Pension Fund Committee

Minutes of a meeting held at County Hall,
Colliton Park, Dorchester on Monday 9 September 2013.

Present:
Neil Sorton (Borough of Poole) (Chairman)
John Beesley (Borough of Bournemouth) (Vice-Chairman)
Mike Byatt, Andrew Canning, Ronald Coatsworth, Colin Jamieson, Mike Lovell (all Dorset County Council), John Lofts (District Council Representative) and Johnny Stephens (Scheme Member Representative).

Officer Attendance:
Paul Kent (Fund Administrator), Nick Buckland (Chief Treasury and Pensions Manager), Tom Wilkinson (Finance Manager (Treasury & Investments)) and Anne Cheffey (Pensions Manager).

Manager and Adviser Attendance:
Alan Saunders (Independent Adviser), Paul Thompson and Thomas Penlington (KPMG for minutes

(Note: These minutes have been prepared by officers as a record of the meeting and of any decisions reached. They are to be considered and confirmed at the next meeting of the Committee to be held on **21 November 2013**).

Apologies for Absence

37. No apologies for absence were received.

Code of Conduct

38. There were no declarations by members of any disclosable pecuniary interests under the Code of Conduct.

Minutes

39. The minutes of the meeting held on 13 June 2013 were confirmed and signed.

Matters Arising

Minute 35.1 – Dates of Future Meetings

40. The dates of future meetings were confirmed after the meeting. The meeting proposed for 26 February 2014, was changed to 4 March 2014 to be held at County Hall, Dorchester.

Report on Fund Voting Activity for 2012/13

41.1 The Committee considered a report by the Fund Administrator on the Fund's voting activity for 2012/13.

41.2 The Finance Manager (Treasury and Investments) highlighted the Fund's voting activity as equity shareholder in its segregated UK and Overseas equities portfolios. Members were reminded of the voting policy of the Fund which was attached in Appendix 1 and provided a breakdown of the number of votes cast and the direction of voting which was detailed in Appendix 2.

41.3 It was explained that the large number of votes cast was managed on the Fund's behalf by a company called Institutional Shareholder Services (ISS) who followed the Fund's voting issues policy, which itself was based on the National Association of Pension Fund (NAPF) policy and the Combined Code on Corporate Governance.

41.4 The Committee were provided with some detailed examples of high profile shareholder meetings where the Fund, acting in line with its Voting Issues Policy, voted against the resolutions proposed by management.

41.5 In relation to shares held indirectly by the Fund, through pooled investment vehicles and managed by external fund managers, Appendix 3 highlighted the key voting activity of the three managers over the course of the 2012/13 financial year.

41.6 The Chief Treasury and Pensions Manager, explained that more votes had been cast within the overseas equities portfolio than the UK equities portfolio because there were more shares held by the Fund overseas than in the UK.

41.7 A Member asked whether the Fund could choose to override any of the policies if a particular issue arose. The Chief Treasury and Pensions Manager stated that occasionally the Local Authority Pension Fund Forum (LAPFF), the Dorset Fund being a member, would issue separate guidance if it was different to the NAPF policy. In these circumstances, it was explained that members of the Committee would be emailed to ask which way they would like the Fund to vote. If there was a majority in favour of the LAPFF recommendation the voting would be adjusted accordingly.

Noted

Admission Agreement – Colliton Club

42.1 The Committee considered a report by the Fund Administrator on an application for admitted body status for the Collition Club.

42.2 The Fund Administrator explained that the Collition Club had been linked to Dorset County Council for over 60 years as an unincorporated organisation, and that there were three members of staff who worked at the club, who were employed by Dorset County Council and were members of the LGPS.

42.3 He explained that the County Council had sought to formalise the relationship with the Colliton Club, which, if approved by the Cabinet of Dorset County Council on 2 October 2013, would result in the club registering itself as a company limited by guarantee, with no financial link to the County Council.

42.4 The proposal to the Cabinet was that the County Council would act as guarantor to the Collition Club for any future unmet pension liabilities if the Colliton Club ceased trading.

Resolved

43. That, subject to an undertaking from Dorset County Council agreeing to meet any unmet pension liabilities of the Colliton Club, the Pension Fund enters into a community admission agreement with the Colliton Club as a company limited by guarantee.

Admission Agreement – East Boro Housing Trust

44.1 The Fund Administrator gave a verbal update to the Committee on the potential admission of East Boro Housing Trust to the Pension Fund. He explained that a formal paper had not been produced because vital information relating to the agreement had not been received in time for the circulation of the Committee papers.

