

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	18 JULY 2013	AGENDA ITEM NUMBER 8
TITLE:	EMERGING MARKET EQUITY MANDATE – SPECIFICATION AND TENDER PROCESS	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Exempt Appendix 1 – Mandate Specification Exempt Appendix 2 – JLT Brief on Emerging Markets manager search		

1 THE ISSUE

- 1.1 In the new Investment Strategy agreed at the Special Committee Meeting on 6 March 2013, an additional 5% of the Fund's assets are to be allocated to emerging market equities. The Fund is seeking to appoint one manager to manage these assets.
- 1.2 The Panel have a standing delegation from Committee to select and appoint new investment managers.
- 1.3 This report sets out the proposed mandate specifications and selection process for the new emerging market equity mandate.

2 RECOMMENDATION

That the Investment Panel:

- 2.1 Agree the proposed mandate specification at Exempt Appendix 1**
- 2.2 Select their preference for the selection panel makeup from section 5.4**

3 FINANCIAL IMPLICATIONS

- 3.1 The budget provides for investment advice for tendering the emerging market equity mandate.

4 MANDATE SPECIFICATION

- 4.1 The proposed mandate specification is included at Exempt Appendix 1. JLT have provided a brief on the search process for an emerging markets equity manager at Exempt Appendix 2. Key considerations are as follows:

- (1) **Fund Structure** – The Fund will invite tenders from both segregated and pooled products in order to ensure the tender is as inclusive as possible and seeks to evaluate a broad range of products. A segregated mandate provides the potential to customise requirements to the Fund's needs and offers more control (within reason). Where the investment structure is via a pooled fund this minimises administration and custody requirements for investors as these elements are carried out at the pooled fund level. It is important that any pooled fund is of sufficient size so that the Fund does not own too large a share of the pooled fund. For that reason the tender will specify a minimum size such that if the Avon Pension Fund invests it holds no more than 20% at the outset.
- (2) **Management style / approach** – Due to the inefficiency of emerging markets, the Fund is seeking a bottom-up approach that focuses on selecting stocks based on strong company fundamentals. The Fund will not consider top down or quantitative approaches that select stocks by taking sector or country views, (although a top down risk assessment process alongside a fundamental bottom-up stock picking process is desirable). This will be evaluated as part of the selection process.
- (3) **Assessment of ESG risks** – The nature of emerging markets companies means there is more often a controlling shareholder (government, family or a shareholder group). This increases the importance of due diligence undertaken by investment managers on the governance of companies and their management to protect minority shareholder value. This reinforces the importance of a fundamental approach to investing. Although specific ESG engagement programmes and use of bespoke ESG analysis is developing, the focus remains on the quality of the company analysis.
- (4) **Restrictions and off benchmark characteristics** – Investments will be limited to equities or equity related securities, with no investments in debt allowed. No shorting of stocks or portable alpha (i.e. where outperformance generated on another asset class is transported onto an emerging markets portfolio) will be allowed. Investments in companies in frontier and developed markets will be allowed up to a limit when they are selected as a result of stock selection i.e. not an attempt to outperform the index by benefitting from the relative value between emerging, developed or frontier markets. The constraints in the tender specification will be minimised to leave it to the discretion of the manager as to their investment in frontier or developed market stocks but any developed market companies they invest in must derive at least 50% of their revenues from emerging markets.
- (5) **Performance target** – The performance target is to outperform the MSCI Emerging Markets Index (or FTSE Emerging Index) by +2% to +4% per

annum, net of fees, over rolling three year periods. The tender brief will not place additional constraints on the manager by imposing specific volatility or equity correlation targets, but the tender process will evaluate proposals from managers as to how they expect to achieve the return target.

- (6) **Fees** – Fundamental approaches to investing across emerging markets are relatively resource intensive and so attract higher fee levels than some developed markets or quantitative based approaches. It should be noted that the fee estimate in the specification is a realistic assessment of achievable fee levels and the invitation to tender will specify a performance target net of total expenses and fees.

5 SELECTION PROCESS

5.1 Due to the size of the mandate (c. £150m) the fees over the life of the tender exceed the OJEU (Official Journal of the European Union) limit and therefore a full OJEU procurement exercise is required.

5.2 An open OJEU tender will be conducted (where all investment managers that express an interest will be invited to submit a bid). The Fund has commissioned its investment consultant, JLT, to manage the tender process. The process will be as follows:

- (1) JLT develop tender questionnaire based on agreed mandate specification and evaluation criteria
- (2) JLT issue open invite for all qualified organisations to submit a tender bid.
- (3) JLT evaluate bids and draw up a long list report, including combination analysis with Fund's existing assets
- (4) Following meeting on long list with officers, short list drawn up
- (5) Officers and JLT do further due diligence on short listed managers
- (6) Selection meeting to appoint from short listed managers

5.3 It is expected that the process will take 6 months from advertising the tender until the investments are made in the successful tenderers. The tender will be managed through the Council's fully auditable online procurement portal.

5.4 The selection meeting can be arranged as:

- (1) A meeting of the full Panel (an extra meeting would be arranged);

or

- (2) Delegate selection decision to a meeting of a selection panel including Officers, JLT and those members of the Panel who wish to attend

Comments from the Panel on their preference will be sought at the meeting.

5.5 Proposed dates for an all-day selection meeting to be held in Bath are as follows: Weds 4th Dec, Fri 6th Dec, Mon 9th Dec, Tues 10th Dec.

6 EVALUATION CRITERIA

6.1 The evaluation of the tenders will adhere strictly and transparently to the tender process. The following criteria will be used to evaluate each tender:

- Investment Process, Philosophy and Style
- Corporate Governance and Responsible Investment
- Risk Management and Portfolio Construction
- Resources
- Commitment to strategy / asset class
- Corporate Structure
- Performance
- Fees
- Client service

6.2 The tender questionnaire is designed to specifically address the above criteria and the evaluation will be based on the evidence put forward in the tender submissions.

7 RISK MANAGEMENT

7.1 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund’s future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund. The selection and implementation of new investment mandates seeks to achieve the target strategic asset allocation and return profile. The Committee has delegated the manager selection and monitoring process to the Investment Panel.

8 EQUALITIES

8.1 An equalities impact assessment is not necessary.

9 CONSULTATION

9.1 N/a

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 The issues to consider are contained in the report.

11 ADVICE SOUGHT

11.1 The Council’s Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Matt Betts, Assistant Investments Manager (Tel: 01225 395420)
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Background papers	
Please contact the report author if you need to access this report in an alternative format	