

ITEM NO: 3(a)

GREATER MANCHESTER PENSION FUND ADVISORY PANEL

18 September 2009

Commenced: 10.00am

Terminated: 12.40pm

Present: Councillor Oldham (Chair)

Councillors: Baldwin (Wigan), Heffernan (Oldham), Hobhouse (Rochdale), Mitchell (Trafford), Pantall (Stockport), Pennington (Salford), White (Bolton)

Employee Representatives

Mr Fraser, Mr Mulryan, Mr Rayner and Mr Thompson

Apologies for absence: Mr Llewellyn

25. CHAIR'S INTRODUCTORY REMARKS

The Chair welcomed everyone to the meeting and introduced a new Member, Councillor White, representing Bolton MBC.

26. DECLARATIONS OF INTEREST

There were no declarations of interest.

27. MINUTES

The Minutes of the proceedings of the meeting of the Pension Fund Advisory Panel held on 19 June 2009 were signed as a correct record.

The Minutes of the proceedings of the meeting of the Pension Fund Management Panel held on 19 June 2009 were signed as a correct record.

28. LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

(a) Urgent Items

The Chair announced that there were no urgent items for consideration at this meeting.

(b) Exempt Items

RESOLVED

That under Section 100 (A) of the Local Government Act 1972 the public be excluded for the following items of business on the grounds that:

- (i) they involve the likely disclosure of exempt information as defined in the paragraphs of Part 1 of Schedule 12A of the Act specified below; and

- (ii) in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information for reasons specified below:

<u>Items</u>	<u>Paragraphs</u>	<u>Justification</u>
6, 7, 8, 10, 11, 12	3&10, 3&10, 3&10, 1&10, 3&10, 3&10	Disclosure would or would be likely to prejudice the commercial interests of the Fund and/or its agents, which could in turn affect the interests of the beneficiaries and/or tax payers.

29. ETHICS AND AUDIT WORKING GROUP

The Minutes of the proceedings of the meeting of the Ethics and Audit Working Group held on 24 July 2009 were considered.

RECOMMENDED

- (i) That the Minutes be received; and
- (ii) With regard to 'Issues facing the Local Government Pension Scheme', that a special meeting of the Information Services Working Group be arranged to understand, comment and respond on the new Local Government Pension Scheme consultation to be issued by the Department of Communities and Local Government.

30. LOCAL INITIATIVES AND VENTURE CAPITAL WORKING GROUP

The Minutes of the proceedings of the meeting of the Local Initiatives and Venture Capital Working Group held on 31 July 2009 were considered.

It was reported that there was no further information regarding Project Golf at this time.

RECOMMENDED

- (i) That the Minutes be received; and
- (ii) With regard to 'EU Directive on Alternative Investment Fund Managers (AIFM)', that officers attend the proposed Capital Dynamics seminar and continue to liaise with industry/trade bodies regarding the draft AIFM Directive.

31. PROPERTY WORKING GROUP

The Minutes of the proceedings of the Property Working Group held on 31 July 2009 were considered.

The Director of Pensions referred to the case for buying property bank debt through a specialist fund that offered both banking and property expertise. This type of investment was being considered as part of the 'Special Opportunities Portfolio'.

It was noted that Councillor Sweeton be added to the list of persons present.

RECOMMENDED

- (i) That the Minutes be received; and

- (ii) **With regard to 'Pension Fund Property Portfolio', that the issue of monthly payment of rents and current working practices be a separate agenda item for the next meeting of the Working Group.**

32. SUMMARY VALUATION OF THE PENSION FUND INVESTMENT PORTFOLIO AS AT 31 MARCH 2009 AND 30 JUNE 2009

A report of the Director of Pensions was submitted, detailing and comparing the market value of the Fund's investment portfolio as at 31 March 2009 and 30 June 2009.

RECOMMENDED

That the report be noted.

33. UNDERWRITING, STOCKLENDING AND COMMISSION RECAPTURE

The Director of Pensions reported that the fund accepted sub-underwriting via UBS of three issues in the quarter ended 30 June 2009. It was also reported that Capital International did not participate in underwriting activity. Total underwriting commission received during the quarter was £578,566.

