Centre for Policy Studies

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THE LOCAL GOVERNMENT PENSION SCHEME: OPPORTUNITY KNOCKS

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SUMMARY

- This paper makes ten actionable proposals to help secure the future viability of the Local Government Pension Scheme (LGPS). Together, they form a three-step process:

  1. Improve transparency, and adopt widespread standardisation, essential prerequisites for the digitisation required to centralise all LGPS administration.
  2. Redesign the investment process, emphasising investment in passive, not actively managed, funds. Almost all investment management should be brought in-house; today's reliance on external management to invest £9 billion in private equity, for example, is an extraordinary exhibition of profligacy and missed opportunity.
  3. Facilitate fund mergers, preferably using a dramatically improved governance framework. This would require each LGPS fund to conduct annual tests to evidence that fund members are not disadvantaged by a lack of scale in assets or membership.

- Each step has a common theme: cutting costs, by harnessing economies of scale. Costs are controllable, whereas investment performance, by and large, is not. This necessitates structural change.
- Based upon evidence drawn from some of the world's most efficient public pension funds, and allied databases, a restructured LGPS should be able to cut costs by at least £860 million per year.
- This would not be a quick project (five years?), but there are some relatively "quick wins" to hand, which would make a material dent in the cost base. For example, all fund of funds holdings should be sold as soon as practicable.
- This paper includes a cost comparison of the LGPS funds, which shows a strong negative correlation between administration and investment costs per fund member and fund scale: the larger the fund, the lower the costs. Huge disparities in costs incurred by similarly-sized funds are also identified.

TEN PROPOSALS

Proposal 1: All LGPS funds should be required to publish a standard data disclosure template, detailing all their operational costs and charges (including performance fees paid), fund composition, asset turnover, transaction costs and investment performance. A combination of the disclosure standards of the Federation of Dutch pension funds and the CEM Benchmarking annual global pension fund survey for the UK would be a good model for the LGPS to emulate.

Proposal 2: A fundamental appraisal (by the Government Actuary?) is required of the quality of data produced by the LGPS funds, with recommendations as to how to improve it.

Proposal 3: All LGPS funds should use the same methodology, discount rate and mortality table when determining their liabilities (perhaps to be set by the Government Actuary).

Proposal 4: DCLG, and individual LGPS funds, should prioritise cashflow forecasting ahead of other, more nebulous, financial health indicators, such as the funding ratio. Cashflow forecasts for each fund should be published annually, accompanied by an assessment of their implications for future contributions rates.

Proposal 5: DCLG should commission the construction of an entirely digital central administration platform, to service all the LGPS funds. It should also be used to deliver member services.

Proposal 6: The management of all of the LGPS's private equity exposure should be entirely in-house, as a single, stand-alone, business. Individual LGPS funds could then take direct stakes in it, perhaps as shareholders.

Proposal 7: The LGPS funds should allocate most of their resources to passive (index-tracker), not actively managed, funds, with much greater use made of exchange-traded funds (ETFs). Almost all investment management should be brought in-house, particularly private equity and the other alternative assets. In addition, all fund of funds investments should be sold, and there should be a serious cull of third party service providers, particularly investment consultants.

Proposal 8: DCLG should prepare a governance framework that requires LGPS funds' pension boards to conduct annual tests to evidence that their fund members are not disadvantaged by a lack of scale in assets or membership. These should include measurement against benchmarks for readily quantifiable parameters such as costs per member. DCLG should then guide funds to acquire scale, through mergers with other funds, with its scheme advisory board providing advice on individual LGPS funds' progress towards greater efficiency.

Proposal 9: Members of the LGPS deserves a governance framework imbued with an ethos of fiduciary duty. The recommendations of the Law Commission's on-going review of fiduciary legal duties (due in 2014) should be incorporated within it.

Proposal 10: The LGPS's component funds should be required to adhere to the same actuarial and regulatory disciplines as private sector pension schemes.

1. INTRODUCTION

The Local Government Pension Scheme (LGPS) has total assets in excess of £200 billion, 5.4 million members (active, deferred and pensioners) and more than 7,000 participating employers. It is by far the largest funded pension scheme in the country: it matters.

It comprises a disparate collection of 101 opaque, predominately small funds, with excessive costs and lax governance.[1] Consequently, they are delivering sub-optimal performance. In addition, the drivers of costs and income are misaligned:

- because of the ageing membership, contributions are shrinking relative to pension payments;
- this is exacerbated by pensions remaining indexed to inflation while public sector pay is (at least nominally) frozen – hence contributions are not growing as fast as pensions; and
- asset-derived revenues are declining, (because of low interest rates).

Consequently, all 101 funds are underfunded: the average funding ratio for the 89 English and Welsh funds was 77% on the last reported valuation date (31 March 2010), and 94% for the 11 Scottish funds (31 March 2011). Some funds (ten?) are now so under-funded that they are consuming their assets to meet pensions in payment: they are beyond the point of no return.

Structurally, the LGPS is woefully inefficient. More seriously, after implementation of the Hutton reforms (which come into force in 2014), it will remain 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 this will probably be too late to save the LGPS. This observation is based upon cashflow, not nebulous concepts such as funding ratios, which do not manifest themselves in day-to-day life (and nor do they exert much political pressure).

The unfunded public sector schemes' cashflow crisis is potentially a harbinger of what is to come to the LGPS: in 2005-06 they produced a net £200 million deficit, which has grown to £8 billion in 2011-12. The OBR's forecast for 2017-18 is for a £16.2 billion deficit. It will continue to rise after that.[2] This has to be plugged by the Treasury. The LGPS is expected to become cashflow negative within, perhaps, three years.

Over the next few months, the 101 individual funds will publish their annual reports for 2012-13. They are likely to confirm that the scheme's overall financial health is continuing to deteriorate, with the very weakest funds consuming assets to meet pensions in payment. With no realistic prospect of recovery, they are probably in a death spiral, heading to an unfunded status.

2. WHERE DOES THE BUCK STOP?

2.1 A kaleidoscope of conflicting interests

What would happen if an individual fund were to collapse (i.e. run out of cash)? There is no definitive legal position. Not part of the Pension Protection Fund (PPF), and without a Crown guarantee, we appear to be left with the third option: ambiguity and fudge, which could leave the fund concerned in legal limbo, albeit not on the hook.

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1 81 funds in England (assets of £167 billion), 11 in Scotland (£24.5 billion), 8 in Wales (£11 billion) and 1 in Northern Ireland (£4.1 billion).

2 See by the author *The approaching cashflow crunch: why coalition reforms to public sector pensions will not hold* (CPS, November 2012) and *Public service pensions: Parliamentary Ping-Pong, anyone?* (CPS, March 2013).

It would appear that Department for Communities and Local Government (DCLG) itself is not responsible for plugging any cashflow shortfalls. Responsibility for paying benefits lies with administering authorities, acting on behalf of the participating employers, with the ultimate liability falling on council taxpayers.

This brings to light the ever-present conflict of interests between council leader and pension committee chair. The leader naturally wants a politically acceptable level of pension contributions (with low taxes), whereas the chair has a fiduciary duty, on behalf of the pension fund, to negotiate on an arms-length basis with the leader – who appointed him to the position.

Cuts to services would feature large in any discussions, but they could only go so far, raising the prospect of political confrontation between DCLG and councils.

Meanwhile, actuaries continue to fudge the discount rate, and Section 151 officers (who never seem to be held to account) sign off on reports containing unrealistic modelling assumptions. This does nothing to help address any cashflow crisis.

2.2 A slow demise

The lack of clarity around how a cashflow crisis would be resolved is exacerbated by the LGPS being exempt from employer debt legislation. Consequently, there appears to be no situation in which all of an administering authority's pension liabilities could be crystallised simultaneously. That would at least force some kind of resolution. (In contrast, the sponsoring employer of a private occupational scheme would be immediately required to meet the liabilities.) Instead, the LGPS is provided with a ready excuse not to have to confront reality, potentially leaving a troubled fund to continue deteriorating. The final outcome would probably cost more than the cost of taking action earlier.

2.3 The Treasury: ultimate underwriter?

In reality, although there is no legal requirement for it to be so, the Treasury is probably the ultimate underwriter of the LGPS's liabilities, albeit perhaps via a convoluted (local government) route. The quiet assumption made by many is that, one day, the Treasury will have to step in ("grant from central government"). This legitimises the Treasury taking a close interest in the governance of the LGPS, perhaps through an agent such as The Pensions Regulator (TPR).

Perhaps, *in extremis*, the Treasury could be tempted to take a failing fund's assets in-house, punting the liabilities into the unfunded future (as per the Royal Mail Pension Plan). This would leave a landscape of moral hazard in respect of the remaining LGPS funds. So, why not take all the LGPS assets into the Treasury? The temptation of using £200 billion of pension assets to reduce the national debt would be strong but short-sighted – and must be resisted: not least as a funded scheme should be able to achieve a better long-term return on investment than the cost of government borrowing (which would be necessary to fund the alternative of a pay-as-you-go (i.e. unfunded) framework).

2.4 Should there be a Crown guarantee?

With many people considering the Treasury to be on a "soft" hook, perhaps a more fundamental question should be addressed. Given that the LGPS's financial health will probably continue to deteriorate, why not come clean, face an inconvenient truth, and provide a Crown guarantee, notwithstanding the adverse implications for HMG's Whole of Government Accounts? Central government formally standing behind the LGPS's accumulated liabilities would be in the interests of simplicity and transparency, and would certainly ease the process of reform.

It is reasonable to raise this question because, although the Public Service Pension Act 2013 ("the 2013 Act") sets out the necessary legal framework for an employer's cost cap, it is woefully lacking in detail, which does not inspire confidence that it will ever be effective. Essentially, the proposed cap mechanism is misaligned with the cost drivers. For example, it excludes the past service costs of deferred and pensioner members. Given that they account for more than half of the LGPS's membership, this is a serious omission. In addition, the cost control mechanism should be prescriptive (rather than merely triggering a meeting of stakeholders).

