

# Pensions Committee

2.00 p.m., Tuesday, 6 December 2016

## Pension Fund Cost Benchmarking

Item number	5.4
Report number	
Executive/routine	
Wards	All

### Executive summary

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The purpose of this report is to inform Committee of 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 297 global pension funds. Actual cost of 0.36% was below the benchmark cost of 0.45%. The 0.09% difference amounts to approximately £4.4m 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 of £22.42 for the three Funds is within the range of the 14 broadly comparable local authority funds, £12.93 to £26.69. However, the cost is higher than the peer group average of £18.89. In this context, it should be noted that the peer group average is being distorted by an outlier, whereby the lowest cost fund per member is £12.93, some £2.49 (16%) lower than the next lowest of £15.42. Had this been excluded, then the average peer group cost per member would have risen to £19.39.

### Links

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Coalition pledges

Council outcomes

[CO26](#)

Single Outcome Agreement

## Pension Fund Cost Benchmarking

### Recommendations

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Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;
- 1.2 Note the report; and
- 1.3 Note that the CEM Investment Benchmarking Analysis 2015 and the CIPFA Pensions Administration Benchmarking 2016 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

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- 2.1 The annual report 2015/16 for the pension fund identifies £36.3 million of expenses 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 four years.
  - 2.3.1 CEM's global database comprises 297 funds representing £5.6 trillion in assets, 56% of which are based in North America.
  - 2.3.2 It includes 8 UK pension funds with aggregate assets of £152bn, which compares with 28 UK pension funds in last year's database. This reflects pooling developments in the Local Government Pension Scheme in England & Wales. It does not change the headline analysis or the basis on which CEM calculates the benchmark cost for the Fund.
  - 2.3.3 The size of the funds range from £122 million to £721 billion.

- 2.3.4 The median fund size was £4.5bn, which compares with Lothian Pension Fund's assets under management of £5.1bn at 31 December 2015.
- 2.3.5 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

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### 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 reported by CEM 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 0.36% was below the benchmark cost of 0.45%. The 0.09% difference amounts to approximately £4.4m per year. The equivalent figures for the prior year were 0.39% versus the benchmark cost of 0.50%.
- 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.
- 3.4 The annual report 2015/16 for the pension fund identifies £34.5m of investment management expenses, £29.5 million (85%) of which are external management fees. All other expenses, the largest of which are transaction costs, internal asset management costs, property operational costs and custody fees, amounted to £5m. External management fees represent 0.56% of average assets, while all other expenses represent 0.10% of average assets. The direct costs attributable to internal asset management are approximately 0.03% of average assets.

## **CIPFA Pensions Administration Benchmarking Club**

- 3.5 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.
- 3.6 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 in the CIPFA benchmarking exercise. The selected peer group of 14 funds also comprises, as far as is possible, similar sized English and Welsh authorities and only one of the other Scottish funds (total memberships ranging from 62,000 to 109,000, with this Council's being 82,000).
- 3.7 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, to the Convener of the Pensions Committee, Convener of the Pensions Audit Sub-Committee and the Independent Professional Observer.
- 3.8 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.
- 3.9 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 £22.42 is within the range of the 14 comparable funds, £12.93 to £26.69. LPF cost is higher than the peer group average of £18.80; It should be noted, however, that the peer group average is being distorted by an outlier, whereby the lowest cost fund per member is £12.93, some £2.49 (16%) lower than the next lowest of £15.42. Had this been excluded, then the average per group cost per member would have risen to £19.39.
  - Cost per member for LPF in 2015/16 was £21.76 hence costs have increased by £0.66 (3.0%) from the previous year, this reflecting the recruitment of trainee pension administrators, both to meet the additional demands of the new scheme and enhance workforce sustainability. The peer group average for 2015/16 was £19.17.
  - Active members represent a higher percentage of overall membership for LPF (40.3%) than the peer group average (35.3%). The proportion of

pensioners to total membership (28.4%) is again higher (than peer group of 22.5%), with the consequence being that the proportion of deferred members (20.5%) is lower than that of the typical fund (32.6%). As deferred members are less demanding on administration services, these factors would tend to increase pension administration and payroll workload and therefore cost.

### **Performance Benchmarking**

- 3.10 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.
- 3.11 For pension 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. The 2015/16 comparator report disclosed relatively low performance for the Fund in respect of the calculation and notification of deferred benefits and also the notification of dependants' benefits. These administrative procedures of the Fund were revised to align with best practice, with implementation effective from 1 April 2016. Performance, therefore, has improved from the data encompassed by the benchmarking report. Quotations to members in respect of transfers-out also continue to lag in comparison to the peer group. In this context, Lothian Pension Fund's published performance in respect of transfers out is 30 days as opposed to the CIPFA target of 10 days. The 30 day target is normally achieved, which is in full compliance with the Disclosure of Information regulations, whereby schemes have 3 months to provide a transfer out.

## **Measures of success**

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

## **Financial impact**

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- 5.1 There are no financial implications arising directly from this report. Out of the Lothian Pension Fund total cost of £34.4 million for 2015/16, pension administration costs amounted to £1.8 million, with the remaining largely attributable to investment. Continuous improvement initiatives will be met from the approved budget 2016/17.

## **Risk, policy, compliance and governance impact**

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

## Equalities impact

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

## Sustainability impact

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

## Consultation and engagement

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

## Background reading/external references

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Not applicable

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## Links

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### Coalition pledges

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

**Single Outcome Agreement**

**Appendices**