

ITEM NO: 3(a)

GREATER MANCHESTER PENSION FUND ADVISORY PANEL

20 November 2009

Commenced: 10.00am

Terminated: 12.40pm

Present: Councillor Oldham (Chair)

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

Employee Representatives

Mr Mulryan, Mr Fraser, Mr Llewelyn, Mr Thompson, Mr Rayner

51. DECLARATIONS OF INTEREST

There were no declarations of interest.

52. MINUTES

The Minutes of the proceedings of the meeting of the Pension Fund Advisory Panel held on 18 September 2009 were signed as a correct record.

The Minutes of the proceedings of the meeting of the Pension Fund Management Panel held on 18 September 2009 were signed as a correct record.

The Minutes of the proceedings of the meeting of the Annual General Meeting held on 18 September 2009 were signed as a correct record.

53. 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

RECOMMENDED

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 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. |

54. ETHICS AND AUDIT WORKING GROUP

The Minutes of the proceedings of the meeting of the Ethics and Audit Working Group held on 23 October 2009 were considered.

The Chair, Councillor Middleton, made reference to Minute 16 – CIPFA Benchmarking Reports and the comparative statistics with all members of the benchmarking club and it was noted that the Fund had the third lowest annual cost per member. The Fund also continued to have the lowest annual cost per member amongst larger funds. The Executive Director of Pensions gave a short presentation providing further explanation of the comparative statistics.

The Head of Pensions Investments made reference to Minute 18 – 2009 Investor Statement on a Global Agreement on Climate Change commenting that three major international bodies representing institutional investors had issued an open letter which was designed to influence decision makers ahead of the United Nations Climate Conference in Copenhagen. The Chair of the Panel, Councillor Oldham, then commented on Tameside MBC's newly formed Carbon Reduction Forum and the possibility of its involvement with the Fund's investments in buildings. He added that the Chair of the Forum, Councillor Holland, was also a Member of the GMPF Management Panel.

RECOMMENDED

That the Minutes be received.

55. INFORMATION SERVICES WORKING GROUP

The Minutes of the proceedings of the meeting of the Information Services Working Group held on 23 October 2009 were considered.

Councillor Middleton (in the Chair), made reference to Minute 7, the Pensioners Forum, and informed Members that this could no longer be held at New Century House, the venue for the Forum for the last 11 years. He added that the Communications Team were working hard in order to find a suitable replacement.

With regard to Minute 6, Department of Communities and Local Government: Consultations. The Executive Director of Pensions advised that the second consultation exercise on Scheme Design had not yet been issued and it could be delayed until after the general election. He also made reference to the recent amendments to the LGPS in relation to ill health retirements and the implications of these changes on scheme members, the employer and the Fund as administrator.

For small employers, the cost of a tier 1 retirement could, in exceptional circumstances, be very significant for the employer. He advised that he had written to Communities and Local Government outlining the position on this matter and he also advised of the assistance provided to employers in helping to manage the associated costs.

The Chair of the Panel reiterated his support for a defined benefit pension scheme and the need to be ready to contribute to the national debate on the future of the LGPS.

RECOMMENDED

That the Minutes be received.

56. 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 30 October 2009 were considered.

The Chair, Councillor Cooney, made reference to Minute 6, Project Golf and formally thanked all staff involved for their hard work. This was echoed by the Chair and Members of the Panel.

RECOMMENDED

That the minutes be received.

57. PROPERTY WORKING GROUP

The Minutes of the proceedings of the meeting of the Property Working Group held on 30 October 2009 were considered.

The Executive Director of Pensions drew attention to minute 8 relating to the issue of development commitments that could be offered to public authorities and could assist in securing more development opportunities.

RECOMMENDED

That the Minutes be received.

58. SUMMARY VALUATION OF THE PENSION FUND INVESTMENT PORTFOLIO AS AT 30 JUNE 2009 AND 30 SEPTEMBER 2009

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

RECOMMENDED

That the Minutes be received.

59. UNDERWRITING, STOCKLENDING AND COMMISSION RECAPTURE

The Executive Director of Pensions reported that the Fund accepted sub-underwriting via UBS of one issue in the quarter ended 30 September 2009. It was also reported that Capital International did not participate in underwriting activity. Total underwriting commission received during the quarter was £222,320.

Stocklending income during the quarter was nil compared with £139,859 in the same quarter of 2008. The Head of Pensions Investments commented that the Fund was on target to recommence the stocklending programme following the resolution of certain legal issues which are being worked on at the moment. He added that the Fund's prudent programme had proved robust when stress tested by the collapse of Lehman Brothers.

Commission 'recaptured' during the quarter was £23,997 and compared with £17,414 in the same quarter of 2008.

RECOMMENDED
That the report be noted.

60. EXTERNAL MANAGERS' PERFORMANCE

The Executive 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 September 2009, Capital outperformed by 0.4% against their benchmark index of 19.1%. UBS had also outperformed by 2.6% against their benchmark index of 18.7% and Legal and General had succeeded in broadly tracking their benchmark.

