Pension Fund Committee

Minutes of a meeting held at County Hall,
Colliton Park, Dorchester on Thursday 13 June 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) and Tom Wilkinson (Finance Manager (Treasury & Investments)).

Manager and Adviser Attendance:
Alan Saunders (Independent Adviser), Peter Scales (Independent Observer), John Finch (JLT), Akua Brako and Mike Collins (Pictet), Paul Richmond and Gary Wilkinson (Insight), Ian Wilson and James Clifton-Brown (CBRE).

Election of Chairman

Resolved

19. That Neil Sorton be elected Chairman for the remainder of the year 2013/14.

Appointment of Vice-Chairman

Resolved

20. That John Beesley be appointed Vice-Chairman for the remainder of the year 2013/14.

Apologies for Absence

21. No apologies were received.

Code of Conduct

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

Terms of Reference

23. The terms of reference for the Committee were received by members.

Noted

Minutes

24. The minutes of the meeting held on 20 February 2013 were confirmed and signed subject to:-

The word “on” in Minute 3 being replaced by “one”
Minute 5.2 being amended to read “The Independent Adviser stated that 8% of the overseas equities portfolio was being managed by Intech and JP Morgan. …”

Matters Arising

Minute 3 – Local Government Chronicle Award

25.1 The Independent professional observer stated that Dorset County Pension Fund was one of the best run funds in the Country and that was the reason why the Fund Administrator had been nominated for the Local Government Chronicle Award.

Minute 10 – Report of the Fund Administrator

25.2 The Committee noted that the distribution of £10m to JP Morgan and £6m to Barings Asset Management had been implemented.

Report of the Fund's Independent Professional Observer

26.1 The Fund Administrator introduced the Independent Professional Observer (IPO) and explained that the IPO usually reported on Fund governance issues once a year in February, but that this had been delayed in anticipation of the completion of government changes in scheme regulation and governance. The anticipated changes had not been finalised by the June meeting so the IPO had been asked to report on the current position of the Fund.

26.2 The Committee considered the report by the Independent Professional Observer. He updated the Committee on progress made since his previous report in February 2012, the only area where the Committee was not fully compliant was in relation to the representation on the Committee.

26.3 The IPO made 4 recommendations detailed on page 2 of his report which covered the updating of the Governance Compliance Statement; changes to the 2012-13 Annual Report; compliance with the Myners principal 4 and keeping abreast of the governments changes to regulations and reviewing efficiency and effectiveness.

26.4 The Fund Administrator agreed with all the recommendations and stated that he would report back to the Committee any new developments and changes that were proposed by the government. He stated that he was concerned by the direction taken by the DCLG in relation to the apparent confusion between Local Authorities and the Local Government Pension Scheme Funds. The pension funds were there to invest on behalf of, and for the benefit of, scheme members rather than a source of funding for local or national projects.

26.5 The Fund Administrator stated that there should be more clarity on the different governance arrangements and the on future role that the Pensions Regulator and HM Treasury would play. He was concerned that there would be greater interference and direction from government about how and where funds could and should be invested.

26.6 He raised concerns about any delay in laying the regulations for new scheme and the corresponding impact on the planned implementation date of April 2014, fund valuations and the ability to have the necessary IT systems in place to administer the new scheme.

26.7 The Chairman stated that he was concerned about increased levels of interference and the use of Fund assets for government projects.

26.8 One member asked about infrastructure investment and what the impact might be for the Fund. The Fund Administrator stated that all investments should be made in the best interests of the Fund, and that infrastructure could play an important part of a diversified portfolio of investments. One member raised a concern that local infrastructure investment may result in a conflict of interest between the local councils and the Fund and that the Fund had an obligation to ensure it received the best rate of return when making such investments.

26.9 One member stated that private sector company pension schemes were not allowed to invest in the parent company and that had been made illegal following the Maxwell affair. He was concerned that if LGPS funds were used for investment in local initiatives it could result in a second Maxwell type scandal.