2.5 Consider the Pension Protection Fund (PPF)

There is a strong case for individual LGPS funds to join the PPF, perhaps on the same basis as the Universities Superannuation Scheme (USS). The USS is recognised by the PPF as a last-man standing scheme, which means that it would only become eligible to enter the PPF in the extremely unlikely event that the vast majority (if not all) of the scheme's employers were to become insolvent.

Unfortunately, this raises another question (which could become known as "the Doncaster question"). It is unclear how a local authority could go bankrupt, nor does there appear to be a mechanism for Parliament to dissolve a local authority (a new Order of Parliament would be required). Perhaps the PPF should look through the local authorities, at the thousands of underlying employers?

3. A BASTION OF OPAQUE INEFFICIENCY

3.1 Lack of access to data

The LGPS's individual funds should be open to independent public scrutiny, but sourcing the primary data to do this is very difficult. Two Oxford academics, for example, eventually succeeded in analysing the transaction costs of public sector pension funds, but only after experiencing immense obstruction.[3] After issuing over 100 Freedom of Information requests for the funds' IMA Disclosure Tables (which were denied), they had to resort to appealing (successfully) to the Information Commissioners; a two-year battle. Eventually they found that whilst average commission rates fell slightly over a five year period (2003 to 2007, inclusive), this apparent triumph for scheme members was extinguished by the discovery that trading volumes had tripled over the period. Consequently, total commission payments to brokers more than doubled, because of the higher portfolio turnover.

LGPS funds' asset turnover data continues to be undisclosed, along with transaction and third party service costs, and (net and gross) investment performance data. Consequently, it is not possible to:

(i) expose the impact of costs on performance (and Council Tax bills);

(ii) hold third party service providers to account; nor

(iii) provide a guide to sourcing future improvements in operational efficiency.

Meanwhile, a culture of opacity remains, which reinforces the defence of those opposed to change. This is at odds with the today's clamour for more transparency in respect of the financial services industry. And the often cited "commercial confidentiality" should not be an acceptable excuse. If nothing else, this saga suggests a failure of governance.

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3 Mark Abrahamson and Tim Jenkinson, Saïd Business School, Oxford University; *Does transparency overcome conflicts of interest? Evidence from investment managers and their brokers,* March 2009.

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3.2 Insufficient data, and dismal quality

What gets measured gets managed. DCLG does not produce a consistent set of consolidated data for the whole of the LGPS and, in addition, the quality of some of the data that does exist, at individual fund level, is of such dubious quality as to be close to useless for the purpose of informing rational debate. DCLG has acknowledged these shortcomings.[4]

Consider, for example, the 89 England & Wales funds, which together report total annual costs and charges of 30 basis points (bps).[5] This is a ludicrously low figure given the complexity of many of their investments. The actuarial consultancy to half of all LGPS funds believes that the figure for total investment costs *alone* (i.e. excluding administration coasts) is 63.5 bps.[6] Once all the implicit costs are taken into account (such as the trading costs, currently unreported), the true figure may well be over 100 bps.

The LGPS's high operating costs have been compounding over many years, stealthily and iniquitously eroding capital: a major cause of its dire financial position.

"Compound interest is the eighth wonder of the world." But if costs are not attacked *"the magic of compounding returns is overwhelmed by the tyranny of compounding costs."*[7]

Proposal 2: A fundamental appraisal (by the Government Actuary?) is required of the quality of data produced by the LGPS funds, with recommendations as to how to improve it.

3.3. Valuations: standardisation required

(a) The discount rate dance

The SF3 data template for each individual LGPS fund excludes liabilities, so the funding ratio cannot be determined. These can be sourced from the annual reports (a time-consuming process), but with at least seven different valuation methodologies in use, there is no meaningful basis for comparing different funds.[8] In addition, the four actuarial consultancies[9] which control the LGPS market use a panoply of different discount rates (even amongst their own clients). This has a substantial impact on liability calculations (and therefore the funding ratio), and has produced accusations of "discount rate shopping"; i.e. LGPS funds are attracted to whichever consultancy is offering the highest discount rate (leading to a smaller liability).

4 DCLG minister Brandon Lewis's speech to the NAPF Local Authority Conference, May 2013.

5 Administration and fund management costs of £536 million divided by a total asset market value of £178 billion (31 March 2013).

6 *Investment management costs in the LGPS: global benchmarking study*, Hymans Robertson, September 2013.

7 Albert Einstein and John Bogle (founder of The Vanguard Group), respectively.

8 Methodologies in use include "projected unit", "market value", "market related", "accrued benefits" and "projected accrued benefits": all different.

9 Aon Hewitt, Barnett Waddingham, Hymans Robertson and Mercers.

Consider an example. The discount rates used by the 35 London-based funds ranged between CPI + 2.5% and CPI + 4.5%.[10] Had the SCAPE rate[11] of CPI + 3% been adopted across London (it is used for all the unfunded public sector schemes), the reported (aggregated) deficit for London, £7.3 billion, would have been £1.2 billion higher (and £1.4 billion *lower* had CPI + 3.5% been used): discount rate selection is a sensitive matter.

(b) Brent: on the rack?

Brent, the second weakest London fund with a last reported funding ratio of 61%, used the ***highest*** discount rate. Had it used the SCAPE rate of CPI + 3%, its funding ratio would have been 47%. Brent's use of CPI + 4.5% helped mask the seriousness of its (under) funded position. In addition, a Brent Pension Fund Sub-Committee report (20 November 2012) pointed out that *"actuarial modelling currently indicates that a typical LGPS fund is likely to see its funding position deteriorate by a further 5% in the 2013 actuarial valuation, since 2010."* For Brent, this would mean a funding level of around 42%, discounting at CPI + 3%.

Valuation methodologies should be standardised, with the same discount rate (and mortality table) applied across all LGPS funds. This could be the SCAPE rate used by all of the public sector's unfunded schemes (CPI + 3%): increasingly appropriate given that a growing number of LGPS funds are moving towards an unfunded status.

Better still, all of the funds could be required to report their liabilities based upon a range of discount rates, e.g. CPI + 2%, +2.5%. +3%, + 3.5% and + 4%. This would put an end to "discount rate shopping", as well as giving DCLG a sense of each fund's sensitivity to interest rates (over the last few years, falling gilt yields have been the primary driver of widening deficits).

Proposal 3: All LGPS funds should use the same methodology, discount rate and mortality table when determining their liabilities (perhaps to be set by the Government Actuary).

Standardisation would enhance transparency, as well as facilitating comparison between funds. But this alone would not shed light on what is potentially *the* major issue: deteriorating cashflow.

3.4 Management info.: focus on cashflow

On an aggregated basis, the LGPS is currently cashflow positive, but this is likely to turn negative by 2016 (i.e. pension payments will start to exceed the sum of contributions and asset-derived income), and deteriorate thereafter: a clear sign that the scheme has "matured". This is an inevitable consequence, after decades of under-pricing the value of the pension promise, with commensurately insufficient contributions (today, roughly 21% of pensionable pay).[12] But actuarial consultants have calculated that private sector workers would require contributions of between 33% and 37% of pay to match the retirement income paid to a public sector worker on an equivalent wage. There are only two possible outcomes: renege on the pension promise or face a cashflow collapse due to insufficient assets. Lord Hutton's reforms are too timid to enable "catch up".

10 This is for the 2010 triennial valuations: the 2013 data is not yet in the public domain.

11 The Superannuation Contributions Adjusted for Past Experience (SCAPE) rate is a government methodology for setting contributions in the absence of a fund of assets.

12 Contributions range between 17.4% to 21.8% (between 11.9% and 14.3% from employers, and between 5.5% and 7.5% from members).

The prospect of negative cashflow is being accelerated by workforce contraction, wage freezes (so contributions do not grow) while pensions remain indexed to inflation, improving life expectancy, portfolio de-risking, low interest rates and correspondingly low dividend incomes.

Whilst concerning, the real question is what will become of the individual funds that are already experiencing cashflow difficulties. The most recent publicly available data (31 March 2010) shows that nine funds had funding ratios below 70%.[13] A low ratio does not necessarily mean cashflow problems, but some of these funds may be consuming (i.e. selling) assets simply to meet pensions in payment: if so, they are in a death spiral. But we do not know: the information is not in the public domain.

Proposal 4: DCLG, and individual LGPS funds, should prioritise cashflow forecasting ahead of other, more nebulous, financial health indicators, such as the funding ratio. Cashflow forecasts for each fund should be published annually, accompanied by an assessment of their implications for future contributions rates.

That aside, a deteriorating cashflow has adverse implications for asset allocation. Fund managers then tend to reduce their holdings of growth assets (notably equities) in favour of income-generating (predominately fixed income) assets, which compromises their ability to recover any deficits. In addition, they become less inclined to chase the illiquidity premium attached to (high yielding) alternative asset classes, as well as long term investments such as infrastructure.

3.5 Transparency: conclusion

Improving transparency, and adopting widespread standardisation, are essential pre-requisites for digitisation. A significant step towards cutting costs and boosting efficiency could then be taken: the centralisation of all LGPS funds' administration, thereby harvesting economies of scale. A single platform could also be used to deliver top quality services to the LGPS membership, as well as providing the government with an opportunity to engage with millions of people, not just in respect of the LGPS, but also with retirement saving.

4. COSTS MATTER

4.1 The DCLG's perspective

The DCLG recently published an Invitation to Tender[14] requesting an advisor to prepare an option appraisal on three separate proposals for the future structure of the LGPS. Clause 2.3:

"The primary objectives of reform ought to be improved investment returns and reduced pension fund deficits. The secondary objectives of reform should be focused on finding investment fee and administration cost savings, increasing the flexibility of investment strategies and infrastructure investment, and developing better in-house investment resources."

These two objectives are inextricably linked, because improved investment returns come from cost savings. More specifically, costs are controllable, whereas investment performance, by and large, is not.

13 Waltham Forest 60%, Brent 61%, Havering 61.3%, Hackney 65.8%, Croydon 66%, North Yorkshire 67%, Sutton 69%, Worcestershire 69% and Haringey 69.2%. Data from the 2013 triennial valuations is not yet in the public domain.

