Agenda Item:

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Pension Fund Committee

Dorset County Council

Date of Meeting	26 June 2014
Officer	Pension Fund Administrator
Subject of Report	**Review of the Fund's Strategic Asset Allocation**
Executive Summary	At the meeting of the Pension Fund Committee in March 2014 a new strategic asset allocation mix was agreed. This report reviews the progress that has been made in implementing this new asset allocation and highlights areas where decisions are required to progress. The key areas that require action are the appointment of new managers for Infrastructure and Diversified Growth, the additional allocation to the Liability Hedging portfolio, and the need to make additional commitments to Private Equity.
Impact Assessment: *Please refer to the protocol for writing reports.*	Equalities Impact Assessment: N/A
	Use of Evidence: The Strategic review of Asset Allocation as presented to the March meeting of the Pension Fund Committee
	Budget: Additional manager appointments will be a charge to the Fund
	Risk Assessment: The risk of investment in specific asset classes is assessed in the Strategic Review, and an appropriate balance of risk/reward has been assessed and agreed within the revised strategy.

	Other Implications: None
Recommendation	It is recommended that the Committee: i) note the report and comment on the progress made in implementing the new asset allocation ii) delegate authority to the Fund Administrator, after consulting with the Chairman and Vice-Chairman, to appoint at least one Infrastructure manager iii) delegate authority to the Fund Administrator, after consulting with the Chairman and Vice-Chairman, to appoint at least one DGF manager (subject to a verbal update on progress) iv) agree to commit £50M to Private Equity investments every two years v) review and approve the revised Statement of Investment Principles.
Reason for Recommendation	To ensure that the Fund is implementing the revised Asset Allocation Strategy appropriately.
Appendices	1. Statement of Investment Principles
Background Papers	JLT's strategic review of asset allocation
Report Originator and Contact	Name: Nick Buckland Tel: 01305 224763 Email: n.j.buckland@dorsetcc.gov.uk

1. Background

1.1 At the meeting of this Committee on 4 March 2014, John Finch from JLT presented the results of the review of the Fund's Strategic Asset Allocation. The objective of the review was summarised as "Ensuring that the Fund has the most efficient investment strategy with respect to risk-adjusted return".

1.2 The starting point for the review was to assess the levels of risk within the existing investment portfolio, and look to reduce these risks, where possible without adversely affecting return. Given that the Fund had undertaken a thorough review resulting in changes to the asset allocation in 2012, this assessment took a lighter touch approach, accepting that a lot of the hard work had already been done, and that the existing strategy was a good starting point.

1.3 Prior to the presentation of the review's findings to the formal Committee meeting in the afternoon of 4 March, the Committee spent the morning of that day in a training session with JLT understanding the key ingredients to a successful investment strategy. It was felt that it was essential that the Committee be given the appropriate amount of time to understanding and considering the findings of the review, and the implications for the Fund.

1.4 As a result of the time spent on reviewing this piece of work the following strategic asset allocation framework was agreed, the third column shows the change from the existing strategy:

Asset Class		Target Allocation (%)	Change (%)
Equities			
	UK	25	-3
	Overseas (Developed)	22	-1
	Emerging	3	-1
Bonds			
	Corporate	10	0
	Inflation (Liability) Hedging	12	+2
Property		10	0
Alternatives			
	Hedge Funds	0	-6
	Private Equity	4	0
	Diversified Growth (DGF)	10	+5
	Infrastructure	4	+4

2. Implementation

2.1 The revised strategy shown in paragraph 1.4 requires a number of changes to bring the allocation in line with the new target positions. This report addresses the progress that has been made, and explains where further work is required.

Infrastructure

2.2 The new strategic asset allocation includes 4% invested in the Infrastructure asset class. This is a new asset class for Dorset, and the members spent some time understanding the benefits of investing in this area at the training session prior to the

March meeting. It is considered to be a good fit for Pension Funds, as it has long term time horizons, and also gives an element of inflation and interest rate protection.

2.3 Members will recall that JLT reported that they had a number of other clients that were looking at investing in infrastructure, and 2 of these were preparing to undertake a collaborative procurement exercise, which Dorset were also invited to join. The collaborative process was seen as an efficient way for the 3 Funds to benefit from one procurement exercise, and one set of analysis from JLT, whilst still retaining the final decision of which managers to appoint.

2.4 The procurement process commenced in early March, and concluded in April. Responses were received from 37 different Fund managers, and JLT analysed them all against a pre-agreed matrix, including qualitative and quantitative factors, and fee levels. Given that this type of search involves reviewing each manager history and ability to achieve performance in previous funds qualitative factors formed a much larger part of the analysis than might be seen in searches in other asset classes.

2.5 JLT issued officers with a 2 reports summarising the results of their analysis, and the other summarising the proposals of each manager. These were issued in early May ahead of a meeting with officers and the Fund's independent adviser on 14 May. Copies of these reports will be available for members to review at the meeting.

