

# Pensions Committee

2.00pm, Wednesday, 11 December 2019

## Pension Fund Cost Benchmarking

Item number	5.3
Executive/routine	
Wards	All
Council Commitments	

### 1. Recommendations

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The Pensions Committee is requested to:

1.1 note the report; and

1.2 note that:

- the interim CEM Investment Cost Effectiveness Analysis (to 31 March 2019);
- the CIPFA Pensions Administration Benchmarking 2019; and
- the interim CEM Pension administration benchmarking report 2019, have been provided, on a confidential basis, to the Conveners of the Committee and Audit Sub-Committee and the Independent Professional Observer.

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## Pension Fund Cost Benchmarking

### 2. Executive Summary

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- 2.1 The purpose of this report is to inform Committee about the benchmarking of investment costs for the Lothian Pension Fund and of pension administration costs for Lothian Pension Fund and Scottish Homes Pension Fund (and collectively known as LPF).
- 2.2 *Analysis of investment costs* was carried out by an independent provider, CEM Benchmarking Inc. Its database now includes 37 LGPS funds (with £193 billion of assets), and a wider global universe of 325 funds, including half of the world's top 300 funds (with £7.1 trillion of assets).
- 2.3 Lothian Pension Fund's actual investment cost of 0.39% of average assets was below the benchmark cost of 0.48%. The majority of LPF's investment cost relates to external management. The 0.09% difference with the benchmark is equivalent to a saving of approximately £6.3m per year. The main contributing factor to this difference is the fact that LPF manages a high percentage of assets on an internal basis compared to the benchmark peer group.
- 2.4 *Analysis of pension administration costs* was undertaken by the Chartered Institute of Public Finance & Accountancy (**CIPFA**). Pension administration cost per member of £22.09 for LPFs fell within a very wide range for local authority funds and was slightly higher than the average of £21.34. Qualitative measures, however, indicate, that the overall service provision exceeds the average.
- 2.5 In order to obtain further insight into pension administration cost and also quality of service, for the first time LPF has also participated in the pension administration benchmarking survey carried out by CEM. Whilst CIPFA is exclusive to the LGPS, CEM also includes UK private sector schemes. Participating funds, both private and public, are of a significantly larger size than LPF. Interim results show LPF's pension administration service to be categorised as "low cost; high service standard".

### 3. Background

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- 3.1 LPF's annual report for 2018/19 identifies £38.6 million of expenses, with investment costs (£36.1 million) representing by far the largest proportion of the total, as expected.
- 3.2 Benchmarking is undertaken to help identify areas where improvements can be made to deliver better value for money. The exercise should facilitate:
- comparison between costs and performance;
  - the provision of evidence to support decisions on budget relating to the sustainability and capability of the investment and administrative teams to enhance customer satisfaction;
  - sharing of information and ideas with peers; and a review of performance trends over time.
- 3.3 LPF has contributed to CEM's database for the past five years to better understand its investment expense base and how it compares with other pension funds.
- 3.3.1 The CEM 2019 global database comprises 325 funds representing £7.1 trillion in assets, including 241 North American funds with assets of £3.9 trillion and 74 European funds with assets of £2.4 trillion.
- 3.3.2 The global database also includes 37 LGPS funds with total assets of £193 billion.
- 3.3.3 The global funds range in size from £0.1 billion to £861 billion; the LGPS funds range from £0.6 billion to £22 billion.
- 3.3.4 The peer group for calculating LPF's benchmark cost contains 18 funds (including 10 LGPS funds). The peer group funds have been selected on the basis of fund size. The median fund size within the peer group is £7.8 billion, with half the funds in the range of £6.4 billion to £8.8 billion. This compares with Lothian Pension Fund's assets of £7.8 billion at 31 March 2019.
- 3.3.5 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.
- 3.4 CIPFA's pensions administration benchmarking club has been used for a number of years to assess the costs of administration of the Funds. The outputs and analyses have served to supplement internal performance management information.

