Pointmaker

THE LGPS: A LOST DECADE

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SUMMARY

Active fund management of the Local Government Pension Scheme's (LGPS) assets has been an expensive folly. Over the last decade, the combined assets of the 89 funds increased by a nominal 79%, to £214 billion at 31 March 2016.

This paper reveals that over the last decade, the assets have under-performed the major UK and global equity and bond indices: passive investing would have been more rewarding.

The only winner has been the industry, garnering over £4.5 billion in *reported* fees which, as a percentage of asset market value, have more than *doubled* over the decade. In addition, this paper estimates *unreported* fees, including performance fees paid to alternative assets managers, to be between £3.6 billion and £4.6 billion.

The 89 individual LGPS funds exhibit an extraordinary range of total annual costs per member. Enfield's £592 (2015-16) is a staggering 21 times larger than West Yorkshire's £28. Generally, the larger the fund, or the more in-house the asset management, the lower the cost per member.

In addition, some funds have an alarmingly high degree of inter-year cost volatility, which shows that they are in a state of administrative and governance disarray. It demands explanation, as does the difficulty in determining the LGPS's cashflow, discussed below.

The price of localism

Notwithstanding the advent of asset pooling, the 89 funds and their operational overhead remain, primarily a legacy of history. Consequently, the structure of the LGPS is becoming ever more labyrinthine, an ineffective and inefficient bureaucracy riddled with costly functional replication. Administering authorities' claims that their fund's local identity is important is self-serving nonsense, and meaningless to the membership.

Dysfunctional governance

Nowhere is localism worse felt than scheme governance, involving over 1,500 individuals, devoid of accountability. Their inability to challenge the fund managers suggests a

dangerous cocktail of incompetent amateurism, indifference, inertia, and an abject lack of curiosity. Meanwhile, scheme members' and taxpayers' contributions continue to be innocuously eroded by unnecessary, high and recurring fees and costs.

Asset pooling: not enough

The cost-savings anticipated from the on-going asset pooling exercise will have little material impact on the sustainability of the scheme, given the scale of the funds' deficits. Pooling needs to be accompanied by a much more assertive approach to asset management, including the consolidation of all private equity and infrastructure investments into specialist vehicles that should aspire to become centres of global expertise.

Structural simplification required

A dramatic structural simplification of the LGPS is required: the local architecture should be swept away, to leave just the asset pools and specialist investment vehicles, each with an independent governance committee (IGC). The IGCs' should demand disclosure to the standards required for retail investors.

Ultimately, seed a sovereign wealth fund with LGPS assets

But the Government could go further. It could use the LGPS's assets to seed an infrastructure-focused sovereign wealth fund, thereby socialising the benefit of the assets across the whole of society: we all use airports, railways, roads and utilities.

Indeed, this fund could be used to invest in new housing projects, thereby tackling another pressing issue facing current and future generations. Thereafter, pensions would be met on a pay-as-you-go basis.

This paper's findings resonate very strongly with those in a recent FCA report into the asset management industry.[1] Indeed, the LGPS perhaps serves as a meaningful case study to consider alongside it.

This paper is in two parts. Part I considers LGPS fund performance and costs, Part II looks at some potential next steps for the LGPS. There are 15 specific proposals.

[1] Market Study MS15/2.2; *Asset Management Market Study, Interim Report*; FCA, November 2016. A final report will be published later in 2017.

PROPOSALS

Proposal 1: LGPS funds should be encouraged not to engage with any fund manager whose fees are tied to the size of the assets under management. Fees should be predominately performance-driven.

Proposal 2: Such is the scale of some individual funds' unreported costs that DCLG, as scheme sponsor, should discipline the funds' internal audit functions and consider suing their external auditors, not least to recover fees paid.

Proposal 3: DCLG should "encourage" the LPP pool to merge with another pool so that its meets the minimum asset threshold of £25 billion.

Proposal 4: DCLG should put the proposed LGPS asset pools on notice that, for five years from 2018, they will be in a performance-based competition, before being whittled down to three much larger pools.

Proposal 5: The FCA should be encouraged to brief DCLG as to the implications for LGPS fund performance of the findings in its recent Asset Management Market Study.

Proposal 6: The Government should require *all* of the LGPS's actively managed *listed* assets to be replaced with passively managed (index-tracking) funds.

Proposal 7: All LGPS funds' alternative and infrastructure investments should each be consolidated into a vehicle, managed by in-house teams specialising in unlisted, illiquid assets. They should both aspire to be global centres of expertise, each accountable to an Independent Governance Committee.

Proposal 8: The Government should push ahead with its 2014 proposal that the LGPS's funds sell off their funds of funds investments.

Proposal 9: DCLG should actively discourage LGPS funds from investing in hedge funds.

Proposal 10: DCLG should, at the very least, tie LGPS investment consultants' remuneration to asset out-performance relative to indices. If no value-added, then no fee. Better, LGPS funds should be strongly discourage from using investment consultants.

Proposal 11: Consideration should be given to repealing Section 36(3) of the Pensions Act 1995, requiring trustees to take advice prior to making an investment.

Proposal 12: The LGPS's governance arrangements (Pension Boards, s101 Committees and s151 officers) should be scrapped and replaced with one Independent Governance Committee for each investment pool.

Proposal 13: The pools' Independent Governance Committees should establish a Disclosure Standards Committee to develop standardised reporting templates, to include pool performance and all asset management fees and charges. They should be published annually by all the pools, disclosure being to the same standards that retail investors are entitled to.

Proposal 14: DCLG should demise the LGPS's local operational structures and centralise all administration.

Proposal 15: The Government should develop a parallel plan to de-fund the LGPS and use the assets to seed a sovereign wealth fund, with a significant allocation to infrastructure. As a *quid pro quo*, a Crown guarantee could be provided on the pension promises, which would subsequently be met on a pay-as-you-go basis.

INTRODUCTION

The LGPS's 89 funds in England and Wales have total combined assets of some £214 billion, 5.4 million members (active, deferred and pensioners) and more than 7,000 participating employers.[2] It is by far the largest funded pension scheme in the country, and ranks sixth globally: it matters.

This paper was catalysed by the almost simultaneous publication of the Local Government Pension Scheme's (LGPS) 2015-16 performance data and the FCA's refreshingly direct interim report into the asset management industry.[3] Coincidental, yes, but highly appropriate, because the FCA's robust, independent and damning condemnation of both the industry and active fund management partly explains the (continuing) deterioration in the LGPS's financial condition. Other contributing factors include its ageing membership (contributions are therefore shrinking relative to pension payments), declining investment income, improving life expectancy, misaligned drivers of cost and income (pensions remain indexed to inflation even when public sector pay (which drives contributions) is frozen), and decades of insufficient contributions relative to the size of the defined benefit (DB) pension promise.

More seriously, after implementation of the Hutton reforms (which come into force in 2014), the LGPS remains unsustainable. The ten year "grandfathering"renders the reforms, in the near- to medium-term, largely impotent, although there could be significant long-term savings. But these are likely to be too late to save the LGPS.

PART I: LGPS FUND PERFORMANCE

1. The last decade: aggregated data

1.1 Overview

Over the last decade, the combined assets of the 89 funds increased by a nominal 79%, to £214 billion at 31 March 2016, coinciding with each fund's triennial actuarial valuation of liabilities. Results, however, have yet to be made public, but KPMG estimates a combined deficit (i.e. funding shortfall) of some £70 billion, making for an overall funding ratio of 75% (i.e. the scheme was 25% under-funded on that day). This would be a £23 billion increase on 2013's deficit of £47 billion, with a funding ratio of 79% (assets of £178 billion, liabilities of £225 billion). KPMG also expects that the deficit will have subsequently increased to over £100 billion at year end 2016.

So, we must wait for 2016's definitive valuations. These may not be directly comparable with previous years' because Section 13 of the Public Service Pensions Act 2013 will apply for the first time. This requires the Government Actuary to report on whether the following main aims are achieved in respect of each fund's valuation:

(i) is it **compliant** with the scheme regulations?;

(ii) **consistency**: has the valuation been carried out in a manner consistent with the other LGPS funds' valuations?; and

[2] England has 81 funds, Wales 8. The 11 Scottish funds, the one for Northern Ireland and the Environment Agency Pension Fund report separately and are not considered in this paper.

[3] Market Study MS15/2.2; *Asset Management Market Study, Interim Report;* FCA, November 2016.

(iii) are the employer contribution rates sufficient to ensure both the **solvency of the pension fund**, and the **long-term cost-efficiency of the scheme**?

Given that four different actuarial consultancies produce the valuations for the 89 funds, the consistency requirement would appear to demand that they communicate with one another to standardise their approach. In addition, given that the minimum funding ratio required to ensure solvency is not specified, employer contribution rates are more likely to be determined by employers' tolerance for financial pain, rather than the long-term needs of the scheme. Certainly, the rapid growth in many funds' deficits suggests that contributions should either be increased, or benefits should be curtailed, or a combination thereof.

It should be noted that a valuation is a nebulous, potentially volatile, point-in-time measurement requiring some long-term assumptions; it does not manifest itself in day-to-day life.[4] Consequently, to-date, valuations have exerted little political pressure for change. How, for example, should the Secretary of State respond to being told that the overall scheme funding ratio for 2016 was, say, 5% lower (or 5% higher) than at the time of the last valuation (2013)? What could he do usefully with the information?

Given the LGPS's public sector context, valuations are probably a waste of money. They are certainly a distraction from what really matters: cashflow. Yes, they may have a role in determining contribution rates, but these could be equally well be determined by cashflow considerations.

1.2 Cashflow

Until recently, DB pension funds have spent little time fretting over cashflow but, as they mature, managing cashflow is now becoming critical. But discerning LGPS funds' cashflow is extremely difficult because individual funds put different interpretations on how to present their data within the Department for Communities and Local Government's (DCLG) management accounting SF3 format.

One item, "*net profit on realisation of assets*", is particularly troublesome. The Guidance Notes for it state that *gains and losses, other than those on assets realised, should not be included here*.[5] The author's interpretation of this is that it is the net profit generated from selling assets above their "book value" at the time of sale, i.e. that it is a cash item that *excludes* mark-to-market adjustments (which are a non-cash item). The author has communicated with a number of officials to seek confirmation or clarification, but the outcome is that we all agree that it is unclear, and that it is likely that many individual funds are equally confused as to what is required. Consequently, SF3 reporting of this item is unreliable.

In addition, it is evident that some funds have not properly reconciled their year-to-year change in asset market value with their financial accounts.

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4 Valuations are subject to the vagaries of the gilt yield curve, which influences the rate at which future promises are discounted to establish a present value.

5 *SF3 2015-16 Guidance Notes*; Section B – Realisation of fund assets at 31 March 2016.

Given these uncertainties, Table 1 shows two interpretations of the 89 funds' net combined cashflow, over the last decade. The reality probably lies somewhere between the two, but it is shocking that no one would appear to have a confident understanding of the LGPS's cashflow.

The combined net cashflow data belies some significant cashflow issues within some individual funds. In 2015-16, contributions to only 13 of the 89 funds exceeded expenditure, and five of these each had a shortfall of well over £100 million, making them very reliant on investment income to plug the gap. A few funds are now so under-funded that they are having to consume assets to meet pensions in payment.[6] With no realistic prospect of recovery, they are probably in a death spiral, i.e. beyond the point of no return, slowly heading to unfunded status.

1.3 Fund management's performance

(a) Overview

The lack of reporting clarity frustrates attempts to assess fund management's value-added to the LGPS. Appendix I shows one approach, year-to-year changes in asset market value being adjusted for non-investment-related cashflows, primarily contributions and pensions-in-payment. Across the decade, the nominal return was 67% (5.3% per annum), a real 31% (2.7% per annum) over the indexation used to revalue the LGPS's pensions in payment: RPI until March 2011, and CPI thereafter. These figures, however, mean little in isolation.

(b) Benchmark indices: comparisons

Table 2 shows the nominal returns of the 89 funds' assets and some mainstream domestic and global indices (in £ terms) over the last decade, each commencing with the actual LGPS assets of £119.8 billion at 31 March 2006. Real returns can be determined by subtracting RPI or CPI, 3.0% and 2.5% per annum, respectively, over the decade.

It is evident that, in all cases, the indices performed better than the LGPS's fund managers. This is a strong endorsement of passive fund management, and it would have led to smaller funding deficits than today's reality. In addition, it would have been a lot cheaper, and considerably simpler, to implement.[7]

Table 1: The 89 funds' combined net cashflow, £ billion

	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07
Expenditure (pensions, fund mgt etc.)	-£10.8	-£12.9	-£9.5	-£9.1	-£9.2	-£8.5	-£8.1	-£6.9	-£6.6	-£6.2
plus contributions	£9.2	£9.4	£8.4	£8.1	£8.3	£8.5	£8.3	£7.9	£7.2	£6.7
plus other net inflows, including transfers	£0.5	£3.1	£0.7	£0.6	£0.9	£0.9	£0.9	£0.7	£0.8	£0.9
plus investment income	£3.6	£3.5	£3.3	£3.1	£3.2	£2.8	£2.7	£3.0	£3.3	£3.1
Net cash inflow Version I	**£2.5**	**£3.1**	**£2.9**	**£2.8**	**£3.1**	**£3.7**	**£3.8**	**£4.6**	**£4.7**	**£4.6**
plus net profit on realisation of assets (cash item)	£5.5	£9.1	£7.1	£5.5	£2.9	£4.8	£2.5	-£4.8	£11.9	£39.3
Net cash inflow Version II	**£8.0**	**£12.2**	**£10.0**	**£8.3**	**£6.0**	**£8.5**	**£6.3**	**-£0.2**	**£16.6**	**£43.9**

Source: SF3 data.

6 Note that under-funding also means that investment income is lower than otherwise, exacerbating a fund's financial condition.

7 Note that the LGPS performance data takes into account the reported fund management costs.

1.4 Reported costs

Table 3 is a summary of the costs reported by the 89 funds, and Appendix II shows costs as they developed over the last decade, year by year.

