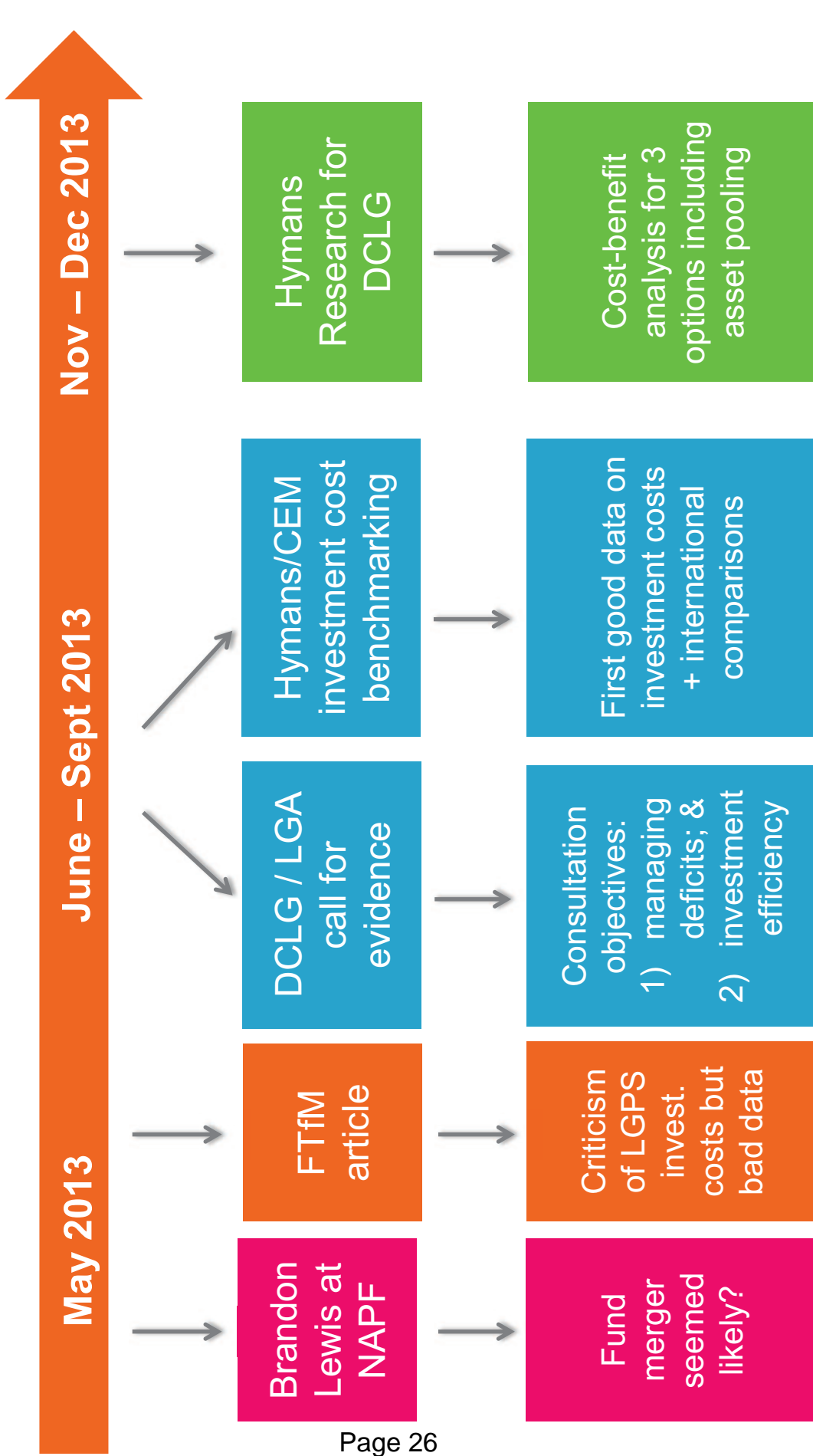


Consultation on LGPS investment structure

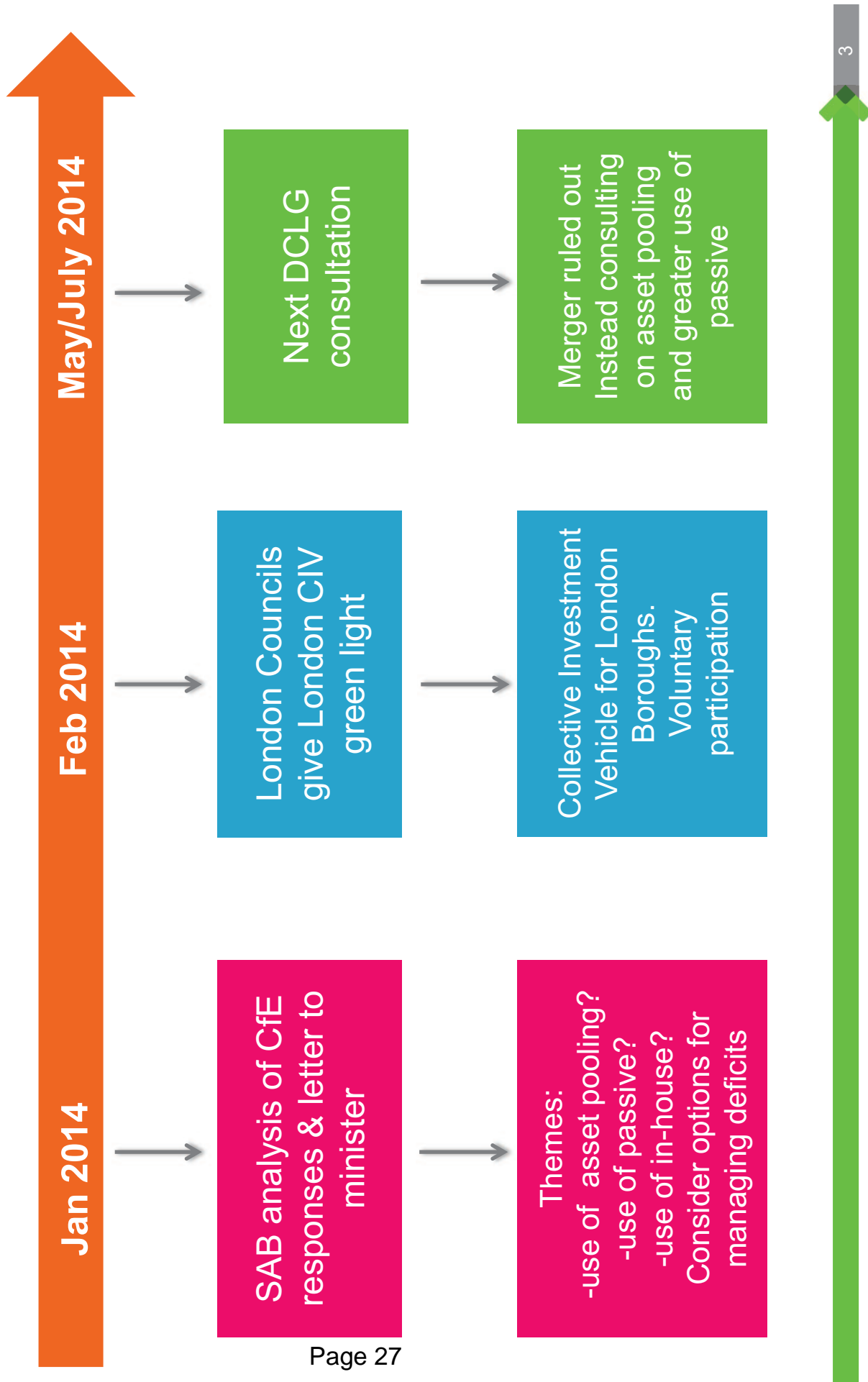
Briefing for Surrey Pension Fund Board

- John Wright
- Matt Woodman
- 15 May 2014

Story so far



Story so far



Research for DCLG* (December 2013)

Question in brief	Finding
LGPS Investment costs	c£790m per annum
LGPS vs international peers	LGPS lower on some asset classes
Areas for savings	Implementation style (FoFs, passive)
Est savings from no longer using FoF on alternatives	£240m per annum after 10 years (13bps of assets, 136 bps of listed)
Savings if all listed investments passive	£230m per annum (12bps of assets, 15bps of listed)
Transition cost	£215m (£47m stamp duty)
Impact on aggregate LGPS performance for listed	Over last 10 years no impact on performance
Merger vs asset pooling	Merger delays emergence of savings and lost local decision making

New government consultation (May 2014)

- Merger no longer government's preferred option
- Instead consulting on:
 - use of asset pooling (collective investment vehicles) for investment scale benefits
 - CIVs for alternatives and listed investments
 - greater use of passive for listed
 - governance aspects
- Consultation closes 11 July 2014

Consultation Qs

- Q1. Do you agree that CIVs would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Explain and evidence your view.
- Q2. Do you agree with proposal to keep decisions about asset allocation with local fund authorities?
- Q3. How many CIVs should be established and which asset classes should be separately represented in each of the listed and alternative asset CIVs?

