West Midlands Pension Fund

Question 1 – How can the Local Government Pension Scheme best achieve a high level of accountability to local taxpayers and other interested parties – including through the availability of transparent and comparable data on costs and income - while adapting to become more efficient and to promote stronger investment performance.

Accountability

Within the LGPS 70-80% of Fund liabilities are with local authorities and their subsidiaries, this proportion being even higher for single authority funds, such as the London boroughs. The funding of these local authorities has changed considerably over recent years and more widely, the employer base within the LGPS is increasingly varied. In order to ensure accountability to local taxpayers and interested parties, clarity is needed on who the accountability is actually to; whether it is to the beneficiary, to the employer or to the local taxpayer as a stakeholder, particularly given that there is a degree of commercial decision making undertaken when outsourcing contracts. That said, the current and proposed governance structure of the LGPS; composed primarily of locally elected councillors and employee representatives, does provide a significant amount of accountability and disclosure to interested parties, through compliance and assurance statements, regular reporting and annual publications.

Transparency

In respect of transparent and comparable data, a number of agencies already collect comparative data on an annual basis, such as CIPFA for the benchmarking club and DCLG for the SF3 returns, in addition to the annual accounts disclosures. However, the content of these returns is not directly comparable due to differing data submitted by LGPS funds in respect of activity, management fees, performance and income etc.

In terms of actuarial valuation, assumptions used vary from fund to fund, some adopt a more optimistic view and some a more realistic view, hence deficits/surplus are not directly comparable.

Further detail to data collection and comparability requirements is included in the response to question 5.

Efficiency and investment performance

LGPS funds have a fiduciary duty to strive to improve investment returns, having due regard to risk appetite and by taking a long term view in order to strike a balance between risk, reward and diversification. There is no consistency between investment returns and fund size according to research undertaken. Larger funds naturally have greater access and capability for diversification and cost management because of economies of scale. It is very difficult to compare fund returns due to differing risk appetite as a result of individual fund profiles. The attached research paper (Appendix 1) undertaken by Hymans Robertson illustrates the fact that size of fund does not solely have an influence on investment returns.

This review should not necessarily be about big versus small funds, but about the effective and efficient running of the scheme and about determining the optimal size to achieve this. There are advantages and disadvantages to both large and small funds, with larger funds having the potential for bigger resources, internal fund management and research capability in addition to reduced key man risk. However, evidence shows that small funds can and do perform consistently well within the local authority universe, although volatility tends to be higher than in larger funds, and can experience fewer challenges in deploying cash for investment.

Flexibility to make investment decisions through an appropriate governance structure and delegated powers is crucial, and funds with in-house management capability are better placed to make and implement asset allocation decisions on a more timely basis. Access to these capabilities is more widely available to larger funds and the combination of in-house expertise, larger governance budgets and economies of scale in investment activities could demonstrate, subject to a robust cost benefit analysis, that larger funds have the resources and capability to be more cost efficient.

Finally, we see a benefit in reviewing the legal status of the LGPS fund and one option would be considering the Pensions Authority Model. This model can be seen in the structure of LPFA and South Yorkshire Pension Fund who have powers conferred, which the administering or lead authority do not.

Question 2 – Are the high level objectives listed above those we should be focussing on and why? If not, what objectives should be the focus of reform and why? How should success against these objectives be measured?

The two high level objectives of dealing with investment deficits and improving investment returns are appropriate, but with the required addition of scheme affordability and addressing the long-term benefit structure. Balancing affordability and prudence is a challenge and the implementation of the 2014 scheme with the 1/49 accrual rate will require close monitoring in respect of the cost mechanism; which has to work in order to avert a review of the 2014 scheme in the not too distant future. The 2014 scheme does not deal with existing deficits, which will be carried forward and must be addressed. This means that the affordability question still remains and has an implication for the 2014 scheme being sustainable in the future.

Addressing deficits is challenging for all funds and implementation of a realistic recovery plan is crucial. Failure to address a growing deficit will result in the position being extremely difficult to recover. It might seem attractive to defer action in difficult times, for example by extending recovery periods and increasing investments risks, however this could lead to the scheme ultimately being unsustainable. Deficits within the scheme are primarily derived from liabilities, with costs accounting for 30-40bp as detailed by Actuarial Valuation exercises. Dealing with deficits can only be addressed by:

- Increased contributions – this raises the affordability issue for both employees and employers, however inconsistency or failure to set sufficient contribution rates will result in recovery plans being unachievable and a repeat of previous poor policy decisions, particularly in respect on pensions holidays, creating even more problems for all stakeholders in the future.

