

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Panel and Board
Date:	26 July 2019
Title:	Governance: Pension Fund costs 2018-19
Report From:	<i>Director of Corporate Resources – Corporate Services</i>

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Purpose of this Report

1. This report provides an overview of the costs of managing the Pension Fund in 2018/19.
2. The Fund's business plan states that, as part of the Panel and Board's role of making sure that its investment managers are providing value for money, it should review each year:
 - the level of management fees paid to its investment managers in the previous financial year
 - the level of transaction costs, in particular brokerage and stamp duty, incurred in the previous financial year.

Recommendations

3. That the Panel and Board notes the total cost of managing the fund and the new reporting requirements for 2018/19.

Executive Summary

4. There are a variety of costs that are incurred in the management of the Pension Fund, which are disclosed in the Pension Fund's annual report and accounts under the following three categories:
 - Investment management costs – the cost of managing the Fund's assets, which includes fees paid to the Fund's investment managers and its

custodian. This includes the fees that are not paid directly for pooled and other investments, such as alternative investments like Hedge Funds and Private Equity that are netted off against investment income.

- Administration expenses – all activities the Administering Authority must perform to administer entitlements and provide members with scheme and benefit entitlement information.
 - Oversight and governance – a new category which includes the costs of accounting for and monitoring the Pension Fund, plus the additional professional advice and support that is required by the Fund.
5. The total costs of managing the Pension Fund are shown in the table below and also as a percentage of the average value of the Pension Fund in 2018/19 (2017/18 and 2016/17 costs are shown as a comparison):

Table 1 – Pension Fund management costs

	2018/19		2017/18		2016/17	
	£000	%	£000	%	£000	%
Investment management	37,576	0.54	38,186	0.59	28,496	0.49
Administration	2,417	0.04	2,000	0.03	1,920	0.03
Oversight and governance	632	0.01	546	0.01	628	0.01
Total	40,625	0.59%	40,732	0.63%	31,044	0.53

6. The remainder of this report provides further detail on the three elements of the Pension Fund’s management costs.

Investment management expenses

7. Fees paid to the investment managers in 2018/19 are summarised in the confidential appendix. Fees are split into three categories:
- Direct – fees paid to investment managers as a percentage of the portfolio they manage according to their investment management agreement. Higher fees are payable to the ‘active’ managers who are aiming for high performance returns, with portfolios run on a passive basis attracting the lowest fees.
 - Indirect – the cost of broker commissions and any stamp duty (taxes) incurred in the purchase and sale of equities and bonds by the Fund’s active managers, plus the costs incurred in the management of the Fund’s direct property portfolio, such as legal and professional fees for managing tenants’ leases, surveyors’ costs and the cost of any property repairs and

maintenance that fall on the Fund. The general partner fees of private equity and infrastructure costs are also paid indirectly as part of the cash payments that the Pension Fund makes.

- Pooled funds – fees applied to investment products such as pooled funds and hedge funds. These fees will be the funds recovering their own management and transaction costs, plus performance fees in some instances, including for private equity and infrastructure funds. These costs are netted off against the investment income that these investments return to the Fund, so no costs are directly paid by the Fund. In the case of hedge funds these costs are typically quite high but are considered as part of the overall investment decision for every investment.
8. There has been a small reduction in investment manager fees as a result of the change in the mix of investment managers used, through disinvesting from relatively expensive hedge funds, greater levels of passive investments and changes to the Pension Fund’s active global equity investment managers.

Investment management expenses

9. As part of the updated statutory CIPFA guidance on preparing the Pension Fund Annual Report additional data is provided, most notably about investment pooling. Investment management costs are separated as follows between costs incurred from investments held through the pool and those that continue to be held directly.

