Dorset County Pension Fund Committee

Minutes of a meeting held at County Hall,
Colliton Park, Dorchester on 20 February 2013

Present:

Neil Sorton (Borough of Poole) (Chairman), John Beesley (Borough of Bournemouth) (Vice-Chairman), Ronald Coatsworth, David Crowhurst, Howard Legg, Mike Lovell (all Dorset County Council), John Lofts (District Council Representative) and Johnny Stephens (Scheme Member Representative).

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

Managers and Advisers: Alan Saunders (Independent Adviser),

Apologies for Absence

1. An apology for absence was received from Susan Jefferies (County Council representative)

Code of Conduct

2. There were no declarations of any disclosable pecuniary interests by Members under the Code of Conduct.

Local Government Chronicle Award

3. The Committee were informed that the Fund Administrator had been awarded the LGC award for Pension's Finance Officer of the year, and congratulated him on his success. The Fund Administrator said the award was a reflection of the hard work of the whole pension's team and not just on individual.

Minutes

4. There was one correction from the minutes of the meeting held on 22 November 2012 whereby Mike Lovell was in attendance which was omitted from the original minutes. The minutes of the meeting held on 22 November 2012 were confirmed subject to the insertion of Mike Lovell to those present and signed.

Matters Arising

5.1 Arising from minute 70.5 regarding the Pictet overseas allocation mandate limits, the Chief Treasury and Pensions Manager brought to the Committee's attention that there were no restrictions to the quantity and sector of overseas equity or any jurisdiction in which they could be held. The only restriction placed on the Pictet mandate was in relation to the maximum amount of cash that could be held, which was limited to 10 percent of the value of the mandate. The Committee were shown a chart illustrating the divergence from the benchmark holdings over the past five years and which showed that all variances were within plus or minus 4 per cent over that time period. The Chief Treasury and Pensions Manager reported that he had had a conversation with the Pictet Fund Manager who stated that he was happy with the flexibility afforded to him and that any additional flexibility would detract from the strategy and the benchmark that he was targeting.

5.2 The Independent Adviser stated that 70% of the overseas equity portfolio was being held in line with the benchmark and was, therefore, passive in nature. The holding in cash had protected this portfolio over the past four years, but he questioned whether this strategy needed to be reviewed in the future in favour of a more active portfolio. The current

Pictet portfolio had a beta of 0.9. The Independent Adviser commented that the Fund could retain them as a core part of the Fund but switch to a more active mandate. The proportion of the Fund allocated to overseas equities was 27% in total, with 19% allocated to Pictet, who managed the allocation passively and 8% which was being actively managed by Intech. The Chief Pensions and Treasury Manager confirmed that the fees being charged were consistent with a passive mandate, and that the Fund did indeed have Pictet as the core overseas portfolio, with Intech and JP Morgan managing active portfolios.

5.3 The Fund Administrator said that the overall strategy would be reviewed at some point, but reminded the Committee that the Fund was only 12 months into the current strategy. The Independent Adviser stated that Pictet had taken a more defensive position and that it could be considered that the market may be overvalued and, therefore, their performance would be better if the markets were to fall. One Member asked that this was put into context, in that Pictet had not asked for a change to their limit on cash holdings and that a bearish view within a mandate was good in light of the Fund having a diversified portfolio.

5.4 The opportunity was taken to remind Members of the imminent retirement of the current Director for Corporate Resources and congratulations were given to the Fund Administrator on being appointed to that position.

Pension Fund Administration Strategy

6.1 The Chief Treasury and Pensions Manager presented the Pension Fund Administration Strategy, which sought to formalise arrangements between the Fund and the Employers who paid into the Fund, in order to help improve and drive the efficiency of the administrative function of the Fund and enable performance indicators to be further developed for the benefit of its members.

6.2 Members were reminded that the business objectives of the Fund were the efficient management of the Fund and effective customer service. The strategy was intended to enable the Dorset County Pension Fund to be considered as one of the best funds in the country and be in the best position possible to attract additional work from other LGPS funds if there was further pressure on funds to merge and share more resources. It was highlighted that the Pension Fund Committee now had responsibility for the management of the whole Fund rather than just investments as it had in the past.

