

CIPFA Pension Network



Building on the Call for Evidence

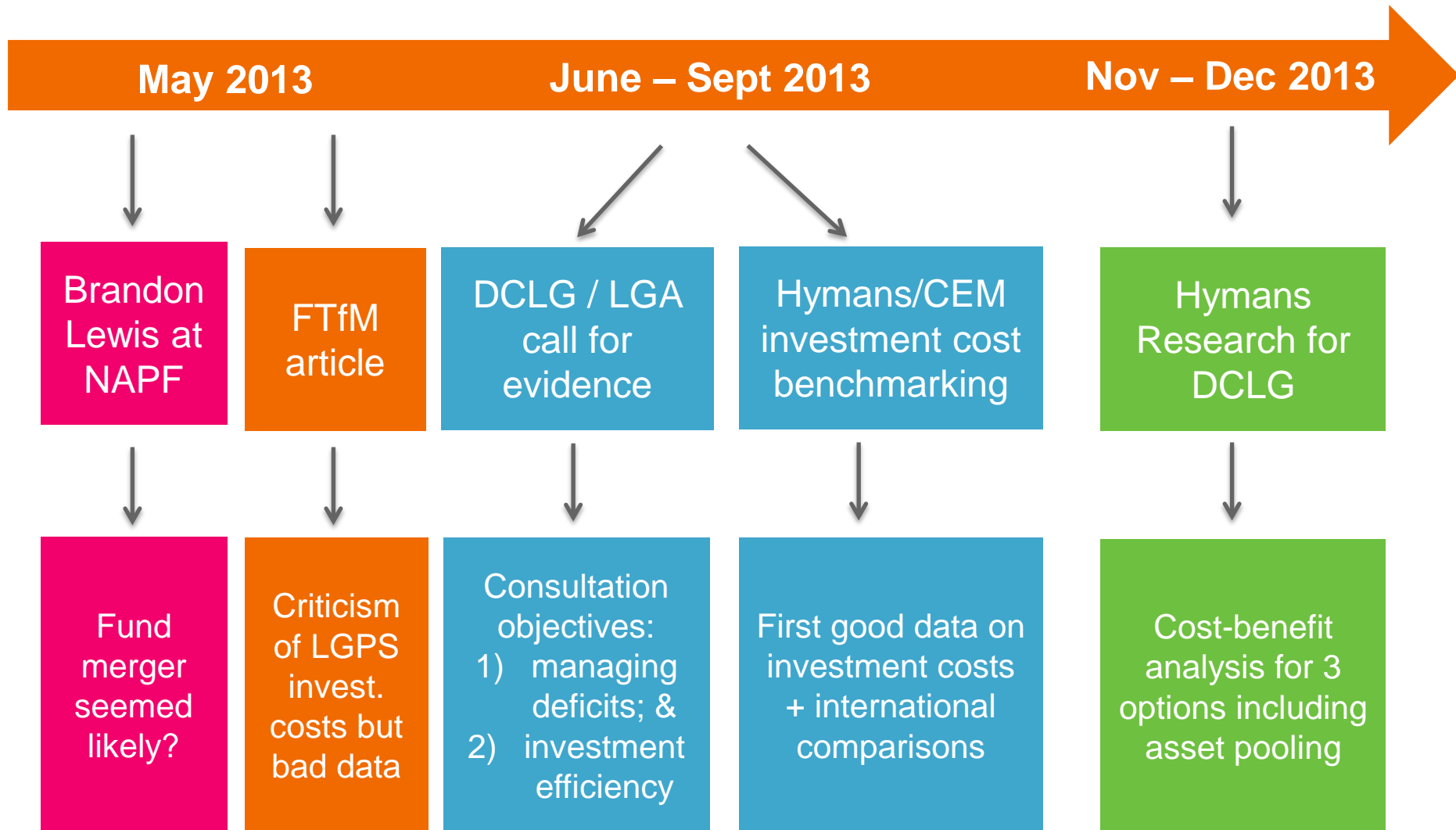
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- April 2014

Agenda

- The story so far
- Issues highlighted in Call for Evidence
 - The fees LGPS funds pay
 - Passive investment - a no brainer?
 - Getting efficient access to alternatives
 - Asset pooling
- Current developments
- Summary and next steps

Story so far



Story so far

Jan 2014

Feb 2014

April - June 2014

SAB analysis of CfE responses & letter to minister

London Councils give London CIV green light

Next DCLG consultation

Themes:
-use of asset pooling?
-use of passive?
-use of in-house?
Consider options for managing deficits

Collective Investment Vehicle for London Boroughs.
Voluntary participation

Options TBC
Likely to include asset pooling?



