SOUTH YORKSHIRE PENSIONS AUTHORITY

INVESTMENT BOARD

8 DECEMBER 2011

PRESENT: Councillor M Lawton (Chair)
Councillors: K Goulty, T Hussain, B Johnson, B Perrin and A Sangar

Officers: F Bourne (Administration Officer), L Cooksey (Member Services Manager), J Hattersley (Fund Director), M Oades (Deputy Clerk & Solicitor & Monitoring Officer) and S Smith (Head of Investments)

Trade Union Members: M Stowe (Unison) and G Warwick (GMB)

Investment Advisors: S Arkle, R Gilson and T Hardy

Councillor R Wraith (observer)

1 ANNOUNCEMENTS.

None.

2 URGENT ITEMS.

None.

3 ITEMS TO BE CONSIDERED IN THE ABSENCE OF THE PUBLIC AND PRESS.

RESOLVED – That that agenda item entitled "Currency Hedging" be considered in the absence of the public and press.

4 DECLARATIONS OF INTEREST.

None.

5 MINUTES OF THE MEETING OF THE BOARD HELD ON 22 SEPTEMBER 2011

SA requested an amendment to Item 13 – page 6, fourth paragraph from the bottom – the last word should be 'contacts' not 'contracts'.

RESOLVED – That the minutes of the meeting of the Board held on 22 September 2011 be agreed and signed by the Chair as a correct record.

6 WORK PROGRAMME

A report of the Fund Director was submitted reminding Members of the responsibilities of the Board and the matters it may need to consider over the next twelve months or so.

Councillor Perrin requested that the Board receive a briefing on the effect of market volatility on the Fund portfolio and investments. He emphasised that it did not require actuarial input.

Councillor Sangar requested that the dates and frequency of Board meetings be reviewed in order to try and make them more timely.

The trades union representatives requested more training and a greater opportunity to be involved in the decision making process.

M Oades stated that Officers had begun a review of the Authority's structure and this would take into account Board meeting timetables. She also referred to the Pensions Advisory Panel.

RESOLVED – That Officers be requested to arrange a training session on investment market volatility and its consequences for the Fund.

7 LOCAL AUTHORITY PENSION FUND FORUM - JUNE 2011 BUSINESS MEETING

A report of the Fund Director was submitted informing the Authority that the minutes of the June 2011 Business Meeting had been issued.

RESOLVED – That the report be noted.

8 LOCAL AUTHORITY PENSION FUND FORUM: UPDATE

A report of the Fund Director was submitted bringing to Members' attention responses made by the Forum to Government consultation processes during the year. The report also referred to the Forum's engagement with the United Nations Principles for Responsible Investment and the request by the latter for greater UK Pension Fund involvement. Whilst applauding the aims of UNPRI, Members noted the cost and associated administrative burden of subscribing to the principles.

RESOLVED – That the Authority notes the contents of the Forum's consultation responses but that it declines to subscribe to the United Nations Principles for Responsible Investment.

9 IIGCC PAPERS AND SUBSCRIPTION RENEWAL

A report of the Fund Director was submitted updating the Board on the work of the Institutional Investors Group on Climate Change. The report sought the approval of the Board to renew the Authority's membership of the Group.

RESOLVED – That the Board accepts the report now submitted and agrees to renew membership of the Institutional Investors Group on Climate Change for a further year.

10 WINTERHILL RETAIL PARK, MILTON KEYNES: REFURBISHMENT

A report of the Fund Director referred to a proposal from a Member that the Board made an inspection visit to Winterhill Retail Park at Milton Keynes. The park was one of the more valuable investment properties owned by the Fund and was multi-let. Over the last few years the property had been subject to a rolling programme of refurbishment works. Four potential dates in February 2012 were put forward and Members asked to select one. After a discussion it was agreed to extend the invitation to trades union representatives as well.

RESOLVED – That the Board agrees to visit the Winterhill Retail Park at Milton Keynes on a date to be agreed.

11 EMERGING MARKET EQUITY EXPOSURE

In accordance with the discussions that had taken place at the last meeting of the Board on the 22 September, 2011, the Fund Director submitted a report outlining the various externally managed funds that had been identified as potential investment vehicles and the responses received from the advisors. Subsequent to that correspondence the managers of two of the favoured funds had indicated that they were not open to new business. The manager of a non-favoured fund had quoted a fee of 80bps per annum for a £100m investment. (i.e. £800,000). During the discussion which followed advisors reiterated their view that the Authority should seek an external manager for an actively managed vanilla global emerging market segregated mandate for the additional allocation of £100m to the Other International equity portfolio. In the interim, despite the governance issues it raised, advisors recommended investing in a physically-backed non-synthetic ETF. Advisors rejected using investment trusts or other existing vehicles because of costs.