One would expect costs to fall over time, not just in real terms but also in *nominal* terms, partly through tech-driven cost savings. In addition, there is a reasonable expectation that as fund size increases, economies of scale cut the operating cost on a per member basis. Consequently, the 110% increase in the LGPS's total costs per member, over the last decade, is an utterly shocking figure.

Similarly, the more than *doubling* of fund management charges as a percentage of asset market value begs some major questions, particularly as, over the last decade, the LGPS's fund managers have under-performed major UK and global equity and bond indices.

Ultimately, above a modest asset threshold, costs should be significantly detached from the size of assets under management, something that the fund management industry is very keen to resist. Only clients saying "no" will change this.

Table 2: LGPS fund management performance vs. indices

		Nominal returns: Decade 2006-07 to 2015-16	Nominal returns: Compound % per annum	Assets 31 March 2016, £bn.	
	Actual performance of combined 89 LGPS funds	67.2%	5.3%	£200	*Adjusted*
UK indices	50% as Barclays Equity index**	68.8%	5.4%	£202	
	50% as Barclays Gilt Index***	80.4%	6.1%	£216	
	50:50 Barclays Equity and Gilt Indices	85.0%	6.3%	£222	
Global indices	FTSE All-World Index of equities	121.0%	8.3%	£265	
	World Government Bond Index	106.1%	7.5%	£247	
	50:50 World Equity and Bond indices	113.9%	7.9%	£256	

** Down from £213.9 bn after removing the impact of non-investment-related cashflows on performance*
*** Based upon the FTSE Actuaries All-Share Index with gross income reinvested*
**** Represents a portfolio of 15-year par yielding gilts with gross income reinvested*

Table 3: LGPS (England and Wales) funds: reported costs

£ millions	2015-16	Ten year change
Market value (end of year)	£213,935	79%
Fund management costs	£802.5	277%
Admin costs incl governance	£159.7	63%
Total costs	£962.2	209%
Fund management costs as % market value	0.38%	111%
Total costs as % market value	0.45%	73%
Total membership	5,396,477	47%
Total costs per member	**£178.3**	**110%**

Source: SF3 *Local Government Pension Funds: 2015-16*; DCLG, October 2016.

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1.5 Unreported asset management costs

(a) Assumptions required

The last decade's 110% jump in cost per member is based upon *reported* data. The *actual* increase in costs is likely to be less than this because LGPS fund reporting is now, finally, catching up with reality. Which prompts a question: how much has the LGPS historically under-reported its asset management costs?

Dealing with counterfactuals is hard, but a reasonable approach is to consider last year's total reported costs of 0.45% of fund market value as the baseline. Assuming that actual incurred costs were no lower than this throughout the previous nine years, then asset management costs have been under-reported by some £1.45 billion over the last decade: Table 4.

However, this approach is very generous to the LGPS, partly because some fund managers have reduced their charges in recent years, i.e. 0.45% as the baseline is too low. In addition, it assumes that 2015-16's costs were indeed fully reported when, based upon evidence from private sector schemes, they were almost certainly not. Consequently, a more appropriate baseline could be 0.5%, or higher: we just do not know for sure. Using 0.5% would lead to additional under-reported costs of £678 million, to total £2.126 billion over the decade.

But, more significantly, whatever the figure, it excludes performance fees.

(b) Performance fees

The LGPS has never collected, let alone reported, performance fees its funds have paid to third party "alternative assets" fund managers (including "carried interest")[8]. Collectively, the 101 LGPS funds (i.e. including Scotland and Northern Ireland) have one of the largest private equity portfolios in the world; in excess of £10.5 billion, with another £5.4 billion in hedge funds and £3.4 billion in other "alternative" assets.[9]

An earlier paper estimates that if the LGPS were to manage its private equity investments in-house, it could retain, rather than pay out, performance fees of more than £200 million *each year*.[10] Perhaps another

Table 4: Development of unreported costs (LGPS England and Wales)

£ millions	**2015-16**	**2014-15**	**2013-14**	**2012-13**	**2011-12**	**2010-11**	**2009-10**	**2008-09**	**2007-08**	**2006-07**
Average asset market value that year	£214,004	£201,764	£183,824	£167,749	£155,210	£146,922	£122,074	£115,441	£128,672	£124,862
Reported total costs as % av. assets	0.45%	0.44%	0.34%	0.32%	0.33%	0.32%	0.34%	0.33%	0.32%	0.30%
Unreported costs vs 0.45%	0%	0.01%	0.11%	0.13%	0.12%	0.13%	0.11%	0.12%	0.13%	0.15%
Unreported costs that year	**£0.0**	**£29.4**	**£199.8**	**£218.3**	**£189.9**	**£186.4**	**£130.0**	**£133.0**	**£172.5**	**£188.4**
Total unreported costs	**£1,448 million**									

8 "Carried interest" is the fund manager's (or general partner) share of the fund's profit, typically some 20% of the net profits.

9 *Local authority annual league tables;* 31 March 2015, State Street. Scaled up: the data is for 85 of the LGPS's 101 funds, representing £200 billion of the total £245 billion in assets (as at March 2015).

10 *The LGPS: opportunity knocks, section 4.5(b)*; Michael Johnson, CPS, November 2013.

£100 million could be added in respect of hedge funds.

(c) Unreported costs: conclusion

Over the last decade the opportunity cost of not managing alternative assets "in-house" could be reasonable estimated at between £1.5 billion and £2.5 billion. Adding this to the aforementioned £2.1 billion makes for unreported costs ranging between £3.6 billion and £4.6 billion. So, how did this come about? Essentially, through a catastrophic failure of governance, discussed below.

2. Individual fund data

Aggregated data for the LGPS funds belies some wildly inconsistent data year-to-year, at individual fund level. This further undermines confidence in the robustness of the LGPS funds' cost reporting.

2.1 Total costs per member

Last year the 89 funds reported total costs per member of £178, up 110% over the last decade. But there is an extraordinary diversity between individual funds: Table 5 shows the ten funds reporting the lowest and highest costs per member in the last year (Appendix III shows the data for all 89 funds).

Putting aside the West Yorkshire exemplar (discussed below), observations from Table 5 include the following:

- the range in reported costs is breath-taking, Enfield's £591.6 per member being 13 times larger than East Riding's £46;
- there is a clear negative correlation between costs per member and fund size. The ten lowest cost funds had assets four times larger, on average, than the

Table 5: Total reported costs per member: last three years

	Local Authority	2015-16	2014-15	2013-14	Two year change	Assets, 31 March 2016 £'000
1	West Yorkshire Super. Fund	£28.4	£28.3	£27.8	2.1%	£11,210,980
2	East Riding of Yorkshire UA	£46.0	£47.6	£51.2	-10.1%	£3,714,119
3	Nottinghamshire	£46.2	£52.8	£54.6	-15.5%	£4,066,670
4	Tameside	£55.1	£53.5	£61.1	-9.8%	£17,324,623
5	Middlesbrough UA	£73.4	£67.7	£42.8	71.5%	£3,133,118
6	Leicestershire	£73.5	£84.4	£103.5	-29.0%	£3,163,872
7	Lewisham	£95.9	£102.5	£104.6	-8.3%	£1,041,429
8	Swansea UA	£105.9	£228.9	£348.3	-69.6%	£1,511,116
9	Merton	£107.5	£81.1	£137.8	-22.0%	£529,190
10	Windsor & Maidenhead UA	£107.8	£91.8	£79.3	36.0%	£1,656,559
Average for top ten (down 27%)		**£74.0**	**£83.9**	**£101.1**		**£4,735,168**
80	Bexley	£419.2	£198.3	£184.6	127.1%	£688,318
81	South Yorkshire PTA	£438.7	£379.4	£382.0	14.9%	£204,310
82	Kensington & Chelsea	£449.9	£359.5	£384.5	17.0%	£841,015
83	Flintshire UA	£465.0	£511.4	£212.3	119.0%	£1,381,467
84	Westminster	£484.6	£439.3	£243.6	98.9%	£1,057,935
85	London Pensions Fund Authority	£484.8	£487.2	£469.9	3.2%	£4,549,608
86	Waltham Forest	£496.7	£437.2	£483.0	2.8%	£716,495
87	Hammersmith & Fulham	£535.2	£504.5	£389.7	37.3%	£856,319
88	City of London	£558.8	£393.4	£326.1	71.4%	£802,222
89	Enfield	£591.6	£141.7	£121.6	386.5%	£916,311
Average for bottom ten (up 54%)		**£492.4**	**£385.2**	**£319.7**		**£1,201,400**

average assets of the ten most costly funds: scale economies made manifest;

- the ten least costly funds cut costs by an average of 27% over the last three years. Conversely, the ten most costly funds reported an average rise of 54%; and
- many funds' reported costs exhibit an alarming inter-year volatility. Swansea, for example, reported costs last year of less than one third of 2013-14's costs, whereas Enfield's costs more than quadrupled over the same period. Bexley's and Flintshire's costs more than doubled. Such volatility begs huge questions over the quality of historic cost reporting: it demands explanation.

What did Swansea do to slash its costs so dramatically (can other funds learn from Swansea?) and, for those funds which have recently reported substantially increased costs, what, historically, has been hidden from public scrutiny, and why? Who benefitted from such opacity, and what were the consequences for decision-making?

Given that fund management costs account for the lion's share (83%) of total costs across the 89 funds, these observations are primarily about fund management.

2.2 The cost of fund management

Last year, across the 89 funds, total reported fund management costs increased by 7% (assets fell marginally) whereas, in 2014-15,

Table 6: Fund management costs per member

	Local Authority	2015-16	% change	2014-15	% change	2013-14	Two year change	Assets, 31 March 2016 £'000
1	West Yorkshire Super. Fund	£14.4	26%	£11.5	26%	£9.1	58%	£11,210,980
2	East Riding of Yorkshire UA	£27.3	-15%	£32.2	6%	£30.2	-10%	£3,714,119
3	Nottinghamshire	£31.8	-3%	£32.8	-20%	£41.1	-23%	£4,066,670
4	Tameside	£37.5	-4%	£39.0	-13%	£44.9	-17%	£17,324,623
5	Middlesbrough UA	£48.7	10%	£44.2	163%	£16.8	190%	£3,133,118
6	Lewisham	£52.5	-15%	£62.1	-7%	£66.6	-21%	£1,041,429
7	Croydon	£53.9	-56%	£122.8	33%	£92.0	-41%	£877,026
8	Leicestershire	£58.0	-15%	£68.1	-20%	£85.3	-32%	£3,163,872
9	Merton	£66.0	112%	£31.2	-64%	£85.6	-23%	£529,190
10	Hounslow	£72.4	-35%	£111.8	-19%	£138.4	-48%	£779,241
	Average for top ten funds	**£46.2**	**-17%**	**£55.6**	**-9%**	**£61.0**	**-24%**	**£4,584,027**
	Average per LGPS member	**£34.2**	**-8%**	**£37.3**	**-39%**	**£61.0**	**-44%**	**£42.4**
80	Brent	£342.0	-3%	£350.8	200%	£117.0	192%	£675,937
81	Bexley	£353.2	143%	£145.5	17%	£123.8	185%	£688,318
82	Kensington & Chelsea	£372.5	18%	£315.6	-7%	£340.0	10%	£841,015
83	London Pensions Fund Author	£386.8	-3%	£400.1	-1%	£402.3	-4%	£4,549,608
84	Flintshire UA	£396.6	-18%	£483.4	162%	£184.5	115%	£1,381,467
85	Waltham Forest	£434.9	12%	£386.7	-9%	£425.2	2%	£716,495
86	Westminster	£439.6	12%	£391.6	95%	£200.4	119%	£1,057,935
87	Hammersmith & Fulham	£474.9	4%	£457.8	33%	£344.5	38%	£856,319
88	City of London	£504.4	49%	£337.8	7%	£316.9	59%	£802,222
89	Enfield	£536.5	393%	£108.8	36%	£80.0	570%	£916,311
	Average for bottom ten funds	**£424.1**	**26%**	**£337.8**	**33%**	**£253.5**	**67%**	**£1,248,563**
	Average per LGPS member	**£411.6**	**12%**	**£368.4**	**29%**	**£286.5**	**44%**	**£51.9**

they increased by 51% (while assets rose by 13%). On a per member basis, they rose by 49% over the two years, evidencing a substantial reporting catch-up with reality. But these aggregated figure shrouds some dramatic changes at individual fund level.

(a) The West Yorkshire exemplar

Last year Enfield reported that it spent a mind-blowing £536 per member on fund management, 38 times larger than West Yorkshire's £14: see Table 6 (and Appendix IV, showing data for all the funds). West Yorkshire is unique amongst the LGPS funds in that its entire investment portfolio is managed in-house, and it also benefits from scale economies: the result is dramatically lower costs. Meanwhile, Enfield's reported costs are likely to be out of control and / or misreported (and it is not alone in this regard). Either way, a thorough investigation is required.

(b) Some patterns apparent

One striking observation from Table 6 is that, collectively, the ten least costly funds reported an average cost reduction of 44% per member over the last two years, whereas the ten mostly costly funds reported an average 44% cost *increase*. Thus, either the cost differential is *really* widening between the larger and smaller funds, or the smaller funds have historically under-reported costs to a much greater extent (and therefore have more catching up to do).

Whatever the explanation, it is a damning indictment of operating a sub-scale pension fund: the private sector should take note.

