Notice of Meeting

Surrey Pension Fund Board

Date & time	Place	Contact	Chief Executive
Friday, 15 November 2013 at 9.30 am	Committee Room A, County Hall	Cheryl Hardman Room 122, County Hall Tel 020 8541 9075 cherylh@surreycc.gov.uk	David McNulty

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This meeting will be held in public. If you would like to attend and you have any special requirements, please contact Cheryl Hardman on 020 8541 9075.

Elected Members
Ms Denise Le Gal (Chairman), Mr Nick Skellett CBE (Vice-Chairman), Mr W D Barker OBE, Mr Mike Goodman, Mr John Orrick and Mr Stuart Selleck

Co-opted Members:
Mr Tony Elias (District Representative), Judith Glover (Borough/District Councils), Ian Perkin (Office of the Surrey Police and Crime Commissioner) and Philip Walker (Employees)

AGENDA

1 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

2 MINUTES OF THE PREVIOUS MEETING: 20 SEPTEMBER 2013 (Pages 1 - 170)

To agree the minutes as a true record of the meeting.

3 DECLARATIONS OF INTEREST

To receive any declarations of disclosable pecuniary interests from Members in respect of any item to be considered at the meeting.

Notes:

- In line with the Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012, declarations may relate to the interest of the member, or the member's spouse or civil partner, or a person with whom the member is living as husband or wife, or a person with whom the member is living as if they were civil partners and the member is aware they have the interest.
- Members need only disclose interests not currently listed on the Register of Disclosable Pecuniary Interests.
- Members must notify the Monitoring Officer of any interests disclosed at the meeting so they may be added to the Register.
- Members are reminded that they must not participate in any item where they have a disclosable pecuniary interest.

4 QUESTIONS AND PETITIONS

To receive any questions or petitions.

Notes:

1. The deadline for Member's questions is 12.00pm four working days before the meeting (*11 November 2013)*.
2. The deadline for public questions is seven days before the meeting (*8 November 2013)*.
3. The deadline for petitions was 14 days before the meeting, and no petitions have been received.

5 ACTION TRACKING (Pages 171 - 172)

An action tracker is attached, detailing actions from previous meetings. The Board is asked to review progress on the item listed.

6 PENSION FUND ADMINISTRATION STRATEGY (Pages 173 - 178)

A Pension Fund Administration Strategy is set out in Annex 1 for the Board to approve as a basis for consultation with scheme employers.

7 KEY PERFORMANCE INDICATORS (Pages 179 - 184)

In line with best practice, Pension Fund Board members will be supplied with Pension Fund key performance indicators (KPIs) on a quarterly basis, covering investment and administration practices.

8 **PENSION FUND RISK REGISTER** (Pages 185 - 192)

Surrey County Council, as administering authority for the Surrey Pension Fund, is responsible for the delivery of benefit promises made to members of the Surrey Pension Fund. It achieves this by setting objectives and goals with varying timeframes. Risks lie in failing to meet the intended goals.

Risks that are established as an issue must be identified and evaluated via a risk register. The risks must be prioritised with existing controls or new controls
implemented to mitigate the risks. This should be recorded in a risk register, which needs monitoring on a quarterly basis.

9 **REVISED STATEMENT OF INVESTMENT PRINCIPLES** (Pages 193 - 208)

With the three additions to the private equity portfolio, it is necessary to approve a revised Statement of Investment Principles (SIP).

10 **LGPS: CALL FOR EVIDENCE ON THE FUTURE STRUCTURE OF THE LOCAL GOVERNMENT PENSION SCHEME** (Pages 209 - 218)

The Department for Communities and Local Government has issued a call for evidence on the future structure of the Local Government Pension Scheme. This paper sets out the document that the Chief Finance Officer submitted on behalf of the Pension Fund Board, in consultation with the Chairman of the Pension Fund Board.

11 **ILL HEALTH RETIREMENT INSURANCE** (Pages 219 - 228)

When a scheme member is retired early due to permanent ill health, the member’s accrued pension benefits are paid immediately without reduction and, in the majority of cases, with an enhancement to benefits.

The cost of providing an ill health pension can be substantial and therefore a significant financial risk to fund employers. Legal and General have developed an insurance product to insure against this risk which can be taken out by individual employers or on a whole fund basis. This report seeks approval from the Pension Fund Board to insure against the financial risk of ill health retirements on a whole fund basis.

12 **MANAGER ISSUES AND INVESTMENT PERFORMANCE** (Pages 229 - 248)

This report is a summary of all manager issues that need to be brought to the attention of the Pension Fund Board, as well as manager investment performance.

13 **DATE OF NEXT MEETING**

The Surrey Pension Fund AGM is on 22 November 2013.

The next meeting of the Surrey Pension Fund Board will be on 14 February 2014.

David McNulty
Chief Executive
Published: Date Not Specified

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- Interrupt presentations and debates
- Mean that you miss a key part of the discussion

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MINUTES of the meeting of the **SURREY PENSION FUND BOARD** held at 9.30 am on 20 September 2013 at Committee Room C, County Hall, Kingston upon Thames, Surrey KT1 2DN.

These minutes are subject to confirmation by the Committee at its meeting on Friday, 15 November 2013.

Elected Members:

* Ms Denise Le Gal (Chairman)
* Mr Nick Skellett CBE (Vice-Chairman)
* Mr W D Barker OBE
* Mr Mike Goodman
* Mr John Orrick
* Mr Stuart Selleck

Co-opted Members:

* Mr Tony Elias, District Representative
* Judith Glover, Borough/District Councils
* Ian Perkin, Office of the Surrey Police and Crime Commissioner
Philip Walker, Employees

In attendance:

Paul Baker, Pensions Manager
Cheryl Hardman, Regulatory Committee Manager
John Harrison, Surrey Pension Fund Advisor
Sheila Little, Chief Finance Officer (Section 151 Officer) – for Minutes 20/13-30/13
Alex Moylan, Senior Accountant
Phil Triggs, Strategic Manager – Pension Fund & Treasury
Steve Turner, Partner, Mercer

20/13 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]

Apologies were received from Philip Walker.

21/13 MINUTES OF THE PREVIOUS MEETING: 31 MAY 2013 [Item 2]

The minutes were agreed as an accurate record of the meeting.

22/13 DECLARATIONS OF INTEREST [Item 3]

There were none.

23/13 QUESTIONS AND PETITIONS [Item 4]

There were none.

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24/13 AFFIRMATION OF DISCUSSIONS HELD AT THE INFORMAL BOARD MEETING OF 31 MAY 2013 [Item 5]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Chairman introduced the report.

Actions/Further Information to be Provided:
None.

RESOLVED:

i. To **APPROVE** the notes of the Board's informal London meeting of 31 May 2013.
ii. To **AGREE** to amend CBRE's benchmark outperformance requirement to +0.5% per annum (gross of fees) over rolling three-year periods with the injection of a further £25m;
iii. To **AGREE** that a breach in the control range on the asset allocation categories as shown in the newly approved Statement of Investment Principles (SIP) would not stipulate that steps be taken immediately to restore parity, but that this breach would necessitate discussion amongst the Chairmen and officers and, where appropriate, the Pension Fund Board;
iv. To **AGREE** that the Fund should continue to ensure a diverse portfolio of assets to mitigate risk and volatility of returns;
v. To **AGREE** to balance the portfolio by removing £25m from LGIM's passive mandate and transferring to Baillie Gifford Diversified Growth Fund; and
vi. To **REVISIT** discussions concerning the transfer of £50m from LGIM's passive mandate and transferring to the Standard Life GARS Fund, subject to the outcome of discussions with Standard Life at Item 13 on the agenda.

Next Steps:
None.

25/13 MANAGER ISSUES AND INVESTMENT PERFORMANCE [Item 6]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager, Pension Fund and Treasury introduced the report, explaining to Members an issue with a recent Board decision to subscribe to the BlackRock DivPep V Fund. While the Board had previously agreed to invest USD 20m, BlackRock's understanding was that the Board was going to invest £20m. The structured fee level was higher for investing with USD 20m, so officers held back from confirming subscribing to this fund. Following a discussion, the Board agreed not to go ahead with the BlackRock DivPep V Fund investment.

2. The Pensions Manager explained the auto enrolment statistics. Members queried the effect on cash flow but the Pensions Manager stated that this wouldn't be known until mid-November. The Chief Finance Officer informed the Board that the People, Performance and Development Committee had built £1m into the Medium Term Financial Plan based on an opt-out rate of 10%. This would need to be reviewed as opt-out had been higher than 10%.
3. At the previous Surrey Pension Fund Board meeting, it had been agreed that a stock lending programme with Northern Trust should commence. The legal agreement was being scrutinised by Mercer. The Mercer representative highlighted a clause regarding indemnification which was very advantageous to Northern Trust. Negotiations are ongoing and the outcome will be reported to the next Board meeting.
4. There was a debate regarding the Standard Life Capital Secondary Opportunities Fund. The Surrey Pension Fund Adviser stated that the concept of focusing on secondary opportunities was good. The Mercer stated that it would be useful to have an indication from Standard Life regarding the level of discounts that it thought was available in the market. However, he was comfortable with Standard Life as a private equity manager and was supportive of the proposal to invest. The Board was informed that Standard Life had presented to a number of local authority pension funds on this opportunity but it was not known whether any had bought in. There was some concern that the total exposure to Standard Life would be high if this investment was made. The Strategic Manager, Pension Fund and Treasury informed the Board that the Secondary Opportunities were specifically for private equity products while GARS was concerned with the Diversified Growth fund, a separate entity. The Chairman questioned whether the Board would be taking a credit risk by investing in the Fund. The Mercer representative explained that there would be some credit risk as the opportunities are generally off-shore and so do not have as much protection. The Chief Finance Officer pointed out that the Pension Fund was underweight on the private equity asset class. It was agreed to defer a decision on this investment until after meeting with Standard Life at Item 13.
5. There was a discussion with regard to a proposed investment in the Capital Dynamics Global Clean Energy and Infrastructure Fund. The Board expressed concern that the fee was a little high as some other similar funds dealing with solar energy have a fee of 50-60bps. It was agreed that it would be worthwhile to test whether Capital Dynamics would be prepared to negotiate on fees.
6. The Strategic Manager, Pension Fund and Treasury introduced the Darwin Property Fund investment opportunity. He explained that it is a property type opportunity, but which had a number of characteristics in common with private equity. The Mercer representative explained that the people running the Darwin Group were experts in the field and that Mercer considered this to be an interesting return opportunity. The fund however, had a number of very specific risks, which needed to be clearly understood by the Board. The Chairman informed the Board that some other local authority pension funds had already invested in this Fund. There was some concern that the current management was not tied into the Fund and could leave while the Pension Fund is locked in for ten years. The Chairman pointed out that this was a private equity investment and investors were usually in these for the

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long term. The Strategic Manager, Pension Fund and Treasury stated that the documentation listed a penalty cost if the Pension Fund disinvested before the end of five years. The Board went on to debate fee levels, the duration of any lock-in time and the amount to be invested.

7. The Strategic Manager, Pension Fund and Treasury informed the Board that an initial report from the actuary suggested that the Pension Fund is now at least 70% funded. Following the full results, the contribution rate would be reviewed. The actuary would attend the Board meeting on 15 November 2013 and the AGM on 22 November 2013. Before that, he would communicate with the Borough and District Councils and other scheme employers.
8. The Surrey Pension Fund Adviser reported back on his meetings with Fund Managers. He stated that Franklin Templeton had recorded good results overall. He was slightly uncomfortable with the level of fees. The Surrey Pension Fund Adviser also reported that the new Fund Managers for UBS had had a good year. The Chairman highlighted that the UBS contract had been under watch two years ago and had been kept on after UBS agreed to a reduction in fees, so the Pension Fund was receiving good value. The Surrey Pension Fund Adviser reported that Majedie had also seen good performance over the past year. Majedie was particularly good at sensing market changes and repostioning its fund. The Surrey Pension Fund Adviser reported that Marathon was also doing well. It had benefited from a strong process for cash flow and income generation. It is playing different parts of the economic cycle.
9. The Strategic Manager, Pension Fund and Treasury introduced the Financial and Performance Report and informed the Board that the current estimated market value of the Fund had since improved further from the reported value on page 47 of the report. A question was raised over what value Mirabaud was adding to the overall Pension Fund portfolio.
10. The Strategic Manager, Pension Fund and Treasury highlighted that the Pension Fund was slightly overweight on equities. The Chairman stated that she was not currently worried about this position.
11. Members queried the fee levels for Fund Managers as listed on page 52. The Mercer representative informed the Board that it would need to look at the added value of Fund Managers and that many of them had outperformed their benchmarks net of fees. The Chairman assured the Board that the Surrey Pension Fund was not soft on its investment managers.

Actions/Further Information to be Provided:
The Pensions Administration Strategy and the Pensions Administration Service Level Agreement to be presented to the Board on 15 November 2013.

RESOLVED:

vii. To **APPROVE** the report and the decisions as laid out;

viii. To not go ahead with the investment of USD 20m in BlackRock DivPep V Fund;

ix. To negotiate for a desired fee level of 125bps before bringing back a recommendation to the Board to make a USD 25m commitment to the Global Clean Energy and Infrastructure Fund;

x. To negotiate the fee level before bringing back a recommendation to the Board to make a £20m commitment to the Darwin Property Fund, with a lock-in period of nine years.

Next Steps:
None.

