The Division(s): n/a

ITEM

PENSION FUND COMMITTEE – 10 OCTOBER 2022

REPORT OF THE PENSION BOARD

Report by the Independent Chairman of the Pension Board

RECOMMENDATION

1. **The Committee is RECOMMENDED to**
   a) **note the comments of the Board as set out below,**
   b) **advise whether they wish to see any further analysis of investment fees since the introduction of pooling, and**
   c) **note the suggested changes to the risk register which have been incorporated into the risk register report elsewhere on their agenda.**

Introduction

2. This report is part of the process by which the Local Pension Board works with the Committee in fulfilling its duty to support the work of the Committee and ensure that the Committee delivers its responsibilities in line with the regulatory framework. The report covers the key issues discussed by the Board and any matters that the Board wishes to draw to the attention of the Committee.

3. This report reflects the discussions of the Board members at their meeting on 8 July 2022. The virtual meeting was attended by Matthew Trebilcock as the independent Chairman, four of the voting members of the Board and Cllr Bob Johnston. Apologies were received from Sarah Pritchard and Elizabeth Griffiths.

Matters Discussed and those the Board wished to bring to the Committee's Attention

4. The Board considered the Annual report of their own work, three of the standard reports which had been presented to the June meeting of this Committee, the Valuation report and the confidential report on AVC provision also presented to the June Committee meeting, and a new report on investment management fees.

5. The Board's Annual Report in included in the Annual Report and Account for the Pension Fund which is elsewhere on today's agenda. The Board did not identify any element of their report that they wanted to bring to the attention of the Pension Fund Committee. Nor did they offer any comments on the report reviewing performance against the annual business plan.

6. In discussing both the report on the risk register and the administration report, the Board focussed on cyber security. The Board raised concerns that there is currently no single over-arching policy document in respect of cyber security for the Fund. They also felt that the current cyber risks in respect of both risks 16 and 17 on the risk register were understated. The issues set out in the Administration Report which suggested a lack of clear policy in respect of a data breach of Fund data by a third party was seen as evidence that the current risks were not fully mitigated.

7. The Board therefore recommended the Committee to review the risk scores for both risks 16 and 17 and to introduce an over-arching policy document in respect of cyber security. Both these issues are covered elsewhere on today's agenda.

8. The Board noted both the Valuation Report and the confidential report on AVC Provision and offered no further comments to the Committee.

9. The final report considered by the Board was their annual report on Investment Management Fees. A copy of the report is included as Appendix 1. The Board noted that overall fees paid in 2021/22 had risen to £13.7m from £10.1m in the previous financial year, with a corresponding increase in the average fee level from 38bps to 44bps.

10. The Board accepted the difficulties on drawing any conclusions from the increase in fees, and noted fees had risen as a result both of the overall increase in assets under management and the relative increase in the allocation to the more expensive private markets. They did though feel that more meaningful analysis could be produced by simply focussing on the listed equity figures and asked for more work to be presented to this Committee.

11. The additional analysis requested has been included as Appendix 2 to this report. Unfortunately, even with limiting the analysis to equities there are a number of complexities which make drawing firm conclusions difficult.

12. The total fees paid on equity portfolios immediately before the first transition to Brunel were £3.6m which was 24.4bps on the assets under management. At the end of March 2022 when all equity portfolios were under the management of Brunel, total fees had grown to £3.9m, although the average fee level had reduced to 22.6bps.

13. The analysis completed within Appendix 2 suggests three reasons for the movement in fees being an increase in assets under management, a reduction in fee levels negotiated by Brunel plus an increase in fees as a result of changes in the passive equity specification, with the Paris Aligned portfolio more expensive than the previous market cap portfolios. Even in the analysis of the passive fees though, no account has been taken of the change in performance associated with the legacy portfolios and the current portfolios resulting from the switch from separate UK and developed world portfolios to a single global portfolio, where the allocation to the UK market will be lower than that previously seen.

14. The comparisons for the active market portfolios are also weakened by the changes made to the portfolio specifications. In the analysis of the UK equity portfolios there is no allowance for the change in out-performance target, which would allow for greater analysis of whether the fees now paid provide better value for money than the legacy arrangements. For the global equity markets, specifications have changed in terms of out-performance targets, a specific allocation to emerging markets and the allocation to sustainable equities. Given the changes in specifications it is not possible to provide a full analysis of the movement in fees beyond that shown in Appendix 2

Matthew Trebilcock
Independent Chairman of the Pension Board

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August 2022

Appendix 1 – Report to the Local Pension Board

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:

   a. 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.
   b. 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.
   c. 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.
   d. 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

e. 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.

f. 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.

a. 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.
b. 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.
c. 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 June 2022

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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

Appendix 2 – Equity Fee Savings on Pooling

Analysis of Equity Fees pre and post Pooling

Fees Paid pre Pooling (Equity Mandates) - June 2018

	AUM	Fees	Average bps
UK Active Mandate	461,715,000	1,043,430	22.6
Global Active Mandate 1	261,645,000	1,232,403	47.1
Global Active Mandate 2	314,950,000	912,375	29.0
	576,595,000	2,144,778	37.2
UK Passive	199,775,000	89,899	4.5
Global Passive	227,586,000	295,862	13.0
	427,361,000	385,761	9.0
	1,465,671,000	3,573,968	24.4

Fees Paid Post Pooling - September 2021

UK Passive	153,946,000	18,012	1.2
Global Passive	361,518,000	54,951	1.5
	515,464,000	72,962	1.4

Fees Paid post Pooling (Equity Mandates) - March 2022

	AUM	Fees	Average bps
UK Active Mandate	486,075,000	951,772	19.6
Global High Alpha	334,815,000	1,227,725	36.7
Global Sustainable	315,963,000	1,068,988	33.8
Emerging Markets	85,802,000	436,153	50.8
	736,580,000	2,732,866	37.1
Paris Aligned Passive	493,610,000	187,572	3.8
	1,716,265,000	3,872,210	22.6

Analysis of Fee Movement

UK Active Mandate	-91,658
Global Equities	588,088
Passive	-198,189
	298,242

	AUM	Average bps	Specification	Total
UK Active Mandate	55,051	-146,709		-91,658
Global Equities	595,101	-7,013		588,088
				-
Passive	59,800	-375,692	117,703	198,189
	709,952	-529,414	117,703	298,242