Table 7: Administration and governance costs per member

	Local Authority	2015-16 Admin	2015-16 Gov	2015-16 Total	2014-15 Total	2013-14 Total	Two year change	Assets 31 March 2016 £'000
1	West Yorkshire Super. Fund	£11.3	£2.6	£13.9	£16.8	£18.7	-25.3%	£11,210,980
2	Nottinghamshire	£9.7	£4.7	£14.4	£20.0	£13.6	6.0%	£4,066,670
3	Essex	£7.3	£7.3	£14.6	£19.1	£17.8	-18.0%	£5,037,104
4	Leicestershire	£14.3	£1.2	£15.5	£16.3	£18.2	-15.1%	£3,163,872
5	Hampshire	£11.6	£5.0	£16.6	£16.2	£16.4	1.4%	£5,213,406
6	West Sussex	£9.2	£8.3	£17.6	£19.0	£28.5	-38.4%	£2,985,801
7	Tameside	£13.8	£3.9	£17.7	£14.5	£16.2	8.9%	£17,324,623
8	West Midlands Pension Fund	£11.5	£6.3	£17.7	£15.4	£19.2	-7.8%	£11,660,700
9	Windsor & Maidenhead UA	£17.7	£0.9	£18.7	£15.9	£19.7	-5.4%	£1,656,559
10	East Riding of Yorkshire UA	£14.6	£4.1	£18.7	£15.4	£21.0	-10.5%	£3,714,119
Average for top ten (down 13%)		**£12.1**	**£4.4**	**£16.5**	**£16.9**	**£18.9**		**£6,603,383**
80	Bexley	£42.2	£23.9	£66.0	£52.8	£60.7	8.8%	£688,318
81	Harrow	£36.2	£30.3	£66.5	£70.7	£58.7	13.2%	£661,001
82	Flintshire UA	£36.7	£31.7	£68.4	£28.0	£27.8	145.7%	£1,381,467
83	Croydon	£49.6	£20.1	£69.6	£72.1	£80.0	-13.0%	£877,026
84	Islington	£59.8	£17.5	£77.4	£62.7	£52.7	46.8%	£1,083,305
85	Kensington & Chelsea	£57.3	£20.0	£77.4	£43.9	£44.5	73.9%	£841,015
86	Lancashire	£25.6	£53.5	£79.1	£23.2	£21.0	276.6%	£6,036,228
87	London Pensions Fund Auth	£59.1	£38.9	£98.0	£87.1	£67.6	45.0%	£4,549,608
88	South Yorkshire PTA	£18.0	£81.2	£99.2	£87.4	£73.4	35.2%	£204,310
89	Sutton	£33.3	£82.0	£115.3	£62.8	£41.3	179.1%	£507,121
Average for bottom ten (up 55%)		**£41.8**	**£39.9**	**£81.7**	**£59.1**	**£52.8**		**£1,682,940**

(c) Random (and chaotic?) too

Over the last two years South Yorkshire reported an increase in fund management costs of 624%, Enfield up 570%, West Midlands up 507%, and Tyne and Wear up 331% (Appendix IV). Conversely, other funds reported significant reductions (Swansea down 75%, Hounslow 48%, Croydon 42%). Even more puzzling are the inconsistent trends in some funds' year-to-year reporting. Newham, for example, reported a 163% cost increase in 2014-15, and a 55% reduction for the following year (Cheshire: up 80% then down 45%; Merton down 64%, then up 112%; Worcestershire: down 43%, then up 47%; Flintshire: up 162% then down 22%).

(d) Administration costs

2016 was the first year that the funds reported administration and governance costs separately: combined, they account for some 17% of total costs with, again, a wide disparity in costs per member between individual funds (Table 7). At the extremes, Sutton's £115.3 per member is more than eight times West Yorkshire's £13.9, a clear indication of the virtues of scale (the funds' 2016 membership being 12,954 and 264,234 respectively).

The top ten's reported admin plus governance costs per member fell by 13% over the last two years, whereas the bottom ten's increased by 55%.

Appendix V lists all 89 funds, and a more detailed study of the underlying SF3 data reveals some extraordinary individual numbers. How, for example, did Lancashire manage to spend £8.7 million on governance alone, in 2015-16 (the average per fund was £576,000), more than double what it spent on administration?[11]

(e) Reported data: conclusion

The inconsistency of the reported data shows that many funds are in a state of administrative and governance disarray. Notwithstanding the historic (and on-going?) challenge of identifying costs, there is clearly confusion over how to allocate them. This suggests a lack of established methodology and procedures. What of standardisation?

> **Proposal 2:** Such is the scale of some individual funds' unreported costs that DCLG, as scheme sponsor, should discipline the funds' internal audit functions and consider suing their external auditors, not least to recover fees paid.

2.3 CIPFA: ignored, or misunderstood?

In 2014, CIPFA issued several documents summarising the LGPS funds' statutory reporting requirements for 2015-16.[12] One objective behind CIPFA's guidance is to ensure that previously unreported transaction costs would, from 2015-16, appear in the data. The recent year-to-year volatility of reported cost data suggests that some (many?) of the LGPS funds have either chosen to ignore CIPFA's guidance, or, at the very least, are struggling to interpret it.

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[11] One potential explanation is that this includes development costs associated with the Local Pensions Partnership (LPP), the asset pool being established by the London Pensions Fund Authority and Lancashire County Pension Fund.

[12] CIPFA: the Chartered Institute of Public Finance and Accountancy, an accountancy body exclusively dedicated to public finance.

2.4 The FCA: on the case

The FCA is currently consulting on the transaction costs incurred by workplace pensions, having proposed rules and guidance to improve and standardised their disclosure.[13] Its paper could almost have been written with the LGPS in mind.

Meanwhile, we should remain mindful of the background noise. Some elements of the industry loathe standardisation, partly because it logically leads to digitisation….which would put an end to many profitable inefficiencies (as well as fewer opportunities for consulting).

3. Governance: collective failure to the fore

The LGPS's mind-numbingly irresponsible rise in reported costs, and historic unreported costs, have been documented in previous papers.[14] The reasons are primarily structural and cultural.

3.1 Byzantine structure

Today's arrangements for the governance of the LGPS include:

- a Scheme Advisory Board (SAB) with 14 members, plus a variety of sub-committees and working groups with in excess of 50 members[15];

and, for each individual fund:

- a s101 Pension Committee to make executive and non-executive decisions (through delegated powers from the administering authority);
- a (recently established) Pension Board, to assist the administering authority in carrying out its functions and complying with legislation i.e. a scrutiny function; and
- a gamut of professional services consultants (including actuarial, accounting, investment and legal).

Regulations permit a fund's Pension Board to be combined with its s101 Committee, but many funds have not done this, taking the view that the two roles are incompatible. Consequently, there are over 1,500 people involved in the governance of the LGPS, for what is, ultimately, just one, albeit large, public service occupational pensions scheme.

In stark contrast, the Universities Superannuation Scheme (USS), another large DB, multi-employer scheme, has a single trustee board of between 10 and 12 members. Internationally, the three big funded Canadian public service schemes, for example, have, between them, 27 people

[13] *Transaction cost disclosure in workplace pensions*; FCA consultation paper CP 16/30, October 2016. This takes into account the proposed requirements under the EU's Packaged Retail and Insurance-Based Investment Products (PRIIPs).

[14] See, for example, *The LGPS: opportunity knocks* (2013); *What price localism? A case study: the LGPS* (2014) and *The LGPS: unsustainable* (2015); Michael Johnson, CPS.

[15] Including a Cost Management, Benefit Design and Administration Committee (13 members); an Investment, Governance and Engagement Committee (14); Administration and Communications (14); Value for Money and Collaboration (12 members) and a Deficit Management working group.

involved in governance (with combined assets similar in size to the LGPS's).[16]

3.2 Cultural failure pervades

The abysmally high (and erratic) cost data suggests that governance of the LGPS is accompanied by a caustic cocktail of incompetent amateurism, indifference, inertia, an abject lack of curiosity from all parties, and an absence of personal accountability (has any Section 151 Officer ever been held to account?). Who, ultimately, is responsible *and* accountable?

Given that what gets measured gets managed, the implications for the quality of decision-making based upon the LGPS's reported data are grim. This is manna from Heaven for a fund management industry that is all too willing to take advantage of what has historically been a docile client, only now beginning to wake up.

3.3 Opacity, partly due to a reporting blizzard

In 2014 the author did a page count of the reporting output of some funded public sector pensions schemes. The USS's annual report and accounts has 120 pages (101 in 2015), and the three big Canadian schemes average 122 pages each (down to 100 pages each in 2015). Contrast this with the 2013 annual reports of the 89 LGPS funds, with 8,186 pages between them. In addition, their Communications Policy, Funding Strategy and Governance Compliance Statements, plus their Statement of Investment Principles, come to another 4,670 pages, and their 2013 valuation reports total another 3,769 pages.

This comes to a total of 16,625 pages, all for what is *one* occupational pension scheme (and this excludes the 12 funds in Scotland and Northern Ireland). This is bureaucratic madness, at a substantial cost. And perhaps worst of all, the reporting avalanche does not provide transparency. A simple example: one fund's 2013 annual report shows a single investment of £250 million (17% of total assets) yet, within its 102 pages, there is no clue as to what that asset is.

[16] Healthcare of Ontario Pension Plan (HOOPP, 16 in the governance committee), Ontario Municipal Employees Retirement System (OMERS, 6) and Ontario Teachers' Pension Plan (OTPP, 5).

PART II: WHERE NEXT FOR THE LGPS?

4. Asset pooling: coming

4.1 Good intentions

In recent years there has been a growing recognition that the LGPS's cumbersome, indeed dysfunctional, operational structure is the source of considerable value leakage (including through operational replication and the array of sub-scale funds). At the 2015 Conservative Party conference, in an attempt to rectify the LGPS's travails, the then Chancellor announced an initiative with four laudable objectives to:

(i) achieve "scale", through the creation of up to six British Wealth Funds comprising assets from the 89 LGPS funds;

(ii) improve the quality of governance;

(iii) increase the amount invested in infrastructure ("get Britain building"); and

(iv) generate cost savings and value for money.

Administering authorities were subsequently "invited" to come forward with initial proposals for pooling by 19 February 2016, final proposals being due by 15 July 2016, detailing plans at both an individual fund and collective level.

All of the pools are required to achieve FCA authorised manager status by 1 April 2018. Tasks include creating legal structures, staff transfers, creating supervisory committees, obtaining FCA authorisations, appointing providers and legal and financial advisors, assessing MiFID II implications, and determining appropriate pool structures for each asset type. Thereafter, assets are to be transferred to the pools, and it has been noted that, in respect of illiquid assets, this is likely to take some time (i.e. years).

4.2 Some progress, but lacking in ambition

In July 2016, eight prospective groupings (see Appendix VI) submitted their proposals to DCLG, and ministers are currently considering them. By January 2017, five proposals had been approved (Border to Coast, Brunel Pension Partnership, LGPS Central, the London CIV and Wales), and others are at various stages of development. The LPP group, for example, already has FCA and Authorised Contractual Scheme (ACS) approval, and is now launching a series of asset class funds.

The Treasury set a £25 billion minimum threshold for the assets of each pool, but two of the pools (Wales and the LPP, comprising Berkshire, Lancashire and the London Pension Fund Authority (LPFA), a LGPS anachronism) are well below the threshold, both being around £14 billon.[17] The LPP may argue that its business model is different to that of other pools, in that it offers a fuller pensions service to its shareholders, including investment, administration and risk management. But this is not sufficient to justify ministerial

[17] The LPFA is an legacy organisation with assets of £4.6 billion to predominately meet the pensions of former Greater London Council and the Inner London Education Authority employees. Post-pooling, its purpose is unclear: the admin services that it currently provides to eight London and county authorities will presumably, post-2018, be provided by their respective pools.

approval, notwithstanding that the Welsh pool already has it. Wales could, however, be considered a special case, given its quasi-sovereignty through devolved government. That aside, pooling should be merely an administrative exercise, and the LPP should be "encouraged" to merge either with Wales or another pool, so that it meets the minimum asset threshold of £25 billion.

> **Proposal 3:** DCLG should "encourage" the LPP pool to merge with another pool so that its meets the minimum asset threshold of £25 billion.

4.3 Fund size

(a) Pools: small on the global stage

DCLG's minimum pool size of £25 billion is small relative to many other public sector pension funds: see Table 8.

At the end of 2015, the largest of the 89 funds (Tameside) ranked 154th by size on the global stage. Had all the LGPS funds been considered as one, then they would have ranked 6th, with all the attendant benefits of being able to exercise significant bargaining power with both the market (through transaction pricing) and third party service providers. This opportunity is being lost by the current structure.

(b) The sweet spot

The optimum size of a single asset pool is debatable, but the consensus seems to be between £50 billion and £75 billion, i.e. there is a limit to the blind pursuit of economies of scale. In this range, relatively small investments can still be made efficiently, and the pool is too small to overly influence any mainstream asset class, but large enough to support a staff that could consider some customised investments.

From 2018, the proposed LGPS asset pools should be put on notice that over the following five years they will be in a performance-based competition, before being whittled down to three pools. Ideally, the LGPS should be presented to the market as one asset pool (albeit with listed and unlisted assets being separately managed).

> **Proposal 4:** DCLG should put the proposed LGPS asset pools on notice that, for five years from 2018, they will be in a performance-based competition, before being whittled down to three much larger pools.

As an aside, Sweden has, for over a decade, been considering the consolidation of five of its AP funds (each with assets of roughly £26

Table 8: A selection of public sector pension funds, USD billions

Rank	Pension fund	End-2015 assets
5	ABP (Dutch civil service scheme)	$385
7	California Public Employees' Retirement System (CalPERS)	$286
10	PFZW (Dutch healthcare sector pension fund)	$186
11	California State Teachers	$182
12	PFALGO (Japanese local government civil servants)	$176
18	OTPP (Ontario Teachers)	$124
58	OMERS (Ontario Municipal Employees)	$56
154	Greater Manchester / Tameside	$25

Source: *The world's 300 largest pension funds for year ended 2015*; Willis Towers Watson.

billion to £34 billion) down to three, to save on costs and further capitalise on economies of scale.[18] To date, vested interests (including the funds' employer groups) have stymied progress and usurped common sense.

4.4 Cost savings from pooling: derisory expectations

Unsurprisingly, all of the prospective pools are claiming that they will save money. For example, the London Collective Investment Vehicle (CIV) initially expects to save some £2.8 million a year from reduced fund management charges relating to nine sub-funds, equivalent to 0.046% of their £6.1 billion in assets (and 0.01% of the CIV's total £25 billion in assets). London expects substantial further savings as it harvests economies of scale by negotiating other costs down (such as custodian fees and procurement costs).

