Pension Fund Committee

Minutes of a meeting held at County Hall,
CollitonPark, Dorchesteron 4 March 2014.

Present:
Neil Sorton (Borough of Poole Council) (Chairman)
John Beesley (Bournemouth Borough Council) (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), Richard Bates (Head of Financial Services) and Tom Wilkinson (Finance Manager (Treasury & Investments)).

Manager and Adviser Attendance:
Steve Tyson (Independent Adviser), John Finch and Martin Mercer (JLT Employee Benefits)

(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 **26 June 2014**).

Apologies for Absence

1. Alan Saunders (Independent Adviser), Steve Tyson attended as his substitute.

Code of Conduct

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

Minutes

3. The minutes of the meeting held on 21 November 2013 were confirmed and signed.

Matters Arising

Minute 61 – Administration Strategy

4. The Fund Administrator stated that reference to the Equalities Act had been included in the Administration Strategy that had been adopted subject to its inclusion at the previous Committee.

Minute 72 – Investment in Standard Life Capital Secondary Opportunities Fund

5. The Fund Administrator confirmed that contracts had been signed between Dorset County Pension Fund and Standard Life Capital and that funds were available for draw down by Standard Life Capital.

Public Participation

Public Speaking

6.1 There were no public questions received at the meeting in accordance with Standing Order 21 (1).

6.2 There were no public statements received at the meeting in accordance with Standing Order 21 (2).

Petitions

7. There were no petitions received in accordance with the County Council's petition scheme at this meeting.

Review of the Fund's Strategic Asset Allocation

8.1 John Finch and Martin Mercer from JLT Employee Benefits presented the results of the review of the Fund's strategic asset allocation. Mr Finch explained to the Committee that the review followed on from a major strategic review that had taken place in 2011, and that the latest review represented an evolution from the previous piece of work, following updated data that had resulted from the Fund's 2013 Actuarial Valuation.

8.2 Mr Finch stated that the outcome of the latest review was to allocate 78% of the Fund portfolio into Growth Assets (Equities, Property and Alternatives), 10% in Corporate Bonds and 12% in stabilising assets, which hedged against inflation.

8.3 Mr Finch said that the revised strategy could potentially increase expected returns by 0.2% from 6.2% to 6.4% per annum, but reduced the risk to the Fund by 0.4% to 8.5%. The actuary had assumed a rate of return of 6% per annum so the revised strategy provided an increased margin against this.

8.4 The proposed changes were to decrease the asset allocation to UK equities by 3% from 28% to 25%; decrease the asset allocation to overseas equities by 1% from 23% to 22%; decrease the asset allocation to emerging markets by 1% from 4% to 3%; decrease the asset allocation to hedge funds from 6% to zero; to increase the asset allocation to diversified growth by 5% from 5% to 10%; increase the asset allocation to liability driven investments by 2% from 10% to 12%; and to create a new asset allocation to infrastructure of 4%.

8.5 This would result in a final asset allocation of UK Equity 25%; Overseas Equity 22%; Emerging Market Equity 3%; Private Equity 4%; Diversified Growth Funds 10%; Corporate Bonds 10%; Liability Driven Investments 12%; Property 10%; and Infrastructure 4%.

8.6 It was proposed that the fine detail of the changes and the resulting manager searches be carried out by officers.

8.7 The Chief Treasury and Pensions Manager stated that the proposed changes would result in the loss of two fund managers and the appointment of two new fund managers covering infrastructure and diversified growth. He said that whilst the Fund already had a diversified growth mandate with Barings Asset Management, that in the interests of further diversification, it would be prudent to appoint a different manager for the additional asset allocation to this area.

8.8 John Finch stated that there were 32 active diversified growth funds in the UK at the time. However, there were in the region of only 8 managers who would be able to accommodate an allocation of £100m (5% of the Fund's allocation). In relation to infrastructure, he stated that there would be a broad manager search before being narrowed down.

8.9 The Chief Treasury and Pensions Manager confirmed that the searches would commence immediately after the revised strategy had been approved and that the results of the search and the recommendation would be sent to Members of the Committee in advance of the Committee meeting in June 2014, where a formal selection could be agreed. In the interests of collaboration and on grounds of cost savings the infrastructure

search would be conducted with a number of other Local Government Pension Scheme (LGPS) Funds who were also seeking similar mandates to the Dorset Fund.

