

Agenda Item:

# Pension Fund Committee

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**Dorset County Council**


Date of Meeting	21 June 2017
Officer	Pension Fund Administrator
<b>Subject of Report</b>	<b>Fund Administrator’s Report</b>
Executive Summary	<p>The purpose of this report is to update the Committee on the allocation of the assets and overall performance of the Fund as at the end of the financial year 2016/17 Financial Year to 31 March 2017. The report also provides a commentary on the performance of the fund managers who are not considered elsewhere on the agenda and to address other topical issues for the Fund that do not require a separate report.</p> <p>The Independent Adviser’s report is contained at Appendix 1, and will be presented separately at the meeting.</p> <p>The report shows that overall the Fund returned 23.6% over the twelve months to 31 March 2017, outperforming its benchmark which returned 23.3%. Return seeking assets returned 20.9%, whilst the liability matching assets returned 43.6%.</p>
Impact Assessment:	<p>Equalities Impact Assessment:</p> <p>N/A</p> <p>Use of Evidence:</p> <p>N/A</p> <p>Budget:</p> <p>N/A</p>

	<p><b>Risk Assessment:</b> The Fund assesses the risks of its investments in detail, and considers them as part of the strategic allocation. In addition, risk analysis is provided alongside the quarterly performance monitoring when assessing and reviewing fund manager performance.</p>
	<p><b>Other Implications:</b> None</p>
<p><b>Recommendation</b></p>	<p>That the Committee :</p> <ul style="list-style-type: none"> <li>i) Review and comment upon the activity and overall performance of the Fund.</li> <li>ii) Make no additional changes to asset allocation at this time.</li> <li>iii) Note the publication of the draft Pension Fund accounts for 2016/17.</li> <li>iv) Consider and approve the Funding Strategy Statement (FSS) as a basis for consultation with the Fund’s employers.</li> </ul>
<p><b>Reason for Recommendation</b></p>	<p>To ensure that the Fund has the appropriate management arrangements in place and are being monitored, and to keep the asset allocation in line with the strategic benchmark.</p>
<p><b>Appendices</b></p>	<p>Appendix 1: Report of the Independent Adviser  Appendix 2: New Money Forecast  Appendix 3: HSBC Manager Performance to 31 March 2017  Appendix 4: Draft Pension Fund Accounts 2016/17  Appendix 5: Funding Strategy Statement June 2017  Appendix 6: Actuarial Valuation 2016</p>
<p><b>Background Papers</b></p>	<p>HSBC Performance Statistics</p>
<p><b>Report Originator and Contact</b></p>	<p>Name: David Wilkes  Tel: 01305 224119  Email: d.wilkes@dorsetcc.gov.uk</p>

## 1. Background

- 1.1 The Dorset County Pension Fund currently receives more money in contributions and investment income than it pays out as pensions and retirement grants. There has been a surplus of income over expenditure from these cash flows of approximately £16M in 2016-17, compared to the forecast of approximately £20M for the full year. The outturn cash-flows for 2016/17 and the anticipated cash flows for 2017/18 along with the historic trends are illustrated in Appendix 2.
- 1.2 These “new money” levels are reviewed throughout the year, and Members are alerted if there is any significant variance from what is expected.

## 2. Cash flow

- 2.1 The table below summarises the main cash flows for the Fund for the twelve months under review.

### Statement of cash-flow for the twelve months ended 31 March 2017

	<u>£M</u>	<u>£M</u>
<b>Cash at 1 April 2016</b>		<b>91.8</b>
<b>Less:</b>		
Infrastructure Drawdowns (net)	57.6	
UK Equity transactions (net)	15.7	
Liability Matching Bond (net)	45.0	
Currency Hedge (net loss)	32.2	
		<u>150.5</u>
<b>Plus:</b>		
Property Transactions (net)	4.8	
Hedge Fund redemptions (net)	1.4	
Private Equity (net)	2.2	
Fixed Interest (net)	10.0	
Overseas Equities (net)	55.0	
Increase in Cash	15.6	
		<u>89.0</u>
<b>Cash at 31 March 2017</b>		<u><b>30.3</b></u>

- 2.2 The cash flow above summarises the most significant transactions that have taken place for the twelve months to the end of March 2017. Since the end of March, the most significant transactions have been the third drawdown by IFM (£6M outflow) and the Hermes Infrastructure Distribution No.13 (£2M inflow), Insight redemption (£20M inflow) leaving cash balances of approximately £44M at the 31 May 2017.

