

Report to: **Pension Board**  
Date: **8 September 2015**  
By: **Chief Operating Officer**  
Title: **Officers' Report – Investment Manager Fees**  
Purpose: **To note the Pension Fund costs relating to the East Sussex Pension Fund (ESPF) investment management fees.**

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## **RECOMMENDATIONS**

**The Pension Board is recommended to note the report.**

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### **1. Introduction**

1.1 The reform programme which commenced after the publication of Lord Hutton's report (under the Independent Public Service Pension Committee), includes consultations on two important areas of some significance - cost management and governance reform. These are strongly related. For example there is some pressure on scheme members to pick up the balance of the costs of providing LGPS pensions and the need to be involved more in the decision making and running of the LGPS.

1.2 There is a drive by administrative authorities to reduce costs, and some of the focus has been on investment managers who have struggled, and there has been an appeal to managers that times are tough and managers need to do something to help administrative authorities through fees renegotiation.

### **2. ESPF Investment Manager fees**

2.1 Fees paid to fund managers are often difficult to determine and there have been calls for greater transparency in how, and how much - fund managers are paid and the various fees they charge individual pension fund schemes.

2.2 While there are pressures on fund managers to reduce their charges in an environment of lower returns, comparisons are difficult because fees vary according to different investment strategies, and will sometimes not show up in published accounts, with disparities in the fees paid by the UK's local authority pension funds to their fund managers.

2.3 Over the last five years (Table 1), ESPF has paid £49.1m in fund manager fees; however, the fund value has increased by £744.1m over the same period.

<b>Table 1.</b>	2010/11	2011/12	2012/13	2013/14	2014/15
Investment Management Fees	£7.8m	£9.2m	£10.0m	£10.6m	£11.5m
Increases in fees	-	£1.4m	£0.8m	£0.6m	£0.9m
% Increases in fees	-	17%	9%	6%	8%
ESPF Fund Value	£2.0b	£2.1b	£2.3b	£2.5b	£2.7b
Increases in value	-	£69.0m	£273.8m	£135.2m	£267.0m
% Increases in value	-	3%	13%	9%	11%

Key: (m – Million; b – Billion)

2.4 Schemes which are able to reduce their investment costs – which compound over time, especially when assets swell – can get better value for their members and retain more of their funds. The fund has benchmarked its management fees against peers to check whether ESPF is receiving value for money (Appendix 1).

### **3. 2014/15 Investment Strategy and Manager Fees**

3.1 The total cost of investment manager fees in 2014/15 was £11.5m. In addition to the management fees invoiced to the Fund this figure includes private equity and infrastructure fees which are deducted from the value of the assets. This is an increase of £0.9m on the £10.6m cost in 2013/14. The fee may be considered in the context of the increase in the value of the fund during 2014/15, which increased in value by £267.0m. The fee of £11.5m was therefore covered 23 times by the increase in value of the fund. Appendix 2 presents the fund value and fees paid, by manager/portfolio/asset class.

3.2 A feature of the ESPF investment strategy is to have 'the right tools for the right jobs', i.e., appropriate combination of growth/return seeking investments (i.e., equities) with matching/stabilising investments, (i.e. property, infrastructures, etc.).

3.3 In the case of equities it is important that we monitor the performance of active managers to ensure that the returns justify the higher fees paid to managers. Therefore we need to see a significant out performance of the benchmark to cover the high fees, although there may be an argument that the fee level is not as relevant as the return net of fees and the extent to which the investment objectives were met.

3.4 Further, a slight increase in the fees for alternatives management is as a result of the further implementation of the Investment Strategy to mitigate volatility risk. The strategic movement towards alternatives to achieve the funding strategy assumptions but reduce volatility has contributed towards a slightly higher fee structure for the fund.

### **4. Approaches to Managers**

4.1 The ESPF has previously renegotiated fee arrangements with one of its fund managers (Lazard) and saved £0.456m. Officer's view is that taking into consideration the funds long-term relationship with managers; we should attempt fees re-negotiation, even though the best opportunity for negotiation is before the manager is appointed.

4.2 The Chief Finance Officer recently wrote to ten of the fund managers employed by the ESPF, requesting them to consider a fee reduction in respect of the fund, with a point that all Councils are facing reduced grant funding, severe cuts to services and that in this difficult environment, pension fund employers contribution rates have increased, which has put further pressure on employers within the East Sussex Pension Fund.

