MERCER

INVESTMENT STRATEGY CONSIDERATIONS

CAMBRIDGESHIRE PENSION FUND

Current strategy health check

We would expect the current strategy of 64.5% equities, 23.5% alternatives and 12% bonds to be supportive of the funding arrangements in place as part of the 2013 actuarial valuation.

Whilst we do not wish to duplicate the work previously carried out by Hymans Robertson, we would expect the current investment strategy to produce a return, over the long term of 3.4% p.a. above gilts (a proxy for the Fund's liabilities).

The Actuary, as part of the actuarial valuation as at March 2013, assumes a return of 1.6% p.a. over gilts. This highlights the degree of prudence in the Fund's actuarial valuation versus the "best estimate" approach we can take when setting investment strategy. This doesn't reflect a difference in outlook or a difference in timeframe; it simply reflects the fact that the actuary cannot take advance credit for a 50/50 outcome.

We are comfortable therefore that the investment strategy is in line with the funding plan from a return perspective, but suggest this is reviewed in more detail as part of the 2016 valuation discussions, with a specific focus on the levels of risk that are embedded within the return assumptions.

Equities

The current global equity structure (nine different managers / mandates) is complex with a mixture of regional and global equity mandates – and a degree over overlap.

First and foremost, the Committee should be clear on their long term "beliefs" around equities and equity managers. Most notably, including views on active versus passive; the "types" of active and passive, and the complexity of the structure given governance and fees.

In light of these views, we would look to re-focus the portfolio by ensuring managers are "best in class" and focusing on the strategic rationale for each mandate in the Fund. In short, we believe this can be achieved be improved by focusing on better use of passive and more focused high conviction active mandates and would suggest the following next steps:

- Review Newton Global Equity and Amundi European Equity mandates
- Consider moving regional Schroder equity allocations to a global mandate
- Appointment of a high conviction active global equity manager (should Newton / Amundi be terminated)
- Consider the Fund's stance on currency hedging
- Decide on the structure of the passive portfolio (to compliment active managers in place).

A separate paper on the global equity portfolio has been provided.

Bonds

Bonds in the context of the Fund can have two roles – return generation or risk reduction. The current portfolio is structured with a significant focus on returns.

We would advocate that the Fund looks to maximise returns (to the extent they are required as part of the funding strategy); but to achieve this at the lowest level of risk.

We believe there are two areas to consider further:

1) *How to maximise returns* – The global fixed income mandate with Schroder is "absolute return" in nature and is therefore looking to achieve positive returns in a range of bond market conditions. Whilst the bond environment is changing (as a result of falling bond yields and narrowing credit spreads) this element of the bond portfolio has the flexibility to take advantage of the current opportunities in any market.

2) *How to reduce risk* - The structure currently has no protection against inflation (the Fund's largest investment risk). We would therefore recommend a plan is put in place to reallocate to index linked gilts, in order to provide this protection, as and when it becomes affordable to do so (i.e. bonds are more attractive and / or the funding level has improved). We recommend the UK element of the current bond portfolio is used as a basis for this change. Firstly, to switch the current UK fixed interest bonds into index linked gilts; and also to build up a degree of protection over time (e.g. from equities).

Alternatives / diversification

The Fund has already achieved a reasonable degree of diversification through the existing allocations to property, infrastructure, private equity and loans. We note that building out this diversification further (by reducing the existing equity allocation) has already been agreed.

Alternatives can have a place to add to the Fund's return expectations and / or to also improve the matching characteristics against the Fund's liabilities (in particular protection against inflation).

We believe there are two options to consider:

1) To bring together the existing alternative holdings into a "real assets" portfolio and build this out over time, noting the intention to allocate an additional 9%.
2) Allocate to a Diversified Growth Fund ("DGF") to achieve broad asset diversification in one "wrapper".

Whilst the latter would provide a simple low governance solution, similar principles (equity like returns but lower volatility) can be achieved, at lower cost, through "smart beta" equity type products which will be considered within the passive equity portfolio. It would also provide no protection against the Fund's liabilities.

We therefore recommend that the current real assets portfolio is built out further and consideration is given to how to structure the portfolio (aims, roles etc) before considering individual asset classes.

Banking funding level improvements / building inflation protection

The Fund currently has limited protection in place against the Fund's liabilities. As the funding level improves we would argue that the Fund does not need to take the same level of investment risk. We therefore recommend that a "plan" is developed to "bank" funding level improvements and build up the level of inflation / liability protection as and when the Fund can afford to do so. This has clear links to the index linked gilts and real assets portfolios mentioned earlier.