Performance figures for the twelve months to 30 September 2009 were also detailed which showed that Capital had outperformed their benchmark by 0.6%, UBS had outperformed their benchmark by 4.3% and Legal and General had succeeded in slightly exceeding their benchmark.

The Head of Pension Fund Investments commented on the excellent performance of UBS over both the latest quarter and twelve month periods.

RECOMMENDED
That the report be noted.

61. REPORTS OF THE MANAGERS

(a) Capital International

Mr Gosztony began by commenting on another very strong quarter in equity markets. The portfolio had outperformed the benchmark despite the somewhat defensive positioning in developed markets. Results were positive in both equities and bonds with a continued strong recovery in US results. He explained that since various recent changes made to the team, the portfolio had outperformed by 3.1%, including 4.0% from the US. It was the continued belief that the defensive orientation in developed markets coupled with high emerging markets exposure was the right balance for the portfolio going forward.

Mr Gosztony made reference to three important economic cycles. The inventory cycle was definitely improving and the capital expenditure cycle was better but utilisation rates were still low. With regard to the consumer spending cycle, households were continuing to rebuild their balance sheets. The combination of these three cycles suggested a subdued recovery.

Mr Hole then reported on equity market valuations which still appeared reasonable and overall the market had recovered from the lows earlier in the year. However, Capital were cautious regarding the outlook for Financials due to stricter capital requirements, the regulatory framework, government ownership and prices being well ahead of events.

The asset allocation breakdown was discussed and the shape of the developed equity portfolio was also outlined. Mr Hole explained that this had not changed a great deal since the last quarter.

In summary, Mr Hole explained that the economic outlook in developed markets would be for slow growth with a faster-paced recovery in emerging markets. It was his belief that Capital had an appropriately defensive portfolio for these conditions. Finally, he stated that the changes to Capital's team and process were starting to bear fruit.

The Advisors were then asked to comment.

Mr Bowie requested Capital's views on inflation. Mr Hole responded that he felt that a rise in inflation was highly unlikely in the next two years.

Mr Moizer agreed with Capital's analysis and sought Capital's views on unemployment. Mr Hole commented on the high speed of increase in US unemployment levels. However he made reference to a number of job creation programmes, such as road building, the effects of which had not yet impacted on unemployment figures.

Mr Hemingway sought Capital's views on the emerging markets and questioned how much more emerging markets outperformance would be needed before investor prospects had been fully discounted by the market.

Mr Hole explained that corporate governance was now much better than it used to be, however there were areas, such as Russia, where this was still an issue. He further added that if emerging markets outperformed developed markets by a further 20% over the next 12 months then the relative valuation would have changed sufficiently to make Capital neutral to emerging markets.

(b) UBS Asset Management

Mr Stemp began by commenting on the favourable market conditions over the last 3 and 12 month periods and the recent strong performance of the portfolio.

It was reported that the recession was still ongoing and the cumulative decline in UK gross domestic product since the start of the recession was outlined.

Mr Stemp made reference to inflation pressures and quantitative easing measures introduced by the Government. He outlined the risk of inflation should the increased money supply move from the banks to the consumer, but stated that the large output gap should depress inflation.

Current asset allocation was detailed. It was reported that since the end of the quarter, equity weightings had been reduced and index linked and UK gilts weightings had been increased.

Mr Stemp also outlined changes to the team, in particular to the fixed income department where two very experienced people had been recruited. He further reported that analysts, the portfolio management team and the asset allocation team had also recruited when the opportunity arose.

Mr Powers then commented on UK equities. He informed Members that it had been a strong 12 months with the drivers of performance being cyclical companies. Negative factors were 'megacaps' which had lagged during the market rally and also the lack of investment in those companies with an exposure to Asia. Mr Powers remained confident that the current wide valuation spreads represented a positive backdrop for UBS' style of investing and expressed his confidence that UBS' good performance would continue in 2010.

The Advisors were then asked to comment.

Mr Moizer congratulated UBS on their performance. He made reference to the experience and expertise of the current team, in particular Mr Powers and sought assurances that their investment style would not change.

Mr Powers, in his response, explained that the UBS UK Value team comprised not only himself, but also Richard West and Steve Magill who were both experienced and shared the commitment to the investing style. He commented further that the strength of the research was better than ever.

Mr Hemingway added his congratulations. He questioned both how far equity markets would have to rise before UBS considered valuations to be too high and also what the active risk was for UK equities.

Mr Stemp responded that the concern over the valuation of equity markets is the speed with which they have recovered. However, he added that markets were not yet overvalued. Mr Powers added that following the period of outperformance, the active risk had reduced to about 4%.

RECOMMENDED

That the reports of the Managers be noted.

62. APPOINTMENT OF EXTERNAL ACTIVE SECURITIES MANAGERS AND ASSOCIATED FEE ARRANGEMENTS

Consideration was given to a report and presentation of the Executive Director of Pensions which considered the continuation of the appointments of the Fund's external Active Securities Managers and detailed the outcome of fee discussions with UBS and Capital International.

