

# CAMBRIDGESHIRE PENSION FUND



## Pension Fund Board

### PRIVATE PAPER

Date: 21 October 2015

Report by: Deputy Head of Pensions

<b>Subject:</b>	<b>Annual General Meeting of the Cambridgeshire Pension Fund 2014-15</b>
<b>Purpose of the Report</b>	To provide the Pension Fund Board with an update of the topics discussed at the AGM which relate to the Fund's financial performance during the period 2014-15
<b>Recommendations</b>	<b>That the Pension Fund Board note the contents of the report.</b>
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## 1. Background

- 1.1 Cambridgeshire Pension Fund has for a number of years hosted an Annual General Meeting at which members of the Pension Committee and professional advisers meet to discuss the Fund's financial performance during the financial year just passed.
- 1.2 The Pension Fund Board was established and fully recruited to in May 2015 and as such this report is intended to provide a brief update on the matters discussed that relate to the Fund's financial performance during 2014-15.
- 1.3 This report will address the following information discussed at the Annual General Meeting;
  - Annual Performance Review 2014-15 (WM State Street Global Services)
  - Annual Custodian Monitoring Report - six months to 31 March 2016 (Mercer Sentinel)
  - Annual Review of the Fund's Investment Managers (Mercer Sentinel)
  - Investment Manager Fee Review (Mercer Sentinel)
- 1.4 Members of the Pension Fund Board will be invited to attend future Annual General Meetings of Cambridgeshire Pension Fund which are normally held in the month of July.

## 2. Annual Performance Review 2014-15 (WM State Street Global Services)

## **2.1 Background to the Annual Performance Review**

- 2.1.1 The Cambridgeshire Pension Fund (the “Fund”) has engaged WM State Street Global Services (“State Street”) to provide performance reporting for the Fund’s investments. State Street provides quarterly reports for review at the meetings of the Investment Sub Committee.
- 2.1.2 State Street have summarised the full year’s performance in the attached presentation to the Pension Fund Committee reviewing the market environment and the total Fund performance covering the period from 1 April 2014 to the 31 March 2015 relative to its other LGPS peers.

## **2.2 2014-15 Annual Performance Review**

- 2.2.1 The Annual Review that State Street presented at the meeting is attached as a Appendix 1 to this paper.
- 2.3 State Street summarise investment performance in the year as follows:-
- The Fund has under-performed its benchmark in the latest year having out performed its benchmark in the two previous years – reflecting underperformance in the year by Skagen arising from equity selection.
- 2.4 It is noted that the Fund underperformed by 0.8% relative to the universe after two years of outperformance.
- 2.5 Over a three year investment cycle the Fund outperformed the universe.
- 2.6 The Committee should note that whilst the universe is not a league table where the highest return is the sole measure of success, However, Officers will investigate consistently high performing LGPS funds in order to understand if there are any lessons to be learned.

## **3. Annual Custodian Monitoring Report 2014-15 (Mercer Sentinel)**

### **3.1 Background to the Annual Custodian Monitoring Report**

- 3.1.1 The Cambridgeshire Pension Fund (the “Fund”) has engaged Mercer Sentinel to review the performance of its global custodian, The Northern Trust Company (Northern Trust), in administering and safekeeping assets and to analyse the efficiency and effectiveness of its active investment managers.
- 3.1.2 This report covers the period from 1 October 2014 to 31 March 2015. It monitors and benchmarks providers’ performance as it relates to:
- Cash Management
  - Operational Efficiency: Trade Settlement, Income Collection, Corporate Actions, Proxy Voting, Tax Reclaims, Foreign Exchange
  - Investment Manager Reconciliations
  - Securities Lending
  - Transaction Cost Analysis

- 3.1.3 As part of the regular monitoring of the Custodian, Officers attend regular quarterly service review meetings with the Custodian to discuss Custodian performance and Fund Manager participation.
- 3.1.4 This report and the Appendix contain information on the performance of the Custodian and commercial arrangements with the Custodian which are considered to be commercially sensitive and are therefore to be treated as private papers.

## **3.2 2014-15 Performance Review**

- 3.2.1 Mercer Sentinel's key findings are noted below, with references to the detailed pages of the report which is attached as Appendix 2.
- 3.2.2 The sterling average on deposit cash was approximately £56,000. The average daily sterling sweep was £34.9m and generated an income of approximately £50,300, which is less competitive than rates of interest received by other Mercer Sentinel clients with similar sized funds.

The average Euro cash balance was approximately £147,000. A charge of 16bps was incurred for these balances. This was applied by the custodian following the ECB's announcement in September 2014 to impose negative interest rates to the Eurozone. The average US Dollar cash balances were £107,500.

