

# Shadow Advisory Board

## **Agenda item 3c - Performance measurement and benchmarking assessment** **(Key Performance Indicators)**

### **Summary**

The Board are asked to agree the work completed by the Annual Report Working Group on the proposals for the performance measurement and benchmarking assessment. These proposals, once agreed, will allow the Board to progress in its proactive role of encouraging best practice and raising standards within the LGPS.

### **Context**

Over the last 9 months the Secretariat has convened a Scheme Report Working Group to develop proposals for measuring, benchmarking and assessing the relative health of individual LGPS pension funds.

The Working Group recommends the LGPS and individual fund performance should be assessed using the following 5 key general themes:

1. Fund governance, management, administration, accountability and transparency
2. Funding level, contributions, deficit reduction, and ability to meet pension liabilities
3. Asset management, stewardship, and investment returns
4. Pension benefits, member service, and communications
5. Independent external review and assurance.

The Working Group also reached a consensus that maintaining and improving the overall performance of the LGPS is best done by focusing on a small number of key financial and governance metrics of problematic “under-performing” funds and concurrently seeking to raise the level of performance of “average” funds to that of the “highest performing” funds.

The Working Group reached the view that the SAB should adopt around 4-5 primary (“alarm bell or trip wire”) indicators to identify and determine under-performing “problem” funds plus a number (18-20) secondary (“health”) indicators that characterised high performing funds that could be applied to the “problem” funds to see where problems lie and improvements could be made.

The Working Group also reached the view the SAB should not seek to develop an LGPS fund league table or multi-tier categorisation system to rank or group LGPS funds relative performance, because such rankings might be mis-interpreted by scheme members and other parties. In publishing the scheme annual report, the SAB will need to be mindful of this as the main source of information for assessing the KPIs will be the individual fund annual report and accounts.

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However, after the finalisation of the primary and secondary indicators, it should, begin to assess the funds against the indicators and also encourage funds to self-assess their relative performance.

## Primary and secondary key performance indicators

The Working Group has developed and agreed the following:

1. 4 primary indicators (KPIs in bold) and 14 secondary indicators (see Table 1 overleaf and Annex 1 for detailed listing and definitions),
2. Some examples of “levels for concern” plus “examples of good practice for high performing funds” and explanatory notes for the more complex KPIs (2, 3, 4, and 10) (see Annex 1).

<b>Table 1 - Performance theme</b>	<b>KPI number and name</b>
Fund governance, management, administration, transparency, and accountability	<b>1) Risk management</b> (covering all pension fund activities)
	5) Pensions Committee and Pensions Board members competence
	6) Administering authority staff leadership, experience, and training
	7) Statutory governance standards and principles (as per DCLG guidance and TPR codes)
	8) Quality and accessibility of information and statutory statements/strategies/policies (governance, FSS, SIP, comms, admin authority and employer discretions policies)
Funding level, contributions, deficit reduction and ability to meet pension liabilities	<b>2) Funding level and contributions</b>
	<b>3) Deficit recovery</b>
Asset management, stewardship, and investment returns	<b>4) Required investment returns</b>
	9) Compliance with LGPS Myners principles and signatory to UK Stewardship Code and UNPRI
	10) Historic investment returns (last 3, 5, 10 years) and total investment costs compared to other LGPS funds.
	11) Annual report(s) and audited financial statements
Pension benefits, member services, and communications	12) Scheme membership data
	13) Pension queries, pension payments, and

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	Annual Benefit Statements
	14) Cost efficient administration and overall VFM fund management
	15) Handling of formal complaints and IDRPCs
Independent external review and assurance	16) Fraud prevention
	17) Internal and external audit
	18) Quality assurance

The key purpose of the 4 primary KPIs is to help the SAB identify individual funds that trigger the 4 “alarm bell warning” indicators. Such funds might then be subject to further investigation and scrutiny by the SAB using the other 14 secondary “health” indicators within the same or other related or relevant performance assessment themes as required.

The SAB and/or LGPS actuarial-investment analytical service providers could generate “scatter-grams” for each KPIs (calculated on a consistent “like for like” basis) showing each LGPS fund and the dispersion of all LGPS funds to highlight the problem “outliers”.

Following such a review process it might be appropriate for an “outliers” and/or “under-performing” fund to be either:

1. supported with technical advice and help from adjacent/higher performing LGPS funds or external advisors/consultants; and or
2. if needed be placed under ‘special measures’ and subject to formal intervention and remedial actions by for example the Advisory Board or TPR or DCLG.

The 18 KPIs could also be used by the SAB (and or by individual LGPS funds) to develop balanced “score-cards” to undertake an assessment of a fund’s current level of performance (and thus sustainability) against the level for high performing funds.

They may also be useful for Local Pension Boards to assess the performance of their own fund, and they might be included as an Annex to Board Governance guidance for Pension Boards to monitor the relative performance of the LGPS pension fund Administering Authorities.

**Board secretariat**  
**24<sup>th</sup> November 2014**

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## Annex 1 – the 4 primary indicators and 14 secondary indicators in detail

### Primary indicators

<b>Performance theme</b>	<b>KPI number and name</b>	<b>Examples of level for concern</b>	<b>Examples of good practice for high performing fund</b>
Fund governance, management, administration, transparency, and accountability	1) Risk management	<p>No or only a partial and or an unclear risk register with no or poorly specified or un-implemented mitigation actions over time leading to increased fund risk.</p> <p>Risk register not signed off by Pensions Committee or annually updated or unavailable for public scrutiny.</p>	<p>Comprehensive risk register covering the key risks (in accordance with current CIPFA guidelines) with robust mitigation actions, timelines, and action tracking to completion.</p> <p>Risk register and completed actions signed off by Pensions Committee after at least annual update and disclosed via a summary version published on fund website.</p>
Funding level, deficit reduction and ability to meet pension liabilities	2) Funding level and contributions (see explanatory note)	<p>Decreasing funding level (calculated on a standardised and consistent basis) and/or in bottom decile of LGPS, over the last three triennial valuations.</p> <p>Weak funding covenants with larger employers or a large number of smaller employers.</p> <p>Declining contributions and actual contributions received in last 6 years less than that assumed and certified in last 2 triennial valuations.</p> <p>Net inward cash</p>	<p>Funding level rising and getting closer to 100% funded (or above) over last three triennial valuations.</p> <p>Strong funding covenants with all employers.</p> <p>Rising contributions or actual contributions received in last 6 years equate to (or exceed) that assumed and certified in the last 2 triennial valuations.</p> <p>Net inward cash flow</p>

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		flow less than benefit outgoings so need to sell assets.	significantly exceeds benefit outgoings.
	3) Deficit recovery  (see explanatory note)	No or weak/unrealistic deficit recovery plan.  Lengthening implied deficit recovery period (for contributions) than majority of other funds.  Implied deficit recovery periods >25 years for last 3 valuations.	Well-articulated deficit recovery plan for tax raising and non-tax raising bodies.  Implied deficit recovery reducing each triennial valuation.  Implied deficit recovery period in line with TPR best practice for DB schemes (<10 years) or top decile of LGPS
Asset management, stewardship, and investment returns	4) Investment returns  (see explanatory note)	Required future investment return (calculated on standardised and prudently consistent basis) not aligned to the investment strategy target return, so lower likelihood of the fund achieving its funding strategy.	Required future fund investment return consistent with and aligned to investment strategy (asset mix expected target returns) so higher likelihood of the fund meeting its funding strategy.

## Secondary indicators

<b>Performance theme and number of KPIs</b>	<b>KPI number and name</b>	<b>Examples of level for concern</b>	<b>Examples of good practice for high performing funds</b>
Fund governance, management, administration, transparency, and accountability	5) Pensions Committee and Pensions Board members competence	No large employers or member representation.  No training needs analysis, or training strategy, or training log or use of CIPFA LGPS training framework.	Both large employer and different member type representation.  Regular and completed training recorded against the CIPFA knowledge and understanding framework. CIPFA training disclosure in

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		Appointees unable to clearly articulate the funds funding and investment objectives.	Annual Report. Appointees able to clearly explain the funds objectives.
	6) Administering authority staff leadership, experience, and training	No or only part time Head of Fund and or only part time officers with no or little induction or on-going training or experience on the CIPFA LGPS knowledge and understanding framework.	Experienced Head of Fund with full time dedicated officers with at least 3+ years' experience and regular CIPFA and other CPD training recorded across all LGPS skills and topics.
	7) Statutory governance standards and principles (as per DCLG guidance and TPR codes)	Several key areas of non-compliance and reasons why not explained. Poor key decision taking recording and no or poor self-assessment of effectiveness.	100% compliant and meet or exceed guidance/codes on best practice including key decision taking recording and self-assessment of effectiveness.
	8) Quality and accessibility of information and statutory statements, strategies, policies (governance, FSS, SIP, comms, admin authority and employer discretions policies)	Publications poorly articulated and some not in place nor published on fund website nor updated in accordance with regulatory requirements and due timelines.	Publications well articulated and all in place and published on fund website and updated in accordance with regulatory requirements and due timelines and meet Plain English and other e-publishing standards.
Asset management, stewardship, and investment performance	9) Compliance with LGPS Myners principles and signatory to UK Stewardship Code and UNPRI	Several areas of unexplained non-compliance and/or non-support of UK and or UN codes.	100% compliance and signatory status.
	10) Historic investment returns	Investment returns in LGPS bottom	Investment returns top quartile for last 5 and 10

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	(last 3, 5, 10 years) and total investment costs compared to other LGPS funds.  (See explanatory note)	quartile and investment costs in top LGPS quartile for last 3 to 5 years.  Retention of fund managers underperforming their stated investment mandates for 2 triennial valuation cycles.  Fund manager sackings within 3 years of appointment.	years.  Fund managers deliver or exceed their mandates over rolling 3 to 5 year performance periods.  Infrequent fund manager changes.
	11) Annual report(s) and audited financial statements	Do not fully meet some regulatory requirements or CIPFA LGPS guidance or not issued by due date.	Meet and or exceed all regulatory and CIPFA best practice guidance and published on Advisory Board website by 1 September.
Pension benefits, member services, and comms	12) Scheme membership data	Some common and conditional data do not meet the TPR standards, guidelines, or due timelines. No plans in place to rectify this.	All common and conditional data meet the TPR standards, guidelines, due timelines.
	13) Pension queries, pension payments, and Annual Benefit Statements	No or poor website with no scheme member or employer access.  ABS do not meet regulatory requirements or due timelines for issuance.	Good website with interactive scheme member and employer access.  ABS meet or exceed regulatory standards and due timelines for issuance.
	14) Cost efficient administration and overall VFM fund management	In bottom quartile with high total admin cost pa per member (based CIPFA or other benchmark tool).	In top quartile with low total admin cost pa per fund member (based CIPFA or other benchmark tool calculated on a

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		Not in any national or regional frameworks for any externally procured services or collective investments.	consistent and transparent basis).  Lead and/or actively participates in joint and collective LGPS procurement mechanisms.
	15) Handling of formal complaints and IDRPCs	Pensions Ombudsman determinations (and any appeals) find against the actions of the fund.	No Stage 2 IDRPCs or no Pensions Ombudsman determinations against the funds actions in last 3 years.
Independent external review and assurance	16) Fraud prevention	No or minimal systems/programme or mechanisms in place to detect fraud	Fraud prevention programme in place. Use external monthly, quarterly/annual mortality screening services, and participate in bi-annual National Fraud Initiative.
	17) Internal and external audit	No annual internal audit or qualified internal and external audit opinions with urgent management action recommended on high/serious risks.	Unqualified annual internal and annual external audit opinions with no management recommendations.  Full assurance against all key audit areas.
	18) Quality assurance	No externally assured systems or processes or peer recognition awards.	Has ISO/BSI quality management certification and/or Crystal Mark for plain English and or externally approved website accessibility, and/or peer or pensions & investment industry recognition award(s)

Indicator number and name	Draft explanatory notes
2) Funding level and contributions	Funding level calculated at last triennial valuation (on consistent HMT SCAPE financial assumptions) compared to the actual proportion of the fund's deficit (calculated on the above consistent HMT assumptions) being paid off annually.

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	<p>Actual contributions paid (sourced from annual accounts) as compared and expected total contributions (sourced from last 2 triennial valuations)</p> <p>Net inward cashflows (excluding investment income) as a proportion % pa of fund assets. Use to monitor if negative cash flow is close to or above say 3% of total assets. Above this should be sufficient income from assets to supplement contributions to meet benefit payments without having to sell assets.</p>
3) Implied deficit recovery period	<p>Implied deficit recovery period (derived using figures under indicator 2) reducing each triennial valuation. This metric is not the deficit spreading period used to set contributions. It is the estimated number of years required to repay each fund's deficit assuming a) current levels of contributions continue and b) the liabilities targeted for full funding are measured on like for like HMT assumptions (not each funds valuation assumptions).</p> <p>Also the contributions assumed in the calculation (and other metrics like required future investment return) should be the actual total contribution income expected into a fund based on actual payroll information from each employer at the valuation date and the rates of contribution certified at the valuation.</p> <p>The estimate of aggregate contributions for a fund is not the same as the "common rate" in the valuation report.</p>
4) Investment returns compared to the funds required future investment return	<p>The fund's required future investment return (calculated as the return needed to repay its deficit over a specified standard period (say 20 years) using common financial assumptions (HMT SCAPE) for the value of the fund liabilities to be met over that period and assuming the rates of contributions certified at the last valuation). All returns post 1 April 2014 must be quoted net of fees.</p> <p>The required future investment return should also be compared with the estimated future return being targeted by a fund's investment strategy calculated on a consistent agreed basis.</p>
10) Investment returns and costs compared to other LGPS funds	<p>Historic investment returns (over 1, 3 and 5 year and 10 years and longer period) as compared with other LGPS funds from external service provider. Going forward all figures post 1 April 2014 to be net of fees and preferably all investment returns on an agreed and consistent risk adjusted basis.</p> <p>Care will be needed to compare the absolute level of returns between funds because each fund has different asset allocations. So the external provider should use a metric that takes account of performance and or risk or sub-divide funds into high, medium, low growth asset allocation and make comparisons within these categories (not across categories).</p>

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	<p>Total investment costs should be as per the financial accounts as % of total assets under management. This may need a specialist external service input to do analysis and reporting on a consistent and transparent basis and to enable benchmarking</p>
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