6.3 The Chief Treasury and Pensions Manager drew attention to page 3 of the report which stated that the Administration Strategy was designed to put improvements in place that would allow better reporting and monitoring of performance so that it could be continually improved. It would allow better employer and administration monitoring to help drive performance. The strategy highlighted a potential collaboration with another LGPS fund to make shared use of a website platform that would help deliver the objectives of the strategy. Appendix 1 of the report set out the standards to which employers were expected to sign up. Page 6 set out the financial obligations of the employers. Appendix A showed the proposed charging schedule and system of penalties that could be levied on employers who regularly failed to meet their obligations and which put pressure on the rest of the administrative function.

6.4 It was highlighted to Members that this strategy was a draft that was out to consultation with the employers and that a final version would be presented at the June meeting.

<u>Resolved</u>

7. Members resolved that the draft Administration Strategy be approved for consultation and circulated to scheme employers.

Treasury Management Strategy

8.1 The Finance Manager (Treasury and Investments) presented a paper setting out the proposed Treasury Management Strategy for the management of the Pension Fund's cash balances. He explained that the Fund received income from member contributions and investment returns and expenditure in the form of pensions and retirement grants. These cash flows were currently positive and built up over the course of the year prior to the cash being distributed in line with the strategic allocation and investment strategy.

8.2 The paper recommended that the Fund adopt the best practice from local authority treasury management and, in doing so, proposed taking a low risk approach to cash management, which was aimed at safeguarding the value of the cash investments, as opposed to seeking a high yield. The rationale for this was that the Fund did not hold a strategic allocation for cash, so it was not an investment class in its own right.

8.3 The paper focused on how the security of cash investments was ensured by making use of credit ratings and other market information. Section 2.8 set out the parameters considered before investing cash with a financial institution and looked at factors such as the country in which the bank was based and how well supported that bank was by its government. It was proposed that the Fund invested only in those highest rated institutions from the highest rated sovereign countries.

8.4 Elsewhere in the report the proposed parameters in relation to the liquidity of funds was explained, which included the limits put in place on the length of time funds could be invested for, the maximum investment amount per institution and the maximum length of time funds could be invested with an individual counterparty. In addition, there were further restrictions governing how much, as a proportion of the portfolio, could be invested for periods of more than one year.

8.5 The Finance Manager explained that the policy was designed to act as a framework and point of reference for officers when taking day to day treasury management decisions.

8.6 In referring to Table 5 the Independent Adviser stated that it would be unlikely, and not preferable, to invest cash sums for more than a year because it would mean that the cash would be neither available to fund member benefits or for distribution. It was agreed that these limits were maximums and were consistent with the Dorset County Council policy but, in reality, would not be used in conjunction with the Pension Fund cash management activity. The Independent Adviser stated that the strategy was a sensible and sound approach to the management of the risks associated with holding cash balances.

Resolved

9. That the Treasury Management Strategy be adopted.

Report of the Fund Administrator

10.1 The Committee considered a report by the Fund Administrator on the allocation of assets and overall performance of the Fund for the nine months ending 31 December 2012.

10.2 The Independent Adviser presented his report on the investment outlook. He stated that equities were rallying and had increased by 5-6% in January and February although he questioned the sustainability of such increases. In the US, the fiscal cliff had been temporarily delayed but discussions in Congress would resume in relation to the debt ceiling. The EU remained stagnant and there had not been much change over the quarter, with the Euro crisis having abated for now. In Spain and Italy, bond prices had reduced significantly but were now on the rise again due to the uncertainties surrounding elections there.

10.3 In relation to the inflation hedging, the gap between RPI/CPI rates had narrowed, but the decision by the Office of National Statistics' to not change the method of calculation of RPI resulted in future swap prices increasing significantly from 3% to 3.5%, which had in turn increased the value of the RPI hedges that had already been placed.

10.4 With regard to Quantitative Easing (QE), this now stood at £375 billion with calls for a further tranche of £25 billion of QE being made by a significant minority, including the Governor of the Bank of England, at the last meeting of the Monetary Policy Committee. The main issue that might affect the rate of inflation was that some of the bonds purchased under QE were close to maturity which meant that the Treasury would have to repay the gilts, with the proceeds passing to the Bank of England. There was some concern about whether the Treasury would ask for these receipts to be returned to the Treasury to fund current expenditure. If this 'leaking' were to take place then the Government would be, in effect, printing money to fund its expenditure which would lead directly to inflation.

