

Pensions Committee

2.00 p.m., Wednesday, 16 December 2015

Pension Fund Cost Benchmarking

Item number	5.8
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to inform Committee of summary conclusions of the benchmarking of investment for Lothian Pension Fund and pensions administration costs for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

The report on investment costs relies on data provided by CEM, an independent provider of benchmarking data. Its database is comprised of 320 global pension funds. Actual cost of approximately 0.39% was below the benchmark cost of 0.50%. The 0.11% difference amounts to approximately £5.5m per year. This is almost certainly due to the fact that the Fund manages a relatively high percentage of assets internally compared with the universe of pension funds.

Pension administration cost per member for this Council of £21.76 is within the range of the 18 broadly comparable local authority funds, £15.84 to £24.33. However LPF cost is higher than the peer group average of £19.17. Cost per member for LPF in 2014/15 has reduced by £3.14 (12.6%) from the previous year, in excess of the saving attained by the peer group of £1.11 (5.5%).

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Pension Fund Cost Benchmarking

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider;
- 1.2 Note the report;
- 1.3 Note that the CEM Investment Benchmarking Analysis 2014 and the CIPFA Pensions Administration Benchmarking 2015 comparator reports have been provided, on a confidential basis, to the Convener of the Pensions Committee, Convener of the Pensions Audit Sub-Committee and the Independent Professional Observer.

Background

- 2.1 The annual report 2014/15 for the pension fund identifies £28.7 million of costs for the Lothian Pension Fund, with investment costs representing by far the largest proportion of the Fund's total expenses.
- 2.2 Benchmarking can be a helpful tool to help drive improvements and deliver value for money. It is intended that participation in the benchmarking of service provision should facilitate:
 - Comparison between the costs and performance;
 - Provision of evidence to support decisions on budget and improvement and thereby enhance customer satisfaction;
 - Sharing of information and ideas with peer(s);
 - Review of performance trends over time.
- 2.3 In an effort to better understand its investment expense base, Lothian Pension Fund has contributed to CEM's database for the last three years. CEM's global database comprises 320 funds representing £5.5 trillion in assets, three fifths of which are based in North America. It includes 28 UK pension funds with aggregate assets of £168bn. The size of the funds range between £35 million and £591 billion. The median fund size was £3.7bn, which compares with Lothian Pension Fund's assets under management of £4.8bn at 31 December 2014. However, care should be taken in deriving conclusions from the headline data. CEM itself states that "being high or low cost is neither good nor bad". What matters is whether a pension fund is receiving sufficient value for the costs incurred. This is reflected in the long term returns of pension funds, net of costs.

- 2.4 Chartered Institute of Public Finance and Accountancy (CIPFA) pensions administration benchmarking club has been used for a number of years to assess the costs of administration of the Lothian Pension Fund, Lothian Buses Pension Fund and the Scottish Homes Pension Fund. The outputs and analyses have served to supplement internal performance management information.

Main report

Investment Cost Benchmarking Analysis

- 3.1 The benchmarking provided by CEM aims to provide comparable data but is unable to capture all investment costs from all funds. Accordingly, it excludes transaction costs and private asset performance fees from its analysis. For this reason, and also because the data is collected on a calendar year basis rather than a financial year basis, the actual costs differ from those reported in Lothian Pension Fund's annual report.
- 3.2 CEM calculates a benchmark cost for Lothian Pension Fund reflecting the Fund's size, asset mix and domicile. Lothian's actual cost of approximately 0.39% was below the benchmark cost of 0.50%. The 0.11% difference amounts to approximately £5.5m per year, and is an improvement of 0.02% over the prior year.
- 3.3 CEM concludes that the primary reason for costs being low compared with the benchmark is almost certainly 'implementation style' – a relatively high percentage of assets are internally managed and fund-of-fund usage is less than average. External active management tends to be much more expensive than internal management, while fund-of-funds tend to be the most expensive type of external management.

