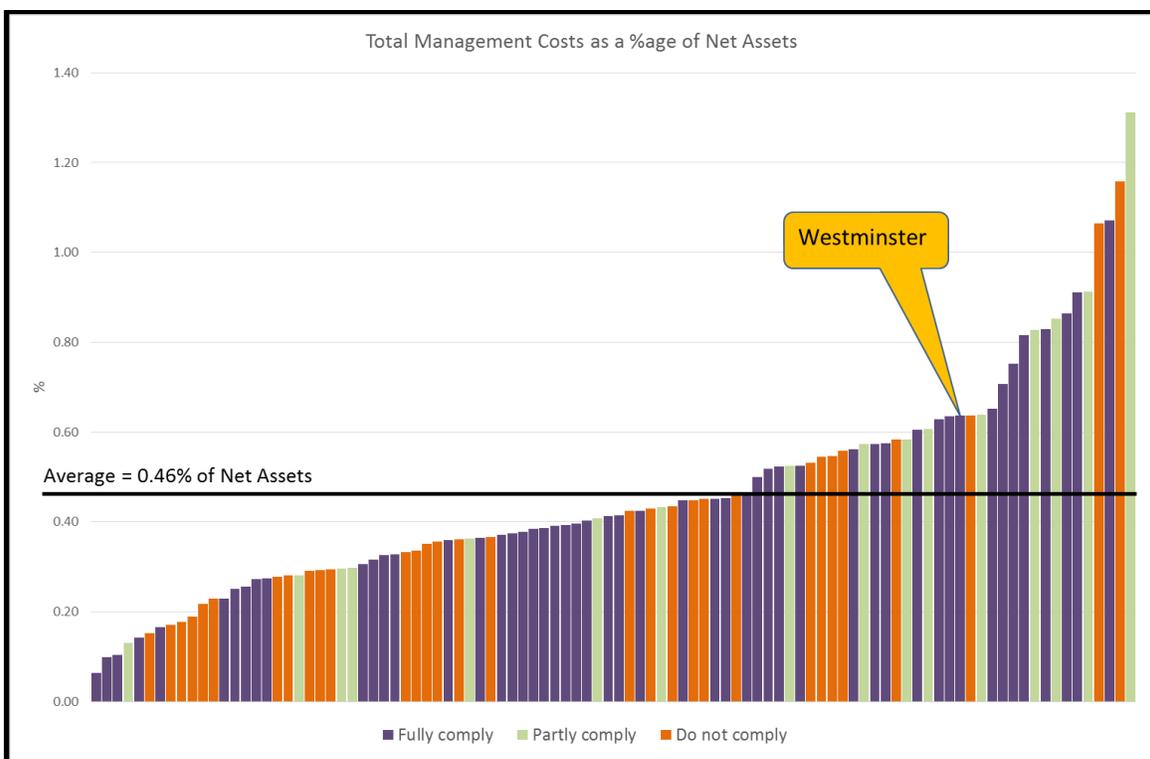
Restating 2013/14

4. Michael Johnson states that the cost of running LG pension funds has risen by 40%. His analysis is based on the data reported on the DCLG website. The pension funds which fully implemented the CIPFA guidance also restated the comparator financial information for 2013/14 to ensure consistency of reporting – the DCLG data for 2013/14 has not been restated.
5. Just looking at the authorities who fully implemented the CIPFA guidance, total management costs rose by 29% rather than 40%.

6. Additionally a significant number of LG pension funds have active pension fund management mandates with some fund managers. These are designed to out-perform the market. The reward for fund managers under active mandates is a performance fee on top of the basic *ad valorem* fee. Performance fees are inherently volatile between years. Overall 2014/15 was a good year compared with 2013/14 so part of the 29% increase is due to performance fees.

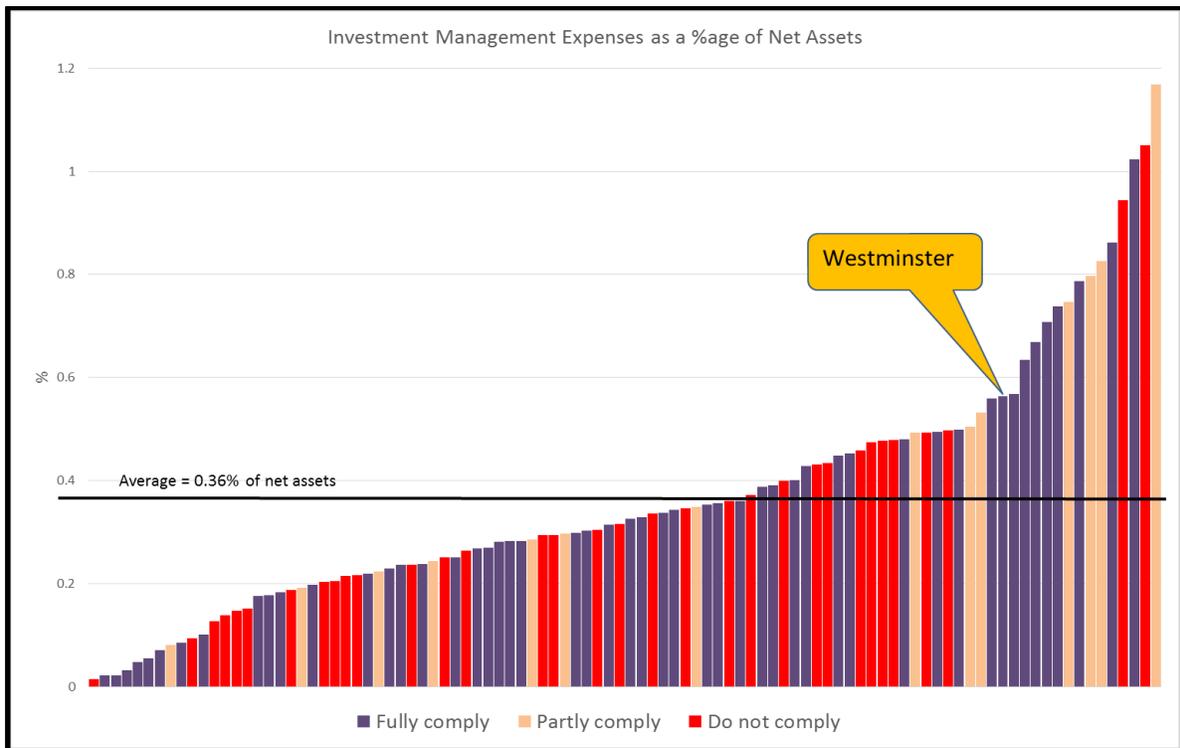
Total management costs

7. The average total management costs for a LG pension fund were 0.46% of net assets. Westminster pension fund was above average at 0.64% of total net assets –see graph below. The difference of 0.18% is around £1.9m. To a large extent this reflects that investment management expenses are higher than the average- see next section.



Investment management expenses

8. The average total investment management costs for a LG pension fund were 0.36% of net assets. Westminster pension fund was above average at 0.56% of total net assets –see graph below. However this compares favourably against pension funds in the private sector where investment management fees are in the range 0.75 to 1.25%.
9. The difference of 0.20% equates to around £2.2m of net assets.



10. Westminster's Pension Fund's above average costs reflect that the pension fund paid around £2.2m in performance fees to one fund manager to reward out-performance.

11. Given that overall management costs are 0.18% above average, but investment management expenses are 0.2% above average, this means that the pension fund's administration and oversight and governance costs are below average.