Local Government Pension Scheme
Scheme Advisory Board

Briefing Note – April 2019

LGPS Code of Transparency and compliance system

Circulation: [LGPS Investment contacts, Finance contacts]
[LGPS pension managers] [Pension Committee chairs] [LGPS Advisers]
[LGPS Investment Managers, signatories to the Code] [Press contacts]

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Summary

The move toward investment fee transparency and consistency is seen by the Board as an important factor in the perception that LGPS is a value led and innovative scheme. Transparency is also a target for the revised CIPFA accounting standard issued for inclusion in the statutory annual report and accounts and included in the government’s criteria for pooling investments.

Investment Costs are a complex area that pension committees need to be familiar with. The LGPS Code of Transparency helps LGPS clients (defined by the Code as administering authorities and LGPS pool companies) gather cost information in a consistent format. Cost information must always be viewed in context of risk and return and should only form part of any overall value for money assessment.

The Scheme Advisory Board has been running a procurement of a collation and compliance system for all parties (funds, pools & investment managers) to use. This compliance system will make the process of collation more efficient and will ensure compliance for the funds and
the pools – as well as streamlining the process for the managers providing the data in the first place.

This briefing note provides the background to the LGPS Code, the procurement of a compliance system, and answers frequently asked questions from both the Investment Manager1 and LGPS client points of view.

The LGPS Code of Transparency

A Code of Transparency into investment management fees and costs was developed and approved by the Scheme Advisory Board and launched in May 2017. (A copy of the Code can be found at http://lgpsboard.org/index.php/the-code#theCodetop). Fund managers to the LGPS are being encouraged to sign up to this Code and as at April 2019, there were over 110 signatories.

The total LGPS assets under management falling under the Code is estimated at over £180bn. The total proportion of LGPS assets that could be reported in compliance with the Code (excluding direct property and closed end private equity holdings) is likely to be around 80%.

The largest Investment Managers by LGPS assets under management are L&G, Baillie Gifford, BlackRock and UBS (all in excess of £10bn). The signatory list also includes smaller, more specialist, managers holding one or two LGPS mandates and less than £0.5bn LGPS assets overall. A full list of managers signed up to the Code can be found on the Board website, this is updated as new signatories provide an organisation summary. Four LGPS investment pool companies are signatories; Border to Coast Pensions Partnership Limited, Brunel Pension Partnership Limited, LGPS Central Limited and Local Pensions Partnership Investments Ltd. Link Fund Solutions, the provider of asset management services to the ACCESS and Wales pools, have also signed up. Northern and London CIV have indicated their intention to do so soon.

From its outset, the Code of Transparency was an LGPS Advisory Board (England and Wales) initiative. However, since its launch, the Scottish LGPS and LGPS (Northern Ireland) clients have been included at their request.

The Templates

The Financial Conduct Authority (FCA) launched the Institutional Disclosure Working Group (IDWG) as part of the remedies package designed as a result of their asset management market study and noted the success of the LGPS Code.

The FCA has wanted to see more consistent and standardised disclosure of costs and charges for institutional investors. It thought that a standardised disclosure template should provide institutional investors with a clearer understanding of the costs and charges for a given fund or mandate. This should allow investors to compare charges between providers and give them a clear expectation of the disclosure they can expect.

1 In this document, Investment Manager refers to an investment manager, as appointed by an Administering Authority in accordance with the Investment Regulations
In November 2018, the Cost Transparency Initiative (CTI) was launched and became the organisation taking forward the work of the previous IDWG. It is currently in the process of piloting test templates with a number of schemes.

For the LGPS funds to have the relevant data to investigate and understand their respective fees and costs, the Scheme Advisory Board alongside the Investment Association developed the templates currently used by the Code. At present, the LGPS Code’s templates cover listed assets only for both segregated mandates and pooled funds. A copy of the current template can be found at: http://www.lgpsboard.org/index.php/the-template

However, once the CTI’s institutional-investor-wide templates are launched, they will be adopted by the LGPS Code. There will be a transitional period of up to 12 months for managers of listed assets to move from the current template to the CTI templates.