It was reported that the contracts with both the Fund's active Securities Managers contained fee arrangements which covered a three year period ending 31 March 2010. The current fee arrangements and asset allocation were detailed and information with regard to research findings on the nature of the determinants of the success, or otherwise, of Local Authority pension funds was outlined and discussed.

Details were given of review meetings held with Capital and UBS, where both were requested to present the case for why/how their future investment management activity for the Fund was likely to result in outperformance of the benchmark set for them. The focus of questioning and challenge was on each manager's process and investment approach, their past performance and how it was achieved and on the organisational and staffing changes made by each manager in order to address issues identified hitherto. Key issues arising from those meetings were highlighted.

It was reported that the two main types of fee arrangements for Securities Managers are a flat fee and a performance fee. Fee proposals from Capital and UBS under both of these arrangements were outlined and discussed.

Members of the Panel then asked questions on the report and presentation. The Advisors supported the recommendations.

Mr Moizer also commented on the performance of both Managers and made reference to the research findings that 'the activity of 'hiring/firing' active Securities Managers in an attempt to 'chase' superior performance could be detrimental to fund wealth.

RECOMMENDED

- (i) That the appointment of Capital International be continued for a further three years until March 2013 and that the proposal for a performance fee arrangement as described in the report be accepted and implemented.**
- (ii) That the appointment of UBS Global Asset Management be continued for a further three years until March 2013 and that the proposal for a performance fee arrangement as described in the report be accepted and implemented.**
- (iii) That the current arrangements in respect of passive investments managed by L&G be reviewed in 2010/11.**
- (iv) That the overall allocation of assets to UBS be reviewed during the coming three years.**

63. ADVISOR COMMENTS AND QUESTIONS

Mr Bowie made reference to the unusual conditions in the property market where there was an increasing number of empty shops on the high street yet the 'London feeding frenzy' was bidding up prices.

Mr Bowie further referred to the fact that the Fund's property exposure had fallen to half of what the Fund would want, and that he believed strenuous efforts should be made to build exposure to the long term target allocation of 10%. Mr Bowie encouraged the Head of Property Investments to take advantage of the current 'feeding frenzy' and sell properties that did not feature as part of his long term strategy.

He also made reference to the allocation to the Property Venture Fund and advised that this could be used to build up development sites in the North West.

Mr Bowie also made reference to the funding level and commented on the two sides to funding. Whilst the value of the assets had increased as stock markets had risen, the cost of liabilities had also increased as the markets anticipate inflation in two to three years time. Thus as previously highlighted, it was likely the funding position would have deteriorated compared to the 2007 position when the 2010 valuation is undertaken.

Mr Moizer made reference to quantitative easing and the effect of this on markets. He expressed concerns that the 'green shoots' of recovery were an illusion. He believed that the UK was in a difficult monetary position.

The Chair asked how different the UK position was to that of Europe and the USA.

Mr Moizer responded that the USA was in a very similar position, and that the situation in Europe differed by country, but that in general, Europe had entered the recession with lower borrowing levels.

Mr Hemingway also commented on quantitative easing and the huge expansion of government debt which could lead to increased volatility in gilt and currency markets. He added that the Fund should take advantage when markets became overvalued. Both Mr Moizer and Mr Hemingway supported Mr Bowie's views on the relative attractiveness of property but noted the recent increases in prime property prices. Mr Hemingway advised in favour of the acquisition of agricultural/farmland.

RECOMMENDED

- (i) That the comments of the Advisors be noted.**
- (ii) Further investment in property to progress towards the strategic allocation target to include the acquisition of agricultural/farmland be approved.**

64. SPECIAL OPPORTUNITIES PORTFOLIO: APPROVAL OF INVESTMENT TYPE

The Executive Director of Pensions submitted a report which had been presented to the meeting of the Local Initiatives and Venture Capital Working Group on 30 October 2009, which gave details of a new type of investment for the Fund's newly constituted 'Special Opportunities Portfolio' and provided details of an example of a specific opportunity.

RECOMMENDED

That approval be given to the making of investments from the 'Special Opportunities Portfolio' in the new type of investment as described in sub-section 4.1 of this Report ('Commercial Property Debt Fund'), should officers determine that it is appropriate to do so.

65. 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.

66. NEW SCHEME DESIGN

The Head of Pensions Administration gave a brief presentation on the above and advised that the consultation paper from Communities and Local Government had been delayed. He agreed to report further information on this matter at the next meeting of the Panel, which would be circulated to all members in advance of the meeting.

RECOMMENDED

That a report be submitted to the next Panel meeting giving initial consideration to a response to the expected consultation paper from Communities and Local Government on "New Scheme Design".

67. PENSIONS INCREASE 2010

The Executive Director of Pensions submitted a report which outlined the way in which LGPS pensions were increased each year in line with inflation, the nil increase expected to apply from April 2010 and compared this with past increases and the expected future actuarial assumption on price inflation.

RECOMMENDED

That the report be noted.

68. DATES OF FUTURE MEETINGS

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

5 March 2010

CHAIR