10.5 The inflation outlook was for CPI to remain at more than the 2% target for the next two years. The Bank of England was not concerned about this because 1% of inflation was due to external price pressures. A consequence of QE had been the increase in the price of equities. The money held by the banks from the purchase of gilts by the Bank of England had remained with the banks which were reluctant to lend to businesses and credit markets. This had resulted in continued prospects of sluggish growth for the UK, with 1% expected in 2013. The US economy was expected to grow by about 2% with zero growth expected in the Eurozone.

10.6 The main equities markets had rallied because the majority of the large companies were multinationals and the outlook for the world economy had improved significantly, especially now the situation in China had improved and avoided recession.

10.7 In Japan the central bank had targeted a 2% inflation rate, (from the negative rates currently being experienced) and had embarked on more Quantitative Easing. In the UK, the Governor elect of the Bank of England, Mark Carney, had talked about adopting more unconventional approaches, such as targeting nominal GDP growth rather than inflation. In the US there was a commitment to keeping monetary policy loose until unemployment fell to 6.5%.

10.8 In relation to the Fund, corporate bonds continued to perform well, property generally had been flat but yields had increased whilst hedge funds continued to disappoint. In light of these factors, the Independent Adviser considered that this was the opportunity to realign the portfolio and bring the asset allocations closer to the target.

10.9 One Member asked why the Fund did not make allocations more regularly. The Independent Adviser explained that this allocation was about bringing asset holdings in line with the strategy rather than an allocation of additional cash.

10.10 The issue of currency hedging was raised by one member, in that the value of sterling was expected to fall, asked whether the Fund should continue to hedge. The Independent Adviser stated that the hedge was in place to reduce volatility and that over time the overall impact should be neutral.

10.11 One Member asked how QE would be ended and how this would be done. The Independent Adviser stated that it could be unwound by selling the gilts back on to the open market. However, that doing so during a recession, when the Government was issuing new gilts to fund current expenditure, was what the Bank of England was trying to avoid. If QE was not unwound and the proceeds from the redemption of the gilts were returned to the Treasury, then the consequence would be inflationary.

10.12 The Fund Administrator presented his report. In the first part, this related to the cashflow position on the Fund, which showed a projected net surplus of contributions and investments over payments to retired members of £39m for the year. This surplus was £7m greater than anticipated due to a one off contribution by a large scheme employer of £9.7m.

10.13 One Member asked when the scheme would move into a negative position where the contributions paid in were less than the member benefits paid out. The Fund Administrator stated that whilst a number of schemes were more mature than the Dorset scheme and were in a negative cashflow position, the Dorset scheme was expected to remain positive for a number of years, and this was being regularly monitored. He explained that there was a national concern about the maturing of funds, and that a number of changes were taking place to address this, which included the new schemes 50:50 option that allowed scheme members to reduce their contributions rather than opt out entirely. There was also the introduction of "auto enrolment" which should have a positive effect, whereby all employees were being automatically enrolled into the scheme and had to proactively opt out rather than opt in. In addition part time members would be paying a lower rate based on what they earned rather than what pay band they were in. These changes were designed to reduce the level of opt outs from the scheme.

10.14 The Fund Administrator said that the Dorset Fund remained in deficit so consequently there were more contributions being made from employers. It was estimated that the funding level would be at approximately 82% up from 79% at the last valuation. In relation to the level of cash generated by the Fund it was reported that there was £67.3m held as at 31 December 2012 and, of that, 'new money' received to date was £32.5m.

10.15 The allocation of the Fund was presented in Table 2 of the report and showed that the main allocations were in line with the target, but there was an under allocation to absolute return funds, which was undergoing a review, and of overseas equities, which was mainly because of the tactical position by Pictet to hold cash. The Fund was underweight against Emerging Markets and Diversified Growth Fund, this being addressed in Section 7 of the report.

10.16 As a whole, the Fund underperformed its benchmark for the nine months of the year, but out performed during the final three months. The Fund Administrator drew the Committees' attention to Table 3 which summarised Fund performance between return seeking assets and liability matching assets, which covered the inflation hedging undertaken by Insight.

10.17 In terms of manager performance, Intech had performed well, whilst JP Morgan had almost recovered from their poor start, although it was stressed that all performance should be viewed over a 3-5 year time horizon. Private Equity continued to perform well over that period of time.

10.18 The performance of hedge funds continued to disappoint and as a result a review process had been started and would be reported back to the Committee at the June 2013 meeting. The Pioneer hedge fund was still in the process of liquidation and a distribution of £487k had been received during the last quarter. One Member welcomed the review of this area and considered that there may be a number of alternative areas that could be looked at in light of government initiatives such as infrastructure and social housing investment.