The Compliance System

As part of the Code, investment managers are obliged to complete and submit the Template (without request) to their LGPS clients on either an annual or quarterly basis as agreed with their client. In order to fulfil its stated intention to police the Code, the Board is currently procuring a compliance system. This will take the form of online facility intended to:

- Be capable of accepting and storing template data
- Check the timeliness of data submission and report late returns
- Ensure that template data is signed off by managers as ‘true and fair’
- Provide a check against the MiFID II total cost amount submitted separately by managers to their LGPS clients

As well as ensuring compliance with the Code the system could be used by LGPS clients to:

- Replace the existing excel format templates provided to them by managers
- View a useful but limited set of onscreen reporting and comparison tools
- Give permission to other LGPS clients or trusted third parties (e.g. their investment advisor) to access and export their template data
- Provide advanced reporting facilities under a phase 2 development subject to the agreement of Code clients

In specifying the system, the Scheme Advisory Board has placed great emphasis on security and confidentiality. The template data held within the compliance system will be separate from any other database held by the service provider and cannot be shared by the service provider with any third parties for any purpose.

The Board may publish aggregate totals or averages from the system as part of the scheme annual report. Such reporting will not identify any data at the fund, pool, manager or mandate level.

Procurement Process

The procurement process for a system to ensure compliance with the Code was agreed at the Board meeting in June 2018 and the Board expects to award the contract during June 2019. The compliance system (core system) is likely to be operational by the end of
Purpose of the Compliance System

The purpose of the compliance system is to provide cost effective template data collection and LGPS Code compliance checking, it will include useful but limited reporting and data comparison facilities.

The system will be procured using a provision from within the Board budget and funded by the levy. LGPS clients and investment managers will be provided access to the system free of any further charge.

The procurement process included in its specification the potential for a further 2 phases of system development including:

Phase 2 detailed and customisable reporting and comparison tools plus facilities for LGPS asset pools to produce template data for clients and LGPS fund accounts to link with annual reports

Phase 3 the use of predictive algorithms to identify unexpected patterns of cost.

It is not the Board’s intention at this stage to procure additions to the system to provide potentially costly and specialist analytical, data manipulation and benchmarking services unless there is a demand from LGPS clients to do so.

It may be that centrally procuring such facilities would provide the most cost-effective solution. However, the Board recognises that it may not be the wish of all LGPS clients to have such a service procured centrally but rather procured individually or collectively in groups of funds or pools.

To facilitate either option, the system has been specified to industry standards, therefore whichever supplier is selected by the Board it will be possible for LGPS clients to appoint their own providers who will be able, with the necessary manager permissions, to extract their template data from the compliance system for further analysis, reporting and benchmarking without the need for an additional collection exercise.

Engagement with users

To assist with the effective implementation of the system, a steering group will be created consisting of representatives of system users, both from the LGPS client side, and Investment Manager side. Please contact the Board secretariat if you are interested in becoming a member of this group. Details of the group will be communicated once the Board is in a position to announce the appointment of the system supplier.

This group will also consider the potential for, and funding of, further development of the system including phases 2 and 3, and/or other developments specific to user types, for example facilities for pool companies and pension fund accountants.

To further the objectives of the Board in this area, additional resources to provide support to users in both the implementation and business as usual stages will be made available within existing budget provision.
Frequently asked questions about the Code

**As an LGPS client, what information will the Code templates provide?**
There are three main categories of investment cost: management fees, performance fees and transaction costs. Establishing a total cost of ownership requires that all of these are collected. Management fees may be invoiced or paid from the Net Asset Value NAV, similarly for performance fees. Transaction costs have typically been unreported and include both explicit (broker research costs, execution commissions and transaction taxes) and implicit (bid offer spread, exchange and clearing fees and entry and exit fees).