Issues highlighted in CfE: The fees LGPS funds pay

CEM Benchmarking Inc

- Global pension cost benchmarking specialists
- Extensive database of global client data
 - Consider embedded costs
 - Full look through costs on alternatives
- Providing a truly global reach
- Ability to aggregate fund data to compare costs for a group of (LGPS) funds with a comparable larger fund



Comparison analysis

CEM aggregated 15 LGPS funds and compared with a peer group of comparable aggregate size

- Fees paid by LGPS funds comparable with those paid by larger schemes
 - Governance costs comparable with large comparators (Surprising?)
- Analysis highlighted key areas of difference
 - Greater use of passive in LGPS
 - but
 - Fees paid for alternatives higher in LGPS funds





Passive investment – a no brainer?

Active versus passive management



Active management:

"Don't just sit there, do something!"

Passive management:

"Don't do anything, just sit there!"



So achieving index performance is easy?

Market	Annual cost of turnover (bps)
UK	8
North America	1
Japan	1
Europe ex-UK	3
Asia Pacific ex Japan	4
Emerging Markets	10

The benchmark doesn't suffer

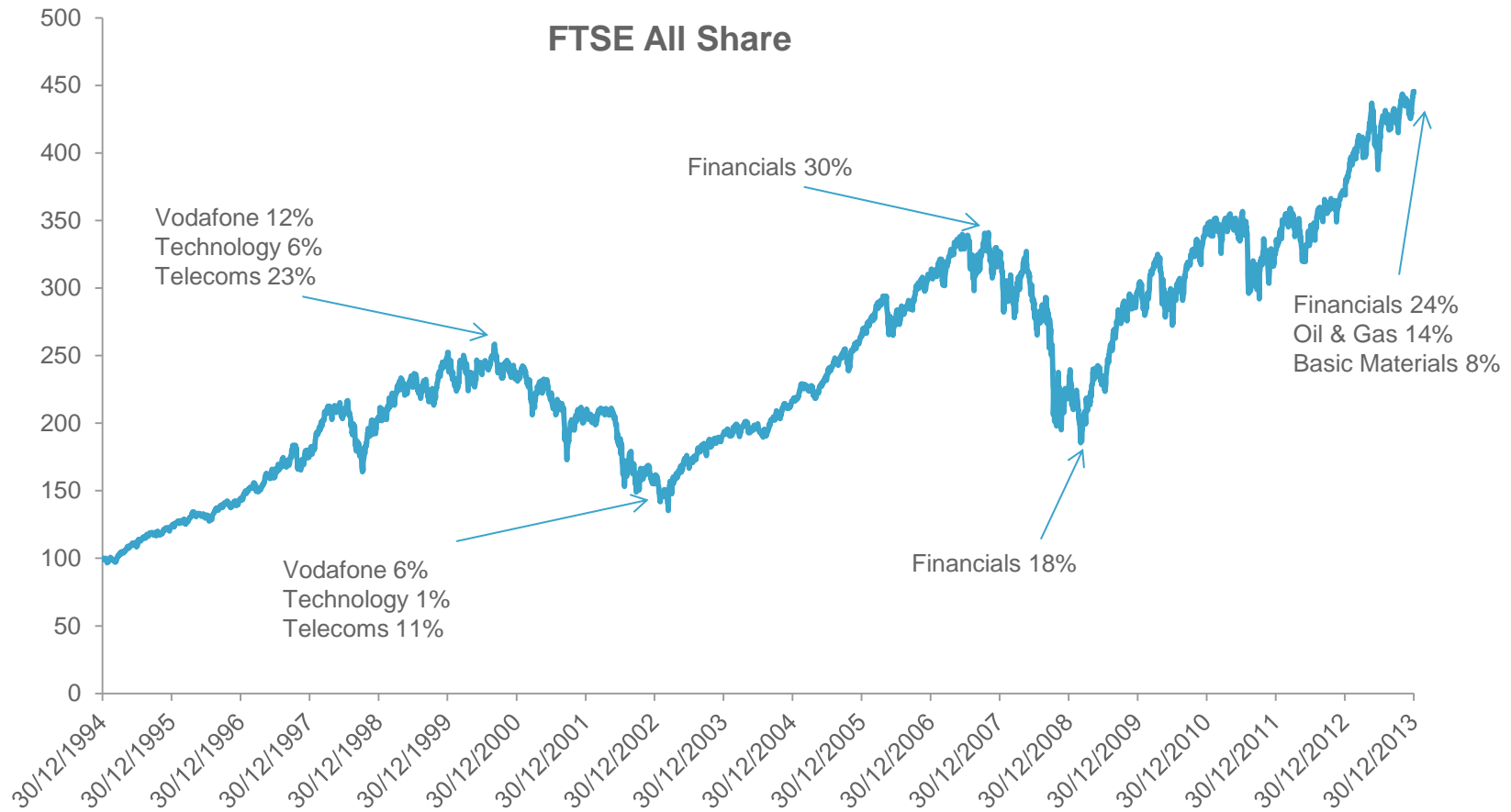
- the costs of the turnover
- manager fees