26/13 PENSION FUND RISK REGISTER [Item 7]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager, Pension Fund and Treasury introduced the report, clarifying that there had been no changes to the Risk Register since the previous meeting.
2. There was a discussion about including the residual risk following mitigating actions. Officers agreed to do this for future reports.

Actions/Further Information to be Provided:
Officers to evaluate the residual risk following mitigating actions and include this as a column within the Risk Register.

RESOLVED:
To **NOTE** the Risk Register.

Next Steps:
None.

27/13 KEY PERFORMANCE INDICATORS [Item 8]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager, Pension Fund and Treasury introduced the report. He pointed out that, with regard to the data quality indicator, the interim feedback from the actuarial evaluation suggested that the data provided by the pensions team had been of a very high quality. The team was talking to the actuary about what method can be used to evaluate data quality. This information will be used to inform a method for measuring performance on data quality within the Pension Fund. The Pensions Manager suggested that this will probably be an annual measurement.
2. The Strategic Manager, Pension Fund and Treasury informed the Board that a mechanism would be devised to allow the customer service indicators to be measured. The Chairman suggested that officers speak to the team who undertakes the employee survey. The Pensions Manager pointed out that the member satisfaction survey results may be influenced by attitudes towards different employers within the Fund. This would need to be addressed in the development and evaluation of a survey.

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Actions/Further Information to be Provided:
None.

RESOLVED:
To **APPROVE** the KPI statement format.

Next Steps:
None.

28/13 REVISED STATEMENT OF INVESTMENT PRINCIPLES [Item 9]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager, Pension Fund and Treasury introduced the report, outlining changes from the previous Statement of Investment Principles.
2. There was a query over why the Borough/District representatives, the external employer representative and the Fund Member representative were listed as Co-opted Members. It was explained that the Board is a County Council committee to which non-Councillors can be co-opted. There was a query about the composition of Local Committees which the Regulatory Committee Manager agreed to respond to.

Actions/Further Information to be Provided:
Regulatory Committee Manager to respond to a Member regarding the composition of Local Committees.

RESOLVED:

i. To **APPROVE** the revised Statement of Investment Principles;
ii. To **AGREE** that a breach in the asset allocation control range of greater than +/- 3.0% will not require steps to be taken immediately to restore parity, but require that the breach will necessitate discussion amongst the Chairman and officers and, where appropriate, the Pension Fund Board.

Next Steps:
None.

29/13 LGPS: CALL FOR EVIDENCE ON THE FUTURE STRUCTURE OF THE LOCAL GOVERNMENT PENSION SCHEME [Item 10]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager, Pension Fund and Treasury introduced the report.

2. The Chairman informed the Board that the Government had established a LGPS Advisory Board on which she sat. The Government believes that if Pension Funds are pooled it will reduce the cost of administering them. However, current data does not suggest that there is any correlation between the size of the Pension Fund, associated investment management fees and investment performance. The Mercer representative confirmed that many consultees were saying the same thing.
3. The Chairman suggested that the Government was taking a London-centric view of Pension Funds. In London there are many very small Funds which are not comparable with a Fund such as the Surrey Pension Fund.
4. Members suggested that forcing Pension Funds into a few super-Funds would be a mistake. The only positive would be a possible saving on fees but the data has already shown this to be unlikely.
5. Members also argued that pooling Pension Funds would be unfair on taxpayers in different areas as some Funds have not been managed as effectively as others. This would lead to some areas seeing taxes rise to support Funds which have not been effectively managed. The Surrey Pension Fund Adviser informed the Board that when mergers were first discussed it did mean that assets and liabilities would be merged. It now only refers to assets but the Board needs to be clear on this in its response.
6. The Chairman informed the Board of a requirement under the Pensions Act to establish a Pension Fund Scrutiny Board to oversee the operation and decision making of the Pension Fund Board. This would require the establishment of a further Board which would be difficult to find members for.

Actions/Further Information to be Provided:
None.

RESOLVED:
To **DELEGATE** the drafting of a formal response to the LGPS Call for Evidence on the Future Structure of the Local Government Pension Scheme to the Chief Finance Officer, in consultation with the Chairman of the Surrey Pension Fund Board, taking into account the views and observations of the Board.

Next Steps:
A further report to the Surrey Pension Fund Board following proposals due to be published before the end of 2013.

The Surrey Pension Fund Board adjourned its meeting at 11.30am for a short break and reconvened at 11.35am.

Item 11 was deferred to follow Item 14.

30/13 LIABILITY MANAGEMENT, INFRASTRUCTURE DEBT [Item 12]

Declarations of Interest:
None.

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Also in attendance:
Toby Buscombe, Principal, Mercer
Marc Devereux, Principal, Mercer

Key Points Raised During the Discussion:

1. The Mercer representatives provided a presentation on liability risk management and infrastructure (slides attached as Annex 1).
2. It was suggested that Risk Ref. 2 within the Risk Register – bond yields fall leading to an increase in value of liabilities – was a crucial risk to watch and that mitigating actions should be developed further based on the information provided during Mercer's presentation.
3. There was general support for the concept of dynamically de-risking by setting trigger levels but not at this time.
4. The Chairman suggested that the Board needed a more detailed discussion on equity derivatives in the future.
5. The Board considered the investment in Funds managing infrastructure debt. It was informed that while the management of infrastructure debt was a relatively recent phenomenon with only a limited number of fund managers focusing on this area, each of those managers had very specific strategies. Due diligence would need to be exercised and risk controls developed if investing in these Funds. The Chairman pointed out that the credit analysis was key. The Mercer representatives added the need to ensure that the portfolio was well-diversified and that the Manager has the ability and track record to enforce when required.

Actions/Further Information to be Provided:
To schedule a discussion on equity derivatives.

RESOLVED:
To **NOTE** the presentation on Liability Risk Management and Infrastructure Debt.

Next Steps:
None.

The Surrey Pension Fund Board adjourned its meeting at 12.55pm for lunch and reconvened at 1.27pm.

John Orrick and Sheila Little sent apologies for absence from the afternoon session.

31/13 PRESENTATION: STANDARD LIFE [Item 13]

Declarations of Interest:
None.

Also in attendance:
Dale MacLennan, Investment Director, Standard Life
Neil Richardson, Investment Director, Standard Life

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Key Points Raised During the Discussion:

1. The Standard Life representatives gave a presentation. They assured the Board that the departure of Euan Munro as the Director of Multi-Asset Investing and Fixed Income at Standard Life had not been a surprise and that the team was capable of continuing without him. The name and brand was still attracting the best people to work within the team. The Board was informed that Euan Munro had in recent years taken on board other responsibilities and had not been as involved as he had been when the team was first put together. The Standard Life representatives agreed that Guy Stern's style was different from Euan Munro's but that he had been working on the product since 2008 and knew and understood its strengths. He was also keen to be as inclusive as possible. In response to concerns raised that Euan Munro may wish to take people with him to his new company, the Standard Life representatives considered that this was unlikely, although could not be ruled out. It was also pointed out that morale was high in the team and there was no feeling that anyone wished to leave. Members suggested that if the Board was investing in a Fund because of one person, that strategy should be reviewed. It was clarified that investment in Standard Life had not been on the basis of Euan Munro being in the lead post. It was recognised that Standard Life had a well-resourced team, with significant experience. In response to a query about Guy Stern's new responsibilities, it was clarified that he had not taken on all of Euan Munro's previous responsibilities and so would still be involved in the day to day running of the team.

RESOLVED: That under Section 100(A) of the Local Government Act 1972, the public be excluded from the meeting for the rest of Item 13 and for Item 14 on the grounds that they involve the likely disclosure of exempt information under paragraph 3 of Part 1 of Schedule 12A of the Act.

THE REST OF ITEM 13 AND ITEM 14 WAS CONSIDERED IN PRIVATE BY THE SELECT COMMITTEE. HOWEVER, THE INFORMATION SET OUT BELOW IS NOT CONFIDENTIAL.

2. Following further discussion based on a confidential presentation (slides attached as Annex 2), the Standard Life representatives left the meeting.

Tony Elias left the meeting.

3. The Board discussed the various investment opportunities with Standard Life. The Strategic Manager, Pension Fund & Treasury tabled a paper which outlined the Pension Fund's exposure to Standard Life (attached as Annex 3).

Actions/Further Information to be Provided:
None.

RESOLVED:
To **AGREE** that the Surrey Pension Fund make a USD 20m commitment to the Standard Life Secondary Opportunities Fund.

Next Steps:
None.

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32/13 PRESENTATION: CBRE [Item 14]

Declarations of Interest:
None.

Also in attendance:
Alex Bignell, Head of UK, CBRE
DJ Dhananjai, Director, CBRE
Max Johnson, Director, CBRE

Key Points Raised During the Discussion:

1. The CBRE representatives gave a confidential presentation (slides attached as Annex 4).

Actions/Further Information to be Provided:
None.

RESOLVED:
To **NOTE** the CBRE presentation.

Next Steps:
None.

RESOLVED:

i. To go back into public session (Part One);
ii. That the items considered under Part Two of the agenda should remain confidential and not be made available to the press and public.

33/13 SURREY PENSION FUND ACCOUNTS 2012/13 [Item 11]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager, Pension Fund and Treasury introduced the report. He explained that Jon Evans had been responsible for preparing the Financial Statements and had since departed his role. The recently appointed Senior Accountant, Alex Moylan, had taken responsibility for steering the Accounts through the external audit process. The External Auditors had made no recommendations, with only some minor adjustments made following discussions.
2. The Strategic Manager, Pension Fund and Treasury showed the Board a mock up of the cover of the Pension Fund's Annual Report.

Actions/Further Information to be Provided:
None.

RESOLVED:

i. To **NOTE** and **APPROVE** the financial statements;
ii. To **NOTE** the content of the Audit Findings for Surrey Pension Fund Report;
iii. To commend Jon Evans and Alex Moylan for their excellent work in the production and audit of the accounts; and

iv. To **NOTE** the Letter of Representation.

Next Steps:
None.

34/13 PRESENTATION: MANIFEST [Item 15]

This item was **WITHDRAWN**.

35/13 THE STEWARDSHIP CODE [Item 16]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager, Pension Fund and Treasury introduced the report and informed the Board that, since its last meeting, an external governance adviser had been appointed.

Actions/Further Information to be Provided:
None.

RESOLVED:
To **ADOPT** The Stewardship Code and **APPROVE** the Fund's commitment to the Code.

Next Steps:
Compliance with the Code is kept under regular review and progress reported to the Board where appropriate.

36/13 DATE OF NEXT MEETING [Item 17]

The date of the next meeting was noted.

Meeting ended at: 3.25 pm

Chairman

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MERCER

TALENT • HEALTH • RETIREMENT • INVESTMENTS

SURREY COUNTY COUNCIL PENSION FUND
TRAINING ON:
LIABILITY RISK MANAGEMENT & INFRASTRUCTURE

20 September 2013

Steve Turner, Partner
Marc Devereux, Principal
Toby Buscombe, Principal

MARSH & McLENNAN COMPANIES

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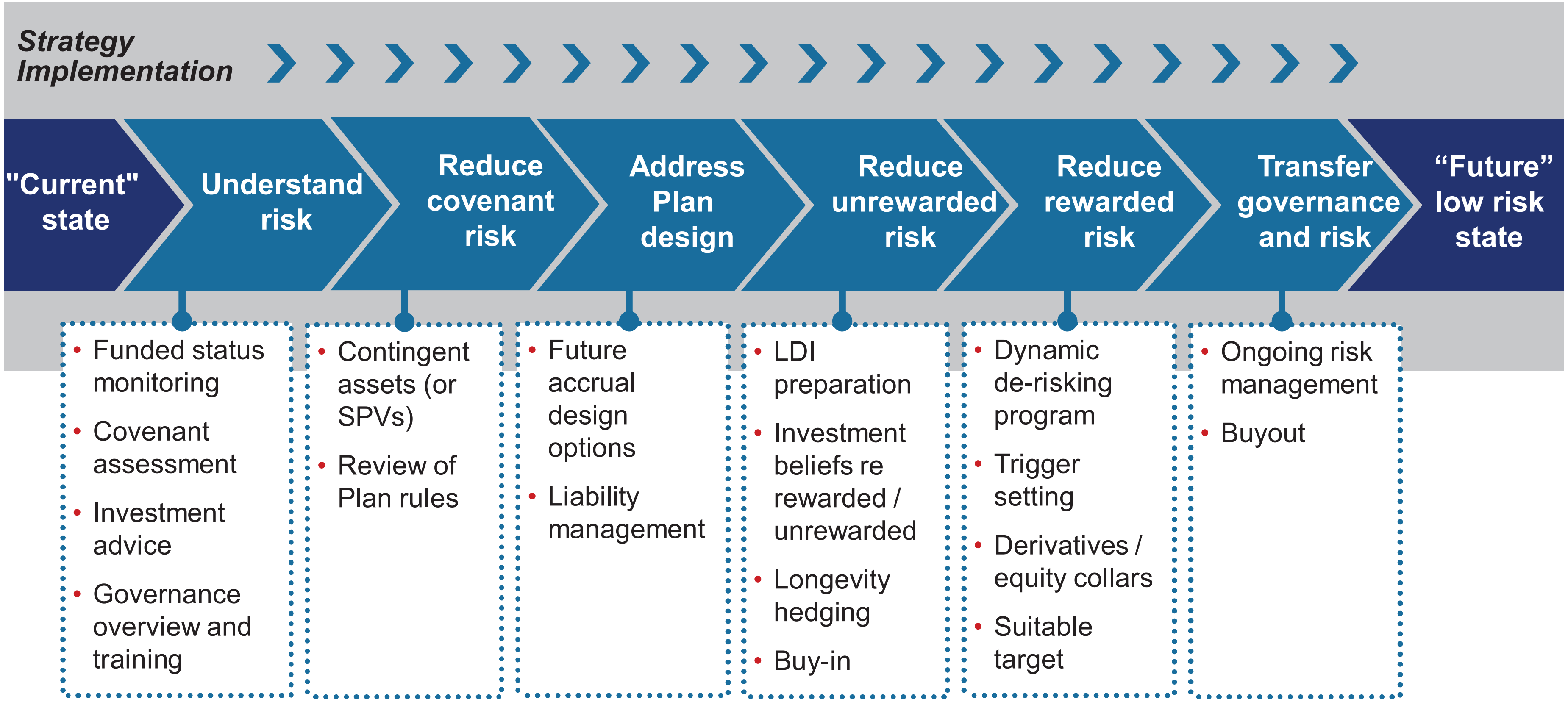
- The analysis shown in this presentation is approximate and for illustration purposes only.

