London Borough of Enfield

Report Title	Investment Management Fees 2023-24
Report to	Pension Policy & Investment Committee
Date of Meeting	31 July 2024
Cabinet Member	Cllr Tim Leaver
Executive Director / Director	Fay Hammond
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Classification	Part 1 and Part 2 Private
Reason for exemption	By virtue of paragraph(s) marked below with * of Part 1 of Schedule 12A of the Local Government Act 1972: 3 Information relating to the financial or business affairs of any particular person (including the authority holding that information).

Purpose of Report

1 This report provides an overview of the investment management expenses paid by the Enfield pension fund during the financial year 2023/24 and compares them with the previous year.

Recommendations

I. PPIC is recommended to note the contents of the report.

Background

1 The Enfield Pension Fund (the “Fund”) is a local government pension scheme (LGPS) that provides retirement benefits for its members, who are employees of the London Borough of Enfield and other admitted employers.

2 The Fund is administered by the London Borough of Enfield (the administering authority), which is responsible for setting the investment strategy, appointing the investment managers, and monitoring the performance and risks of the Fund.

3 The London Borough of Enfield has delegated the key decision making and management of the Fund to the Pension Policy and Investment Committee (PPIC) supported by officers of the Council and advisers to the Pension Fund.

4 The primary objective of the pension fund is to provide benefits to the members, now and in the future, in accordance with the scheme rules and to meet the statutory funding requirements. In order to do this, the pension fund has significant assets, built up from member and employer contributions. These assets are invested in order to generate a return to keep pace with inflation and ensure that there are sufficient funds to meet current and future liabilities. The assets are invested by external fund managers who have the relevant expertise to manage investments.

5 It is good practice for the PPIC to be updated on investment management expenses to ensure effective governance and oversight of pension fund investments. It is crucial for the PPIC to have a clear understanding of all costs associated with managing the fund's investments, including management fees, transaction costs, and performance fees. This transparency enables PPIC to provide effective governance about the fund's investment strategy and to assess the value for money of the investment management services provided. PPIC also requested in late 2023 information on what fees were paid to investment managers.

6 Small savings on management fees can add up to large savings over time due to the power of compounding. Even a small reduction in fees can have a significant impact on the growth of an investment over a long period. This is because every pound saved on fees is a pound that remains invested and has the potential to earn returns year after year. Over time, this can lead to a substantial difference in the value of an investment portfolio. While investment returns can fluctuate and are not guaranteed, management fees are typically charged regardless of performance. This means that fees will consistently erode the value of an investment over time. Therefore, minimising fees is an important part maximising long-term investment return.

7 PPIC should note that while minimising fees is important, it should not be the sole focus. The overall value provided by the investment, including returns, risk management, and other services, should also be considered. Balancing cost with value is key to effective investment management.

8 The fund follows the CIPFA guidance on accounting for management expenses in the LGPS. The guidance defines management expenses as the costs incurred by the fund in relation to the administration, oversight and governance, and investment management of the scheme.

9 **Administrative costs** are the costs of running the pension scheme, such as paying benefits, collecting contributions, maintaining records, and providing information and advice to members and employers.

10 **Oversight and governance costs** are the costs of ensuring the proper management and accountability of the fund, such as the costs of the local pension board & PPIC, the internal and external audit, the actuarial and legal services, and the training and development of the staff and board members.

11 **Investment management costs** are the costs of managing the fund's assets, such as the fees paid to external investment managers, the costs of the internal investment team, the custody and transaction costs, and the costs of the investment consultants and advisers.

12 This report focuses on the investment management costs of the fund, which are the most significant and variable component of the management expenses.

13 Within the CIPFA guidance, investment management expenses are categorised into three types: Management, Transaction, and Performance Fees. These categories are further explained within the analysis of the Funds costs in paragraphs 20 to 37 below.

14 The CIPFA guidance requires the Fund to report the full cost of investment management expenses, this means including any fees and charges that are deducted directly from the net asset value (NAV) of an investment as well as any fees invoiced directly to the Fund. In order, to compile the information, the Fund relies on investment managers providing the data on a standardised template created as part of a joint arrangement between the LGPS Scheme Advisory Board (SAB), the Pensions and Lifetime Savings Association (PLSA) and the Investment Association (IA).