2.6 On 14 May The Fund Administrator, the Chief Treasury and Pensions Manager and the Finance Manager were joined the Independent Adviser, and met JLT's officers to review the proposals and analysis. At the meeting each of the proposals was reviewed and a shortlist of managers to take forward to the interview stage was agreed. It was hoped that the interviews with the short-listed managers would be able to take place in advance of this Committee meeting, but due to other diary commitments this has been impossible, and will now take place on 2 July. The interview process will be attended by officers and the Independent Adviser, and will be guided by John Finch from JLT.

2.7 At the short-listing it was felt the Fund would only wish to appoint a maximum of two managers for this mandate. As the allocation to Infrastructure totals £80 Million initially, it was felt that appointing any more than two would dilute the impact of any one manager. Given this position it was decided to split the potential managers between those that invest exclusively in the UK, and those that have a more global remit, with the potential to appoint one from each. The resultant shortlist, therefore, includes 2 exclusively UK managers, and 4 global managers. This number reflected the overall split between these two areas.

2.8 Since the short-listing meeting JLT have conducted further due diligence on the short-listed managers and have confirmed that they see no reason to change their view.

2.9 Appointment of Fund Managers is the responsibility of the Committee, but in this instance, given that the next meeting of the Committee is not until September it is requested that authority is delegated to the Fund Administrator in consultation with the Chairman and Vice-Chairman. This will enable the decision to be confirmed promptly after the 2 July, and investment can be made with the successful manager(s). This decision will be reported to all members of the Committee and a full report will be made to the September meeting.

Diversified Growth (DGF)

2.10 The revised strategy increases the Fund's allocation from 5% to 10% in Diversified Growth Funds. Members will be aware that the Fund currently invests in this area through the Baring Dynamic Asset Allocation Fund, and has done so since 2012.

2.11 There are two different ways in which the Fund could increase its allocation to DGF; firstly, and the simplest option would be to allocate more funds to the Barings fund. This would be a straight forward option, and certainly a possibility, as Barings were only appointed relatively recently, and would still be viewed as a good option. The second option is to invest in another alternative DGF approach, and the officers and advisers have been doing some work on this to ascertain whether an alternative provider could give the Fund a complementary approach to the Barings fund.

2.12 With this in mind JLT are currently reviewing the potential providers and it is planned that should there be an appropriate investment opportunity for the Dorset Fund, an additional manager appointment will be recommended to the Committee.

2.13 At the time of writing this report the exact process has yet to be confirmed, and so a verbal update will be given to members at the meeting with any additional progress that has been made.

Hedge Funds

2.14 The revised investment strategy no longer contains hedge funds, and therefore it was necessary to redeem the Fund of Fund investments that the Fund has with IAM and Gottex. As members will be aware Hedge Fund investments by their very nature are illiquid, and therefore take a number of months to redeem. After the February meeting officers held discussions with each manager and the positions with each are:

(i) Gottex – the Gottex pooled fund has quarterly redemption days for which investors need to give notice of their intention to redeem. The Dorset Fund has completed its redemption request, and it is anticipated that the full proceeds will be received in September.

(ii) IAM – the IAM investments are held in a segregated account, and therefore are potentially more liquid. This being the case, IAM started the process of deconstructing the Dorset portfolio soon after the last meeting of the Committee in March. They have put in place a plan of disinvestment, and will transmit proceeds to Dorset at regular intervals. The first of these payments (£9.4M) was received on 27 May. It is expected that this process will be concluded by the end of September

Inflation (Liability Hedging)

2.15 Members will be aware of the Inflation Hedging process which Insight undertake for the Fund, however whilst the theory of buying inflation protection is a relatively simple one, the processes involved to involve a good deal of complexity. It was felt, therefore that a holding a training session with Insight on the afternoon of 25 June, prior to this meeting on the 26 June, was sensible. It will give members the opportunity to have a greater understanding of the theory and processes that Insight follow when implementing this mandate.

2.16 Given the objective of the overall review was summarised as "Ensuring that the Fund has the most efficient investment strategy with respect to risk-adjusted return", it was sensible to review whether it was possible to make a small increase in the allocation to Insight. This 2% increase will allow the Fund to improve its protection against inflation, whilst still maintaining enough assets in the growth part of the portfolio to achieve the long term actuarial funding target of 6% return.

2.17 The Fund's officers met with Insight in April to discuss the additional funds, and also to review the appropriateness of the current matrix of trigger levels that are in place to enable Insight to implement the hedging programme. There was a concern that the current set of trigger levels were too aggressive, and subsequently the Fund was at risk of designing a program that in reality had little chance of being implemented. A compromise solution was reached whereby the trigger levels have been reset to give more chance of them being hit. As well as this the Fund will have in place an underpin which states that should none of the trigger levels be reached, Insight will implement a proportion of the hedge at the most favourable rates. This will result in the overall hedging solution being implemented over a 5 year period whether the target levels are hit or not. This process will be kept under review, and could be revised further.

2.18 The second conversation with Insight was around the allocation of an additional 2% of Fund assets to the program to increase the level to 12%. This was not so much of an issue with Insight, but potentially a legal issue around the LGPS investment regulations. Members will recall that the investment with Insight is set up in an unlisted Qualifying Investor Fund (QIF), due to LGPS funds be unable to enter into derivative transactions directly. The bespoke QIF enables Insight to manage the hedging programme effectively and still remain within the LGPS investment regulations.