Adding value in passive

- Stock-lending
 - Not a free lunch, risks needs to be managed
 - Remember 2008?
- Index arbitrage
 - Market differences
 - Opportunities have diminished by as much as 50%
- Crossing transactions
 - Best opportunities in large pooled funds with range of types of investor



Market capitalisation indices – chasing bubbles



Sensitive to size (a historic measure), price, high PE ratios

Weight watchers



50 Shades of Passive

- Market cap
- Fundamental
- Equally weighted
- Minimum volatility
-

“Smart Beta”

Why break the price link?

➤ Market Cap Index



➤ Other approaches



Historic data supports the idea that systematic rebalancing from outperforming to underperforming shares adds value over time

Passive summary

- Getting passive right takes time and resources
- The cost of passive done well is modest
- Passive could get smarter and more diversified without breaking the bank

Focus on risk-adjusted returns – net of fees



Getting efficient access to alternatives

Extra layers add considerable fees

- Existing approach largely uses fund of funds for diversification
- Impact on returns

	Potential cost saving* (per annum)
Stop using FoFs	c200bps
Direct management**	c300-400bps

* Source: CEM research paper

** Very large funds only – larger than combined LGPS

- Pooling alternatives could remove layer of fees, but
 - needs scale
 - cost savings may accrue slowly

Case study – Industry Funds Management (‘IFM’)

- Started out as a fund of funds manager in 1999
 - Finally excised last FoF relationship in 2010
- Deal constrained market, add a competitor, prices go up
- Resourcing
 - Cultural alignment is key
 - Remuneration must be sufficient
 - Diverse range of skills and experience



**30 Major not-for profit
pension funds**

A\$50bn AUM

Remember whose money you are managing!

Closer to home - Pension infrastructure platform

- November 2011
 - Government plans for large scale infrastructure investment
- July 2012
 - Original announcement
- Late 2013
 - Managers appointed
- March 2014
 - First commitment, but
 - Less three founding partners