## 3. Fund Portfolio Distribution

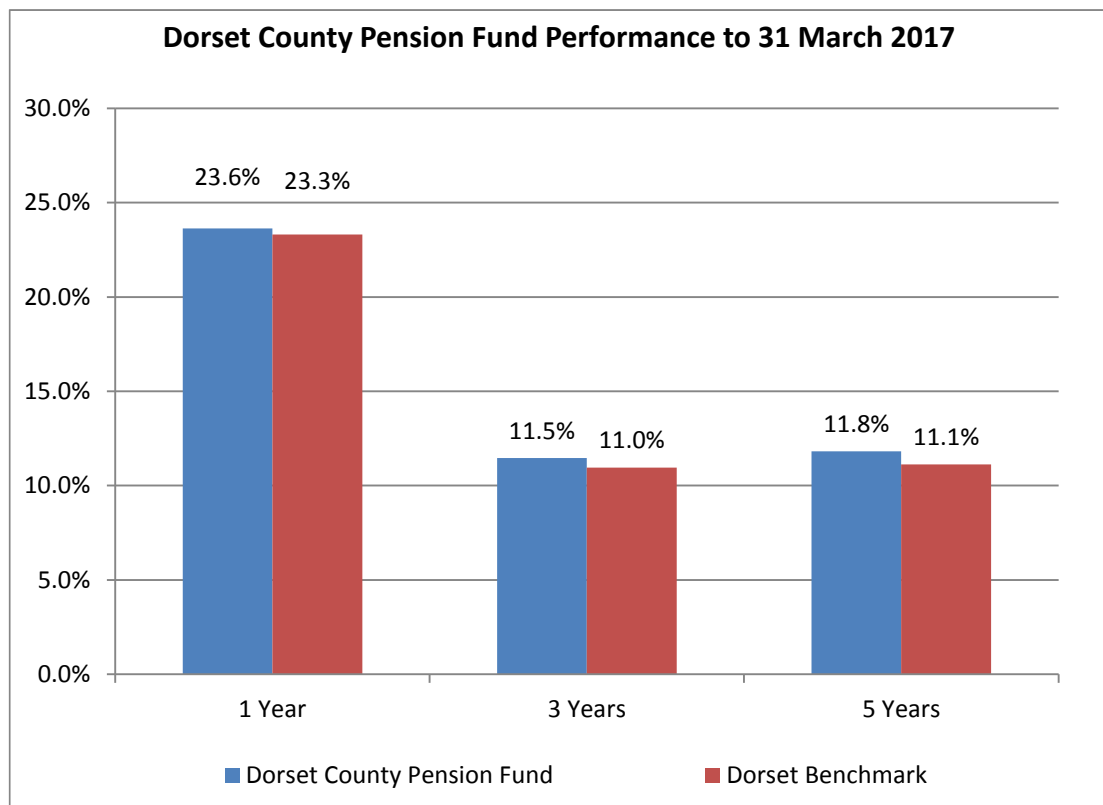
- 3.1 The table below shows the position as at 31 March 2017. The target allocation shown is the strategy as agreed at the September 2014 meeting of the Committee, due to the then concerns over the Barings mandate, and subsequent postponement of the search for an additional Diversified Growth Fund manager, amended by the decision made at the meeting 1 March 2016 to equalise the target allocations for UK Equities and Global Equities at 26.25% each.