44.2 It was explained that the agreement sought related to the transfer of 35 to 40 staff currently employed by Dorset County Council, who provided residential care to customers with a disability, to East Boro Housing Trust, which specialised in providing such care within its housing portfolio.

44.3 The admission agreement required a bond to be put in place which would meet any pension fund liabilities should East Boro Housing Trust cease trading. The Fund Administrator explained that the Company was in sound financial health with low levels of debt in relation to assets and regular operational surpluses. He also stated that the Housing Trust was registered with the Care Quality Commission.

44.4 The Fund Administrator stated that the timescale for the transfer would be before the next meeting of the Committee on 21 November 2013, and he asked that the decision to admit East Boro Housing Trust, subject to the implementation of an appropriate bond, be delegated to the Fund Administrator after consultation with the Chairman and Vice Chairman, and that it be reported back to the Committee at the next meeting on 21 November 2013.

Resolved

45.1 That the Fund Administrator, after consultation with the Chairman and Vice Chairman, be given delegated authority to admit East Boro Housing Trust to the Dorset County Pension Fund as an admitted body, subject to a satisfactory insurance bond being in place.

45.2 That the outcome of the process be reported back to the Committee at its meeting on 21 November 2013.

Fund Management Arrangements

46.1 The Committee considered a report by the Fund Administrator on a review of investment management arrangements that formally reviewed three fund managers. It was explained that all external fund managers were reviewed every three years, unless there had been performance concerns, in which case they were reviewed more regularly.

46.2 The report highlighted that there were seven managers awaiting review during the 2013/14 financial year. However, four of the managers investing in hedge funds and private equity would be considered as part of the wider strategic review which would take place following the Fund valuation later in 2013.

46.3 The three managers reviewed as part of this report were Standard Life UK equities, CBREi property managers and Janus Intech, who managed US active equity. Standard Life was on an annual review cycle because of past performance issues.

46.4 The Chief Treasury and Pensions Manager outlined the performance of Standard Life in the 3 month, 1 year, 3 year and 5 year periods to 30 June 2013. The performance of this fund over the 3 month and 1 year periods was encouraging. However, whilst the performance over 3 and 5 years was ahead of the benchmark returns, it was stated that the mandate of Standard Life was to outperform the benchmark by 2.5%, which had not happened over those longer time periods.

46.5 The performance of Standard Life was compared to that of another UK equities fund manager, AXA Framlington, who had out performed their benchmark. The relative risks of the two managers was compared and it was shown that Standard Life had taken significantly more risks than AXA Framlington, but had achieved lower returns over the longer term.

46.6 The Chief Treasury and Pensions Manager recommended that because of the recent improvements in performance, that Standard Life be reappointed, but that it be reviewed again formally in 12 months time.

46.7 One member raised, as a concern, the relative risk taken by Standard Life, and although recent performance was positive it was because much higher risks had been taken.

46.8 The Independent Advisor explained that the active UK equities managers were employed by the Fund to complement the passive UK equities portfolio managed by the in-house team. He stated that Standard Life had performed well over the past 12 months but overall their performance had been more volatile than AXA Framlington. However, he stated that the two fund managers had different strategies and, therefore, complementary investment strategies. He gave an example that AXA Framlington tended to avoid banks and favoured mid cap and industrial shares, which had driven performance over the last 5 years. He felt that these sectors might not do as well in the future, but areas that Standard Life favoured investing in might do better and although Standard Life had tested the patience of the Fund, based on recent performance they should be reviewed again in 12 months.

46.9 One member asked whether the Fund invested directly in the Dorset area. The Fund Administrator stated that active fund managers had a free rein to invest with any company, within the investment mandate, and received no direction from the Dorset County Pension Fund. It was explained that this was so that there would not be any conflict of interest. It was also explained that the Fund focused on delivering the best possible return to its members and employers and that emphasising Dorset based investments might compromise that goal and result in conflicts of interest.

46.10 The Chief Treasury and Pensions Manager highlighted the performance of Janus Intech and explained that the investment model they adopted was mathematical formula that aimed at pairing stocks which were negatively correlated to each other and were traded on a disciplined regular basis.

46.11 The report illustrated that the performance of Janus Intech had been positive over the previous 3 and 5 year periods, but had lagged behind the benchmark over the past 3 and 12 month periods. The risk analysis showed that Janus Intech produced steady returns for little volatility and therefore risk. However, because the performance over the past 12 months had disappointed it was recommended that they be reappointed but subject to a further review in 12 months time.

