GREATER MANCHESTER PENSION FUND - INVESTMENT MONITORING AND ESG WORKING GROUP

Friday, 14 October 2016

Commenced: 10.30 am **Terminated:** 12.30 pm

Present: Councillors Taylor (Chair), Ricci, Brett, Grimshaw, Mitchell, Pantall, Stogia and Mr Llewellyn

Apologies for Absence: Councillor Middleton and Mr Allsop

9. DECLARATIONS OF INTEREST

There were no declarations of interest.

10. MINUTES

The minutes of the meeting of the Investment Monitoring and ESG Working Group held on 15 July 2016 were approved as a correct record.

11. INVESTEC PORTFOLIO MONITORING

The Working Group welcomed James Hand, Stephen Lee and Jonathan Parker of Investec who attended the meeting to present Greater Manchester Pension Fund's (GMPF) investment activity for periods to 30 June 2016. An extract of Investec's latest quarterly report and their Global Core Equity Strategy Performance Review as at Quarter Two 2016 were appended to the report.

The Working Group were informed that Investec had been appointed by the Fund as a specialist external investment manager with a Global Equity Mandate in February 2015 and were expected to exceed a global equity benchmark by 2-3% per annum on a three year rolling average basis. Their stated approach was "*to achieve long term capital growth primarily through investment in a focused portfolio of equities issued by companies established in the larger, more liquid equity markets of the USA, Continental Europe and Japan*."

Investec adopted a '4Factor' investment philosophy and process to managing GMPF's portfolio. Companies were scored against the four factors of; Strategy, Earnings, Technicals and Value. Those companies who scored highly against these were subject to detailed fundamental, bottom-up research by an experienced team of analysts and portfolio managers and reviewed on a weekly basis for possible purchase, which should drive portfolio outperformance in the long term.

It was reported that Investec's relative performance for Quarter Two was - 2.2%. The key driver of the portfolio's underperformance was stock selection partially related to the effects of the UK's decision to leave the EU following the referendum in June 2016, which would continue to dominate market sentiment and risk appetite. Despite the markets being presented with frequent challenges, Investec believed that their disciplined process and ability to select individual investments according to key long-term growth drivers would withstand the current financial climate.
A performance review for 2015-2016 was also provided. For the 12 months to 30 June 2016, the Strategy had underperformed its benchmark by 7.9%, however, over the longer term the Strategy had achieved an outperformance of 2.1% per annum, within the target of 2-3% per annum over a three year rolling period. Investec had experienced underperformance previously between 2010

and 2011 in addition to the last two quarters and Mr Hand was confident that the team had the skills and knowledge to turn the position around.

A performance analysis of the top five positive and top five negative stock contributions over the three month period and the 12 month period to 30 June 2016 were outlined to the group and details of significant transactions over these periods were provided. Sector positions and regional allocations alongside the portfolio's tracking error were also outlined.

The struggling environment and currency had been key drivers for returns over the past year. Stable businesses had performed well but the financial sector had struggled. With regards to the '4Factor' process, 'Earnings' and 'Technicals' had been less effective as they worked less well during downturns and at economic turning points, 'Value' had been a drag on performance and had underperformed in the second half of 2015 and in the second quarter of 2016.

It was confirmed that team performance was constantly monitored and changes were made where necessary to research and portfolio management procedures. This ensured the efficacy of stock selection and portfolio construction and value would continue to be added over the long term through fundamental research and stock selection. This strong, focused philosophy should enable the generation of stable outperformance over time.

RECOMMENDED:
That the report be noted.

12. CAPITAL INTERNATIONAL CORPORATE GOVERNANCE REVIEW

The Working Group welcomed Richard Carlyle, Alison Fletcher, Rob Beale and Becky Sinclair of Capital International who attended the meeting to report on corporate governance activity (non-UK) for the past 12 months.

The case for shareholder dividends was outlined to the group. It was explained that dividends were distributions of cash to investors by owners of a company; they had become increasingly attractive to investors due to historically low bond yields. Their use sent a positive signal to investors and helped to instil financial discipline. Capital International regularly discussed the importance of dividends with senior company management.

Share buybacks were a form of distribution to investors where a company bought its own shares in the secondary market, which reduced the number of shares in issue and increased the stakes held by remaining shareholders. This option had become increasingly popular with corporate management. Although it sent a positive signal to investors and supported the share price, value was only created if shares were purchased below their intrinsic value.

Despite market volatility dividends had provided a respectable 4% return over a 115 year period in global equities. Since December 1979, across the S&P 500 stocks, dividend-growing companies tended to be better allocators of cash with an 11% return as of 30 June 2016 compared to 9.1% those companies undertaking share buybacks.

A summary of proxy voting activity for the 12 months to September 2016 for the Greater Manchester Pension Fund (GMPF) and Capital International Emerging Markets Fund was provided. For GMPF, there had been 3159 proposals at 245 worldwide company meetings; Capital had voted with management on 93.8% of occasions with 23 abstentions and 172 votes against management recommendations.

