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Efficiency and governance in the LGPS: Fund merger and alternative approaches

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LGPS governance and efficiency – Fund mergers and alternatives?

- What are you trying to achieve?
- Investments
- Administration
- Governance arrangements
- Alternative ways of achieving same objectives?

What are you trying to achieve?

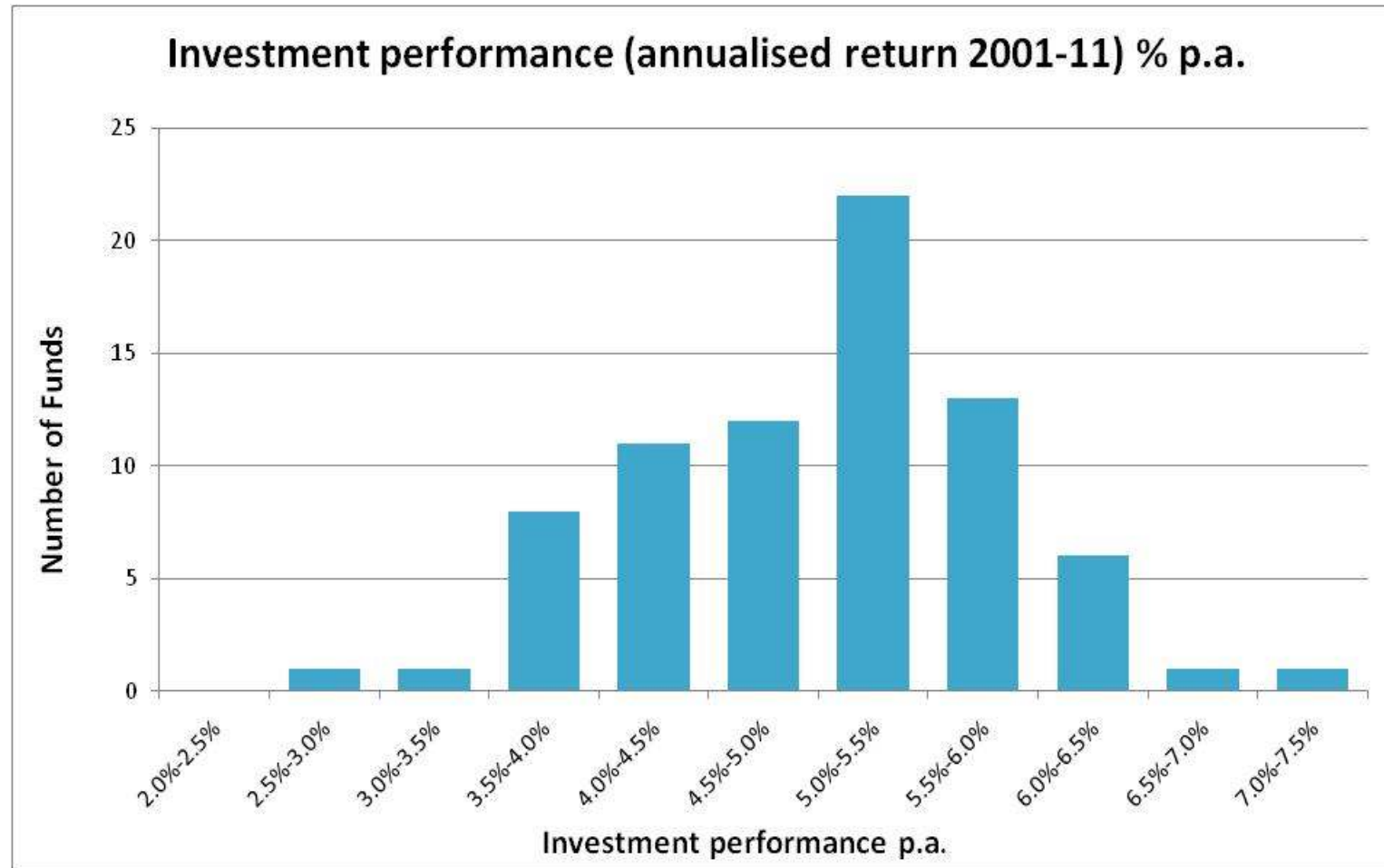
- Save money?
- Improve performance?
- Reduce risk?
- Pool resources?
- Retain local decision making?
- Invest in broader asset classes
- Reduce deficits?

Worthwhile goals - can all of this be achieved?



