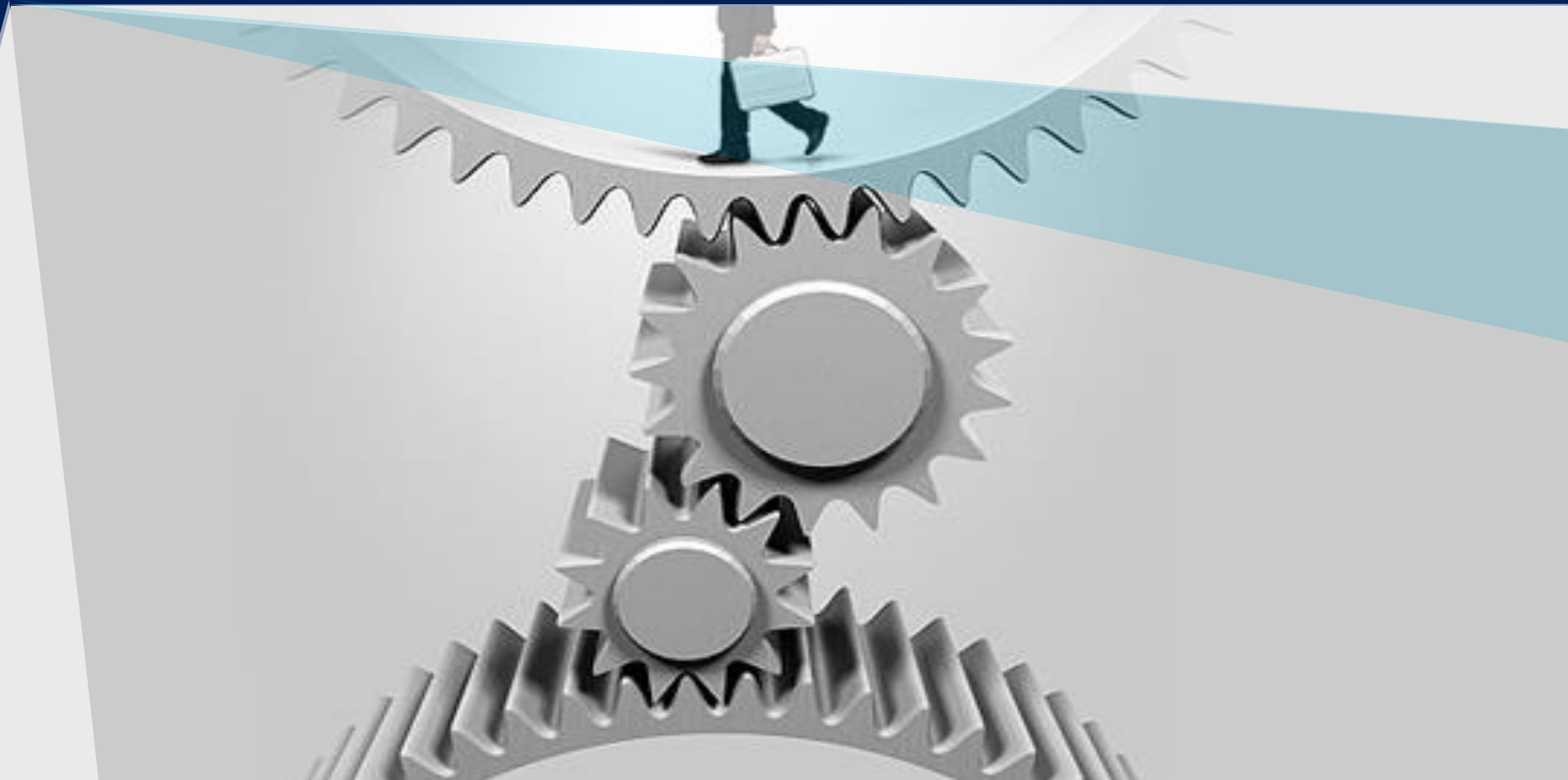


# ACHIEVING INVESTMENT EFFICIENCY

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JULY 2014



# AGENDA

- Defining Investment Efficiency
- Achieving Investment Efficiency
- Alternative Structures

# Defining Investment efficiency

Investment efficiency is a function of the **risk**, **return** and total **cost** of an investment management structure, subject to the fiduciary and other constraints within which investors must operate

Hodgson, Breban, Ford, Streatfield, Urwin, 2000

# Measuring Efficiency

- Net information ratio

Active return – costs

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Active risk

# Measuring Efficiency

- Net information ratio

$$\frac{\text{Active return} - \text{costs}}{\text{Active risk}}$$

Relative to  
market or  
liabilities?

Over what  
timeframe?

# Measuring Efficiency

- Net information ratio

Active return – costs

---

Active risk

More than just  
volatility of  
returns

But how to  
measure?