Stages of defined benefit pension risk management

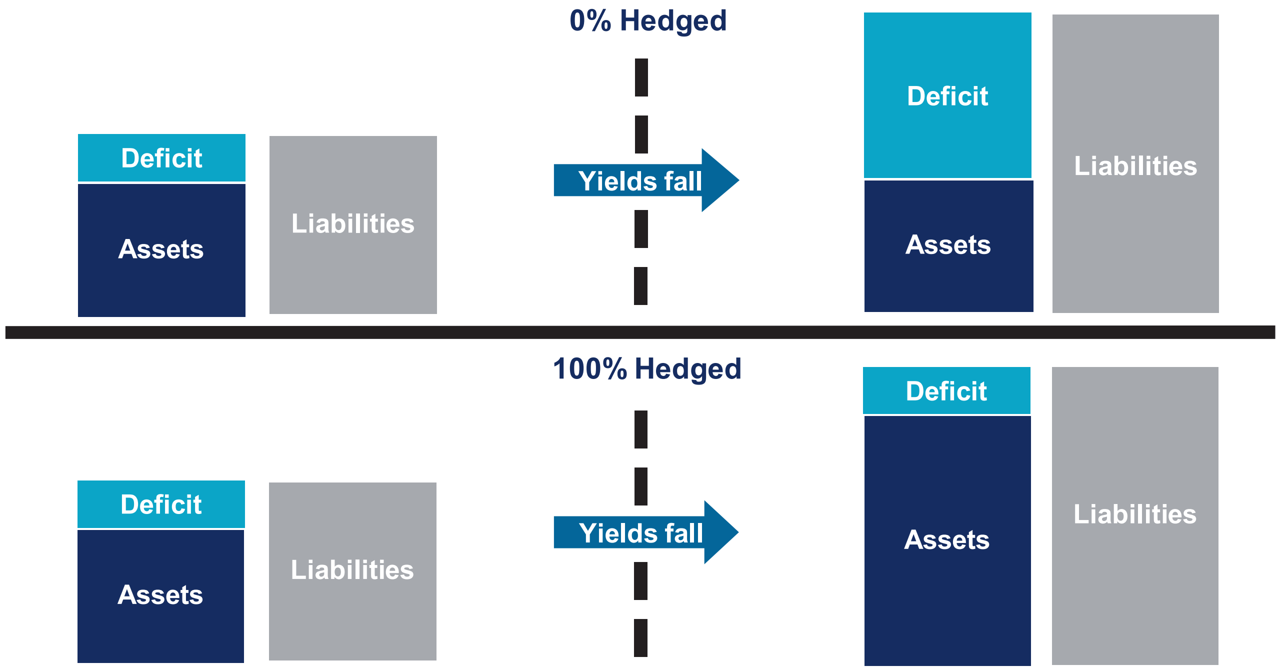


Understanding the liabilities
Main factors influencing the Fund's liabilities

	Factor	Effect	Impact
Liability Driven Investments	Discount factor (interest rates)	Affects amount needed now to pay for future cashflows	Big impact
	Inflation	Affects amount of pension if linked to inflation / salaries	Big impact
	Pension increases	Usually linked to inflation or known in advance	Substantial proportion of impact through link to inflation
Longevity hedging	Life expectancy	Affects number of years for which pension is paid	Big impact

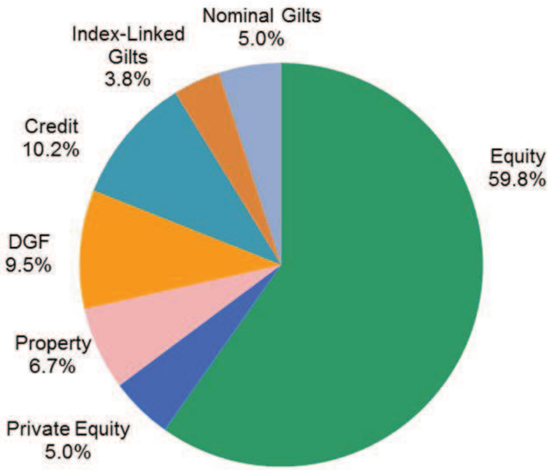
Liability Driven Investment (LDI)
What is it?

- 'Liability hedging' simply means that you offset the impact of movements in interest rates and inflation on the value of the liabilities by holding an asset that responds in the same way as the liabilities to movements in interest rates and inflation. A 'hedge ratio' of 50% means that the change in value of the asset is expected to be around 50% of the change in the value of the liabilities.
- Assuming the Fund has no interest rate hedging, then a fall in interest rates results in a rise in liabilities, whilst the assets remain unchanged, thus increasing the deficit. Had the Fund been 100% hedged on interest rates, then the assets would rise by the same amount as the liabilities, and the deficit would remain the same size.
- Similar analysis applies with changes in inflation and the amount of inflation exposure that is hedged.

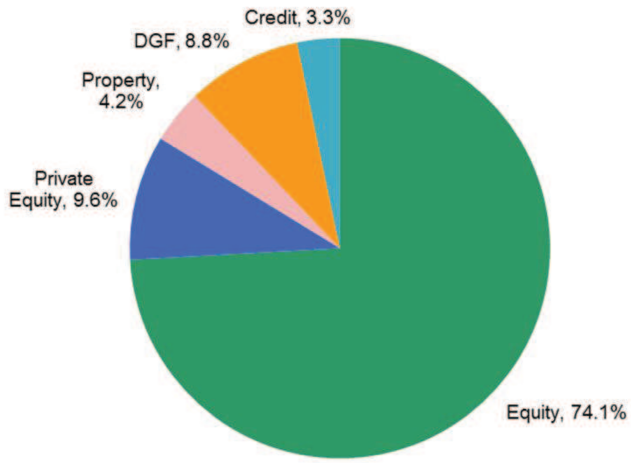


Surrey - current investment policy

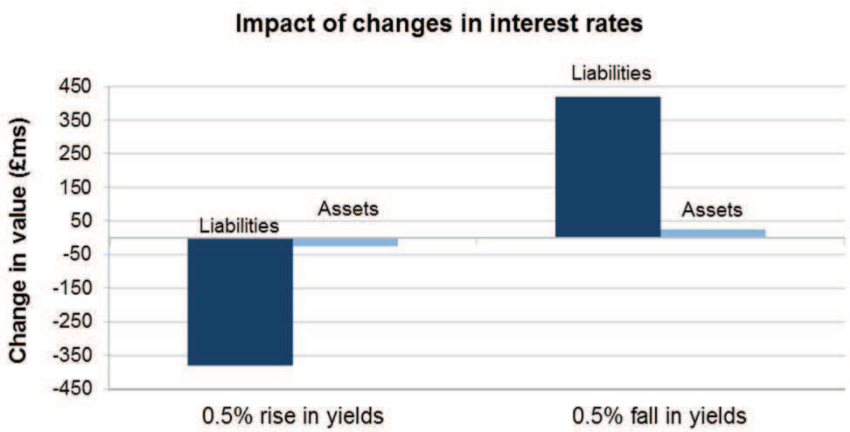
Benchmark asset allocation



Sources of expected return (gilts + 3.2% p.a.)



Understand liability mis-match risk



Equity dominates the sources of expected returns

Liability risks are significant

Funding level will be highly volatile

Diversifying the assets and more focus on liability risks is required to effectively manage overall funding level risk

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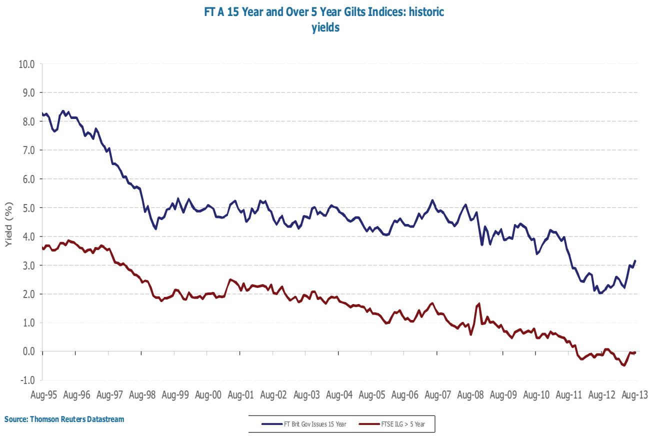
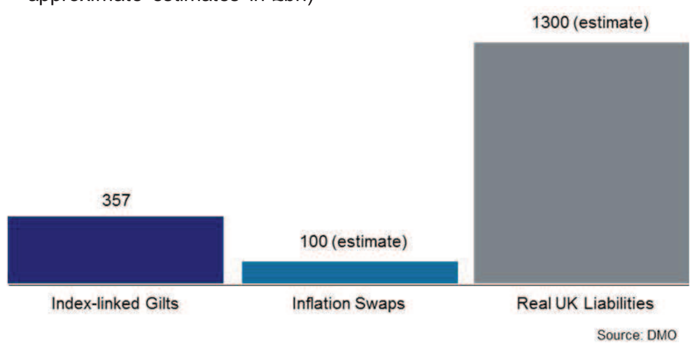
Index-Linked Gilts (ILG) are your best liability matching asset…
But there is a massive long-term structural demand & supply imbalance

1. Long-term decline in ILG yields

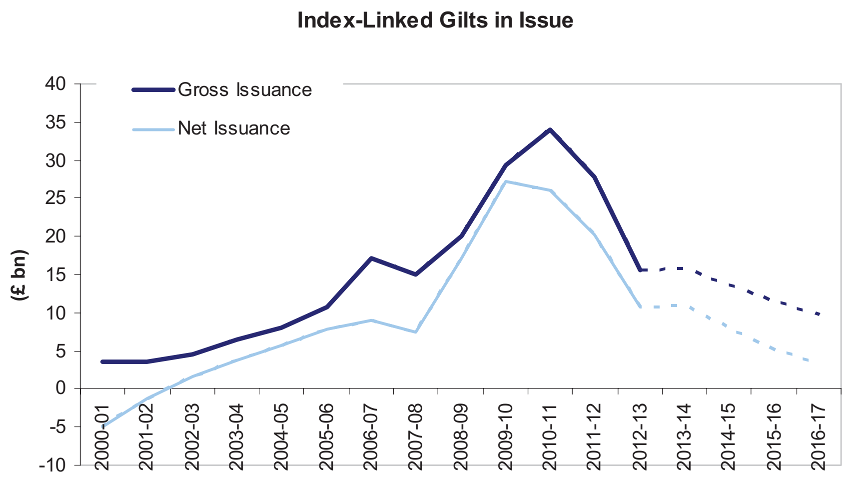


2. Demand for ILG exposure outstrips supply

Comparison of index-linked gilts in issue, plus inflation swaps transacted with UK pension scheme real liabilities (figures are very approximate estimates in £bn)