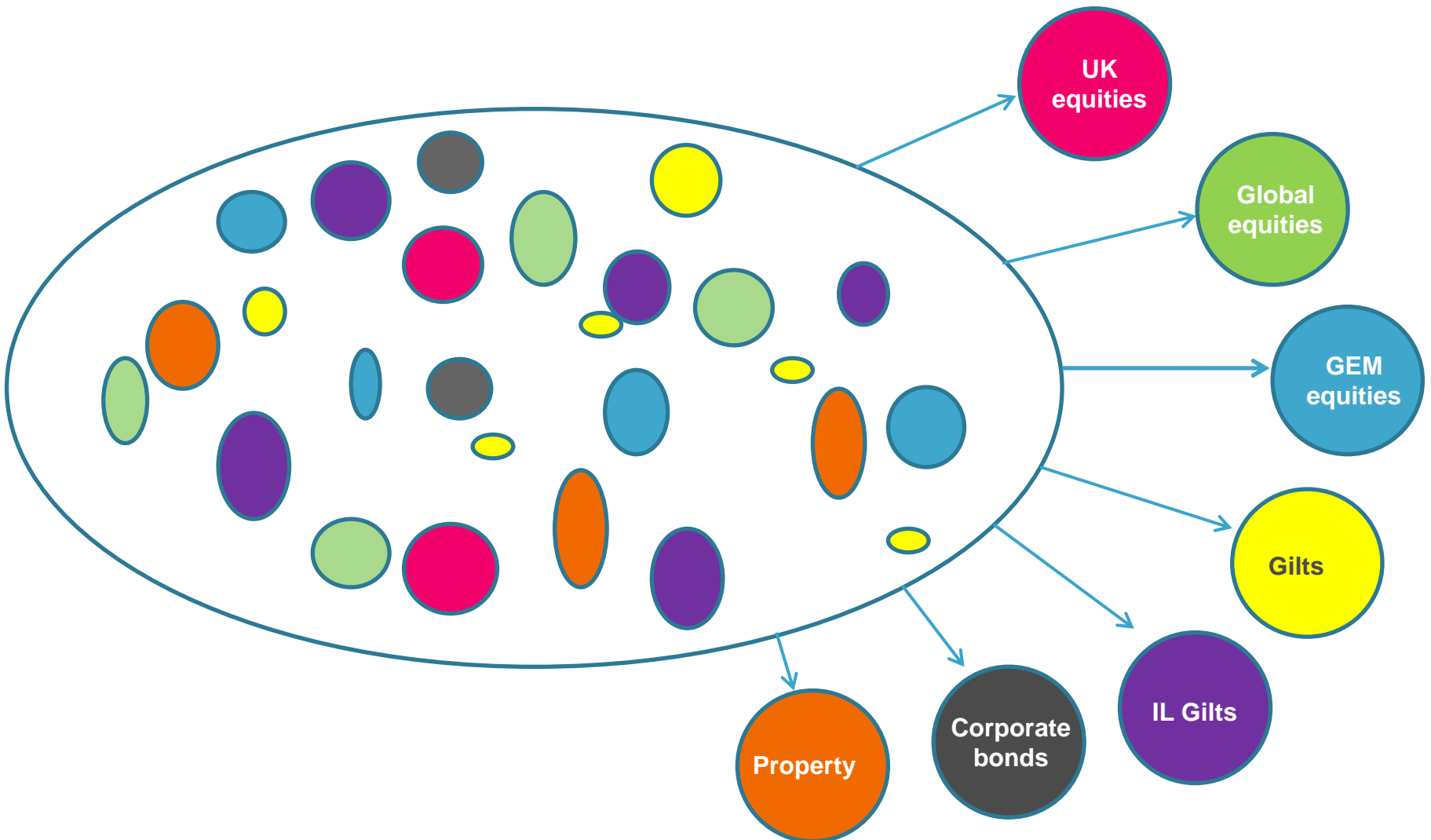


Potential notable benefits from accessing alternatives more efficiently but good governance is key.



Asset pooling (listed assets)

Funds managing common mandates



Advantages of asset pooling – scale benefits

Global Equity fee scale

Asset value	fee
First £50m	0.60%
Next £50m	0.45%
Next £100m	0.40%
£200m+	0.35%

Fee impact diminishes with size

Asset Value	Effective fee
£50m	0.600%
£100m	0.525%
£200m	0.462%
£400m	0.406%
£1bn	0.372%

Scale benefits without fund merger?

Benefits of pooling

- Central monitoring and management
 - Time can be re-focused on strategy?
- Scale benefits without fund merger?
- Improve the quality of manager decisions?