Cost of change

Any change to the Fund's investment strategy will need to make a meaningful difference to the Fund's overall return expectations (to the extent they are required); or to reduce the overall level of risk. Transaction costs should of course be taken into account, but changes should have a meaningful enough impact for these to be quickly absorbed.

Introduction

This paper sets out our initial views on the Fund’s long term investment strategy with a particular focus on what should be retained and any potential for change.

Current investment strategy

The Fund’s investment strategy, at a high level, is 64.5% equities, 23.5% alternatives (including property) and 12% bonds. The split between these asset classes is the key driver to the Fund’s total return and risk profile.

Whilst we do not wish to duplicate the work previously carried out by Hymans Robertson, we would estimate the current investment strategy to produce a return, over the long term of 3.4% p.a. above gilts (a proxy for the Fund’s liabilities).

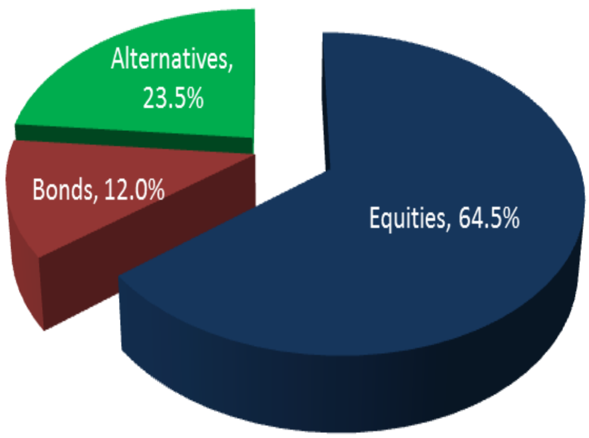
The Actuary, as part of the actuarial valuation as at March 2013, assumes a return of 1.6% p.a. over gilts. This highlights the degree of prudence in the Fund’s actuarial valuation versus the “best estimate” approach we can take when setting investment strategy. This doesn’t reflect a difference in outlook or a difference in timeframe; it simply reflects the fact that the actuary cannot take advance credit for a 50/50 outcome.

We suggest this is revisited as part of the 2016 actuarial valuation but confirm that the current headline allocations are appropriate in the context of the funding plan. However, to maintain the agreed risk / return levels, we suggest that the rebalancing of the Fund’s current strategy is reviewed and provide comment on this under a separate cover.

The following chart shows this current strategy and provides a recap of what each portfolio is looking to achieve.

Alternatives
- Provide diversification away from equities.

- Can have return generating and / or liability matching characteristics.



Equities

- Primary aim is to enhance long-term returns.

- Can improve the funding position and ensure contributions remain affordable.

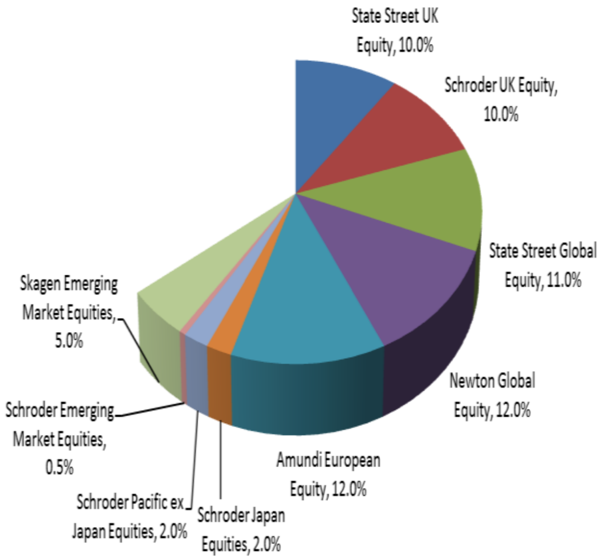
Bonds
- Can be return generating or risk reducing.
- Current focus is largely return seeking (although there is a small allocation to fixed interest gilts).
- No inflation protection in place.