- Scheme benefit structure – managing liabilities is a key area for review. A potential move to a 5-year actuarial valuation cycle and funding plan, with annual monitoring, would provide longer term stability for employers who themselves are facing challenging times. Some of the changes in the 2014 scheme are helpful; revised employee tiered contribution rates, link to the state pension age and the 50/50 option. However, the move to a 1/49 accrual rate could prove to be expensive and could be better structured to address affordability issues.

- Investment returns – have a role to play but are not the overall solution, and further flexibility on investments from the investment regulation review may be helpful. Returns are usually reported net of fees and larger in-house teams with management expertise can contribute to the lowering of investment management, risk management and other associated costs. Collaborative investment opportunities could potentially provide a reduction in investment management fees, and some colleagues such as the London Treasurers Group are investigating a common investment vehicle. The national framework agreement has also been implemented with some success. Further collaboration such as the Pensions Infrastructure Platform (LGPS and corporate schemes) and investing for growth (the five main LGPS metropolitan funds) are also in place.

Investment managers have a role to play in addressing the matter of costs, and lobbying of managers is crucial to drive down the costs of existing mandates and future contracts.

A small number of managers offer LGPS fee structures currently, and aggregation of fees across mandates for related schemes is already in practice. It is our understanding that according to discussions being held with fund managers, a truly collective fee structure for the LGPS may be offered, but subject to the assets being overseen by one, national 'body'.

As stated above, this is not a case of big versus small, and although research and benchmarking exercises have been undertaken, the evidence is not conclusive as detailed in Appendix 1. Factors such as risk appetite, funding level, covenant strength and contribution rates, must be taken into consideration in the funding plan and will influence the investment strategy.

Measurements of success will include:

- Credible recovery plans in order to address deficits, and regular monitoring against the plan.
- Affordability – setting a threshold where the total cost of pension provision is set at a reasonable percentage of an employer payroll, including both PSD and FSR, and to maintain a benefit structure that is both fair, and affordable for the long term.
- A cost effective scheme.

Question 3 – What options for reform would best meet the high level objectives and why?

The options that would best meet the high level objectives are considered to be:

- A review of the benefits structure to focus on costs of pension provisions and long-term sustainability. Setting a transparent affordability limit on the cost envelope.
- Credible recovery plans with a longer term outlook, robust stewardship and annual monitoring of progress against the plan.
- Allowing a longer timeframe for the actuarial valuation exercise, moving to a 5-year cycle from a 3-year cycle will provide increased stability and facilitate the longer term view referred to in the above point.
- Flexibility in investments, not just infrastructure would be beneficial, facilitated by the review of investment regulations as mentioned earlier.
- Co-operation and collaboration across pension funds, incorporating a structural review of the LGPS legal entity, facilitating additional in-house capability, on a singular or shared basis that would provide an in-house team with increased expertise, efficient working practices and accountability for the services provided.

- If mergers were considered an appropriate option in order to meet the objectives then we believe that a legislative change would be necessary rather than voluntary participation, in order to fully implement the required changes and potentially meet the objectives stated.

Question 4 – To what extent would the options you have proposed under question 3 meet any or all of the secondary objectives? Are there any other secondary objectives that should be included and why?

Identification of the optimum size of Fund and operational procedures is key to meeting a number of the secondary objectives, with existing data suggesting that larger funds with access to higher quality in-house expertise benefit from lower costs overall and benefit from greater risk management and mitigation capabilities, particularly in respect of key-man risk, which is naturally higher in smaller funds in respect of investment and administration. There is some anecdotal evidence that funds which have internal investment management will generally have a lower cost base.

A recent study of LGPS investment management costs indicated that there is no evidence that larger funds will deliver significant savings in fund manager fees, see Appendix 2 attached. Co-operation and collaborative working across the LGPS will help towards lowering investment management costs; however we do not believe that costs should be looked at in isolation but should be considered alongside target and achieved returns net of costs. Flexibility in investing in other asset classes, not just infrastructure would be beneficial, facilitated by the review of investment regulations as mentioned earlier.