Berkshire, part of the LPP group, anticipates potential savings of some £30 million in investment management fees over five years and, in the second year of operations, perhaps £1m in pension administration costs: a total saving of some £7 million per year, equivalent to 0.054% of the pool's £13 billion in assets.[19]

Brunel is projecting £20 million in annual fee savings from pooling, by 2021, rising to £30 million by March 2027 (0.12% on today's £25 billion of assets). The LGPS Central pool claims that by 2033 it will save £29 million in fees each year, on £35 billion of assets, i.e. a mere 0.08% in 17 years' time !

Yes, additional cost savings will emerge, from selling off the externally-managed unlisted investments, for example. But these will emerge only very slowly, because many of the investments are very illiquid: selling them all could take a decade. Meanwhile, the launch costs of the pooling vehicles are considerable: £1.5 million for the LPP, for example, plus regulatory and working capital of £17.5 million.[20]

4.5 Pooling: conclusion

It is clear that cost-savings derived from pooling *alone* will have no material impact on the sustainability of the scheme, given the scale of the LGPS's assets and the funds' aggregated deficit. Pools' expectations are dramatically at odds with the £660 million of annual cost savings (and £6.6 billion over the next 20 years) anticipated in a report considering the merits of moving to passive fund management (commissioned by DCLG).[21] The implication is that the pools are intending to merely tinker with asset allocation. Pooling needs to be accompanied by a much more assertive approach to asset management.

5. Managing the assets

5.1 Active fund management: a lottery

(a) Inconsistency to the fore

Every three months, since 2008, F&C has published its active funds consistency ratios. These measure the proportion of funds in the

[18] The AP funds (AP1, AP2, AP3, AP4 and AP7) were set up to meet potential shortfalls within the Swedish state pension system. They have been criticised for producing lacklustre returns and for their expensive management structure.

[19] Berkshire Pension Fund Panel meeting documents for 11th July 2016: *LGPS Investment Pooling – Annex 2 Stakeholder Briefing.*

[20] Ibid.

[21] *LGPS structure analysis*; Hymans Robertson LLP, published in 2014.

12 main Investment Association (IA) retail sectors (representing the major asset classes) that have produced top quartile, and above median, annual returns over *each* of the three previous years. Table 9 shows the most recent results, based upon 1,137 funds.

Only 28 funds (i.e. 2.5% of all funds) consistently produced top quartile returns in each of the last three years. Using blind luck, one would expect 18 funds to achieve this, which leaves only 10 managers of funds, 0.9% of a universe of 1,137, who could legitimately claim that their success was down to skill.[22]

Over the same three year period, only 161 funds (14.2%) consistently produced above average (i.e. top half) returns. Statistically, this includes 142 which would achieve this through luck, which leaves 19 funds (0.2% of the total) that performed through skill.[23] The other 976 funds (85.8%) failed to achieve what should be considered a modest objective, that of delivering above median (i.e. top half) annual performance over three consecutive years.

(b) Benchmark comparisons

S&P Dow Jones Indices regularly compares the performance of a range of actively managed equity funds, denominated in the major currencies, against the performance of their respective benchmark (passive) indices, over 1-, 3-, 5-, and 10-year investment horizons.[24] Appendix VII shows the results for the major fund categories, in three major currencies (Euros, Pounds Sterling and US dollars), summarised in Table 10. The results are astonishing.

Over the medium term (five years, say), roughly eight in ten passive benchmarks outperform their actively managed

Table 9: F&C MM consistency ratios, 30 September 2016.

	Outcome	Luck	+ Skill	"Fail"
Top quartile	28 (2.5%)	18 (1.56%)	10 (0.9%)	1,109 (97.5%)
Top half	161 (14.2%)	142 (12.5%)	19 (0.2%)	976 (85.8%)

Table 10: Average proportion of equity funds <u>outperformed</u> by their respective benchmarks

Category of funds	1 year	3 years	5 years	10 years
European equity funds, in Euro	73.8%	72.6%	74.7%	82.8%
European equity funds, in GBP	69.6%	83.6%	86.9%	91.4%
US equity funds, in USD	89.2%	88.4%	92.8%	91.1%

Source: S&P Dow Jones Indices LLC: SPIVA® Europe and US Scorecards mid-2016.
Note: Data for periods ending June 30, 2016. Outperformance is based on equal-weighted fund counts. Index performance based on total return.

22 1,137 x 25% x 25% x 25% = 18.

23 1,137 x 50% x 50% x 50% = 142.

24 The SPIVA Scorecard series, which address the main criticisms as to the robustness of comparing active funds with benchmarks by eliminating survivorship bias; ensuring that a fund's returns are measured against against an appropriate benchmark; using asset-weighted returns to take account of different fund sizes; monitoring fund style consistency to counter "style drift"; and regular data cleaning to ensure that managers other than "active" are excluded from benchmark comparisons.

competition. In the US, where passive funds have the benefit of huge economies of scale (their costs are generally lower than in Europe) it is more than nine in ten. Even in emerging equity markets, which are generally viewed as less efficient than developed markets, passive managers usually outperform their active rivals.

This data only reinforces the consensus amongst impartial observers that passive fund management should be embraced in favour of active management.

(c) The FCA rides in

(i) Refreshingly direct

The FCA's recent interim market study of fund management is a damning indictment of the industry.[25] It reinforces a view long held by the author that this is an industry dominated by self-interest, underpinned by a culture of obfuscation and opacity wrapped within a web of meaningless terminology, pseudo-science and sales patter. Few enter the industry with the expressed purpose of enriching others.

The FCA's report comments on fund performance, concluding that:

- institutional active investment products, on average, outperformed their benchmarks before charges were deducted. After charges there was no significant return over the benchmark for institutional products;
- active funds for sale in the UK, on average, outperformed benchmarks before charges were deducted, but underperformed benchmarks after charges on an annualised basis by around 60 basis points (i.e. 0.6%);
- there is little evidence of persistence in outperformance in the academic literature, but there is some evidence of persistent underperformance. The FCA looked at the best-performing quartile of funds over the 2006-10 period and examined how they performed in the next five years. Just under a quarter stayed in the highest quartile, *which is exactly what chance would suggest.* More than one-third of the stars of 2006-10 slipped to a bottom-quartile ranking, or were closed or merged; and
- about £109 billion of investor assets are held by managers who charge high fees but do not offer significant variation from an index-tracking strategy: these are the so-called "closet trackers". Once their high costs are deducted, the outcome of sub-index performance is no surprise.

The FCA compared the net return on a £20,000 equity fund over 20 years, assuming the same average FTSE all share growth for two funds, one actively managed, the other passive. It found that an active manager's charges can eat up one third of an investor's return. The passive fund produced £9,455 (24.8%) more than the active fund, rising to £14,439 (44.4%) once transaction costs were taken into account: see Figure 1.

[25] Market Study MS15/2.2; *Asset Management Market Study, Interim Report*; FCA, November 2016. A final report will be published in 2017.

One consequence of all this, as described by the FCA, is high operating margins for asset management firms, consistently averaging around 36%, one of the highest of any industry. The Economist suggested that *profits that heady smack more of an oligopoly than of a cut-throat battle for business,* and went on to say that *in chasing performance, investors are pursuing a chimera.*[26]

The FCA contrasted the 36% with the average margin of the FTSE All share companies, at some 16%, and commented on how charges for active funds have remained stable over time. Conversely, passive funds' fees have fallen by more than half since 2010. The FCA also identified price clustering for active funds for sale in the UK, stating that *"there is little evidence that firms compete on the basis of price*". Its conclusion is clear: competition is not functioning properly.

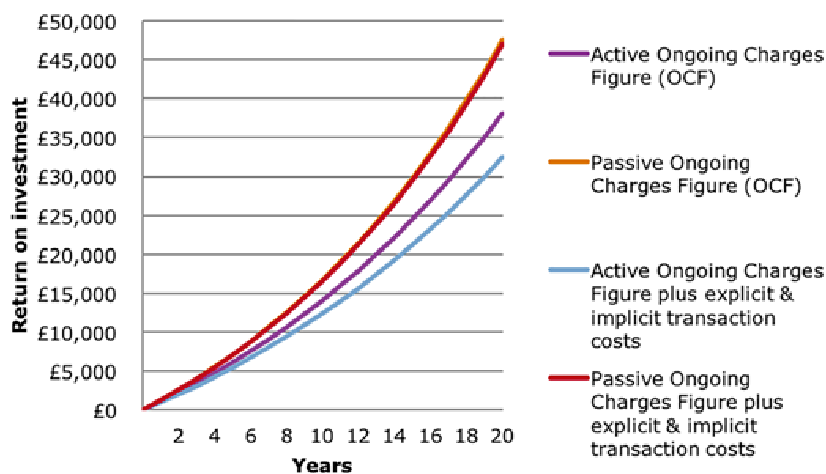
Meanwhile, passive funds comprise fewer than 7% of the funds on financial advisers' "best-buy lists" (and, before January 2014, there were none).

(ii) The FCA's findings: unsurprising

The FCA's findings are not recent revelations:

- Nobel laureate Daniel Kahneman: *"there are domains in which expertise is not possible. Stock picking is a good example"*.
- Nobel laureate Eugene Fama: "*after taking risk into account, do more managers than you'd see by chance outperform with persistence? Virtually every economist who studied this question answers with a resounding 'no'*."
- Warren Buffett: *"By periodically investing in an index fund, the know-nothing investor can actually out-perform most investment professionals"*.

Figure 1: Active managers underperform passive funds after costs



Source: *Figure 1.2, Market Study MS15/2.2; Asset Management Market Study, Interim Report*; FCA, November 2016.

[26] Ibid.

Proposal 5: The FCA should be encouraged to brief DCLG as to the implications for LGPS fund performance of the findings in its recent Asset Management Market Study.

(iii) Active management: conclusion

It is clear that a stunningly small number of funds beat their peers on a regular basis, over any meaningful timeframe. But the crucial point is that at the start of any three year period, say, no one knows which funds they will be, including investment consultants. As a recent F&C report says, *consistency in core markets such as the UK, US and Europe seems as rare as ever*.[27]

We have seen that, unlike costs, investment performance is not, by and large, controllable. The FCA's robust, independent and damning evidence skewers any justification that active fund management of listed assets is worth the candle. Yet some 75% of UK assets are actively managed.

The mantra that *past performance is no guide to future growth* cannot be faulted. Hindsight being useless, this is active fund management's Achilles heel, and the crux of the debate.

5.2 Implications for the LGPS

(a) The LGPS: already diversified

There is one other consideration concerning fund management that is specific to the LGPS. Such is the scale and investment diversity of the LGPS's funds that, when viewed in aggregate, the scheme is invested in *everything*. Thus, its assets could be considered as a proxy for the market as a whole, akin to an index. Consequently, paying active fund managers over £800 million per year in fees (likely still under-reported, and ignoring performance fees) to try to out-perform both the market and one another, in what is ultimately a giant negative sum game, is imbecilic. And it is the scheme members and taxpayers who pay the price, as their hard won capital is persistently and innocuously eroded by utterly unnecessary, high and recurring charges and fees.

(b) Listed assets: embrace passive funds

(i) Resuscitate a past proposal

In May 2014, DCLG issued a consultation paper proposing that all of the LGPS's actively managed listed assets (such as bonds and mainstream equities, totalling some £85 billion at the time) should be replaced by passive, index-tracking, funds. The proposal emerged after the author proposed it to DCLG in a 2013 paper, following extensive analysis of LGPS data.[28] The key conclusion is that across the 89 funds, any additional performance generated by active management of listed assets (relative to their benchmark indices) is, on average, insufficient to overcome the additional costs. The FCA's own analysis resonates with this.

Predictably, the (deep-pocketed) industry fought back and, shamefully, the proposal was shelved. But the FCA has now laid bare the nonsense that is the active fund management of listed assets. It is time for the proposal to be implemented.

[27] F&C Investments *Fund Watch report*, Q3 2016.

[28] *The Local Government Pension Scheme: opportunity knocks*; Michael Johnson, Centre for Policy Studies, 2013.

Proposal 6: The Government should require *all* of the LGPS's actively managed *listed* assets to be replaced with passively managed (index-tracking) funds.

This proposal offers the Government, acting through DCLG as sponsor of the LGPS, a great opportunity to exhibit leadership. Assuming other schemes followed DCLG's implementation, it would mark a seminal moment for all funded occupational pension schemes, i.e. public and private. Millions of scheme members would benefit, and it would become apparent that we do not need 80% of the fund management industry. The remaining 20% should focus on adding value in the unlisted asset arena that lacks the indices required by (passive) tracker funds to replicate investment performance: principally "alternative" assets (including private equity), emerging markets, infrastructure, property, and investments in smaller companies.

Note that given the prevalence of closet trackers, moving to passive fund management would, for many pension funds, simply represent a switch from expensive to inexpensive passive investing.

(ii) Passive funds: ignore the standard refrain

Whenever the author makes the case for passive fund management within pension funds, it elicits the same line of defence from the industry: how will price discovery work? The answer is: as it always has, because pension funds own only 3% of UK shares, down from 21.7% in 1998.[29] This is a surprisingly low figure, perhaps a consequence of the de-risking agenda being pursued by many pension funds (a big mistake, in the author's opinion.)

(c) The case for infrastructure

(i) A premium for illiquidity

There is a case for the LGPS funds' risk appetite to be more aggressive because, as a public sector pension scheme, its sponsor is effectively a corporation without end (i.e. sponsor solvency should not be a consideration).[30] Indeed, its asset allocation to equities (roughly 60%) is high relative to private sector pension funds'.[31] The LGPS's status therefore puts it in a strong position to harvest illiquidity premia, i.e. to invest in longer term, higher yielding asset classes that are not readily saleable, such as infrastructure.

(ii) The LGPS's current position: a data gap

The LGPS Advisory Board's website provides a summary of the 89 funds' aggregated asset allocation, showing £951 million in

[29] ONS; *Ownership of UK Quoted Shares, Table 1: Beneficial ownership of UK shares by value,* at 31 December 2014 (the latest data: ONS only reports this bi-annually). The Rest of the World owns 54% of UK shares, individuals 12%.

[30] It is unclear how a local authority could go bankrupt, and there appears to be no mechanism for Parliament to dissolve one; a new Order of Parliament would probably be required.