CIPFA Pensions Administration Benchmarking Club

- 3.4 The CIPFA Pensions Administration Benchmarking Club aims to collect the transactional volumes and processing costs for administering members' LGPS benefits (i.e. excluding investment) using standard definitions. "Employing authority work" and any work associated with the administration of non-LGPS pensions are excluded.
- 3.5 Each administering authority has scope to select a suitable peer group for the "comparator report" and also the submission by any individual LGPS administering authority is also available through the club database "interactive" report. Of the eleven Scottish LGPS administering authorities, only four (including this Council) have chosen to participate. The selected peer group of 19 funds also comprises, as far as is possible, similar sized English and Welsh authorities (total memberships ranging from 56,000 to 104,000).

- 3.6 CIPFA has stated that, in order to protect its commercial interests, its report “Pensions Administration Benchmarking Club 2015” “cannot be put in the public domain. It is for internal uses only within the authority....and for contacting and communicating with other members of the club”. Accordingly, the full comparator and interactive reports have been provided, on a confidential basis, only to the Convener of the Pensions Committee, Convener of the Pensions Audit Sub-Committee and the Independent Professional Observer.
- 3.7 It is emphasised that it would be incorrect to derive definitive conclusions on the basis of apportioned costs. This is an inherent issue given the scale of central support costs which are typically apportioned to the pension fund by the host Councils, the extent of co-provision of employer services and also the bases of overhead apportionment to the pension administration function, as distinct from other activities within the Fund Accounts.
- 3.8 Recognising this caveat, summary findings on costs and other observations on differences in the make-up of the Fund are as follows:
- LPF cost per member of £21.76 is within the range of the 18 comparable funds, £15.84 to £24.33. LPF cost is higher than the peer group average of £19.17; Cost per member for LPF in 2014/15 has reduced by £3.14 (12.6%) from the previous year, in excess of the saving attained by the peer group of £1.11 (5.5%). In context, LPF cost and the average from a similar peer group from 2008/09, were £24.39 and £19.86 respectively;
 - Staff costs (administration and pensioner payroll) per member for LPF of £10.40 show similar results to those of total costs, both in terms of correlation to the peer group and also prior year;
 - Active members represent a higher percentage of overall membership for LPF (42.0%) than the peer group average (35.5%). The proportion of pensioners to total membership (28%) is again higher (than peer group of 23.9%), with the consequence being that the proportion of deferred members is lower than that of the typical fund. As deferred members are less demanding on administration services, these factors would tend to increase pension administration and payroll workload and therefore cost;
 - Previous benchmarking reports have showed LPF as having the highest number of employers (in 2008/09, approximately 170 compared to an average of 105). Recently in England, the average number of employers has increased significantly with the inclusion of academy schools as separate entities and now LPF’s number of employers is broadly comparable with the average.
 - Staff turnover was higher than the peer group at 23% compared to 13%.

Performance Benchmarking

- 3.9 CEM highlights that investment costs should be taken in the context of a fund's long term net returns. However, relevant comparisons of long-term returns are not readily available.

- 3.10 For pensions administration, CIPFA analysis shows that for key retirement calculation and payment processes, Lothian Pension Fund's performance is seen to exceed that of the peer group. Aspects of the service where attainment is weaker against the comparators are in respect of the calculation and notification of deferred benefits and also the notification of dependent's benefits. These administrative procedures will be the focus of review within Lothian Pension Fund in order to seek appropriate service enhancement aligned to best practice. Quotations to members in respect of transfers-out also lag in comparison to the peer group, although it is considered that the degree of rigour applied by the Fund in seeking to mitigate the risk of pensions liberation fraud is very relevant.

Measures of success

- 4.1 Benchmarking of costs provides management information, which serves to inform the service planning and budgetary process of the three Lothian Pension Funds.

Financial impact

- 5.1 There are no financial implications arising directly from this report. Out of the Lothian Pension Fund total cost of £28.7million for 2014/15, pension administration costs amounted to £1.78million, with the remaining largely attributable to investment. Continuous improvement initiatives will be met from the approved budget 2015/16.

Risk, policy, compliance and governance impact

- 6.1 The provision of summarised conclusions of benchmarking is intended to enhance the governance of the three Lothian Pension Funds.

Equalities impact

- 7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

- 8.1 There are no adverse equalities impacts arising from this report.

Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

Not applicable

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Links

Coalition pledges

Council outcomes CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

Single Outcome Agreement

Appendices