2.19 The LGPS regulations, however limit investment within unlisted securities to no more than 10% of the Fund by value. However, the Fund is permitted, in accordance with Regulation 14, to extend this limit to 15%. This can be done by reference within the Fund's revised Statement of Investment Principles, and agreed by the Pension Fund Committee. This is addressed in later paragraphs.

Equity (UK and Overseas)

2.20 Members will be aware that the Fund has a significant cash holding which the revised strategy addresses, however, the cash balances will prove helpful in the transition from the current position to the new target weights. The cash balances will enable investments to be made in the new asset classes before any dis-investment is made from Equities. It is also likely that investment in Infrastructure and Private Equity will take some time to build up. It is therefore proposed, to ensure that the Fund's cash balances reduce and that the Fund remains fully invested, the withdrawal from equities is more of a staged process over a period of months.

Private Equity

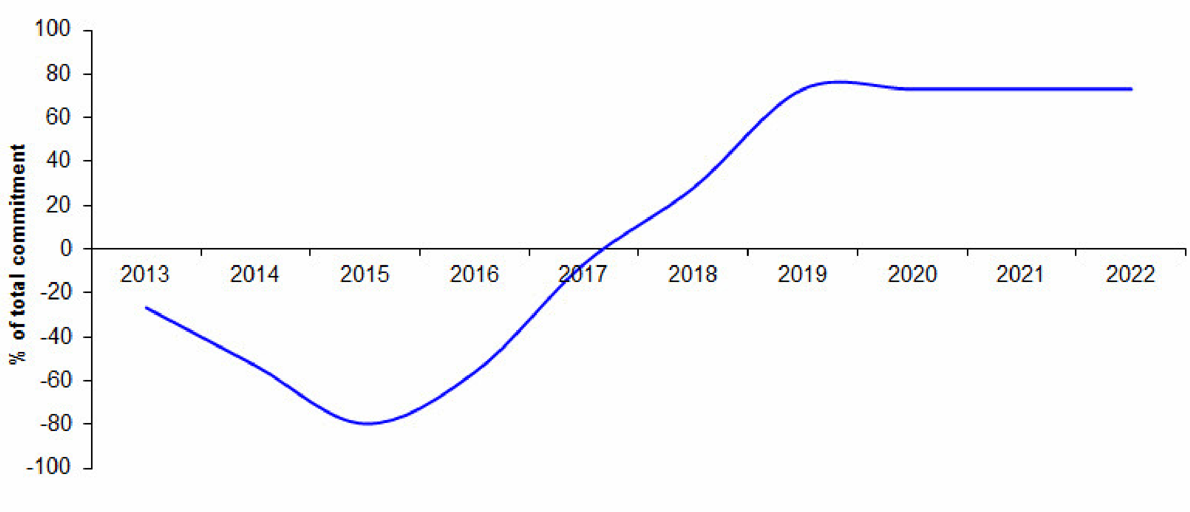
2.21 The Dorset Fund has been investing in Private Equity (PE) since 2006. The addition of investments in PE were seen as a way of diversifying the equity exposure of the Fund, and driven by the ability of the asset class to generate returns that significantly outperform quoted equity in the long run. It is an asset class suited to long term investors such as Pension Funds, as investments are generally held for seven to ten years.

2.22 The Fund undertook a procurement process in late 2005, and as a result selected 2 managers that best met our requirements. SL Capital and HarbourVest gave the Fund a diverse exposure to the asset class, as SL Capital specialises in Europe, and HarbourVest the US.

2.23 The recent strategic review confirmed the place that PE has in the portfolio, and retained the 4% target weight. It is appropriate therefore, to review the current position and put in place a programme of commitments to ensure that this target weight is reached, and maintained.

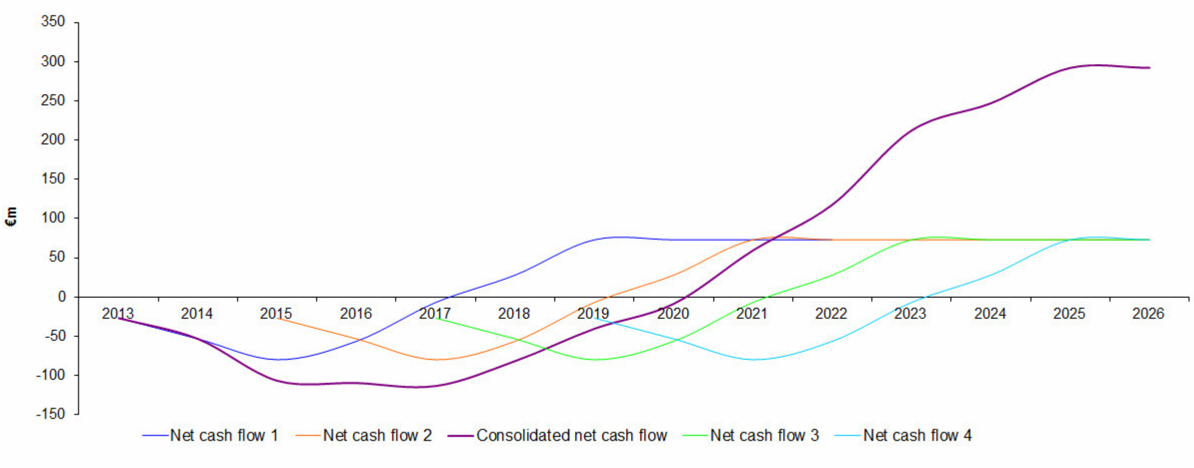
2.24 An issue, which is specific to PE investing, is the need to over-commit to achieve the desired target allocation. This is due to the cash only being drawn down by the PE funds when investment opportunities arise. It generally takes a fund at least 5 years to invest all of the committed funds. During this 5 years, however, some of the early investments will be sold, and cash returned, meaning that the PE fund will never achieve 100% investment. This is shown in the cash flow illustration chart below which shows the so called “J-curve” effect of PE investing.