14 *Structural reform of funded public service pension schemes*, posted 7 October 2013. Contract number CDP/004/106/057.

4.2 Lessons from abroad

(a) Denmark: the "gold standard" for efficiency

The LGPS's true total annual operating costs,[15] probably over 100 bps, should be compared with those of other large funded public sector pension schemes (see Table 1).

While Table 1 should be treated with caution (some funds, for example, spend far more on member services than others), the low cost of running Denmark's ATP fund is striking.[16] There are four reasons behind its efficiency:

(i) mandatory membership of one giant fund, which delivers huge economies of scale (contrast this to LGPS's 101 funds);

(ii) significant use of *internal* fund management;

(iii) access to state databases (including the tax office), which helps speed up the administration; and

(iv) significant investment in electronic communication with members.

(b) The Australians' experience

A few years ago the Australian government conducted an international comparison of pension scheme costs. They noticed that ATP's 2008 administration costs (i.e. excluding fund management costs) were eight times smaller than those of the large Australian schemes

15 Total operating costs as the sum of investment management and administration costs.

16 ATP is a public pension fund to complement Denmark's universal state pension.

Table 1 Cost comparison of large funded public sector pension schemes

Assets US$ billions	2012	2011	2010	2009	2008
ABP (Netherlands)	$371	$319	$314	$298	$244
ATP (Denmark)	$157	$154	$138	$123	$106
Australian funds > A$20bn	$379	$316	$216	$176	$188
CALPERS	$244	$225	$193	$211	$246
Ontario Teachers PP	$123	$112	$102	$92	$98
USS	$52	$49	$41	$40	$46
Total operating costs / assets	**2012**	**2011**	**2010**	**2009**	**2008**
ABP (Netherlands)*	0.73%	0.67%	-	-	-
Australian funds > A$20bn	0.66%	0.62%	0.67%	0.52%	0.52%
ATP (Denmark)	0.12%	0.11%	0.13%	0.19%	0.13%
CALPERS	0.43%	0.51%	0.43%	0.63%	0.48%
Ontario Teachers PP	0.71%	0.59%	0.66%	0.50%	0.47%
USS	0.21%	0.21%	0.20%	0.18%	0.14%
Investment management costs / assets	**2012**	**2011**	**2010**	**2009**	**2008**
ABP (Netherlands)*	0.68%	0.63%	-	-	-
Australian funds > A$20bn	0.20%	0.19%	0.18%	0.11%	0.12%
ATP (Denmark)	0.08%	0.07%	0.08%	0.10%	0.08%
CALPERS	0.21%	0.29%	0.20%	0.36%	0.26%
Ontario Teachers PP	0.43%	0.30%	0.34%	0.23%	0.28%
USS	0.14%	0.14%	0.13%	0.11%	0.09%
Administration costs / assets	**2012**	**2011**	**2010**	**2009**	**2008**
ABP (Netherlands)	0.05%	0.04%	-	-	-
Australian funds > A$20bn	0.46%	0.43%	0.49%	0.41%	0.40%
ATP (Denmark)	0.04%	0.04%	0.05%	0.09%	0.05%
CALPERS	0.22%	0.22%	0.23%	0.27%	0.22%
Ontario Teachers PP	0.28%	0.29%	0.32%	0.27%	0.19%
USS	0.07%	0.07%	0.07%	0.07%	0.05%

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(those with assets of more than A$20 billion), with total operating costs being four times smaller (see Table 1).

These observations prompted Australian's Stronger Super agenda, the objective being to encourage consolidation of Australia's fragmented retirement savings industry, based on the premise that bigger funds tend to have lower costs per member, due to economies of scale. Expectations have been set high, and the implications for pension funds are huge. According to the Australian government, the Stronger Super program could, once fully implemented, *"lower pension fund fees by 40%, potentially lifting the retirement savings of a 30 year old on average full-time wages by A$40,000 or 7%, equivalent to a further 1% increase in annual pension contributions."*

As part of Stronger Super, the pensions industry will be required, by 1 July 2014, to adopt the SuperStream Standards, a package of measures designed to bring the pensions industry's back-offices up to date. These include:

(i) the increased use of technology to improve processing efficiency (consigning manual processing to history) and straight-through processing of contributions and transfers;

(ii) the electronic transmission of financial and member data; and

(iii) the adoption of uniform data standards across the industry.

In addition to SuperStream, Stronger Super also sets out detailed transparency requirements. All pension schemes will have to disclose their investment performance data, costs and charges, and key risk metrics, to help trustees drive efficiencies *and* lower costs.

Several other governments are also pursuing measures designed to dramatically cut public *and* private sector pensions administration costs. Data standardisation is invariably being identified as the place to start. The Dutch, for example, have created a standard annual pension statement, a format now in use by *all* Dutch pension funds and insurers.[17]

4.3 A digital, centralised, LGPS

The Government Digital Service (GDS) is intent upon building a digital government. It is an impressive operation, ambitious and with a clear sense of mission to improve the state's quality of service when interacting with the public, as well as helping Whitehall to save money.

The GDS's user-led approach to website design could also be adopted when the state interacts with its own (and past) employees, such as members of the LGPS. It could help DCLG build an entirely digital central administration platform to service *all* the LGPS funds, and also use it to deliver member services. Pensions administration, with its transactions emphasis, would be well-suited to the GDS's skills set. In addition, any outsourced technology should be brought back in-house, subject to skills availability (note that the GDS is also building a recruitment hub to help departments re-skill).

Such an initiative would require a huge cultural change within DCLG and the LGPS, but the LGPS's expensive, paper-based, administration is in need of transformation. The challenge of data reconciliation (a pre-requisite for digitisation) cannot be over-estimated, but the introduction of career average-based benefits from April 2014 (replacing today's final salary scheme) will, in any event, force DCLG to grasp the nettle.

[17] Chapter 7 of *Aggregation is the key* provides more detail.

Proposal 5: DCLG should commission the construction of an entirely digital central administration platform, to service *all* the LGPS funds. It should also be used to deliver member services.

4.4 Scale matters

(a) The benefits of scale

There is incontrovertible evidence that scale matters to pension funds, and while increased scale may not guarantee improved investment performance, it would squeeze out the industry's profitable inefficiencies,[18] reducing unit costs per member. This is a theme that the UK pensions industry has repeatedly tried to ignore: scaling-up is not in its interests, but it is in the interests of scheme members.

Larger pension funds:

(i) can utilise their buying power to secure more attractive transaction pricing, win big reductions in fund managers' annual management charges, and rebut initial charges;

(ii) are better placed to afford the in-house expertise needed to research the complex range of available investments;

(iii) can exploit co-investment opportunities (i.e. the ability to buy a share of portfolio companies without fees);

(iv) have greater reach across asset classes, geographies and asset maturities, resulting in more diversification (thereby reducing risk). This reach advantage is particularly valuable in respect of accessing private market opportunities that are not open to small funds;

18 Such as generating profits on administrative activities that would no longer be required.

(v) can better exercise annuity buying power on behalf of retiring members (albeit not a consideration for the LGPS);

(vi) can more easily manage their longevity risk, because their membership demographics more closely resembles the national average. Longevity risk insurance, for example, would be cheaper;

(vii) are better placed to afford the best advice, and also harvest a "governance dividend", estimated to add 0.5% and 1% to annual returns to defined benefit and defined contribution schemes, respectively; and

(viii) enjoy lower per member administration costs. A fund with more than 50,000 members costs £15 to £30 per member to administer, compared with up to £200 for one with fewer than 1,000 members.

To the extent that these benefits reduce fund costs, they help address deficits. Sub-scale schemes lead to sub-optimal consumer outcomes, yet the UK's c.146,000 DC schemes have an average membership of only 46: in Australia (where the regulator has the powers to force schemes to merge) there are now roughly 230 schemes with an average membership of over 100,000. The UK has c.7,000 DB schemes, the Dutch: fewer than 350.

Notwithstanding the dubious quality of some of the LGPS funds' reported SF3 data, it does unambiguously confirm the merits of scale. Tables 2 and 3 rank the top and bottom ten individual LGPS funds (for England and Wales), by administration and fund management costs per member, respectively. The latest fund market values are also shown, to provide a sense of fund scale (and in this context, market values are a fair proxy for membership headcount).

Table 2 LGPS funds' administration costs, per member (2012-13)[19]

Rank	LGPS fund	Admin. costs per member	Fund market value 31 March 2013 £000's
1	Nottinghamshire	£13.7	£3,496,446
2	Tameside	£14.0	£12,589,029
3	Cornwall	£14.4	£1,342,577
4	Essex	£14.8	£3,958,473
5	Derbyshire	£14.8	£3,120,045
6	Leicestershire	£16.3	£2,627,018
7	Hampshire	£16.3	£4,340,618
8	North Yorkshire	£16.5	£1,840,733
9	Oxfordshire	£17.8	£1,523,748
10	West Yorkshire Super. Fund	£18.0	£9,940,305
	Average for top 10	**£15.7**	**£4,477,899**
79	Kensington & Chelsea	£54.7	£633,489
80	Islington	£55.0	£918,282
81	Tower Hamlets	£55.4	£911,778
82	Greenwich	£55.6	£885,012
83	Barking & Dagenham	£57.0	£636,402
84	Bexley	£57.4	£556,273
85	Waltham Forest	£58.3	£599,787
86	Kingston upon Thames	£63.2	£501,357
87	South Yorkshire PTA	£72.7	£194,220
88	Durham	£119.4	£2,085,556
	Average for bottom 10	**£64.9**	**£792,216**

Table 3 LGPS funds' investment costs, per member (2012-13)[20]

Rank	LGPS fund	Fund mgt costs per member	Fund market value 31 March 2013 £000's
1	West Yorkshire Super. Fund	£7.6	£9,940,305
2	South Yorkshire Pensions Fund	£14.6	£5,288,266
3	Middlesbrough UA	£21.2	£2,929,601
4	Harrow	£28.1	£551,730
5	Durham	£28.8	£2,085,556
6	East Riding of Yorkshire UA	£30.1	£3,078,080
7	Nottinghamshire	£34.1	£3,496,446
8	Cambridgeshire	£37.6	£1,879,486
9	Tameside	£42.0	£12,589,029
10	West Midlands Pension Fund	£43.2	£9,886,293
	Average for top 10	**£28.7**	**£5,172,479**
79	Gwynedd	£192.0	£1,193,579
80	Hammersmith & Fulham	£194.6	£724,086
81	Cheshire	£223.9	£3,231,838
82	Hillingdon	£224.7	£683,052
83	South Yorkshire PTA	£234.9	£194,220
84	Shropshire	£243.3	£1,234,725
85	Camden	£268.1	£1,123,636
86	Waltham Forest	£283.2	£599,787
87	Kensington & Chelsea	£301.9	£633,489
88	City of London	£317.3	£709,367
	Average for bottom 10	**£248.4**	**£1,032,778**

19 Data source: SF3 returns for 2012-13. Table 2 excludes data from the LPFA, which includes significant costs associated with the provision of administrative services to other LGPS funds.