10.19 Section 7 of the report proposed the allocation of £10m to the JP Morgan Emerging Markets fund and £6m to Baring Diversified Growth Fund, in order to align them with the strategic target. One Member asked what the timing of the distribution would be and whether it would be sensible to pick a time to maximise possible returns. The Chief Pensions and Treasury Manager explained this would be as soon as possible given that the Fund invested over a long period of time and was not influenced by speculation of when the peaks and troughs might occur.

10.20 Section 8 of the report detailed the Dorset County Fund's response to the consultation on the proposed new Local Government Pension Scheme which would begin from April 2014.

Resolved

11. That the distribution of £10m is made to JP Morgan and £6m to Barings Asset Management is made at the earliest opportunity.

Manager Reports – CBRE Property Portfolio

12.1 Members noted that the CBRE Fund Manager performance had improved slightly, with the direct portfolio returning 3.3% a year over the previous 5 years. Members were reassured by the performance, despite being affected by a retail fund that had gone into administration. Two new property transactions were reported, with the sale of Howard House, Bristol, which had been held since 1994 together with the purchase of offices at Clerkenwell Road, in London, which represented a good opportunity for rental and capital growth in the medium term.

12.2 Members were updated on the search for new purchases and were informed that CBRE were giving consideration to offices in the Kings Cross area of London and a portfolio of properties across the South East of England.

Noted

Manager Reports – Insight Investments – Inflation Hedging

13 Members considered the performance report of Insight and were updated on the latest position of the inflation hedging operation. Approximately 50% of the hedges had been put in place before the Office of National Statistics announced their decision not to change the method of the RPI calculation. Since that announcement the inflation rate swaps price had increased significantly, and consequently they are now some way from the trigger points which had been set. Accordingly the value of the swaps that had already been implemented had increased in value significantly and, therefore, increased the value of the Insight portfolio by £35m during January 2013.

Noted

Manager Reports – Pictet – Overseas Equities

14.1 The Chief Treasury and Pensions Manager presented the report and reminded members that the Pictet strategy was to take a "top down" view of each sector, rather than pick individual stocks. The performance showed a small 0.6% underperformance for the quarter, which was mainly because of the bearish allocation. It was highlighted that over a 5 year period the performance was in line with the benchmark.

14.2 The allocation within the benchmark showed that Pictet were broadly allocating in line with the benchmark, once their cash holdings had been omitted. It was explained that the Pictet fund was a core allocation and was intended to move with the market and maintain its relative value.

Noted

Manager Report – Royal London Asset Management – Bonds

15 The RLAM report was considered by Members with attention being focused to the current holding which was almost at its 100% bond allocation, with a small holding of gilts, which made the difference. The performance showed a 4.3% return over the quarter. Page 5 of the report highlighted the longer term performance, which over 5 years was disappointing, but over the final 3 years of that period had been very strong.

Noted

Internal Managers Report

16.1 Members were reminded that the FTSE 350 index was tracked by the internal Treasury and Investments team. The index represented 97% of the value of UK equities. The Internal Fund had underperformed the benchmark by 0.1% which was within acceptable tolerance levels. Over the previous three years, the annual return had been 7.49% against the benchmark of 7.42%.

16.2 The externally managed funds were also reviewed and their performance was complementary. AXA Framington's performance had slipped recently against the benchmark following a previously strong performance, but the recent slip was compensated for by strong performance from Standard Life. The Schroders small cap fund underperformed on the quarter by 3.8%. When considered as a whole UK equities performed in line with the benchmark, returning 3.9% over the quarter.

Noted

Dates of Futures Meetings

17.1. The Fund Administrator informed the Committee of a change to the venue for the June meeting, which would now be held in Dorchester, owing to an anticipated change in membership of the County Council representatives on the Committee following the County Council elections in May. The use of 12 June as a training session for new members of the Committee was noted. The dates and venues of future meetings in 2013 were confirmed as follows:

12/13 June	County Hall, Dorchester
9 September	County Hall, Dorchester
20/21 November	London (venue to be confirmed)

17.2 The Chairman thanked the County Council members for their work and contributions to the Committee over the past four years and wished them all every success in the future.

Questions

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

Meeting Duration 10.00 am – 12.45 pm