Cumulative Net Cashflow Illustration - committing €100m to a fund in 2013



2.25 The chart shows the typical nature of the cash flows from private equity fund investing, this is known as the “J-curve”. Because of this “J-curve” effect it can be seen that only around 70% of the committed investment will actually be invested at any one time, and therefore “over-commitment” is required to achieve the target allocation. The chart below shows the typical cash-flows from committing every two years.

Cash flow illustration - committing €100m to funds in 2013, 2015, 2017 and 2019



2.26 The second chart shows the combined effect on cash-flow of committing to funds every two years. The purple line consolidates the individual flows, and shows that committing €100M every two years would result in a maximum of around €135M actually invested.

2.27 Members will know that the Dorset Fund has a target allocation to PE of 4%; at current fund values this equates to £84M. To achieve this target weight, assuming that around 70% will be invested, a commitment of around £120M is required. The Dorset Fund has appointed 2 fund of fund managers; HarbourVest, whose focus is mainly in the US, and SL Capital who invest solely in Europe.

2.28 Since commencement of the programme Dorset has committed around £92M to a number of different funds managed by the two appointed managers. These investments have returned £17.6M to Dorset, and currently around £35M remains undrawn.

2.29 It is clear that without making regular additional commitments the Dorset Fund will never reach its target allocation. Since the original commitments in 2006, additional commitments were made in 2010, and most recently, at the end of 2013. However, these investments have been made in a "piece meal" fashion, and with the recent confirmation of PE's position in the overall portfolio it is appropriate to put in place a more robust plan to reach and maintain the target weight to this area.

2.30 The Fund's manager's, regularly launch new "vintages" of pre-existing funds. These new "vintages" maintain many of the characteristics of the existing funds, and allow investors to regularly top-up their investments. These new "vintages" of existing funds are generally launched every two years, whilst other, more opportunistic vehicles, such as the SL Capital secondary opportunities fund will look to take advantage of particular market conditions. The Committee will have a training session with HarbourVest and SL Capital on 25 June to explain the processes in more detail.

2.31 It is recommended, therefore that the Fund agrees to commit £50M every two years to new "vintages" and other such fund launched by SL Capital and HarbourVest. The officers and advisers will review the opportunities when they become available and will regularly make recommendations to the Committee as to which funds to commit. This target level of commitment will be regularly reviewed, to ensure that it is achieving the objective of reaching and maintaining the 4% allocation.

3. Statement of Investment Principles

3.1 The Statement of Investment Principles (SIP) is a statutory document for Local Government Pension Funds, and there is an obligation to review and update the document on a regular basis. The appendix contains the updated SIP, which has a number of amendments from the previous version which are highlighted.

3.2 The most significant changes relate to the revised Strategic Asset Allocation which is explained earlier in the report. The other change which needs to be included in the revised SIP relates to the Insight mandate. The situation, as explained earlier in the report relates to the limit within the LGPS investment regulations for investment in unlisted securities. Fund's are permitted to extend the 10% limit to 15% provided the appropriate advice has been received, and it is published in the SIP.

DORSET COUNTY PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES – June 2014

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1. THE STATUTORY REQUIREMENTS FOR A STATEMENT OF INVESTMENT PRINCIPLES (SIP)

- Regulations made by the Secretary of State (The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009) under powers contained in Section 7 of the Superannuation Act 1972 revised the requirement for administering authorities to prepare, maintain and publish a Statement of Investment Principles (SIP) and consult with persons they deem appropriate when drawing up their statements. The revised statements must be published no later than 1 July, 2010. The regulations came into force on 1 January, 2010.
- The County Council have delegated all aspects of the management of the pension scheme to the Pension Fund Committee the minutes of which are reported to the County Council.

- This revised document was presented to the Pension Fund Committee, which provides the appropriate basis for consultation, on 14 June 2014.

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2. COMMITTEE CONSTITUTION

- The Pension Fund Committee is a Committee of the County Council which appoints five County Council members, with invitations to Bournemouth and Poole unitary authorities (one member each) and to the six Dorset district councils (one member in total). The scheme members are also represented on the Committee by one member, who is nominated by the Trade Unions.