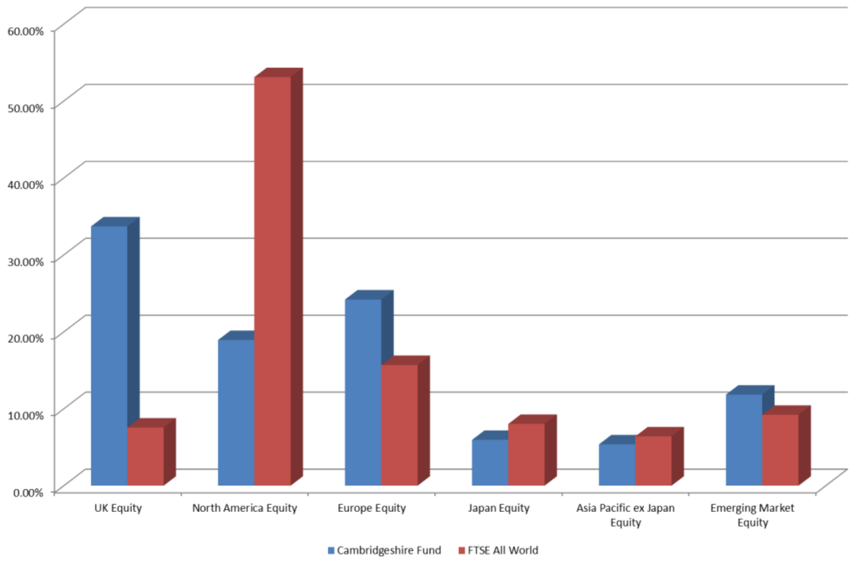
Equities

We have provided a more detailed review of the equity portfolio as a separate report but summarise our thoughts as follows:

Current structure

Equities currently account for 64.5% of the Fund's investment strategy and this is made up of nine equity mandates - summarised in the chart left hand below. The equity structure categorised by region is also outlined on the right hand chart.





Our initial observations on the current structure are as follows:

- The Fund's current structure is relatively complex with nine manager/mandates in place. We appreciate that the Schroder Multi-Asset mandate has historically been viewed as one mandate; however, explicitly it is four underlying allocations to equity regions. For the purposes of making strategic decisions, we believe it is appropriate to separate it out into its component parts. We would question the value in a Multi-Asset mandate in this context.

- Owing to the regional mandates in place, the Fund has some overlap with respect to the regional exposures. This is outlined in the right hand chart (above) whereby the Fund is overweight UK and Europe at the expense of North America and to a lesser extent Asia.

- At a manager level, we have some concerns with Amundi (European mandate) and Newton (Global Equity) in particular. We also prefer Schroder's global equity capabilities (rather than regional component funds). We do however rate State Street highly as the Fund's current passive manager (they are one of our "preferred providers.")

- Strategically we do not believe there is a compelling reason to hold an explicit allocation to European equities. In addition, we do not see Amundi as being top tier and note their performance has been disappointing. As a core global equity manager, Newton's performance has also been lacklustre, and we question whether they have the same proposition as they did when appointed. We have provided comment on Newton under a separate cover.

Proposals for consideration

- We believe the Fund's structure can be simplified and improved by making better use of more focused, high conviction global equity mandates; and better use of passive management.

- With respect to the current mix of global and regional equity mandates, we have a preference for global where governance time is limited, but believe there is rationale for some high octane regional exposures in less efficient markets (e.g. Skagen for Emerging Markets).
  We are also content to retain a UK overweight (which brings high concentration by stock and sector) to reduce currency risk where we have access to a well rated active manager.

- When considering the extent to which the Fund's equity assets are actively managed, we note the supporting documentation for the recent Consultation on cost savings and efficiencies which suggested that on average the LGPS does not make good use of active management. The Fund may therefore be subject to a prescribed allocation to passive management when the outcome of the Consultation is decreed.

- However, regardless of the outcome of the Consultation, the Committee's own risk tolerances (and past experiences) should be considered; noting there may well not be a single "right" answer. Subject to discussion, we propose that the current allocation to passive (with SSgA) is broadly maintained for now, at least until the active structure is determined, but would suggest the passive structure itself is reviewed.

- There are a range of passive options (including fundamental indexation, lower volatility, but broadly referred to as "Smart Beta"). We suggest these are reviewed once the structure of the active equity components are agreed.

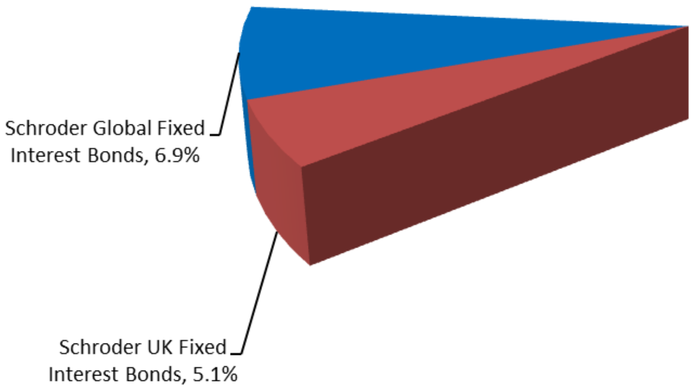
- We recommend a proposed structure for discussion in respect of the current equity portfolio (c64.5% of total Fund assets), as follows:

Fund	**Current**	**Proposed**	**Change**
SSgA – Passive	32%	35%	Broadly maintained - structure of passive to be reviewed following proposed active fund changes.
Schroder – UK equity	15%	15%	Retain.
Schroder – Regional Equity Funds	7%	-	Re-allocate to global equity fund (see below).
Schroder – Global Equity	-	20%	Move regional equity funds to a global high conviction approach (value tilt)
Amundi – European Equity	19%	-	Consider removal.
Newton – Global Equity	19%	-	Consider removal.
Global Active Equity Manager	-	20%	Style of new manager to be reviewed but likely to have more of a growth bias.
Skagen – Emerging Market Equity	8%	10%	Retain and marginally increase.
Total	**100%**	**100%**	

- In addition, the proposed structure will also need to be reviewed to the extent that the Fund's equity portfolio is reduced to further allocate to alternative / diversifying assets (discussed later in the paper). We also recommend the level of currency hedging is considered as part of the overall structure once new managers are appointed.

Bonds

The Fund's bond portfolio makes up 12% of total assets and is made up of a UK and a global fixed income portfolio with Schroder as outlined in the chart below:



Current structure

Bonds in the context of the Fund can have two roles – return generation or risk reduction. The current portfolio is structured with a significant focus on returns.

We set out a brief overview of the current structure below:

- The Global Fixed Income mandate (c60% of the overall bond portfolio) is structured to generate an absolute return of 3% above cash (LIBOR). Its objective is return seeking and structured to deliver in a wide range of bond market conditions.

- The UK Fixed Interest mandate (c40% of the overall bond portfolio) is actively managed and invests in a mix of fixed interest gilts and corporate bonds. Whilst this will have delivered strong returns in an environment where interest rates have fallen and credit spreads have reduced, the future return prospects are less compelling. They also do not provide any protection against the Fund's inflation linked liabilities.

Proposal for consideration

We would advocate that the Fund looks to maximise returns (to the extent they are required as part of the funding strategy); but to achieve this at the lowest level of risk. We believe there are two areas to consider further:

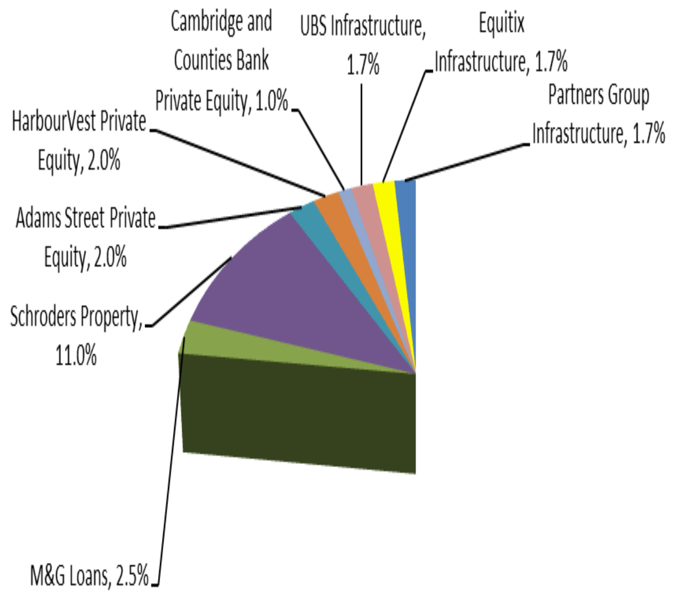
1) *How to maximise returns* – The global fixed income mandate with Schroder is "absolute return" in nature and is therefore looking to achieve positive returns in a range of bond market environments. Whilst the bond environment is changing, this element of the bond portfolio has the flexibility to take advantage of the current opportunities in the market. We recommend this allocation is maintained.

2) *How to reduce risk* - The structure currently has no protection against inflation (the Fund's largest investment risk). We would therefore recommend a plan is put in place to reallocate to index linked gilts, in order to provide this protection, as and when this becomes affordable to do so (i.e. bonds are more attractive and / or the funding level has improved). We recommend the

UK element of the current bond portfolio is used as a basis for this change. Firstly, to switch the current UK fixed interest bonds into index linked gilts; and also to build up further protection over time. We would suggest that this is done as soon as possible, but discussion should be had with Schroders to discuss fees as we would not suggest the index linked gilts are actively managed. Nor would we recommend housing the index linked gilts at SSgA because it is more likely that Schroder are best placed to help the Fund deal with inflation risk (this is not an area we rate SSgA highly for).