Stocklending income during the quarter was £239 and compared with £761,727 in the same quarter of 2008.

With effect from 19 September 2008, GMPF temporarily suspended its stocklending programme pending a return to less volatile market conditions. The Head of Pension Fund Investments commented that an internal review had taken place which indicated that, subject to the completion of a number of legal amendments, it was likely that GMPF would recommence the stocklending programme. The income received during the quarter was a one off correction of previous underpayments.

Commission 'recaptured' during the quarter was £31,202 and compared with £17,538 in the same quarter of 2008.

RECOMMENDED

That the report be noted.

34. EXTERNAL MANAGERS' PERFORMANCE

The Director of Pensions submitted a report which advised Members of the recent performance of the external Fund Managers.

It was noted that in the quarter to 30 June 2009, Capital underperformed by 1.5% against their benchmark index of 7.2%. UBS had outperformed by 2.3% against their benchmark index of 8.0% and Legal and General had succeeded in broadly tracking their benchmark.

Performance figures for the twelve months to 30 June 2009 were also detailed which showed that Capital had underperformed their benchmark by 0.6%, UBS had outperformed their benchmark by 3.5% and Legal and General had succeeded in broadly tracking their benchmark.

RECOMMENDED

That the report be noted.

35. REPORTS OF THE MANAGERS

(a) UBS Global Asset Management

Mr Powers began by expressing UBS's satisfaction at recent and long term performance.

It was reported that during 2009, forecasts of economic growth had been revised down. However, a more stable picture was expected in 2010, when some economic growth was forecast. CPI inflation was now bottoming out and some inflation was forecast for 2010.

Markets were showing clear signs of stabilisation as global credit spreads have reduced, and 'green shoots' of relative improvement were noted in the manufacturing PMI indices and by way of increased US real consumption spending.

The inflation-deflation debate was outlined, with the key argument for deflation being the output gap – the largest since the early 80s – which would stay large as a result of weak economic recovery. The key argument for inflation was the massive increase in the monetary base which would eventually lead to money growth. Both views are held in the market and Mr Powers stated that the arguments suggest near term lower inflation or even deflation, followed by higher inflation.

Current asset allocation was detailed. Mr Powers stated that equities were still cheap, particularly compared to relatively expensive bonds. However, he was of the view that banks needed more regulation than there had been in the past.

He concluded by commenting on the need to redress the imbalance between over consumption in the West and over saving in the East.

Mr West then made reference to the second half of 2008, when a portion of the portfolio had been switched from defensive to cyclical stocks, and commented on how this better positioned the portfolio for a rising market.

He also commented on wide valuation spreads which implied further significant gains ahead, and that the very largest companies were set to beat the market.

He summarised by stating that, looking ahead, equities and corporate bonds were attractive while government bonds remained overvalued.

The Advisors were then asked to comment.

Mr Hemingway congratulated UBS on their performance, and commented that it was reassuring that their style remained value orientated.

Mr Moizer also added his congratulations.

(b) Capital International

Mr Gosztory began by commenting on the strong equity market performance in quarter two of 2009 and explained that the portfolio performance had lagged in this quarter largely because of its defensive positioning within developed markets. The main problem area over the longer term had been stockpicking in the US and the UK. Various changes had been made to the management team, culminating in the change of the US equities portfolio manager in October 2008. Since that change, the portfolio had outperformed by 1%, including 2.9% from stockpicking in the US.

He acknowledged the disappointing recent performance, however was confident that the defensive orientation in developed markets, coupled with high emerging markets exposure, was the right balance going forward.

Mr Carlyle then commented on three important economic cycles. The inventory cycle was V-shaped and had recovered quickly. There had been no recovery in the capital expenditure cycle which remained negative due to spare industrial capacity. The consumer spending cycle is the most important of the three, but it could take many years for households to pay down debt and rebuild their balance sheets.

He explained that emerging market economies remained generally healthy, with strong surpluses and healthy domestic credit conditions.

The asset allocation breakdown was discussed and the shape of the developed equity portfolio was also outlined.

Mr Carlyle concluded by recognising the portfolio's disappointing results, but stated that changes had been made to improve the investment process and teams.