46.12 CBREi property managers were reviewed with performance being analysed between the direct property portfolio and the total combined portfolio which included investment in property funds. The performance of the direct portfolio showed a consistent out-performance against IPD benchmark over the 3 month, 1 year, 3 year and 5 year periods to 30 June 2013. The combined portfolio was shown to have out-performed the benchmark over the 3 month, 1 year and 3 year periods, but had been affected over the 5 year period by one investment which had failed and acted as a significant drag on the overall property portfolio.

46.13 It was felt that both the Dorset Fund and CBREi had learned from this poor investment, in particular the use of debt (gearing), and the portfolio was well placed going forward.

46.14 The Independent Advisor stated that he sat on one of the performance oversight committees, unrelated to the Dorset Fund, at CBREi and felt that they could have been sacked during the 2008 property slump due to the losses. However, he stated that the underlying direct portfolio had always performed well and the indirect portfolio had since been restructured.

Resolved

47.1 That Standard Life be reappointed for a further 12 months subject to ongoing performance.

47.2 That Janus Intech be reappointed for a further 12 months subject to ongoing performance

47.3 The CBREi be reappointed for a further three years subject to ongoing performance.

Report of the Fund's External Auditors

48.1 The Fund Administrator introduced Paul Thompson and Thomas Penlington from the Fund's external auditors, KPMG.

48.2 Paul Thompson confirmed that the audit had gone smoothly and that an unqualified opinion on the accounts would be issued. It was explained that the control environment which covered the systems and controls were designed and operated effectively and that the working papers were clear. There was an issue that was raised by the main audit team which audited the Dorset County Council accounts about the IT environment, which was not a direct issue for the Fund and would be addressed by Dorset County Council. There were two non trivial audit adjustments which were required as a result of the audit and these related to more up to date valuations which had arrived during the audit process.

48.3 The Chief Treasury and Pensions Manager stated that the change in valuations was frustrating and that issues had been raised with the investment managers concerned.

48.4 One member queried the change of figures and why changes had taken place. It was explained that the accounts had not yet been published, the auditors were presented with draft accounts prior to publication, and the audit was the key part of the review and accounts production process and the accounts would form part of the annual report which would be presented to the next meeting of the Committee on 21 November 2013.

Noted

Report of the Fund Administrator

49.1 The Committee considered a report by the Fund Administrator on the economic outlook and the impact on Fund investments.

49.2 The Independent Adviser highlighted the triennial Fund valuation, and stated that it had the potential to affect the underlying strategy of the Fund and affordability of the scheme. However, he stated that unlike private sector schemes, the valuation process did not produce as volatile results.

49.3 The Independent Adviser gave a summary of the financial markets over the last quarter. He stated that the UK stock market reached its highest level in May, since the stock market peak in December 1999, before a sell off started by the announcement by the US Federal Reserve that they might start to slow down their quantitative easing (QE).

However, markets had rallied since, reflecting a risk on risk off approach which had reflected market sentiment.

49.4 In the US the expansive QE had driven down mortgage rates which had resulted in increased house prices, which had been badly affected during the US recession. It was likely that the US would reduce the amount of QE, before stopping it, then eventually selling the financial instruments back to the market. This all resulted in the yield on bonds increasing with 10 year gilts moving from 1.5% to 2.5% in a few months.

49.5 In the UK the Bank of England (BoE) had introduced a new policy of forward guidance in an attempt to steer market expectations. The BoE had stated that it would maintain interest rates at 0.5% until 2016 at the earliest, which was when unemployment was expected to fall to 7% from 7.8% currently. The BoE believed that the recovery would be weak and slow and wanted to send a message to the market that rates would remain low in order to encourage businesses and homeowners to invest. The BoE retained some exit clauses from this statement, which included if inflation were forecast to rise in the medium term or if there were further financial shocks. Despite this new policy bond yields continued to increase.

49.6 In terms of the economic outlook the Committee were informed that the economic growth figures for the UK and the US were positive. The UK grew by 2.5% annualised rate with the following quarter's growth figures expected to show an annualised growth rate of 4%. Property prices had also picked up during the quarter.

49.7 Globally, in Japan, an expansive monetary policy had been adopted to kick start the Japanese economy after 20 years of stagnant output. In the EU it seemed as if the difficult times were beginning to come to an end. Emerging markets, which was a large part of the modern world economy, was entering a difficult period, affecting the performance of emerging markets generally. This was linked to the proposed ending of QE in the US and the flight of capital from emerging markets back to the US having a deflationary impact in those economies. In China growth had slowed to 7% as the Government attempted to switch the economy from government investment to more consumer spending and private sector investment.