8.10 One Member raised concerns relating to fund manager fees, if two diversified growth funds (DGF) were selected and questioned whether fees could be reduced by increasing the Dorset Fund's allocation to their existing DGF manager.

8.11 John Finch stated that the size of the proposed mandate was large enough to attract competitive fees, and that after funds got to a certain size that the scope for fee reductions reduced, that doubling the size of the existing mandate would not result in a very large reduction in fees. He also stated that the proposal to divest from hedge funds would result in a large fee saving, as hedge funds were traditionally the most expensive asset class in relation to fees.

8.12 A member asked that the results from the searches and initial proposals be circulated to the Committee well in advance of the June 2014 meeting so that an informed decision could be made by the Committee.

8.13 The Chief Treasury and Pensions Manager said that once the revised strategy had been approved by the Committee notice would be given to both hedge fund managers that week and they would be asked to provide a timeline for the return of funds. He also stated that the allocation to DGF could be partially financed from current cash balances and that work would be done on how to manage the transition.

8.14 John Finch summarised that the strategy was evolutionary, that the Fund was in a good position and performing well. The move into infrastructure was significant, but not too large and it would be sensible to review performance after the proposed strategy had been implemented.

Resolved

9.1 That the proposed asset allocation be adopted and the new strategy be implemented by the officers and advisers.

9.2 That the decision on which managers to appoint be taken at the June 2014 meeting, with the proposal to be circulated electronically to Members for comment in advance of the meeting.

Treasury Management Strategy

10.1 The Finance Manager (Treasury and Investments) presented his 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 made expenditure in the form of pensions and retirement grants. These cash flows were currently positive and would build up over the course of the year prior to the cash being distributed in line with the strategic allocation and investment strategy.

10.2 The report 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.

10.3 The report 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 the highest rated institutions from the highest rated sovereign countries.

10.4 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.

10.5 The Finance Manager explained that the strategy was designed to act as a framework and point of reference for officers when taking day to day treasury management decisions. It was also explained that there was a proposed change to the strategy from the one that had been presented to the Committee in February 2013, this was to reduce the maximum time that an investment could be made for from 5 years to a maximum of 2 years. This change had been proposed to reflect the fact that the Fund did not have a strategic asset allocation to cash and it should not be able to be invested for long periods of time.

Resolved

11. That the Treasury Management Strategy be adopted.

Application for admission body status in the Local Government Pension Scheme (LGPS) from the Arts Service/DepARTure Arts

12.1 The Fund Administrator presented an application for The Arts Service/DepARTure Arts, to be admitted into the Dorset County Pension Fund. The Arts Service/DepARTure Arts had been formed from the Dorset County Council Arts Service, and set up as a standalone company. He said that admitted bodies either had to have an insurance bond in place or a guarantee from a parent company to underwrite any potential future pension liabilities. The guarantee had to be approved by the Dorset County Council's Cabinet. It was requested that The Arts Service/DepARTure Arts be granted admission body status, subject to the Dorset County Council guarantee.

Resolved

13. That The Arts Service/DepARTure Arts be granted admission body status, subject to Dorset County Council agreeing to guarantee any future pension liabilities of the organisation.

Report of the Fund Administrator

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

14.2 Steve Tyson, acting in the capacity of Independent Adviser presented Appendix 2 of the Fund Administrator's report. He provided a summary of the equity markets and reminded the Committee that it had been 5 years since equity market low point, and that from that point in 2008 to the present time there had been an impressive run. He said that the tone of the markets in 2014 had been positive, but he expected markets to be a bit more subdued moving forward. The outlook for global equities had been affected by the start of the US Federal Reserve's slowing down (tapering) of its asset purchasing programme, and that markets were worried about what would happen at the end of this programme, which had provided unprecedented support to US and global equity markets.

14.3 The UK was a long way from tightening its monetary policy, with the Governor of the Bank of England committed to keeping interest rates at their record low of 0.5%. The

policy of forward guidance had been adjusted, but the aim of it was to maintain the stability of the markets.

14.4 He stated that a potential problem for the world economy was emerging markets, which had been affected by the Federal Reserve decision to start the process of tapering, which had caused nervousness in some countries with high balance of payment deficits. Generally, it was felt that there was an improving world economic environment. The USA was forecast to grow at 3% during 2014 and that Janet Yelland, the recently appointed Head of the Federal Reserve, would reduce the asset purchasing programme very slowly, and it was likely that this would continue until at least the end of 2014.