The overall overdraft interest paid across sterling, US Dollars and Euro was approximately £25,000 and arose largely from the transition to the new custodian in October 2014. Overdraft interest rates appear slightly high compared to other Mercer Sentinel clients (Pages 5 to 8).

- 3.2.3 Trade settlement, income collection and corporate actions were satisfactory and well within market standards for the six months to 31 March 2015. No follow ups required (Pages 9 to 11).
- 3.2.4 Tax reclaims are disappointing, with only £245,922 being received during the six months to 31 March 2015. Total tax reclaims outstanding was £757,808 and are largely due to longer recovery times for aged outstanding tax reclaims. This is a result of local tax authorities in the individual countries concerned, requiring increased documentation from the clients before they are prepared to release the funds (Pages 12 and 13).
- 3.2.5 Foreign exchange analysis indicated that the overall cost for the six months to 31 March 2015 was marginally better than average of the universe (Pages 14 to 17).
- 3.2.6 Securities lending delivered a strong performance returning £86,837 of net earnings for the six months to 31 March 2015. This reflects the improved fee split with the Custodian from 70/30 to 81/19 as part of the appointment of Northern Trust as Custodian effective from 1 October 2014 (Pages 18 and 19).

- 3.2.7 Transaction Cost Analysis indicated that all three managers delivered an acceptable performance during the period, although Amundi (who have been terminated post 31 March) appeared to be expensive compared to the market standard. Total commissions for the six months to 31 March 2015 were approximately £134,000 or 7.24 bps which in aggregate remain within market standards despite high costs of 7.96bps for Amundi (Page 20).
- 3.2.8 The process for investment manager reconciliations was bedding in during the period, following the transition to the new Custodian. However, all four managers reconciled within tolerance in March 2015 (Page 21).

### 3.3 Conclusion

- 3.3.1 Mercer Sentinel consider the services provided by the Fund's various investment managers and its global custodian, Northern Trust, in each of the following areas to be:-

	6 Months to 31 March 2015
Cash Management	Below Standard
Operational Efficiency	
Trade Settlement	Satisfactory
Income Collection	Satisfactory
Corporate Actions	Satisfactory
Proxy Voting	N/A
Tax Reclaim	Satisfactory
Foreign Exchange	Satisfactory
Securities Lending	Satisfactory
Transaction Cost Analysis	Below Standard *
Investment Manager Reconciliations	Below Standard

\*Arising from manager now terminated

- 3.3.2 In the opinion of Officers, the Custodian has provided a satisfactory service to the Fund during the first six months of the contract, as evidenced by the findings of Mercer Sentinel.
- 3.3.3 The efficiency of foreign exchange and trade execution and commissions paid by the Fund's ongoing investment managers remains competitive in comparison to the market. Trades executed by Amundi were expensive relative to the market but this manager has been terminated subsequent to the period end.
- 3.3.4 Officers and Mercer Sentinel will follow up with the Custodian on Cash Management and Investment Manager reconciliations.

## 4. Annual Review of the Fund's Investment Managers 2014-15 (Mercer Sentinel)

### 4.1 Background to the Annual Review of the Fund's Investment Managers 2014-15

- 4.1.1 The Investment Strategy of the Fund is approved by the Pension Committee with the Investment Sub Committee (ISC) being responsible for the delivery of the Strategy.
- 4.1.2 The Fund Investment Strategy is based on a high allocation to growth assets with the expectation that these will deliver higher returns over the longer term.

- 4.1.3 The Investment Sub Committee reviews the State Street/WM performance report each quarter to monitor the performance of the Fund and its investment managers.
- 4.1.4 This report and appendix 3 provide qualitative research views from Mercers and additional quantitative analysis of the performance of each investment manager for the year ending 31 March 2015. This includes an overview of the key contributors or detractors to performance and key issues to consider for each mandate going forward.
- 4.1.5 This report and appendix 3 contain Mercer's proprietary research and manager ratings which are considered to be commercially confidential data and the papers are therefore to be treated as private papers of the Pension Committee and the Pension Fund Board.

## 4.2 Summary of the Fund's performance 2014-15

- 4.2.1 The Fund returned 12.2% (estimated 11.6% net of fees) over the year to 31 March 2015. This was 1.3% behind the benchmark return of 13.5%.
- 4.2.2 The Fund's assets grew by £231 million over the year to 31 March 2015. The Fund's liabilities also grew by £537 million over the same period. This represents a reduction in funding level from 78% to 72% between 31 March 2014 and 31 March 2015.
- 4.2.3 All managers achieved positive absolute returns and all active managers (with the exception of Skagen and Schroders Property) outperformed their benchmark over the year to 31 March 2015. However, it should be recognised that Skagen's role in the Fund is to take a contrarian view and as such a degree of underperformance might be expected to compare less favourably when other managers out perform their benchmarks.