20 Data source: SF3 returns for 2012-13. Table 3 excludes the LPFA. Full tables can be found at the end of this document.

Clearly, as a general rule, the larger the assets, the lower the administration and investment costs per member, although there are some significant outliers.

The extraordinary disparity in costs partly reflects the inconsistent bases on which they are reported: some funds, for example, include significant "corporate service" costs (such as attributing a cost for the use of council premises), whereas others do not. But this is unlikely to fully explain why, for example, the Durham fund's administration costs are more than eight times Cornwall's (Table 2), although they have a similar number of members to service, and Durham has 55% more assets.

Investment costs per member exhibit a similarly strong (negative) correlation to fund scale, although the range is far wider than that for administration costs. It is hard to understand why, for example, Cheshire's investment costs are more than ten times those of the Middlesbrough UA fund, although both funds have roughly £3 billion in assets. And while the City of London fund's investment costs are very high, the fund's 2012-13 performance was fourth highest of all LGPS funds in that year.

(b) How many funds should there be?

DCLG has recently been reported as saying that it "confirms research into a *single* national LGPS fund for England and Wales".[21] One "super-fund" with assets of nearly £180 billion could raise some practical issues, concerning:

(i) portfolio flexibility. A 1% asset reallocation, for example, would require the sale and purchase of £1.8 billion of assets which, outside of the major equity and government bond markets, is difficult to execute quickly, quietly and efficiently, i.e. without an adverse market impact. It would also have a *de minimis* impact on total fund returns;

(ii) a reduction in the range of investible funds. Small funds, for example, may not warrant the necessary due diligence, because even a modest investment, for a super-fund, could be too large a slice of the recipient fund. In addition, mandate sizes could be so large as to swamp an investment strategy;

(iii) a lack of competition from service providers: one giant one would prompt some providers to drop away; better five or ten medium-sized funds; and

(iv) cultural issues within a super-fund. Individuals could become too powerful (key man risk), and the fund itself could become an overly-dominant marker participant, harbouring an unchallenged closed culture.

Raising the *possibility* of a single super-fund for England and Wales may simply be an expectations management ruse. On balance, five regional funds (plus one for Scotland and Northern Ireland) would probably make more sense, each with some £33 billion of assets (the USS has assets of roughly £39 billion). They could then compete with one another to deliver the best service to members, using a common central administration platform.

4.5 Cut costs by simplifying the investment process

Aside from making the changes to the LGPS's structure, discussed herein, there are several cost cutting measures available *today* that would be relatively quick and simple to implement.

21 *Professional Pensions*, 22 October 2013.

(a) Pursue passive,[22] rather than active, fund management

(i) Active fund management: alchemy

The active fund management business is a web of meaningless terminology, pseudo-science and sales patter. Consider, for example, the rise of "absolute return" investing, now considered an asset class in its own right, after being positioned as The Answer in the mid-2000s.

Dispassionate analysis[23] concludes that this is nonsense; no one has provided a simple definition for "absolute return" investing. This includes the industry's own trade body (the IMA), which habitually tinkers with their own definition. In 2011 the IMA's "Absolute Return" tag promised "*at least a meagre positive return*", but that year more than 60% of such funds produced negative returns. In early 2013 the tag was relabelled Targeted Absolute Return.

(ii) The tyranny of turnover: performance drag

"Performance drag" is a by-product of active fund management: it is the erosion of capital care of transaction costs. Table 4 shows the adverse impact on different equity funds' annual returns, for a range of portfolio turnover rates. The median turnover for actively managed equity funds is about 58% (i.e. every 20 months), which cuts annual returns by 0.55% to 0.75%. The weighted average Total Expense Ratio (TER) then needs to be added to this, which is quoted in the range of 1.56% to 1.66%,[24] giving a total of 2.2% per annum, say. This should be compared to the cost of investing in passive, index-tracking, funds: typically 0.25% per annum.[25] The tracker fund, in theory, always lags the index by 0.25%, whereas an active fund manager needs to beat it by 1.95% simply to justify his higher costs.

22 "Passive" relates only to funds that are tracking an investable index. Private assets such as private equity and property are, by their very mature, incapable of being tracked (i.e. there is no index to replicate). In addition, any investment that sets out to beat an index is regarded as active.

23 See, for example, *The myth of the absolute-return investor;* M. Barton Waring and Laurence B. Siegel, Financial Analysts Journal, 2006.

24 1.56% from IMA press release, 27 January 2012, for active retail UK equity funds, 1.66% from Lipper.

25 The cost of larger tracker funds is even lower. In the UK, Vanguard's FTSE 100 exchange-traded fund (ETF) and iShares FTSE 250 ETF have annual charges of 0.1% and 0.4% respectively. In the US, HSBC's S&P 500 ETF costs 0.09% per year.

Table 4 Reduction in annual return due to portfolio turnover

Portfolio turnover	UK Large Cap	Balanced fund	Global Equities	Emerging Markets	Multi-Manager
10%	0.2%	0.1%	0.2%	0.8%	0.3%
50%	0.9%	0.5%	0.8%	3.8%	1.3%
100%	1.8%	1.0%	1.7%	7.6%	2.7%
200%	3.1%	1.9%	3.0%	11.0%	4.9%

Source: Frontier Investment Management

Table 5 Active and passive funds: capital grow comparison.

	Annual costs	Active 2.20%	Passive 0.25%	Fund size % difference
Years	5	£11,481	£12,612	9.0%
	10	£13,180	£15,905	17.1%
	15	£15,132	£20,059	24.6%
	20	£17,372	£25,298	31.3%
	25	£19,945	£31,904	37.5%
	30	£22,898	£40,237	43.1%

Table 5 shows how £10,000 invested in each of an active and passive fund would grow over time (assuming 5% annual growth, less costs). After 30 years, the passive investment would be 43% larger, a benefit that could lead to one, or a combination, of larger pensions and smaller contributions from the next generation.

Most independently-produced evidence concludes that, after fees, the majority of actively management funds underperform an index fund.

This is partly due to a lack of discipline: fund managers cannot resist fiddling with their investments, which incurs costs.[26] This is not to deny that there are a few active managers with good records of outperformance over a sustained period, but identifying them *ex-ante* is a skill beyond almost everyone.

(iii) Inconsistent returns

Every quarter, Foreign & Colonial publishes consistency ratios measuring the proportion of funds in the 12 main IMA sectors that produced top quartile returns each year, over the prior three years.[27] In the three years to September 2013, of 1,212 funds, only 40 consistently produced top quartile returns (i.e. 3.3%). Using blind luck, one would expect 19 funds to achieve this,[28] which leaves 21 fund managers out of a universe of 1,212, roughly 1.7%, who could legitimately claim that their success was down to skill. Over the same period, only 166 funds (13.7%) consistently produced above average returns; 1,046 funds did not. The mantra "*past performance is no guide to future growth*" cannot be faulted.

These results are typical: the historic range for producing top quartile returns over three consecutive years is 2% to 4%.[29] A stunningly small number of funds beat their peers on a regular basis, but the crucial point is that at the *start* of any three year period, *no one knows which funds they will be*.

(iv) Conclusion: after costs, active fund management adds no value

Given that when it comes to investing, hindsight is useless, there seems little point to paying up for active fund management. This conclusion is supported by analysis of the CEM global pension fund database, which shows that over the 22 years to the end of 2012, active fund management produced an average annual net value added of 0.15%: trivial.[30] CEM concluded that the dominant contributor to total returns is the asset class mix, not individual stock selection and that, in practice, a significant number of so-called active managers are actually "closet trackers". They rest comfortably behind their standard disclaimers, such as *XYZ funds are generally medium- to long-term investments*. Consequently, their day of reckoning rarely arrives, because the long term never arrives: it simply shuffles forward. In the meantime, over 90% of actively-managed funds have increased their fees in the past decade, by an average of 30 bps.

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26 For example, over the five-year period to 2009, 61% of active American fund managers failed to beat the US stock market's average return of 74%. Similarly with global funds: only 44% of managers beat the average passive fund, which grew by 24%. US active fund investors achieved an average annual return of 3.2%, far below the S&P 500 average of 8.2%.

27 All data is from Lipper, calculated in total return terms in sterling.

28 As $25\%^3$ x 1,212 funds.

29 In addition, there is a clear negative correlation between market volatility and the number of managers producing consistent top quartile returns (i.e. if volatility is high, the number declines).

30 Based upon some 350 global funds with aggregate assets of US$ 7 trillion.

CEM also reported that there is no statistical relationship between the cost of investing in a fund and its performance… and that investors would be better off focusing on cost management. In truth, there are too many variables to contend with (including so-called "Black Swan" events). Too much (expensive) talent is deployed in the pointless pursuit of trying to continually out-perform others.

That said, not *all* fund management should be passive, not least because trackers cannot replicate investment in the more esoteric assets classes (including alternative assets, emerging markets and smaller companies funds). These will remain the domain of active management.