14.5 A member asked whether the impact of falling US Government spending would have an impact on the growth of its economy. The Independent Adviser confirmed that the US Government had managed to delay the difficult decisions, and it was hoped that the pickup in economic growth would help improve the Government's finances. However, the difficult decisions would not disappear and would need to be dealt with at some stage.

14.6 The Independent Adviser said that the UK economy had been the biggest surprise, with economic growth forecast at 3.4% for 2014, and inflation reduced to 2%. Unemployment was down and business sentiment had improved, which it was hoped would translate into a pickup in business investment and the economy would start to rebalance as economic momentum broadened.

14.7 The biggest concern was reserved for the emerging markets, with the tensions in Ukraine destabilising markets further. There was concern that China was in a property and credit bubble and the depreciation of the Chinese currency (the Remnimbi) had concerned the markets. Countries that had current account deficits and inflation had seen their currencies devalued. Emerging markets had been the driver of the world economy since the 2008 financial crisis, but were starting to act as a drag on world economic growth.

14.8 Overall developed market equities had risen between 20-30% over the previous 12 months but their value was considered to be relatively high. Emerging markets had been down by around 4%, but their valuation was considered cheap. Bond returns had been flat and gilts had yielded approximately 2.7%. It was felt that the 2014 performance would depend on how Emerging markets fared.

14.9 UK property was seen to be solid and the gains seen in London had started to spread across the rest of the UK, and had been reflected in the recovery of industrial and retail property values. Property was considered a solid real asset to invest in and was in favour with investors.

14.10 The Independent Adviser summarised that he felt that 2014 would be a steady year, and that the Dorset County Pension Fund's strategy to move part of its allocation from equities to diversified growth funds was sensible. The move into more fee efficient alternative investments such as infrastructure was also sensible.

14.11 One member asked what the outlook for the Japanese economy was. The independent adviser stated that the level of quantitative easing (QE) had started to provide sufficient stimulus to allow inflation to reach 2% and that markets had increased by 50% very quickly in response to the stimulus. He felt that good Japanese equities would start to represent good value.

14.12 One member asked why the Bank of England had got its forward guidance wrong. He said that the timing of the withdrawal of QE was a difficult one, and that if it was

done too soon, the economy could falter, if too late the asset price inflation that had been seen could feed through into retail price inflation.

14.13 The Fund Administrator presented the main part of his report which considered performance for the financial year to 31 December 2014. He said that it had been a positive nine months, with the Fund returning 6.39% against its benchmark of 5.19% an out performance of 1.2% over the nine months. He said that the cash flow position of the Fund remained positive and was likely to do so until at least 2018, when pension payments would start to exceed member contributions, meaning that the Fund would have to start to rely on investment income to fund pension costs. As at 31 December 2013, cash balances stood at £88.8m with net new money from contributions and investment income standing at £28.6m, which was ahead of the forecast. The prediction for total new money for the financial year was £33.3m, £2.9m more than anticipated, which was largely due to the auto-enrolment of all Dorset County Council staff into the Fund.

14.14 He reported that around £30m of the cash would be required to be transferred to the Greater Manchester Pension Fund for the transfer of Dorset Probation Pensions as a result of a national restructure of the Probation Service. He said that liabilities of around £38m would also transfer.

14.15 The overall performance for the 12 months to 31 December 2013 was 17.32% against the benchmark of 15.71%. Performance over 5 years was positive, now that the 2008 time period had fallen out of the measurement. Performance over 10 years was positive, but had slightly underperformed the benchmark. In relation to performance against other LGPS Funds, Dorset had outperformed by more than 2% per annum on average over the 5 years, which had added an extra £120m to the value of the Dorset Fund.

14.16 The liability matching portfolio reduced in value by 9.04%, which was better than the benchmark of -10.04%. Members were reminded that this portfolio tracked liabilities and a reduction in its value was replicated by a reduction in the value of the Fund's liabilities. It was reported that the full hedging programme had to be completed and that early gains had been partially reversed. The Fund Administrator commented that the trigger points for the inflation hedges would be reviewed in light of the actuarial valuation, with a view to completing the programme.