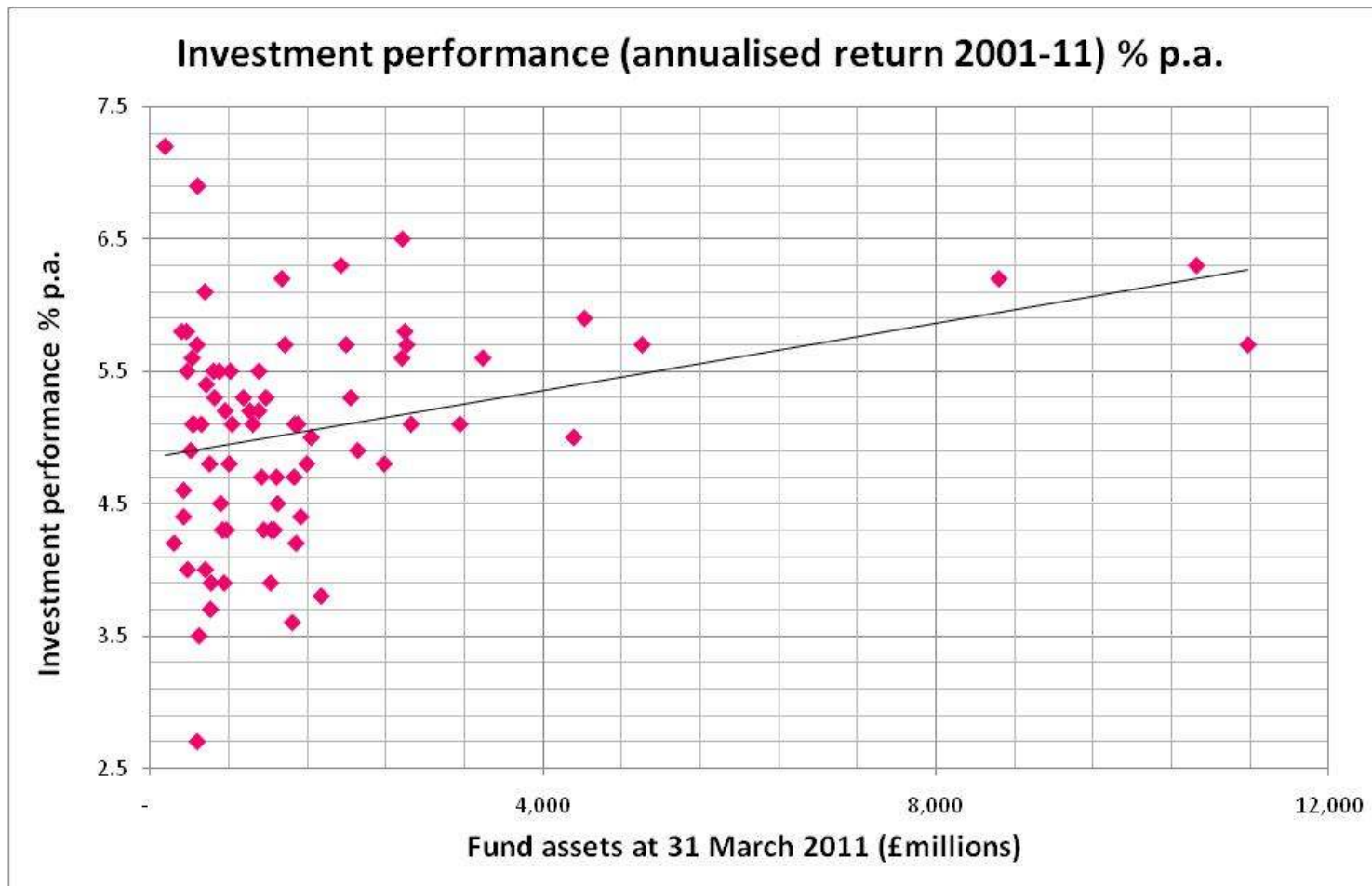
Investments

Investment returns across LGPS Funds



Active management one reason for range

Do larger LGPS Funds do better?



Size doesn't guarantee success but helps?

Larger investment Funds – what's the benefit?

Advantages include

- More internal / professional resource?
- More internal / hands on management?
- Better diversification – asset classes, managers
- More bargaining power on fees?

Diversification and fee advantage?

	Small	Medium	Large Fund
Size	500m	2bn	10-20bn
Number of managers	2 – 8?	10?	10-20 + some internal
Fees e.g. active global equity	60bps	45bps	35bps?

