

Review of controls and processes–Developed Far East Equity Portfolio
30th July 2015

Key Points

Within the last year Nomura's Internal Audit picked up one high and one medium risk. These related to the Finance function and are due to lack of segregation of duties. Additional checks have been implemented to mitigate the risk.

Internal Audit reported a low business error rate overall and no errors on the WCC portfolio.

PWC performs an annual audit of Nomura's systems and no exceptions have been reported for the last five years.

Nomura target 1/3 of outperformance from top down country allocation decisions and 2/3 from bottom up stock selection.

Graham Muirhead, in his position of Head of Investment Asia Pacific ex Japan, is the chair of the Asset Allocation Committee (country allocation) and has final say on target weights, including the split between Japan and Developed Asia – ex Japan. Vipul Mehta, Senior Portfolio Manager, is a member of the committee.

Shigeto Kasahara chairs the Developed Asia ex-Japan monthly Stock Selection Committee and makes the end decision on stock ratings. Vipul Mehta votes on the stock ratings and is responsible for individual security selection on the WCC portfolio.

A Japan Equity Investment Strategy committee meets monthly to determine sector weight splits. The Japan Stock Selection Committee, chaired by Yosuke Uchida, then determines the Japan stock recommendation list.

Team Overview

The Fund contracts with Nomura UK, who then delegate investment management operations and decisions to Tokyo and Singapore. Nomura's investment team is based in Tokyo and Singapore with their back office operations based in London.

Nomura has teams based in Japan, Singapore, Hong Kong, Malaysia, Korea, Frankfurt, UK, Taiwan, USA and representative offices in Korea, Shanghai and Australia. The team responsible for the WCC portfolio is stable with extensive experience and most team members have spent a significant amount of their working life at Nomura. Nomura have implemented a backup structure to reduce 'key man' risk. Investment team members are responsible for a primary and secondary (backup) country for stock selection. The team has lead individuals who interact with other Nomura offices to help construct the overall portfolio. Calls between the investment professionals across the regional offices take place on a daily basis ensuring a continuous flow of information across the investment platform.

Nomura have twenty-two research analysts within its Japanese equity research team. Analysts have specific sector expertise and are responsible for covering stocks within their respective sectors. In terms of final portfolio construction, Tezuka has overview across all sectors and is responsible for the final selection of Japanese securities for the portfolio.

Investment Process

Nomura targets 1/3 of outperformance from top down decisions and 2/3 from bottom up stock selection.

County Allocation Japan and Developed ex-Japan

Regarding the 'top down' investment process, monthly asset allocation meetings are held in Singapore on the last Wednesday of each month to determine the portfolio strategy. The other Nomura offices join the meeting by video conference call. Nomura's in house economist presents his global house view to the group followed by each country specialist presenting papers on their view of why a country over / underweight should be held. Senior managers of the team, which includes Vipul, then decide the county allocation. Graham Muirhead, in his position of Head of Investment Asia Pacific ex Japan, is the chair of the Asset Allocation Committee and has final say on portfolio target weights.

The Asset Allocation Committee first determines the split between Japan and ex-Japan. They then decide the split between the Asia ex-Japan countries. If an underweight position was selected in Australia for example then even if the bottom up investment team identified a significant number of attractive stocks in Australia the overall allocation to Australia would remain underweight.

Stock selection – Developed ex-Japan

The 'bottom up' investment process starts with quantitative analysis, which ranks stocks based on a number of valuation factors such as Price Earnings and Price to Book ratios. Industry analysis, external research and broker reports are also taken into account. Finally the human element is applied through company visits and fundamental analysis. For example, Vipul visits many companies in India between four and six times a year. Visits are also undertaken to China in order to gain a rounded and full view of the world economy.

Sector analysts stocks to either add to the portfolio or reduce. Stocks are ranked from one to four with 1 being the strongest rating and therefore an overweight position would be advised. Supplementary stock selection meetings are held between team members to discuss updates with special focus on the stocks held within the portfolio.

Shigeto Kasahara chairs the weekly Stock Selection Committee and makes the end decision on stock ratings following the committee meeting. Graham Muirhead also attends the Stock Selection Committee (as does Vipul) and is vocal.

Stock selection – Japan

A Japan Equity Investment Strategy committee meets monthly to determine sector weight splits. The Japan Stock Selection Committee, chaired by Yosuke Uchida then determines the Japan stock recommendation list and Tezuka constructs the portfolio with responsibility for individual stock weightings .

Execution of the strategy takes place in Tokyo for Japanese equities and in Singapore for Asia ex Japan securities. Nomura have experienced no issues with execution and use the same trading systems at both offices. Economists supply ideas on sector weights and the team also utilises the expertise held at the other Nomura offices.

Nomura believe a team based approach is optimal with significant information sharing. The Tokyo and Singapore offices link-up regularly and main meetings are held once a month between the offices but other calls are held weekly.

Australia

Kiran was not seen as a 'key man' but it is an awkward situation. Nomura carried out a difficult and protracted search for a specialist in Australia and were lucky to gain Kiran initially. Unfortunately Kiran has made the decision to return to Australia for personal reasons and will leave in July 2015. Nomura do not plan to seek a replacement for Kiran. Graham Muirhead has assumed the country responsibility for Australia within the team. Vipul remains 'back-up' for Australia. Nomura believe a 'passive' approach is again prudent until such point as they are able to demonstrate a consistent ability to generate active performance in this area of the portfolio going forward.

Compliance and Audit

Nomura's internal audit reported a low error rate overall and no errors on the WCC portfolio. Processes and systems are industry standard and are in place to prevent and detect errors.

Within the last year Internal Audit picked up one high and one medium risk. These related to the Finance function and are due to lack of segregation of duties. Due to the small number of team members it has not been viable to segregate duties to Internal Audit's satisfaction, so additional checks have been implemented to mitigate the risk.

Internal Audit as a function is outsourced to Nomura International to increase their independence. NAM UK has an Internal Audit representative who links in with the Internal Audit team to discuss findings. Action points are then assigned to the compliance and risk officer in addition to the lead of the department concerned. Staff are required to certify that they have read Nomura's policies and procedures manual and also receive regular training.

Performance Review Committee

The Performance Review Committee is a forum for high level oversight for strategy decisions of clients' portfolios. The Committee compares and contrasts similar accounts to flag anomalies, for example divergence of tracking errors will be investigated. The committee is also a forum to discuss performance on certain mandates and clients' concerns. The committee is chaired by Richard Bisson, CEO of NAM UK.

Technology

PWC performs an annual audit of Nomura's systems and no exceptions have been reported for the last five years.

Risk, Quant and Performance (RQP)

The RQP team monitor performance and risk and provide reports to managers and the investment team in Singapore and Hong Kong.

Investment managers can run risk impact assessments locally.

Nomura do carry out cross stock correlation analysis along with commonality assessments.

Conclusion

Nomura's investment processes, operational process and controls are functioning in line with Fund expectations and information disclosed to the panel and Fund officers by Nomura on such processes and controls is deemed accurate.