Although larger funds are reported as having lower pensions administration costs, the quality and type of services provided vary across the scheme. In respect of secondary objective 4, the pensions administration cost is small relative to the overall cost of managing a pension fund and efficiencies gained in this area are unlikely to have an impact on overall costs. However efficiency gains can be recycled into benefits to the customer.

In the case of additional secondary objectives, these should include improved customer experience, with quality of service and responsiveness to employers and employees being focussed upon and enhanced by any changes implemented, and through better working practices.

Question 5 – What data is required in order to better assess the current position of the Local Government Pension Scheme, the individual Scheme fund authorities and the options proposed under this call for evidence? How could such data be best produced, collated and analysed?

Notwithstanding the need for additional disclosure – any data collected or disclosed must be comparable and be arrived at through a standard basis of preparation and content. Effectively ensuring a 'level playing field'.

As referred to previously, there is a significant volume of data collected on a regular basis, by CIPFA in respect of annual administration cost and activity benchmarking and by DCLG in the annual SF3 return. There are however inconsistencies in the data disclosed in respect of both of the above exercises, such as internal/external costs of fund management, that need standardising in order to be utilised objectively in any decision making process.

Clarity of data should be arrived at by clear guidance and specification on what information is to be disclosed in respect of deficits, accounting practices (grossing or netting of fees), actuarial assumptions and contribution rates.

Whilst it is accepted that varying practices are necessary dependent on circumstances, the full disclosure of data would allow for these to be taken into account when comparing outcomes.

The LGPS structure and governance arrangements are interlinked, and forthcoming changes to overall scheme governance will assist in providing consistency and oversight; however it is important to define quality standards across the scheme.

In order for the data to be produced, collated and analysed in a consistent manner, there should be:

- Clear requirements and guidance, prescribed by the relevant third party (professional body) and applicable to all participants. A particular example of this would be the disclosure of netted off fees, e.g. private equity LP structure, in respect of investment management, and analysis of the returns generated by participating in those particular vehicles. Viewing either component in isolation does not give a true picture of the cost/return profile.
- Oversight by one body, CIPFA, on accounting standards and requirements, particularly in respect of cost disclosures in both the benchmarking exercises and annual accounts disclosures.
- TPR guidance, in line with the corporate sector, on governance and oversight and GAD, along with the actuarial profession setting parameters and guidance on actuarial assumptions.

Summary

In response to the call for evidence WMPF recognise that change is necessary in order to protect the future affordability and sustainability of the LGPS, and that change should be arrived at through assessment and analysis of comparable data on a level playing field basis.

Options for change:

- Co-operation and collaborative working and collective investment vehicles should be allowed to be developed. When data is available fund merger may then be taken forward as appropriate for further debate supported by a robust cost benefit analysis.

- Monitoring of the benefit structure to ensure affordability.

- Structural review of the LGPS legal status, with reference to the Pensions Authority Model.

- Investment regulation review to provide flexibility of investment management.

- Longer term view of actuarial valuation, suggesting a 5-year cycle with closer monitoring on an annual basis.

HYMANS ROBERTSON
The Spirit of Independence

briefing
note

Call for Evidence - Fund performance in the LGPS

September 2013

Linda Selman
Partner

William Marshall
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"There is no reliable evidence within the LGPS dataset that we have examined to support the assertion that the larger funds perform better than the smaller funds"

Fund performance within the LGPS

A frequent question that is relevant to the current Call for Evidence is what contributes to strong and weak relative performance across the LGPS funds. There are always difficulties in assessing performance, particularly over shorter term periods. Further, any assessment may be period specific. Nevertheless, taking these factors into account, we still feel it is helpful to address the question. Some of the results of our analysis may be surprising.

Background

The period we have considered covers the seven accounting years from April 2005 to March 2012. Over this period we have collected information on delivered and benchmark performance (typically from the published reports and accounts of the 101 LGPS funds). In terms of background conditions, the major feature over this period was the build up to the credit crunch, the market collapse and the subsequent rebound. This has therefore been an unusual period. At the same time, the unusual conditions create an interesting period for investigation. We have also drawn on some high level aggregate performance data measured over the same period based on the peer group which The WM Company tracks.