[31] The 60% comes from Pensions & Investment Research Consultants Ltd (PIRC), with bonds 16%; alternatives 12%; property 9%; and cash 3%. The LGPS Advisory Board's website lists equities at 36.8%, but this excludes an unspecified amount of equities within £93 billion of assets held in Pooled Investment Vehicles.

infrastructure, i.e. just 0.4% of total assets. This is tiny by international comparison (the Ontario Teachers' Pension Plan (OTPP), for example, has £7.7 billion in infrastructure, over 9% of net assets), but the website also shows £93 billion allocated to Pooled Investment Vehicles (PIVs), which probably include some infrastructure. A total figure for infrastructure of around £2 billion is more likely (0.9% of total assets). The author has asked CIPFA, DCLG and the LGA for details of what is inside the PIVs but, to date, none has been forthcoming.

(iii) One pool for infrastructure

A report compiled by 24 local authorities recognises that, for some asset classes (including infrastructure and private equity), LGPS-wide collaboration would produce greater benefits than leaving the eight pools to work individually.[32] It proposes a national platform to accommodate all of the 89 funds' infrastructure risk appetites, by offering low, medium and high-risk assets, while reducing costs. Given the small allocation to infrastructure (£2 billion is only £22 million per LGPS fund), a single national pool covering LGPS infrastructure investment operationally makes eminent sense.

Meanwhile, other infrastructure initiatives are ongoing, including GLIL Infrastructure, a partnership between the LPP and Northern pools, with an intention to raise infrastructure allocations to 10% of each of the six participating pension funds' portfolios (i.e. £4.7 billion in infrastructure). Other pools may join in, and it is possible that GLIL, by acting quickly, could emerge as the national LGPS pool for infrastructure.

An Independent Governance Committee should be appointed to oversee a single LGPS infrastructure investment vehicle, to include a representative from the National Infrastructure Commission.[33]

(iv) Infrastructure: a warning

There are some significant practical challenges to investing in infrastructure, particularly on the scale that the Government would like to see. Although the 2014 National Infrastructure Plan valued the UK pipeline at £466 billion, of which £277 billion is currently under construction, critics highlight the lack of available projects that meet pension funds' risk / return criteria. Several LGPS funds have commented on the difficulty in filling even today's targets for infrastructure investment, and the Pensions Infrastructure Platform, for example, has struggled to develop.[34] A lack of available cash is not cited as an issue.

Consequently, to access what funds want (mature assets with stable cash flows that rise with price inflation to mirror inflation-linked pension payments), they sometimes have little choice but to invest via private equity-style vehicles. These are often accompanied by high fees, blind risk pools and quite a degree of concentration. Indeed, infrastructure investing has been described as "private equity-lite", essentially buyouts in disguise,

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32 *Summary Report, Project POOL*; Joint Working Group of Local Authorities, January 2016.

33 The National Infrastructure Commission was established In October 2015 to provide the government with expert independent advice on the country's infrastructure needs. It will be established as a permanent executive agency in January 2017, chaired by Lord Adonis.

34 Launched in 2011 by the National Association of Pension Funds and the Pension Protection Fund.

albeit sold as low-risk, stable and with inflation-beating returns.

(d) Private equity: a single pool required

The 89 funds' combined investment in alternative assets is small relative to total assets, primarily comprising some £11 billion in private equity (it is disconcerting that precise data is unavailable).[35] It would be more efficient to concentrate such investments into a single, in-house vehicle rather than have them spread across eight proposed pools.

This vehicle should aspire to become a global centre of expertise, managed by a dedicated team familiar with illiquid asset classes such as private equity. It should seek to emulate the likes of the OTPP private equity offshoot, which had CAN$28.4 billion invested at end-2015 (i.e. £13.8 billion, not much more than the estimated total for the 89 funds).

OTPP private equity returned 32.3% in 2015, and has delivered an IRR of 20.2% per annum over the last 25 years. *Crucially, it retains performance fees in-house.* The LGPS's illiquid assets investment vehicle should do likewise.

> **Proposal 7**: All LGPS funds' alternative and infrastructure investments should each be consolidated into a vehicle, managed by in-house teams specialising in unlisted, illiquid assets. They should both aspire to be global centres of expertise, each accountable to an Independent Governance Committee.

(e) Funds of funds

Funds of funds are, from a cost perspective, the worst offenders in fund management's product suite, because of their multiple layers of costs. There is mounting evidence that they should be avoided, a case the author put to the Government in 2013. DCLG's 2014 proposal concerning passive funds was accompanied by a proposal to replace all funds of funds with alternative assets, to be held in a common investment vehicle. The first part of this proposal should be resuscitated and implemented.

> **Proposal 8**: The Government should push ahead with its 2014 proposal that the LGPS's funds sell off their funds of funds investments.

(f) Hedge funds

(i) Beware sophistication

Hedge funds often sell themselves to unwitting clients on the basis of being highly sophisticated investors. Evidence in recent years suggests that many hedge funds are a busted flush, charging high fees but delivering poor results. There are always exceptions, of course, but hindsight is required to identify them, confirmed by numerous academic studies.

Princeton's Professor Burton Malkiel, for example, has monitored hedge fund performance for decades, taking into account diversification, expenses, taxes,

[35] Pensions & Investment Research Consultants Ltd (PIRC) has suggested to the author (21 December 2016) that private equity accounts for "a touch under 5%" of total assets: i.e. £10.7 billion. Conversely, the LGPS Advisory Board's website lists private equity at £4.15 billion (March 2015), but this excludes an unspecified amount in Pooled Investment Vehicles, with £93 billion of unspecified assets.

risk, and turnover.[36] His conclusion is that *in the long-run it is almost impossible to beat the market on an after-tax, after-expense, risk-adjusted basis*. Unsurprisingly, Professor Malkiel is an ardent fan of the index approach to investing, i.e. passive investing.

Others are equally scathing of hedge funds' performance. They have received huge amounts of capital from sophisticated investors, yet had it *all* been invested in Treasury bills, the results would have been substantially better.[37]

(ii) Some data

The average hedge fund has underperformed the S&P 500 Index in ten of the last 13 years (and in every year since 2008).[38] Over the last 15 years, the S&P 500 Index has delivered an average annual return of 8.82%, whereas it is 6.62% for the average hedge fund. One reason for the performance gap is the traditional "two and 20" hedge fund fee structure, which can work out to be up to 30 times larger than the fees on mutual funds.[39]

Many pension funds now avoid hedge funds: for example, CALPERS, the California state pension fund, stopped investing in hedge funds in 2014.

> **Proposal 9**: DCLG should actively discourage LGPS funds from investing in hedge funds.

(g) No more investment consultants

The FCA's ire towards investment consultants is palpable: *they are not effective at identifying outperforming fund managers*. It is also critical of consultants' poor management of conflicts of interest, which are often poorly understood by clients, and the difficulty that clients have in monitoring their consultants, assessing the value of their advice, and holding them to account. According to the FCA's report, the information presented *was at times difficult to understand and important factors were not always highlighted. This could lead to poor performance not being communicated or being easily disguised.* The FCA is picking up on an all-too familiar theme, the industry's cultural attachment to opacity around fees and performance (particularly against indices).

Furthermore, the FCA will now consult on making a market investigation reference to the Competitions and Markets Authority (CMA) in respect of investment consultants. It this comes to pass, as it should, then consultants' pay could become tightly linked to value that is added through judgement, not luck.

But, apart from reiterating the benefits of diversification (by asset class, and market exposures, such as currency and term), giving consideration to liquidity needs and, over the long term, focusing more on income (and growth thereof) than stock selection, it

[36] Prof. Malkiel is perhaps best known for his seminal investing book *Random Walk Down Wall Street.*

[37] See *The Hedge Fund Mirage*; Simon Lack, published by John Wiley, 2012.

[38] S&P 500 index compared to the Barclay Hedge Fund Index, both on a pre-tax basis (to 2015).

[39] "Two and 20": 2% per annum on assets under management, plus 20% of profits.

is very unclear what value investment consultants could add to the LGPS.[40]

Proposal 10: DCLG should, at the very least, tie LGPS investment consultants' remuneration to asset out-performance relative to indices. If no value-added, then no fee. Better, LGPS funds should be strongly discourage from using investment consultants.

(h) Fiduciary management[41]

The FCA is particularly exercised by investment consultants who also offer fiduciary management services. Originally, consultants would advise pension scheme trustees on investment issues, but now they make and implement investment decisions directly. Conflicts abound.

In the meantime, the FCA and the Government should ponder the requirement of trustees that *by statute* they must take advice on investments.[42] This sits very awkwardly with the FCA's report.

Proposal 11: Consideration should be given to repealing Section 36(3) of the Pensions Act 1995, requiring trustees to take advice prior to making an investment.

Irrespective of whether this proposal were implemented, the calibre of trustees would have to be improved: professionalisation beckons.

But the key point is that the rise of fiduciary management consultancy is symptomatic of the abject failings of some of those with governance responsibilities. Resolve this, and there would be no need for the fiduciary management business, which, according to data from KPMG, has grown tenfold since 2007.

6. Governance

6.1 Failings now being made manifest

A theme that ripples through this paper is the need to dramatically improve the quality of LGPS governance, essential for driving fund management reform, a pre-requisite to generating *material* cost savings to improve value for money, and ultimately to help maintain the sustainability of the LGPS.

The consequences of decades of lax governance are now appearing as pressure on councils to increase their pensions contributions. Seven councils, for example, have recently been asked for an additional £100 million to top up the West Midlands Pension Fund. £65 million of this is due from Birmingham, which has already paid £122 million in top-ups since 2014. It has had to reduce its spending by £500 million in the past six years, and expects to have to cut another £250 million by 2020. Service provision (and jobs) will inevitably suffer.

6.2 Radical simplification required

Ideally, those with governance responsibilities should be in close proximity to the day-to-day management of the assets.

[40] Over the long term, relative price performance (pursued through stock selection) dominates less than income (and to a lesser extent growth in income). Consequently, much of the diversification sold by consultants is long-term illusory. Credit: Con Keating.

[41] Fiduciary, from the Latin *fiducia*, meaning "trust".

[42] Section 36(3) of the Pensions Act 1995.

However, once the pools are operational, there will be an *additional* layer between governance and assets. Today's labyrinthine dysfunctional dystopia of Pension Boards, s101 Committees and s151 officers, in which accountability is entirely absent, should be scrapped and replaced with one small, Independent Governance Committee (IGC) for each pool.

Proposal 12: The LGPS's governance arrangements (Pension Boards, s101 Committees and s151 officers) should be scrapped and replaced with one Independent Governance Committee for each investment pool.

6.3 Pool IGCs: composition

The pool IGCs should include representatives of the major stakeholders (the scheme membership, employers and taxpayers), and technically-minded individuals who exude a natural curiosity in numbers and are capable of challenging the fund management industry, in particular.

The question of whether DCLG (as scheme sponsor) or local councillors should be represented on the IGCs is for debate. Ideally, the IGCs should be politically autonomous to ensure that the quality of governance is not compromised (and also that it does not deter high quality business world candidates from applying for an IGC role). This issue goes to the heart of some major questions, discussed in section 7.2.

6.4 Pool IGCs: behaviour

The IGCs should behave as though they are mutual bodies, adhering to the principals of trust-based governance (but not necessarily structured as trustee boards). Their members should have no commercial interests within the pensions and investments arena, which would exclude professional trustees, and other consultants, from participating.

The FCA's recent report into asset management expresses concerns about *low and variable levels of investment experience on the committees*. Consequently, all pool IGC members should be required to pass an appropriate competency test to ensure that relevant niche expertise is represented (regulatory, investment, legal, etc.).

The IGCs should aspire to be the governance quality benchmark to beat, embracing an enhanced version of the Stewardship Code (with agency issues thoroughly addressed), the Myners' Principles[43] and some of ShareAction's proposals to strengthen the link between scheme members and the institutions that invest in the UK's largest companies.[44]

6.5 Pool IGCs' role

Ordinarily, the key purpose of a governance committee should be to ensure the sustainability of the pension fund. But the LGPS pools' IGCs would have no control over the benefits (i.e. the scheme's liabilities), so their focus would primarily be on optimising asset performance. This

[43] The six Myners' Principles concern effective decision-making, clear objectives, risk and liabilities, performance assessment, responsible ownership and transparency and reporting.

[44] ShareAction, a non-profit group that campaigns for responsible investment.

should include ensuring that the stakeholders (the membership and taxpayers) get value for money from third party service providers.

Given the size of the assets, pools should be encouraged to build in-house capabilities, notably for asset management. Not only would performance fees then be retained, but it would be easier, for example, to monitor investments for environmental, social and governance (ESG) compliance.

To the extent that any external fund managers were to be retained, then their remuneration should be performance-linked, and not related to the volume of assets under management.

More broadly, the IGC's should seek to foster a culture whereby everyone associated with the pools treats the assets as if they were their own money.

6.6 The pools: disclosure

High quality disclosure is a pre-requisite to enabling both the LGPS's stakeholders and independent observers to hold the pools to account (and it would encourage good performance).

(a) The regulators' perspective

Today, regulators assume that big institutions (banks, insurance companies, hedge funds and pension funds) can look after themselves as "sophisticated" (i.e. "qualified") investors; that, for example, they experience fewer information asymmetries than retail investors do when dealing with the industry.[45] Consequently qualified investors are not afforded the protections of retail investors, on the basis that they will invest sensibly. But there is an abundance of evidence to suggest otherwise (including the behaviour of many banks, pre-2008).

In addition, institutional investors essentially "front" the financial interests of large numbers of individual "retail" clients….and their staff's interests are sometimes misaligned with their clients' (i.e. they have no "skin in the game"). Regulators would appear to have missed the principal / agent problem embedded within institutional investors.

(b) Adopt "retail" client standards

The regulators' current treatment of pension funds as institutional investors disenfranchises the at-risk (retail) stakeholders. One way to (partly) remedy this would be to require the pool IGCs to meet retail client disclosure standards (or, alternatively, disclosure standards similar to those required of corporate directors, when reporting to their shareholders).

