Pension Fund Committee

Minutes of the meeting held at Welington Management,
80 Victoria Street, London, W1E 5LJ on
Thursday, 21 June 2018

Present:
John Beesley (Chairman)
Andy Canning, Colin Jamieson, Mark Roberts, John Lofts, Peter Wharf and Andrew Turner

Officer Attendance: Richard Bates (Chief Financial Officer) and David Wilkes (Finance Manager - Treasury and Investments).

Manager and Advisor Attendance
Alan Saunders, Independent Advisor
Andy Brough, Schroder Investment Management
Olivia Docker, Schroder Investment Management
Paola Binns, Royal London Asset Management
Rob Nicholson, Royal London Asset Management
Jonathan Platt, Royal London Asset Management
Jason Vaughan, Dorset Local Pension Board

(Notes: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 Pension Fund Committee to be held on **Monday, 17 September 2018**.)

Election of Chairman
15 That John Beesley be elected Chairman for the year 2018/19.

Appointment of Vice-Chairman
16 That Peter Wharf be appointed Vice-Chairman for the year 2018/19.

Apologies for Absence
17 Apologies for absence were received from Spencer Flower (Dorset County Council) and May Haines (Borough of Poole).

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

Terms of Reference
19 The Terms of Reference for the Committee were received by members.

Noted

Statement by the Chairman

The Chairman welcomed Mark Roberts to the Committee, replacing Tony Ferrari. He informed members that he had written to Cllr Ferrari thanking him for his valuable contribution to the Dorset County Pension Fund during his time as a member of the Committee.

Minutes
20 The minutes of the meeting held on 28 February 2018 were confirmed and signed.
Public Participation
21 Public Speaking

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

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

Petitions
There were no petitions received at the meeting in accordance with the County Council's Petition Scheme.

Manager Presentation from Schroders

22 The Committee received a presentation from Olivia Docker and Andy Brough, Schroder Investment Management, the Fund's smaller companies UK equities manager. Mr Brough summarised their guiding philosophy that equities were a great hedge against inflation.

Mr Brough highlighted the fast-changing market, with the internet in particular destroying some businesses and creating others, in particular retailers. A strategy of 'buy and hold' no longer worked, and investors needed to be constantly looking for new opportunities. He highlighted the rapid turnover of companies in the small cap universe, and said that Schroders looked for the FTSE 100 companies of the future.

Schroders looked to invest in companies with good management teams, with stretching targets and equity holdings, that had a market for their products or services. He also highlighted the importance of understanding a company's financial statements, and seeing through the use of exceptional items or the treatment of costs as assets on the balance sheet rather than expenses on the income statement. He believed the real investment skill was selling shares not buying them. Their approach was to sell shares when additional capacity and competition came into a market.

Noted

Manager Presentation from RLAM

23 The Committee received a presentation from Paola Binns, Rob Nicholson and Jonathan Platt, Royal London Asset Management, the Fund's bonds manager. Mr Platt stressed the importance of an investment manager having a core philosophy that underpinned all investment decisions. He summarised RLAM's philosophy as believing there were key inefficiencies in bonds markets that could be exploited.

Yields on bonds were largely determined by the credit ratings of the issuing company. However, credit ratings only assessed the likelihood of payment being missed, not the likelihood of what would be returned in the event of such a default – an unsecured bond with a higher credit rating could be assessed as riskier than a secured bond with a lower credit rating. Consequently, bonds with a claim on underlying assets and strong covenants were preferred by RLAM, and the fund had over twice the exposure to secured debt to that of the benchmark. Also, RLAM undertook their own credit analysis, and were not solely reliant on third party credit ratings.

Yields on corporate bonds were driven by two factors, the yield on government bonds and the premium for holding riskier debt, with the difference referred to as the "credit spread". The credit spread was now a lot lower than at the time of the 2008 financial crisis but still higher than pre-crisis levels. Mr Platt also noted the generally accepted minimum credit rating for both issuers and investors had fallen from A to BBB.

The Independent Adviser asked whether the trend towards 'covenant-lite' loans was a concern. Mr Platt replied that market conditions can dictate the strength of covenants generally available, but covenants with lighter assurances were an 'alarm bell' for RLAM. He gave the example of lending to Social Housing organisations where covenants had changed initially from very strong to much lighter restrictions on borrowers now, therefore, making older bonds preferable to newer issues for lenders.