Alternatives / diversifiers

The alternatives allocation makes up 23.5% of total Fund assets and includes investments in property, infrastructure, private equity and loans and is summarised in the chart below. We also note that building out this diversification (by reducing the existing equity allocation) has also already been agreed.



Current structure

Our views on the Fund's alternatives can be split into the strategic asset allocation and our views on the managers themselves.

Alternatives can have a place to add to the Fund's return expectations, to diversify, and / or to also improve the matching characteristics against the Fund's liabilities (in particular protection against inflation).

The current asset allocation goes some way in achieving both of these objectives. In aggregate, we would expect the portfolio to provide a level of return of around 3% p.a. above gilts (a proxy for the liabilities). The infrastructure allocation in particular will also provide some inflation-like characteristics to protect (to a degree) against the Fund's liability risks.

At a manager level, we rate all of the Fund's highly (with the exception of Equitix which we do not currently research and the local private equity allocation which can be assessed on its own merits).

Proposal for consideration

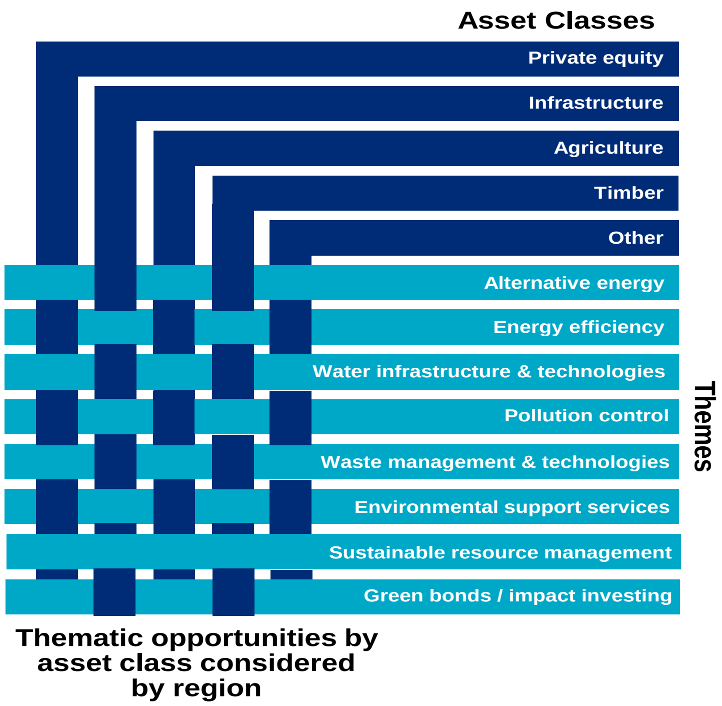
The Fund already has a number of the components of a functioning “real assets” portfolio. We believe this could be built out further (from the existing equity allocation) but note that an alternative option of allocating to a Diversified Growth Fund (“DGF”) to achieve broad asset diversification in one “wrapper” was also discussed.

Whilst a DGF would provide a simple low governance solution; similar principles (equity like returns but lower volatility) can be achieved, at lower cost, through “smart beta” equity type products which will be considered within the equity portfolio. It would also provide no protection against the Fund’s liabilities.

If the Committee agree, and further diversification is to be achieved via a real assets portfolio, then the first step is to identify the “roles” the Fund is expecting the real assets portfolio to play (e.g. diversification, inflation protection, opportunistic allocations). We also recommend a “sustainability theme” is incorporated into the portfolio.

We are not proposing this as the first priority because in short we believe there are “easier wins” elsewhere (in particular relating to the equity structure) and suggest that this is re-visited next year when there will be more time to devote to how this can be properly structured.

However, in order to illustrate our thinking, the chart below shows what a sustainable assets portfolio might contain. The idea would be to build the portfolio around the existing alternatives rather than reinventing the wheel.



Cost of change

Any change to the Fund’s investment strategy will need to make a meaningful difference to the Fund’s overall return expectations (to the extent they are required); or to reduce the overall level of risk.

The cost of change also needs to be factored in to any re-structure – both explicit costs (e.g. transaction costs) and implicit costs (e.g. Members and Officers time etc).

To put this into context, when reviewing any changes to the Fund's investment strategy we will look to quantify the impact on the Fund's long term expected risk and return against the costs of change when considering each specific change in more detail.