The pools would have to substantially improve upon the quality of information currently provided by the individual LGPS funds (and DCLG). They should convene a Disclosure Standards Committee to develop standardised reporting templates to cover themes such as pool performance and asset management fees and charges. It would not need to start from scratch because the LGPS Advisory Board and the Investment Association are already developing such templates and, crucially, the theme now has

[45] See *So much for sophistication*; Peter Morris, IFS Learning, October 2011.

the FCA's attention, with two related sets of proposals currently out for consultation.[46]

The templates should by published annually by all the pools, not least to facilitate pool comparison.

> **Proposal 13**: The pools' Independent Governance Committees should establish a Disclosure Standards Committee to develop standardised reporting templates, to include pool performance and all asset management fees and charges. They should be published annually by all the pools, disclosure being to the same standards that retail investors are entitled to.

7. The LGPS: big questions remain

7.1 Farcical localism

Given the on-going pooling exercise, asset consolidation is clearly on the agenda, yet decisions concerning asset allocation, risk and diversity will continue to be made at individual fund level. This is an absurd consequence of political considerations masquerading under the banner of localism, which is at odds with fully harvesting the benefits of scale. Thus, the intention is to retain the 89 funds' individual identities, accompanied by their operational and governance architecture. Meanwhile, an *additional* layer of eight separate pool management teams is now emerging.

Administering authorities' claims that their fund's local identity is important is self-serving nonsense, and meaningless to the membership.[47] There is little evidence that they are wedded to localism or care much about asset allocation: their top priority is that pension are, or will be, paid in a timely manner.

Contributions are higher than otherwise care of the cost of maintaining a vast, unaccountable, bureaucracy that ultimately renders the scale derived from pooling as somewhat cosmetic. A dramatic structural simplification of the LGPS is required.

> **Proposal 14**: DCLG should demise the LGPS's local operational structures and centralise all administration.

It is perhaps no surprise that the first theme cited by Margaret Hodge MP, recent chair of the Public Accounts Committee, as mitigating against securing best value for the taxpayer, is tension between localism and efficiency. [48]

7.2 Asset allocation: who decides?

In 2016, legislation came into force which essentially gives DCLG's Secretary of State powers to intervene in the investment function of an administering authority.[49] The initial consultation's references to intervention include *directing an authority to develop some or all of its assets in a particular way*. UNISON, however, argues

46 CP16/30, *Transaction cost disclosure in workplace pensions* (October 2016) and *Market Study MS15/2.2; Asset Management Market Study, Interim Report* (November 2016).

47 This theme is explored in more detail in *What price localism? A case study: the Local Government Pension Scheme;* Michael Johnson, CPS, 2014.

48 *Called to Account, Chapter 16;* Margaret Hodge, 2016.

49 The Local Government Pension Scheme (Management and Investment of Funds) Regulations, 2016 SI / 946, effective 1 November 2016.

that *investment decisions should be made by the funds and their members, not ministers.* Meanwhile, the House of Lords' Secondary Legislation Scrutiny Committee recently commented that *while DCLG describes the power to intervene as a fall-back to protect public funds, likely to be used only rarely, significant numbers of consultation respondents consider that such a power is incompatible with the independence of the funds*.[50]

The issue of who determines asset allocation raises some big questions, such as what is the LGPS for (should asset allocation prioritise supporting the economy, above all else?), and who "owns" the assets? Departmental funding pressures increase the significance of the debate: the 2015 Spending Review, for example, committed the government to invest £100 billion in infrastructure by 2020-21.

7.3 Where does the buck stop?

The question of who, ultimately, will ensure that the LGPS's pensions are paid has, to date, not required an answer. Technically it is the responsibility of the administering authorities (i.e. it would fall upon council tax payers to bail a fund out, *not* the central government sponsor, DCLG) but, in practice, it would almost certainly be the Treasury that has to step in.

One way of ending the ambiguity would be to provide a Crown guarantee on the LGPS's pensions promises, currently absent. The LGPS membership should have no reason to complain, given that their pensions would then be more secure than without the guarantee. Such an initiative would legitimise central government's right to have a say (or perhaps the *final* say) in asset allocation, or indeed to take *all* the assets in-house (discussed in an earlier paper).[51]

8. Seed a sovereign wealth fund

8.1 A change of heart

A few years ago the author concluded that the LGPS should remain as a funded pension scheme.[52] Subsequently, that sentiment has substantially weakened, for several reasons:

- the structure of the LGPS is becoming ever more labyrinthine, an ineffective and inefficient bureaucracy riddled with costly functional replication, primarily a legacy of history;
- the governance framework remains dysfunctional, utterly devoid of personal accountability; and
- insipid asset performance, closely related to a fund management industry that is blatantly self-serving, and showing little interest in changing its behaviour.

Given the political difficulty in confronting the DB benefits package, there would appear to be little prospect of the transformational changes required to make the LGPS sustainable for the long term. Consequently, the least that should be done would be to socialise the benefit of the

[50] 10th Report of Session 2016–17, HL Paper 53, 20 October 2016.

[51] *LGPS (2018)*; Michael Johnson, CPS, January 2016

[52] *Self-sufficiency is the key, Chapter 5, Funded or unfunded pensions*?; Michael Johnson, CPS, 2011.

LGPS's assets across the whole of society, by using them to seed a sovereign wealth fund (SWF), with a significant allocation to infrastructure: we all use airports, railways, roads and utilities.

Proposal 15: The Government should develop a parallel plan to de-fund the LGPS and use the assets to seed a sovereign wealth fund, with a significant allocation to infrastructure. As a *quid pro quo*, a Crown guarantee could be provided on the pension promises, which would subsequently be met on a pay-as-you-go basis.

A Crown guarantee would be merely making explicit a practical reality, but the unfunded liabilities would have to be reported in the Whole of Government Accounts (WGA).

8.2 SWF: governance

SWFs are more complex than other institutional investors because they are likely to be pursuing multiple objectives, some of which could be mutually incompatible. Commercial objectives, such as maximising the risk-adjusted financial return, could clash with strategic objectives, for example advancing national economic policies (perhaps relating to infrastructure, security or industry interests).

Consequently, political aims are unlikely to be far from a SWF; one challenge for the governing body would be to hold them at bay.[53] The investment strategy, and who makes asset allocation decisions, would be subject to considerable scrutiny…..when even agreeing what best serves the national interest could be difficult. How much should be invested abroad, for diversification benefits? Investing for the *long-term* should be emphasised, primarily in equity (rather than debt) investments.

There are different SWF models to consider. Some, including Norway's NBIM, embrace transparency, whereas others (including China Investment Corporation and the Kuwait Investment Authority) object to greater public disclosure, citing privacy and competitive advantage.[54] SWFs have traditionally assumed a low profile to avoid accusations of interference (particularly in respect of foreign asset holdings), but corporate activism is now on the rise. NBIM is one of very few SWFs that has an internal function dedicated to corporate governance; every year, it votes on hundreds of shareholder proposals on environmental and social issues.

The governance framework for a British SWF should be consistent with that required of private sector pension funds, with transparency being paramount.

Conclusion

The LGPS epitomises a clash of perspectives: it is a single national pension scheme riven by the demands of localism. This comes at a very high price: such ambiguity has helped accommodate ineffective and inefficient governance, characterised by a marked absence of

[53] The Generally Accepted Principles and Practices (GAPP) for SWFs focus on creating a governance structure that encourages the separation of political and commercial interests of a fund.

[54] Norges Bank Investment Management (NBIM), part of the central bank. Asset allocation is 60% equities, 35% fixed income, and 5% real estate

accountability. Consequently, poor asset performance and excessive costs have not been challenged, and some service providers, notably within the fund management industry, have taken advantage of the LGPS. They have, over many years, been iniquitously undermining the long-term sustainability of the scheme. It is the membership, and other taxpayers, who will have to pay the price.

APPENDIX I

LGPS fund management performance, the last decade, £ billion[55]

	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	Decade	Annual
Assets market value at start of year	£214.1	£189.5	£178.5	£157.3	£153.1	£140.7	£103.4	£127.5	£129.9	£119.8		
Assets market value, end of year	£213.9	£214.1	£189.5	£178.5	£157.3	£153.1	£140.7	£103.4	£127.5	£129.9		
Change in assets market value	**-£0.1**	**£24.6**	**£11.0**	**£21.2**	**£4.2**	**£12.4**	**£37.3**	**-£24.0**	**-£2.4**	**£10.0**		
less cash contributions	-£9.2	-£9.4	-£8.4	-£8.1	-£8.3	-£8.5	-£8.3	-£7.9	-£7.2	-£6.7		
less other net cash inflows, including transfers	-£0.5	-£3.1	-£0.7	-£0.6	-£0.9	-£0.9	-£0.9	-£0.7	-£0.8	-£0.9		
plus total expenditure (pensions, fund mgt etc.)	£10.8	£12.9	£9.5	£9.1	£9.2	£8.5	£8.1	£6.9	£6.6	£6.2		
less fund management costs	-£0.8	-£0.7	-£0.5	-£0.4	-£0.4	-£0.3	-£0.3	-£0.3	-£0.3	-£0.3		
Fund management value-added	**£0.1**	**£24.3**	**£10.9**	**£21.1**	**£3.9**	**£11.1**	**£35.9**	**-£25.9**	**-£4.1**	**£8.3**		
Nominal return on start of year assets, % p.a.	0.1%	12.8%	6.1%	13.4%	2.6%	7.9%	34.7%	-20.3%	-3.2%	7.0%	**67.2%**	**5.3%**
less inflation, as RPI to 2010-11, CPI thereafter *	0.5%	0.0%	1.6%	2.8%	3.5%	5.3%	4.4%	-0.4%	3.8%	4.8%		
Real return due to fund management, % p.a.	**-0.4%**	**12.8%**	**4.5%**	**10.6%**	**-0.9%**	**2.6%**	**30.3%**	**-19.9%**	**-7.0%**	**2.2%**	**30.9%**	**2.7%**

Note that:

- the inflation adjustment mirrors the indexation used to revalue the LGPS's pensions in payment (RPI until March 2011, and CPI thereafter); and
- investment income derived from fund management activities is already taken into account in the year-end market value.

APPENDIX II

The last decade: development of reported costs (LGPS England and Wales), £ millions

£ millions	2015-16 *	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	2005-06	Ten year change
Fund management costs	£802.5	£747.6	£494.1	£408.6	£381.1	£340.5	£296.3	£265.0	£293.0	£271.0	£213.0	277%
Admin costs incl governance	£159.7	£130.2	£132.6	£127.3	£126.9	£133.7	£122.6	£121.0	£113.0	£102.0	£98.0	63%
Total costs	£962.2	£877.8	£626.6	£535.9	£508.0	£474.1	£418.9	£386.0	£406.0	£373.0	£311.0	209%
Total membership	5,396,477	5,168,379	4,944,843	4,684,039	4,530,140	4,428,552	4,331,049	4,180,000	4,008,000	3,837,000	3,666,000	47%
Total costs per member	£178.3	£169.8	£126.7	£114.4	£112.1	£107.1	£96.7	£92.3	£101.3	£97.2	£84.8	110%
Annual increase	5.0%	34.0%	10.8%	2.0%	4.7%	10.7%	4.7%	-8.8%	4.2%	14.6%	-	-
Market value (end of year)	£213,935	£214,073	£189,455	£178,193	£157,305	£153,116	£140,729	£103,418	£127,464	£129,880	£119,843	79%
Fund mgt costs as % mkt value	0.38%	0.35%	0.26%	0.23%	0.24%	0.22%	0.21%	0.26%	0.23%	0.21%	0.18%	111%
Total costs as % mkt value	**0.45%**	**0.41%**	**0.33%**	**0.30%**	**0.32%**	**0.31%**	**0.30%**	**0.37%**	**0.32%**	**0.29%**	**0.26%**	**73%**