A member noted that one of the bonds was secured on Ministry of Defence accommodation, and he asked if any credit research could be shared with the Committee. Mr Platt said he would check but he did not think this would be a problem.

Noted

Independent Adviser's Report

24 The Committee considered a report by the Independent Adviser that gave his views on the economic background to the Fund's investments, and the outlook for different asset classes. He explained that Allenbridge had been acquired by MJ Hudson, but there would be no change to the services provided to the Fund.

The global economy was generally in a 'sweet spot' (reasonable growth with low inflation) but there were signs of growth levelling off, particularly in Europe. Tax cuts had boosted US markets, but they could prove inflationary and create problems for government debt. The strength of the US dollar had been challenging for many emerging markets, given the large dollar denominated debts of some countries and companies.

The UK economy was in a reasonable position but on a lower growth trajectory than other economies largely due to uncertainty regarding the final outcomes of the Brexit process. The risk of a 'hard' Brexit was now widely considered unlikely but if it was to happen a significant adverse impact on markets would be expected. Inflation had peaked at 3% and had now fallen to 2.3%, the same level as wage growth, with continued low levels of unemployment.

The US Federal Reserve was expected to continue to increase interest rates at regular intervals. The US was firmly on the path to a return to 'normalised' rates, albeit at slightly lower levels than pre-crisis, with the expected end position 3% interest rates against 2% inflation. In addition to the expected end of Quantitative Easing in all major markets by the end of 2018, this was a potential negative for global markets. A potential trade war between the US and other countries was also a risk.

More volatility in markets was expected, with diminishing liquidity also being seen when looking to sell equities. The Fund continued to de-risk by selling equities back towards target allocation but the challenge was to get the proceeds invested in the more illiquid asset classes, such as private equity, infrastructure and property, where the Fund was below target. A member suggested that the Fund should consider selling into strength, and run with higher cash balances in the short term.

The Independent Adviser explained to new members of the Committee that the Fund's Liability Driven Investment (LDI) mandate with Insight Investments was in place to hedge against the impact of higher than expected inflation on the size of the Fund's liabilities. This could be achieved solely using index linked bonds but by using swaps as well Insight were able to leverage a hedge against roughly 40% of liabilities using only approximately 14% of assets.

A member asked if a reduction in the number of contributors as a result of Local Government Reorganisation (LGR) in Dorset would have an impact on the Fund. The Fund Administrator clarified that in the event of an early retirement either the scheme member would take a reduced pension or the scheme employer would make additional contributions to the Fund, with the impact to the Fund neutral in both scenarios.

Noted

Fund Administrator's Report

25 The Committee considered a report by the Pension Fund Administrator on the asset allocation, valuation and overall performance of the Fund's assets up to 31 March 2018. The value of the Fund's assets at 31 March 2018 was £2.9 billion, and the Fund outperformed its benchmark for the financial year by 1.2%, by 0.6% (annualised) over three years and by 0.8% (annualised) over five years.

The correction in equity markets in the last quarter of the financial year had adversely impacted absolute returns for the year, although this had been offset by performance exceeding expectations in other asset classes such as property.

The Fund Manager highlighted the identical performance since inception of two of the Fund's three global equities managers, Allianz and Wellington, despite their very different approaches. Both had returned 1.4% (annualised) above benchmark, compared to the third manager, Investec, who were below benchmark by 0.5%. Investec would be invited to present at either the September or November meeting of the Committee later this year.

The Vice-Chairman asked why a summary of the performance of CQS, the Fund's Multi Asset Credit (MAC), was not included in the report, and he requested an early review of the mandate. Officers informed the Committee that such a summary had not been included in this report because the mandate was only funded in December 2017, but it would be added to all future reports. CQS would be invited to present at either the September or November meeting of the Committee later this year.

Re-negotiations with Insight Investments, the Fund's Liability Driven Investment (LDI) manager, had resulted in a reduction in base fees, an improved performance fee mechanism and an updated benchmark. Some significant changes to reporting had also been made by Insight but officers were seeking further improvements.

Members were informed that the Dorset County Council draft unaudited accounts for 2017-18, including the Pension Fund accounts, had been published on 30 April 2018, one month earlier than the statutory deadline of 31 May 2018. The final audited accounts were to be presented to the Council's Audit and Governance Committee for approval at its meeting on 29 June 2018.