Banking funding improvements / building inflation protection

Current structure

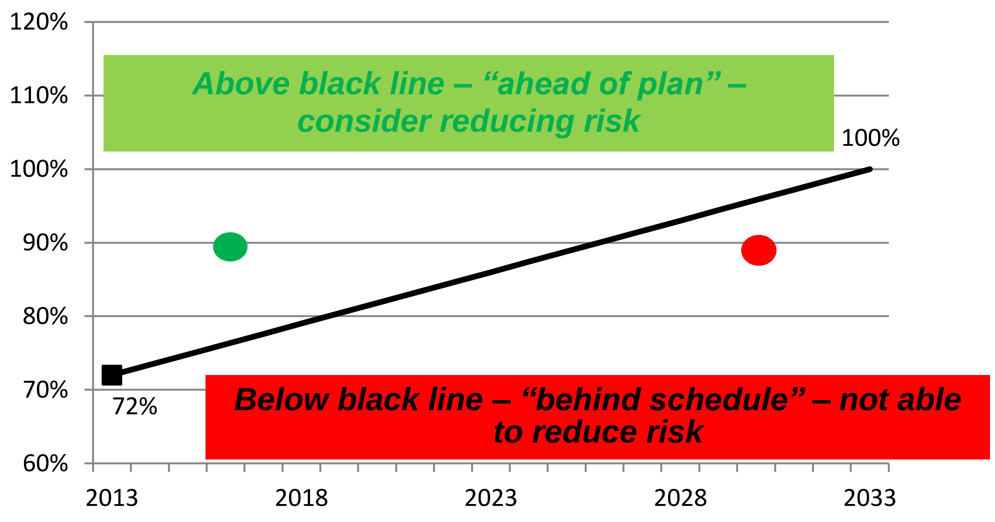
The Fund currently has limited protection in place against the Fund's liabilities – owing to the deficit and the need for additional returns. However, as the funding level improves we would argue that the Fund does not need to take the same level of investment risk. For example, does the Fund need to take the same level of risk when it is 72% funded (as at 31 March 2013) than if it was 100% funded? We do not believe so.

Proposal for consideration

With this in mind we would look to work with the Committee to put a plan in place to be structured around the long term funding arrangements – i.e. to reach fully funded over 20 years since the 31 March 2013 valuation.

As and when the funding level "improves" ahead of what is expected, growth assets (e.g. equities) can be "banked" into lower risk / matching assets (e.g. bonds) to "lock in" to funding level improvements and reduce the level of investment risk.
The following chart simplistically highlights the type of "plan" proposed. During times when the funding level may be in the "green" shaded area – the funding level is "ahead" of where we are expecting it to be. This highlights an opportunity to reduce risk.

- Examples on the chart:
  - c90% funded in 2016 – "ahead of plan" – opportunity to de-risk
  - c90% funded in 2031 – "behind schedule" – no opportunity to de-risk



We would propose structuring a de-risking framework in conjunction with the actuarial valuation cycle (i.e. 31 March 2016). This will allow us to consider what the "end point" investment strategy. For example, our current target is 100% funded, but taking enough risk to justify the Actuary's gilts plus 1.6% return assumption. If we have reduced risk, our target implicitly becomes 100% on a lower risk funding basis.

However, in the interim, we suggest that we develop a series of "pragmatic" triggers and propose that this is considered in Q1 2015 in conjunction with the real assets portfolio.

Summary and next steps

We are comfortable with the overall level of risk and return that we expect to be generated from the current asset allocation.

In terms of proposals for change, at a high level we suggest:

- The equity portfolio is reviewed and simplified.

- The bond portfolio is split into return seeking and risk reduction portions, with the latter looking to provide a degree of protection against the Fund's liabilities.

- The alternatives portfolio is maintained and added to with a focus on "real assets" and also to incorporate an allocation to sustainable investing.

- Put a "plan" in place to reduce the level of investment risk (by "banking" funding level improvements and building in a degree of inflation protection) as the funding level improves.