## 4.3 Summary of the investment manager performance 2014-15

The contribution of each investment manager to the Fund's total return over the year to 31 March 2015, net of fees, is shown in the table below:

Manager	Asset Allocation as at 31 March 2015 (%)	Contribution to Total Return over the Year (%)
State Street UK	9.6	0.7
State Street Global	14.3	2.7
Newton	12.6	2.6
Amundi	10.7	1.4
Skagen	4.1	0.1
Schroders Multi Asset	31.9	2.8
Schroders Property	8.0	1.2
M&G	2.3	0.1
<b>Total Return (ex PE and Infrastructure)</b>	<b>93.4</b>	<b>11.6</b>
Adams Street	2.6	-
HarbourVest	1.8	-

UBS	0.8	-
Equitix	0.8	-
Partners Group	0.6	-
<b>Total*</b>	<b>100.0</b>	<b>n/a</b>

Net of fees returns have been estimated by Mercer using data from the managers.

- A total Fund return cannot be estimated due to the complexities of the private asset returns, Mercer have shown private asset returns in more detail in sections 9 and 10 of the Appendix.

#### 4.4 Summary of the Fund's investment managers

4.4.1 The table below provides a summary overview of the review that was carried out on the Fund's investment managers and their mandate:

	Comments
<b>Statestreet Global &amp; UK Equity</b>	<b>Retain</b> No immediate concerns with the current mandate.
<b>Newton Global Equity</b>	<b>Terminated</b> Performance had picked up more recently after several years of disappointing performance although issues remained with the communication of Newton's approach and style. The transition to JO Hambro was completed in Q1 2015/16.
<b>Amundi</b>	<b>Terminated</b> Decision to terminate for strategic reasons and due to lack of confidence in the manager. Transition to Dodge & Cox was completed in Q1 2015/16.
<b>Skagen Emerging Market Equity</b>	<b>Watch</b> Performance over the last 12 months has been poor and there have been a number of personnel changes at the firm. Skagen are also currently in the process of a potential change in ownership. Skagen should remain on watch for now.
<b>Schroders Multi Asset</b>	<b>Retain (but review the multi-asset structure)</b> The manager should be retained but the multi asset structure and fees charged should be reviewed following the termination of the regional equity funds in favour of Dodge & Cox.
<b>M&amp;G Bonds</b>	<b>Retain</b> M&G's performance over the last year has been good despite a challenging market.
<b>Schroders Property</b>	
<b>Adams Street Private Equity</b>	<b>Retain</b>
<b>HarbourVest Private Equity</b>	All alternative managers should be retained. However, a review of the Fund's Property and Alternatives strategy as a whole is scheduled to be carried out in late 2015/16.

	Comments
UBS Infrastructure	
Equitix Infrastructure	
Partners Group Infrastructure	
<b>5. Investment Manager Fee Review 2014-15 (Mercer Sentinel)</b>	
<b>5.1 Background to the Investment Manager Fee Review</b>	
5.1.1	The Investment Strategy of the Fund is approved by the Pension Committee with the Investment Sub Committee (ISC) being responsible for the delivery of the Strategy.
5.1.2	The Investment Sub Committee has mandated different investment managers according to their areas of expertise to assist the Fund in the delivery of its Strategy.
5.1.3	The performance of the Fund's investment managers is reviewed on a quarterly basis by the Investment Sub Committee.
5.1.4	This paper reviews the fees paid by the Fund to its investment managers over the 3 year period to the 31 March 2015. The fee is compared against the median fee of similar sized mandates across Mercer's global client base, which is documented in Mercer's 2014 Global Fee Survey. The report also considers the performance delivered by each manager in order to contextualise fees paid.
5.1.5	The report also reviews transaction costs which can lead to erosion of Fund assets if not monitored.
5.1.6	This report contains confidential information on the fees paid to individual managers which is considered to be commercially sensitive and therefore should be treated as a private paper.
<b>5.2 Investment Manager Fee Review 2014-15</b>	
5.2.1	The table below shows the estimated fees for each of the Fund's managers over the 3 years to 31 March 2015. Given the fees are charged on Fund specific tiered fee scales on the assets under management, the table sets out the actual amounts charged by the investment managers each year (which also accounts for any performance related fees).
5.2.2	The fees charged are compared to the performance of the manager in order to highlight their magnitude in comparison to both the absolute returns achieved and relative to benchmark.
5.2.3	Given the long-term nature of private equity and infrastructure a "fees versus value added" comparison is not possible over short periods, however a comparison across the managers can be seen from the table:

Manager/Portfolio	Fund Asset Under Management (£m)	Fees charged Over 3 Years (£m)	Fees Charged* (% p.a.)	Relative Value Add Over 3 Years after fees (£m)	Total Return (£m)
State Street (UK)	215.4	0.2	0.04	Passive	64.2
State Street (Global)	320.5	1.0	0.11	Passive	99.7
Newton	283.5	1.5	0.18	2.8	105.5
Amundi	241.4	1.7	0.24	2.3	79.7
Skagen	91.6	3.5	1.40	-0.9	10.7
Schroders Multi- Asset	717.0	8.6	0.40	37.1	202.4
Schroders Property**	179.3	1.0	0.19	-12.9	35.3
M&G	51.8	0.8	0.54	0.9	6.2
<b>Sub total</b>	<b>2,100.5</b>	<b>18.4</b>		<b>29.3</b>	<b>603.6</b>
Adams Street	58.7	2.3	1.32	-	-
HarbourVest	40.6	1.9	1.55	-	-
UBS	18.0	0.8	1.52	-	-
Equitix***	18.4	0.5	1.11	-	-
Partners Group	11.1	1.2	3.47	-	-
<b>Total</b>	<b>2,247.3</b>	<b>25.2</b>	-	<b>29.3</b>	<b>603.6</b>

May not sum due to rounding

\*Estimated by Mercer and based on 31 March 2015 asset values

\*\*Includes Schroders fees only and is not inclusive of the underlying manager fees

\*\*\*Equitix was only able to provide a breakdown in charges from 31/12/12 to 30/6/15.

5.2.4 The table shows that over a three year period the fees paid to managers, excluding the private equity and infrastructure, were £18.4m compared to returns of £603.6m. In addition, Investment managers with the exception of Schroders property and Skagen have added value to the Fund over the last three years after fees.

### 5.3 Comparison of the Fund's Investment Manager fees 2014-15

5.3.1 By estimating the percentage fee charged per annum, the Fund's investment management fees can be compared to those being paid by other pension funds. The performance related fees does not always make for a fair comparison due to its nature.

5.3.2 The table below compares the Fund's management fee to other pension funds using the average ("median") for similar sized mandates covered by Mercer's Global Fee Survey. The upper quartile and lower quartile respectively refers to the top and bottom 25% fees in the universe:

Manager/Portfolio	Average Annual Fee (% p.a.)	Median Annual Fee (% p.a.)	Fees Quartile**
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State Street (UK passive)	0.04	0.10	lower quartile
State Street (Global passive)	0.11	0.13	second quartile
Newton	0.18	0.47	lower quartile
Amundi	0.24	0.55	lower quartile
Skagen	1.40	0.76	upper quartile
Schroders Multi-Asset*	0.40	0.50	lower quartile
Schroders Property	0.19	0.25-0.9	below median
M&G	0.54	0.5-1.5 with performance fee	competitive fee
Adams Street	1.32	0.75-2	average fee
HarbourVest	1.55	0.75-2	average fee
UBS	1.52	0.5% plus 10% carried interest above a return of 8%	average fee
Equitix	1.11		average fee
Partners Group	3.47		high fee relative to peers

5.3.3 The majority of the Fund's investment managers have competitive fee arrangements in place when compared to the wider universe.

5.3.4 Only Skagen and Partners Group are charging a fee above the median manager for their respective asset classes

5.3.5 Given the performance fee element of their fee schedule, Newton's fee is significantly lower than the median manager. Although Newton have outperformed over the last 3 years, because of historical underperformance, the Fund had accumulated a fee credit which has resulted in no outperformance fee being paid during the last 3 years.

- 5.3.6 Given the performance fee element of their fee schedule, Newton's fee is significantly lower than the median manager. Although Newton have outperformed over the last 3 years, because of historical underperformance, the Fund had accumulated a fee credit which has resulted in no outperformance fee being paid during the last 3 years.

#### **5.4 Summary of Transaction costs 2014-15**

- 5.4.1 The level of transaction costs incurred within LGPS portfolios is also under increased scrutiny. The following table summarises the transaction costs incurred within each portfolio over the last three years.