3. COMMITTEE RESPONSIBILITIES

- The Terms of Reference of the Pension Fund Committee are to exercise all functions of the Council as administering authority under the Local Government Superannuation Act and Regulations and to deal with all matter relating thereto. Such as:

  - Determining the overall investment strategy and strategic asset allocation of the Fund, and in doing so taking proper professional advice
  - Overseeing the preparation of and regularly reviewing the Fund's key policy documents including the Statement of Investment Principles (SIP), Funding Strategy Statement, Governance Policy and Compliance Statement, Business Plan, Communications Strategy.
  - Appointing and reviewing the performance of all Fund Managers and other professional service providers
  - Reviewing all aspects of performance across the Pension Fund service

- Deciding upon requests for admission of qualifying organisations wishing to join the Fund
- Deciding upon key pension policy and discretions that are the responsibility of the Administering Authority
- Ensuring that at all times that these responsibilities are discharged in the best interests of the Fund.

4. INVESTMENT POLICY

- The investment policy of the Pension Fund is intended to ensure that all statutory payments made from the fund are at the least possible cost to local taxpayers.

- Investment returns are a key factor and achieving satisfactory returns will to a considerable degree reflect the risks taken. The Committee seeks to control risk, not eliminate it, and deals only with reputable service providers to minimise counterparty risk.

- Consideration is given to the ongoing risks which may arise through a mismatch, over time, between assets of the Fund and its liabilities. These are looked at in greater detail within the Fund's Funding Strategy Statement. However, the major risks that the Fund has are the impact of Interest and Inflation Yields on the liabilities, which can lead to this mismatch. This was highlighted in a Strategic review of the Fund undertaken by JLT in June 2011. The Committee decided to begin a process to reduce the level of mismatch, but without significantly reducing the potential for return. As part of this review process a new strategic target allocation for the portfolio was agreed. This strategy was revised in 2014, and the new target allocation is shown below.

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- Investment risk can be measured and managed in many other ways:

  - The absolute risk of a reduction in the value of assets through negative returns. Whilst this cannot be avoided entirely, it can be mitigated by positioning the assets of the Fund across a number of different types of assets and markets.

  - The risk of underperforming the benchmarks or relative risk. Our investment managers can, to a large extent, control relative risk by using statistical techniques to forecast how volatile their performance is likely to be relative to their benchmark or target. Each manager has a mandate specific benchmark and controls.

  - Different asset classes have different risk and return characteristics, e.g. equities. In setting the investment strategy, the Committee takes into account with the Fund actuary, the expected risks and returns of the various asset classes and the correlation between those returns to target or expected return within an acceptable level of risk.

  - Other financially material risks such as corporate governance and environmental issues are required to be considered and managed by our investment managers in relation to all asset classes.

- The adoption of a asset allocation strategy and the detailed monitoring of performance and risks relative to the targets set, constrains the investment

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managers from deviating too far from the intended outcome, whilst at the same time allowing adequate flexibility to manage the portfolios in such a way as to enhance returns.

- Risks may also arise from a lack of suitable balance or diversification of the Fund's assets. The Committee believes that the asset allocation policy currently in place provides an appropriately diversified distribution of assets for this purpose.

- The key measure for the Fund will be the performance against its own unique benchmark which is derived from the asset allocation structure and the performance benchmarks set for each of the asset and manager categories. The strategic asset allocation of the Fund was revised at the Committee meeting in February 2014, with a target implementation date of 1 October 2014, and is:

Asset Class	Exposure
Equities	
UK	25%
Overseas (developed)	22%
Emerging Markets	3%
Bonds	
Corporate	10%
Government	12%
Property	10%
Alternatives	
Diversified Growth	10%
Private Equity	4%
Infrastructure	4%
Liability Hedging Programme	Backed by Government Bonds

Note: There is flexibility bands of +/- 5% on UK and Overseas Equities, and +/- 2.5% on Bonds and Property.

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Liability Hedging

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- The Committee reviews asset allocation on at least a six monthly basis, and the individual manager's reports setting out activity and transactions are received quarterly.

- The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 set out certain restrictions to apply in managing investments including:-

  - Not more than 10% of the Fund may be invested in unlisted company securities.

  - Not more than 10% to be invested in any one holding (excluding unit trusts, gilt edged stock and bank deposits).

  - Not more than 25% to be invested in unit trust schemes managed by one person, but not more than 10% in a single holding.

  - Not more than 10% to be deposited with any one bank (excluding the National Savings Bank).

- Any loans, other than to the Government, may not exceed 10% of the Fund.

- Not more than 25% to be invested in insurance contracts.

- Not more than 25% of all securities to be transferred (or agreed to be transferred) by the Fund under stock lending arrangements.

- Not more than 15% in all sub-underwriting contracts, and not more than 1% in any single sub-underwriting contract.

- Not more than 8% invested in all partnerships, and not more than 5% in any single partnership.