Consultation Qs

- Q4. What type of CIV do you believe would offer the most beneficial structure? What governance arrangements should be established?
- Q5. In light of evidence on relative costs and benefits of active vs passive investment and aggregate LGPS performance data, which option for passive investment offers best value for tax-payers:
 - 1) Compulsion (all listed securities to be passive)
 - 2) Specified % age passive or progressive increase
 - 3) “comply or explain”
 - 4) Funds simply be expected to consider the benefits

Next

- Consultation closes 11 July 2014
- Date for government decision and action unknown
- Other related developments:
 - London CIV progressing – live 2015?
 - Closer look at ways of managing deficits (SAB)
 - Changes to investment regulations
 - Changes to local governance arrangements

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Initial thoughts on consultation questions?



APPENDICES

Research commissioned by Ministers - scope

- Quantify **investment costs** including turnover costs
- Identify potential **cost savings**
- Costs and benefits of active and passive strategies
- Since cannot look at costs in isolation, assess net of fees **performance** against market indices for LGPS in **aggregate**
- Estimate **cost of change** to new operational structures that might be used to deliver cost savings (collective investment vehicles or merged funds)
- Practical and legal impediments to implementation and the realisation of benefits

Research to inform next phase of consultation

Out of scope

- A recommendation on which option should be taken forward
- Dealing with deficits
- Member administration
- Quantification of any governance dividend
- Focus on “hard” costs, not “soft” outcomes

We were not asked to make any recommendation
e.g. on the amount that should be invested passively
or the most appropriate way forward

Total fees by asset class and active/passive

Asset class	% of total assets	Active fees (£000)	Passive fees (£000)	Total (£000)	% of total fees
Equities	65.8	256,963	31,103	288,068	38.5
Bonds and cash	17.6	54,535	7,141	61,674	8.2
Property	6.8	97,996	0	97,996	13.1
Alternatives	9.8	300,883	268	301,151	40.2
Total	100.0	710,377	38,512	748,890	100.0

Source: CEM Benchmarking Inc., data provided by 18 LGPS funds

Fees analysed by asset class and style of investment

LGPS aggregate performance

10 years to 31 March 2013: Index and weighted ave. returns (% p.a.) gross of fees

Equity market	UK	North America	Europe ex UK	Japan	Developed Pacific ex Japan	Emerging Markets
FTSE Index	10.7	9.5	11.4	7.4	16.4	18.2
Aggregate LGPS	10.8	8.4	11.6	7.5	17.3	17.1
Excess active return	0.1	-1.1	0.2	0.1	0.9	-1.1
Extra cost p.a. of active	0.34*	0.27	0.20	n/a	0.49	0.53

Sources: State Street Investment Analytics (The WM Company), CEM Benchmarking Inc.

* This is our estimate of the extra cost which reflects the low fees that the LGPS in aggregate pay for active management of UK equities. The global cost premium is estimated by CEM as 0.56%

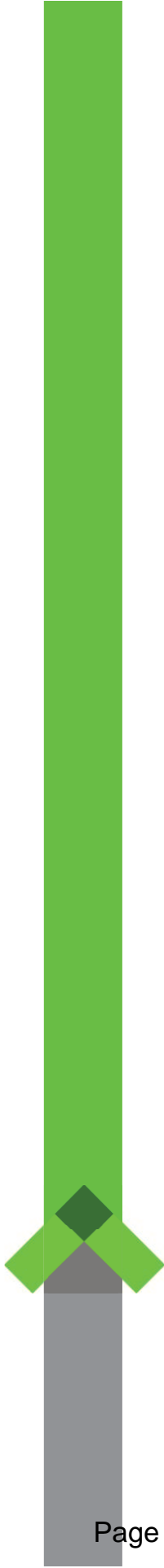
When to use active management?

Costs could be reduced by increasing the extent of passive management. This does not mean that we advocate 100% passive for all LGPS funds. The balance between active and passive should depend on:

- your governance budget
- your investment beliefs
- your investment objectives, e.g. any specific requirements you have for income or low absolute volatility
- the expected net of fee returns

Reliances and limitations

- Data in our report: “LGPS Structure Analysis”, December 2013
- The information in our report is based upon our understanding of legislation and events as at 12 December 2013 and we have used all reasonable endeavours to ensure the accuracy or completeness of the information used in the report.
- We have relied on data and legal advice provided by our partner organisations in compiling the report, CEM and Squire Sanders, both under sub-contracting arrangements. Whilst reasonable efforts have been made to ensure the accuracy of the data and advice expressed, we cannot verify the accuracy of such advice and data and we cannot be held liable for any loss arising from use and/or reliance on such advice and data.
- It should be noted that we do not provide legal services and therefore, we accept no liability to any third parties in respect of the legal opinions expressed in our report. Third parties are advised to take independent legal advice in respect of any legal matters arising out of our report.



Thank you

Any questions?