**LGPS Roundtable on Investment Cost Transparency**

Attendees: Mike Ellsmore (Chair), Neil Sellstrom, Duncan Whitfield, Nigel Cook, Andrien Meyers, Peter Worth, Monica Bell, Laura Davies, Tom Broughton, Steve Harrison, Grant Patterson, Sandy Trust and Sunil Chadda.

On 19th July 2017 CIPFA and Grant Thornton hosted a roundtable discussion in London to consider the issues around investment cost transparency along with wider cost pressures facing the LGPS.

While future investment costs and charges *are predictable and can be controlled* by decision-makers, investment returns can not. Some commentators are highlighting a risk of ‘lower for longer’ economic conditions, pointing to a complex and uncertain macro-economic environment, with ongoing low interest rates, high levels of quantitative easing, political volatility and current high levels of asset valuations in many asset classes.

In a lower for longer environment, investment costs could have a more significant impact on net outcomes as they would represent a larger proportion of the overall outcome. This reinforces the importance of managing such costs effectively – which in turn points to a need to both measure and understand the various components of cost.

The Chair opened the discussion with a brief summary of the background to the transparency agenda including the work of CIPFA in producing the Investment Management Expenses Guidance and the Scheme Advisory Board in developing the Cost Transparency reporting template. It is important to differentiate between accounting requirements and the additional management information which should be of interest to Pension Funds in managing their external asset managers. This was ultimately summarised as a three stage process starting with directly invoiced charges, moving to the transaction costs reported in the cost template and finally there are the more difficult to identify and quantify costs related to the hierarchy of the investment structure, the investment itself and each asset manager’s individual approach.

The initial part of the conversation focused on contract management and the basic principles involved in regularly reviewing contract terms and invoiced figures. These are basic controls but there was a challenge as to whether all Funds currently do this well enough given current cost and staffing constraints and the increasingly litigious environment, especially in the US

Sunil Chadda shared some slides on a case study of the Railpen Scheme who have carried significant work in this area. Their aim was a deeper relationship with asset managers to create a partnership where costs and performance were shared proportionally. Railpen have moved to bring more investments in-house but have found that there is a significant resource requirement to monitor and control the costs of both internally and externally managed investments.

This led to a discussion on the use of segregated mandates and role of the global custodian as providing independent and accountable ‘books and records’ information to Funds. Where reliance is placed on Asset Manager figures for the purposes of valuation and fee calculation, there is a need to seek greater assurance of the figures which are used to calculate invoices for both ad valorem and performance-related fees. Ideally, Funds should avoid the use of asset manager valuations for fee calculation purposes.

The role of asset pools was then brought into the debate and it is clear they will have a key role to play in terms of both the initial procurement and ongoing reporting. The procurement process is extremely important as it provides the opportunity to re-set the terms of the Fund-asset manager relationship by removing asymmetrical contract terms & conditions, by documenting total investment costs & expected transaction activity and by clearly defining the investment performance calculation process. In addition, the benefits of scale should become apparent with larger mandates and the use of “Most Favoured Nation (MFN)” clauses, albeit there are issues with how MFN clauses work to the detriment of the investor.

The conversation then moved to wider concerns around cash flows and maturity of some LGPS Funds which is starting to impact upon investment strategies. Beyond the Fund level, there will be individual employers who are in a difficult position in terms of cash flows and pension fund deficits. At the Fund level the requirement for appropriate resources to meet fiduciary responsibilities is an increasing concern and the CIPFA Pensions Panel will shortly be writing to CFO’s to highlight this issue as savings made in the monitoring and controls space could be shown to be a false economy. The last Triennial Valuation highlighted significant data quality problems across the LGPS which in themselves impact on the costs of the Scheme and the quality of reporting.

Sunil Chadda then highlighted some of the content of the recent FCA Asset Management Study which will have a major impact on the industry in the years ahead. In particular the role of advisers was discussed and how they manage conflicts of interest between clients and asset managers. This will become increasingly important as advisers become involved in advising on fund selection for asset pools but have their own in-house pooled fund range to sell. It is clear that there is a huge amount of new regulation facing the sector from a range of sources which in many cases is overly complicated and piecemeal and, despite the lauded objectives, may lead to greater confusion and less transparency if not adequately managed.

The group then considered a slide from Grant Thornton identifying a range of sources of investment costs and discussed examples of how each of these impacted upon investment outcomes. These ranged from transaction costs, investment costs, agent-agent & agent-principle issues, chargeable extras, IMA and Pooled Fund documentation asymmetries, undeclared income and inappropriate benchmarks. It is clear that there are complex issues involved in many of these areas which require a degree of specialist resource and expertise not generally available to all Funds. There will be an expectation on asset pools to improve this situation.

Across all Funds it is important to recognise the fact that monitoring ‘true’ investment costs, quality of service and investment performance enable Funds to make a proper judgement on Value For Money. There have been a number of national initiatives which are all positive including the Scheme Advisory Board work and the Transparency Task Force. These initiatives are helping to identify and explain different cost types and enable Funds to focus on Net of Fees returns.

CIPFA and Grant Thornton will continue to work to support the LGPS Funds and this topic will be covered in more detail at workshops planned for the autumn.