Differences between asset classes, mandates and fee structures make the task of collecting cost information across a pension fund difficult. Templates provide a consistent means for investment managers to report and LGPS clients to receive cost information.

**As an LGPS client, what should be done with this information?**
More transparent cost data can support pension committees in decision making. It demonstrates good governance, and when monitored and evaluated in the context of asset class, risk and return, ensures value for money.

The templates also assist pension fund accountants in meeting their reporting requirements, as collected in the same format, the aggregation of transaction costs across the pension fund investments are made easier. Investment managers reporting cost information via the templates also fulfil their obligations under MiFIDII.

**What is the benefit for LGPS funds and pool companies/organisations?**
Understanding cost of ownership is fundamental to good investment governance and better decision making. An important benefit of knowing cost of ownership is an improved negotiating position. This is best illustrated with a Case Study of the West Midlands Pension Fund.

“WMPF’s journey began around four years ago when its investment costs appeared to shoot up after adopting the Chartered Institute of Public Finance and Accountancy’s (CIPFA’s) updated accounting standard which required LGPS funds to report transaction and performance fees as well as invoiced fees.

Under the old standard, WMPF reported £11.2m in 2013/14. However, after putting in a significant amount of work to investigate and unearth fees beyond those invoiced its declared costs for 2013/14 ‘increased’ to £87.3m.

This was a challenging time for WMPF but it immediately took action and has each year since reduced those declared costs, to £58.9m in 2017/18.”

**What is the benefit for Investment Managers to sign up to the Code?**
Those Investment Managers who sign up to the Code will be listed on the Board website and be able to use the Code logo on their marketing literature. Code signatory status demonstrates their commitment to transparent reporting of costs.

Institutional investors outside of the LGPS are increasingly recognising the Code as a differentiator in requests for proposal; there is no similar equivalent Code in the UK or internationally.
What will it cost Investment Managers to sign up to the Code?
There is no cost to Investment Managers to sign up to the Code. Nor is there any cost to LGPS clients to benefit from it.

The work to get to the Code to its current stage and ongoing administration has already been accounted for in the draft budget of the SAB E&W².

Are the CTI templates available to use in advance or are LGPS clients and Investment Managers able to participate in the pilot?
The CTI (formerly IDWG) templates have not been officially released. They are available in draft from the [CTI webpage](#) together with contact details for the pilot.

Until the CTI templates are adopted by the SAB Code, the LGPS/IA template should be used.

Are managers of unlisted asset types able to sign up to the Code?
The current templates only apply in relation to listed asset classes. Templates for unlisted asset classes are under development (see CTI above). An Investment Manager may sign up on the understanding that within a period of 12 months (or such longer period as the Board may in its discretion agree) it will put in place the systems necessary to allow the completion and automatic (i.e. without the client having to make a request) submission of cost data substantially similar in scope and detail to that covered by existing templates. The exact format of that cost data is to be agreed with each Administering Authority that the Investment Manager is appointed by (whether at the time of signing up to the Code or in the future). Managers who sign up to the Code under this provision must adopt and make use of relevant Code templates as they become available.

Is the Code of Transparency intended for benchmarking?
It is not intended for benchmarking at this time. Cost comparisons and benchmarking are not the primary aim of the system. Users of the system may give their permission for third parties to compare their data with benchmarks outside of the system.

How does the Code work for LGPS investment pools?
LGPS pool companies are both Investment Managers and clients. The Code will enable pool companies to receive transparent cost information from their signatory underlying managers and also provide a framework for the pool companies to report transparently to their LGPS fund clients.

What happens if an Investment Manager doesn’t comply with the Code?
The Board may revoke use of the Code logo and publicly remove an Investment Manager from the list on its website at any time if an Investment Manager is reported by an Administering Authority to be in breach of the Code. The introduction of the compliance system will allow the SAB to monitor and engage with Investment Managers to ensure that the Code is followed.