The current and proposed allocations are set out below:

Asset Class	**Current %**	**Proposed %**	**Range %**
Equities	**64.5**	**64.5** initially but noting the desire to reduce in favour of alternatives	**59.5 – 69.5** (noting that there will be initial ranges around UK until the passive portfolio is restructured)
Passive	21	22.5	
UK	10	10	
Regional	5	-	
Global	12	25	
European	12	-	
Emerging Markets	5	7	
Bonds	**12**	**12**	**9-15**
Global	7	7	
UK Fixed Interest	5	-	
UK Index Linked	-	5	
Alternatives	**23.5**	**23.5** initially but noting the desire to increase	**No formal range** noting the costs of trading illiquids
Total	**100**	**100**	

We see the next steps for the Fund as follows:

Q4 2014:
Review of Global Equity Portfolio structure (to be discussed at November ISC)

Q1 2015:
Confirmation of Global Equity decisions (focus on active funds)
Consideration of funding level improvements and building up the Fund's inflation protection

Q2 2015:
Decisions on passive equity (following decisions on actively managed funds earlier in the year)
Further work on funding level and inflation protection

Q3 2015:
Decision on real assets

Q4 2015:
Annual review of strategy – 2016 actuarial valuation planning

I look forward to discussing this further.

Important notices

Jo Holden
November 2014

Appendix

Mercer Ratings

Manager	Mandate	Rating
State Street	UK Equity (passive)	PP
Schroder	UK Equity (active)	B+ (T)
State Street	Global Equity	PP
Newton	Global Equity	B+
Amundi	Europe	N
Schroder	Japan	B+
Schroder	Asia Pacific (ex Japan)	B+
Schroder	Emerging Markets	B+
Skagen	Emerging Markets	B+ (T)
Schroder	Sterling Broad Market Fund	B+
Schroder	Strategic Bond Fund	B+
M&G	Bonds & Fixed Income	A
Schroder	Property	A (W)
Adams Street	Private Equity	A
HarbourVest	Private Equity	A
UBS	Infrastructure	B+
Equitix	Infrastructure	N
Partners Group	Infrastructure	A

Guide to Mercer Ratings

What do Mercer ratings signify?

Mercer's research rating of an investment strategy signifies Mercer's opinion as to its prospects for outperforming a suitable benchmark, on a risk-adjusted basis, over a full market cycle. The rating is recorded in the entry for the strategy on Mercer's Global Investment Manager Database (GIMD™).

Strategies rated A are those assessed as having above average prospects. Those rated B are those assessed as having average prospects. Those rated C are assessed as having below average prospects. B+ is an intermediate category in between A and B. Strategies which are B+ rated would satisfy at least one of the following:

1. Above average probability of beating the benchmark but there are a significant number of strategies more likely to beat the benchmark;

2. Likely to have above average probability of beating the benchmark but more "evidence" is needed to confirm this assessment; or

3. Above average probability of beating the benchmark but there is a potential for downward re-assessment due to uncertainly regarding the strategy or organisation.

If the rating shown on GIMD is N, or if no rating is shown at all, this signifies that the strategy is not currently rated by Mercer.

Mercer has an established process for ratifying and reviewing the ratings that are proposed by individual researchers. For most categories ratings are reviewed regularly by one of several Ratings Review Committees that operate within Mercer. These Committees draw on research carried out by Mercer manager researchers and consultants. The role of these Committees is to review this research from a quality control perspective and ensure consistency of treatment across strategies within a product category, rather than to redo the research from scratch.

For certain asset classes ratings will not have been reviewed by a Rating Review Committee. They will however have been reviewed by at least two suitably qualified researchers/consultants other than the researcher who recommended the rating.

What do they not signify?

The rating assigned to a strategy may or may not be consistent with its past performance history. While the rating reflects Mercer's expectations on future performance relative to benchmark, Mercer does not provide any guarantees that these expectations will be fulfilled.
Also, unlike credit ratings assigned by agencies such as Moodys and S&P, the research ratings are not intended to imply any views about the creditworthiness of the investment manager providing the strategy.

Mercer research ratings are assigned to strategies rather than to specific funds. We use the term "strategy" in this context to refer to the process that leads to the construction of a portfolio of investments, regardless of whether it is offered in separate account format or through one or more funds. Potential investors in specific funds should therefore consider not only the Mercer ratings for the strategies being offered through those funds, but also any fund-specific issues such as fees, frequency of dealing dates and any legal or regulatory issues relating to the type of fund and where it is domiciled.

Mercer does not generally take investment management fees into account in determining ratings. The rationale for this is that the fees charged for a specific strategy will often vary from one client to the next, due to differing account sizes, differing inception dates or other factors. Potential investors in a specific strategy should therefore consider not only the Mercer rating for that strategy, but also the competitiveness of the fee schedule that they have been quoted for that strategy.