(b) Bring most (if not all) investment management in-house

(i) Internal management is a lot cheaper

The LGPS should aim to become an expert client of the market, one that can extract best value from its counterparties. To achieve this, it should internalise its investment management, today a common feature of almost all large public sector pension schemes (although some leave the door ajar for exceptional asset classes). The big Canadian funds, for example, have all completed multi-year strategies to move most, if not all, externally managed assets in-house, to cut investment management costs and to have better control of their investments. Table 6 compares the costs of internal and external fund management.

(ii) An LGPS example: private equity

Table 7 compares the private equity returns in the world's largest pension funds, for three different implementation styles.

The differences in returns are far more dramatic than what may be expected from Table 6's comparison of costs. The reason is that private equity's fees are based on the "commitment", not Net Asset Value (NAV). Using a NAV basis (consistent with how returns are measured), all-in costs (including internal costs, management fees, performance fees, transaction and other costs within limited partnerships) are typically 100 bps for internal management, 600 bps for external management and 800 bps for fund of funds; i.e., much closer to the return differentials in Table 7.

The economic advantage of internal management is clear, yet the LGPS's £9 billion commitment to private equity (5% of total assets) is managed either externally[31] (63%, with median

[31] This is based upon a sample of 15 LGPS funds.

Table 6 Internal and external fund management: cost comparison (bps)

Fund management style	Global equity	Global fixed income	Property	Private equity
Internal passive	2.4	2.0	-	-
Internal active	3.9	10.3	24.8	24.8
External passive	7.7	5.8	-	-
External active	25.3	51.6	81.4	165.0
Fund of funds	-	-	173.6	250.4

Source: CEM Benchmarking data for 350+ large pension funds around the world.

Table 7 Average private equity returns (1996 – 2012)

	Internal	External	Fund of funds
Average return	14.3%	10.8%	3.6%
Benchmark return	8.2%	9.3%	8.4%
Net value added	6.1%	1.5%	-4.8%
Sample size	154	1,494	822

Source: CEM Global Universe private equity returns (1996 – 2012).

fees of 165 bps per annum) or in funds of funds (37%, with fees of some 250 bps).[32] The total fees paid by the LGPS to private equity fund managers are therefore roughly:

	£9 billion x 63% x 165 bps = £93 million	
+	£9 billion x 37% x 250 bps = £83 million	
	TOTAL	**£176 million per annum**

But these annual costs are understated as:

- the 37% figure refers to the general category of "alternative assets", which includes private equity: in practice, the proportion of LGPS private equity investments held within funds of funds is higher than this; and
- carried interest (or "carry") is excluded, the share of profits paid to the investment manager (historically 20%), once he has returned all of the initial capital contributed by investors, plus any previously agreed rate of return (the "hurdle rate").

Once these additional costs are factored in, the LGPS is paying some £250 million per year in fees and carried interest perhaps on its private equity investments. This should be compared with the cost of internal management: on average, about 25 bps (Table 6) which, on £9 billion, is £22.5 million. Thus, the LGPS could save itself more than £200 million per year by managing its private equity investments in-house. If a more balanced portfolio of direct and indirect (i.e. third party managed) investments were assumed, this saving would reduce to perhaps £150 million per year.

Another way of gauging the opportunity cost of *not* using internal management is to consider the differences in net value added (Table 7): on average, nearly 7% per annum over the last 16 years.[33] Given the aggregate size of the LGPS's private equity exposure, £9 billion, this lost value accumulates over the years to many £ billions (and over £500 million in 2012 alone).

The LGPS's reliance on external management for its private equity investments is an extraordinary example of profligacy and missed opportunity.

Indeed, this represents the greatest opportunity for the LGPS to leverage the advantages of scale, and cut costs.

Proposal 6: The management of all of the LGPS's private equity exposure should be entirely in-house, as a single, stand-alone, business. Individual LGPS funds could then take direct stakes in it, perhaps as shareholders.

The gold standard for managing a private equity portfolio is probably set by the Ontario Teachers' Pension Plan (OTPP, via Teachers' Private Capital, TPC), with C$12 billion in assets (or £7.2 billion, a bit smaller than the LGPS's investments). TPC has generated an annual internal rate of return of 19.2% since inception (1991).

(iii) Pay up for talent

As part of restructuring the LGPS, it should be prepared to pay to attract the necessary talent. For example, the average 2012 compensation paid to each of the five top executives at the OTPP was C$3.4 million (£2 million), and C$2.7 million (£1.6 million) at the Ontario Municipal Employees Retirement System (OMERS). Typically 75% of these packages are variable, i.e. subject to performance. The LGPS may not need to go that far, but sourcing the top talent is subject to global competition.

32 CEM Benchmarking data, presented at AMTN, November 2012.

33 As [(6.1% - 1.5%) x 63% external + (6.1% - -4.8%) x 37% fund of funds)] = 6.9%.

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(c) Other investment-related cost savings

(i) Sell all fund of funds investments

There is no evidence to justify fund of funds' additional layer of costs and charges (on average, an extra 85 bps per year). But the LGPS has a larger stake in funds of funds than typical private sector pension scheme. This is partly because smaller funds (i.e. most LGPS funds) are unable to access private market opportunities, so they try to replicate them using high-cost structures, such as funds of funds. A further disadvantage is that they are, invariably, illiquid.

(ii) Significantly reduce the purchase of third party professional services

For example, given that we know that every LGPS fund is underfunded, conducting 101 actuarial valuations this past March is unlikely to have furnished DCLG with any useful additional information. What actions, for example, will result from learning that a funding ratio is 74%, as opposed to 79%, say, when there is no specific link between a funding ratio and any cost control levers? With Hutton-based benefits negotiations now concluded, the LGPS (currently) has little flexibility to respond to changes in its financial health.

(iii) No more external consultants

With total assets of over £200 billion, the LGPS could justify having all the necessary skills in-house, doing away with (expensive) third party consultants. In addition, a recent, detailed paper reports that there is no evidence that investment consultants' recommendations add any value to plan sponsors.[34]

One area of exception is that external consultants could be used to assist trustees in assessing a fund's effectiveness and efficiency. Alternatively, why not professionalise, or at least upgrade, the pension committees?

(iv) Use exchange-traded funds (ETFs)

The LGPS should look much more closely at ETFs for UK investments. Traded like shares, there is no upfront Stamp Duty (0.5%).

(v) Slow down portfolio rebalancing

This could significantly reduce asset turnover, and therefore transaction costs.

(d) A Canadian perspective

The CEO of one of the UK's largest pension funds recently visited Toronto, perhaps the world's epicentre of expertise in the management of public pension funds. Meeting with four of the giant funds,[35] he was struck by the primacy of their investment strategies (asset mix), with stock selection being subordinated. Observations such as this help validate the opinion of Daniel Kahneman, Nobel laureate: "*there are domains in which expertise is not possible. Stock picking is a good example.*" Similarly Warren Buffett: *"by periodically investing in an index fund, the know-nothing investor can actually out-perform most investment professionals".*

Toronto is also the home of the Rotman School of Management, which produces some excellent pension fund analyses. The summary of one of their papers[36] resonates with a number of the above observations:

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34 Tim Jenkinson, Howard Jones, and Jose Vicente Martinez, *Picking winners? Investment consultants' recommendations of fund managers;* Saïd Business School, University of Oxford, September 2013.

35 Canada Pension Plan Investment Board (CPPIB, with net assets of C$183 billion), Healthcare of Ontario Pension Plan (HOOPP, C$47 billion), Ontario Municipal Employees Retirement System (OMERS, C$88 billion) and Ontario Teachers' Pension Plan (OTPP, C$130 billion).

36 *Is bigger better? Size and performance in pension plan management,* Alexander Dyck and Lukasz Pomorski, Rotman School of Management, University of Toronto, February, 2011.

"We document substantial positive scale economies in asset management using a defined benefit pension plan database. The largest plans outperform smaller ones by 45-50 basis points per year on a risk-adjusted basis. Between a third and one half of these gains arise from cost savings related to internal management, where costs are at least three times lower than under external management.

Most of the superior returns come from large plans' increased allocation to alternative investments and realizing greater returns in this asset class. In their private equity and real estate investments large plans have both lower costs and higher gross returns, yielding up to 6% per year improvement in net returns. Poorer governance reduces overall plan returns and attenuates scale economies."

Proposal 7: The LGPS funds should allocate most of their resources to passive (index-tracker), not actively managed funds, with more use made of exchange-traded funds (ETFs). Almost all investment management should be brought in-house, particularly private equity and the other alternative assets. In addition, all fund of funds investments should be sold, and there should be a serious cull of third party service providers, particularly investment consultants.

5. IMPLEMENTATION

5.1 Ignore the sceptics

There are inevitably people who oppose LGPS reconfiguration, fuelled by personal vested interests. They include the panoply of service providers to the individual LGPS funds (better 101 clients than six, say), council leaders and heads of finance, and pension committee chairs. Their defence usually relies on challenging the counterfactual, hard to refute when the benefits of fund merger cannot be *proven* until after the event.

The LGPS is no ordinary pension scheme: some see it as also behaving as an empire, serving the vested interests of those who work within it and deliver services to it. They naturally oppose fund consolidation, claiming that merging funds with different funding ratios would disadvantage the members of the relatively strong funds, as well as risking moral hazard: this is a red herring (see below).

In addition, some opponents within local government refer to "localism", and the need for local accountability, as a justification for the *status quo.* A good example can be found in the "evaluation of options" document that was presented to the London Councils Leaders' Committee (LCLC), currently considering reconfiguring the London LGPS funds.[37] The opponents to change forget that since the centralisation of business rates (1990), local government contributes only 12% of all contributions to LGPS funds: the rest comes from central government and employees. The members' best interests, and indeed the national interest, should prevail. That requires strong ministerial leadership.