<u>Asset Class</u>	<u>Manager</u>	<u>31-Mar-16</u>		<u>31-Mar-17</u>		<u>Target Allocation</u>	
		<u>£M</u>	<u>%</u>	<u>£M</u>	<u>%</u>	<u>£M</u>	<u>%</u>
Bonds	RLAM	286.1	12.6%	313.5	11.5%	342.1	12.50%
UK Equities	Several	584.2	25.7%	694.7	25.4%	718.4	26.25%
Overseas Equities	Several	625.6	27.5%	763.0	27.9%	718.4	26.25%
Property	CBRE	246.3	10.8%	241.1	8.8%	273.7	10.00%
Absolute Return Funds	Several	1.8	0.1%	0.4	0.0%	-	0.00%
Infrastructure	Several	29.0	1.3%	98.0	3.6%	109.5	4.00%
Private Equity	Several	65.4	2.9%	77.0	2.8%	109.5	4.00%
Diversified Growth	Barings	107.6	4.7%	119.1	4.4%	136.8	5.00%
Cash	Internal	91.8	4.0%	30.3	1.1%	-	0.00%
<b>Total Return Seeking Assets</b>		<b>2,037.8</b>	<b>89.5%</b>	<b>2,337.1</b>	<b>85.4%</b>	<b>2,408.5</b>	<b>88.0%</b>
Liability Matching Assets	Insight	238.0	10.5%	399.8	14.6%	328.4	12.00%
<b>Total Asset Valuation</b>		<b>2,275.8</b>	<b>100.0%</b>	<b>2,736.9</b>	<b>100.0%</b>	<b>2,736.9</b>	<b>100.0%</b>

3.2 The table above shows that in most asset classes the Fund’s allocation is now close to or slightly above target, with the exception of Private Equity which will take a number of years to fully drawdown. Since December 2016, there has been two drawdowns of approximately £30.1M (£23.9M on 3 February 2017 and £6.2M on 19 April 2017) against the commitment with IFM, one of the Fund’s two Infrastructure managers, to bring the Fund’s allocation to this asset class closer to target.

#### 4. Overall Fund Performance

- 4.1 The performance of the Fund for the twelve months to 31 March 2017 shows an overall return of 23.64%, a marginal over-performance of the benchmark of 23.32% by 0.32%. This high level of short term returns by the Fund and its benchmark have been driven largely by the impact of sterling’s depreciation, following the result of the EU referendum, on the asset classes the Fund is invested in, rather than relative outperformance of the markets by the Fund’s managers.
- 4.2 Over the longer term, the Fund has exceeded its benchmark over 3 years, returning an annualised 11.47% against the benchmark of 10.96%, and over 5 years, returning an annualised 11.82% against the benchmark of 11.13%. The chart below shows the overall performance for 1, 3 and 5 years against the Fund’s bespoke benchmark.



- 4.3 When considering the overall performance it is important to note the split between the “Return Seeking assets” and the “Liability Matching assets”. Since the implementation of the strategic review in 2012, the Fund has held a proportion of the assets in an Inflation Hedging Strategy, managed by Insight Investments. These assets are not held to add growth, but to match the movements in the Fund’s liabilities. It is therefore important to consider that in normal circumstances, the benchmark movement of these assets is a proxy for the Fund’s liabilities.
- 4.4 For the twelve months to 31 March 2017, Return Seeking assets have returned 20.86% against the benchmark of 19.99%, and the Liability Matching assets have returned 43.58% against the benchmark of 44.23%. This strategy is intended to hedge against the impact of increasing pensions liabilities which are linked to, amongst other things, the Consumer Prices Index (CPI). CPI cannot currently be hedged as there is not a sufficiently developed futures market, so the Dorset strategy targets the Retail Prices Index (RPI) swaps market to act as a proxy for CPI which tends to be lower than RPI. The table below shows the overall performance of the Fund, but makes the distinction between the return seeking assets and the liability matching assets.

Asset Category	Manager	12 Months to 31 March 2017		
		Dorset %	Benchmark %	Over/(Under) %
<b>Overall Fund Performance</b>	<b>All</b>	<b>23.64</b>	<b>23.32</b>	<b>0.32</b>
<b>Total Return Seeking Assets</b>	<b>Various</b>	<b>20.86</b>	<b>19.99</b>	<b>0.87</b>
UK Equities	(Various)	18.08	21.84	-3.76
Overseas Equities	(Various)	44.24	33.62	10.62
Bonds	(RLAM)	12.79	11.71	1.08
Property	(CBRE)	4.56	4.61	-0.05
Private Equity	(Various)	17.81	21.95	-4.14
Diversified Growth	(Barings)	10.67	4.46	6.21
Infrastructure	(Various)	16.71	10.00	6.71
<b>Total Liability Matching Assets</b>		<b>43.58</b>	<b>44.23</b>	<b>-0.65</b>
Liability Driven Investment	(Insight)	43.58	44.23	-0.65

