OXFORDSHIRE LOCAL PENSION BOARD – 7 JULY 2023

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 sixth 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.

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 led to a loss of 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.

g. Fees paid in respect of a number of the private market portfolios are paid on the basis of resources committed rather than actual money invested, and even where invested, performance often follows the J-curve with a dip in value before stronger investment performance later in the life of the asset/company (as a result of construction costs, investing in start up companies etc)

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 2022/23 amounted to £14.3m including the fees payable to Brunel to cover the operating costs of the company. This equates to 45bps when taken as a percentage of a simple average of the assets invested over the course of 2022/23. The equivalent figures for the previous financial year were £13.7m and 44bps. Further details are included in the annex to this report.

6. Over the course of 2022/23, the investments reduced in value by 3.9%, which was 3.1% below the benchmark return or -0.8%. Over the longer periods of 3, 5 and 10 years the Fund under-performed its benchmark by 1.3%, 0.6% and 0.2% per annum respectively.

7. Last year, all the equivalent figures indicated out-performance against the benchmark, indicating the impact on the long-term position of one poor year. It is equally true that another good year in 2023/24 would restore all the long-term figures to indicate outperformance against the benchmark. This volatility makes it very difficult to draw any clear conclusions in respect of the value for money paid to the active managers.

8. As noted above, it is difficult to draw any firm conclusions from the data. Looking at the individual average fees paid for each asset class shows that whilst the total average fee has risen from 44bps to 45bps, many of the fees for individual asset classes has fallen. However, as the Fund has increased its commitments into the private markets, there is now a higher weighting to the more expensive asset classes.

9. The figures indicate that the most expensive asset class is infrastructure at 205bps. This though is down from a figure of 263bps in 2021/22 largely as more of the commitments have now been called without a corresponding increase in fees. Whilst the figures show it is the most expensive asset class in 2022/23, the performance figures also indicate it was one of the best performing within the Fund, outperforming the benchmark by over 4.0% (three-year

outperformance is 3.4%). This suggests that the Fund is receiving value for money for the higher fees paid.

10. The other high-cost asset classes are private equity and private debt. Private equity too has seen long-term outperformance against the benchmark of more than 3% so again justifying the higher fee level. Private debt does not yet have a long-term record within the Oxfordshire Fund so it is difficult to draw any conclusions at this stage. The fee level on private debt should also fall going forward as more of the commitments are called without a corresponding increase in fees paid (the same issue which explains the movement in average fees from 460bps to 98bps over the last year.

11. The challenges of interpreting the data for the private debt portfolio are replicated across the majority of the private market asset classes where the majority of the allocations to Brunel have not yet reached their third year, so distorting fee levels when expressed relative to assets invested, and where we have no long-term performance records to demonstrate the extent to which these portfolios are delivering value for money for the Fund.

Lorna Baxter
Director of Finance June 2023

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

Annex 1

Asset Class	Fees Paid 2021/22 £000	Fees Paid 2022/23 £000	Average Investment 2021/22 £m	Average Investment 2022/23 £m	Average Fees 2021/22 bps	Average Fees 2022/23 bps
Equity	4,624	4,289	1,713	1,720	27	25
Fixed Income	628	459	489	379	13	12
Diversified Growth Fund	650	561	159	139	41	40
Private Equity	3,134	4,255	305	360	103	118
Property	2,226	1,890	202	233	110	81
Infrastructure	1,261	1,609	48	79	263	205
Multi-Asset Credit	543	461	70	137	78	34
Secured Income	355	512	78	98	46	53
Private Debt	276	254	6	26	460	98
Cash	n/a	n/a	42	39	n/a	n/a
Total	13,697	14,290	3,112	3,210	44	45