Table 2 – Investment management costs pooled/non-pooled 2018/19

	Non-pooled £000	Pooled £000
Equities	8,957	684
Fixed income	805	0
Passive investments	0	635
Property	4,146	0
Alternative investments	21,786	0
Custody and other costs	563	0
Total costs	36,257	1,319

10. In this presentation the Pension Fund’s investment management costs are disproportionately split between pooled and non-pooled investments. Currently pooled investments only account for the relatively cheap passive investments, and some of the Fund’s active global equity managers that transferred to the pool in the second half of 2018/19, therefore only a part year cost shows in the pooled column. Conversely the ACCESS pool has not yet developed its plan for pooling illiquid alternative investments. These investments account for the vast majority of the Pension Fund’s costs and remain outside the pool.

11. The Annual Report also includes analysis of the pool’s ongoing costs and savings achieved to date both at the pool level, which is reported in the ACCESS annual report section of the Annual Report, and for Hampshire specifically. These figures are combined in the table below.

Table 3 – Pool costs and savings

	ACCESS		Hampshire	
	2018/19 £000	Cumulative £000	2018/19 £000	Cumulative £000
Setup and ongoing costs	-1,248	-3,221	-123	-279
Transition costs	-674	-674	-403	-403
Savings (active)	1,190	1,190	29	29
Savings (passive)	5,188	5,869	541	623
Total net savings/(costs)	4,456	3,164	44	-30

12. ACCESS’ financial position is better than expected in its original business case from July 2016, predominantly due to the greater than anticipated savings from pooling passive investments.
13. As set out in previous reports to the Panel and Board, expectations were that the financial benefits of pooling would be shared unevenly amongst the 11 members of ACCESS, with Hampshire benefiting to a below average extent. This expectation has so far proved to be correct and Hampshire is still showing a net cost from pooling, however this should change next year when the benefits of a full year of savings from active equity investment management are felt for the investments that transferred to the pool in the second half of 2018/19, and as more investments transfer overall and the relative cost of the Operator (Link) reduces.

Administration

14. The cost of administration represents the cost of the staff and systems required to record the pension benefits accrued by active and deferred scheme members and to pay pensioners once they retire. The cost of pension administration is often described as a cost per member. For Hampshire’s 171,800 scheme members this figure is £14.07. This figure is expected to remain one of the lowest for an LGPS fund, which is in line with Hampshire being in the top ten largest funds. Benchmarking data will be available later in the year that will enable the comparison of administration costs with other LGPS funds.
15. Administration costs were higher than in previous years as they include an additional £150,000 of IT costs to upgrade the Members Portal with improved online functionality. Furthermore, there were additional costs of £335,000 for the Guaranteed Minimum Pension (GMP) reconciliation, which

all LGPS funds have been required to undertake following Central Governments' decision not to maintain their systems after December 2018.

Governance and oversight

16. Governance costs include the costs of staff that produce the Fund's accounts, monitor the Fund's investment managers and support the Panel and Board. In addition, it includes the various professional services, such as actuaries, lawyers, consultants and advisors that are required to support the Fund's activities and the Pension Fund's share of the external costs of establishing the ACCESS pool (shown in Table 3 above).
17. Year-on-year governance costs have increased as the cost of pooling has increased in comparison to 2017/18, as ACCESS moves towards its fully operational state. In addition, a small amount of additional consultancy costs were incurred in reviewing options for reducing investment risk in the Fund's investment strategy.

REQUIRED CORPORATE AND LEGAL INFORMATION:**Links to the Strategic Plan**

Hampshire maintains strong and sustainable economic growth and prosperity:	no
People in Hampshire live safe, healthy and independent lives:	no
People in Hampshire enjoy a rich and diverse environment:	no
People in Hampshire enjoy being part of strong, inclusive communities:	no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because: For the ongoing management of the Hampshire Pension Fund.	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

DocumentLocation

None

EQUALITIES IMPACT ASSESSMENT:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

2. Equalities Impact Assessment:

Equality objectives are not considered to be adversely affected by the proposals in this report as the proposals do not directly affect scheme members.