14.17 In relation to the attribution of the Fund performance, the strategic allocation was driving performance, with stock selection decisions detracting from it. The performance of the Active US equity mandate was positive and in line with the benchmark. Emerging markets equity performance had been poor, but it was considered an attractive time to invest as the assets were considered to be undervalued against historic measures. The Members' attention was drawn to the volatility of emerging market performance, with quarterly movements of plus and minus 10% typical.

14.18 The performance of private equity remained positive over three years, but lagged against the benchmark over five years. Members were reminded that the benchmark was the FTSE All share which had seen very high returns since the financial crisis in 2008. Private equity remained underweight and officers were to consider new vintages of investment to achieve the target weight.

14.19 An update was given on the external audit plan for the Fund, which would take place during July 2014, and the introduction of the LGPS 2014 scheme. The Fund Administrator stated that the transitional regulations which paved the way for the movement from the current regulation to the proposed LGPS 2014 scheme had not yet been issued, even though it was less than 4 weeks to the proposed start of the new scheme. He stated

that the Fund was working to draft regulations, but the lateness of the final regulations would place additional pressures on the Benefits Team.

14.20 An update was given on the proposed Local Pension Boards, which were due to come into effect from 1 April 2015 as part of the Pensions Act 2014. It was expected that guidance would be issued by summer 2014. In relation to the proposed merger of Funds, it was stated that this seemed less likely, although work was being carried out to consider the merger of investment activity and investment vehicles, with the establishment of collective investment vehicles for each major asset class. Under this model, it was proposed that individual funds could set their own strategy, but would have to invest with the collective investment vehicles. This proposal was aimed at reducing investment manager fees.

14.21 A member asked whether it was possible for Committee members to lobby their MPs to explain that the reforms were not very well thought through. The Fund Administrator stated that there were a number of options that could potentially be proposed, these included the creation of 6 large funds, the collective investment vehicle model, or variation of these. He felt that the forced merger route would not result in the saving anticipated and cost money in the short term. The transition to a common investment vehicle would be time consuming as a lot of funds held a large percentage of illiquid assets and investment performance would be evened out for all funds as there would only be one vehicle for each asset class.

Noted

CBRE Global Investors

15. The Chief Treasury and Pensions Manager presented the Property Manager's report and drew members' attention to the performance of the property fund, and that one of the drivers was the low level of void properties. He informed members that there were debt write offs of £18k which were in relation to unpaid rent from a company that had gone into administration. He also drew their attention to the strong covenant strength of the current tenants, which helped to deliver high performance.

Noted

Insight Investments

16. The Chief Treasury and Pensions Manager presented the Insight Investments report, who had the mandate for the liability matching strategy. The Committee were referred to the performance since inception, in July 2012, which was more than 25% in absolute returns and 2.52% ahead of the benchmark.

Noted

Pictet Asset Management

17.1 The Chief Treasury and Pensions Manager presented the Global Equities report from Pictet Asset Management. He stated that the performance was disappointing, although it was to be expected given the bearish position of the manager. He said that the manager was due for review and that this would be done for the September 2014 meeting.

17.2 The Independent Adviser stated that the Pictet fund structure was unusual and that similar results could be achieved in a number of ways. The Fund Administrator said that the underperformance was due to the tactical cash holdings by the manager, and that if the cash had been allocated in line with the rest of the portfolio it would have outperformed its benchmark. He said that consideration to the structure of the mandate would be considered as part of the manager review and that a review of asset mix was a possibility.

Noted

Royal London Asset Management

18. The Chief Treasury and Pensions Manager presented the Corporate Bond Manager's report and drew attention to the performance which was positive and to the report and how the manager set out his strategy. Members commented on the quality of the report and the overall performance.

Noted

Barings Asset Management

19. The Chief Treasury and Pensions Manager presented the Diversified Growth Fund Manager's report which set out the changes in the strategy over the past 5 years which illustrated the benefits of active management between asset classes.

Noted

UK Equity Report

20. The Finance Manager (Treasury and Pensions) presented the UK Equity report which highlighted the performance of the internally managed UK equities portfolio, the Standard Life UK equities fund, the AXA Framlington fund and the SchrodersSmall Cap fund. All funds had performed well and Standard Life had recovered from its underperformance position when it was last reviewed.

Noted

Dates of Futures Meetings

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

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

Questions from Members of the Council

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

Meeting Duration 2.00pm to 4.07pm.