49.8 Overall the Independent Adviser felt that US and UK stocks were fairly valued, but future pressure on profit margins might push stocks into an overvalued position. He felt that EU and emerging market stocks represented good value. Property was said to be fairly valued with some upward pressure likely. The key question raised was how far the developed markets could go. The increase in bond yields may have a negative impact, but they reflected the fact the economy was recovering.

49.9 One member asked whether inflation in the UK would become a problem. The Independent Adviser stated that much of inflation seen in the UK had come from commodity prices which were a function of the exchange rate or regulated prices such as the VAT increase, student fees and water prices. He also felt that there was sufficient slack in the labour market to keep wage growth under control and, as a result, it was unlikely that the UK would see the type of inflation of the 1970s.

49.10 The Independent Advisor was asked about the new BoE policy of forward guidance and change of approach in the linking of the base rate to the level of unemployment. He replied that unemployment was a lagging indicator and that once unemployment started to reduce it would mean that the recovery was becoming embedded. He felt that QE would be allowed to mature rather than the gilts being sold back into the market.

49.11 The Fund Administrator presented his report on the smaller managers. He stated that the Fund had net new money of £9.7m which was slightly ahead of expectations. However, there had been a reduction in the amount of property income to be received during the year, because of a rent restructure which resulted in a rent free period being granted. Overall projections for the financial year were that income would be slightly higher than expected but this would be offset by higher pension payments.

49.12 In relation to the portfolio weightings Bonds and UK equities were broadly in line with the strategic target and overseas equities were overweight largely due to the level of cash held by Pictet. Cash was also overweight, with property, private equity and absolute return funds being underweight. The weighting of property was expected to increase as more assets were purchased, and private equity and hedge funds were subject to the review of alternative assets so would remain underweight in the short term.

49.13 In terms of overall performance, it was reported that the Fund continued to outperform its benchmark over a 3 month, 12 month and 3 year time period, but lagged behind over a 5 year period. Over the 3 months to 30 June 2013 the Fund overall outperformed its benchmark by 48 basis points. In relation to return seeking assets, a positive return of 0.08% was achieved against a benchmarked loss of 0.48%. On the liability matching assets, there was a reduction of 9.97% over the quarter which reflected the reductions in future inflation liabilities.

49.14 The Committee was referred to the HSBC performance report in Appendix 3a which showed that the out performance for the quarter was due to the asset allocation position of the Fund.

49.15 In relation to the smaller fund managers, the Barings managed diversified growth fund underperformed on the quarter but had out performed its benchmark since inception. Janus Intech had underperformed, but this was within accepted tolerances. The Emerging Markets portfolio managed by JP Morgan had a poor quarter and was subject to a high degree of volatility. The manager believed that emerging market stock was at crisis level valuations and it was therefore a good time to buy into the market, with values expected to increase going forward.

49.16 Private equity continued to show positive results, with the performance of both managers being positive over 3 years. Overall all vehicles had delivered positive investment returns to date.

49.17 Hedge Fund performance continued to disappoint with only the IAM fund delivering positive returns over 5 years, although these returns were below the benchmark. The hedge funds were to be reviewed as part of the strategic review following the Fund valuation.

49.18 The cash management of the pension fund showed that cash of £66.7m was held returning an average of 0.69%. All of the cash held was invested for a period of less than 12 months.

49.19 The Committee was updated on the responses to a number of consultations that affected the LGPS. These included the new scheme, the transitional arrangements for the new scheme and changes to member pensions, as well as the more recent call for evidence in relation to investment management fees and the structure of the LGPS.

49.20 The Fund Administrator updated the Committee about the Government's call for evidence on improving performance of funds and reducing deficits. There were a number of secondary objectives which focused on investment management fees, improved flexibility of administration, cost effectiveness of administration and how in-house investment resources were arranged. The response to this consultation was due by 27 September 2013 and Dorset would respond on its behalf and on behalf of the Society of County Treasurers.

49.21 One of the main problems for the LGPS and the government was the limited comparable information on the relative costs and performance of the LGPS funds, compared to other pension fund schemes. This had resulted in speculation about the effectiveness of the LGPS. As a result of the call for evidence, the Dorset Fund had taken part in a detailed benchmarking exercise that compared a group of LGPS funds, and also used the data to create a combined fund with a notional value of £30bn which could be compared to some of the larger private sector funds. The results showed that the LGPS super fund was marginally more expensive than the larger funds. The main driver behind the extra costs was the way in which alternative assets were managed. The LGPS tended to use fund of funds investment vehicles to gain exposure to alternative investments. Fund of funds were more expensive than investing directly, which larger funds had the size and in-house expertise to do. It was felt that these results were encouraging and would help to identify ways in which the LGPS could make the necessary efficiencies.