Looking at the peer group in aggregate

The following table shows the year by year and total period returns for the peer group.

	2006-07 %	2007-08 %	2008-09 %	2009-10 %	2010-11 %	2011-12 %	Annualised % p.a.
Median return	7.0	-3.1	-20.3	35.6	8.1	3.0	3.8
Weighted average	7.0	-2.8	-19.9	35.2	8.2	2.6	3.8
Index return	7.4	-0.7	-16.1	35.9	7.9	1.8	4.9
Average less index	-0.4	-2.1	-3.8	-0.3	+0.2	+1.2	-1.1

Source: The WM Company

We can see that the median return (half of funds better and half worse than the median) and the weighted average returns (weighted by value of fund assets) are quite similar. However, the performance of both is well behind the (average) performance of the funds' own benchmark indices. The cumulative underperformance over this period is 1.1% p.a. Much of the underperformance arose in the early and late stages of the credit crunch (from April 2007 to March 2009). The extent of index underperformance lends credence to a view that funds would benefit from a higher allocation to passive management than the current level of 24%.

The data does not explain the source of the underperformance. There is a widespread belief that asset allocation is the dominant influencing factor, but that was not the case when the entirety of this seven year period is examined. Although asset allocation was quite influential in 2008-09 when a higher allocation to equities was damaging, in 2008-09 a higher allocation to equities was beneficial; over the two years, the damage and the benefit had equal impacts.

It is always possible to mine data from statistics. At end June 2012, the 10 year annualised returns from UK equities, global equities and fixed interest bonds were each around 6% p.a. with index-linked gilts the surprising outperformer at 7.4% p.a. Over three years measured to the same date, i.e. starting from close to the recent bottom for equity markets, the annualised returns from equities and property were around 13% p.a. and not much better than bond returns (particularly long-dated bond returns). So asset allocation is not necessarily dominant even over extended periods. However, suppose we then factor in another calendar year of returns. Over the period from July 2012 to June 2013, UK equities returned +18%, global equities +21%, gilts -4%, I-L gilts -6.5% and property +2%. If we incorporate the most recent period and look back for 11 years rather than 10, the 25% outperformance of equities versus gilts over the last 12 months makes a huge difference to the annualised returns from the two asset classes. Equities now show an additional 2% p.a. excess return above gilts over 11 years. What figures reveal the truth? Both sets do and neither set does. It all comes down to interpretation and understanding more about what lies behind the data.

Comparing fund returns

We compared the performance of the best and worst decile of funds against the full peer group (excluding the closed funds which can disturb the results). The determination of best and worst decile is based on 7 year annualised performance (from April 2005 to March 2012).

Chart 1: All Funds (Source: Hymans Robertson LGPS database)

The leftmost bar each year shows the returns of the top 10, top quartile, median, bottom quartile and bottom 10 funds in each of the 7 financial years from 1 April 2005 - 31 March 2012 and over the cumulative period (right hand bar). The blue bar shows the spread of returns each year for the funds making the top 10 over the full 7 year period and the green bar shows spread for the funds which are in the bottom 10.

Observations on Chart 1

The top 10 funds have avoided very poor performance in individual years. Over the full seven year period, this compounds to produce above average outcomes. In contrast the bottom 10 funds have had a mix of average and weak performance. The weaker relative performance has occurred in periods of poor market returns and the impact has been very damaging. We conclude that there is no need to aim to shoot the lights out; consistent average performance is good enough to deliver strong long term returns. However, it is vital to avoid the extremes on the downside.

Characteristics of funds in the top 10

What else can we learn from the top 10 funds? Examination of their published accounts reveals some characteristics which are shared by a significant number of the ten. We have set these out in the table below, identifying the implication of each, with some caveats.

