

WIRRAL COUNCIL

PENSIONS COMMITTEE

24 JUNE 2013

SUBJECT:	MEDIUM TERM ASSET ALLOCATION
WARD/S AFFECTED:	ALL
REPORT OF:	STRATEGIC DIRECTOR TRANSFORMATION AND RESOURCES
KEY DECISION	NO

1.0 EXECUTIVE SUMMARY

- 1.1 The purpose of this report is to request that Members approve a framework for active management of medium term asset allocation.
- 1.2 Appendix 2 to the report contains exempt information. This is by virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972, i.e. Information relating to the financial or business affairs of any particular person (including the authority holding that information).

2.0 BACKGROUND AND KEY ISSUES

- 2.1 Members will be aware that on 12th March 2013 there was a specific meeting to deal with active management of medium term asset allocation. At this meeting there were presentations from both Aon Hewitt and the internal team. The core themes of the presentation were that
 - The Fund in its SIP targets out performance through tactical or medium term asset allocation from its strategic benchmark;
 - The Fund's performance in this aspect has been poor but, to a greater extent, the underperformance has been caused by an inability to correct unintended asset allocation positions. The Fund has not been able to quickly move back to benchmark weightings;
 - It is very difficult to move assets between managers to implement changes to asset allocation and almost impossible for illiquid asset classes;
 - Asset allocation in the medium term should, in the first instance, focus on the balance between equities and bonds and then separately between different types of bonds and geographical equity regions;
 - Derivatives can provide a solution to these issues for the equity and bond split but there are risks that need to be clearly understood and controlled/mitigated where possible. The most likely solution would be an overlay manager using derivatives to complement the real assets of the fund with the objective to bring the fund to a net position either in line with its

strategic benchmark or implementing a deliberate medium term active position;

- There needs to be a clear governance structure providing a framework for MTAA, including objectives, roles, investment limits and performance measurement for officers, advisers and fund management.

2.2 The meeting concluded with broad agreement on the following action points

- Officers to design a proposal for a framework for MTAA and present it to this meeting of Pensions Committee for further consideration.
- Aon Hewitt would undertake due diligence on the operation of an MTAA framework and to attend this Pensions Committee to give a presentation to Members.

3.0 RELEVANT RISKS

3.1 The appendices include consideration of risks related to implementation of active management of medium term asset allocation. The control of risks is a key part of the due diligence.

4.0 OTHER OPTIONS CONSIDERED

4.1 The appendices include consideration of options for implementation of active management of medium term asset allocation.

5.0 CONSULTATION

5.1 Not relevant for this report.

6.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

6.1 There are no implications arising directly from this report.

7.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

7.1 The aim of this exercise is to improve the overall returns and risk adjusted returns of Merseyside Pension Fund and therefore will have beneficial financial implications. The targeted return from medium term asset allocation is 0.25% of the Fund which at present would potentially improve returns by approximately £15m per annum.

7.2 There are no Staffing or IT implications of this report.

7.3 To date consultancy fees of £25,000 have been invested in the due diligence on this project and an on-going £50,000 per annum is estimated for the MTAA consultant as a variance to the Aon Hewitt contract under agreed draw down rates.

8.0 LEGAL IMPLICATIONS

8.1 There are no implications arising directly from this report.

9.0 EQUALITIES IMPLICATIONS

9.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

(b) No because there is no relevance to equality.

10.0 CARBON REDUCTION IMPLICATIONS

10.1 There are no carbon usage implications, nor any other relevant environmental issues arising from this report.

11.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

11.1 There are no planning or community safety implications arising from this report.

12.0 RECOMMENDATION/S

12.1 That Pensions Committee approves a framework for active management of medium term asset allocation including the following key aspects:

- The setting up of a MTTA panel as outlined in the appendix
- The appointment of an overlay manager subject to completion of due diligence work by Aon Hewitt (This will be delegated to officers and reported to Committee in September).
- The provision of additional services from Aon Hewitt as MTAA advisors under their existing contract.

12.2 Subject to approval, the Compliance Manual will be amended to reflect the MTAA framework.

12.3 That Pensions Committee notes the additional consultancy fees paid to Aon Hewitt for conducting due diligence on the recommended arrangements.

13.0 REASON/S FOR RECOMMENDATION

13.1 The approval of investment strategy by Pensions Committee forms part of the governance arrangements of Merseyside Pension Fund.

REPORT AUTHOR: **Paddy Dowdall**
Investment Manager
telephone: 0151 242 1310
paddydowdall@wirral.gov.uk

APPENDICES

*There are 2 appendices to this report
Appendix 1 Internal Report setting out governance framework and implementation of active management of medium term asset allocation.*

Exempt

Appendix 2 Initial Aon Hewitt discussion document with revisions for developments since 12th March 2013

REFERENCE MATERIAL

No reference material used in the production of this report.