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² SAB E&W Budget and work programme: The Board is required to submit a budget and work programme to the Secretary of State each year for approval. Once approved the budget for the Board is funded via a statutory levy on LGPS administering authorities which is classified as an administration expense and therefore can be recharged to the pension fund.
Frequently asked questions about the compliance system

Once the compliance system is in place, will LGPS clients still receive templates via email?
The Template(s) must be submitted automatically (i.e. without the client having to make a request) for each appropriate period to the compliance system. The Code requires managers to continue to also send templates to their LGPS clients. However such clients may choose to access their templates directly from the compliance system instead and not require the receipt of excel templates.

Will the information in the templates be publicly available?
No, the Code provides for template information to be submitted by the Investment Manager to the compliance system, with no access by third parties or sharing with third parties. The compliance system may also be used by the Board to analyse and publish aggregate, generic, non-attributable information obtained from the Templates at a scheme level (no Investment Managers or LGPS funds would be identifiable).

How does my pension fund or Investment Manager access the compliance system?
There will be further communication with stakeholders in due course, and the system will be set up with key contacts from each LGPS fund and Code signatory pre-populated.

What will the compliance system do once launched?
The solution the SAB is procuring will initially be a Core system to providing the following functionality:

Core system, access and security
- Secure access for permitted organisations and users (i.e. Investment Managers, LGPS funds
- Ability for users to grant access to trusted third parties (Subject to the necessary permissions being provided by both the LGPS clients and relevant Investment Managers)
- Provide for the online uploading of a number of data templates (in particular in MS Excel format) by Investment Managers in respect of LGPS clients

Validation/compliance
- Check the format of the data template and reject any incorrectly formatted data
- Ensure templates are verified as true and fair
- Load correct data into a secure ring-fenced database
- Log the date of receipt of templates against pre-set timescales
- Provide checking against separately provided MiFID II totals

Reporting and support
- Provide onscreen reporting to users in respect of due, incomplete and late submission of templates
- Provide a set of basic analytical and comparative reports for data clients to view onscreen and download in industry standard formats
- Provide support to users via both online help facilities and a helpdesk facility
When will the compliance system be launched?
It is likely to be operational by the end of 2019.

What might the compliance system do in future?
The solution the SAB is procuring has attached two development options; development option 2 would likely be completed within five years if a decision is made to move ahead.

**Development Option 2** is to provide a suite of extended custom reports for data clients to view and download. In addition, to provide the ability for users to create, run and save custom queries, the results of which should be viewable onscreen and downloadable in industry standard formats (i.e. csv, xls, pdf)

Development option 3 will be explored at a later date and may include funding considerations outside of scope of the initial contract and contract period.

**Development Option 3** is the introduction of predictive algorithms to the system. Such algorithms would seek to identify patterns or instances where data is outside of expected parameters and signal these to users. For example where a cost element or elements within a template uploaded for a client, although correctly formatted, fall significantly outside of the historical pattern of expectation for that mandate or the pattern of cost elements within similar mandates (asset type, mandate size, mandate performance) across other clients for that provider or across all providers.

There appear to be other systems out there. Why should we use the system procured by the Board?
Compliance with the Code requires that Investment Managers submit template information to the system procured by the Board. This does not apply to other systems. However, the information may be exported or used by third parties at the discretion of LGPS clients, provided the necessary permissions have been granted.

What will it cost administering authorities to use the compliance system?
The cost of bringing the compliance system to the core system stage has already been accounted for in the draft budget of the SAB E&W, with proportionate potential contributions from the Scotland and Northern Ireland LGPS Scheme Advisory Boards.

Will the supplier of the compliance system be able to sell LGPS information or services based on that information?
No, the information on the compliance system database will not be sold to third parties or used for any other purpose.