Characteristic	Implication	Caveat
Short manager roster	Reduced governance demands, allowing time to focus on strategy	You need the right managers
Low manager turnover	Reduced costs – transitions can be expensive and poor firing / hiring destroys value	You need the right managers and patience
Simple structure (typically, equities, bonds and property)	Reduced governance demands	Rebalancing discipline required
Some internal management	Alignment of interests arguably leads to better governance. Familiarity with the issues leads to better decisions.	You need the right internal resources
Evidence that funds re-balanced back to benchmark weights	Avoid the strategy becoming either too aggressive or too conservative	Frequency and timing matters

We should of course be cautious about drawing firm conclusions from a single set of data; seven years is not a long period over which to judge performance and the period from 2005 to 2012 was an unusual one for markets. Even if there is some connection between the characteristics we have identified and good performance, there can be no guarantee that the same characteristics will deliver good performance in the next seven years when the market environment may be very different.

Does size make a difference?

Much has been written about the potential of larger funds to perform better; their costs of investment are likely to be lower and they make more use of internal management. On the other hand there is some research which argues that there are diseconomies of scale. Andonov, Bauer and Cremer[1] found that

"*While larger pension funds have lower investment costs, this does not lead to better net performance. Rather all three components of active management – asset allocation, security selection and timing - exhibit substantial diseconomies of scale directly related to liquidity. Our results suggest that larger pension funds in particular would have done better if they had invested more in passive mandates without frequent rebalancing across asset classes.*"

[1] **Can Large Pension Funds Beat the Market? Asset Allocation, Market Timing, Security Selection and the Limits of Liquidity, October 2012**

Is there evidence of the influence of size in LGPS data?

To try to detect whether size makes a difference, we plotted the performance of LGPS funds split between those with assets in excess of £1bn at 31 March 2012 and those with assets less than £1bn. The split was designed to give sufficient numbers in each group - 58 funds in the first group and 40 funds in the second. The results are shown in Charts 2 and 3 below.

Chart 2: Funds >£1bn

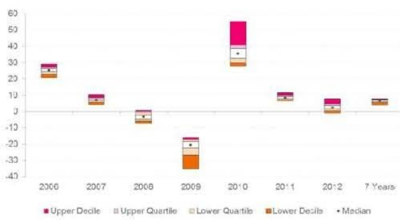
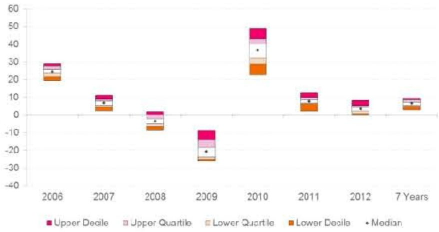


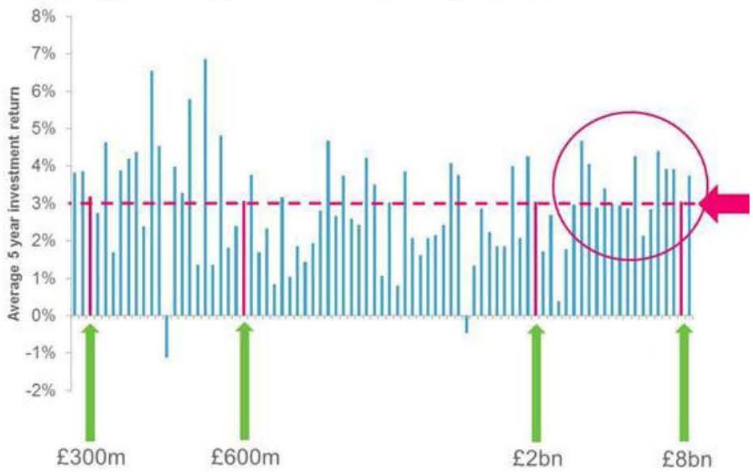
Chart 3: Funds<£1bn



We could not detect any strong evidence that the larger funds outperform the smaller funds. We do observe however that there is a wider dispersion of returns for the smaller funds. Perhaps scale helps to remove the extremes of performance? Surprisingly, over the seven years, the median return for the large funds is equal to the median return for the small funds.

Chart 4 below shows a more granular analysis of performance by fund size, this time considering the average returns over the five year period ending March 2012. The weighted average return of the open LGPS funds over this period is 3% p.a. (shown by the dotted red line). This chart confirms the analysis above; there is no evidence from the data that bigger funds do better but the dispersion of returns is wider for the smaller funds.