15 As each manager within the Fund operates a different reporting timetable, the Fund has not received returns for all mangers in relation to the 2023/24 financial year (ending 31 March 2024). Where a return has not yet been provided, cost has been estimated by either using data from the most recently reported quarter (Dec 23) or using the template provided from the prior year updating for changes in assets under management (AUM).

Total Investment Management Expenses for 2023/24

16 Details of investment expenses, listed by investment manager, are shown in Appendix A. Total investment management expenses for 2023/24 were £7.2m, representing 0.46% of the Fund’s total nets assets as at 31 March 2024.

17 This was a decrease of £1.8m or 0.17% from the previous year, when the investment management expenses were £9.0m (0.63% of the Fund's net assets as at 31 March 2023).

18 This total reduction in fees was primarily driven by the Fund's divestment from the Davidson Kempner and Stratus Feeder Hedge fund investments in the final quarter of 2022/23. Although some of these proceeds were reinvested across the portfolio, The bulk of it has been earmarked to cover commitments made to Infrastructure investments which have yet to be called. Whilst these proceeds are held in cash, investments management expenses are lower.

19 When the impact of the hedge fund divestment is excluded, fees for most managers has increased compared to last year – this was to be expected as the value of the underlying investments increased.

Management Fees

20 In the context of the LGPS, management fees refer to the charges levied by investment managers for the administration and active management of the fund's assets. These fees are typically calculated as a percentage of the assets under management and cover the costs associated with making investment decisions, executing trades, and providing regular reports on fund performance.

21 This means the fees in this category cover not just the fee paid to the investment manager but also any associated cost of running the investment. Charges are therefore likely to differ based on the complexity or nature of the investment product. For example, a passive equity mandate is likely to be cheaper than an active mandate as you do not need to pay for active investment decisions. A pooled property fund is likely to have higher management costs than a pooled bond fund as the cost of running and maintaining a portfolio of properties is greater than that of a portfolio of bonds.

22 During 2023/24 total management fees decreased by £1.5m, a significant proportion of this is explained by the aforementioned divestments (see para 18). If we exclude the impact of divested assets management fees have still fallen but by a more modest £0.2m. The reasons for this are analysed by individual manager and asset class in the following paragraphs.

23 Total fees for equity mandates have stayed relatively flat compared to last year, although there was a notable increase in management fees paid on the LCIV (Baillie Gifford) mandate and a reduction on the MFS mandate. This is in line with expectations as during 2022/23 the equity allocations were rearranged, and the Fund invested in the LCIV (Baillie Gifford) mandate and reduced holdings in MFS and the LCIV (Global Alpha) mandates. Now that these changes have been in place for a full period the net reduction in fees is reflected in the data.

24 Similarly, total management fees across the fixed income mandates have maintained a similar level to last year. This contrary to expectations as, all

else being equal, it would be expected that fees increase as AUM increases. The main reason this did not occur was due to the investment with Insight novating into a cheaper share class.

25 Private equity and infrastructure have seen a reduction in management fees compared to last year of £0.3m. Some of this reduction is attributable to movements in foreign exchange rates. The Adams Street and Antin investments are in USD and EUR respectively. As the Pound strengthened against these currencies during 2023/24, fees paid in USD and EUR have been booked at a lower price in Sterling. PPIC should also note that as private market investments report on a quarterly lag we are yet to receive the full fee templates from Adams Street. Currently direct costs have been included but there may be some additional indirect costs to add on when the final returns are confirmed.

26 In contrast to the other asset classes property funds have seen an increase in total management fees during 2023/24. This was driven by an increase in indirect costs in the LGIM mandate.

Transaction Fees

27 Transaction fees within the context of the LGPS and investment management fees are costs associated with the buying and selling of securities within the fund. These fees are important to consider as they can impact the overall return on investment for the fund. There are two types of transaction costs: Explicit costs and Implicit Costs.

28 Explicit costs are the direct costs paid by the fund and include brokerage fees, stamp duty, and other costs directly associated with the transaction.

29 Implicit costs are a type of transaction cost that are not directly observable and can be difficult to quantify. They are costs that are embedded in the bid-offer spread and can include the market's response to a trade, such as market impact, opportunity cost, and delay costs.

30 Total transaction fees fell from £1.2m in 2022/23 to £0.9m in 2023/24. When adjusted for divested assets the reduction in fees from year to year is £0.1m. Although Transaction fees have remained relatively stable there are some noticeable movements in individual mandates.