# Achieving Investment Efficiency



## Improving returns

Time frame

Long term  
approach

Consistency

High  
conviction  
investing

Rebalancing

Great ideas  
versus  
simplicity

Objectives and Governance

# Reducing leakages



# Random (simple) rebalancing example

£1 bn Fund  
80% equity  
20% index linked gilts

10 years to 1 Jan  
2014

No rebalancing versus  
annual rebalancing

Rebalancing gains  
£36 million

# Operational Risks

Can result in significant value destruction

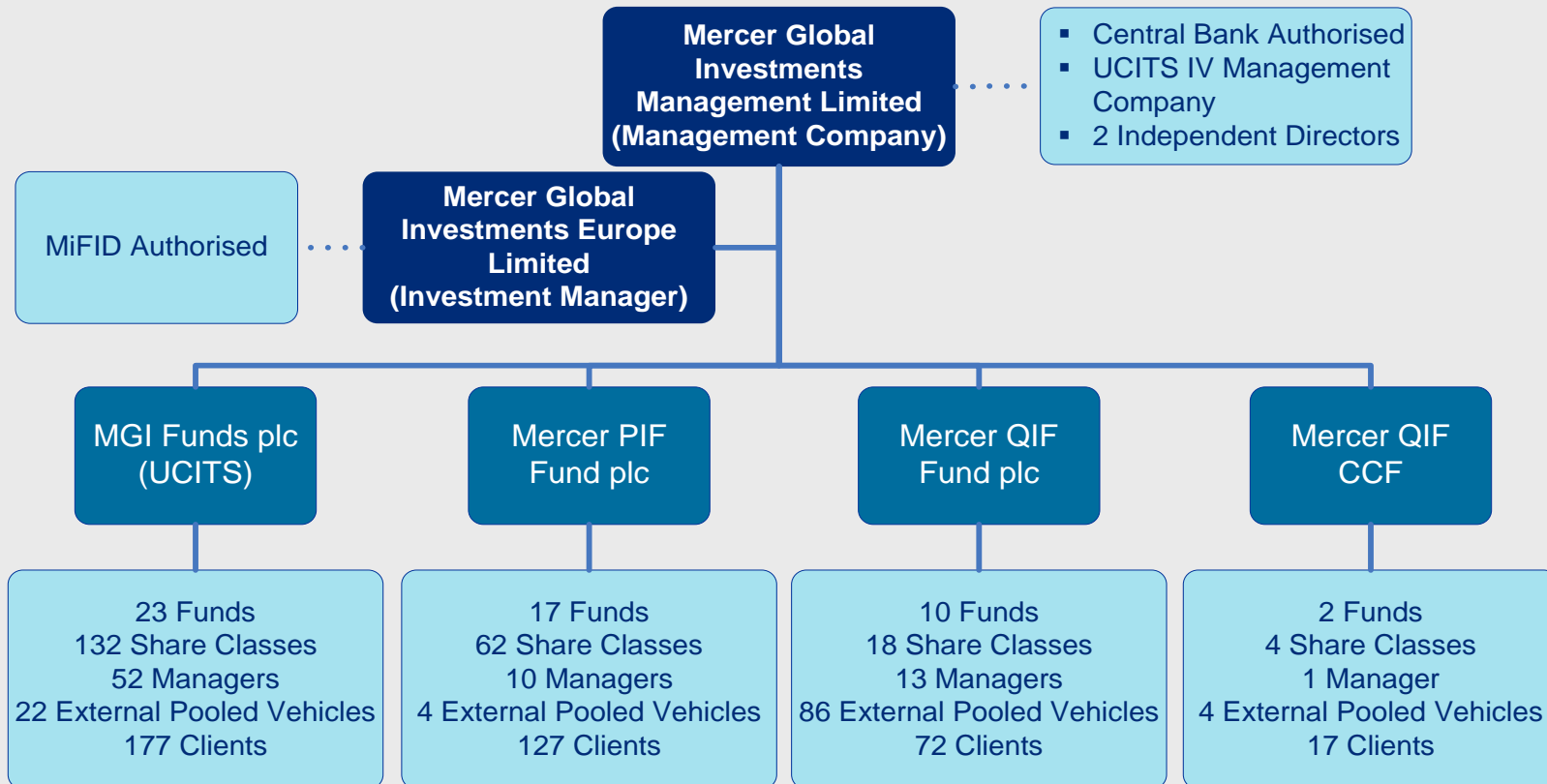
Good predictors of underperformance

Difficult to manage and expensive to mitigate

When choosing managers

When setting up internal structures

# Operational management



# Operational delivery and investment expertise



# LGPS Collaboration

## Custodian Procurement – Results so far

- Estimated **30 LGPS** are interested in procuring under the Framework
  - Larger or more complex Schemes may wish to procure independently
  - Smaller Schemes that are invested exclusively in pooled funds may not require a custodian
- **Completed**
  - Norfolk, Suffolk and London Borough of Hackney
  - Agreed to pool assets for joint procurement of 3 separate Schemes
  - Outcome was deemed to be efficient, transparent and cost effective
  - No incumbent bias: **HSBC** was selected over Northern Trust and State Street
- **Pending**
  - Northamptonshire and Cambridgeshire (LGSS)
  - 2 others are in progress
  - 7 more are intending to call off shortly