3. Net issuance of ILGs is expected to fall

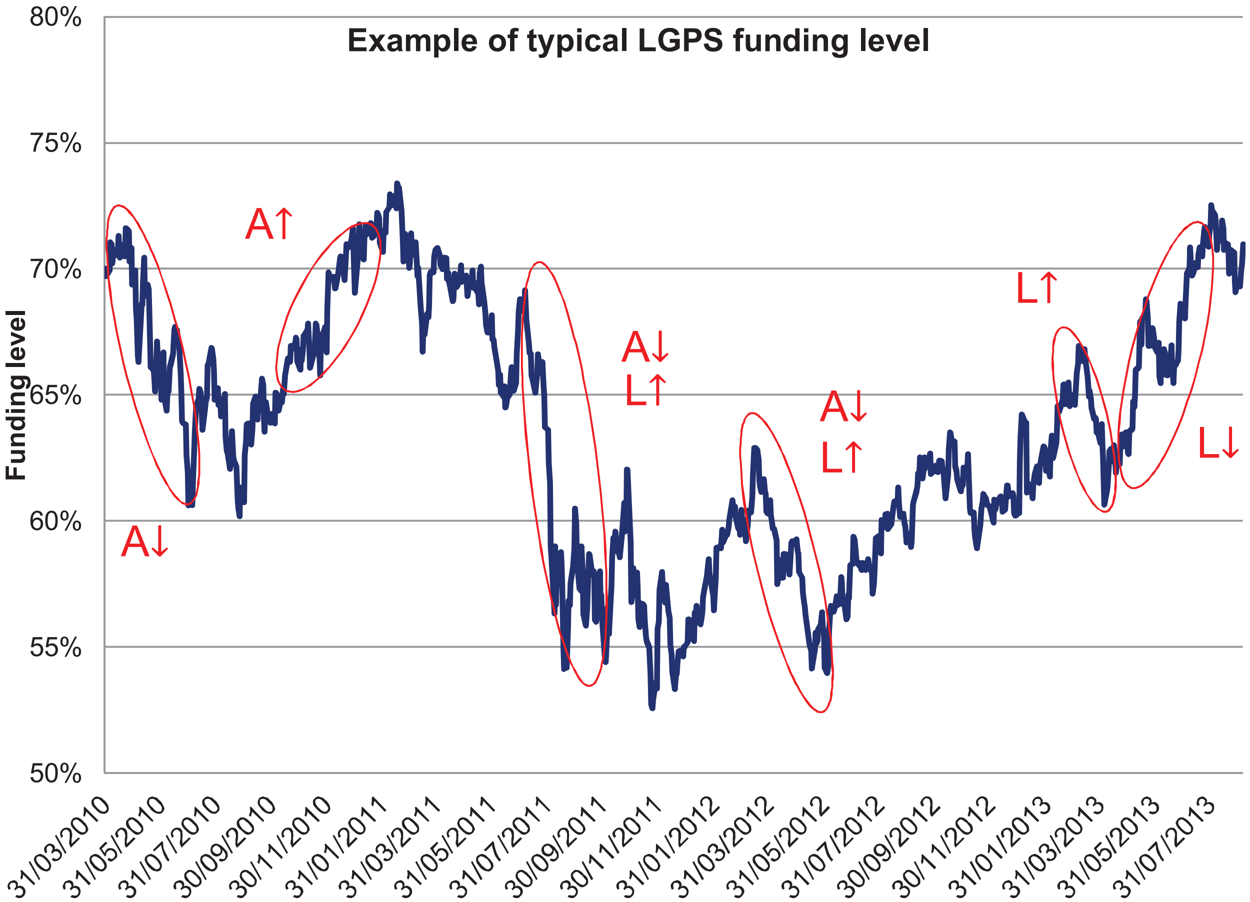


Sources: Mercer based on DMO and PPF “Purple Book” data and RBS data

Strong argument to put in place a plan to introduce liability hedging, e.g. based on funding level improvements

Real yields are likely to remain at depressed levels for an extended period of time due to supply and demand imbalance

Estimated funding level volatility
Typical LGPS Fund

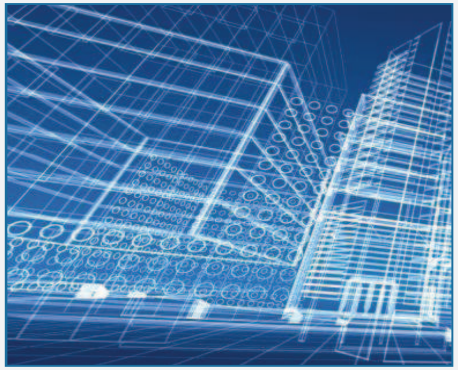


- Based on an 80 / 20 Growth / Bond asset split and typical LGPS liabilities
- Funding levels remain broadly unchanged over the period shown, but £ deficits are expected to have increased materially due to higher liabilities.
- For the Fund, between the last two valuation dates the deficit has increased by c£500m to c£1.3bn. The monetary value of the liabilities will continue to grow with interest and future accrual of benefits
- Volatility in funding level clearly evident – may be unacceptable to some Employers

Key: A and L refer to the material movement of the either the Fund's assets and/or liabilities, which have contributed materially to the change in funding level over the highlighted periods. The arrow shows the direction of the change in value.

Surrey CC & LGPS
There's a lot on your plate…..

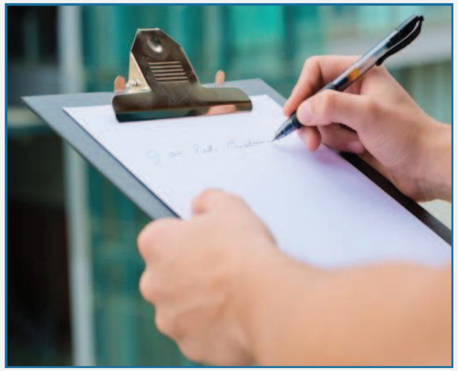
New LGPS 2014 scheme design



Austerity and affordability

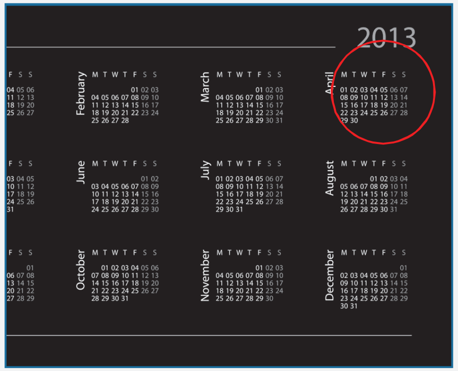
Potential Scheme Mergers

Call for Evidence



New governance structures

Actuarial Valuation year



Improved risk management is going to be a key way of helping to address many of the challenges ahead

HEDGING INSTRUMENTS

Hedging instruments
‘Toolkit’

Funded instruments

- Index-Linked Gilts
- Network Rail Bonds
- Overnight Cash
- Money Market
- Fixed-Interest Gilts
- Corporate Bonds
- ABS
- Covered Bonds

Unfunded instruments

- Interest Rate Swaps
- Inflation Swaps
- Gilt Repos
- Total Return Swaps
- LPI Swaps
- Asset Swaps
- Equity Options
- Swaptions
- CDS
- Futures
- Forwards
- Spread Locks

Most common

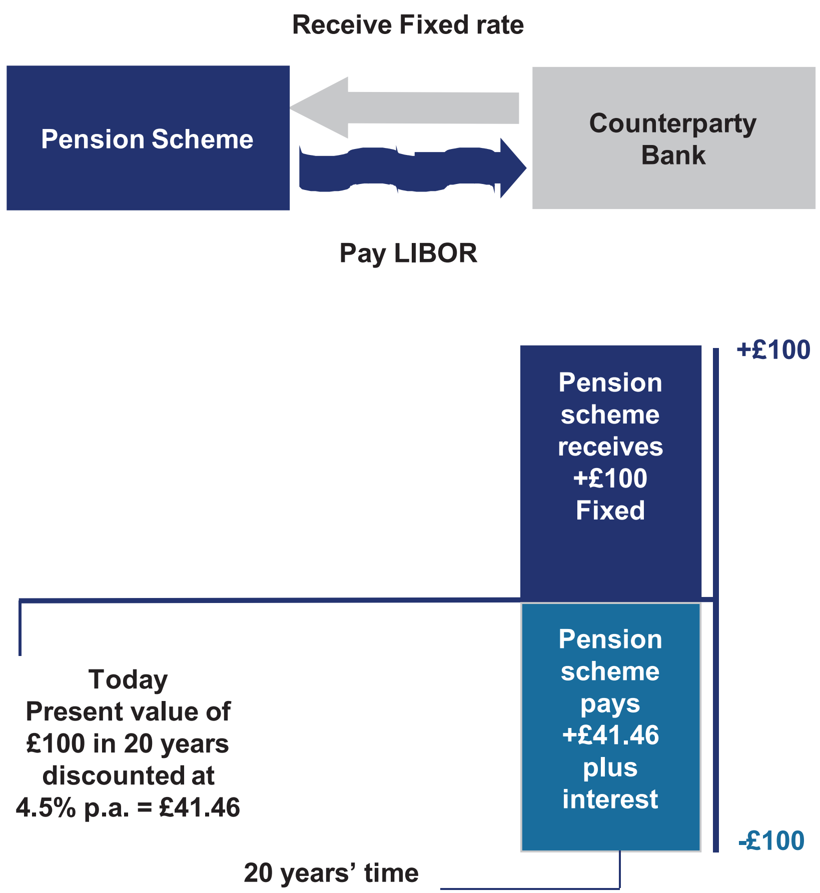
Hedging instruments
Common features among unfunded instruments

Receive fixed or inflation-linked cashflows	• The Fund would receive fixed or inflation-linked cashflows from the counterparty. • These would be used to match the Fund's fixed or inflation-linked liability cashflows.
Pay floating cashflows	• The Fund would pay a floating rate of interest in exchange for the fixed or inflation-linked cashflows. • For example, in the case of swaps this interest rate would most likely be LIBOR.
Change in value of the instrument hedges change in liability value	• As interest rates change over time, the value of the instruments change. • These changes in value hedge the changes in the liability value.
Limited initial capital required	• In theory, apart from transaction costs and initial collateral, no initial capital is required to enter into these transactions. It is for this reason that gearing is possible.
Subject to counterparty credit risk	• Instruments are traded directly with investment banks. However, some derivatives will be moved to central clearing houses. • If the counterparty defaults, the Fund may make a loss. • This is partially mitigated by collateralisation, but some risks still remain, for example: – The Fund may be out of the market for some time after default. – The collateral received may fall in value or the Fund may have posted collateral worth more than its loss on derivative positions.
Ongoing collateral requirements	• The Fund must have collateral to post to cover any losses on the derivative positions. • Similarly, the Fund will receive collateral on any gains on its derivative positions.

Most unfunded instruments involve the payment of a floating interest rate in exchange for fixed or inflation-linked cashflows.

Hedging instruments
Interest rate swaps and Inflation swaps

How it works



Interest Rate and Inflation Swaps

Purpose

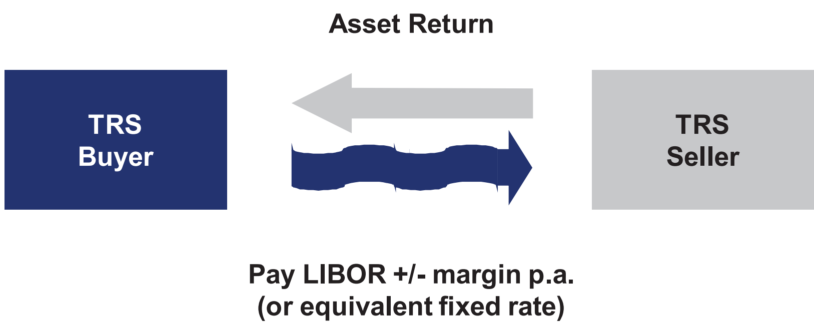
- Pension schemes use interest rate swaps to hedge interest rate risk
  - Pay a floating "cash" rate (usually LIBOR)
  - Receive fixed "swap" rate.

Mechanics

- A zero coupon swap is quoted in terms of the fixed rate and the notional exposure, which equates to the present value of the cashflows. For example:
  - 20-year zero coupon swap rate of 4.5% p.a.
  - Cashflow of £100 in 20 years
  - Notional of £41.46.
- Interest rate swaps provide fixed payments.
- Inflation swaps can be used in addition to provide inflation-linked payments:
  - Pay a fixed rate (breakeven "swap" inflation)
  - Receive actual RPI.
- Cashflows have equal value at outset – in theory no payment is required (apart from transaction costs).
- Both interest rate and inflation swaps could be traded with terms of up to 50 years.

Hedging instruments
Total Return Swaps

How it works

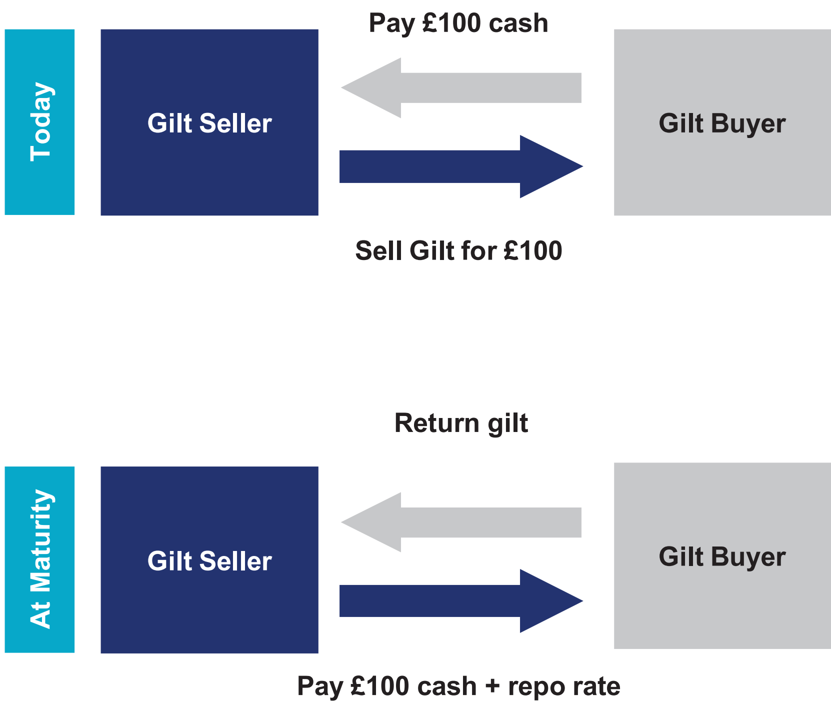


Total Return Swaps

- Under a gilt TRS, a pension plan agrees to:
  - pay a floating rate (LIBOR +/- a margin) on a specified notional amount
  - receive the total return on a specified gilt applied to the same notional amount
  - for a specified term
- No assets are exchanged up-front, so the Fund would therefore obtain unfunded economic exposure to the specified gilt.
- Unlike swaps, the term of gilt TRS is limited to 2-3 years. This means that the position must be rolled from time to time. This creates **roll risk**:
  - The margin relative to LIBOR may be unattractive
  - It may in extreme cases be impossible to roll the position. If this happens other instruments could be considered (e.g. swaps or gilt repo).
- Each time a gilt TRS position is rolled, it must be cash settled, creating **liquidity risk** if insufficient cash set aside (and the Fund has made a loss)
  - In practice, pooled funds and manager processes (and ongoing collateral management) are designed to ensure that this situation does not happen.