31 The BlackRock fixed income mandate saw a significant fall in transaction fees this was attributable to a sharp reduction in indirect transaction fees. There was an increase in the transaction fees for the LCIV (PIMCO) fixed income mandate this was caused by the anti-dilution levy paid when the Fund increased its investment in this product.

32 An anti-dilution levy is a charge that investment funds may apply to protect existing investors from the costs associated with investor activity. When investors enter or exit a fund, the transactions can incur costs that affect the fund's value, potentially diluting the value for existing investors. To prevent this, a fund may charge an anti-dilution levy to offset the impact of these transaction costs.

33 Within the two inflation protection mandates transaction fees increased for the M&G investment and reduced for the CBRE fund. The increase for M&G was driven by the fact that the 2022/23 fees included a anti-dilution offset which brought down total transaction fees – this was not replicated in 2023/24. CBRE fees increased following increases in indirect transaction costs.

Performance Fees

34 Performance fees are fees paid to investment managers based on the performance of the investments they manage. These fees are designed to incentivise the manager to achieve returns that exceed a predefined benchmark or target.

35 There was a reduction in total performance fees from 2022/23 to 2023/24 of £11k. However, if we exclude divested assets, there was a significant increase of £1.3m compared to last year.

36 The Enfield fund currently pays performance fees, in the form of carried interest, to three managers: Adams Street, Antin and Brockton. Carried interest is a share of any profits that the general partners of private market funds receive as compensation, regardless of whether they contributed any initial funds. This form of interest is typically a percentage of the fund's profits and is paid only once a certain return level is achieved. Because it is based on the overall profit of the fund the amount charged will vary year to year until crystallised, meaning can be a negative accrual in any given period.

37 During the previous year (2022/23) returns for Adams Street, Antin and Brockton were negative as a result the accrual for carried interest in each fund was also negative (total of -£1.2m). During 2023/24 performance for Antin and Adams Street and has been positive and the previous negative accruals have been reversed. In the Brockton mandate there was a further negative accrual for 2023/24.

Savings from Pooling

38 The Enfield Pension Fund joined the London Collective Investment Vehicle (LCIV) in 2015. The LCIV was established as a collaborative vehicle to enable the London Local Authorities to achieve their pooling requirements. Membership of the LCIV allows the Fund take advantage of economies of scale, reduce costs, and improve investment returns. Pooling assets with other London boroughs allows for greater bargaining power and access to a wider range of investment opportunities. LCIV also provide governance and monitoring capacity of partner fund investments. Additionally, the LCIV's commitment to responsible investment and stewardship aligns with the values and goals of the Enfield Pension Fund.

39 Actual savings from pooling can be hard to quantify for a variety of reasons. However, in order to demonstrate typical savings, the LCIV does provide analysis of the savings compared to the industry average fees. This analysis is shown in the table below:

Savings from Pooling		Annual Saving £000s	Annual Saving as % of AUM
LCIV (Longview)	Equities	293	0.22
LCIV (Baillie Gifford)	Equities (Passive)	153	0.13
LCIV (JP Morgan)	Equities	59	0.19
LCIV (PIMCO)	Fixed Income	157	0.19
LCIV (CQS & PIMCO)	Fixed Income	64	0.11

40 The table demonstrates that significant savings are likely to have been made by the Fund from investing as part of LCIV.

Summary

41 Although the Enfield Pension Fund has seen significant reduction in total fees during 2023/24 this was largely driven by divestment from hedge funds and the resulting capital being deployed in cash funds. The Fund's investment strategy is for these funds to eventually be allocated to infrastructure investments, as this happens over the next couple of years it is likely to put upward pressure on fees. At the same time as more of the Fund's assets come under the management of the LCIV investment pool this should exert downward pressure on fees.

Financial Implications

42 It's important to look at management fees in the context of investments as a whole, including return and risk. Management fees are just one part of the total cost of investment, but they are recurring expenses that can erode the gross returns over time. Therefore, it's crucial to consider them alongside the investment's return and risk profile to assess whether the investment is achieving its financial objectives efficiently. For instance, a high management fee might be justified if the investment is delivering superior returns above its benchmark after all costs. However, if the returns are not commensurate with the fees or the investment is taking on excessive risk, it may not be a prudent choice.

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Appendices

Appendix A – Investment Management Fees 2022-23 and 2023-24 – PART 2 – Private & Confidential