##### **3 Years to 31 March 2015**

<b>Manager</b>	<b>Transaction Costs (£m)</b>	<b>Actual Turnover Over 3 Years (% p.a.)</b>	<b>Expected Turnover (% p.a.)</b>
Newton	0.5	29.3	50.0
Amundi	0.2	25.8	50.0
Skagen	0.3	21.0	25.0
Schroders Multi-Asset	1.1	13.5	-
Schroders Property	0.6	7.6	10.0
M&G	0.0	7.3	-

Source: Investment Managers

- 5.4.2 All managers are under their expected annual turnover for the three year period under review.
- 5.4.3 While transaction costs are important to monitor, investment managers are incentivised to keep a handle on the transaction costs incurred as their quoted returns are net of these transaction costs
- 5.4.4 Depending on a manager's approach for investing, we would expect differences in the level of turnover and transactions costs incurred.
- 5.4.5 M&G's transaction costs are paid for by the custodian and are ultimately charged on the assets through the additional expenses which includes various other items e.g. administration costs. The additional expenses are capped and therefore, regardless of the level of turnover in the portfolio, the Fund will not be charged an additional fee.

#### **5.5 Investment Manager Performance**

- 5.5.1 The Fund's total return over three years to 31 March 2015 is £603m with Schroders Multi Asset the biggest contributor, reflecting the performance of this manager and size of the mandate.

5.5.2 The table below summarises the investment return generated by manager (excludes private equity and infrastructure) over three years to 31 March 2015. The total return comprises capital gains and the income paid out by the Fund:

Manager	Return over 3 year		
	Capital Gain/Loss (£m)	Income (£m)	Total Return (£m)
State Street (UK passive)	42.3	21.8	64.2
State Street (Global passive)	76.1	23.6	99.7
Newton	90.7	14.8	105.5
Amundi	64.0	15.7	79.7
Skagen	5.0	5.7	10.7
Schroders Multi-Asset	157.7	44.7	202.4
Schroders Property	18.3	17.1	35.3
M&G	0.7	5.4	6.2
<b>Total</b>	<b>454.7</b>	<b>148.8</b>	<b>603.6</b>

5.5.3 Capital gain has contributed 75% of the return over 3 years and 25% has been generated through investment income.

## 6. Relevant Pension Fund Objectives

Perspective	Outcome
<b>Funding and Investment</b>	<ul style="list-style-type: none"><li>• To ensure that the Fund is able to meet its liabilities for pensions and other benefits with the minimum, stable level of employer contributions.</li><li>• To ensure that sufficient resources are available to meet all liabilities as they fall due.</li><li>• To maximise the returns from its investments within reasonable risk parameters.</li></ul>

## 7. Finance & Resources Implications

7.1 The finance implications are set out in the report.

## 8. Risk Implications

a) Risk(s) associated with the proposal:

Risk	Mitigation	Residual Risk
Impact of the performance of an investment manager on the risk and return profile of the Fund.	Regular monitoring of the Fund's investment managers is undertaken by officers supported by a range of professional external providers.	Amber

b) Risk(s) associated with not undertaking the proposal:

Risk	Risk Rating
The Fund will not be meeting key governance requirements as part of its decision making process.	Amber

## 9. Communication Implications

9.1 There are no communication implications with the recommendations.

## 10. Legal Implications

10.1 There are no legal implications with the recommendations.

## **11. Consultation with Key Advisers**

- 11.1 The reports presented at the Annual General Meeting was originally produced in consultation with Mercer, the Fund's appointed investment consultant, in compliance with the LGPS (Management and Investment of Funds) Regulations 2009 and utilising information and advice provided by WM State Street Global Services and the Fund's investment managers

## **12. Alternative Options Considered**

- 12.1 Not applicable.

## **13. Background Papers**

- 13.1 None.

## **14. Appendices**

- 14.1 Appendix 1 – WM State Street Global Services Cambridgeshire Pension Fund Annual Review 2014-15 (section 2)
- 14.2 Appendix 2 – Mercer Sentinel Custodian Monitoring Report 2014-15 (private) (section 3)
- 14.3 Appendix 3 – Mercer Annual Manager Report 2014-15 (private) (section 4)

<b>Checklist of Key Approvals</b>	
Is this decision included in the Business Plan?	Not applicable
Will further decisions be required? If so, please outline the timetable here	Not applicable
Is this report proposing an amendment to the budget and/or policy framework?	No
Has this report been cleared by Chief Finance Officer/Section 151 Officer?	Not applicable
Has this report been cleared by Deputy Head of Pensions?	Mark Whitby – 18/09/2015
Has this report been cleared by Legal Services?	Not applicable