

**SURREY COUNTY COUNCIL**

**PENSION FUND COMMITTEE**

**DATE: 16 NOVEMBER 2018**

**LEAD OFFICER: LEIGH WHITEHOUSE, SECTION 151 OFFICER**

**SUBJECT: CEM BENCHMARKING REVIEW**



### **RECOMMENDATIONS:**

It is recommended that the Pension Fund Committee:

- a) Note the main findings of the report; the Fund's Net Value added, as a result of its investment strategy and active management decisions, was higher than other LGPS Funds by +0.1%. The Fund's overall investment costs in 2017/18 were lower than the peer benchmark by approximately -£1m. The fund also made cumulative savings in investment costs from 2013/14 to 2017/18, of approximately -£1.4m.

### **REASON FOR RECOMMENDATIONS:**

The Pension Fund Committee must approve and review all working documents produced for the Pension Fund.

### **DETAILS:**

#### **Background**

1. As part of the Fund's transition to Border to Coast (BCPP), Surrey Pension Fund has signed up to benchmark against other funds to compare different areas of performance, such as returns, asset mix, cost, risk, etc.

The Company chosen to carry out this benchmarking exercise is Cost Effective Measurement (CEM) Benchmarking. They specialise in benchmarking cost and performance of investments and providing insights into best practices. This is then compared against a custom peer group in addition to a collection of other funds.

#### **Methodology**

2. CEM's main performance comparisons are with other funds within the LGPS universe, which includes the partner funds within BCPP. The average asset worth of these funds is £5bn. This report provides insight into the level of inherent risk within the portfolio, what may have caused costs to change over time and assessing whether value for money has been achieved.

The information is based on survey returns provided by the Fund for the last 5 years ending March 2018, as well as information provided directly from Fund Managers. The report is currently in draft form pending data submissions from

other LGPS funds (which could affect the results).

## Findings

### 3. Investment return

It is important to note that having returns above or below peers does not necessarily reflect positively or negatively on the Fund. Each fund has a different set of priorities, funding position, risk appetite, etc. Each therefore has a different asset mix and this largely drives the total return. In this respect, return comparisons are interesting and provide context for the cost comparison, but they need to be interpreted with caution. The analysis breaks the Fund's total returns down into its two most important constituent parts and compares each.

- The strategic asset mix return is the return the Fund could have earned passively by indexing its investments in line with its strategic asset allocation. In effect, this is the return from decision making by the Committee about asset mix. It is typically the most important 'driver' of total returns. This part of the total return will be the responsibility of the Committee after pooling is complete.
- Net value added is the value created, after costs, through the implementation of the Committee's investment strategy and in particular by active management decisions, including tactical asset allocation, manager selection, stock selection, etc. This part of the total return will be the responsibility of BCPP after pooling is complete.

<b>5 year returns</b>	<b>Surrey Pension Fund</b>	<b>LGPS Median</b>	<b>Global Median</b>
Strategic asset mix return	8.0%	8.6%	7.6%
Net value added	0.2%	0.1%	0.2%
Total net return*	8.2%	8.6%	7.9%

\*The LGPS and global median total return is not the sum of the median strategic asset mix return and median net value added (hence the numbers do not add in the columns)

There are two important observations here:

- The Fund's strategic asset mix return was lower than LGPS peers reflecting the Fund's lower risk mix of assets (i.e., a lower weighting to more volatile assets). Less risk typically means more stability in contribution levels.
- Over the 5 years, the Fund's active management decisions were rewarded to a greater extent than other LGPS funds.

### 4. Investment Costs Comparison

The Fund's Investment Costs were compared against a peer group of LGPS Funds and non-LGPS funds excluding partners in BCPP, with a median size of £4bn. The Investment Costs are specifically those costs attributed to fund managers, as well as oversight and custodial costs.

The Fund's overall investment costs of 47.5bps were lower than the benchmark 50.2bps. The benchmark reflects what the peers would pay to manage the Fund's assets. The saving of 2.7 bps (£1m) relative to benchmark is made up of paying less in manager, oversight and custody fees by -5.9bps (-£2.3m), which is offset by a higher cost implementation style. The Fund differed from its peers in this area by approximately +£1.3m, as a result of having external managers rather than internal, more partnerships/ fund of funds held within private equity, but also holding more passive assets (cheaper) rather than active (more expensive).

<b>Reasons for Investment Cost Differences relative to benchmark</b>			<b>Excess Cost/ Savings (-)</b>	
			£000s	bps
<b>1. Higher cost implementation style</b>				
More passive management vs. higher cost active			-1,508	-3.9
More external management vs. lower cost internal			941	2.4
More partnerships for private assets (vs. funds)			510	1.3
More fund of funds			1,373	3.5
Less overlays			-55	-0.1
			<b>1,261</b>	<b>3.3</b>
<b>2. Paying less than peers for similar services</b>				
External investment management costs	The Fund	Peer Median		
Stock - Global	25.8 bp	44.3 bp	-1,482	-3.8
Diversified Private Equity – Fund of fund - top-layer base fees	57.0 bp	101.4 bp	-753	-1.9
Fixed Income - Global	11.4 bp	25.1 bp	-368	-0.9
Global Total Absolute Asset	64.5 bp	56.7 bp	306	0.8
All other differences			-50	-0.1
Oversight, custodial and other costs			56	0.1
			<b>-2,292</b>	<b>-5.9</b>
<b>Total savings</b>			<b>-1,031</b>	<b>-2.7</b>

#### 5. Cost changes over the years

The investment costs of The Fund decreased from 53.9bps in 2013/14 to 47.5bps in 2017/18, which amounts to £1.4m. The majority of these changes were as a result of paying lower fees for Stock/ Fixed Income (-7.3bps), lower base fees for Private Equity (-2.9bps), offset by higher performance fees paid to Private Equity Managers (+3.8bps).

#### **CONSULTATION:**

6. The Chairman of the Pension Fund has been consulted and fully supports the conclusions of the report.

#### **RISK MANAGEMENT AND IMPLICATIONS:**

7. Continue to benchmark with partners within BCPP as the Fund transitions more of its assets

8. Benchmark future assets that have transitioned into BCPP, to ensure expected cost savings are being achieved, in addition to competitive return on investment assets

#### **FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

9. There are no financial and value for money implications.

#### **DIRECTOR OF FINANCE COMMENTARY**

10. The Section 151 Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

#### **LEGAL IMPLICATIONS – MONITORING OFFICER**

11. There are no legal implications or legislative requirements

#### **EQUALITIES AND DIVERSITY**

12. The CEM Benchmarking Review analysis does not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

#### **OTHER IMPLICATIONS**

13. There are no potential implications for council priorities and policy areas.

#### **WHAT HAPPENS NEXT**

14. The following next steps are planned:
- Implementation of the recommendation.

#### **Contact Officer:**

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#### **Consulted:**

Pension Fund Committee Chairman

**Annexes:** None

**Sources/background papers:** CEM Benchmarking Review

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