



## Pensions Committee

2.00pm, Wednesday, 20 March 2024

### Cost Benchmarking

#### Item number 6.11

#### 1. Recommendations

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The Pensions Committee (Committee) is requested to:

- 1.1 note the report; and
- 1.2 note that the CEM Investment Benchmarking Analysis (for the year to 31 March 2023) and the CEM Pension Administration benchmarking report 2023 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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# Cost Benchmarking

## 2. Executive Summary

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- 2.1 CEM Investment Benchmarking Analysis for the year to 31 March 2023 shows that Lothian Pension Fund (LPF)'s investment costs are significantly lower than its benchmark. LPF's costs are also significantly lower than the CEM-selected global peer group and the CEM LGPS universe.
- 2.2 Over the long term (CEM analysis over 9 years), Lothian has delivered investment returns above the LGPS peer group median with a lower level of risk and at lower cost.
- 2.3 CEM Pension Administration Analysis shows that Lothian delivers a high level of above-benchmark service at below-benchmark cost.

## 3. Background

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- 3.1 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 (collectively known as **LPF**).
- 3.2 LPF's annual report for 2022/23 identifies £48.1m of total management expenses, of which investment costs (£41.4m) are by far the largest share, as expected.
- 3.3 Benchmarking is undertaken to help identify areas where improvements can be made to deliver better value for money and benefiting employers and members. 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
  - a review of performance trends over time.

## 4. Main Report

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### Investment Cost Benchmarking

- 4.1 Analysis of investment costs was carried out by independent provider CEM Benchmarking Inc. ('CEM'). CEM's 2022/2023 database includes 34 LGPS funds with fund assets from £0.8bn to £27.8bn, and a wider global universe of 293 funds with £8.3tn of assets.
- 4.2 Lothian Pension Fund's actual investment cost of 0.26% of average assets was below the benchmark cost of 0.49% (adjusted for Lothian's asset mix). The majority of LPF's investment cost relates to external management of private markets assets (including infrastructure, private equity and private credit) and externally managed equity mandates. The 0.23% difference with the benchmark is equivalent to a saving of £21.8m 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.
- 4.3 CEM analysis shows that the Lothian Pension Fund investment cost of 0.26% is significantly below the median cost of 0.78% for the 39 funds in the global peer group (peer group costs are unadjusted for Lothian's asset mix).
- 4.4 Lothian's investment cost of 0.26% is also significantly below the median cost of 0.73% for the 34 funds in the LGPS peer group. This equates to a c.£45m saving in investments costs compared to the LGPS peer group median.
- 4.5 CEM also highlight that investment costs should be taken in the context of a fund's long-term net returns and risk. As part of the benchmarking, CEM provide the median annual return from their LGPS universe.
- 4.6 Lothian's 9-year<sup>1</sup> net return of +8.3% p.a. was above the LGPS median of +7.6% p.a., and in the 95<sup>th</sup> percentile of the CEM LGPS fund universe of 34 funds, where the 100<sup>th</sup> percentile is the highest return.
- 4.7 Lothian's 9-year higher net return was also delivered with less risk (8.4%) than the median LGPS level of risk (10.0%).
- 4.8 Appendix 1 provides further detail on the investment cost benchmarking process.

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<sup>1</sup> 9 years is the longest period for which CEM provide LGPS data.

## Pension Administration Benchmarking

- 4.9 In previous years, analysis of pension administration costs was undertaken by the Chartered Institute of Public Finance & Accountancy (**CIPFA**). Due to delays in receiving reports from CIPFA and a reduction in comparable peers, the decision was taken to end participation in CIPFA benchmarking.
- 4.10 To obtain further insight into pension administration cost and benchmarking on quality of service, LPF has also participated in the pension administration benchmarking survey carried out by CEM. Whilst CIPFA was 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. CEM's methodology includes an adjustment to business-as-usual costs to allow for fairer comparison to eliminate the effect of economies of scale. As a result, peer costs are increased by £8.25 per member.
- 4.11 Results from the 2023 CEM benchmarking survey again show LPF's pension administration service to be categorised as "low cost; high service standard", with a cost per member of £30.49. The adjusted peer average is £35.42 per member.
- 4.12 As with investment costs, cost in isolation is unhelpful, and as agreed in the 2022/23 strategy, the fund strives to provide a quality service which offers value for money rather than being cheap. Again, the CEM benchmarking survey provides positive confirmation of this as LPF's service score is 68 compared to the peer median of 63.
- 4.13 Further details of the pension administration cost benchmarking process are provided in Appendix 2.

## 5. Financial impact

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- 5.1 There are no financial implications arising directly from this report. Out of LPF's total management costs of £48.1m for 2022/23, investment costs amounted to £41.4m, administrative costs to £2.7m and oversight and governance costs to £4.0m. The benchmarking exercise should aid future cost management efforts.

## 6. Stakeholder/Regulatory Impact

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- 6.1 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.
- 6.2 There are no adverse health and safety, governance, compliance, or regulatory implications as a result of this report.

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

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7.1 None.

## **8. Appendices**

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Appendix 1 – Investment Cost Benchmarking

Appendix 2 – Pension Administration Benchmarking

## 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.

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.

### 2023 Cost Benchmarking

The CEM 2022/2023 database includes 34 LGPS funds with fund assets from £0.8bn to £28 bn, and a wider global universe of 293 funds with £8.3tn of assets.

The peer group for calculating LPF's benchmark cost contains 39 funds, including 7 LGPS funds. The peer group funds have been selected on the basis of fund size and holding a broadly similar portfolio of assets to LPF.

The median fund size within the peer group is £9.7bn, which compares with Lothian Pension Fund's average assets of £9.6bn over the year to 31 March 2023. 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 2023 of c.0.26% of average assets was below the benchmark cost of 0.49%. CEM calculate that the 0.23% difference is equivalent to a saving of £21.8m for the year to 31 March 2023.

CEM analysis also shows that the Lothian Pension Fund cost of 0.26% is significantly lower than the median cost of 0.78% for the 39 funds in the global peer group (unadjusted for Lothian's asset mix) and also significantly lower than the median cost of 0.73% for the 34 funds in the LGPS peer group.

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

- 31 March 2022: 0.29% versus benchmark cost of 0.50%
- 31 March 2021: 0.35% versus benchmark cost of 0.46%
- 31 March 2020: 0.35% versus benchmark cost of 0.51%
- 31 March 2019: 0.39% versus benchmark cost of 0.48%
- 31 March 2018: 0.43% versus benchmark cost of 0.55%
- 31 March 2017: 0.31% versus benchmark cost of 0.48%
- 31 December 2015: 0.36% versus benchmark cost of 0.45%
- 31 December 2014: 0.39% versus benchmark cost of 0.50%