Mercer's research process and ratings do not include an evaluation of a manager's custodian, prime brokerage, or other vendor relationships or an assessment of its back office operations. Research is generally limited to the overall investment decision-making process used by managers. Mercer does not perform operational infrastructure due diligence or personal financial or criminal background checks on managers. Mercer's manager researchers start from the assumption that the manager's back office is satisfactory from an operational point of view unless we are aware that the manager's auditors or regulators have a contrary view. Having said that, any operational weaknesses that do come to light in the course of Mercer's manager research are noted and taken into account in determining ratings as appropriate.

Provisional (P) ratings

If the Mercer rating for a strategy is followed by (P) – e.g. A(P), B+(P) etc - this denotes that the rating is provisional. This means that there is some temporary uncertainty about the rating that we expect will be resolved soon. An example would be a case where two firms have announced that they will be merging, but no further details are yet available. In this type of case the rating for a strategy may be changed to provisional – e.g. from A to A(P) - to highlight this uncertainty. The intention is that provisional ratings should only be temporary and normally last for no more than two weeks. Once the temporary uncertainty has been resolved, or if it becomes apparent that this uncertainty is unlikely to be resolved quickly, the provisional rating will be replaced with a firm rating or it will be assigned the designation Watch (W).

Watch (W) ratings

If the Mercer rating for a strategy is followed by (W) – e.g. A(W), B+(W) etc - this denotes that the rating is Watch. This means that there is some uncertainty about the rating that we do not expect to be resolved soon, but we do not believe the resolution of this uncertainty will lead to a change in the rating for that strategy. W ratings would most likely be used where ownership changes, or the potential for ownership changes exists, and there is an expectation of long term uncertainty surrounding the rating.

High tracking error (T) ratings

If the Mercer rating for a strategy is followed by (T) – e.g. A(T), B+(T) etc - this denotes that the strategy is considered to have potential to generate a tracking error substantially higher than the average for the product category concerned. In this context, "tracking error" refers to the variability of performance relative to the nominated benchmark for the strategy. A strategy may be assigned this type of rating either because the potential for high tracking error has been demonstrated by the strategy's past performance, and/or because the nature of the investment process is such that a significantly higher than average tracking error could be expected.

Preferred provider status

Preferred provider status is assigned to strategies within product categories for which Mercer does not maintain formal ratings. Examples include Cash, Passive and LDI strategies. Most Preferred Provider lists will not have been reviewed by a Ratings Review Committee. They will however have been reviewed by at least two suitably qualified researchers/consultants other than the researcher who recommended the rating.

Four factor ratings

In deriving Mercer's overall rating for a strategy, manager researchers also arrive at ratings for four specific factors labelled idea generation (IG), portfolio construction (PC), implementation (Imp) and business management (BM) respectively. Each of these factors is rated as either negative (-), neutral (=), positive (+) or very positive (++).

To explain these four factors, every investment process can be thought of as consisting of three main components as follows:

1. Idea generation – this covers everything that the manager does to arrive at views on the relative attractiveness of different investments.

2. Portfolio construction – this covers how the manager goes about translating its investment ideas into decisions on which investments it wants to include in a portfolio, and what weightings to give to each of these investments.

3. Implementation – this covers the implementation of the buy and sell trades required to achieve the desired portfolio structure.

Mercer believes managers that can do these three things well should have above average prospects for outperforming.

Over longer periods, managers must be able to maintain and enhance their capabilities in these three areas in order to remain competitive. To do this they need to manage their business well. This is where the business management factor comes in.

Whilst the overall rating for a strategy will take into account the four factor ratings for that strategy, it is not determined as some sort of weighted average of the four factor ratings. The final decisions on ratings take into account the relative importance of each of the four factor ratings to the overall performance prospects of the strategy under consideration on a case-by-case basis.

Environmental, social and corporate governance (ESG) ratings

Mercer also assigns ratings to investment management firms that represent Mercer's view on the extent to which ESG and active ownership practices (voting and engagement) are integrated into the fund manager's strategy – the four factors include idea generation, portfolio construction, implementation, and business management.
The ratings scale is ESG1 to ESG4, with ESG1 being the highest assigned to managers that are assessed as being 'leaders' in integrating ESG and active ownership into their core processes, with clear evidence that it is core to idea generation and portfolio construction.
ESG2 indicates that ESG factors are part of decision making with a strong level of commitment made at the firm wide level and some indication that data and research is being taken into account by the fund managers in their valuations.
An ESG3 rating is given to strategies where, in Mercer's view, the manager has made some progress with respect to ESG integration and active ownership, but there is little evidence that ESG factors actually factor into valuations and investment processes.
Strategies rated ESG4 have, in Mercer's view, done very little with respect to ESG integration or active ownership.

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