- 4.6 In considering the performance of the Fund as a whole, there are two main areas that explain where the performance is being generated - the asset allocation (market contribution) of the Fund and within those allocations the stock selection (selection contribution) choices that have been made. The stock selection element is a measure of the fund managers’ ability to outperform their benchmark. The asset allocation is the effect of decisions to change the weighting of the different asset classes within the Fund.
- 4.7 The HSBC performance report, contained at Appendix 3, gives an attribution analysis of the performance for the year to date on pages 7 to 8. This analysis shows that the market contribution had a positive effect of 142bps against the benchmark and stock selection was positive by 5 bps.

## 5. Manager Progress

### Diversified Growth

- 5.1 The Diversified Growth allocation was mandated to Barings on 30 March 2012. Diversified Growth Funds are designed to give fund managers total discretion over how and where they invest which means that the portfolio holds a wide range of investments against a diverse range of asset classes. The Barings fund seeks to achieve out performance against a cash benchmark by focussing on asset allocation decisions. This fund targets equity like returns with about 70% of the equity risk.
- 5.2 The performance for Barings for the twelve months to 31 March 2017 is summarised below.

	Market Value	Market Value	12 months to 31 March 2017	
	01-Apr-16	31-Mar-17	Performance %	Benchmark %
	£000s	£000s		
Barings	107,588	119,069	10.67	4.46

- 5.3 The return of 10.67% for the twelve months to 31 March 2017 was above the benchmark of 4.46% by 6.21%. The fund manager comments that their allocation to the emerging markets and European equities delivered strong gains. The holding in government bonds contributed most to returns in emerging markets whilst both the European small cap holding and allocation to the broader market helped returns in European equities. The fund is ahead of its performance comparator over all periods.

Emerging Market Equity

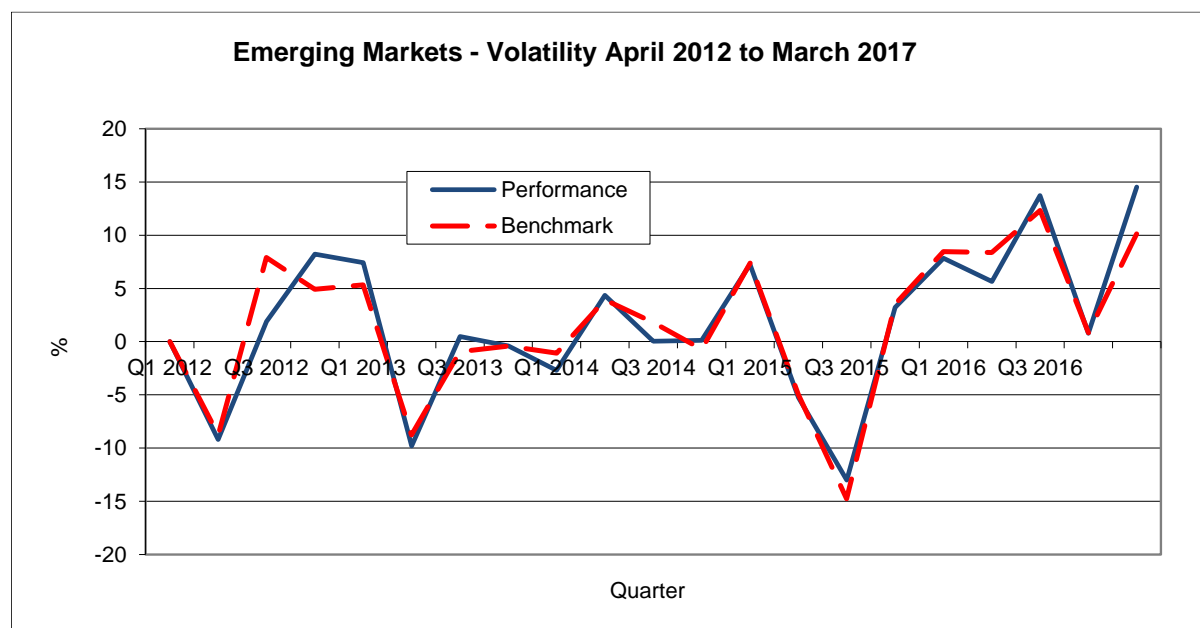
5.4 The performance of JP Morgan is summarised below.