What price for asset management?

Asset class	Annual fees
Alternatives	300-400bps?
Property	90bps
Bonds and cash	22bps
Active equity (International)	35bps
Active equity (UK)	25bps
Passive – bonds	10bps
Passive – equity	5-8bps

Total fees*



What does this tell us?

- Getting value from active management?
 - “closet” trackers vs differentiated / exotic
- Greater use of passive?
 - big fee saving, little impact on performance
 - concentrate on management by sector / region
- Are all investment mgt expenses measured?
 - e.g. Fund of Funds
- More collectivisation
 - pool resources for alternatives?
 - strip out a layer of cost?



**Is fund merger the only way to
get investment scale benefits?**

Financial benefits of scale – other options?

- LGPS asset pools / collectivisation
 - passive, alternatives, property?
 - negotiated scale fees
- Re-negotiate fees of existing managers?

Scale benefits without merger

Operational benefits of scale – other options?

- Share services for investment functions?
 - pool resources, strengthen governance
 - Centralised monitoring
- Centralised / shared procurement?
 - one jointly procured UK equity tracker
 - pool assets for alternatives eg infrastructure investment



Other costs?

Administration costs

	Cost per member (£)
Highest	£38
Lowest	£15
Average UK	£20-£23
Outsourced	£18
Survey of large schemes (40,000 +)	£36

Comparing apples and oranges

Concentrate on big ticket items?

	Small Fund 500m	Larger Fund 2-10bn	Nature
Investment management	40-60bps	30-40bps	Speculative?
Administration	5-10bps	4-8bps	Necessity
Advisers and custody	2-3bps	<1-3bps	Risk management

Small saving on investment management,
covers a large proportion of other costs



How big are LGPS Funds?

How big are LGPS Funds?

	UK	Europe	World
Largest	BT Group (Euro 39.6bn)	Norway Govt (Euro 376.9bn)	Japan Govt (Euro 920.8bn)
Strathclyde (Euro 12.2bn)	15 th	64 th	203 rd
Greater Manchester (Euro 11.3bn)	18 th	69 th	219 th
Median (Euro 1.1bn)	209 th	583 rd	Not available
London Borough (Euro 0.9bn)	231 st	661 st	Not available
Combined LGPS (Approx Euro 170bn)	1 st	3 rd	12 th

Large compared with many UK private sector schemes, small by international standards



Governance and operational arrangements

Governance & investment decision making

Scheme	Size	Decision making	Investment resource
LGPS	£500m	Elected Member Committee	1 FTE?
LGPS	>£4bn	Elected Member Committee + Investment Sub	4-5 FTE?
USS	c£30bn	Supervisory board, Investment Sub, 7 other committees, CEO, CIO	N/A
BP	c£17bn	Supervisory Board sets policy, CEO with delegated authority	20+
Ontario Teachers	c£70bn	Board of Directors sets strategy, Executive management team with has authority for tactical asset allocation, currency management, manager selection	10+

Would larger schemes require a different governance and operational model?

Alternative governance/operational models?

- More internal, professional resource
- Supervisory Board: agree strategy, monitor, hold Executive to account
- Executive team: delegated authority (execution, tactical decisions, etc)
- Decision making less tied to timing of committee meetings?
- But loss of local accountability and decision making?



Summary

What are you trying to achieve?

- Improve performance?
- Save money (e.g. manager fees)?
- Reduce risk (e.g. manager diversification)?
- More internal, professional resource?
- Invest in broader asset classes?
- Retain local accountability and decision making?
- Reduce deficits?

Is it possible to achieve all of these?

Can scale benefits only be achieved by merger?

Consider

- Shared services?
- Joint procurement?
- LGPS asset pools / collectivisation?
- Re-negotiate fees with existing managers?

Concentrate on big ticket items

Hutton and LGPS rationalisation

- 6.23 “Commission does not propose rationalising governance and administration of locally administered schemes through moving to wholly national arrangements, **instead** advocating greater co-ordination and collaboration”
- 6.25 “there is a case supplementing local pension boards with a national pensions board .. separate from individual local authorities”
- 6.72 “desirable for LGPS Funds to have incentives to obtain performance improvements, including merging the investment of assets or even the underlying Funds where appropriate”

Praise for shared service
and procurement initiatives



Thank you

Any questions?

Investment returns across LGPS Funds