Disadvantages of pooling

- Some control over manager selection may be ceded
- Choices may be limited,
 - e.g. global rather than regional mandates for equities
- Cost of set up

The impact on decision making

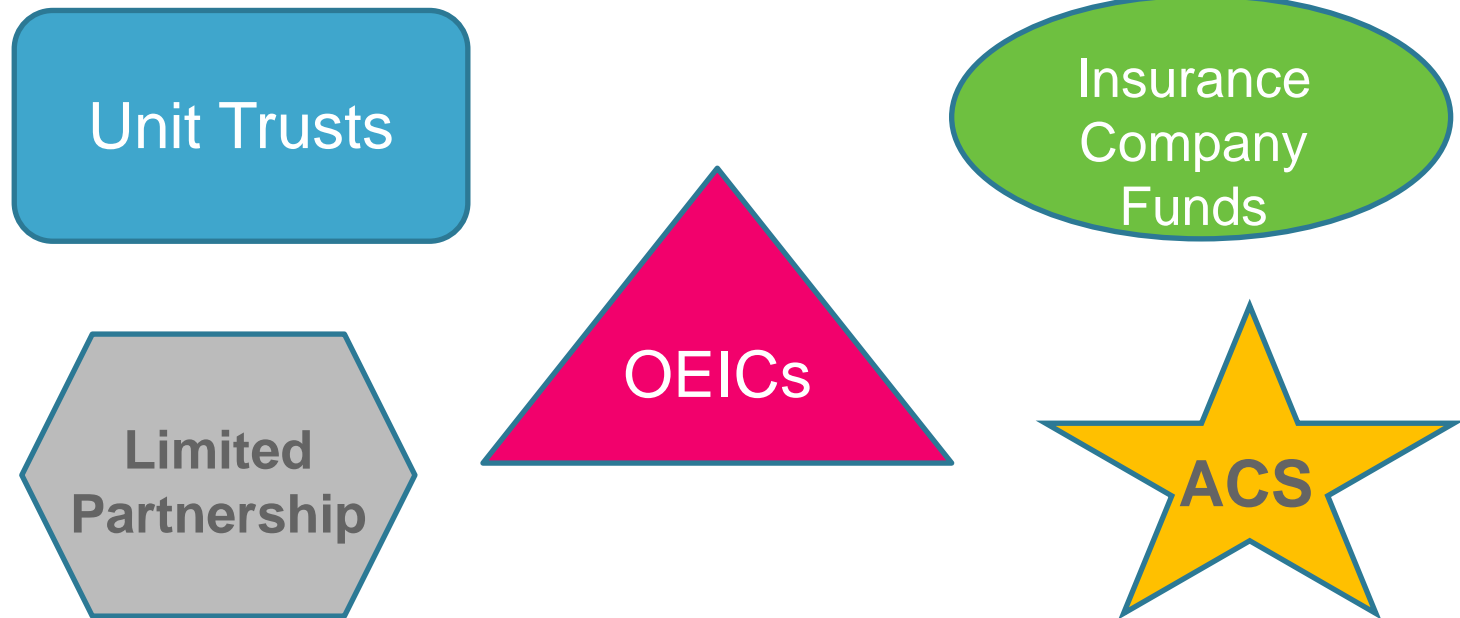
Decisions	Performance monitoring	Manager selection	Investment strategy	Contribution strategy
Current arrangements	✓	✓	✓	✓
Collaborative	?	✓	✓	✓
CIVs	C	C	✓	✓
Superpool	C	C	C	✓