26.10 The Independent Adviser stated that making local investments did result in a conflict of interest as it distorted the long term view. He was concerned about the role of the Pensions Regulator and whether it would be intrusive as it was with private sector funds. There was a concern that there were different value approaches between public sector pension funds and private sector schemes and that there may be a lack of understanding from the Pensions Regulator.

Training Policy

27.1 The Chief Treasury and Pensions Manager presented a report summarising the training policy that had been agreed previously. The Committee were reminded of the minimum level of training that the policy contained, and an updated log of the previous two years was presented. He stated that the Fund had easily met the minimum requirement.

27.2 The Fund Administrator commented that, as part of new CIPFA guidance, he was required to comment in the Fund's annual report on the level of training undertaken by the Committee. He stated that he had no problem in stating that the Committee collectively possessed the requisite knowledge and skills to undertake their role.

27.3 The Chief Treasury and Pensions Manager concluded by listing a number of training opportunities that were available to the Committee over the next year. He asked members to contact officers if they wished to attend any of the external events.

Noted

Review of Alternative Assets

28.1 The Committee considered a report by the consultancy JLT on the review of the alternative assets held in the Fund's portfolio.

28.2 John Finch from JLT presented the report which considered the current portfolio mix and the different asset classes that were available to invest in. He presented an analysis of asset types and typical risks and returns from the different asset classes with a view to assessing whether the current Dorset Fund holdings were appropriate. He stated that he had met with officers and the Independent Adviser to discuss the report and that, at this stage, there was no compelling case for a change of strategy.

28.3 The Independent Adviser stated that one of the drivers for the review had been the poor performance of fund of fund hedge funds during and after the financial crisis. He also stated that the Fund had been invested in private equity since 2006 and, in light of this, the review was necessary. However, because there were no other compelling asset classes it was sensible to wait until after the triennial actuarial valuation to assess the position of the Fund's liabilities and consider the strategy in light of these results.

28.4 The Chief Treasury and Pensions Manager stated that the JLT work would feed into this wider review once the Fund valuation results were available in September 2013.

Noted

Fund Administrator's Report

29.1 The Committee considered a report by the Fund Administrator.

29.2 The Fund Administrator introduced the Independent Adviser to give his view of the current economic climate and its impact on the Fund. The Independent Adviser stated that economists had started to think that the worst of the recession in the UK was over, with a triple dip recession having been avoided, and whilst growth was likely to remain weak, it was expected that there would be more positive surprises than negative ones over the course of the next year.

29.3 In the markets there had been a strong run in equities which had left assets such as commodities and property behind the rest of the markets. The resulting performance of the Dorset Fund had, therefore, been strong despite its below average equities holding (55%). He felt that the markets had got ahead of themselves in a relief rally following the Euro crisis, with government bond yields being low and signs that the US had turned itself around. The recent easing was largely due to a combination of US sequestration, which would result in $1 trillion removed from US public spending and signs that the Federal Reserve would start to slow down its $80 billion a month of asset purchases.

29.4 In Japan, the central bank embarked on a programme of aggressive monetary expansion in an attempt to end two decades of persistent deflation. This new approach had caused the Yen to devalue significantly.

29.5 In the EU, austerity appeared to be off the agenda with the larger economies of France and Spain being given a further two years to address their deficits. There was the realisation that in order to address deficits economies needed to grow and as a result sentiment had improved.

29.6 In the UK a new Governor of the Bank of England, was due to start his role in July 2013 and was expected to keep monetary policy loose to help boost economic growth and reduce the budget deficit. The squeeze on government spending, the continued weakness in consumer demand and disappointing export growth, despite the 20% devaluation of sterling, were all concerns for the new Governor and the government. Questions about how to exit from quantitative easing (QE) continued and would probably be answered by holding the bonds bought under the scheme to maturity before cancelling them. It was felt that if the Bank of England tried to sell them back to the markets it would not help market sentiment and act as a drag on growth.

29.7 Overall the Independent Adviser felt that global prospects were better than they had been and the Fund should see returns of more than 5% over the next year. In relation to the portfolio, alternatives continued to disappoint which was why the review had been initiated. The overall portfolio allocation was a strategic allocation and should remain so, although there would be the review, post valuation.