Two engagement examples were outlined to the group, which highlighted the consistent message given to companies around Capital International's voting policy.

RECOMMENDED:
That the report be noted.

13. CAPITAL INTERNATIONAL REPORT ON TRADING COSTS

The Assistant Executive Director of Pensions (Investments) submitted a report to facilitate Members' scrutiny of Capital International's approach to, and practice with regard to, trading costs by considering their 'level one' and 'level two' disclosure reports for the year to 30 June 2016.

It was reported that the 'level one' report detailed the fund managers' policies and procedures for the management and monitoring of total trading costs in order to achieve best execution for clients. The 'level two' report provided an analysis of Greater Manchester Pension Fund's (GMPF) trading volumes and commissions, which could be compared with Capital International's average client commission rates.

The Working Group were notified that Capital expected to review and update their 'level one' report by the end of 2016 and a copy of the report would be presented to a future meeting of the Working Group in 2017. A copy of the December 2014 'level one' disclosure was appended to the report and had been considered by the Working Group at its meeting on 16 October 2015.

Alison Fletcher of Capital International presented GMPF's 'level two' report for the 12 month period ending 30 June 2016, a copy of which was appended to the report. In order to increase transparency and give investment managers greater flexibility when acquiring broker or research providers, there had been a recent move away from bundled brokerage arrangements towards using commission sharing agreements.

The comparative disclosure table was outlined and detailed the value of trades, total commission paid, split between execution and research, for the 12 months to 30 June for the three years 2014, 2015 and 2016. The average commission rate had decreased between 2014 and 2016, which was in line with expectations.

It was confirmed that officers of the Fund had reviewed the report and any questions had been satisfactorily answered by Capital International.

RECOMMENDED:
That the report be noted.

14. UPDATE ON ACTIVE PARTICIPATION IN CLASS ACTIONS

The Assistant Executive Director of Pensions (Investments) submitted a report, which provided Members with an update on litigation in which Greater Manchester Pension Fund (GMPF) sought to actively recover losses in the value of its shareholdings in various companies as a result of actions taken by those companies.

A summary of active Class Action recommendations, which remained outstanding and recent developments of each action was provided.

RECOMMENDED:
That the report be noted.

15. UNDERWRITING, STOCKLENDING AND COMMISSION RECAPTURE

The Assistant Executive Director of Pensions (Investments) submitted a report advising Members of the activity and income generated on Underwriting, Stocklending and Commission Recapture during the quarter ending June 2016.

It was reported that Capital International did not participate in underwriting activity and the Fund did not participate in any sub-underwriting via UBS in the quarter ended June 2016. Stocklending income during the quarter was £394,603 and Commission 'recaptured' was £26,171.

The report outlined that income generated from these activities were very sensitive to market conditions, therefore the amounts generated were expected to vary from one quarter to another, and from one year to another.

RECOMMENDED:
That the report be noted.

16. UNITED NATIONS PRINCIPLES FOR RESPONSIBLE INVESTMENT REPORTING FRAMEWORK

The Assistant Executive Director of Pensions (Investments) submitted a report detailing the 2015 results for the United Nations Principles for Responsible Investment (PRI) reporting framework. The PRI's 'Summary Assessment Report' for the Fund was appended to the report.

It was reported that in October 2011, the Chairman of the Local Authority Pension Fund Forum (LAPFF) wrote to all Member Funds encouraging them to become direct signatories to the PRI. GMPF became a direct signatory in late 2013 and were required to publicly report on responsible investment activity through the PRI's reporting framework.

In June 2016, the Fund received feedback on its responses to the PRI's 'Reporting Framework' for 2015. The assessment results were broadly in line with the Fund's expectations, with scores matching or outperforming the PRI median scores in all areas where they were required to report. In particular, the Fund outperformed the PRI median scores for both the 'Direct Listed Equity – Active Ownership', and 'Strategy and Governance' modules.

RECOMMENDED:
That the report be noted.

17. ROUTINE PIRC UPDATE

The Working Group welcomed Tim Bush and Tessa Younger of PIRC Ltd who attended the meeting to present an update on PIRC's role in corporate governance reform.

The Working Group heard that PIRC had been involved in the following areas of director election and their independence since 1992:-

- Separation of Chairman and Chief Executive Officer (CEO) role
- CEO not to become Chairman in the same company
- Regular director re-election
- Annual election of directors
- Sufficient biographical information on directors
- Definition of independent director

PIRC had also suggested independent remuneration committees, votes on executive pay, one year contracts and disclosure of below-board pay. With regards to audit and accounts, wholly independent audit committees were included in the Combined Code 2003 and the accountability for corporate donations had been included in the Political Parties, Elections and Referendums Act 2000.

The key structural milestones were highlighted and included The Cadbury Committee 1992 and Hampel Committee 1998. It was reported that work was progressing with regards to share buybacks, equal pay and gender balance on boards.

RECOMMENDED:
That the report be noted.

18. URGENT ITEMS

There were no urgent items.