**Emerging Markets Equity**

	Market Value	Market Value	12 months to 31 March 2017	
	01-Apr-16	31-Mar-17	Performance %	Benchmark %
	(£000’s)	(£000’s)		
JPM	65,186	91,232	39.96	35.23

5.5 The return of 39.96% for the twelve months to 31 March 2017 was above the benchmark of 35.23% by 4.73%. The fund manager comments that the overweight position in North Asia and Eastern Europe shows the best combinations of attractive valuations and positive trends in earnings. Materials have been added to since the start of 2016 and this positioning has contributed. The exposure to Chinese names, particularly banks, which hurt through 2016 has now turned and is contributing, with asset quality expected to improve.

5.6 Emerging market equities are seen as the asset class which is likely to offer the most growth over the medium term, albeit with high levels of volatility. The chart below shows the differences in quarterly performance since inception and highlights the volatility of the performance to date alongside the benchmark.



Private Equity

5.7 The Fund has committed to investing with HarbourVest and Standard Life in their Private Equity Fund of Funds. Private Equity is an area that takes several years for commitments to be fully invested, and the table below shows the position as at 31 March 2017.

5.8 The table shows the commitment Dorset has made to each fund in Euros and US Dollars, the draw-downs that have taken place to date and the percentage of the total drawdown against Dorset’s commitment. It also shows the funds that have been

returned to the Dorset Fund, the valuation as at 31 March 2017 and the total gains or losses, which includes the distribution plus the latest valuation.

### Private Equity Commitments, Drawdowns and Valuations

<u>Manager / Fund</u>	<u>Commitment</u>	<u>Drawdown</u>	<u>% of</u> <u>Commitment</u>	<u>Distribution</u>	<u>Valuation</u>	<u>Gain /</u> <u>(Loss)</u>
	<u>€m</u>	<u>€m</u>		<u>€m</u>	<u>€m</u>	<u>€m</u>
HV Partnership V	12.000	11.400	95%	13.072	4.597	6.269
HV Direct V	3.000	2.880	96%	3.387	0.617	1.124
<b>HarbourVest Total €m</b>	<b>15.000</b>	<b>14.280</b>	<b>95%</b>	<b>16.459</b>	<b>5.214</b>	<b>7.393</b>
SL 2006	22.000	20.018	91%	20.020	7.405	7.408
SL 2008	17.000	15.065	89%	7.483	12.208	4.625
<b>Standard Life Total €m</b>	<b>39.000</b>	<b>35.083</b>	<b>90%</b>	<b>27.503</b>	<b>19.613</b>	<b>12.033</b>
<b>Overall Total €m</b>	<b>54.000</b>	<b>49.363</b>	<b>91%</b>	<b>43.962</b>	<b>24.827</b>	<b>19.426</b>
	<u>\$m</u>	<u>\$m</u>		<u>\$m</u>	<u>\$m</u>	<u>\$m</u>
HV Venture VIII	15.200	14.896	98%	13.539	11.082	9.726
HV Buyout VIII	22.800	21.432	94%	22.390	11.223	12.180
HV Buyout IX	15.000	9.038	60%	3.112	8.525	2.599
HV Partnership VII (AIF)	20.000	7.050	35%	0.431	6.846	0.228
HV Venture IX	10.000	8.250	83%	2.282	9.070	3.103
Harbourvest Partners X AIF	10.000	0.850	9%	0.000	0.865	0.015
Harbourvest Partners X AIF	5.000	0.475	10%	0.000	0.463	-0.012
<b>HarbourVest Total \$m</b>	<b>98.000</b>	<b>61.991</b>	<b>63%</b>	<b>41.755</b>	<b>48.073</b>	<b>27.838</b>
SL SOF I	16.000	11.102	69%	4.504	11.506	4.908
SL SOF II	20.000	8.274	41%	2.643	10.157	4.525
SL SOF III	20.000	0.000	0%	0.000	0.000	0.000
<b>Standard Life Total \$m</b>	<b>56.000</b>	<b>19.376</b>	<b>35%</b>	<b>7.146</b>	<b>21.664</b>	<b>9.434</b>
<b>Overall Total \$m</b>	<b>154.000</b>	<b>81.367</b>	<b>53%</b>	<b>48.901</b>	<b>69.737</b>	<b>37.271</b>

5.9 For the twelve months to 31 March 2017 total drawdowns have been £13.5M and total distributions £15.7M. In order to meet the target allocation, there is a requirement to keep committing to Private Equity funds, and officers are in regular discussions with HarbourVest and SL Capital to identify further opportunities.