4.3 The responses from fund managers and reasons for their unwillingness to reduce fees includes - increases in mandatory complex reporting requirements, limited capacity within the fund, existing high demand for the product, their ability to achieve performance target that exceeded the agreed benchmark, and that current fees remain competitive.

### **5. Collective Investment Funds**

5.1 The Council with its neighbouring authorities will be exploring options which we believe will give a better deal to the Council Tax payer and to scheme members. The options include a greater collaboration through greater use of Collective Investment Funds. In simple terms these are pooled investment funds will be a route through to reduced costs and overall improved investment returns. The fund has previously considered a move towards in-house asset management to reduce cost.

### **6. Conclusion**

6.1 In the light of the on-going consultation, pressures on fund managers to reduce their fees are growing and comparisons are difficult because fees vary according to different investment strategies. The observations are that fund managers are more likely to be open to reducing fees where the mandate is large, or opportunity to 'pool' investments with larger authorities.

6.2 The Board is recommended to note the report.

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#### LOCAL MEMBERS

All

#### BACKGROUND DOCUMENTS

None

## Management fees benchmark

The fund has benchmarked its management fees against peers to check whether ESPF is receiving value for money.

Administrative Authority	Fund Value at 31 March 2015	Managers Fees	Comments
	£m	£m	
Surrey	3,193.5	14.9	Excludes £0.2m of custody
Norfolk	2,948.9	13.1	Excludes £0.1m of custody
East Sussex	2,746.5	11.5	Excludes £0.1m of custody
West Sussex	2,972.7	10.4	Excludes £0.2m of custody

The above figures were obtained by contacting the relevant similar size authorities pensions fund managers/officers and from the individual administrative authorities published annual reports.

## Appendix 2

Manager	Portfolio	Class	Value 2014 £m	Value 2015 £m	Value increase £m	% increase	Fees 2014 £m	Fees 2015 £m	Fee increase £m	% increase
Lazard	Global Equities	Active	344.9	410.2	65.3	18.9%	1.7	1.8	0.1	5.88%
Longview	Global Equities	Active	137.1	174.6	37.5	27.4%	0.8	1.0	0.2	25.00%
Newton	Absolute Return	Active	233.5	249.7	16.2	6.9%	1.3	1.4	0.1	7.69%
Ruffer	Absolute Return	Active	230.0	256.7	26.7	11.6%	1.7	1.9	0.2	11.76%
Schroders	Property	Fund of Funds	247.7	294.1	46.4	18.7%	1.1	1.2	0.1	9.09%
M&G	Corporate Bonds	Active	96.1	112.5	16.4	17.1%	0.2	0.3	0.1	50.00%
	Absolute Return Bond	Active	66.8	67.7	0.9	1.3%	0.0	0.0	0.0	0.00%
	UK Financing Fund	Partnership	12.9	10.6	-2.3	-17.8%	0.0	0.0	0.0	0.00%
(Infracapital)	Infrastructure	Partnership	31.6	39.2	7.6	24.1%	0.5	0.5	0.0	0.00%
UBS	Infrastructure	Partnership	22.0	22.1	0.1	0.5%	0.3	0.3	0.0	0.00%
HarbourVest	Private Equity	Fund of Funds	60.0	69.8	9.8	16.3%	1.1	1.2	0.1	9.09%
Adams Street	Private Equity	Fund of Funds	68.4	85.4	17.0	24.9%	1.1	1.3	0.2	18.18%
Legal & General	Global Equities	Passive	248.9	216.1	-32.8	-13.2%	0.4	0.3	-0.1	-25.00%
	UK Equities	Passive	398.5	270.9	-127.6	-32.0%	0.2	0.2	0.0	0.00%
	Index linked Bonds	Passive	0.0	144.3	144.3	-	0.0	0.0	0.0	0.00%
State Street	Global Equities	Passive	253.3	290.7	37.4	14.8%	0.1	0.1	0.0	0.00%
Blackrock	Transition manager		0.0	0.0	0.0	0.0%	0.1	0.0	-0.1	-100.00%
Total Excluding Custody			2,451.7	2,714.6	262.9	10.7%	10.6	11.5	0.9	8.49%
Northern Trust	Custodian		23.0	25.3	2.3	10.0%	0.1	0.1	0.0	0.00%
Other Assets	ESCC		4.8	6.6	1.8	37.5%	-	-	-	-
Total			2,479.5	2,746.5	267.0	10.8%	10.7	11.6	0.9	8.41%