Hedging instruments
Gilt Repo

How it works



Gilt repo

Today

- Transact a gilt repo with a counterparty bank, i.e. sell a gilt and agree to buy it back at a future date at a pre-determined price.
- Pension fund retains economic exposure to gilt. Cash may be subject to a “haircut” retained by bank counterparty.

At Maturity

- Pension fund re-purchases gilt at the pre-determined price.
- At the end of each repo contract, the Fund would roll the repo (i.e. enter into another repo to continue borrowing).

Comments

- The Fund could use its existing gilt holdings to held establish an LDI portfolio. Cash raised from repos could be used to purchase further gilts. At the end of each repo contract, the Fund would roll the repo (i.e. enter into another repo to continue borrowing).
- Economically, the transaction is broadly equivalent to the use of gilt TRS, the key difference being the funding cost (i.e. the difference between the gilt repo rate and the gilt TRS rate).
- Gilt repo typically have terms of up to 1 year and must be rolled from time to time, so like gilt TRS they are subject to **roll risk**.

Hedging instruments
Key risks in the use of Over The Counter (OTC) derivatives and repos

Counterparty risk

- The Fund should understand the approach taken by any investment manager to selection and monitoring of counterparties and measures of controlling this risk

Regulatory / legal risk

- Documentation will need to be reviewed from both legal and investment perspectives. The scope of the reviews depend on delivery mechanism, structure, instruments and techniques used. Any structure would need to be "future-proof" to accommodate regulatory changes, such as central clearing of derivatives.

Operational Risks

- Liquidity and costs of ongoing management of synthetic/repo positions needs to be understood. For gilt repo, 'the roll risk' in particular.

Gearing

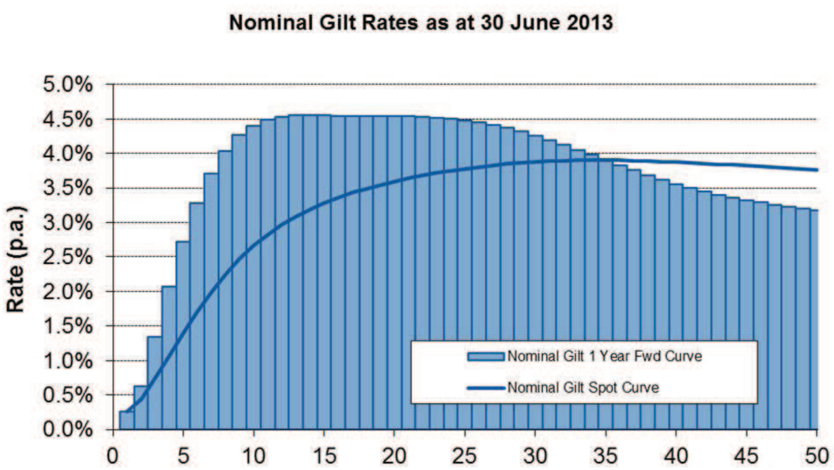
- If positions are geared the level of gearing will vary with the changes in yields. The process will need to be understood and agreed on how to manage the gearing within the portfolio.

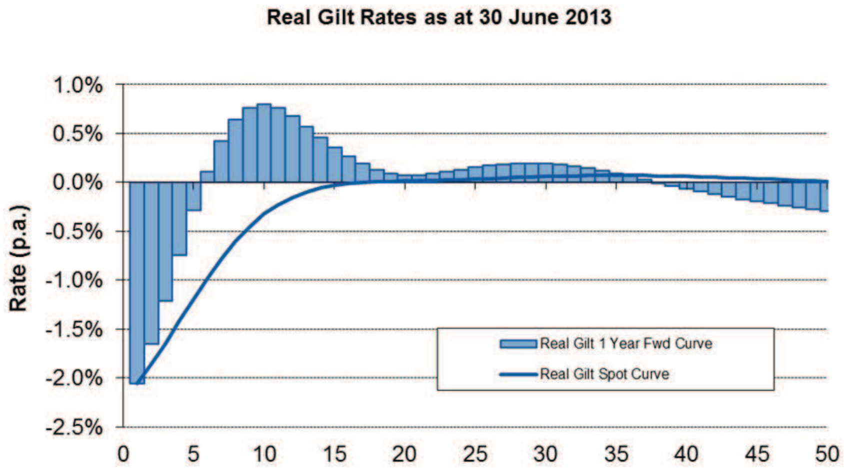
LIBOR/Repo rate generation

- Risks associated with LIBOR and/or Repo rate needs to be understood.

GILT MARKET UPDATE

Gilts market update
Spot and forward yields (as at 30 June 2013)





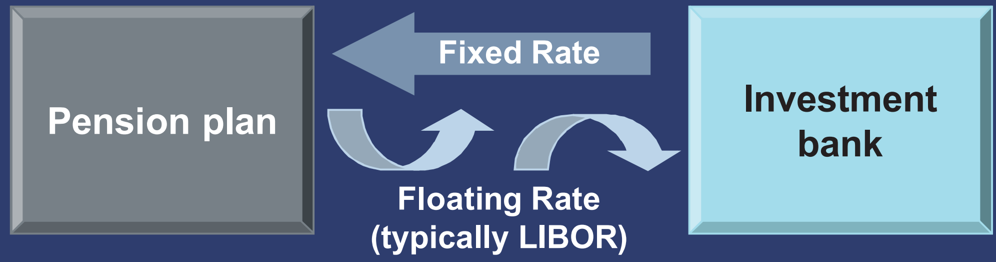
- The charts show gilt yields (**dark blue curve**) as at 30 June 2013 and the year-by-year forward rates implied by these yields (**light blue bars**). Forward rates show the path of cash returns that would result in the same return as the gilt yield over the relevant period.
- A forward rate is the expected rate at a point in the future. For example,
  - Based on 30 June 2013 pricing, the markets expect that the nominal (left-hand chart) cash return in 2033 (i.e. in 20 years time) will be just over 4.5%. This is significantly higher than the current nominal cash return of c.0.5%.
- A spot rate is the expected average rate between today and a point in the future, e.g.
  - A 20 year spot nominal rate is the average expected rate from years 1 to 20 (i.e. it is the average of forward rates over the next 20 years). Using the same example, the gilt yield (spot rate) is c.3.6% p.a.

Gilt yields are being dragged down by current low short-term interest rates. This is consistent with Bank of England's current base rate of 0.5% p.a.

What is fair value?

Long-term interest rates (or yields) are said to be fair value if there is a broadly even chance of cash returns being higher or lower over the same period…

… or in other words if the fixed (interest) rate is broadly in line with the expected floating (cash) rate over the term of a swap. (Note: the economics of an interest rate swap are akin to borrowing to invest in a bond.)



Fair value is…

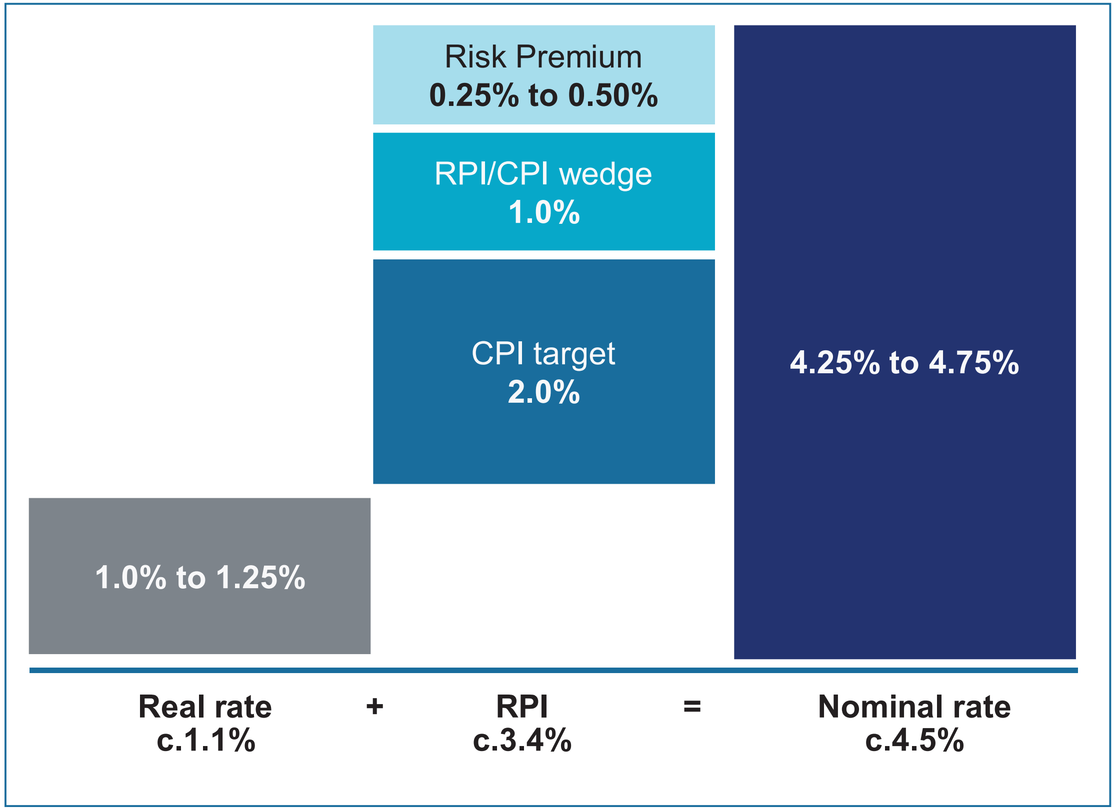
- A consideration for when hedging should be undertaken.
- A highly subjective judgement.

Fair value is not…

- A target for all hedging.
- More important than broader strategic considerations (e.g. risk tolerance).
- A short-medium term prediction for reversion of long-term interest rates. Long-term interest rates may be below fair value for a long time.

Gilts market update

Mercer 'fair value' for long term nominal and real gilt interest rates – defined as 5yr+ forward rates



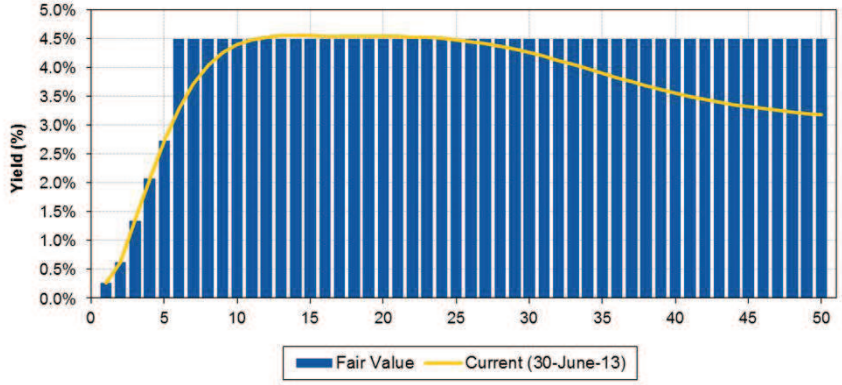
- The Mercer Rates Committee (MRC) sets 'fair value' views for gilt yields and inflation (RPI).
- Specifically, taking a view on forward rates *beyond* five year maturities. The first five years are assumed to be fair value.
- Mercer fair value views are informed by historic averages for real rates, projections for inflation, and the expectation that the Bank of England will be successful in meeting its inflation target. The nominal rate is the by-product of the two.
- The real rate and inflation views are reviewed on a quarterly basis or more frequently should a significant event occur such as the CPAC review of the method of calculating RPI inflation.

Fair value views are subjective and should not be solely relied on when setting hedging policies.

