OXFORDSHIRE LOCAL PENSION BOARD – 8 JULY 2022

INVESTMENT MANAGEMENT COSTS AND PERFORMANCE

Report by the Director Finance

Recommendation

1. **The Board are invited to discuss the contents of this report and consider what advice, if any, to send to the Pension Fund Committee.**

Introduction

2. This is the fifth in a series of reports considered by this Board in respect of the costs and performance of the investment management portfolios run on behalf of the Pension Fund Committee. The previous reports looked at annual performance in the years ending March 2018, 2019 and 2020 respectively, with the final report looking at three-year performance to 31 March 2021.

3. The previous reports have highlighted a number of complexities when considering investment management fees. These include:

    - The majority of fees paid are on a fixed rate basis and vary in line with overall asset values rather than performance. In any one year therefore comparison of fees paid to performance against benchmark will be impacted by the position in the investment cycle with results likely to imply different conclusions for value and growth managers for example.
    - Looking simply at fees and investment performance is too narrow a view of the overall performance of fund managers and fails to take into account the wider objectives of the Committee's investment strategy. In particular, there is a requirement to ensure the overall investment strategy provides for a sufficiently diversified set of investments to mitigate risk.
    - In recent years there is also much greater attention paid to the management of the environmental, social and governance risks within the investment portfolios which may not necessarily be reflected in short-term investment performance. Indeed, many of those companies best placed to manage the transition to a low carbon economy may suffer poorer investment performance in the short term as they fund the transition.
    - In many asset classes, particularly within the private markets, there is no alternative to paying the market fee rate if you want to remain invested in the asset class i.e. there is not a passive alternative where for a lower fee you can achieve the average return of the asset class without the additional risk of paying active fees
    - The transition to Brunel as part of the Government's pooling agenda has destroyed all long term trends in the fee and investment performance data.

- In recent years, there has been a much greater level of transparency in the reporting of all investment fees. The increase in fee levels in recent years can be in part simply be explained by this greater transparency, with fees paid to under-lying fund managers now explicitly included in reported fee levels with a corresponding increase in the new performance of the portfolio.

4. Despite the number of concerns around the complexity of assessing investment manager fees though, it is important to undertake a regular review of the level of fees paid to ensure the Fund is obtaining value for money in respect of the fees paid to their active investment managers.

Current Data

5. The total management fees paid in 2021/22 amounted to £13.7m including the fees payable to Brunel to cover the operating costs of the company. This equates to 44bps when taken as a percentage of a simple average of the assets invested over the course of 2021/22. The equivalent figures for the previous financial year were £10.1m and 38bps. Further details are included in the annex to this report.

6. Over the course of 2021/22, the investments returned 10.3% of the value of the assets, which was 0.4% below the benchmark return. Over the longer periods of 3, 5 and 10 years the Fund performed better than its benchmark by 0.2%, 0.5% and 0.2% per annum respectively.

7. It is difficult to draw any conclusions from the investment management figures for 2021/22 due to the significant movements in the asset allocation across the last two years.

8. Even analysis of the investment fees paid to Brunel in respect of the equity funds is complex. 55% of the total Fund is currently invested in equities, although total fees payable in respect of the equity portfolios only amount to 34% of the total fees paid. The level of fees paid varies across the equity portfolios with the lowest fees paid to the passive fund manager, and higher fees paid to the Fund Managers in the Sustainable Equity and Emerging Market portfolios. The movement into the Sustainable Equity portfolio and the switch of the passive allocations to the Paris Aligned Portfolio will both have led to small increases in the total fees paid. It is too early to make any meaning analysis of whether these increased fees have been more than offset by improved long term performance, although it is clear that the new allocations are better aligned to the Funds Investment Strategy Statement and in particular the climate policy.

9. A significant element of the increase in total fees paid reflects the continued re-allocation of assets to the private markets. This impacts on total fees paid in three ways.

    - Firstly, the level of fees paid in the private markets is considerably higher than those paid in the listed markets. Fees for private equity for example are in the region of 4 times those paid to the listed equity Fund Managers, with total fees in excess of 1% of the Funds invested, compared to 27bps for a listed portfolio. It should be noted though that private equity remains the highest performing asset class within the Oxfordshire Fund with both Brunel and the legacy private equity managers returning performance significantly above the fees paid with both 5 and 10 year performance in excess of 10% a year.

- The majority of the private market portfolios include an element of performance related fees. In periods therefore of good performance, the total fees payable to the managers increases. The increase in property fees in 2021/22 includes a substantial performance element paid to Partners in respect of their Real Estate portfolio.
- The majority of fee arrangements in the private markets involve the payment of a fee based on money committed to a portfolio rather than the actual money invested. In the early years of a private market portfolio therefore fees when expressed as a percentage of money invested are inflated. This is most notable on the private debt portfolio where very little money was called by 31 March 2022. Indeed the Fund is paying fees both in respect of the commitment made to the private market portfolio and to the Fund Manager who is holding the investments until the commitments are actually called. In the long term, as the actual investments in the private market portfolios increases towards the committed level, we should see a reduction in both the fees expressed as bps for the individual portfolios and for the Fund as a whole.

Lorna Baxter
Director of Finance

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Contact Officer: Sean Collins, Service Manager (Pensions)
Email: sean.collins@oxfordshire.gov.uk
Telephone Number: 07554 103465

Annex 1

Asset Class	Fees Paid 2020/21 £000	Fees Paid 2021/22 £000	Average Investment 2020/21 £m	Average Investment 2021/22 £m	Average Fees 2020/21 bps	Average Fees 2021/22 bps
Equity	3,366	4,624	1,495	1,712	23	27
Fixed Income	1,273	628	497	477	26	13
Diversified Growth Fund	597	650	147	159	41	41
Private Equity	2,862	3,134	217	305	132	103
Property	1,228	2,226	164	186	75	120
Infrastructure	718	1,261	27	48	266	263
Multi-Asset Credit	0	543	0	70	n/a	78
Secured Income	41	355	34	78	12	46
Private Debt	0	276	0	6	n/a	460
Cash	n/a	n/a	72	71	n/a	n/a
Total	10,085	13,697	2,653	3,112	38	44