## First results of LGPS Collaboration on Custody Procurement

“Norfolk, Suffolk and Hackney Pension Funds have appointed HSBC Securities as custodian through the National Local Government Pension Scheme (LGPS) Frameworks. The three funds, with combined assets of £5.2bn, are *expected to save a total of £1.25m over the lifetime of the contracts, with an additional £250,000 saved in procurement costs.*”

*- Professional Pensions, 19 May 2014*

- *"This is **real collaboration in action**, already delivering real and significant savings and benefits for the LGPS today. The achieved and potential savings are very significant - based on evidence from the custody framework alone, as participation matures and grows, the LGPS could collectively benefit by more than £50m."*

*- Nicola Mark, Norfolk County Council*





1bps reduction saves £20m p.a.

What are the fixed costs?

Different approach to performance fees?

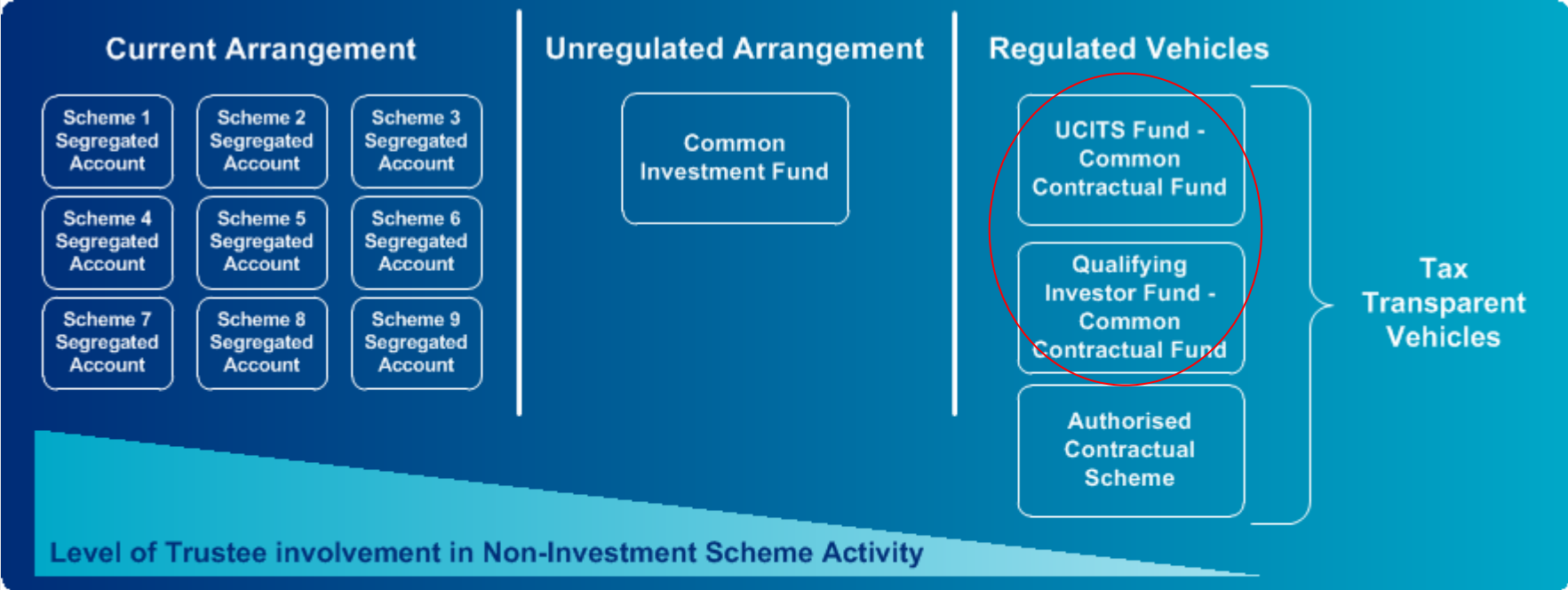
Structures

# Options

- CIVs
- Joint procurement
- Pooling assets
- Internal teams
- Delegation

# Asset Consolidation

## Continuum of Options: Potential Structures Available



Consolidation improves efficiencies, reduces risks and can allow greater flexibility

# CIV Case Study

## Unilever

- Circumstances:
  - 80 funded pension plans
  - c€20billion in assets
- Established pooled funds to capitalise on combined scale and improve governance
- Originally established 11 funds; c€6.5bn of assets in the pooled funds
- The set up process:
  - Time
  - Leadership
  - Comfort
  - Providers
- Costs
  - Set up
  - On-going
  - No “disappearing act”
- Ongoing
  - Currently rationalising number of funds to 8
  - Changing operational structure of pooled funds.
  - Adhering to changing regulatory requirements

# Options

- CIVs
- Joint procurement
- Pooling assets
- Internal teams
- Delegation

## Alternatives to CIVs?



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