

EXEMPT Appendix 1

Framework for Implementation of Active Management of Medium Term Asset Allocation Revised as at 30th August 2013

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 At previous meetings of Pensions Committee and IMWP Members have agreed the following core principles following presentations from advisers and officers.
 - 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 Members have delegated; the following action points to implement these core principles.

- 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.
- 2.3 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 The Overlay Manager will be BlackRock who will manage the overlay portfolio through a Qualified Investment Fund. This is an efficient solution for the trading accounting custody and administration for the overlay mandate. The

cost of the overlay manager is £150,000 per year; this will be withdrawn from the pooled vehicle directly on a quarterly basis.

- 6.2 BlackRock will receive data on the current asset allocation of the Fund from the Custodian (Northern Trust) in a timely fashion and put together a portfolio of derivatives and other financial instruments that rebalances the overall MPF 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 Officers are in the process of conducting contractual due diligence with Black Rock. Once complete BlackRock will set up the QIF and MPF will fund in cash approximately £50m (The cash will be largely be utilised as collateral for derivative instruments).
- 9.2 The aim is for the panel will be convened in early November to give first instructions to BlackRock who will then implement the required portfolio. (There are risks that can cause delays to this project)
- 9.3 Officers will report to Pensions Committee on the final implementation in November 2013 or in January 2014 if there are delays to commencement.