He believed the economic outlook in developed markets would be for slow growth and in emerging markets a faster-paced recovery.

It was Mr Carlyle's belief that Capital had the right portfolio balance for these conditions. As an active manager with a strong research base, Capital were well positioned to benefit from resulting investment opportunities.

The Advisors were then asked to comment.

Mr Bowie acknowledged the disappointing performance and agreed with Capital's analysis.

Mr Moizer also agreed with Capital's analysis. He questioned why Capital did not have the right portfolio position in March 2009 and what had gone wrong as regards Capital's poor European equity performance, but stated that the portfolio was now well placed, agreeing with Capital's overweight emerging markets position and acknowledging the improvement in Capital's US performance.

Mr Carlyle concurred with Mr Moizer's view on Europe and added that there had been a brief period of change in the market which Capital had been slow to take advantage of.

RECOMMENDED

That the reports of the Managers be noted.

36. REVIEW OF INVESTMENT MANAGEMENT ARRANGEMENTS

Consideration was given to a report of the Director of Pensions which explained that the contracts with both of the Fund's active Securities Managers (Capital International and UBS) contained fee arrangements which covered a three year period ending 31 March 2010. Capital International had a performance fee arrangement with a base fee whilst UBS had a base fee only. The end of the three year cycle provided a natural break-point for the initiation of a review of the Investment Management arrangements of the Fund.

It was explained that the 19 June 2009 meeting of the Panel received a presentation by David Cullinan of the WM Company which covered the key findings of WM's internal research on the nature of the determinants of the success, or otherwise, of Local Authority pension funds (minute 17 refers).

The key findings were summarised in the report.

The report concluded by stating that the medium and long term performance of the Fund remained strong (minute 13 refers). In terms of investment management arrangements, the broad

conclusion of the Panel at the 19 June 2009 meeting was that the overall approach taken by GMPF in terms of having a combination of two active managers (currently Capital and UBS) together with one passive (i.e. index-tracking) manager (currently L&G) had served the Fund well in terms of relative performance over the medium and long term.

The WM research had not produced any convincing evidence which would contradict a view that the Fund's current arrangements remained fit for purpose and there was no compelling evidence that any alternative approach would be more likely to lead to better outcomes going forward.

It was proposed that following the Panel meeting, the Director of Pensions and Head of Pensions Investments hold 'review meetings' at the offices of Capital and UBS to discuss the manager's respective performance record and other matters, with the prime objective of forming a view on the future performance likely to be generated by each active manager. GMPF officers would be assisted at these meetings by one or more of the Advisors and/or an investments specialist from Hymans Robertson.

Following these meetings a further detailed report would be brought to the next meeting of the Panel (20 November 2009).

The Advisors were then asked to comment.

Mr Bowie explained that he considered that the present structure broadly suited the Panel and commented on the current manager roster. He stressed the importance of the proposed 'review meetings' being held at the offices of Capital and UBS and stated that an active manager's continuity of style was very important.

Mr Moizer concurred with Mr Bowie's comments and added that Capital should be questioned closely with regard to their underperformance. He commented on the 'key personnel' risk and that the 'review meetings' were an opportunity to monitor this risk.

Mr Hemingway agreed with the comments made by Mr Bowie and Mr Moizer. He stated that he was disappointed with Capital's performance over the last two years and that there was a need to look at Capital in detail, given the higher costs of active management versus those of cheaper passive management, although he himself was against passive management. He stated that big asset allocation decisions were not being taken by UBS and Capital which had led to the Fund's use of the L&G Tactical portfolio and he suggested that in future, the internal investment team could be more active in asset allocation.

RECOMMENDED

- (i) That the report be noted and that the conclusion that the overall approach taken by GMPF in terms of having a combination of two active managers [currently Capital & UBS] together with one passive (ie index-tracking) manager [currently L&G] be endorsed as having served the Fund well in terms of relative performance over the medium and long term;**
- (ii) That the Director of Pensions and Head of Pensions Investments, assisted by one or more of our Advisors and/or an investments specialist from Hymans Robertson, hold 'review meetings' at the offices of Capital and UBS; and**
- (iii) That a further report on the matter be considered at the next meeting of the Panel on 20 November 2009.**

37. ADVISORS COMMENTS AND QUESTIONS

Mr Moizer commented on the future of the UK economy and stated that talk of the recession being over was premature, and he felt that it would be a number of years before the UK economy recovered to its previous level.

