Agenda Item:

8

Pension Fund Committee

Dorset County Council

Date of Meeting	8 September 2014
Officer	Director for Corporate Resources
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. A report was taken to the meeting of the Committee in June reviewing the progress that had been made in implementing the new strategy. This report updates the Committee on further progress, and highlights any issues or outstanding areas.
Impact Assessment:	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: Investment management fees are charged directly to the Pension Fund and are budgeted for.
	Risk Assessment: The risk of investment in specific asset classes was 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	That the Committee : i) Note and comment upon the progress made in implementing the revised strategy. ii) Note the appointments of IFM and Hermes to manage Infrastructure. iii) Agree to defer the search for an additional DGF manager for 12 months. iv) Agree to amend the strategic allocation, and implement as shown in paragraph 2.15.
Reason for Recommendation	To ensure that the Fund is implementing the revised Asset Allocation Strategy appropriately.
Appendices	None
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 Committee spent time with officers and advisers prior to the formal Committee meeting, understanding the key ingredients to a successful investment strategy. This training session was a key part of the overall process of setting the new strategy.

1.3 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

1.4 After the setting of the revised strategy a programme of implementation was started. A report was presented to the meeting of the Committee in June updating on the progress made, and it was agreed a further update would be given, in the form of this report, to this meeting.

2. Implementation

2.1 The revised strategy shown in paragraph 1.3 required a number of changes to bring the allocation in line with the new target positions. The report to the June meeting addressed the progress that has been made, and this additional report summarises further progress.

<u>Infrastructure</u>

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 the Fund undertook a collaborative procurement process with two other LGPS funds, managed by JLT. The process resulted in one set of analysis being produced by JLT for all 3 Funds, but then each fund was left to reach its own conclusions.

2.4 The Dorset Fund short-listed 6 potential investment managers; 2 with a UK focussed strategy, and 4 with more global approaches. Theses 6 short-listed managers were interviewed on 2 July by the Chief Treasury and Pensions Manager and the Independent Adviser supported by JLT.

2.5 Each of the short-listed managers presented their strategy, and were asked a numbers of questions to assess the most appropriate for the Dorset Fund. At the end of the process the managers and their strategies were compared, and the two most appropriate were selected. The two preferred managers were then subject to an additional due diligence meeting with the Chief Treasury and Pensions Manager and the Independent Adviser on the 22 July to ratify the decision.

2.6 The meeting of the Committee in June delegated authority to the Pension Fund Administrator after consulting with the Chairman and Vice Chairman to appoint at least one manager. As a result of the process detailed above, and after consulting with the Chairman and Vice Chairman, Hermes Fund Managers and IFM were appointed to manage £40 Million each. The Hermes strategy has specific focus on UK investments and IFM has a global approach.

2.7 The Legal documents for each investment are currently with the Fund’s legal advisers, and it is hoped that this process will be concluded by the end of September to enable the Dorset Fund to be admitted into each investment by the end of the year.

2.8 Both investments will take a number of months to draw down, in a similar way to Private Equity. It is anticipated that both will be fully invested within 18 months. It is planned to invite each new manager to present to the Committee over the next year, to enable member to become more familiar with the asset class, and the specific approaches.

<u>Diversified Growth (DGF)</u>

2.9 Members will recall that the revised strategy increased the allocation to DGF from 5% of the Fund to 10%. It was decided to review potential providers to ascertain whether there was an alternative provider that would give Dorset a complementary approach to the existing investment in the Barings Dynamic Asset Allocation Fund (DAAF). It was reported at the meeting in June that the progress in this area had been slower while the focus had been on the Infrastructure manager search.

2.10 Since the meeting in June some progress had been made in identifying the alternative approaches available, and identifying those that would give the Dorset Fund something that would complement the Barings Fund. However, this work has now stopped after an announcement from Barings in early August.

2.11 Barings announced that the two most senior members of the Multi-Asset group, that is responsible for managing the DAAF, had resigned. Percival Stanion, and Andrew Cole have both presented to the Dorset Committee, and will clearly be a loss to Barings. Percival has been replaced as Head of the Multi-Asset group by Marino Valensise, who was formally the Chief Investment Officer.

2.12 This is clearly a significant change to the management arrangements of the DAAF, and one which brings into question the future of Dorset’s investment.

2.13 Barings have done all they can to reassure investors that this process will be appropriately managed, and that the majority of the Multi-Asset group will remain the same, and this gives a good degree of comfort. However, given the significance of the departing executives, it would be appropriate for the Dorset Fund to keep under close scrutiny the performance of the DAAF for the next 6-12 months. This will enable an assessment to be made of the significance of the departures. It is recommended, therefore that this investment is kept "on watch" until the position becomes clearer.

2.14 Given the issues that have arisen at Barings, it would seem illogical to proceed with the process of selecting a manager to complement them. It is therefore recommended that this search process is deferred for 12 months, pending developments at Barings.

2.15 As the rest of the implementation is progressing the Fund is holding a significant amount of cash, and it is therefore appropriate to invest the cash that was due to be invested in DGF. Given that a DGF approach broadly gives investors something between bond and equity like returns; it is recommended that the £100 Million is split 50/50 between the internally managed UK Equity portfolio, and rlam's Bond portfolio. The strategy shown at paragraph 1.3 will be revised to show this change, and will increase the target allocation to rlam to 12.5% of the portfolio, and UK equities to 27.5%, and reduce DGF to 5%.

<u>Hedge Funds</u>

2.16 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. Further investments were sold, and additional proceeds of £30.8 Million were received on 31 July. As reported at the last meeting it is still expected that this process will be concluded by the end of September.

<u>Inflation (Liability Hedging)</u>

2.17 The revised strategy increased the allocation to the mandate, managed by Insight, to 12% of the Fund. At the last meeting of the Committee members approved the revised Statement of Investment Principles, which was required for the Fund to make this additional investment.

2.18 On 1 August the additional investment of £50 Million was made with Insight, and this will be managed in line with the revised trigger levels that were discussed at the last meeting. The new trigger levels contained a time based under-pin, whereby, should none of the trigger levels be reached, Insight will implement a proportion of the hedge at the most favourable rates. The aim of this was to ensure that the overall hedging solution was implemented over a 5 year period. This first activity on this time based approach was implemented by Insight on 22 July.

Private Equity

2.19 At the meeting in June it was agreed that £50Million be committed to Private Equity every 2 years, which was necessary to ensure the Fund reaches its strategic target allocation of 4%.

2.20 Members will recall that a commitment was made to the Standard Life secondary opportunities fund in 2013. Standard life are launching a second version of this fund, and the Dorset fund has agreed to commit $20 Million (approximately £12 Million) to the new fund. This is the first allocation made from the £50 Million. Members will be updated when future commitments are made.

Paul Kent
Pension Fund Administrator
August 2014