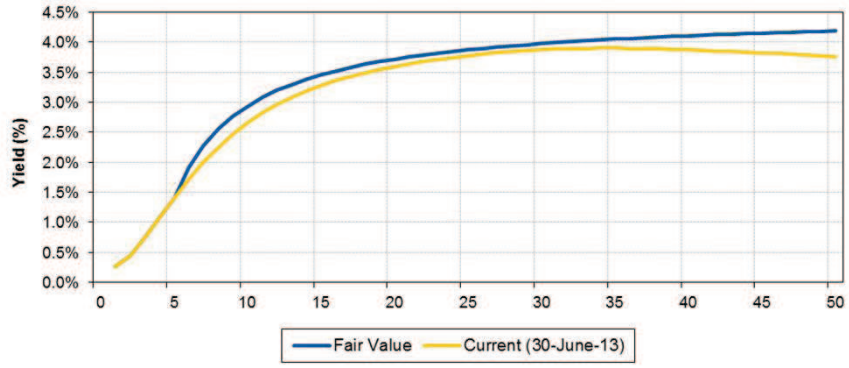
Gilts market update

Forward rates vs. Spot rates (current vs. Mercer ‘Fair Value’ views as at 30 June 2013) – assumed 1.25% real and 4.5% nominal

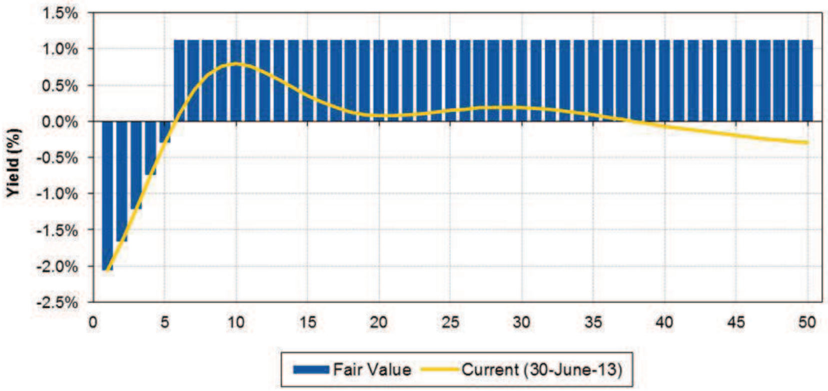
Nominal Forward Rates



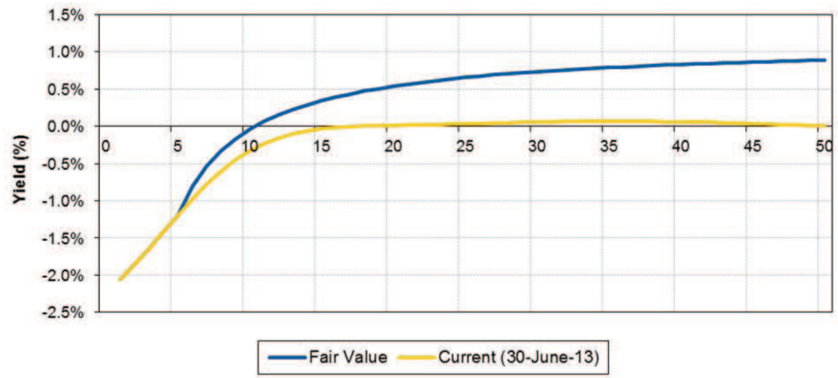
Nominal Spot Rates



Real Forward Rates

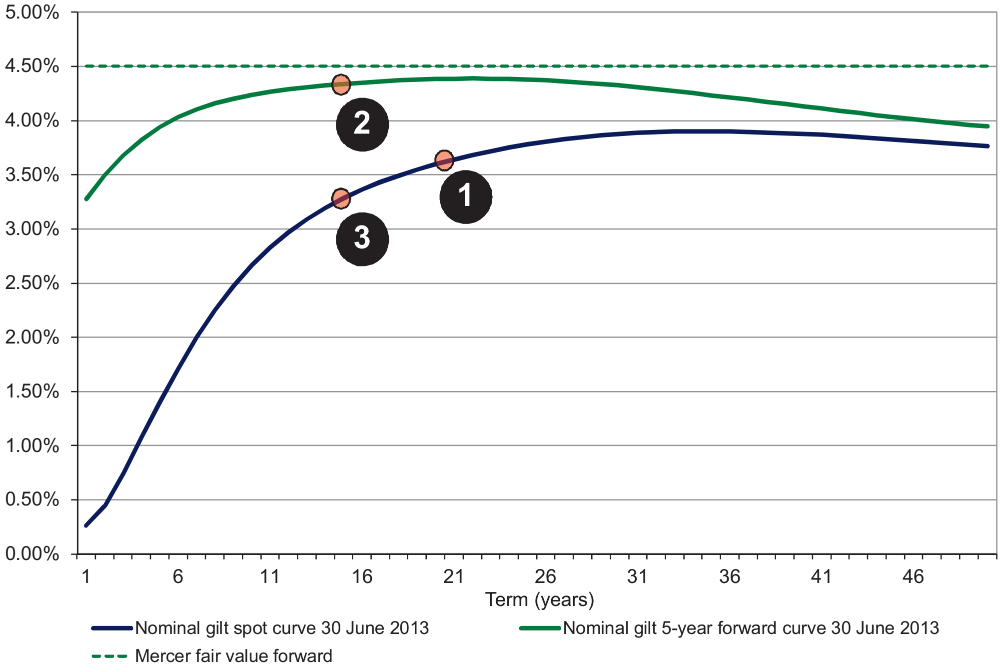


Real Spot Rates

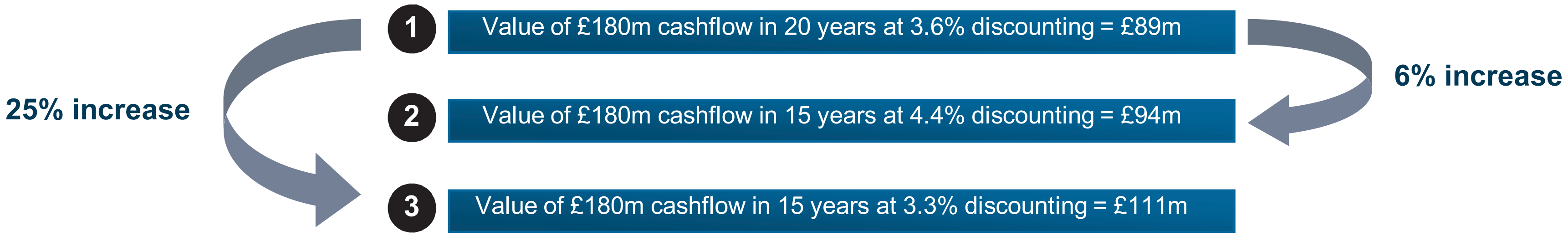


Are yields too low to hedge?
Yields are not as unattractive as they appear

Nominal spot and forward curves



- Significant increases in nominal yields are already priced in
- Under a traditional approach to valuing liabilities, the steepness in yield curve implies fixed liabilities would increase in value over 5 years by around 6%
- If yields remain unchanged, the value of a 20-year fixed liability would increase by around 25% over 5 years
- Any fall in yields would lead to even greater losses
- Similarly for real yields



Scope for significant losses in a "muddle-through" scenario

IMPLEMENTATION

Implementation considerations
Overview of main approaches

SIMPLICTY

COMPLEXITY

IMMEDIATE EXECUTION

Immediate switch from the current to the target strategy, irrespective of the price (e.g. yield levels)

PHASED OVER TIME

Phase the switching over time by splitting the trade into tranches (e.g. 10 switches of equal sizes). The switches are done irrespective of price.

TRIGGER BASED

Set minimum pricing criteria (e.g. trigger level or levels) which, once satisfied, will action switches towards the target strategy

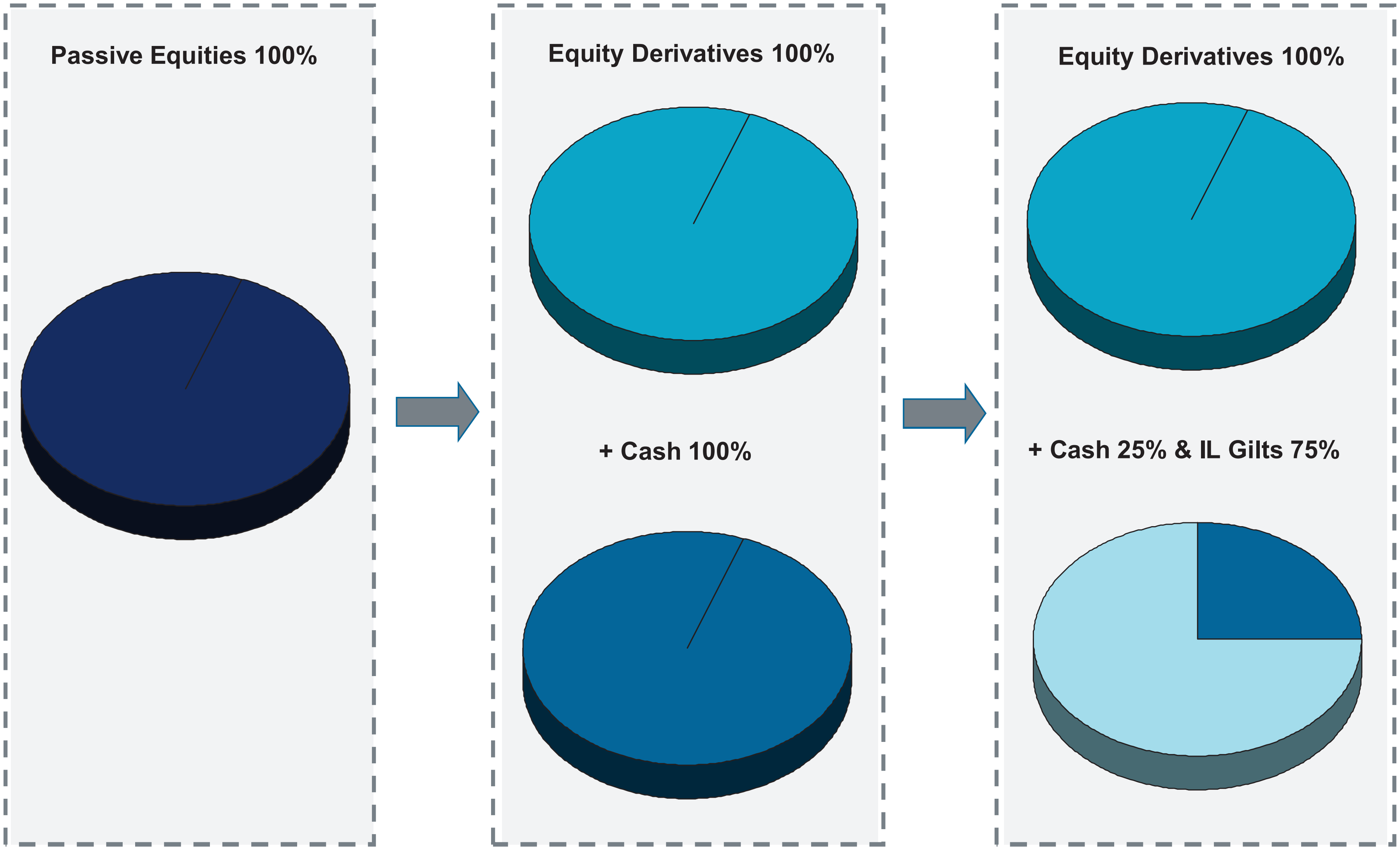
No single right answer – driven by beliefs and risk tolerance

In the following slides we show how the Fund could finance an LDI mandate without reducing the expected return on the assets

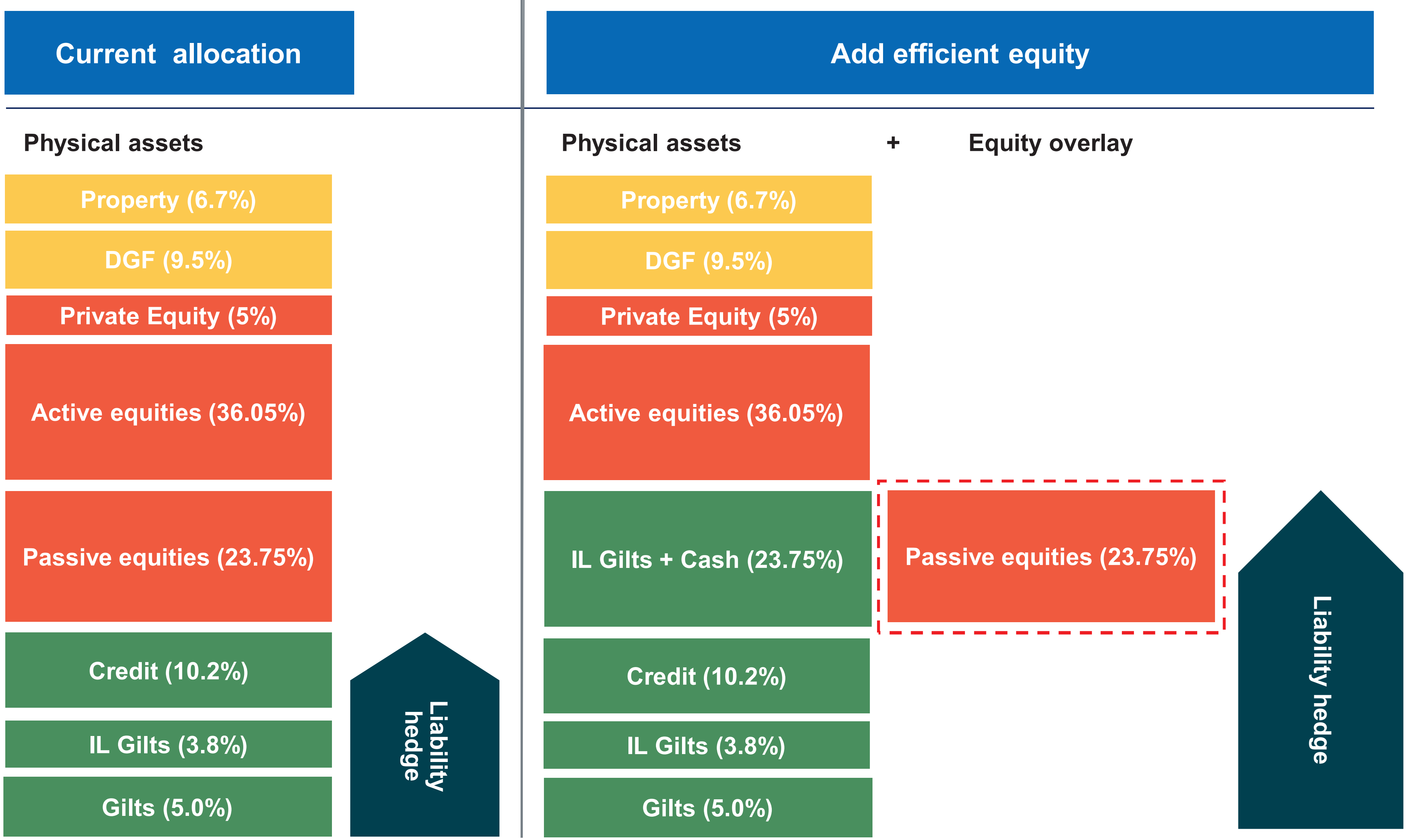
Make the Fund’s passive equities work harder