Flexibility is given around some of these limits, under the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2003. On 26 June 2014 were recommended to make use of the headroom allowed for unlisted securities. The limit for all unlisted securities will now be 15%. The regulations require that the following information be included in the SIP:

Requirement	**Statement**
Take proper advice	From Fund Administrator, Independent Adviser and Legal Advisers
The description of investment to which it applies	Unlisted securities
The limit on the amount	Increase limit from 10% to 15%
The reason for that decision	To extend the Inflation hedging programme with Insight
The period for which the decision will apply	Until further notice
That the decision complies with the regulation	Confirmed
The decision must be published in the SIP before it takes effect	Revised SIP considered on 26 June 2014

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In addition the County Council, as the administering local authority, must have regard to:-

- The need for the diversification of investments (as described above)

- The suitability of investments

- Proper advice, obtained at regular intervals

The regulations also enable the County Council to vary the manner in which monies are invested thus enabling the switching of monies from one investment to another.

The employment of external investment managers is expressly permitted subject to:-

- Appropriate diversification between managers.

- Regular reviews of managers' performance, dealings and employment (which is terminable at not more than one months notice).

- Their authorisation under the Financial Services Act for 1986 or for European Institutions similarly authorised by their home state and reasonably believed to be suitably qualified by ability and practical experience.

5. INVESTMENT MANAGEMENT ARRANGEMENTS

- Dorset County Council is the administering authority for the Fund and has delegated its responsibilities to the Pension Fund Committee.

- The Chief Financial Officer is the Administrator of the Fund and has delegated responsibilities from the Council for the administration of the Pension Fund. These responsibilities are set out in paragraph 7 of this document. In carrying out these duties he and the Committee take advice from the Fund's independent adviser, Mr Alan Saunders from Allenbridge Epic Investment Advisers.

- The appointment of an appropriate number of managers for each major asset class, with different investment styles, helps provide an adequate level of diversification of manager risk.

- Two thirds of UK Equities are managed by staff in the Corporate Resources Directorate, and the remainder by 3 specialist UK equity managers. In addition external managers are employed in specialist areas including Overseas Equities, Bonds, Property, Private Equity, Diversified Growth and Infrastructure. Managers are required to report on portfolio management on a quarterly basis, they must comply with all instructions given to them by the authority (in accordance with the mandates agreed) and contracts can be terminated at one months notice.

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- OVERSEAS EQUITIES

  Overseas equities are presently managed in the developed markets by Pictet Asset Management who are required to hold a well diversified portfolio of stocks. Use of derivatives and currency hedging is permissible but there is to be no financial gearing. Pictet have a benchmark of the MSCI World (ex UK) Index. The objective is to outperform the benchmark, on a rolling 3 year cycle. In addition to Pictet a proportion of the Fund is managed on an active basis in the US with the target of outperforming the relevant index by a margin. Janus Intech were appointed with effect from 1 April 2006 to manage this active portion of the US portfolio. The manager has a target to outperform the Index by 1-2%. The investments are managed on a segregated basis. With effect from 1 April 2012 JP Morgan Asset Management have been managing Global Emerging Market Equities on an active basis. The investment is in a pooled fund, which has a diversified strategy, with a target of outperforming the MSCI Emerging Markets Index by 2%.

- GLOBAL BONDS

Global bonds are presently managed by Royal London Asset Management (rlam) and Insight Investments. rlam were appointed with effect from 1 July 2007, and Insight 1 April 2012. rlam has 10% of the overall Fund under management, and Insight have 12%.

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rlam use the iBoxx Non-Gilt Over 5 Year Index as their benchmark with an outperformance target of 0.75%. This is achieved by investing in the RLPPC Core Bond Fund. The Fund invests in a diversified portfolio of mainly UK Bonds with an emphasis on the corporate sector.

Insight were appointed in 2012 to help the Fund manage its liability risks, with particular focus on inflation. The target is to reduce the Fund's exposure to Inflation by putting together a portfolio that moves in a similar way to the liabilities. This will be achieved initially by holding a portfolio of Index Linked Gilts. Over time and after setting of a series of key trigger points this will develop into a broader hedge of the Fund Inflation risks. This will be achieved by investing in a bespoke Qualifying Investor Fund (QIF), which will enable Insight to use a range of derivative instruments to further protect the Fund.

- PROPERTY INVESTMENTS

CBRE Global Investors is presently the Fund's property advisers and managers. The Manager presents to the Committee for approval sectoral targets within the total approved and carries out acquisitions and disposals to achieve the distribution agreed. Performance of the portfolio is measured against an industry standard benchmark. The Fund also invests in a number of indirect property funds including; Hercules Unit Trust, the Lend Lease Retail Partnership (Jersey) Unit Trust, and the ING Retail Fund Britannica and the ING UK Property Value Added Fund. The manager's target is to achieve a return on assets at least equal to the average IPD Quarterly Universe Portfolio Return for a rolling five year period. The performance against the WM Local Authority Universe is also noted.

- UK EQUITIES

The majority of the UK equity portfolio is presently managed by staff in the Corporate Resources' Directorate on a passive or index tracking basis. The target set is the FTSE 350 Index, with an annual deviation allowed of ± 0.5%. No derivatives or financial gearing is permitted. The constituents of the FTSE 350 index are fully replicated by the in house team. The remaining 3% of the FT All share index not included in the FTSE 350 index is captured by a separate external fund managed by Schroders (w.e.f. 1 April 2006) in a fund specialising in Small Cap investments. Schroders have a target to outperform the FTSE Small Cap index by 2.5% per annum. This is managed in a pooled vehicle. In addition a proportion of the Fund is managed on an active basis. The managers for this part of the portfolio with effect from 1 April 2006 are AXA Framlington and Standard Life with targets of outperforming the FTSE All Share Index by 3.5% and 2.5% respectively. These Funds are all invested in Pooled vehicles.