** 2015-16 was the first year in which governance and oversight costs were disclosed separately: £51.3 million*

55 DCLG's SF3 data tables.

APPENDIX III

LGPS funds: total costs per member, last three years

	Local Authority	2015-16	2014-15	2013-14	Two year change	Assets, 31 March 2016 £'000
1	West Yorkshire Super. Fund	£28.4	£28.3	£27.8	2.1%	£11,210,980
2	East Riding of Yorkshire UA	£46.0	£47.6	£51.2	-10.1%	£3,714,119
3	Nottinghamshire	£46.2	£52.8	£54.6	-15.5%	£4,066,670
4	Tameside	£55.1	£53.5	£61.1	-9.8%	£17,324,623
5	Middlesbrough UA	£73.4	£67.7	£42.8	71.5%	£3,133,118
6	Leicestershire	£73.5	£84.4	£103.5	-29.0%	£3,163,872
7	Lewisham	£95.9	£102.5	£104.6	-8.3%	£1,041,429
8	Swansea UA	£105.9	£228.9	£348.3	-69.6%	£1,511,116
9	Merton	£107.5	£81.1	£137.8	-22.0%	£529,190
10	Windsor & Maidenhead UA	£107.8	£91.8	£79.3	36.0%	£1,656,559
11	Somerset	£108.2	£124.6	£91.4	18.3%	£1,598,018
12	Hounslow	£111.1	£145.9	£164.6	-32.5%	£779,241
13	North Yorkshire	£114.2	£83.8	£96.8	18.0%	£2,417,833
14	Cambridgeshire	£117.5	£142.7	£110.0	6.8%	£2,243,611
15	Carmarthenshire UA	£120.1	£109.9	£70.7	69.9%	£1,895,380
16	Croydon	£123.5	£194.9	£172.1	-28.2%	£877,026
17	Northamptonshire	£128.3	£132.9	£102.5	25.2%	£1,855,809
18	Hampshire	£131.9	£141.7	£97.4	35.5%	£5,213,406
19	Greenwich	£133.4	£116.5	£114.9	16.1%	£1,051,629
20	South Yorkshire Pensions Fund	£133.8	£41.3	£41.8	220.2%	£6,254,424
21	Bedfordshire	£135.1	£119.9	£105.4	28.2%	£1,732,814
22	Kent	£137.7	£130.5	£160.4	-14.2%	£4,597,540
23	Devon	£138.6	£127.2	£106.4	30.3%	£3,336,915
24	Worcestershire	£139.1	£98.8	£160.4	-13.3%	£1,928,700
25	West Sussex	£139.7	£177.4	£148.9	-6.2%	£2,985,801
26	Staffordshire	£146.5	£143.0	£123.9	18.3%	£3,751,927
27	Wiltshire	£147.6	£119.3	£81.2	81.8%	£1,838,661
28	Rhondda Cynon Taff UA	£147.6	£126.6	£118.1	25.0%	£2,465,565
29	Gloucestershire	£147.9	£141.2	£139.9	5.7%	£1,702,503
30	Lincolnshire	£154.5	£72.7	£71.1	117.1%	£1,750,249
31	Redbridge	£157.0	£161.7	£155.3	1.1%	£634,074
32	Oxfordshire	£158.2	£99.4	£98.2	61.2%	£1,842,289
33	Cumbria	£159.2	£85.8	£96.0	65.8%	£2,046,809
34	Richmond upon Thames	£159.7	£154.8	£152.5	4.8%	£604,940
35	Dorset	£164.1	£73.4	£69.2	137.2%	£2,266,446
36	Torfaen UA	£165.9	£176.6	£148.2	12.0%	£2,209,558
37	Hertfordshire	£165.9	£176.2	£114.2	45.3%	£3,584,250
38	Lambeth	£169.1	£186.5	£160.5	5.4%	£1,141,917
39	Islington	£170.5	£129.0	£111.6	52.9%	£1,083,305
40	Surrey	£173.5	£194.6	£156.7	10.7%	£3,223,663
41	West Midlands PTA	£178.8	£168.3	£132.8	34.6%	£474,886
42	Derbyshire	£181.0	£70.5	£79.4	127.9%	£3,671,821
43	Ealing	£184.3	£185.8	£173.8	6.0%	£953,597
44	Warwickshire	£186.5	£170.4	£176.4	5.7%	£1,665,063
45	Norfolk	£189.1	£190.6	£205.4	-8.0%	£2,904,798
46	Tower Hamlets	£193.8	£171.1	£184.8	4.9%	£1,126,129
47	East Sussex	£198.6	£152.9	£150.5	32.0%	£2,771,365
48	Bath & North East Somerset	£200.3	£211.8	£202.6	-1.2%	£3,736,930
49	Haringey	£201.2	£149.0	£116.8	72.3%	£1,045,577
50	Barnet	£202.0	£193.9	£120.9	67.1%	£900,420
51	Havering	£202.2	£190.7	£120.1	68.3%	£572,941
52	Newham	£204.2	£382.3	£169.0	20.9%	£1,105,491
53	Bromley	£210.8	£201.3	£161.3	30.7%	£744,898
54	Southwark	£214.8	£227.5	£229.3	-6.3%	£1,257,562
55	Northumberland	£215.1	£123.4	£123.0	74.8%	£1,055,262
56	Suffolk	£216.4	£229.1	£173.1	25.0%	£2,213,195
57	Essex	£217.1	£213.2	£178.0	22.0%	£5,037,104
58	Barking & Dagenham	£224.5	£178.0	£196.3	14.3%	£772,297
59	Durham	£226.6	£142.0	£134.9	68.0%	£2,321,217
60	Powys UA	£226.8	£201.8	£197.3	14.9%	£501,778
61	Wandsworth	£229.1	£222.8	£190.2	20.4%	£1,188,472
62	Cornwall	£230.0	£158.9	£83.9	174.0%	£1,475,008
63	Hackney	£233.5	£204.2	£186.3	25.3%	£1,143,845
64	Buckinghamshire	£234.2	£248.1	£122.4	91.4%	£2,213,549
65	Kingston upon Thames	£235.1	£287.4	£225.5	4.3%	£648,392
66	Sutton	£246.4	£274.4	£140.8	75.0%	£507,121
67	Merseyside Pension Fund	£248.8	£121.8	£131.3	89.5%	£6,849,753
68	Isle of Wight UA	£257.3	£224.0	£189.9	35.4%	£480,295
69	West Midlands Pension Fund	£260.2	£311.0	£59.1	340.1%	£11,660,700
70	Harrow	£261.4	£70.4	£44.6	486.0%	£661,001
71	Lancashire	£279.0	£231.2	£104.7	166.5%	£6,036,228
72	Gwynedd	£290.0	£247.8	£250.4	15.8%	£1,525,404
73	Shropshire	£300.2	£319.9	£306.7	-2.1%	£1,497,725
74	Hillingdon	£302.5	£335.4	£220.7	37.0%	£810,287
75	Cheshire	£304.6	£530.3	£309.2	-1.5%	£4,144,078
76	Cardiff UA	£329.5	£158.9	£144.9	127.4%	£1,627,898
77	Tyne and Wear Super. Fund	£340.2	£462.7	£99.7	241.4%	£6,427,370
78	Camden	£359.6	£422.3	£376.3	-4.4%	£1,249,295
79	Brent	£379.7	£387.1	£165.2	129.8%	£675,937
80	Bexley	£419.2	£198.3	£184.6	127.1%	£688,318
81	South Yorkshire PTA	£438.7	£379.4	£382.0	14.9%	£204,310
82	Kensington & Chelsea	£449.9	£359.5	£384.5	17.0%	£841,015
83	Flintshire UA	£465.0	£511.4	£212.3	119.0%	£1,381,467
84	Westminster	£484.6	£439.3	£243.6	98.9%	£1,057,935
85	London Pensions Fund Authority	£484.8	£487.2	£469.9	3.2%	£4,549,608
86	Waltham Forest	£496.7	£437.2	£483.0	2.8%	£716,495
87	Hammersmith & Fulham	£535.2	£504.5	£389.7	37.3%	£856,319
88	City of London	£558.8	£393.4	£326.1	71.4%	£802,222
89	Enfield	£591.6	£141.7	£121.6	386.5%	£916,311
	Average per fund	**£217.5**	**£197.7**	**£161.0**	**35.1%**	**£2,403,760**
	Average per LGPS member	**£178.3**	**£169.8**	**£126.7**	**40.7%**	**£39.6**

Source: SF3 data returns, DCLG.

APPENDIX IV

LGPS funds: Fund management costs per member, last three years

	Local Authority	2015-16	% change	2014-15	% change	2013-14	Two year change	Assets, 31 March 2016 £'000
1	West Yorkshire Super. Fund	£14.4	26%	£11.5	26%	£9.1	58%	£11,210,980
2	East Riding of Yorkshire UA	£27.3	-15%	£32.2	6%	£30.2	-10%	£3,714,119
3	Nottinghamshire	£31.8	-3%	£32.8	-20%	£41.1	-23%	£4,066,670
4	Tameside	£37.5	-4%	£39.0	-13%	£44.9	-17%	£17,324,623
5	Middlesbrough UA	£48.7	10%	£44.2	163%	£16.8	190%	£3,133,118
6	Lewisham	£52.5	-15%	£62.1	-7%	£66.6	-21%	£1,041,429
7	Croydon	£53.9	-56%	£122.8	33%	£92.0	-41%	£877,026
8	Leicestershire	£58.0	-15%	£68.1	-20%	£85.3	-32%	£3,163,872
9	Merton	£66.0	112%	£31.2	-64%	£85.6	-23%	£529,190
10	Hounslow	£72.4	-35%	£111.8	-19%	£138.4	-48%	£779,241
11	Somerset	£74.4	-22%	£94.8	55%	£61.2	21%	£1,598,018
12	Swansea UA	£80.3	-60%	£202.4	-37%	£320.0	-75%	£1,511,116
13	Cambridgeshire	£85.6	-17%	£103.7	49%	£69.6	23%	£2,243,611
14	Windsor & Maidenhead UA	£89.1	17%	£75.9	27%	£59.6	50%	£1,656,559
15	Carmarthenshire UA	£89.8	2%	£88.2	80%	£49.0	83%	£1,895,380
16	North Yorkshire	£92.9	41%	£65.8	-16%	£78.5	18%	£2,417,833
17	Islington	£93.2	41%	£66.3	13%	£58.9	58%	£1,083,305
18	Greenwich	£94.5	16%	£81.2	8%	£75.2	26%	£1,051,629
19	Redbridge	£95.0	-22%	£122.5	4%	£117.4	-19%	£634,074
20	Northamptonshire	£95.2	2%	£93.3	51%	£61.8	54%	£1,855,809
21	Bedfordshire	£109.8	8%	£101.8	27%	£79.9	37%	£1,732,814
22	South Yorkshire Pensions Fun	£110.3	649%	£14.7	-3%	£15.2	624%	£6,254,424
23	Hampshire	£115.3	-8%	£125.5	55%	£81.0	42%	£5,213,406
24	Kent	£116.5	9%	£106.8	-20%	£133.3	-13%	£4,597,540
25	Worcestershire	£117.1	47%	£79.4	-43%	£138.6	-16%	£1,928,700
26	Lambeth	£117.2	-13%	£135.4	19%	£113.4	3%	£1,141,917
27	Devon	£117.7	4%	£113.3	33%	£84.9	39%	£3,336,915
28	Staffordshire	£117.7	1%	£117.0	18%	£99.3	19%	£3,751,927
29	Rhondda Cynon Taff UA	£118.2	19%	£99.1	8%	£91.3	29%	£2,465,565
30	Gloucestershire	£121.3	2%	£118.5	0%	£118.2	3%	£1,702,503
31	West Sussex	£122.1	-23%	£158.4	32%	£120.4	1%	£2,985,801
32	Wiltshire	£122.2	31%	£93.0	69%	£55.0	122%	£1,838,661
33	Richmond upon Thames	£123.7	4%	£119.0	7%	£111.0	11%	£604,940
34	West Midlands PTA	£125.8	-4%	£130.9	83%	£71.4	76%	£474,886
35	Lincolnshire	£126.4	138%	£53.2	1%	£52.6	140%	£1,750,249
36	Oxfordshire	£127.8	84%	£69.3	-1%	£69.8	83%	£1,842,289
37	Cumbria	£130.6	107%	£63.0	-10%	£69.9	87%	£2,046,809
38	Sutton	£131.1	-38%	£211.6	113%	£99.5	32%	£507,121
39	Torfaen UA	£134.6	-8%	£145.6	34%	£108.8	24%	£2,209,558
40	Dorset	£137.0	223%	£42.5	-4%	£44.1	211%	£2,266,446
41	Ealing	£139.8	18%	£118.0	-5%	£123.7	13%	£953,597
42	Hertfordshire	£140.9	-8%	£152.5	69%	£90.4	56%	£3,584,250
43	Barnet	£146.8	30%	£112.7	59%	£71.0	107%	£900,420
44	Warwickshire	£151.3	7%	£141.5	-1%	£142.6	6%	£1,665,063
45	Haringey	£151.5	36%	£111.1	41%	£78.7	93%	£1,045,577
46	Surrey	£154.0	-13%	£177.3	32%	£134.0	15%	£3,223,663
47	Havering	£154.3	-2%	£157.8	115%	£73.4	110%	£572,941
48	Tower Hamlets	£155.3	20%	£128.9	2%	£126.6	23%	£1,126,129
49	Newham	£155.3	-55%	£348.3	163%	£132.4	17%	£1,105,491
50	Bromley	£157.6	0%	£158.0	29%	£122.2	29%	£744,898
51	Derbyshire	£161.2	207%	£52.4	-15%	£62.0	160%	£3,671,821
52	Norfolk	£161.3	-2%	£164.7	-9%	£180.7	-11%	£2,904,798
53	Powys UA	£164.8	11%	£148.2	6%	£139.6	18%	£501,778
54	Northumberland	£168.4	103%	£83.1	-2%	£84.5	99%	£1,055,262
55	Kingston upon Thames	£172.0	-21%	£217.5	36%	£160.3	7%	£648,392
56	East Sussex	£172.0	35%	£127.6	2%	£125.5	37%	£2,771,365
57	Hackney	£172.5	-1%	£174.6	19%	£146.7	18%	£1,143,845
58	Southwark	£174.0	-6%	£185.0	-1%	£187.1	-7%	£1,257,562
59	Bath & North East Somerset	£176.3	-4%	£182.7	6%	£172.7	2%	£3,736,930
60	Barking & Dagenham	£180.4	21%	£149.4	-3%	£154.4	17%	£772,297
61	Suffolk	£189.9	-10%	£210.1	48%	£142.4	33%	£2,213,195
62	Harrow	£194.9	n/a	-£0.3	n/a	-£14.1	-1479%	£661,001
63	Durham	£196.5	67%	£117.8	9%	£108.3	81%	£2,321,217
64	Cornwall	£198.2	37%	£144.8	110%	£69.1	187%	£1,475,008
65	Lancashire	£199.8	-4%	£208.1	149%	£83.6	139%	£6,036,228
66	Essex	£202.6	4%	£194.1	21%	£160.2	26%	£5,037,104
67	Buckinghamshire	£206.0	-8%	£224.6	148%	£90.5	128%	£2,213,549
68	Wandsworth	£208.5	5%	£197.8	20%	£165.2	26%	£1,188,472
69	Isle of Wight UA	£217.3	12%	£194.7	27%	£152.8	42%	£480,295
70	Merseyside Pension Fund	£218.8	108%	£105.4	1%	£104.4	110%	£6,849,753
71	West Midlands Pension Fund	£242.5	-18%	£295.5	640%	£39.9	507%	£11,660,700
72	Gwynedd	£254.1	17%	£216.9	3%	£211.3	20%	£1,525,404
73	Hillingdon	£254.1	-14%	£294.2	55%	£190.0	34%	£810,287
74	Shropshire	£267.5	-11%	£301.0	8%	£277.5	-4%	£1,497,725
75	Cheshire	£277.6	-45%	£506.2	80%	£281.6	-1%	£4,144,078
76	Cardiff UA	£302.3	120%	£137.2	17%	£117.6	157%	£1,627,898
77	Tyne and Wear Super. Fund	£314.2	-29%	£444.3	510%	£72.9	331%	£6,427,370
78	Camden	£317.4	-18%	£385.9	14%	£337.7	-6%	£1,249,295
79	South Yorkshire PTA	£339.5	16%	£292.0	-5%	£308.6	10%	£204,310
80	Brent	£342.0	-3%	£350.8	200%	£117.0	192%	£675,937
81	Bexley	£353.2	143%	£145.5	17%	£123.8	185%	£688,318
82	Kensington & Chelsea	£372.5	18%	£315.6	-7%	£340.0	10%	£841,015
83	London Pensions Fund Author	£386.8	-3%	£400.1	-1%	£402.3	-4%	£4,549,608
84	Flintshire UA	£396.6	-18%	£483.4	162%	£184.5	115%	£1,381,467
85	Waltham Forest	£434.9	12%	£386.7	-9%	£425.2	2%	£716,495
86	Westminster	£439.6	12%	£391.6	95%	£200.4	119%	£1,057,935
87	Hammersmith & Fulham	£474.9	4%	£457.8	33%	£344.5	38%	£856,319
88	City of London	£504.4	49%	£337.8	7%	£316.9	59%	£802,222
89	Enfield	£536.5	393%	£108.8	36%	£80.0	570%	£916,311
	Average per fund	**£178.1**	**9%**	**£163.9**	**30%**	**£126.5**	**41%**	**£2,403,760**
	Average per LGPS member	**£148.7**	**3%**	**£144.6**	**45%**	**£99.9**	**49%**	**£39.6**

Source: SF3 data returns, DCLG.