49.22 The Fund Administrator stated that the response to the consultation would include the fact that the current scheme set up had resulted in a high degree of local accountability and that fund mergers would detract from this. He said structural changes to funds were expensive and a strong response would be given to the consultation.

49.23 One member stated that this proved that bigger funds were not necessarily better, and that changes to the structure of funds could undermine performance, increase risk and fund merger would undermine the concept of localism.

49.24 The Independent Adviser commented that the Department for Communities and Local Government was seeking comparability across schemes and that there was a diverse practice in relation to the actuarial valuations which could result in there being greater uniformity of assumptions. This could impact on the valuation levels of different funds.

49.25 One member asked about the level of cash balances, which was £69m, and whether they would be invested. It was explained that cash balances were required to fund pending property purchases and draw downs by the private equity managers. The Chief Treasury and Pensions Manager said that the results of the triennial valuation would mean a review of the strategic allocation and that it was likely that some of the cash balances would be distributed as a result of that exercise.

49.26 One member commented on the volatility of the emerging markets investments. The Fund Administrator stated that the markets had declined further since the end of June 2013. However, he stated that the fund manager believed that emerging markets represented good value for money at current valuation levels.

Noted

Manager Reports

a) CBRE Global Investors

50.1 The Committee considered a report by CBREi on the quarterly performance of the property portfolio. The Chief Treasury and Pensions Manager stated that performance remained strong and one of the key drivers was the low void rate, which stood at 1% of collectable rents and the rents collection rate which was 100% over the quarter.

b) Insight Investments

50.2 The Committee considered a report by Insight on the performance of the liability matching portfolio, which showed an out performance against the benchmark. The Chief Treasury and Pensions Manager explained that no additional hedges had taken place during the quarter due to the market rate of inflation protection being higher than the agreed trigger points.

c) Pictet Asset Management

50.3 The Committee considered a report by Pictet, the overseas equity manager. The Chief Treasury and Investments Manager drew attention to the bearish view still held by the fund manager, and this was reflected in the high level of cash held by the fund. It was explained that the fund manager felt that the economic fundamentals were such that the world economy was heading for another recession which would result in deflation, or the impact of QE would be such that there would be an inflationary bubble and economic depression.

50.4 The Independent adviser stated that the cash levels held were towards the maximum permitted and that they were held in a mixture of currencies.

d) Royal London Asset Management

50.5 The Committee considered a report by Royal London Asset Management on the quarterly performance of the corporate bonds portfolio. The Chief Treasury and Pensions Manager stated that the fund continued to perform well against the benchmark, although the value of the holdings had reduced since the start of the year due to bond prices falling as markets became more confident of economic recovery. The general performance showed strong growth over the past 5 years. The performance was slightly below the benchmark since the fund inception in July 2007, which was the start of the financial crisis. Royal London was on the way to recover those early losses and performance has been consistently solid since the crisis.

e) UK Equity

50.6 The Committee considered a report on the UK Equity portfolio. The Finance Manager (Treasury and Investments) explained that the stock market had rallied to a post 1999 peak during the first 6 weeks of the quarter, but then fell back following remarks made by the US Federal Reserve to finish the quarter lower overall. All funds out-performed their benchmarks with the exception of the Schroders small cap index which underperformed by 0.2%.

50.7 The Committee’s attention was drawn to stock lending which had returned £72.2k for the quarter which was in line with the same period in the previous year.

50.8 One member asked what happened to the dividend income from the UK equities. The Chief Treasury and Pensions Manager stated that it was received as cash income and included in the “new money” calculation reported in the Fund Administrators report, along with overseas equity dividends and property rents. A question was raised as to whether dividends should be reinvested back into equities. The Fund Administrator said that this would be considered as part of the strategic review following the Fund valuation.

Noted

Dates of Futures Meetings

51. The Committee noted that meetings were scheduled as follows:

20/21 November 2013	London (to be hosted by Pictet)
4 March 2014	County Hall, Dorchester

25/26 June 2014	London (to be hosted by Insight)
8 September 2014	County Hall, Dorchester
26/27 November 2014	London (to be hosted by RLAM).

Questions

52. No questions were asked by members under Standing Order 20 (2).

Meeting Duration 10am – 12:40pm