29.8 One member asked whether agricultural land should form part of the review of alternative assets as there was a growing world population and there would be more pressure on owning good quality farm land. Mr Finch stated that this could be considered as part of the wider review of assets in September 2013.

29.9 The Fund Administrator presented his report which showed the performance of the Fund over the last quarter and for the year. The positive cashflows from employer and member contributions and investment income resulted in new money into the scheme of £46.2m. The portfolio distribution was presented and showed that the Fund was broadly in balance although underweight positions continued in property, despite £25.3m of additional net investments during the year.

29.10 The new presentation of the assets split between return seeking assets and liability matching assets was highlighted. Attention was drawn to the performance of the inflation hedging bonds which returned 35.12% since the start of the mandate in July 2012.

29.11 Overall the Fund returned 16.8% over the year and 10.28% per annum over the past three years, which was positive compared to the actuary's assumption of three year returns of 6.9% and the local authority three year average return of 8.1% per annum.

29.12 The positive performance of the RLAM bond portfolio and the Diversified Growth Fund was also highlighted alongside the more disappointing performance of the hedge funds.

29.13 Officers were thanked for their work during the period to achieve this performance, although the Independent Adviser stated that much of the good performance should be seen in the context of the poorer performance during the financial crisis, and that performance as a whole should be considered over the longer term.

29.14 The Fund Administrator stated that the out performance of the Fund over the past three years should afford some flexibility in relation to reducing the deficit recovery period.

Resolved

30.1 That the Committee agree to defer the review of alternative assets until after the result of the valuation is known and an overall review of the strategy has been concluded.

30.2 That the Committee make no changes to the Fund's asset allocation at this time.

Dorset Liability Matching Portfolio

31.1 The Committee considered a report by Insight Investments on the performance of the liability matching portfolio since inception in July 2013. The report highlighted the stage the liability hedging programme was at in relation to the trigger points that had been set as part of the original mandate. It was reported that 8% of the Fund's interest rate risk had been hedged and 16% of the inflation risk.

31.2 Members were informed about the impact of the Office of National Statistics' (ONS) decision not to change the method of calculation of the retail prices index (RPI). The markets were expecting a change and believed that the new methodology would result in a lower RPI, and had, therefore, priced this into the futures market. The ONS decision not to change the methodology resulted in a sudden correction and the price of RPI swaps increased from 3.2% to 3.6% on the day of the announcement. This resulted in a significant gain of £62m in the value of the Dorset Fund's holding.

31.3 It was explained that the increase price of inflation swaps had meant that they were above the trigger levels. One member asked what would lower the price of inflation to bring it into the range of the trigger levels. It was explained that market expectations of lower inflation as a result of a much slower recovery, a change of monetary policy to target a lower rate of inflation or technical changes such as the ones previously proposed would all have an effect of lowering inflation expectations and therefore the price of inflation swaps.

31.4 The Independent Adviser stated that the Committee would need to decide at some point whether to extend the coverage of the inflation hedging beyond the 30% of assets that the mandate had targeted. This decision could be considered following the strategic review once the valuation had been completed.

Noted

The Global Equity Portfolio

32.1 The Committee considered a report by Pictet Asset Management which set out the performance of their developed overseas equities mandate. Mike Collins described his role and the strategy that he adopted. He stated that he has made the decisions about the weighting of the regional asset allocations with a view to targeting an out performance of the benchmark over a 5 year period. He explained that the mandate allowed a 10% allocation to cash holdings which he uses tactically as a defensive tool. He explained that the underperformance during 2012/13 was due to the cash holdings that he had employed.

32.2 Over the last 5 years the portfolio had out performed its benchmark by over 2%. The cash holdings at 31 March 2013 were close to the maximum allocation of 10% due to the view that markets had peaked and would fall over the following 12 months. The defensive position had been increased to reflect this view.