Chart 4: 5 year average investment return by size of fund



Our views on differentiators

Rebalancing asset allocation

As one asset class outperforms the others, a fund's asset allocation will drift away from the intended strategic weighting. The impact of this was clear during the credit crisis and its aftermath. Failure to rebalance the equity allocation after the market collapse in 2008-09 cost around 2%. Some funds were discouraged from rebalancing because their managers were underperforming and they were reluctant to add assets to these mandates. It is more likely that rebalancing took place in multi-asset mandates because the managers themselves would be very aware of the risks they were running if their asset allocation were significantly different from the performance benchmark. This may be one factor in the success (cited above) of funds with limited numbers of managers.

Timing of manager hiring and firing

Research in the US and UK and our experience with committees show that the timing of manager change is often poor. Active manager performance tends to be cyclical; this often results from background, market or economic, conditions that provide either a headwind or tailwind which is favourable or unfavourable to the manager's style. There is a tendency for managers to be hired at the peak of a cycle and fired at the trough; unfortunately a committee's tolerance for underperformance coincides with the typical three year cycle of managers' relative performance. This is a human trait which is behaviourally-based.

Chart 5

Conclusions

There is no reliable evidence within the LGPS dataset that we have examined to support the assertion that the larger funds perform better than the smaller funds. There is however, evidence of greater dispersion of returns among the smaller funds.

There is some support for our intuitive belief that disciplined rebalancing is a contributory factor to stronger long term performance.

In order to derive some more definitive conclusions, we would require a longer history of performance of the funds together with an accurate description of how each fund has been managed in terms of asset allocation and manager selection and de-selection. The national Scheme Advisory Board should require each LGPS fund to provide on an annual basis significant standard elements of performance data (actual and index) as well as information on asset allocation and structure. In relation to performance, it should also be possible for funds to provide historic data for as many financial years as is realistically practicable, so that a historical database can be created quickly.

Even then, the dataset of LGPS funds may be too small to provide meaningful, statistically significant, evidence and any conclusions might be suspect. Accordingly, we believe it is likely to continue to be more appropriate to consider international research in this area rather than endeavour to data mine LGPS information.

HYMANS ROBERTSON
The Spirit of Independence

briefing note

Investment management costs in the LGPS: global benchmarking study   September 2013

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Investment management costs in the LGPS: global benchmarking study

There has been speculation that merging LGPS funds to create fewer, larger funds will deliver big savings in fund manager fees. Research findings from a global benchmarking study shows this idea has no basis in fact. LGPS investment costs are in line with global comparators. The research also shows where funds should focus efforts to make further improvements.

An independent analysis of investment costs for 12 representative LGPS funds, co-sponsored by Hymans Robertson and LGPS funds who contributed data, found that the costs of running their assets are comparable with a peer group of large international pension funds used as a benchmark. This suggests that local authorities, on average, are already paying fees equivalent to those paid by much larger public and private sector funds globally for similar mandates.

The research was completed by the world's leading independent pension benchmarking company, CEM Benchmarking Inc. For the first time it provides reliable data on the investment costs of local authority pension funds. It comes as the Department for Communities and Local Government (DCLG) gathers evidence on whether LGPS funds should consider mergers to improve efficiency and performance.

This new research compares total investment costs of the combined LGPS funds (circa £30bn) with an international peer group of twenty funds of similar size and like-for-like investment mandates. It shows that the difference in total investment costs is only £0.05 per £100 of assets per annum. The difference is not due to the fees paid for external management of similar mandates. The difference is due to the LGPS using more fund of funds arrangements and more external fund management than the international peer group. But these costs are partially offset by the savings that the LGPS makes by making more extensive use of less expensive passive management.

With the agreement of the participating funds, the research findings are now being published so that the research is available to all parties considering their response to the call for evidence. A copy of the report is available on our website by clicking here.

This briefing summarises the headline findings and our own analysis of the implications for the call for evidence.