APPENDIX V

LGPS funds: admin costs per member, last three years

	Local Authority	2015-16 *	2014-15	2013-14	Two year change	Assets, 31 March 2016 £'000
1	West Yorkshire Super. Fund	£13.9	£16.8	£18.7	-25.3%	£11,210,980
2	Nottinghamshire	£14.4	£20.0	£13.6	6.0%	£4,066,670
3	Essex	£14.6	£19.1	£17.8	-18.0%	£5,037,104
4	Leicestershire	£15.5	£16.3	£18.2	-15.1%	£3,163,872
5	Hampshire	£16.6	£16.2	£16.4	1.4%	£5,213,406
6	West Sussex	£17.6	£19.0	£28.5	-38.4%	£2,985,801
7	Tameside	£17.7	£14.5	£16.2	8.9%	£17,324,623
8	West Midlands Pension Fund	£17.7	£15.4	£19.2	-7.8%	£11,660,700
9	Windsor & Maidenhead UA	£18.7	£15.9	£19.7	-5.4%	£1,656,559
10	East Riding of Yorkshire UA	£18.7	£15.4	£21.0	-10.5%	£3,714,119
11	Surrey	£19.5	£17.3	£22.7	-14.2%	£3,223,663
12	Derbyshire	£19.9	£18.1	£17.4	13.9%	£3,671,821
13	Wandsworth	£20.5	£25.0	£25.0	-17.8%	£1,188,472
14	Devon	£20.9	£13.9	£21.4	-2.4%	£3,336,915
15	Kent	£21.1	£23.7	£27.1	-22.1%	£4,597,540
16	North Yorkshire	£21.3	£18.0	£18.3	16.3%	£2,417,833
17	Worcestershire	£22.0	£19.4	£21.8	1.0%	£1,928,700
18	South Yorkshire Pensions Fur	£23.6	£26.6	£26.6	-11.3%	£6,254,424
19	Bath & North East Somerset	£24.0	£29.1	£30.0	-20.0%	£3,736,930
20	Middlesbrough UA	£24.7	£23.5	£26.0	-4.9%	£3,133,118
21	Hertfordshire	£25.0	£23.7	£23.8	5.2%	£3,584,250
22	Bedfordshire	£25.3	£18.1	£25.5	-0.6%	£1,732,814
23	Wiltshire	£25.4	£26.4	£26.2	-3.1%	£1,838,661
24	Swansea UA	£25.5	£26.5	£28.2	-9.6%	£1,511,116
25	Tyne and Wear Superannuatic	£26.0	£18.5	£26.8	-2.8%	£6,427,370
26	Suffolk	£26.6	£19.0	£30.7	-13.5%	£2,213,195
27	Gloucestershire	£26.6	£22.8	£21.7	22.6%	£1,702,503
28	East Sussex	£26.6	£25.2	£25.0	6.7%	£2,771,365
29	Cheshire	£27.0	£24.1	£27.6	-2.1%	£4,144,078
30	Dorset	£27.1	£30.9	£25.1	8.0%	£2,266,446
31	Cardiff UA	£27.3	£21.8	£27.3	-0.1%	£1,627,898
32	Norfolk	£27.8	£25.9	£24.8	12.1%	£2,904,798
33	Lincolnshire	£28.1	£19.5	£18.5	51.7%	£1,750,249
34	Buckinghamshire	£28.3	£23.5	£31.9	-11.3%	£2,213,549
35	Cumbria	£28.6	£22.8	£26.1	9.6%	£2,046,809
36	Staffordshire	£28.8	£26.0	£24.6	17.4%	£3,751,927
37	Rhondda Cynon Taff UA	£29.4	£27.5	£26.8	9.9%	£2,465,565
38	Merseyside Pension Fund	£30.0	£16.4	£26.9	11.5%	£6,849,753
39	Durham	£30.1	£24.2	£26.7	13.1%	£2,321,217
40	Carmarthenshire UA	£30.3	£21.7	£21.6	40.1%	£1,895,380
41	Oxfordshire	£30.4	£30.1	£28.4	7.1%	£1,842,289
42	Torfaen UA	£31.3	£31.0	£39.4	-20.5%	£2,209,558
43	Cornwall	£31.8	£14.1	£14.9	114.0%	£1,475,008
44	Cambridgeshire	£31.9	£38.9	£40.4	-21.1%	£2,243,611
45	Shropshire	£32.6	£19.0	£29.2	11.8%	£1,497,725
46	Northamptonshire	£33.1	£39.6	£40.7	-18.6%	£1,855,809
47	Somerset	£33.8	£29.8	£30.2	11.9%	£1,598,018
48	Warwickshire	£35.2	£28.9	£33.8	4.2%	£1,665,063
49	Gwynedd	£35.9	£30.9	£39.1	-8.3%	£1,525,404
50	Richmond upon Thames	£36.0	£35.8	£41.5	-13.1%	£604,940
51	Brent	£37.7	£36.3	£48.2	-21.8%	£675,937
52	Tower Hamlets	£38.5	£42.2	£58.2	-33.8%	£1,126,129
53	Hounslow	£38.7	£34.1	£26.2	47.8%	£779,241
54	Greenwich	£38.9	£35.3	£39.6	-1.9%	£1,051,629
55	Isle of Wight UA	£40.0	£29.3	£37.1	7.7%	£480,295
56	Southwark	£40.8	£42.5	£42.2	-3.5%	£1,257,562
57	Merton	£41.5	£49.9	£52.2	-20.5%	£529,190
58	Camden	£42.2	£36.5	£38.6	9.5%	£1,249,295
59	Lewisham	£43.4	£40.5	£38.0	14.2%	£1,041,429
60	Barking & Dagenham	£44.1	£28.6	£41.9	5.1%	£772,297
61	Ealing	£44.5	£67.8	£50.0	-11.1%	£953,597
62	Westminster	£45.0	£47.8	£43.3	3.9%	£1,057,935
63	Northumberland	£46.7	£40.3	£38.6	21.2%	£1,055,262
64	Havering	£47.9	£32.8	£46.8	2.3%	£572,941
65	Hillingdon	£48.3	£41.2	£30.7	57.1%	£810,287
66	Newham	£48.9	£34.0	£36.6	33.7%	£1,105,491
67	Haringey	£49.7	£37.9	£38.1	30.5%	£1,045,577
68	Lambeth	£51.9	£51.1	£47.1	10.2%	£1,141,917
69	West Midlands PTA	£53.0	£37.5	£61.4	-13.7%	£474,886
70	Bromley	£53.2	£43.4	£39.1	36.1%	£744,898
71	City of London	£54.4	£55.6	£9.2	493.0%	£802,222
72	Enfield	£55.2	£32.9	£41.6	32.8%	£916,311
73	Barnet	£55.2	£81.1	£49.9	10.6%	£900,420
74	Hammersmith & Fulham	£60.3	£46.7	£45.2	33.4%	£856,319
75	Hackney	£61.0	£29.6	£39.6	54.2%	£1,143,845
76	Waltham Forest	£61.8	£50.5	£57.8	6.8%	£716,495
77	Powys UA	£62.0	£53.7	£57.7	7.3%	£501,778
78	Redbridge	£62.0	£39.2	£37.9	63.7%	£634,074
79	Kingston upon Thames	£63.2	£69.9	£65.2	-3.2%	£648,392
80	Bexley	£66.0	£52.8	£60.7	8.8%	£688,318
81	Harrow	£66.5	£70.7	£58.7	13.2%	£661,001
82	Flintshire UA	£68.4	£28.0	£27.8	145.7%	£1,381,467
83	Croydon	£69.6	£72.1	£80.0	-13.0%	£877,026
84	Islington	£77.4	£62.7	£52.7	46.8%	£1,083,305
85	Kensington & Chelsea	£77.4	£43.9	£44.5	73.9%	£841,015
86	Lancashire	£79.1	£23.2	£21.0	276.6%	£6,036,228
87	London Pensions Fund Auth	£98.0	£87.1	£67.6	45.0%	£4,549,608
88	South Yorkshire PTA	£99.2	£87.4	£73.4	35.2%	£204,310
89	Sutton	£115.3	£62.8	£41.3	179.1%	£507,121
	Average per fund	**£39.5**	**£33.8**	**£34.4**	**14.6%**	**£2,403,760**
	Average per LGPS member	**£29.6**	**£25.2**	**£26.8**	**10.4%**	**£39.6**

** Note that Admin costs for 2015-16 include governance and oversight costs, previously unspecified in data tables (but which may, or may not have been reported).*

Source: SF3 data returns, DCLG.

APPENDIX VI

Potential pools[56]

Pool name	LGPS funds in pool	Assets, £ billion
Access	Northamptonshire, Cambridgeshire, Essex, Norfolk, Isle of Wight, Hampshire, Kent, Hertfordshire, West Sussex and Suffolk	£30
Borders to Coast	Cumbria, East Riding, Surrey, Warwickshire, Lincolnshire, North Yorkshire, South Yorkshire, South Yorkshire Passenger Transport Pension Fund, Tyne & Wear, Durham, Bedfordshire, Northumberland and Teesside	£36
Brunel	Avon, Cornwall, Devon, Dorset, Gloucester, Somerset and Wiltshire, Oxfordshire, Buckinghamshire and the Environment Agency Pension Fund	£25
Central	Cheshire, Leicestershire, Shropshire, Staffordshire, West Midlands, Derbyshire, Nottinghamshire, Worcestershire and the West Midlands Integrated Transport Authority	£34
London CIV	32 London Boroughs plus the City of London Corporation	£28
Local Pensions Partnership (LPP)	Lancashire, Berkshire and the London Pension Fund Authority	£14
Northern Pool	West Yorkshire, Greater Manchester and Merseyside	£36
Wales	Carmarthenshire, Cardiff, Flintshire, Gwynedd, Powys, Rhondda Cynon Taff, Swansea, and Torfaen	£13

APPENDIX VII

Percentage of European and US equity funds <u>outperformed</u> by benchmarks[57]

Fund category	Comparison index	Currency	1 year	3 years	5 years	10 years
Europe equity	S&P Europe 350	GBP	55.1%	64.2%	61.6%	72.9%
Europe ex-UK equity	S&P EuroPE EX-uk BMI	GBP	68.0%	75.2%	65.6%	75.8%
UK Equity	S&P UK BMI	GBP	86.0%	59.9%	63.1%	77.1%
UK Large-/Mid-Cap Equity	S&P UK Large / MidCap	GBP	91.2%	55.2%	55.0%	77.0%
UK Small-Cap Equity	S&P UK SmallCap	GBP	59.7%	66.7%	85.7%	82.4%
Global Equity	S&P Global 1200	GBP	87.2%	88.7%	91.7%	94.7%
Emerging Markets Equity	S&P / IFCI	GBP	50.9%	76.7%	76.0%	85.2%
U.S. Equity	S&P 500	GBP	92.3%	94.2%	98.7%	97.4%
	Average		**73.8%**	**72.6%**	**74.7%**	**82.8%**
Europe equity	S&P Europe 350	Euro	57.4%	72.6%	79.9%	87.5%
Eurozone equity	S&P Eurozone BMI	Euro	67.5%	86.3%	85.9%	91.3%
Global Equity	S&P Global 1200	Euro	87.9%	94.8%	96.7%	98.3%
Emerging Markets Equity	S&P / IFCI	Euro	64.4%	90.4%	89.1%	96.7%
U.S. Equity	S&P 500	Euro	93.5%	95.8%	99.1%	99.2%
France Equity	S&P France BMI	Euro	55.8%	68.9%	80.2%	85.9%
Germany Equity	S&P Germany BMI	Euro	60.4%	76.4%	77.0%	81.3%
	Average		**69.6%**	**83.6%**	**86.9%**	**91.4%**
All Domestic Equity Funds	S&P Composite 1500	USD	87.5%	94.6%	87.4%	90.2%
All Large-Cap Funds	S&P 500	USD	84.6%	81.3%	91.9%	85.4%
All Mid-Cap Funds	S&P MidCap 400	USD	87.9%	83.8%	87.9%	91.3%
All Small-Cap Funds	S&P SmallCap 600	USD	88.8%	94.1%	97.6%	90.8%
All Multi-Cap Funds	S&P Composite 1500	USD	91.6%	86.1%	94.7%	90.3%
Large-Cap Growth Funds	S&P 500 Growth	USD	95.1%	90.3%	97.4%	98.6%
	Average		**89.2%**	**88.4%**	**92.8%**	**91.1%**

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56 *LGPS asset pooling;* LGA, August 2016.

57 S&P Dow Jones Indices LLC: SPIVA® Europe and US Scorecards mid-2016. Data for periods ending June 30, 2016. Outperformance is based on equal-weighted fund counts. Index performance based on total return.

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