5.10 Private Equity is a long term investment and as such the performance should be reviewed over the longer term. The benchmark used for this fund is the FTSE All Share index. The table below shows the performance over 3 and 5 years against the benchmark.

### Private Equity Overall Performance

<b>Manager</b>	<b>3 Years to 31 Mar 2017</b>		<b>5 Years to 31 Mar 2017</b>	
	<b>Dorset</b>	<b>Benchmark</b>	<b>Dorset</b>	<b>Benchmark</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
HarbourVest	22.25	7.68	18.98	9.67
Standard Life	12.02	7.68	13.23	9.67

## **6. Treasury Management**

6.1 The Fund generates cash flows throughout the year which need to be managed. The Fund therefore holds a proportion of cash that is invested in call accounts, money market funds and fixed term deposits. A breakdown of the balances held internally



as at 31 March 2017 is shown in the table below. Relatively small cash balances are also held in the custodian bank account at HSBC and in a property rent collection account where a float is required for working capital purposes.

- 6.2 Internally managed cash returned 0.26% over the twelve months, which is ahead of the benchmark, as measured by the 7 day LIBID, at 0.20% for the same period. These low market rates have broadly been caused by the funding for lending scheme and Bank of England restrictions on how banks have to treat liquid deposits.

	<b>Amount</b>	<b>Rate</b>
	<b>£000s</b>	<b>%</b>
<b><u>Fixed Term Deposits</u></b>		
Total Fixed Term Deposits	-	-
<b><u>Call Accounts</u></b>		
National Westminster Bank	788	0.01%
Total Call Accounts	788	0.01%
<b><u>Money Market Funds</u></b>		
Standard Life	7,600	0.28%
BNP Paribas	10,500	0.32%
Federated Prime Rate	7,500	0.26%
Deutsche	1,550	0.26%
Total Money Market Funds	27,150	0.29%
<b><u>Holding Accounts</u></b>		
HSBC Custodian Account	1,797	0.00%
Property Client Account	557	0.00%
Total Holding Accounts	2,354	0.00%
<b>Total Cash / Average Return</b>	<b>30,292</b>	<b>0.26%</b>

## 7. Pension Fund Accounts 2016/17 (Appendix 4)

- 7.1 Dorset County Council draft unaudited accounts for 2016/17, including the Pension Fund accounts, were approved for publication by the Chief Financial Officer 15 May 2017, two weeks earlier than for 2015/16, and six weeks earlier than for 2014/15. The statutory deadline for publication of the draft accounts is currently 30 June each year, but this will become 31 May with effect 2017/18.

## 8. Funding Strategy Statement (Appendix 5)

- 8.1 The Local Government Pension Scheme Regulations 2004 provided the statutory framework within which Local Government Pension Scheme administering authorities were required to produce a Funding Strategy Statement (FSS) by 31 March 2005. The regulations require that the Fund consults with employers and that the Committee formally approve the FSS for consultation.
- 8.2 The attached document is the fourth revision of Dorset’s FSS and has been produced by the Fund’s actuary after discussions with officers. The intention of the document is for the strategy to be cohesive and comprehensive for the Fund as a whole, recognising that these will be individually desirable but conflicting objectives that need to be balanced and reconciled. The statement aims therefore to set out how the administering authority has balanced the conflicting aims of affordability of

contributions, transparency of processes, stability of employer contributions and prudence in the funding basis.

8.3 The FSS forms part of a framework for the governance of the Fund and the key documents include:

- i) the Rates and Adjustments certificate, which can be found appended to the latest actuarial valuation (see Appendix 6)
- ii) the Investment Strategy Statement (ISS), which is reviewed regularly and updated when appropriate..
- iii) the Fund’s governance policy and compliance statement.

**Richard Bates**  
**Pension Fund Administrator**  
June 2017