- 3.5 However, in recent years, the number of local authority pension funds participating in the CIPFA benchmarking club has declined, making meaningful comparison more difficult. In addition, the Fund's drive for continuous improvement in service delivery led to a desire to be able to measure and compare against other funds in order to identify areas of best practice which could be adopted.
- 3.6 CEM has been benchmarking pensions administration for around 10 years, primarily in the US, Canada and the Netherlands. In the UK, participants include some of the other public sector pension schemes and other large company pension Schemes. The fund was invited to join a group of other large LGPS funds to take part in the survey for the first time in 2019. Although many questions posed are similar to those in the CIPFA survey and a cost per member output is produced, the CEM survey also includes a score for service. The peer group used in the CEM benchmarking survey is made up of Local Authority funds and other comparable UK pension funds.

## 4. Main report

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### Investment Cost Benchmarking Analysis

- 4.1 The benchmarking analysis undertaken by CEM aims to provide comprehensive, like-for-like comparisons with similar funds, but they are unable to capture all investment costs from all funds. Improved transparency has been achieved with the inclusion of private asset performance fees, but investment transaction costs, including property operational costs, are excluded. In addition, the fund undertakes more detailed cost analysis than CEM for its listed private market funds as these cannot be compared with other funds in the database. Thus, the total actual costs reported by CEM differ from those reported in Lothian Pension Fund's annual report.
- 4.2 CEM calculates a benchmark cost for Lothian Pension Fund, which reflects the fund's asset class mix, based on the asset class costs of the peer group funds.
- 4.3 LPF's actual cost figure to 31 March 2019 of approximately 0.39% of average assets was below the benchmark cost of 0.48%. The 0.09% difference is equivalent to a saving of approximately £6.3m for the year to 31 March 2019. Previous CEM cost analyses are shown below (analyses prior to 31 March 2017 were calculated on a calendar year basis):
- 31 March 2018: 0.43% versus the benchmark cost of 0.55%
  - 31 March 2017: 0.31% versus the benchmark cost of 0.48%
  - 31 December 2015: 0.36% versus the benchmark cost of 0.45%
  - 31 December 2014: 0.39% versus the benchmark cost of 0.50%
- 4.4 CEM concludes that the primary reason for cost being low compared with the benchmark is 'implementation style' – a relatively high percentage of assets are internally managed. External active management fees are significantly more expensive than internal management.

- 4.5 CEM analysis also shows that the Lothian Pension Fund cost of 0.39% is significantly lower than the median cost of the global peer group (0.63%) and also lower than the median cost of the LGPS universe (0.57%).
- 4.6 CEM highlights that investment costs should be taken in the context of a fund's long-term net returns.
- 4.7 CEM have compared Lothian Pension Fund's net value added (investment performance in excess of LPF's benchmark) over the medium-term (five years) with the net value added by CEM's global universe and its LGPS universe.
- 4.8 The analysis indicates that Lothian Pension Fund's net value added performance has been very strong - 85th percentile for the global universe and 81st percentile for the LGPS universe, meaning that Lothian has higher net value added than 85% of the funds in the global universe, and 81% of funds in the LGPS universe.
- 4.9 CEM has also conducted analysis on net total returns across its database. Over five years, Lothian Pension Fund's net total return is at the 100th percentile for the global universe, meaning that the fund has the highest five year return out of the 250 global funds for which CEM has five-year returns.
- 4.10 LPF's strong performance relative to peers is attributable to the outperformance of LPF relative to its benchmark in the years to 31 March 2015, 2016 and 2019. This was driven by the performance of LPF's internally managed equity portfolios that aim to deliver stronger returns in periods when equity markets are weaker/less buoyant, which occurred during those years.

#### **CIPFA Pensions Administration Benchmarking Club**

- 4.11 The CIPFA Pensions Administration Benchmarking Club aims to collect the transactional volumes and processing costs for administering members' LGPS benefits (i.e. excluding costs associated with administration and management of investments) using standard definitions. "Employing authority work" and any work associated with the administration of non-LGPS pensions are excluded.
- 4.12 Local authority pension funds subscribe to the CIPFA Benchmarking Club on a voluntary basis. The relative value to be gained from benchmarking analyses is obviously dependent on the scale of take-up of the service. The take-up of the CIPFA service has diminished in recent years and, as a consequence, the separate benchmarking report of funds of comparable size to Lothian Pension Fund is not reported this year.
- 4.13 CIPFA has stated that, in order to protect its commercial interests, its benchmarking reports "*cannot be put in the public domain. It is for internal use only within the authority....and for contacting and communicating with other members of the club*". Accordingly, the full report and executive summary report have been provided, on a confidential basis, to the Conveners of the Committee and Audit Sub-Committee and the Independent Professional Observer.
- 4.14 LPF is, however, able to report restricted summary findings and other relevant observations that affect the cost as follows:
- Lothian Pension Fund cost per member of £22.09 falls within the very wide range of local authority funds of c£13 to c£48. However, the cost is higher than the average of all funds of £21.34.