♦ PRIVATE EQUITY FUNDS

Since April 2006 the Fund has invested in Private Equity Fund of Funds. The Fund invests in Fund of Fund products managed by Harbourvest and Standard Life. Harbourvest specialise in the US, whereas Standard Life focus mainly on Europe, and both managers aim to outperform public equity markets by between 4-6% per annum over the life of the Fund (generally 10-15 years). The reasons for these investments is to potentially improve returns, and to improve Fund diversification.

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<#>ABSOLUTE RETURN FUNDS¶
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In October and November 2004 the Fund made investments with three Fund of Hedge Fund Managers with the objective of providing absolute returns (expressed as a return over cash) with low correlation to bond and equity markets. The current managers are International Asset Management and Gottex..¶

♦ DIVERSIFIED GROWTH

Since April 2012 the Fund has invested with Barings Asset Management in their Dynamic Asset Allocation Fund. This pooled fund seeks to achieve equity like returns with lower risk, by investing in a range of asset classes and focussing on asset allocation. The Fund identifies an optimal long term strategic position, and makes dynamic asset allocation decisions around this. The target return is cash plus 4% with 70% of equity risk. The Fund will increase its allocation to DGF to 10% later in 2014, and this will either be way of an additional manager appointment, or allocating additional funds to Barings.

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♦ INFRASTRUCTURE

As a result of a review of the Fund's Strategic Asset Allocation in 2014, an allocation of 4% will be made to Infrastructure assets. The Fund embarked on a collaborative search process, and will appoint at least one manager later in 2014.

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♦ SOCIALLY RESPONSIBLE INVESTMENTS AND CORPORATE GOVERNANCE

Funds are also required to include a statement on the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments and a summary of the policy (if any) in relation to the exercise of rights (including voting rights) attaching to investments.

The Pension Fund Committee has decided to place no restrictions on investment managers in choosing individual investments in companies in either the UK or overseas markets. It is noted that emerging markets investments, are made in a wide range of developing countries where conditions of employment and standards of environmental protection are not the same as they are in the developed countries.

The Committee expects that the boards of companies in which the pension fund invests should pay due regard to environmental matters and thereby further the long-term financial interests of the shareholders. Ethical and environmental issues arise not only in board policy decisions but in daily operations. The Pension Fund Committee cannot become involved in those decisions and therefore looks to the directors of a company to manage that company's affairs taking proper account of the shareholders' long-term interests.

The Dorset Fund is a member of the Local Authority Pension Fund Forum (LAPFF). The LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders while promoting corporate social responsibility and high standards of corporate governance among the companies in which they invest.

- CORPORATE GOVERNANCE

  The Pension Fund Committee has in place a voting issues policy for UK and overseas equity investments. Advice on such issues is taken from the National Association of Pension Funds and the Fund's voting rights are used according to this advice and the agreed policy. LAPFF also advise the Fund on any contentious areas where voting differently to the agreed policy maybe considered.

- THE UK STEWARDSHIP CODE

  The Fund's compliance with the Seven Principles of the UK Stewardship Code was presented to the Committee on 12 September 2011. This document will be published separately. The Fund complies with each of the Principles, and has confirmed with each of its appointed Equity managers have taken action to comply with the Code. Each manager also publishes a Stewardship Policy.

- OVERSEAS CURRENCY EXPOSURE

  The Fund aims to eliminate the exposure to non-sterling currency by fully hedging any exposures within the Bond and Hedge Fund portfolios. The Fund also has a permanent 50% currency hedge on its entire overseas equity portfolio. This has been in place since July 2005, and is not intended as a speculative decision, but is intended to return the Fund to a level of currency exposure it had before the increase in weight in overseas equities.

- STOCK LENDING

  The Committee permits the lending of UK equities, overseas equities and bonds. This is currently limited by the Fund to 25% of the value of the Fund. The Fund lends Global Equities and UK equities from the portfolios managed by Pictet Asset Management and the Internal manager respectively. The Fund's custodians HSBC and Pictet undertake the stocklending as an agent for the Fund. The custodians ensure that on a daily basis collateral (worth at least 105% of the value of the stock on loan) is collected from the counterparties. The Fund does not have a policy of recalling stock for voting reasons, and accepts that there may be occasion where voting rights are lost due to stocklending.

6. RESPONSIBILITIES OF THE FUND ADMINISTRATOR

The Fund Administrator is responsible for:

- Development of an asset allocation strategy in consultation with the Fund's Independent Adviser and Actuary, for approval by the Committee.

- Funding allocation decisions consistent with the asset allocation strategy agreed by the Committee.

- The provision of monitoring information (provided by HSBC) to the Committee on the performance of each manager and the Fund overall,

- The management of Fund Managers and other professional service providers and advising the Committee on terms of engagement.