He explained that equity markets had risen considerably and were probably due for a correction. He suggested trimming the Fund's exposure to equities. The property market had performed badly and was probably near the bottom.

Mr Hemingway agreed with Mr Moizer with regard to trimming the Fund's exposure to equities and concurred that property was an attractive asset class at the moment. He added that the gilt market held the key to the future of equity markets in which the central banks had created another bubble.

He advocated a reduction in the Fund's overweight equity position through a phased disinvestment from the L&G Tactical portfolio, with the proceeds to be invested in property, possibly via the derivatives market.

Mr Bowie shared the views of Mr Moizer and Mr Hemingway. With the FTSE at around 5,100, he advocated a two tranche disinvestment from the L&G Tactical portfolio, and stated that the Fund should consider reinvesting in the portfolio should equity markets fall by 20%.

38. PROPERTY INVESTMENTS UNIT – STRATEGIC REVIEW

Consideration was given to a report and presentation from the Head of Property Investments which advised Members of the property portfolio and the strategy which the Head of Property Investments would be following over the next twelve months.

He also summarised activity during the year and the current portfolio structure. Forecast returns for the period 2009/2013 and the portfolio strengths and weaknesses were also outlined.

Strategic recommendations were also outlined and discussed.

With regard to staffing issues, Mr Lofstedt added that he hoped to strengthen the team with two new appointments, and it was also hoped to add a building surveyor to the team in the future.

Mr Bowie agreed with Mr Lofstedt's strategy and added that very little property was changing hands at the present time, and patience was required to wait for appropriate opportunities.

Mr Moizer concurred with Mr Bowie's comments and congratulated Mr Lofstedt on a relatively good year.

RECOMMENDED

That the report be noted.

39. PROPERTY INVESTMENT QUARTERLY REPORT

The Head of Property Investments presented his quarterly report on the property investment market together with a summary of recent management and investment activity.

RECOMMENDED

That the report be noted.

40. TREASURY MANAGEMENT COUNTERPARTY LIST

The Director of Pensions submitted a report which recommended that the Pension Fund's lending list be extended to incorporate certain well known high street financial institutions to enhance returns and to reduce the current concentration of investments within money market funds.

The report gave details of 'eligible institutions'. These are institutions with a facility to issue marketable securities with a government guarantee and access to the Special Liquidity Scheme. It concluded by proposing that the Pension Fund broadens its counterparty base to include the seven high street institutions (Abbey National; Bank of Scotland; Lloyds TSB; Clydesdale; RBS; Barclays; and Nationwide Building Society) even though these institutions would not meet the Council's current minimum investment criteria. Such broadening would be subject to the authorisation of the Borough Treasurer.

This proposal was considered a suitable way for the Pension Fund and the Council to enhance the returns on its cash deposits. Other options were available, but they would potentially require a wider compromise in terms of the overall security of investments.

These changes would ease the pressure on investing cash (as evidenced by the scarcity of counterparties and concentration of cash within money market funds) whilst maintaining security of capital as the highest priority of the Council's Investment Strategy.

RECOMMENDED

That the Pension Fund broadens its counterparty base to include the seven high street institutions (i.e. Abbey National; Bank of Scotland; Lloyds TSB; Clydesdale; RBS; Barclays; and Nationwide Building Society) subject to the authorisation of the Borough Treasurer.

41. RECOVERY OF EU WITHHOLDING TAX

Consideration was given to a report of the Director of Pensions which advised the Panel of the recent successful outcome of the Fund's attempt to recover Withholding Tax (WHT) deducted from dividends paid to GMPF in the Netherlands.

RECOMMENDED

That the report be noted.

42. LGPS – DELIVERING AFFORDABILITY, VIABILITY AND FAIRNESS; CLG INFORMAL CONSULTATION

The Director of Pensions submitted a report which commented on the latest CLG consultation about the Scheme. It was explained that the closing date for responses was the end of September 2009.