32.3 In terms of outlook for the future, Mr Collins stated that he was more pessimistic than he had been during the financial crisis of 2008. This was because it was felt that the developed economies had been affected by government and central bank manipulation since the Asian crisis in the early 2000's, and the resulting looseness of monetary policy had caused an unsustainable debt burden on most western economies, especially the US and UK.

32.4 Whilst quantitative easing (QE) could create the conditions for a short term stimulus which would allow economies to restructure, Mr Collins felt that little restructuring had taken place. He stated that QE did not create economic growth. It was for these reasons that a defensive stance had been taken in the portfolio allocation.

32.5 One member asked whether Pictet felt that the Dorset Fund's policy of operating a 50% currency hedge on its overseas equities was appropriate, or whether the hedge should be removed. Mr Collins felt that Sterling had a poor outlook and he personally would not hedge. The Independent Adviser stated that the reason the Dorset Fund operated the 50% hedge was to reduce the levels of volatility and the use of currency hedges was a risk management tool, and not designed as a return seeking function.

32.6 One member asked what would have to change in the overseas economies to make the Fund Manager change his outlook. He stated that a period of sustained increases in investment ratios would result in an improvement for the long term growth outlook.

Noted

The Property Portfolio

33.1 The Committee considers a report by CBREi on the property portfolio. Since the fall in property values during 2007 and 2008 the market had regained most of the value it had lost, but over the previous 18 months prices had drifted downwards slightly. It was felt that this drift had come to an end and vacancy rates had declined, which represented an increase in demand and property values should stabilise.

33.2 In terms of property across the country, excluding London and the South East, which had held up well, there had been a widening of yields between prime properties and secondary properties which had probably reached a peak and meant that there was some value to be found in the higher end secondary market.

33.3 In relation to London, CBREi officers believed that value was returning to the market. They stated that they were bearish against central London, Mid Town and the West End offices, because of the high rents and capitalisation levels, as well as a greater supply coming into the market, and transport infrastructure projects which meant that offices could be more spread out across London and less concentrated in the central area.

33.4 In light of this they explained why the Dorset Fund was underweight against the benchmark in London offices and why they favoured light industrial units and warehousing.

33.5 One member asked what impact the internet had on retail rents. Mr Clifton-Brown stated that in the major cities and affluent towns the outlook for retail remained strong, but retailers were reducing their holdings to the 70 or so largest towns and focusing on acquiring larger units in those towns.

33.6 Mr Wilson provided an overview of the fund performance, which showed an out performance against the benchmark, despite the purchase of 4 and sale of 2 properties. Despite the increase in the Fund's direct property holdings, it remained £30m underweight against its strategic allocation. He outlined a number of potential purchases that were being considered and stressed that any properties that would be purchased would have to be right for the Fund and that purchases would not be made just to bring holdings in line with the strategic allocation. The properties being considered would have strong underlying rents and, where possible, rent reviews would be regular and/or index linked. He highlighted the low voids figure which was less than 1% compared to a 10% for the IPD benchmark and stated that this was one of the factors that drove the performance of the Fund.

Noted

The UK Equity Portfolio

34.1 The Committee considered a report from the Chief Treasury and Pensions Manager on the performance of the UK Equities portfolio, in which the performance of the passive index tracking of the FTSE 350 group of shares was considered. The overall performance was in line with the benchmark as intended for a passive fund.

34.2 The performance of the other three UK equity funds was considered with AXA Framlington and Schroders under performing their benchmark over the 12 months to March, which followed a number of years of out performance. The Standard Life active mandate performed strongly out performing the market and the benchmark by 1.5% returning 18.3% over the year.

34.3 The returns on stock lending were highlighted and these returned £217k for the financial year.

Noted

Dates of Futures Meetings

35.1 The Committee noted the remaining meetings for 2013 and the provisional dates for 2014:

9 September 2013	County Hall, Dorchester
20/21 November 2013	London (to be hosted by Pictet)
26 February 2014	County Hall, Dorchester
25/26 June 2014	London (Committee meeting on 26th)
8 September 2014	County Hall, Dorchester

26/27 November 2014 London (Committee meeting on 27th).

Questions

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

Meeting Duration 10am – 1:30pm