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- All other aspects of the management of the Fund.

7. RESPONSIBILITIES OF THE CUSTODIAN

- Pictet & Cie, based in Geneva and HSBC Global Investor Services, based in London are presently the appointed custodians for all fund assets except for direct property holdings where title deeds are held in the Council's archives.

- The custodians safeguard assets, ensure that all associated income is collected and settle all transactions (purchases/sales and stock loans). The Fund is provided with statements of assets, cash flow and corporate actions which are reconciled by the Fund Administrator' staff to the reported actions of the managers.

- The Custodian will inform the Council of any areas of concern which arise in its dealings with managers.

8. AUDIT RESPONSIBILITIES

- The Dorset County Pension Fund is subject to review by both the County Council's external auditors (KPMG) and the County Council's internal auditors (a service provided by the South West Audit Partnership).

- The external auditors are responsible for reporting on whether the Statement of Accounts presents fairly the income and expenditure for the year and the financial position of the Dorset County Pension Fund, for the year then ended. Their audit report to Dorset County Council is contained in the County Council's Annual Report and Accounts.

- The internal audit team carries out a programme of work designed to re-assure the Fund Administrator that Pension Fund investment systems and records are properly controlled to safeguard the Fund's assets.

9. ACTUARIAL RESPONSIBILITIES

- The Dorset County Pension Fund is subject to a full actuarial review every 3 years by the Fund's actuary, currently Barnett Waddingham. The last full review was at 31 March 2013, which reported an overall 82% funding level.

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- The actuary is responsible for providing advice as to the maturity of the Fund and its funding level and to determine employers' contributions so as to maintain the Fund's ability to meet its liabilities.

10. RESPONSIBILITIES OF INDEPENDENT ADVISER

The Independent Adviser to the Committee is currently Alan Saunders from Allenbridge Epic, and is responsible for assisting the Fund Administrator and Committee:

- in the preparation and review of this document,
- In the development of an appropriate asset allocations strategy,
- in the regular monitoring of the investment managers' performance,
- in asset allocation decisions, and
- in the selection and appointment of investment managers and custodians.

11. RESPONSIBILITIES OF THE INDEPENDENT PROFESSIONAL OBSERVER

The Department for Communities and Local Government (CLG) issued guidance to Local Government Pension Funds in 2008 recommending the participation of an Independent Professional Observer (IPO) in the governance arrangements of schemes. The IPO's role is outlined as undertaking independent assessment of compliance against the Myners' principles and other benchmarks, and to offer a practical approach to the management of risks. The Fund has appointed Peter Scales of Allenbridge Epic to this position. The adviser reports annually to the Committee with his independent assessment on the Fund's work, and its compliance with governance and other principles.

12. COMPLIANCE WITH MYNERS' PRINCIPLES

Since the original Myners Review in 2001 established 10 principles of investment for defined benefit schemes, the Dorset County Pension Fund has carried out a self-assessment of their position and implemented arrangements in order to comply with these principles. The Annual Report & Accounts for 2008-09 reported full compliance.

In October 2008, the Government published their response to consultation on updating the Myners review and restructured the original principles into 6 new high level principles, providing guidance on recommended best practice for applying the principles, and identifying tools to provide practical help and support to trustees and their advisers. The Investment Governance Group – LGPS Sub-Group has issued an adapted version for LGPS pension funds.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 require, inter alia, administering authorities to state in their Statement of Investment Principles, the extent to which they comply with the updated principles as contained in guidance issued by CIPFA. If an authority does not comply with that guidance in any respect, it should describe the relevant aspects of its practice and give the reasons for them.

Dorset County Pension Fund maintains a high level of compliance with the updated principles and guidance, as shown in the following table.

Principle 1: Effective decision-making	**Fully compliant**
Dorset County Pension Fund has ensured that decisions are taken by those with the skills, knowledge, advice and resources necessary to make them effectively, that their implementation is regularly monitored, and that they have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.	

Principle 2: Clear objectives	**Fully compliant**
Dorset County Pension Fund has set out an overall investment objective that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and has clearly communicated these to advisers and investment managers.	

Principle 3: Risk and liabilities	Fully compliant
In setting and reviewing their investment strategy, Dorset County Pension Fund has taken full and proper account of the form and structure of liabilities, including the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.	

Principle 4: Performance assessment	Mainly compliant
Dorset County Pension Fund has made suitable arrangements for the formal measurement of performance of the investments, investment managers and advisers, and periodically makes a formal assessment of their own effectiveness as a decision-making body, reporting to scheme members each year. The Fund is not fully compliant with CIPFA guidance because the Committee does not currently undertake a formal assessment of its own performance as a decision-making body.	

Principle 5: Responsible ownership	Fully compliant
Dorset County Pension Fund has included a statement of the fund's policy on responsible ownership in the Statement of Investment Principles and the discharge of such responsibilities is reported periodically to scheme members.	

Principle 6: Transparency and reporting	Fully compliant
Dorset County Pension Fund acts in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives, and reports regularly to scheme members.	

County Hall
DORCHESTER
June 2014

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