5.2 A central administrator

A previous CPS paper, published in September 2013, describes a central administrator (referred to as PensionClear, with its own database, PensionData), and also provides a cursory road map for establishing it (Chapter 6).[38] Technical considerations are discussed in Chapter 7, delivery in Chapter 8.

37 *Reconfiguring the London LGPS funds: evaluation of options*, October 2012.

38 *Aggregation is the key; retirement saving nirvana for consumers;* Michael Johnson, CPS, September 2013.

5.3 Merging the funds

(a) The mechanics

Before any new structure can be designed, a significant, and sensitive, question must be answered: what is the meaning of the word "merger"? A very limited interpretation of "merger" is to build one or more shared services frameworks, solely for procurement purposes. Switzerland's Avadis Collective Foundation is one such example, essentially a buyers' club of pension funds, akin to a general contractor. Operationally, all the services are under one roof (including asset management, administration and membership communication), with the assets pooled into four different risk-return profiles. The member funds still provide their own financial statements, which would allow each LGPS fund to preserve its current identify.

A more common interpretation is that "merger" means the pooling of assets, but not the comingling of individual funds' liabilities. Some sceptics cite moral hazard, were weak and strong LGPS funds to be merged, but there are structures that preserve individual funds' asset to liability ratios, to avoid relatively well-funded funds being weakened by more underfunded funds. These include making use of collective investment vehicles, with each LGPS fund owning a share of the pooled assets, its legal rights to a share of the assets being ring-fenced (segregated). Mutual funds and unit trusts operate in a similar manner. The Pensions Trust, for example, does this while looking after the pension funds of some 4,300 charities and other not-for-profit organisations.

(b) How to merge funds?

There are at least three approaches to bringing about the scaling up of the LGPS. This is a less challenging objective than may be imagined. Witness, for example, Unison's submission to Lord Hutton's commission, which actively makes the case for LGPS fund mergers.

(i) Top-down diktat

The Secretary of State could simply use his power to merge funds at will, under the 1972 Superannuation Act. This has the merit of clarity, but may not win hearts and minds amongst those with vested interests in the LGPS's on-going profitable inefficiencies, including the numerous third party service providers.

(ii) Voluntary accession

Another approach would be to encourage deep collaboration (akin to merger) amongst LGPS funds by being Nice, Retaliatory, Forgiving and Clear, a process developed by the political scientist Robert Axelrod.[39] Membership of a fund could be achieved in a manner similar to treaty accession, led by a core of enlightened administering authorities, council leaders, employers and unions. This should attract all those with a common sense of responsibility towards their fund members.

[39] Appendix III of *Aggregation is the key* (CPS, 2013) discusses this in the pensions context.

Table 8 Number of Australian pension schemes ranked by size

Assets, A$ billion	2004	2005	2006	2007	2008	2009	2010	2011	2012
< 0.1	400	274	169	132	118	97	88	68	64
> 0.1 < 0.5	135	121	101	93	89	85	67	60	50
> 0.5 < 1	53	49	49	47	37	38	32	23	22
> 1 < 5	64	70	71	76	76	73	74	72	59
> 5 < 10	18	23	20	17	13	13	15	12	12
> 10 < 20	1	2	8	11	11	10	10	10	11
> 20	2	2	3	6	6	6	8	10	11
Total	**673**	**541**	**421**	**382**	**350**	**322**	**294**	**255**	**229**

Source: APRA, 2012 superannuation fund level profiles and performance.

By avoiding the "big-bang" approach of a universal accord, no single fund or bloc could hold the process hostage. But it would be slow, too slow for the LGPS, notwithstanding the recent emergence of a few shared service agreements, such as the South West Framework.[40]

(iii) Use assertive governance to drive fund mergers: the Australian example

As part of its SuperStream agenda, Australia has introduced legislation that requires trustees to self-administer an annual test to evidence that scheme members are not disadvantaged by a lack of scale in assets or membership. This initiative is expected to continue driving the stunning contraction in the number of Australian pension schemes, as they scale up (see Table 8). DCLG could adopt a similar approach, requiring each LGPS fund to consider the "sufficiency" of both its assets *and* its membership headcount, measured against specific efficiency criteria, and other benchmarks. This should prompt many of the pension boards (post-2014) to recognise that they lack scale (and those that do not should have to justify their position). DCLG should then guide them to acquire scale, through mergers with other funds, and also ask its scheme advisory board (once operative) to provide it with advice on individual LGPS funds' progress towards greater efficiency.

Improved governance is key. The OFT concluded that competition alone cannot be relied upon to drive value for money in the workplace pensions market. Although their comments were specific to DC schemes, they could apply equally to the DB world. The OFT pointed to the combination of two factors: weaknesses on the buyer side of the market, and pensions' complexity.[41]

Proposal 8: DCLG should prepare a governance framework that requires LGPS funds' pension boards to conduct annual tests to evidence that their fund members are not disadvantaged by a lack of scale in assets or membership. These should include measurement against benchmarks for readily quantifiable parameters such as costs per member. DCLG should then guide funds to acquire scale, through mergers with other funds, with the scheme advisory board providing advice on individual LGPS funds' progress towards greater efficiency.

5.4 Proof of concept: start with the London LGPS funds?

If the London Councils Leaders' Committee (LCLC) were to progress with some form of reconfiguration of London's LGPS funds, this could provide a valuable opportunity to test the concept of a single regional fund, with centralised administration.

6. THE BUSINESS CASE FOR RESTRUCTURING THE LGPS

With some £200 billion in assets, the LGPS's scope for cost savings is enormous.

6.1 Administration

The Australian Treasury expects the introduction of SuperStream (with its back-office focus) to yield an annual expense reduction of A$650 million, which would go a long way towards its targeted savings of A$1 billion (£590 million) per annum (as identified by Ernst & Young research[42]). Based upon pension fund assets of A$810 billion (end-2012), this is about 8 bps. A similar amount shaved off the cost of administering the LGPS, through digitisation and centralisation, would save £160 million per year.

40 A pooled procurement programme to cut costs, involving the Environment Agency Pension Fund and six LGPS funds.

41 *Defined contribution workplace pension market study*; OFT, September 2013.

42 *The $20 billion prize: An industry blueprint to implement SuperStream*; Joint Ernst & Young and Financial Services Council Research, August 2010.

6.2 *Investment management*

It is hard to say how much could be saved by simplifying, and internalising, most of the LGPS's investment management, because no one really knows how much it currently costs. If we take the actuaries' cost figure of 63 bps (the real figure is certainly higher), then a conservative target would be to cut this to 40 bps, say (compare this with the costs outlined in Table 4): an annual saving of £460 million (23 bps). CEM found that a 10% increase in internal management would increase net value by 3.2 bps, so this would be equivalent to the LGPS managing 70% of its assets in-house.

The largest savings would be found amongst the private assets, notably private equity. Bear in mind that Denmark's ATP fund reports investment management costs of 8 bps, and total costs of 12 bps (Table 1).

6.3 *Scaling up*

In addition, there is scope for capturing economies of scale through fund mergers, perhaps using tough governance to drive fund consolidation. CEM found that a ten-fold increase in fund size typically produces an increase in net value added of 18 bps. The average LGPS fund has assets of roughly £2 billion: with six funds (rather than 101), the average size would rise to £33 billion, a 16-fold increase for, say, a net value added of 24 bps (allowing for the law of diminishing returns): an of some £480 million. This, however, will include elements of double counting (in respect of administration and investment management cost savings), so settle for half of this, for an annual saving of £240 million (12 bps).

6.4 *Total saving*

These three savings total 43 bps, for a net value added of £860 million per year. There is of course no "correct" answer, but hopefully the evidence is sufficiently robust to permit such a forecast to be described as "cautious".

7. GOVERNANCE

7.1 *Today*

Today, responsibility for the three key drivers of LGPS pension cost are divided between three disparate and disconnected bodies:

(i) employers, who set wages;

(ii) central government, which sets the rules governing the funds and the level of benefits; and

(iii) local government, responsible, via the administering authorities, for the funding strategy and investment performance. In practice, there are chains of agents doing this on their behalf.

The catastrophic financial condition of a number of the LGPS funds shows the consequences of lax governance: it is no surprise that the LGPS is in such trouble. Today's governance arrangement is primed for serious failure. DCLG has recognised that the current framework is not fit for purpose, and has issued a discussion document outlining new governance arrangements.[43]

7.2 *Governance, post-2014*

There are two components to the proposed post-2014 governance framework:

(i) a scheme advisory board, appointed by DCLG's Secretary of State to provide advice to him; and

[43] *Local Government Pension Scheme (England and Wales) new governance arrangements: discussion paper*, DCLG, June 2013.

(ii) pension boards, appointed by scheme managers (today's administering authorities), to assist them in securing compliance with the scheme rules and pensions legislation. The 2013 Act's definition of "assist" is unclear: pension boards are likely to become scrutiny committees with no real powers. In addition, they are likely to be set up under pensions legislation, rather than local government legislation, leaving scope for legal conflict.

These two bodies have yet to be established, and there is nothing in the 2013 Act to say when they will become operational. Worryingly, it would appear that the issue of scheme governance is subsidiary to the introduction of the new benefits arrangements (on 1 April 2014). In the meantime, the LGA has established a shadow scheme advisory board and Section 101 from the Local Government Act 1972 will continue to apply (which allows local authorities to delegate to an internal pension committee).

It is unclear how the proposed framework will address the council leaders' and pension committee chairs' conflicting fiduciary duties, to taxpayers and scheme members, respectively. Nor will it resolve the perennial problem of the incongruous mismatch between some relatively uninformed administering authorities and knowledgeable pension board members.

In addition, there is still not enough blue water between fund assets and employers (the councils): surely this is a prerequisite to ensuring that the LGPS is solely run in the interests of its beneficiaries?[44] Finally, the LGPS's future governance framework should imbue an ethos of fiduciary care, but the word "fiduciary" is notably absent from the documentation.

Proposal 9: Members of the LGPS deserves a governance framework imbued with an ethos of fiduciary duty. The recommendations of the Law Commission's on-going review of fiduciary legal duties (due in 2014) should be incorporated within it.