The report detailed the purpose of the consultation and outlined the comments on the proposals provided by the Actuary.

The report concluded by explaining, that for understandable reasons the CLG wished to see relatively stable employer costs as an outcome of the 2010 valuations. They proposed two new methods, neither of which was considered necessary unless there was a desire to fund at less than 100%. Historically, the Panel had been supportive of targeting a 100% funding level and the Panel reaffirmed its support for a 100% funding target. This was in the context of the 'stabilisation mechanisms' considered at the March 2009 Panel which would be the subject of further consultation with the Fund's stakeholders, prior to the completion of the 2010 valuation. Existing regulations encouraged stability and already allowed the phasing in of increases in employer contributions. The guidance on the content of the funding Strategy Statement could be developed to require more risk assessment to be incorporated into the FSS.

There was doubt that marginally reducing employee contributions would increase the rate of membership, and a risk that increasing employee contributions could have a counter-productive effect. On balance, the concerns raised by CLG could be better dealt with in the second phase of

the consultation regarding 'New Scheme' design, rather than increasing contributions at this stage. Thus it was proposed that the current rates were maintained.

RECOMMENDED

That the Director of Pensions be authorised to respond to CLG reflecting the Panel's views as above.

43. EMPLOYERS JOINING GREATER MANCHESTER PENSION FUND

Consideration was given to a report of the Director of Pensions which described the types of employer that could become participants in Greater Manchester Pension Fund and the arrangements in place to minimise risks for existing employers. The overall security of employers was very strong albeit some community admission bodies did not have a local authority guarantor. The larger bodies of this type were listed in the report. This analysis of employers provided essential background to the Actuary in undertaking his actuarial valuation.

RECOMMENDED

That the report be noted.

44. DELEGATION SCHEME – PENSION BENEFITS AND CONTRIBUTIONS – REPORT FOR THE PERIOD 1 APRIL 2008 TO 31 MARCH 2009

The Director of Pensions submitted a report which informed Members of necessary amendments to the Scheme of Delegation to Officers Relating to Pension Benefits and Contributions and what action taken has been taken by the Director of Pensions under them during 2008 – 2009.

RECOMMENDED

That the report be noted.

45. MEMBERSHIP CHANGES

The Director of Pensions submitted a report which outlined the continued changes in membership. It also detailed retirement experience and provided comparisons between local authority employers. Overall the number of ill health and early retirements continued to fall.

RECOMMENDED

That the report be noted.

46. INTERNAL DISPUTE RESOLUTION PROCEDURE

Consideration was given to a report of the Director of Pensions which outlined the IDR process and gives details of the number of Stage 1 and Stage 2 cases and their outcomes that had been received during the period April 2008 to June 2009.

RECOMMENDED

That the report be noted

47. SCHEME ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVCs)

A report of the Director of Pensions was submitted which focused on the investment performance in the with-profits fund, the deposit fund and the unit-linked arrangements for 2008/09 reported by the Prudential, the Fund's AVC provider.

RECOMMENDED

That the report be noted.

48. ANNUAL GOVERNANCE REPORT

The Director of Pensions informed Members that historically the Pension Fund's accounts had been treated as part of the Council's accounts for audit purposes. As a result of regulatory change and Audit Commission national guidance, the District Auditor issued two reports on the financial statement of the Fund, covering:

- (i) The Fund's financial statements as covered in the Fund's Annual Report; and
- (ii) The Fund's financial statements included within the administering authority's accounts.

The District Auditor presented his Annual Governance Report. He envisaged an unqualified audit opinion and drew the Panel's attention to the Action Plan agreed with management.

RECOMMENDED

- (i) **That the content of the reports be noted;**
- (ii) **That the Chair of the Panel and Director of Pensions sign the letter of representation on behalf of the Management Panel; and**
- (iii) **That the proposed action plan be agreed.**

49. ANNUAL REPORT AND ACCOUNTS

RECOMMENDED

That the Annual Report and Accounts be approved.

50. DATES OF FUTURE MEETINGS

The dates of future meetings for the 2009/10 municipal year were noted as follows:

20 November 2009
5 March 2010

CHAIR