



Pensions Committee

2.00pm, Tuesday, 22 March 2022

LPF Cost Benchmarking

1. Recommendations

The Pensions Committee (Committee) is requested to:

- 1.1 note the report; and
- 1.2 note that the CEM Investment Cost Effectiveness Analysis (to 31 March 2021) and the interim CEM Pension administration benchmarking report 2021 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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LPF Cost Benchmarking

2. Background

- 2.1 The purpose of this report is to inform Committee about the annual results from benchmarking of:
- investment costs for the Lothian Pension Fund; and
 - pension administration costs for Lothian Pension Fund and Scottish Homes Pension Fund (and collectively known as **LPF**).
- 2.2 LPF's annual report for 2020/21 identifies £43.9 million of total management expenses, with investment costs (£36.7 million) representing by far the largest proportion of the total, as expected.
- 2.3 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 deliver customer satisfaction;
 - sharing of information and ideas with peers; and
 - and a review of performance trends over time.

3. Main Report

Investment cost benchmarking

- 3.1 Analysis of investment costs was carried out by independent provider CEM Benchmarking Inc. Its database includes 37 LGPS funds with total assets of £216 billion and a wider global universe of 314 funds with £8.2 trillion of assets.
- 3.2 Lothian Pension Fund's actual investment cost of 0.35% of average assets was below the benchmark cost of 0.46%. The majority of LPF's investment cost relates to external management. The 0.11% difference with the benchmark is equivalent to a saving of approximately £10.4m per year. The main contributing factors to this difference are attributable to:
- LPF managing a high percentage of assets on an internal basis compared to the benchmark peer group; and
 - LPF accessing externally managed private market investments at lower costs than the benchmark peer group.

- 3.3 Further details of the investment cost benchmarking process are provided in Appendix 1.

Pension administration benchmarking

- 3.4 Analysis of pension administration costs was undertaken by the Chartered Institute of Public Finance & Accountancy (**CIPFA**), with data provided for the 2021 exercise. Due to delays in provision of data by a number of participating pension funds, a report has yet to be provided. A verbal update will be provided at the committee meeting in March.
- 3.5 In order to obtain further insight into pension administration cost and also quality of service, 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", with a cost per member of £25.59.
- 3.6 Further details of the pension administration cost benchmarking process are provided in Appendix 2.

4. Financial impact

- 4.1 There are no financial implications arising directly from this report. Out of LPF's total management costs of £43.9 million for 2020/21, investment costs amounted to £36.7 million, administrative costs to £3.6 million and oversight and governance costs to £3.6m. The benchmarking exercise should aid future cost management efforts.

5. Stakeholder/Regulatory Impact

- 5.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the fund and they are invited to comment on the relevant matters at Committee meetings.
- 5.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

6. Background reading/external references

- 6.1 None.

7. Appendices

Appendix 1 – Investment Cost Benchmarking

Appendix 2 – Pension Administration Benchmarking

Appendix 1 – Investment Cost Benchmarking

Background

LPF has contributed to CEM's database to better understand its investment expense base and how it compares with other pension funds.

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. Consequently, the total actual costs reported by CEM differ from those reported in Lothian Pension Fund's annual report. CEM includes 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 always be directly compared with other funds in the database.

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.

2021 cost benchmarking

The CEM 2021 global database includes 314 funds with £8.2 trillion in assets, of which 37 are LGPS funds with total assets of £216 billion.

The peer group for calculating LPF's benchmark cost contains 17 funds (including 9 LGPS funds). The peer group funds have been selected on the basis of fund size and holding a broadly similar basket of assets to LPF.

The median fund size within the peer group is £8.8 billion, which compares with Lothian Pension Fund's assets of £8.6 billion at 31 March 2021. 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.

LPF's actual cost figure to 31 March 2021 of approximately 0.35% of average assets was below the benchmark cost of 0.46%. The 0.11% difference is equivalent to a saving of approximately £10.4m for the year to 31 March 2021.

CEM concluded that the primary reasons for cost being low compared with the benchmark are due to implementation style, in two areas:

- internal management, where LPF manages a relatively high percentage of assets internally relative to peers. External active management fees are significantly more expensive than internal management, and
- private markets, where LPF costs for investing in private markets were significantly less than the costs of the peer group.

CEM analysis also shows that the Lothian Pension Fund cost of 0.35% is significantly lower than the median cost of the 17 funds in the global peer group (0.65%).

Previous CEM cost analyses are shown below (analyses prior to 31 March 2017 were calculated on a calendar year basis):

- 31 March 2020: 0.35% versus the benchmark cost of 0.51%
- 31 March 2019: 0.39% versus the benchmark cost of 0.48%
- 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%

Net returns and risk

Separately, CEM also highlight that investment costs should be taken in the context of a fund's long-term net returns as well as risk.

As part of the benchmarking, CEM provide the median annual return from its LGPS universe over 7 years. Lothian's 7-year net return of +9.2% pa was above the LGPS median of +8.8% pa, and in the 74th percentile of the CEM LGPS fund universe of 37 funds. (100th percentile = highest return)

Lothian's 7-year net return (+9.2% pa) was also delivered with less risk (8.9%), than the median LGPS return (+8.8% pa) which was achieved with a higher level of risk (10.6%).

Appendix 2 – Pension Administration Benchmarking

Background

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.

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.

CEM has been benchmarking pensions administration for over 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.

CIPFA Pensions Administration Benchmarking Club

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.

LPF has participated in the CIPFA Pensions Administration Benchmarking Club for a number of years, and data was provided for the 2021 exercise. At the time of writing this report, due to delays in provision of data from a number of participating funds, full benchmarking information, including average cost per member (of the client universe) was not available. A verbal update will be provided to Pensions Committee.

CEM Pensions Administration benchmarking

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 larger size than Lothian Pension Fund.

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.

Final results are being compiled. However, at the time of writing the report, the interim results show that cost per member of £25.59 is lower than the adjusted average of £41.15, (£24.90 and £35.28 respectively in 2020). 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 accommodation, were lower than the peer group average.

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.

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. This score is calculated by weighting the service scores for three customer groups (active members, deferred members and pensioners) based on the membership mix. The interim results show a service score of 67 out of 100, which is higher than the peer median of 62. The 2021 score is below the score of 72 out of 100 for 2020 (the peer median for 2020 was 64). Reasons for the higher score compared to the peer group include:

- paying retirement lump sums more quickly;
- providing assistance to vulnerable members, including offering specially formatted printed materials and including modifications on our website; and
- carrying out targeted campaigns including encouragement to update beneficiary information.

The COVID-19 pandemic has had an impact on service provision, particularly in terms of dealing with telephone enquiries from members. Until recently, all calls from members were directed to a voicemail service with calls returned within 24 hours. This has had an impact on the service score. Since data was submitted to CEM, a new telephone system has been introduced which allows members to once again speak directly to staff.

Although employer service does not feed into the overall service score, compared with the peer group, LPF again scored well for meeting with and reporting to employers and training employer staff.

The full interim CEM benchmarking report is available on request.

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.

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.