Physical equity can be replicated by cash/bonds and equity derivatives

Using derivatives can retain equity returns but reduce interest rate and inflation risk



Using capital efficiently to increase liability hedge whilst maintaining expected return through exposure to return seeking assets



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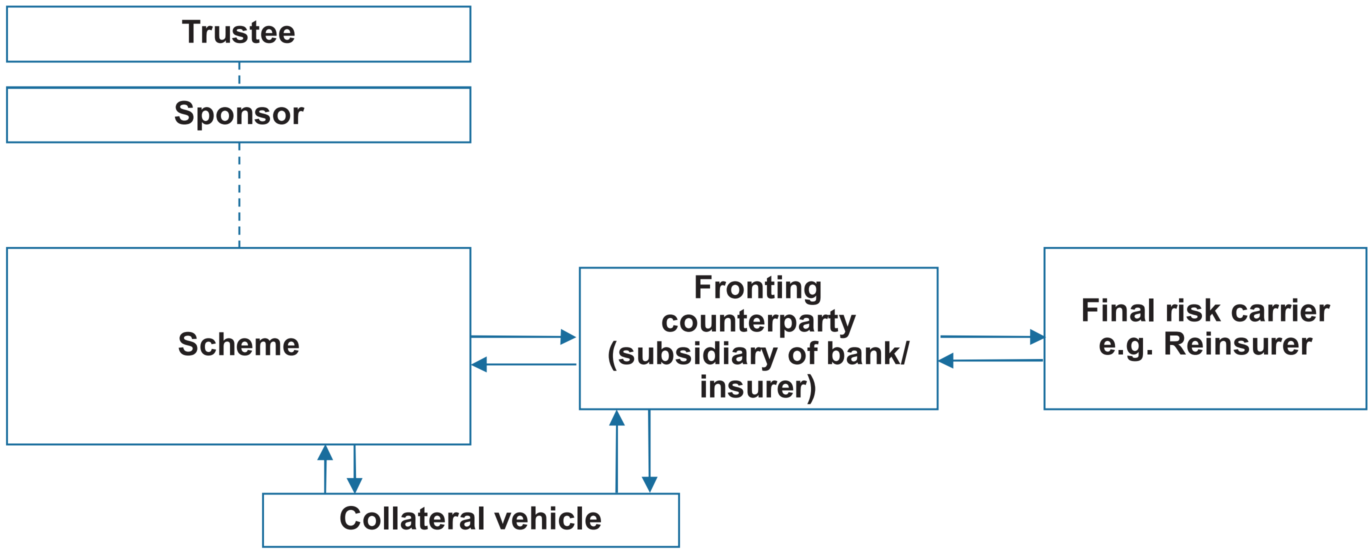
LONGEVITY HEDGING

Longevity swap and buy-in compared

	Pensioner Longevity swap	Pensioner buy-in
Pros	• Removes pensioner longevity risk at below recent trends • "Buy now while stocks last" • Avoid locking into current low yields • Retain asset flexibility • Possible stepping stone to later full risk transfer or self-sufficient run off	• Close matching on portion of liabilities • Investment market dislocations can present pricing opportunities • Consistent with a long term complete exit
Cons	• Possible adverse funding/accounting implications (although can potentially be funded by adjusting investment strategy) • Extra admin requirements	• Illiquid so constraint on investment strategy • If paid for by sale of gilts, potentially limited risk reduction or even increase in risk • If paid for by sale of growth assets, lock in underfunding

A longevity swap is economically similar to an unfunded buy-in, retaining asset flexibility (so risk and reward) and spreading payment of longevity risk premium to the third party over the contract's life

At a high level, the mechanism of a longevity swap is relatively simple…although multiple parties are involved



Need to consider:

- Members covered
- Named life vs. index
- Insurance vs. derivative
- Collateral structure etc

- Pension scheme administrator typically provides a monthly file of pensioner status movements (deaths, contingent spouse pensions becomes due, suspensions, reinstatements)

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A number of longevity swaps have already transacted and the market continues to develop

2009 | 2010 | 2011 | 2012 | 2013

February 2009 – June 2010
Scheme: Babcock
Provider: Credit Suisse
Size: £1,200m

July 2009
Scheme: RSA
Provider: Goldman Sachs/Rothesay Life
Size: £1,900m

November 2009
Scheme: CDC
Provider: Goldman Sachs/Rothesay Life
Size: £400m

December 2009
Scheme: County of Berkshire
Provider: Swiss Re/Windsor Life
Size: £750m

February 2010
Scheme: BMW
Provider: Deutsche Bank/ Abbey Life
Size: £3,000m

June 2010/ Dec 2011
Scheme: BA
Provider: Goldman Sachs/Rothesay Life
Size: £1,300m x 2

January 2011
Scheme: Pall
Provider: JP Morgan; index trade for deferreds
Size: £70m

August 2011
Scheme: ITV
Provider: Credit Suisse
Size: £1,700m

November 2011
Scheme: Rolls Royce
Provider: Deutsche Bank
Size: £3,000m

December 2011
Scheme: Pilkington
Provider: L&G
Size: £1,000m

May 2012
Scheme: Akzo Nobel
Provider: Swiss Re
Size: £1,400m

December 2012
Scheme: LV=
Provider: Swiss Re
Size: £800m

February 2013
Scheme: BAe
Provider: L&G
Size: £3,200m

May 2013
Scheme: Bentley
Provider: Deutsche Bank/ Abbey Life
Size: £500m

- Red boxes denote involvement of Mercer consultant

INFRASTRUCTURE

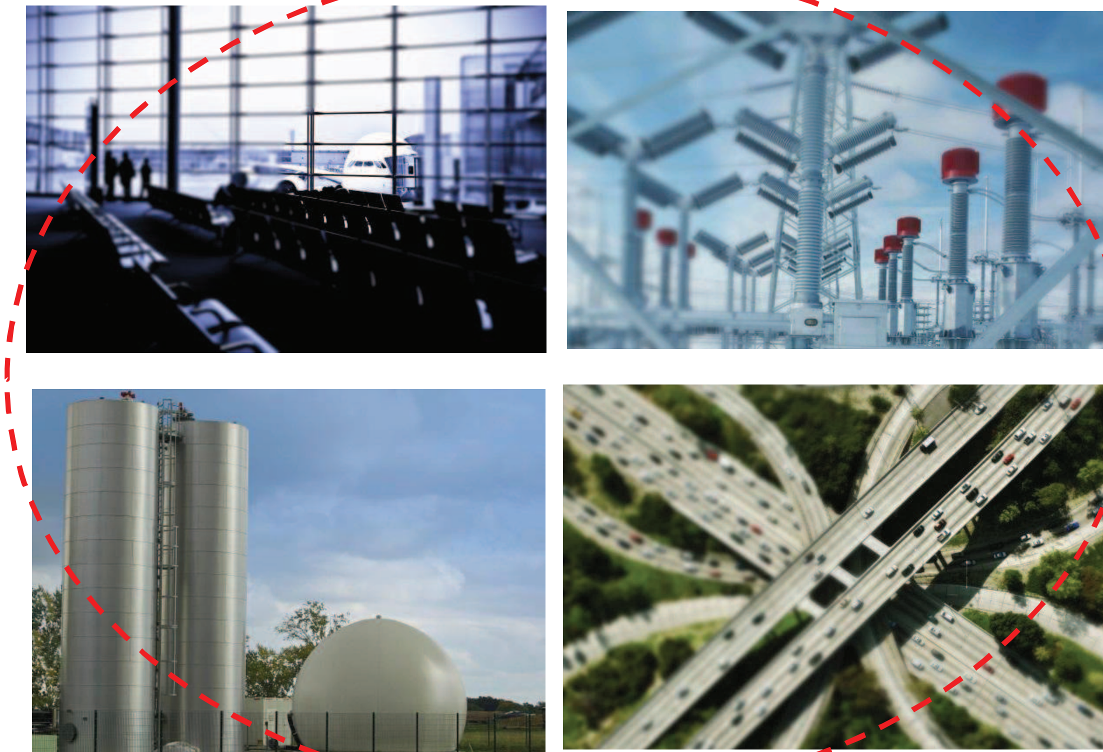
Asset class overview
Defining economic characteristics

High barriers to entry

Economies of scale

Inelastic demand

Long life duration



Inflation linkage

Asset class overview
Comparison to other asset classes

Property:
Tangible underlying assets / concession
Importance of capital structure
Long duration
Interest rate sensitive

Fixed Income:
Current cash yield
Inflation linkage (for ILGs)
Visibility and predictability

"INFRASTRUCTURE"

Private Equity:
Illiquid equity
Due diligence requirement
Active management

Infrastructure:
Political and regulatory risk
Large-scale investments
Unique market positioning
Equity & Debt investment channels

Current investment case
Market backdrop

Demand side

- Ongoing inflation uncertainty & concerns
- Overbid traditional markets for inflation
- High uncertainty around traditional asset pricing

Need to consider alternative investment options

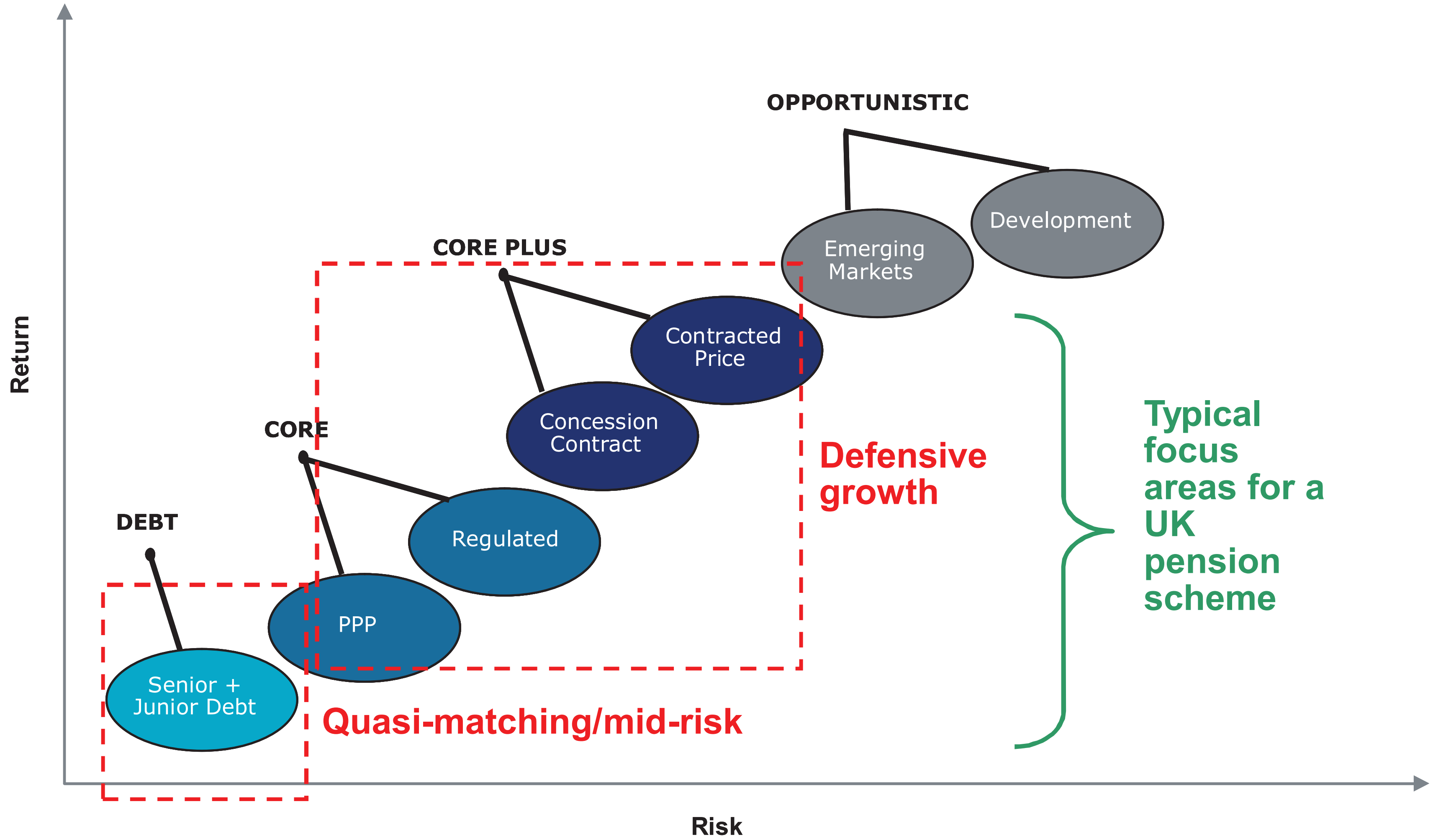
Supply side

- Systemic factors driving supply of new opportunities
- Asset gearing levels coming down
- Strong focus on availability style low risk assets