C – decision transferred to central resource



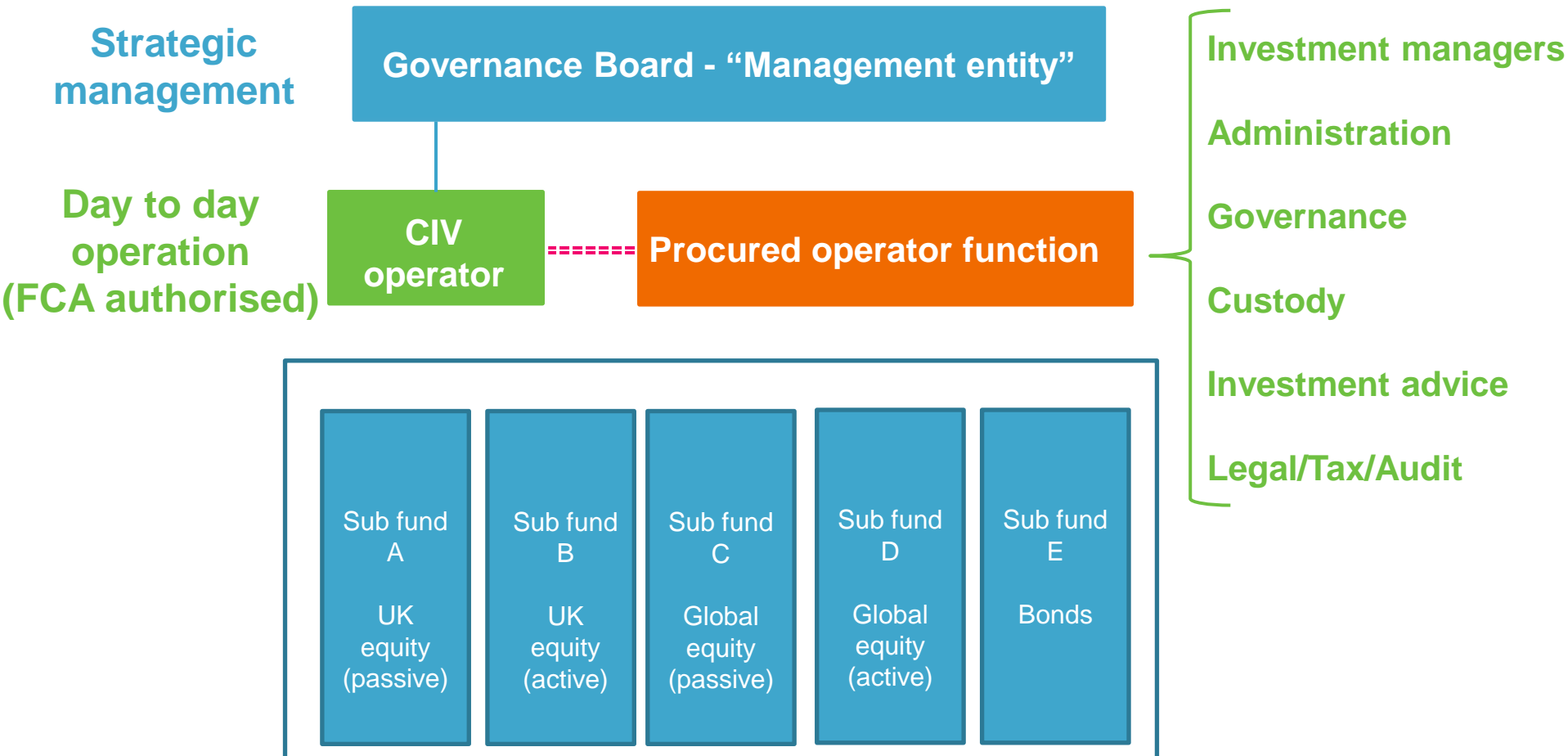
Types of asset pools

Broad range of pooling vehicle available



- A means of pooling assets across investors
- Range of structures each with different attributes
 - Tax, ease of set up, asset classes, etc.

Structure of an umbrella CIV



Could operate multi-manager approach within sub-funds



Current developments

Current developments

- DCLG's recent cost-benefit analysis
 - Three options for restructuring LGPS in England & Wales
 - ◆ Single CIV
 - ◆ 5-10 CIVs
 - ◆ 5-10 merged funds
 - Consultation due now!
- A CIV for London
- Shadow Scheme Advisory Board 7 recommendations

Summary and next steps

- Better data available to inform debate e.g. investment costs
- Debate has moved on ... themes emerging:
 - Asset pooling without merging Funds?
 - More use of passive investment?
 - Less use of Fund of Funds for alternatives?
- Voluntary collaboration initiatives in progress
- Further government consultation – April to June

“Nothing will ever be attempted if all possible objections must first be overcome” Dr Samuel Johnson (1709-1784)



Thank you

General risk warning. Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance