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London Borough of Haringey Pension Fund

The Local Government Pension Scheme **Investment Code of Transparency**

A paper by the Independent Advisor **June 2017**

Introduction

On 16 May 2017, the Scheme Advisory Board issued the Local Government Pension Scheme (LGPS) Investment Code of Transparency. The purpose of this Code is to improve the reporting and understanding of investment management charges and costs. This paper seeks to explain the background and nature of the Code, and the implications of its introduction.

Background

Most LGPS Funds invest all or the majority of their assets through external asset (investment) managers. The London Borough of Haringey invests all of its assets using external asset managers.

The quoted fee paid to an asset manager does not represent the full cost incurred by an LGPS Fund when it engages the services of an external investment manager. There are other fees/expenses paid or income earned by the asset manager which are not readily visible to the LGPS Fund. Therefore in reality asset managers' fees/income is higher than the basic management fee plus any performance related fee as laid down in the investment management agreement between an individual LGPS Fund and an asset manager.

Central Government demonstrated its concerns regarding investment management fees in its November 2015 guidance on the establishment of LGPS Investment Pools entitled "Local Government Pension Scheme: Investment Reform Criteria and Guidance" where it stated "*In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently.*" The Local Government Trade Unions have also expressed very clear concerns regarding the transparency and reporting of the costs associated with the external management of LGPS assets

There have in recent years been moves to improve the transparency and reporting of the costs involved in investing LGPS assets. For example, CIPFA issued in 2014 (and revised in 2016) “Accounting for Local Government Pension Scheme Management Expenses” which aims to promote the inclusion in Pension Fund Accounts of the detailed reporting of LGPS management costs. However, for genuine transparency to occur the involvement and co-operation of asset managers is essential.

The development of the Investment Code of Transparency and how it will work in practice

Therefore, to enable LGPS Funds to obtain full and transparent investment fee/cost information the Scheme Advisory Board (SAB) has developed a voluntary “Code of Transparency” (the Code). Crucially this Code has been developed in consultation with major stakeholders including CIPFA, individual LGPS Funds (with the West Midlands Fund in particular) and most crucially the asset management trade organisation the Investment Association. Dr Chris Sier of Newcastle University who has long campaigned for cost transparency was also involved in the design of the Code.

Under the Code participating asset managers will report their fees, costs and income using standard Templates issued by the Scheme Advisory Board. There are separate Templates for segregated and pooled funds. These Templates require asset managers not only to report basic and performance fees but a range of other costs where applicable (such as Transaction taxes, Broker commissions and entry/exit charges, all payments made to parties providing services to a pooled fund other than the asset manager such as the auditor), details of any income from Stock Lending and any ancillary services provided. Therefore, under the Code participating asset managers will provide a breakdown of both explicit and implicit costs in a standardised format.

At present the Code only covers listed assets such as Listed Equities and Bonds. Listed assets do however form the majority of the assets of most individual LGPS Funds. It is also intended, in due course, to extend the Code to cover unlisted assets. It will however be considerably more challenging to develop Templates for alternative asset classes where fees/cost structures are more complex.

To sign up to the Code an asset manager must write to the Scheme Advisory Board in a form set out by the Board. The asset manager agrees that for the investments covered by the Code it will within a period of twelve months put in place the systems necessary to enable the automatic submission of the relevant Template(s) to each individual LGPS Fund that the asset manager provides services to. The Template(s) must be submitted automatically (that is without an individual Fund having to make a request) on an annual basis.

The Scheme Advisory Board may appoint an independent third party to audit Templates and general compliance with the Code by asset managers. The third party will report the findings of any audit to the Scheme Advisory Board. The asset manager is required to co-operate and work with the Board to address and implement any recommended actions or improvements.

Once individual LGPS Funds receive costs in a standardised form it is understood that they will have to undertake analysis of the data. This may not however be straightforward. Indeed, Jeff Houston the Head of Pensions at the Local Government Association has suggested some Funds may not be able to undertake this analysis – for example because of a lack of resources and therefore Templates may not actually be utilised. Therefore, the Scheme Advisory Board is considering whether to seek to establish/utilise a third party body to collate and check the data on behalf of LGPS Funds. This would be an independent not for profit body which would enable individual LGPS Funds to receive the asset managers' data in a format they can readily use rather than having to analyse it themselves and recruit/train staff to undertake this task.

Will Asset Managers of Listed Assets sign up to the Code?

While the Code is a voluntary Code it would be very surprising if asset managers who manage Listed Assets on behalf of LGPS Funds do not sign up in due course. There are a number of reasons why asset managers are likely to participate including:

- The Code Templates have been developed by the Scheme Advisory Board in consultation not only with CIPFA and LGPS stakeholders but (crucially) the Investment Association which is the asset management trade body
- Managers who sign up to the Code will be entitled to use the Code's Logo on its marketing literature and will be listed on the Scheme Advisory Board website
- A number of asset managers signed up to the Code almost immediately. Given this, those who do not, in due course, join will likely be disadvantaged in seeking to obtain new LGPS business
- The advent of Investment Pooling in the LGPS means that asset managers will in due course be required to re-apply to manage LGPS assets
- LGPS Funds are likely to request asset managers to join the Code in order to be better able to understand their real management fees and costs and to be able to better report these in their Annual Accounts

- Asset managers who do not sign up to the Code will be open to the question from LGPS Funds “if you have not signed up to the Code why should we continue to use your services?”
- The Trade Unions have made it clear that they will be seeking information from each individual LGPS Fund in England and Wales in respect of the Code.

What benefits may the Code bring to individual LGPS Funds?

Assuming that Funds can analyse the Template data provided by asset managers there are a number of important benefits that the Code may bring to individual LGPS Funds. Crucially knowing and understanding costs LGPS Funds will be able to scrutinise and challenge them. The West Midlands LGPS Pension Fund has already undertaken analysis of their asset manager related fees/costs. Jason Fletcher the Chief Investment Officer of the West Midlands Fund has indicated that it was only by genuinely understanding their asset management costs that the Fund was able to challenge them and consequently negotiate fee reductions. As Mr Fletcher has suggested, it is difficult to ask for a fee reduction unless you know what you are really paying.

In addition to improved understanding of costs and possible fee/cost reductions other benefits the Code may bring to individual LGPS Funds include:

- Improved ability to accurately report the true cost of LGPS management costs in the Annual Accounts
- Ability to assure stakeholders including Employers, Trade Unions and individual members of the LGPS that the Fund understands its asset management fees/costs and is in a position to undertake meaningful discussions with asset managers in relation to this issue
- The development of a more trusting relationship with those asset managers who sign up to and provide data in accordance with the Code requirements.

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