Summary of research findings

- This research is the first ever quantification of potential benefits of scale in the LGPS using LGPS data. To date figures quoted in the debate on merger have been speculative and any views expressed on investment costs based largely on opinion rather than robust data.
- The research is sponsored by Hymans Robertson and 15 LGPS funds.
- Analysis is based on data for 12 out of the 15 Funds. The sample chosen is representative of the LGPS as a whole (small, mid-sized, large).
- Actual investment costs are double what is currently disclosed under current accounting conventions (c63bps vs c32bps – £0.32 per £100 of assets per annum) …
- … but compare well with an international peer group
- The peer group is 20 international funds with size c£30bn (which is the combined size of the 12 LGPS funds in the sample) and comparable investment mix.
- The research shows that, on average, the LGPS funds in the sample pay investment manager fees similar to those paid by much larger comparable funds. LGPS funds are, on average, paying fees similar to those of funds 10 times bigger which shows that LGPS funds have been effective in negotiating fees.
- So there is evidence that on average LGPS funds are not paying investment managers over the odds and that simply combining the funds by merger will not on its own result in significantly lower fees.
- On a like-for-like asset mix, the difference in fund management costs between the combined LGPS funds and the c£30bn peer group funds is 5bps per annum (£0.05p per £100 of assets per annum)
- The difference is not due to higher manager fees for comparable services. LGPS has comparable fees on traditional asset classes (equities and bonds).
- The difference is due to implementation approach, for example, greater use of fund of funds and external fund management by the LGPS (partially offset by lower costs from greater use of passive management in the LGPS).
- LGPS funds could achieve total costs less than the international peer group by using even more passive management and less use of fund of funds investments in alternative asset classes such as private equity, infrastructure and property. The latter could be achieved by collaboration between local authorities to pool assets to remove a layer of fees without the need for fund merger.
- The case for making greater use of internal rather than external fund management is not clear cut. It would be wrong to base decisions on use of external fund management on the basis of costs alone. You also need to consider what value it could add and in what areas. In practice it may be difficult and costly to replicate management of some asset classes using internal resource.

- The total oversight costs (internal oversight, monitoring and reporting, custodial and advisory services) for the 12 LGPS funds combined were comparable to the oversight costs of the c£30bn peer funds internationally. Oversight costs are insignificant compared with manager fees which are 30 times greater.

Actual current costs and costs under current disclosure conventions

- It is no surprise that total costs are greater than disclosed under current accounting conventions.
- The LPGS community knew that total costs were probably significantly more if account was taken of additional layers of fees, but this information has not been in the public domain.
- There has not been sufficiently clear instruction on fee disclosure requirements (e.g. what should be in the reported data including layers of fees on pooled funds and funds of funds) and some information is hard to get.
- The impact of the undisclosed fees is reflected in fund performance measurement so the lack of transparent disclosure has not resulted in an overstatement of returns.
- Whatever the outcome of the call for evidence, transparency and full disclosure should become the norm. This would include disclosure of all layers of fees.
- This will allow like-for-like comparisons to be made and enable us to understand the true cost of running LGPS investments and how that is changing over time. The new Scheme Advisory Board has a role to play here.
- We believe the LGPS community will support this change. In fact it is LGPS funds themselves who commissioned this research to help understand better the true cost of running LGPS investments.
- However, when like-for-like comparisons of manager fees are made, it must be remembered that higher levels of fee are not in and of themselves necessarily damaging. What matters is the net return achieved after taking account of fees paid.

Comments and conclusions

- Any claim that merging LGPS funds will result in significant savings in manager fees is not supported by this evidence.
- However, some further reductions in cost are possible and can be achieved without merging funds (e.g. less use of funds of funds for alternative assets by pooling assets across funds and more use of passive).
- The case for or against merger therefore has to consider other criteria such as:

  1 importance of local decision making;

  2 quantification of any other governance benefits and consideration of how they might be achieved; and

  3 the cost, effort and payback involved in change.

- There may be other ways of achieving investment scale benefits (collaboration such as asset pooling in specific asset categories) which are less costly to implement and could deliver financial benefits sooner

- LGPS funds could also look at how they can use existing resources collectively in an even more efficient way; there may be a case for investing more in internal resource. This could improve outcomes.
- Actual total costs are greater than those disclosed under current accounting conventions. Full transparency of total costs should become the norm for future disclosure. This will be helpful to the Scheme Advisory Board for the purpose of making fair comparisons, identifying areas for future improvement and monitoring progress.

We hope you find this research useful in considering how you will respond to the call for evidence on the future structure of the LGPS. If you would like to discuss the research further please contact Linda Selman, William Marshall, John Wright or your usual contact at Hymans Robertson.

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