Advisors acknowledged that there would be costs and a time delay involved in awarding such a mandate. The award would need to be advertised in accordance with OJEU requirements and an external consultant would likely need to be appointed to assist in the process. It was suggested, that if at all possible, informal enquiries be made of an investment consultant to try and determine which external managers would consider such a mandate prior to going to advertisement.

RESOLVED – That subject to the further enquiries outlined above the Board agrees to proceed as follows:

i) Invest £100m into a physically asset backed ETF in the short term.

ii) Appoint an outside consultant to advise on the procurement of a manager for a segregated global emerging market equity mandate at an estimated cost of £15,000 to £25,000.

iii) Subject to (ii), appoint an external manager for a segregated global emerging market equity portfolio in the sum of £100m, at an estimated cost of £800,000 per annum, and for the contract to be awarded in accordance with OJEU procurement requirements if required.

iv) Approve the non-budgeted expenditure that arises from the above decisions and which may fall in the 2011/12 and 2012/12 budgets.

At this point in the proceedings the independent investment advisors left the meeting whilst the following matter was discussed.

12 INVESTMENT ADVISORY PANEL

A report of the Clerk and Treasurer was submitted advising the Board that under the new arrangements agreed in June this year, two of the current three advisors on the Investment Advisory Panel would retire on 31 March, 2012

It was agreed that the Board wanted there to be three members of the Panel. It was also agreed that should either of the two retiring advisors wish to re-apply they be allowed to do so but that any such appointment be for only a specified and limited period, possibly one year, and not for a full ten year term.

It was noted that the Board had been aware of the retirement position when it appointed R Gillson earlier in the year and that some of the short listed candidates who applied for the post of advisor then would be appropriate now. Therefore, the Board instructed the Fund Director to contact those candidates, and others identified at the time but not called for interview for various reasons, to determine whether they would wish to be considered now. If there was a sufficient number of candidates identified as a result of this process interviews would be held as soon as practically possible. If not, the Board agreed to appoint an external consultant to assist with the recruitment process.

It was also agreed that the job specification for the position of advisor needed to be more tightly drawn and that candidates should be encouraged to be pro-active in approach. It was agreed to delegate the interview process to Chair and Vice-Chair rather than full Board.

RESOLVED –

i) That the retiring advisors be informed that they could re-apply for their positions if they so wished but if they did so and were appointed that their tenure would be restricted to a short period of time.

ii) That the Fund Director be instructed to contact the other candidates who had been interviewed earlier in the year and to identify other suitable contacts and ascertain whether they would be willing to put their names forward now.

iii) That if sufficient candidates were identified by the above process that they be interviewed by the Chair and Vice-Chair.

iv) That if insufficient candidates were identified then an external consultant be appointed to conduct a search at an estimated cost of £8,000 to £10,000, and that the appropriate supplementary estimate be included in the budget for 2011/12 or 2012/13.

At this point in the proceedings the independent investment advisors rejoined the meeting.

13 QUARTERLY REPORT - QUARTER ENDED 30 SEPTEMBER 2011

The Board reviewed the performance of the Fund during the quarter ended 30 September, 2011. The Fund returned -6.9% against the expected benchmark return of -6.4%, with the Fund valuation falling from £4508.9m to £4196.3m.

The underperformance over the quarter was due to the asset allocation as stock selection overall added value. Being underweight in bonds, especially UK fixed interest, which was the best performing asset class and being overweight equities cost the fund 1.3%. However, advisors noted that in comparison with other funds the performance was reassuring.

The Board noted that global equity markets were again volatile over the quarter as investor sentiment continued to deteriorate. European debt concerns continued. Perceived political stalemate in the US had led to a ratings downgrade which was compounded by poor economic news in August. September saw the IMF reducing global growth estimates and the Federal Reserve warning of significant risks to the US economy. Added to this was also the fear of a downturn in China. There was a general flight to quality and this led to developed world government bond yields falling further. In the UK the 10 year gilt ended at 2.43%. Corporate bonds significantly underperformed government issues as risk appetite turned negative. Corporate yields rose. Equities were the weakest asset class this quarter.

The activity within the bond portfolios reflected the start of the transition to the new benchmark so monies were switched from UK conventional gilts into emerging market bonds. Within equities £5m was added to each of the US, the OFE and Other International portfolios.