8. REGULATION

Historically, the LGPS has been excluded from TPR's jurisdiction, because of "*the constitutional permanence of local government and a strong employers' covenant*".[45] Fortunately, this is going to change. While the Secretary of State will continue to set the regulations as to how the LGPS operates, from April 2015, under the 2013 Act, TPR will assume regulatory responsibility. It will focus on administration and governance (and the pension boards will be under TPR remit).

Concerns have been expressed that not only does TPR lack the tools to perform its role, but it is unclear how the scheme advisory board, pension boards, DCLG and TPR will interact while overseeing the LGPS.

In addition, the new framework is unlikely to stop LGPS funds continuing to "kick the can down the road". The average LGPS recovery period is 21 years (and prone to extension): contrast this with an average of nine years for the private sector (which supposedly reflects the different nature of the LGPS employer covenant).

Proposal 10: The LGPS's component funds should be required to adhere to the same actuarial and regulatory disciplines as private sector pension schemes.

44 For example, in February 2013 the Wales Audit Office announced that a Swansea Council's £20 million transfer from its LGPS fund, to balance its books, was "unlawful".

45 The Pensions Regulator, Code of Practice No 3 – Funding defined benefits, paragraph 57.

9. CONCLUSION

The *status quo* will no longer suffice: a fundamental overhaul of the LGPS is essential if it is to be placed on a sustainable footing. This requires a forensic focus on cutting costs, which would lead to improved performance.

The back-office needs to embrace digitisation, investment management needs a radical re-engineering and, inevitably, the shoal of sub-scale funds should be consolidated, probably into six regional funds, competing to deliver the best financial performance and customer service. In time, they could become "expert clients", capable of extracting best value from the financial services industry. Fund mergers could be facilitated by robust governance.

Support for such an initiative would come from across the political spectrum, as well as from many within the public sector unions: they understand that fund mergers would best serve the interests of their membership. Reduced costs (akin to improved fund performance) could be used to slowly restore funds' financial health, as well as potentially leaving some scope for sharing the benefits between members and employers through, for example, lower contributions.

But change would require confronting inconvenient truths and entrenched vested interests. Some service providers would, for example, experience a contraction in their client bases, and a reduction in administration headcount would be inevitable. But by reconfiguring the LGPS, the DCLG would be demonstrating leadership, which would resonate with the Chancellor's recent call for greater ambition and a "can do" attitude.

In addition, DCLG would be setting an example to the myriad of sub-scale private sector occupational pension schemes, encouraging them to also scale up, perhaps clustered around particular industries. This would force the retirement savings industry to confront its own inefficiency. It is no longer "cutting edge", a point reiterated in the recent publication of the Mercer Global Pension Index. This scores each country on the adequacy, sustainability and integrity of its publically funded and private pension systems. The UK has now fallen to 9th place, way behind the leaders (Denmark, the Netherlands and Australia). This has serious implications for the UK's economic competitiveness, given that our financial services are (currently) a major export industry.

Centre for Policy Studies

LGPS funds' administration costs, per member (2012-13)[53]

Rank	LGPS fund	Admin. costs per member	Fund market value 31 March 2013 £000's
1	Nottinghamshire	£13.7	£3,496,446
2	Tameside	£14.0	£12,589,029
3	Cornwall	£14.4	£1,342,577
4	Essex	£14.8	£3,958,473
5	Derbyshire	£14.8	£3,120,045
6	Leicestershire	£16.3	£2,627,018
7	Hampshire	£16.3	£4,340,618
8	North Yorkshire	£16.5	£1,840,733
9	Oxfordshire	£17.8	£1,523,748
10	West Yorkshire Superannuati	£18.0	£9,940,305
11	Devon	£19.0	£3,006,684
12	Lincolnshire	£19.3	£1,490,001
13	West Midlands Pension Fund	£20.5	£9,886,293
14	West Sussex	£20.6	£2,367,826
15	Cardiff UA	£21.2	£1,340,485
16	Lancashire	£21.2	£5,011,017
17	Carmarthenshire UA	£21.6	£1,600,839
18	East Riding of Yorkshire UA	£21.6	£3,078,080
19	Worcestershire	£21.7	£2,907,905
20	Bedfordshire	£21.9	£1,467,063
21	Norfolk	£22.3	£2,438,215
22	Somerset	£22.7	£1,369,000
23	Windsor & Maidenhead UA	£23.1	£1,571,295
24	Staffordshire	£23.4	£3,051,503
25	Gloucestershire	£23.5	£1,384,840
26	Surrey	£23.7	£2,558,716
27	East Sussex	£24.3	£2,344,276
28	Wandsworth	£24.4	£990,889
29	Flintshire UA	£25.0	£1,180,955
30	Cumbria	£25.1	£1,659,065
31	Dorset	£25.1	£1,935,850
32	Shropshire	£25.3	£1,234,725
33	South Yorkshire Pensions Fu	£25.5	£5,288,266
34	Wiltshire	£25.5	£1,493,913
35	Hertfordshire	£25.6	£1,697,645
36	Kent	£25.6	£3,812,698
37	Merseyside Pension Fund	£26.4	£5,818,897
38	Middlesbrough UA	£26.6	£2,929,601
39	Tyne and Wear Superannuati	£27.0	£5,432,341
40	Cheshire	£28.0	£3,231,838
41	Bath & North East Somerset	£28.8	£3,146,966
42	Suffolk	£29.1	£1,555,884
43	Swansea UA	£30.8	£1,277,783
44	Rhondda Cynon Taff UA	£31.4	£2,079,336
45	Buckinghamshire	£31.8	£1,784,208
46	Torfaen UA	£32.9	£1,923,800
47	Isle of Wight UA	£33.2	£390,737
48	Hounslow	£33.4	£690,271
49	Hillingdon	£33.7	£683,052
50	Merton	£35.4	£453,329
51	Gwynedd	£35.9	£1,193,579
52	Enfield	£36.0	£731,047
53	Lewisham	£36.1	£867,549
54	Redbridge	£36.6	£533,728
55	Hackney	£36.9	£943,835
56	Bromley	£37.3	£583,686
57	Newham	£38.0	£840,424
58	Warwickshire	£38.5	£1,379,200
59	Richmond upon Thames	£39.2	£504,054
60	Havering	£39.7	£460,575
61	West Midlands PTA	£41.0	£448,936
62	City of London	£42.5	£709,367
63	Northumberland	£42.9	£914,422
64	Camden	£43.2	£1,123,636
65	Haringey	£43.4	£860,379
66	Harrow	£43.9	£551,730
67	Ealing	£45.3	£799,952
68	Powys UA	£45.7	£425,420
69	Hammersmith & Fulham	£46.1	£724,086
70	Lambeth	£46.3	£951,074
71	Westminster	£46.9	£874,176
72	Cambridgeshire	£47.5	£1,879,486
73	Barnet	£48.7	£791,598
74	Southwark	£50.1	£990,689
75	Brent	£51.4	£547,883
76	Sutton	£51.7	£426,871
77	Northamptonshire	£51.8	£1,521,416
78	Croydon	£51.9	£705,292
79	Kensington & Chelsea	£54.7	£633,489
80	Islington	£55.0	£918,282
81	Tower Hamlets	£55.4	£911,778
82	Greenwich	£55.6	£885,012
83	Barking & Dagenham	£57.0	£636,402
84	Bexley	£57.4	£556,273
85	Waltham Forest	£58.3	£599,787
86	Kingston upon Thames	£63.2	£501,357
87	South Yorkshire PTA	£72.7	£194,220
88	Durham	£119.4	£2,085,556
	Average	**£34.6**	**£1,972,174**

53 Data source: SF3 returns for 2012-13. Table excludes data from the LPFA, which includes significant costs associated with the provision of administrative services to other LGPS funds.

LGPS funds' investment costs, per member (2012-13)[54]