SUBJECT HISTORY (last 3 years)

Council Meeting	Date
IMWP minutes	25 March 2013

**Framework for Implementation of
Active Management of Medium Term Asset Allocation**

1. Executive Summary

- 1.1 The purpose of this note is set out the framework for the Implementation of Active Management of Medium Term Asset Allocation.
- 1.2 The note will cover the background, objectives of the framework governance structure, role of the MTAA panel, role of the overlay manager, monitoring regime and next steps.

2. Background

- 2.1 The background to this note is covered in section 2.1 and 2.2 of the main report
- 2.2 The MTAA framework excludes illiquid investments and therefore applies to 76% of the Fund's assets

3. Objectives

- 3.1 The objectives of the framework are two fold
 - To reduce risk of under performance caused by unintended asset allocation positions from the Fund's strategic benchmark
 - To implement in a timely fashion intended asset allocation positions from the Fund's strategic benchmark with a return target of 0.25% per annum on a rolling 3 year basis

4. Governance Structure

- 4.1 The structure for the MTAA would fit in with the current governance structure of MPF as detailed below and make use of current delegated powers. The Compliance manual is currently being revised to reflect the new Constitution and has yet to be approved by this Committee.
 - The Compliance Manual of MPF with reference to the Constitution states that the Pensions Committee is; To be responsible for the overall investment policy, strategy and principles of the Fund and its overall performance of the Fund.
 - The Compliance Manual also states that
 - The Committee has delegated certain powers to the Director of Finance. The following function is delegated to the Director of Finance pursuant to Section 101 of the Local Government Act 1972 and by the Executive under Section 15 of the Local Government Act 2000.

- *“Undertake all day to day administration of Merseyside Pension Fund within the policy laid down by Pensions Committee including the authorisation of admission agreements with transferee admission bodies pursuant to Best Value arrangements, as required by the Local Government Pensions Scheme Regulations.”*
- *“Terminate a contract of an external investment manager and enter into any consequential arrangements for the transitional management of the Fund’s investments pending the decision of the Pensions Committee on the award of a new contract.”*
- Investment Monitoring Working Party (IMWP)
- Has responsibility for reviewing the performance of the Fund’s investments and its asset allocation and regularly reporting their findings to Pensions Committee
- Head of Pension Fund
- Responsible to the Director of Finance and has delegated authority to make investments or to delegate to other employees investment decisions in accordance with the Fund’s strategic benchmark and delegated dealing limits.

4.2 The proposed governance structure for the MTAA complies with his role and broadly consists of

- An MTAA Panel chaired by Head of Pension Fund (acting for DoF under delegated power and having a veto).
- An overlay Manager appointed to implement decisions of MTAA and overseen by MTAA Panel

4.3 The IMWP will oversee and monitor performance of the MTAA Panel and overlay manager and will receive reports from WM (the Fund’s independent performance analyst).

5. MTAA Panel

5.1 Membership

Head of Pension Fund, Senior Investment Manger, Investment Manager, Independent Advisor, Strategic Advisor and new MTAA Advisor (also in attendance Overlay Manager).

5.2 Scope

- Review performance of overlay manager in previous quarter and also longer term in implementing previous instructions

- To determine and implement, with the agreement of the Head of Pension Fund, any medium term asset allocation positions to be taken on the strategic asset allocation.

5.3 Timings

The panel will meet within 5 days of the quarter end to review previous quarter actions, performance and to reset benchmark weightings for coming quarter

6. Overlay Manager

6.1 Aon Hewitt are currently conducting due diligence on two prospective overlay managers Northern Trust and Black Rock. The procurement process is being done on the basis of existing arrangements for custodian services and the transition manager framework (all 4 were asked to submit bids but only BlackRock made a proposal).

6.2 The overlay manager will receive data on the current asset allocation of the Fund and use derivatives and other financial instruments to rebalance the portfolio back to the strategic benchmark in the first instance and potentially to a revised benchmark with active positions around the strategic benchmark as decided by the MTAA panel.

7. MTAA Adviser

7.1 This will be a specialist from the Aon Hewitt team; the cost will be based on the contractually agreed daily rate. Officers are still in the process of confirming the amount of time that will be budgeted for on an annual basis - an early estimate is around £50,000.

8. Monitoring Regime

8.1 The Fund's performance is measured and reported independently by WM Company who will report on performance of the MTAA both separately and in the context of the Fund. The reports will go to the IMWP on a quarterly basis.

9. Next Steps

9.1 Aon Hewitt will complete due diligence on the selection of the overlay manager.

9.2 Officers will then conduct contractual due diligence with the overlay manager who, once appointed, will set up the arrangements; the target date is end of September.

9.3 The panel will be convened in October and the framework will be fully implemented.

9.4 Officers will report to Pensions Committee on the final contractual arrangements.

10. Appendices

- 10.1 Aon Hewitt are presenting a report on the Principles of MTAA and the proposals for implementation at this meeting. An earlier version of this report was presented to Members at the meeting of the IMWP on 12th March 2013.