Looking forward, volatility would be an ongoing feature. For those able to take a long term view equities looked attractive, especially for income seeking investors. Many blue chip companies were trading on PE ratios around 10x, making them cheap on an historic basis. Meanwhile yields on government and corporate bonds were so low that equity dividends in many cases were offering more income than bond coupons. (Nearly 1/3 of S&P companies now paid a dividend that yielded more than the interest on their intermediate bonds meaning that equity investors had the benefit of potential price appreciation, dividend growth and greater income than bondholders.)

The advisors and Board noted that the operational cost of investment management was now identified within the report. This would be carried forward on an annual basis. The figures up to end March 2011 were:-

Hendersons	(portfolio value c£300m*)	£321,064
Standard Life	(portfolio value c£275m*)	£596,461
Bidwells	(portfolio value c£90m*)	£ 29,991
Internal team	(portfolio value c £3440m*)	£657,559

*Values as at end September 2011
*Subject to performance fee on top, if applicable

A Member asked a question regarding the selection of benchmark indices and another Member sought an update on the void level within the property portfolio and the level of incentives needed to entice new tenants. Amongst the questions from advisors were ones on the level of drawdowns within the private equity portfolio, the difficulties that some five to seven year old vintage funds faced in re-financing and the relatively poor performance of the absolute return fund portfolio. A Member sought further information regarding the suggestion that pension funds invest monies into infrastructure projects and was advised that there had been no contact from government about this. An advisor sought more specific country allocation information within the emerging market equity portfolios. There was a discussion over the future of the Euro and the Eurozone but no conclusions were drawn.

RESOLVED – That the report be noted.

14 <u>BOND MANAGEMENT PRESENTATION</u>

The Board received a presentation on bond management from K Palmer, who manages the gilt and international bond portfolios and the currency hedging operation, on behalf of the Authority.

KP set out the rudiments of bond investment management: bond prices move in inverse relation to interest rates – i.e. prices rise when interest rates fall and vice versa – and the two major tools in managing bonds are yield and duration because the longer the bond is to maturity the bigger the impact on price of a change in yields.

The Fund's largest portfolio is index linked at £600m. Real yields at the moment are as low as they have ever been. In response to a question from a Member it was noted that this Fund's relative high weighting in ILGs compared to other LGPS funds stemmed from its slightly more mature liability profile. Conventional gilts are also overvalued. Current yields are extremely low and are a result of both safe haven buying and the quantitative easing policy of the Bank of England. RG asked about issuance by the Government and KP said the Bank of England will have bought roughly half of this year's gilt issuance.

TH asked about the Index used to measure the emerging markets bond portfolio and was told that it is a customised version of a JP Morgan Index reflecting the mix between US dollar and Euro issues.

SA asked about internal reporting disciplines. KP explained the procedures adopted and described his sources of information and market intelligence including specialist bond brokers; Bloomberg and websites, credit rating (S&P and Moody's) agencies and risk analysis. The portfolio's yield and duration are monitored versus the Index, as are country weightings on a duration weighted basis, as risk control was at the heart of the operation.

KP then spoke about high yield bonds which is the newest portfolio and is still being built up with only £15m invested so far. There was a discussion about risks of default in the asset class, which comprises corporate bonds of below investment grade rating, and KP emphasised that the most important criteria was the quality of the company issuing the bonds. He described the structure of the index (Merrill Lynch High Yield BB-B), and how the portfolio would be structured by analysing sector weightings, comparing companies within sectors and comparing individual issues. SA asked what the target weighting was and about liquidity in the market. The target weighting was 2% of the total Fund, say £85m, and might contain 80-100. Liquidity has been poor ahead of the Christmas break, but should improve in 2012.

RESOLVED – That the presentation be noted and that Mr K Palmer be thanked for an interesting and informative presentation.

15 EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED – That under Section 100A of the Local Government Act 1972, the public and press be excluded from the meeting for the following items of business, on the grounds that it involves the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act and the public interest not to disclose information outweighs the public interest in disclosing it.

16 CURRENCY HEDGING

The Fund Director reported upon progress regarding the adoption of a passive currency hedging strategy. The report highlighted the potential extent of the monthly rollover exposure and the effect that increased holdings of cash would have upon treasury management operations.

RESOLVED – That the Board notes the operation of passive currency hedging that commenced in November in accordance with the Board resolution agreed at its meeting held on 22 September 2011.

CHAIR