- The composition of a fund's membership impacts costs. Active members represent 39.4% of Lothian Pension Fund membership compared with an average of 32.7%, and pensioners represent 29.9% compared with 25.5%, with the consequence that deferred members represent a lower proportion of membership (23.6%) than the typical fund (30.5%). As deferred members are less demanding on administration services, these factors would tend to increase pension administration and payroll workload and therefore cost.
- Also, of note is that the proportion of Lothian Pension Fund staff holding relevant pension administration qualifications is significantly higher than the average (more than double).
- Moreover, Lothian Pension Fund's administration performance is above average for 10 of the 13 industry standard indicators, in certain instances by a considerable margin.

4.15 It is important to emphasise that care should be taken in interpreting the data purely on the basis of apportioned costs. This is of particular relevance 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.

4.16 Also, there appears to be potential inconsistency between the presentation of the benchmarking data and the allocation of costs in LGPS funds' financial statements (using CIPFA Guidance) to 'Administration' and 'Oversight and Governance' expenses.

### **CEM Pensions Administration benchmarking**

4.17 Whilst CIPFA is exclusively comprised of LGPS funds, CEM also includes UK private sector schemes, together with LGPS funds. Participating funds, both private and public, are of a significantly large size than Lothian Pension Fund.

4.18 As noted above, the CEM survey poses similar questions around cost as the CIPFA survey. Additional questions, however, focus on delivery of service, particularly on the channels used to communicate with customers and how different customer groups, including employers are served.

4.19 Final results are being compiled. However, at the time of writing the report, the interim results show that cost per member of £25.56 is lower than the adjusted average of £42.64. Results are adjusted to take into account differences in the number of members within the peer group. LPF's third-party fees and other direct costs, which include IT and accommodation, were lower than the peer group average.

4.20 The definition of functions encompassed by the term "pensions administration" does vary between the CIPFA and CEM benchmarking analyses, this explaining the higher cost per member disclosed by the latter. The CEM definition includes some additional areas such as relevant legal and trustee costs and other costs related to governance.

4.21 CEM believes that looking at cost in isolation is unhelpful, and, in order to provide context and measure value for money, a service score is also calculated. Service is defined from a member's perspective and higher service 'means more channels,

faster turnaround times, more availability, more choice, better content and higher quality. The interim results show a service score of 68 out of 100, which is higher than the peer median of 64. This score is calculated by weighting the service scores for three customer groups (active members, deferred members and pensioners) based on the membership mix. Reasons for the higher score compared to the peer group include:

- meeting more members one to one;
- paying retirement lump sums more quickly;
- having a strong social media presence across a number of platforms; and
- carrying out more transactional customer surveys.

Although employer service does not feed into the overall service score, compared the peer group, LPF scored well for meeting employers, training employer staff and for employer website and online services.

- 4.22 Participation in the CEM benchmarking pensions administration survey also allows access to additional research and workshops in order to meet with the peer group and other pension funds in order to identify areas of best practice which could be adopted for future service delivery.
- 4.23 The benchmarking information provides a useful snapshot of costs compared with funds that are prepared to share their data, but care should be taken in interpreting the information as the output relies on the accuracy of the data supplied.

## **5. Next Steps**

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- 5.1 LPF will use the benchmarking information to identify areas for improvement to ensure best value for money across its operations in investment administration and management and in pensions administration.

## **6. Financial impact**

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- 6.1 There are no financial implications arising directly from this report. Out of LPF's total costs of £38.6 million for 2018/19, investment costs amounted to £36.1 million and pension administration costs amounted to £2.5 million. Continuous improvement initiatives will be met from the approved budget 2019/20.

## **7. Stakeholder/Community Impact**

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- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.
- 7.3 There are no adverse sustainability impacts arising from this report.

## **8. Background reading/external references**

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8.1 None.

## **9. Appendices**

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