Rank	LGPS fund	Fund mgt costs per member	Fund market value 31 March 2013 £000's
1	West Yorkshire Super. Fund	£7.6	£9,940,305
2	South Yorkshire Pensions Fund	£14.6	£5,288,266
3	Middlesbrough UA	£21.2	£2,929,601
4	Harrow	£28.1	£551,730
5	Durham	£28.8	£2,085,556
6	East Riding of Yorkshire UA	£30.1	£3,078,080
7	Nottinghamshire	£34.1	£3,496,446
8	Cambridgeshire	£37.6	£1,879,486
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11	Windsor & Maidenhead UA	£43.6	£1,571,295
12	Islington	£43.9	£918,282
13	Carmarthenshire UA	£47.7	£1,600,839
14	Dorset	£48.4	£1,935,850
15	Derbyshire	£48.7	£3,120,045
16	North Yorkshire	£51.5	£1,840,733
17	Buckinghamshire	£53.6	£1,784,208
18	Oxfordshire	£59.5	£1,523,748
19	Merton	£59.6	£453,329
20	Somerset	£62.0	£1,369,000
21	Cumbria	£63.0	£1,659,065
22	Croydon	£63.2	£705,292
23	Wiltshire	£65.1	£1,493,913
24	Gloucestershire	£71.7	£1,384,840
25	Havering	£72.1	£460,575
26	Hampshire	£74.6	£4,340,618
27	Tyne and Wear Super. Fund	£74.8	£5,432,341
28	Greenwich	£77.5	£885,012
29	Brent	£77.5	£547,883
30	Devon	£77.7	£3,006,684
31	Enfield	£79.7	£731,047
32	Haringey	£81.3	£860,379
33	Bedfordshire	£82.3	£1,467,063
34	Lincolnshire	£84.1	£1,490,001
35	Lancashire	£86.4	£5,011,017
36	Surrey	£86.9	£2,558,716
37	Staffordshire	£87.7	£3,051,503
38	Hertfordshire	£87.7	£1,697,645
39	Barnet	£88.2	£791,598
40	Isle of Wight UA	£88.5	£390,737
41	Cornwall	£89.1	£1,342,577
42	Northumberland	£89.3	£914,422
43	Lambeth	£90.6	£951,074
44	Rhondda Cynon Taff UA	£90.8	£2,079,336
45	Leicestershire	£91.3	£2,627,018
46	West Midlands PTA	£91.5	£448,936
47	Richmond upon Thames	£94.7	£504,054
48	Bromley	£95.2	£583,686
49	Northamptonshire	£95.4	£1,521,416
50	Bexley	£95.9	£556,273
51	Cardiff UA	£97.4	£1,340,485
52	Powys UA	£99.0	£425,420
53	Merseyside Pension Fund	£103.1	£5,818,897
54	Lewisham	£103.7	£867,549
55	Kent	£104.7	£3,812,698
56	Torfaen UA	£105.2	£1,923,800
57	Hounslow	£111.8	£690,271
58	Bath & North East Somerset	£113.0	£3,146,966
59	Kingston upon Thames	£113.4	£501,357
60	Ealing	£116.2	£799,952
61	West Sussex	£122.3	£2,367,826
62	Redbridge	£123.1	£533,728
63	East Sussex	£123.7	£2,344,276
64	Worcestershire	£127.4	£2,907,905
65	Southwark	£131.1	£990,689
66	Warwickshire	£131.5	£1,379,200
67	Suffolk	£134.8	£1,555,884
68	Sutton	£136.0	£426,871
69	Westminster	£136.1	£874,176
70	Barking & Dagenham	£136.5	£636,402
71	Tower Hamlets	£136.6	£911,778
72	Norfolk	£146.3	£2,438,215
73	Essex	£149.9	£3,958,473
74	Hackney	£151.0	£943,835
75	Wandsworth	£156.1	£990,889
76	Newham	£166.8	£840,424
77	Flintshire UA	£177.4	£1,180,955
78	Swansea UA	£191.1	£1,277,783
79	Gwynedd	£192.0	£1,193,579
80	Hammersmith & Fulham	£194.6	£724,086
81	Cheshire	£223.9	£3,231,838
82	Hillingdon	£224.7	£683,052
83	South Yorkshire PTA	£234.9	£194,220
84	Shropshire	£243.3	£1,234,725
85	Camden	£268.1	£1,123,636
86	Waltham Forest	£283.2	£599,787
87	Kensington & Chelsea	£301.9	£633,489
88	City of London	£317.3	£709,367
	Average	**£107.1**	**£1,972,174**

54 Data source: SF3 returns for 2012-13. Table excludes data from the LPFA, which includes significant costs associated with the provision of administrative services to other LGPS funds.

LGPS funds' total costs, per member (2012-13)[55]

Rank	LGPS fund	Total costs per member	Fund market value 31 March 2013 £000's	Total membership	Assets per member
1	West Yorkshire Super. Fund	£25.6	£9,940,305	242,968	£40,912
2	South Yorkshire Pensions Fund	£40.0	£5,288,266	132,570	£39,890
3	Nottinghamshire	£47.8	£3,496,446	102,824	£34,004
4	Middlesbrough UA	£47.8	£2,929,601	64,434	£45,467
5	East Riding of Yorkshire UA	£51.7	£3,078,080	92,164	£33,398
6	Tameside	£55.9	£12,589,029	266,375	£47,261
7	Derbyshire	£63.5	£3,120,045	81,151	£38,447
8	West Midlands Pension Fund	£63.7	£9,886,293	260,860	£37,899
9	Windsor & Maidenhead UA	£66.6	£1,571,295	54,105	£29,042
10	North Yorkshire	£68.0	£1,840,733	73,347	£25,096
11	Carmarthenshire UA	£69.2	£1,600,839	39,908	£40,113
12	Harrow	£72.0	£551,730	16,468	£33,503
13	Dorset	£73.5	£1,935,850	57,462	£33,689
14	Oxfordshire	£77.3	£1,523,748	51,000	£29,877
15	Somerset	£84.7	£1,369,000	50,946	£26,872
16	Cambridgeshire	£85.1	£1,879,486	61,431	£30,595
17	Buckinghamshire	£85.4	£1,784,208	55,287	£32,272
18	Cumbria	£88.1	£1,659,065	46,474	£35,699
19	Wiltshire	£90.5	£1,493,913	54,250	£27,538
20	Hampshire	£90.9	£4,340,618	128,294	£33,833
21	Merton	£95.0	£453,329	9,835	£46,093
22	Gloucestershire	£95.2	£1,384,840	44,855	£30,874
23	Devon	£96.8	£3,006,684	88,663	£33,911
24	Islington	£98.9	£918,282	18,047	£50,883
25	Tyne and Wear Super. Fund	£101.8	£5,432,341	115,302	£47,114
26	Lincolnshire	£103.4	£1,490,001	60,556	£24,605
27	Cornwall	£103.5	£1,342,577	40,998	£32,747
28	Bedfordshire	£104.1	£1,467,063	49,519	£29,626
29	Leicestershire	£107.6	£2,627,018	76,767	£34,221
30	Lancashire	£107.7	£5,011,017	142,381	£35,194
31	Surrey	£110.6	£2,558,716	78,851	£32,450
32	Staffordshire	£111.0	£3,051,503	92,031	£33,157
33	Havering	£111.8	£460,575	15,910	£28,949
34	Hertfordshire	£113.3	£1,697,645	49,904	£34,018
35	Croydon	£115.1	£705,292	21,063	£33,485
36	Enfield	£115.6	£731,047	16,180	£45,182
37	Cardiff UA	£118.6	£1,340,485	33,512	£40,000
38	Isle of Wight UA	£121.7	£390,737	12,692	£30,786
39	Rhondda Cynon Taff UA	£122.2	£2,079,336	59,351	£35,035
40	Haringey	£124.7	£860,379	20,190	£42,614
41	Brent	£129.0	£547,883	18,546	£29,542
42	Merseyside Pension Fund	£129.5	£5,818,897	123,984	£46,933
43	Kent	£130.3	£3,812,698	114,120	£33,410
44	Northumberland	£132.2	£914,422	22,918	£39,900
45	West Midlands PTA	£132.5	£448,936	5,149	£87,189
46	Bromley	£132.5	£583,686	14,253	£40,952
47	Greenwich	£133.1	£885,012	17,331	£51,065
48	Richmond upon Thames	£133.9	£504,054	10,729	£46,981
49	Barnet	£136.9	£791,598	20,985	£37,722
50	Lambeth	£137.0	£951,074	18,320	£51,915
51	Torfaen UA	£138.1	£1,923,800	48,058	£40,031
52	Lewisham	£139.8	£867,549	20,845	£41,619
53	Bath & North East Somerset	£141.8	£3,146,966	89,827	£35,034
54	West Sussex	£142.9	£2,367,826	57,154	£41,429
55	Powys UA	£144.7	£425,420	15,837	£26,862
56	Hounslow	£145.2	£690,271	18,752	£36,811
57	Northamptonshire	£147.2	£1,521,416	50,895	£29,893
58	East Sussex	£148.0	£2,344,276	60,226	£38,925
59	Durham	£148.2	£2,085,556	45,254	£46,086
60	Worcestershire	£149.1	£2,907,905	80,641	£36,060
61	Bexley	£153.3	£556,273	12,664	£43,926
62	Redbridge	£159.7	£533,728	13,945	£38,274
63	Ealing	£161.5	£799,952	19,645	£40,720
64	Suffolk	£163.9	£1,555,884	46,757	£33,276
65	Essex	£164.6	£3,958,473	117,911	£33,572
66	Norfolk	£168.6	£2,438,215	70,048	£34,808
67	Warwickshire	£170.0	£1,379,200	39,390	£35,014
68	Kingston upon Thames	£176.6	£501,357	11,661	£42,994
69	Wandsworth	£180.5	£990,889	17,025	£58,202
70	Southwark	£181.2	£990,689	19,942	£49,679
71	Westminster	£183.0	£874,176	14,794	£59,090
72	Sutton	£187.6	£426,871	10,627	£40,169
73	Hackney	£188.0	£943,835	18,769	£50,287
74	Tower Hamlets	£192.0	£911,778	16,717	£54,542
75	Barking & Dagenham	£193.5	£636,402	14,528	£43,805
76	Flintshire UA	£202.4	£1,180,955	32,333	£36,525
77	Newham	£204.8	£840,424	21,308	£39,442
78	Swansea UA	£221.9	£1,277,783	33,689	£37,929
79	Gwynedd	£227.9	£1,193,579	29,784	£40,075
80	Hammersmith & Fulham	£240.7	£724,086	13,707	£52,826
81	Cheshire	£251.9	£3,231,838	77,516	£41,693
82	Hillingdon	£258.4	£683,052	17,458	£39,125
83	Shropshire	£268.7	£1,234,725	35,723	£34,564
84	South Yorkshire PTA	£307.5	£194,220	2,146	£90,503
85	Camden	£311.3	£1,123,636	18,410	£61,034
86	Waltham Forest	£341.5	£599,787	16,740	£35,830
87	Kensington & Chelsea	£356.6	£633,489	9,683	£65,423
88	City of London	£359.7	£709,367	11,048	£64,208
	Average	**£141.8**	**£1,972,174**	**£52,235**	**£40,366**

[55] Data source: SF3 returns for 2012-13. Table excludes data from the LPFA, which includes significant costs associated with the provision of administrative services to other LGPS funds.

THE AUTHOR

Michael Johnson trained with JP Morgan in New York and, after 21 years in investment banking, joined Towers Watson, the actuarial consultants. More recently he was Secretary to the Conservative Party's Economic Competitiveness Policy Group.

He is widely recognised as a leading expert on UK pensions, and is the author of many influential reports on the subject, including: *Don't let this crisis go to waste: a simple and affordable way of increasing retirement income* (Centre for Policy Studies, September 2009); *Simplification is the key: stimulating and unlocking long-term sav*ing (CPS, June 2010); and *Self-sufficiency is the key: addressing the public sector pensions challenge* (CPS, February 2011), *Put the saver first* (CPS, July 2012) and *Aggregation is the key: retirement saving nirvana for consumers* (CPS, September 2013).

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