A member asked what the implications of Local Government Reorganisation (LGR) would be for the Committee structure and membership. The Fund Administrator replied that Lee Gallagher, Democratic Services Manager for Dorset County Council, was reviewing the structure and membership of all committees. An update would be provided at the next meeting of the Committee in September 2018.

Resolved

1. That the activity and overall performance of the Fund be noted.
2. That the progress in implementing the new strategic asset allocation be noted.
3. That the publication of the draft (unaudited) Pension Fund accounts for 2017/18 be noted.
4. That Investec be invited to present at either the September or November meeting of the Committee later this year.
5. That CQS would be invited to present at either the September or November meeting of the Committee later this year.
6. That an update on the Committee structure and membership resulting from LGR be given to the September meeting.

The Brunel Pension Partnership - project progress report

26 The Committee considered a report by the Fund Administrator on the progress to date in implementation of the Full Business Case (FBC) for the Brunel Pension Partnership (BPP), as approved by the Committee at its meeting on 9 January 2017.

Much of the report's content had been covered at the Committee's training day on 20 June 2018 with Dawn Turner, Chief Executive Officer, Brunel Ltd and Matthew Trebilcock, Client Services Director, Brunel Ltd, therefore officers highlighted key topics that weren't covered.

In order to meet the overall target allocation of 20% UK equities, 25% overseas equities it was necessary to approve some minor adjustments to the indicative allocations to Brunel portfolios agreed at the September meeting of the Committee. It was anticipated that all equity investments would have transferred to Brunel portfolios by June 2019, with the first transfers to UK Passive and Global Smart Beta portfolios due to complete in July 2018.

Officers were liaising with Brunel Ltd and the other client funds to discuss the proposed timetable for the transition of all non-equity asset classes. One of Dorset's highest priorities for early transition was Diversified Growth Funds (DGF) as the Fund was nearly 2% below target as at 31 March 2018, however other client funds were likely to have different priorities.

Brunel Ltd were seeking confirmation from all Client Funds of their allocations to each of the available private markets portfolios, and a number of options were discussed. A 2% commitment to Brunel's private equity portfolio was agreed and officers were asked to produce amended recommended commitments to the other private markets portfolios open to investment.

Resolved

1. That the progress establishing the Brunel Pension Partnership be noted.
2. That the Fund's revised indicative asset allocation to the Brunel equities' portfolios be approved.
3. That a commitment of 2% of total Fund investment assets to the Brunel Private Equity portfolio be approved.
4. That officers produce amended recommended commitments to the other Brunel private markets' portfolios for agreement before the next meeting of the Committee.

Pensions Fund Administration

27 The Committee considered a report by the Pension Fund Administrator on the administration of the Fund.

The General Data Protection Regulations (GDPR) came into effect 25 May 2018, superseding the Data Protection Act 1998. Osborne Clarke, the Fund's legal advisors, had been commissioned to assist in preparing for these changes and ensuring compliance. A training session for staff, committee members and local pension board members was provided by Osborne Clarke on 18 June 2018.

Responses to existence checks had not been received from 19 pensioners believed to be living overseas, therefore payment of those pensions had been suspended. Subsequently, 10 of those pensioners have provided the appropriate proof of existence and have had their benefits re-instated, with the remaining 9 still suspended.

The Vice-Chairman asked for further clarification of regulation 13 (the requirement to pay exit credits) of the Local Government Pension Scheme (Amendment) Regulations 2018. Regulation 13 provides for the payment of an exit credit by the Administering Authority to an exiting employer, where that employer's liabilities are fully funded and there is a surplus of assets in the fund. Previously the regulations did not allow such a payment and any such surplus funds would remain in the fund.

Resolved

1. That the contents of the report be noted.
2. That officers provide further clarification of regulation 13 (the requirement to pay exit credits) of the Local Government Pension Scheme (Amendment) Regulations 2018 before the next meeting of the Committee.

Dates of Future Meetings

28 **Resolved**

That the meetings be held on the following dates:

17 September 2018	County Hall, Dorchester
21/22 November 2018	London (venue to be confirmed).

Questions

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

Meeting Duration: 10.00 am - 12.50 pm