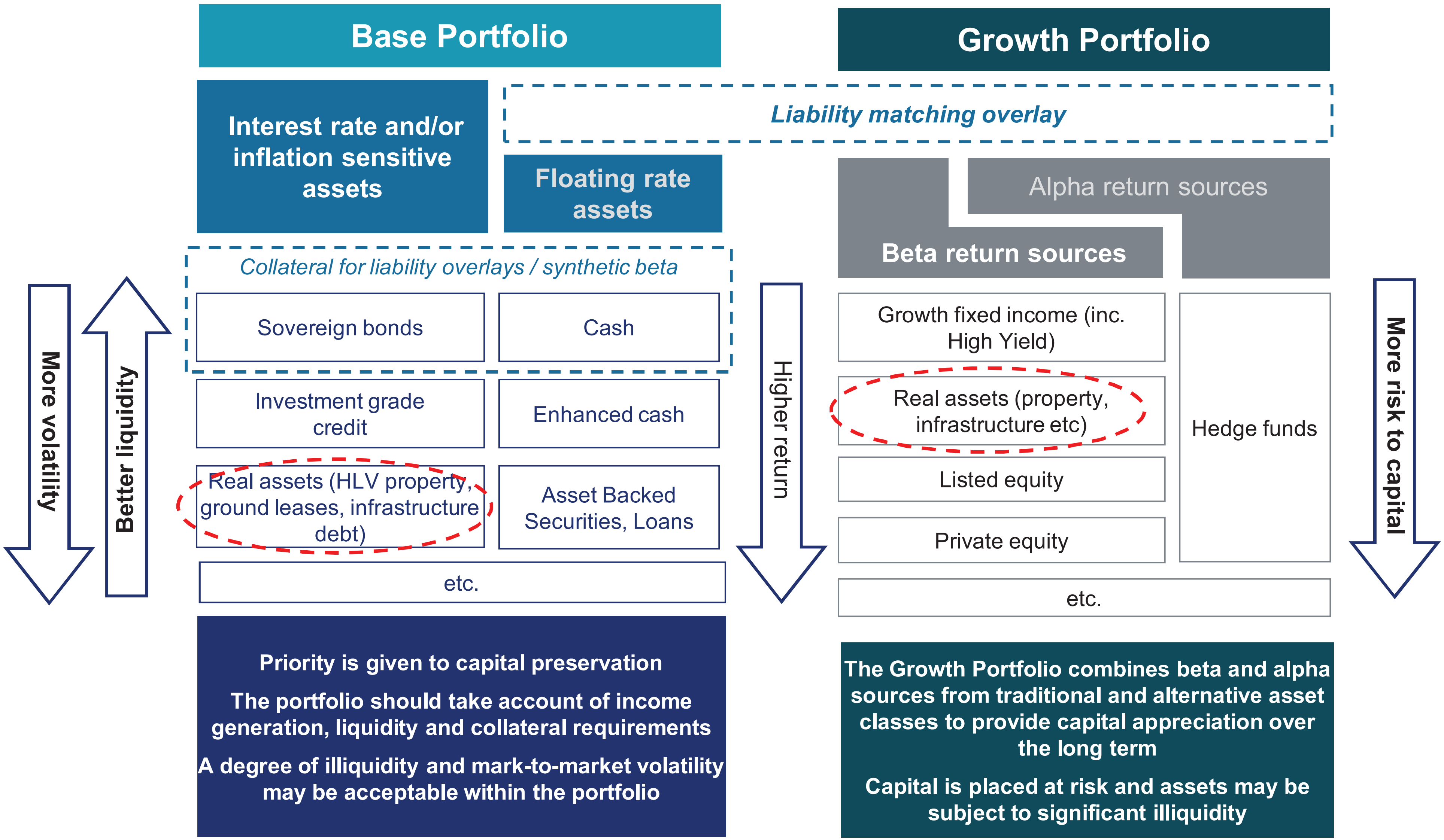
Solid supply of assets

Attractive investment environment on a risk-adjusted basis

Positioning the asset class
A range of risk profiles



Positioning of the asset class
… and differing portfolio roles

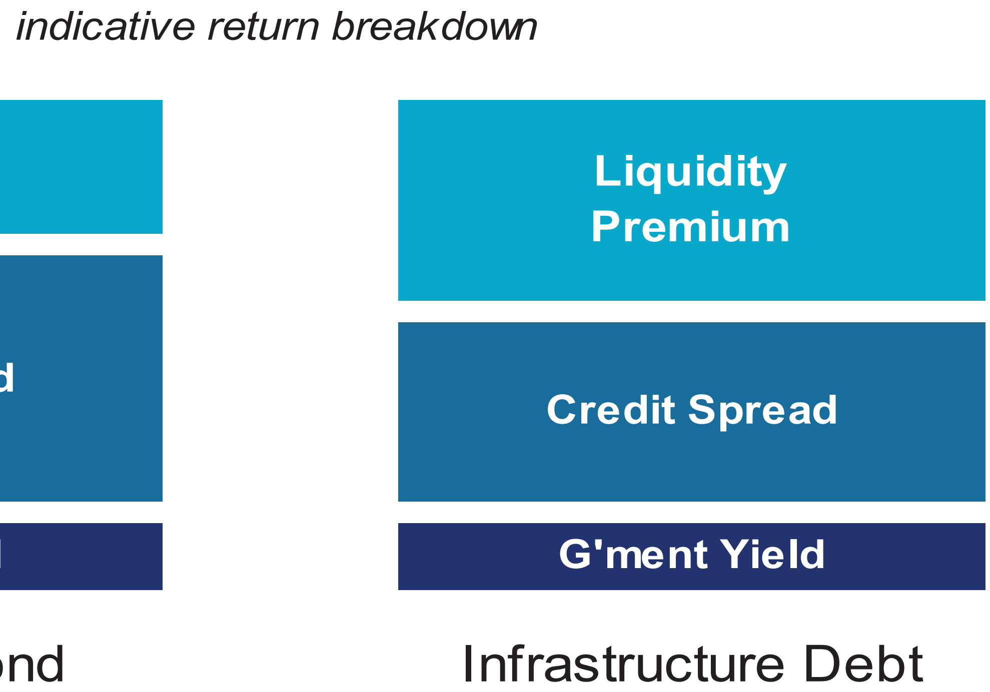


Infrastructure debt
What is it?

- Can take two main forms, **public** (e.g. Network Rail bonds) but more commonly, **private**
- Privately placed loans (often unlisted and unrated) are issued by infrastructure businesses to finance capital expenditure, acquisitions, and ongoing asset ownership
- Pricing and wider terms are tailored to each transaction through a flexible deal structure
- Stable cash flows and high operating margins from infrastructure support relatively high debt levels
  - But also mean risk levels are lower than other sectors of private debt
  - With a commensurate reduction in expected returns (compared to other private debt)

Infrastructure debt
Characteristics

- Compared to debt from other sectors, infrastructure debt trades off **credit risk** for **liquidity risk**
- **Spreads at attractive levels** compared to historical norms



Comparing infrastructure debt to equity
Key features

- Characteristics of infrastructure lead to predictable business plans; senior lender protections further reduce the investment risk profile
  – terms typically allow for significant recovery upon default
- Subordinated debt sits between equity and senior debt on the risk spectrum
  – payments ahead of equity distributions
  – unsecured or 2nd ranking claim on asset

	Senior debt	Subordinated debt	Equity
% of capital structure	■ between 40% and 90%	■ up to 25%	■ between 10% and 60%
Ranking	■ senior to all other stakeholders	■ subordinated to senior debt ■ senior to equity	■ subordinated to all creditors
Term	■ amortisation profile generally matches expected life of asset (with some buffer) ■ may have intermediate maturity	■ maturity after Senior Debt ■ average life longer than Senior Debt	■ perpetual
Security	■ 1st ranking charge over available assets ■ Typically does not include "hard" assets, but provides lenders control/step-in rights	■ unsecured of 2nd ranking charge	n/a

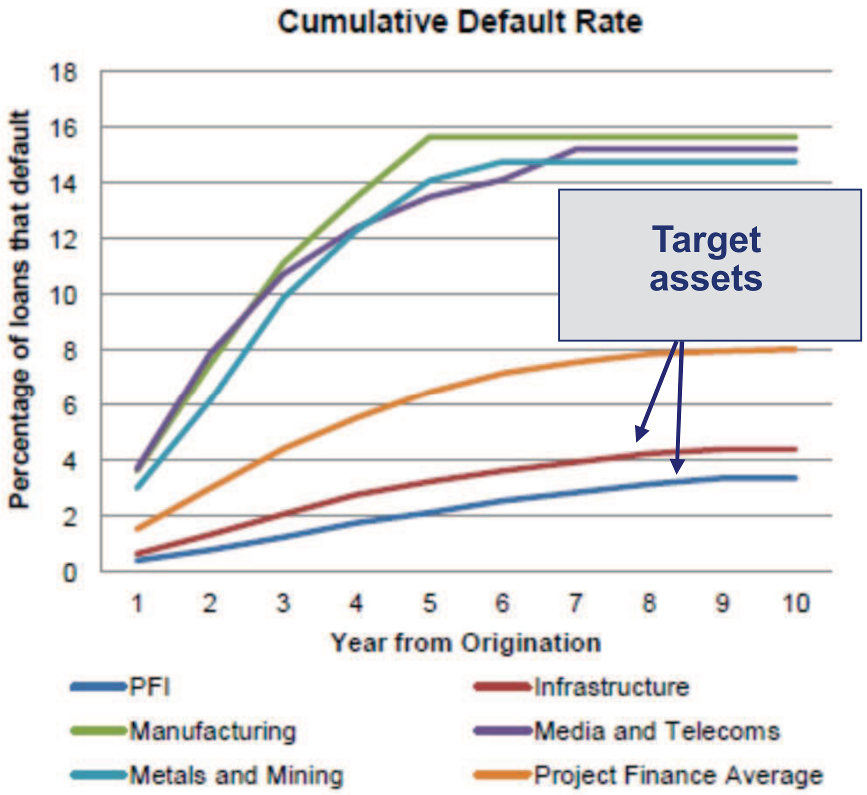
Infrastructure debt
Market pricing and expected returns

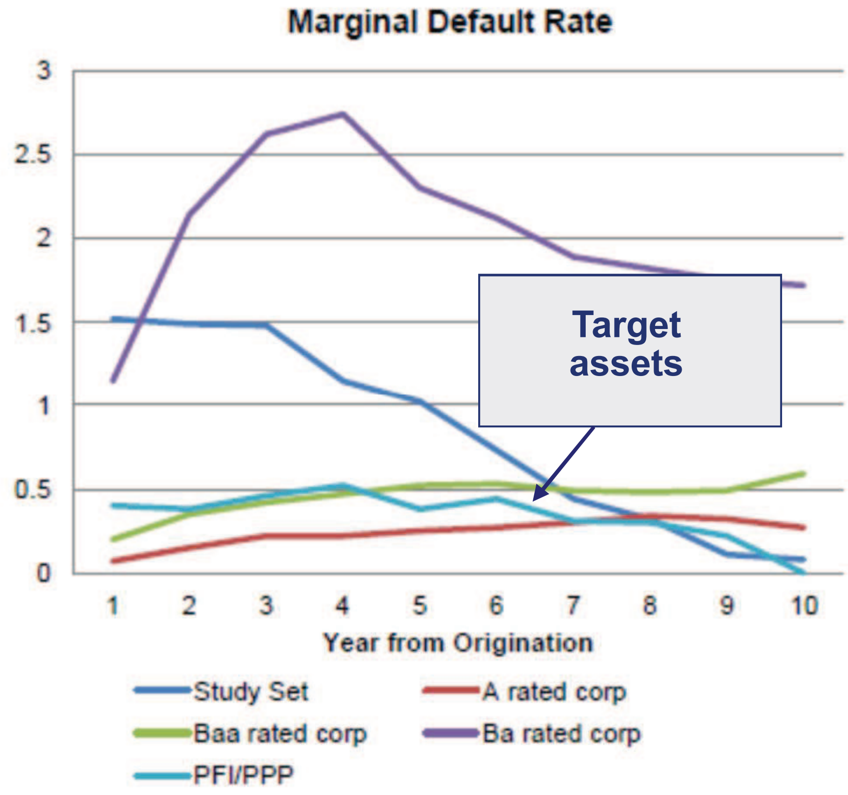
	Senior Debt	Subordinated Debt	Equity
Funding base	■ floating or fixed rate	■ floating or fixed rate	
Form of return	■ regular cash interest	■ primarily regular cash interest ■ potential for accrued interest and capital gains	■ primarily capital gains ■ equity dividends
Return expectations	■ LIBOR + 2.25% - 3.25% for Core	■ typical premium of >= 3% over Senior Debt in same transaction	■ 10-14% IRR for Core/Core Plus ■ Up to 20% IRR for Opportunistic

* Indicative returns for individual investments

These vary according to position in capital structure, sector and risk profile

Infrastructure debt
Default rates compared to other asset classes





Source: Sequoia, Moodys

…and high historical recovery rates

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Implementation considerations
General comments

- For all but the largest investors, implementation will need to be via third party managed funds or separate accounts

- Existing universe of infrastructure senior debt managers, with an increasing array of senior managers entering the market in response to the emerging opportunity

- Preference for separate account for those investors that have the scale to access this format (typically $100m allocations and upwards)
  - greater tailoring potential
  - greater control over mandate management and hold period

- Increasing array of pooled closed end funds emerging for smaller investors (further details below)

- Portfolio planning and objective setting as a necessary first step

Implementation considerations
Implementation routes compared

	Potential Advantages	Potential Disadvantages	Indicative Size Threshold
Direct investment	• Direct influence on investment selection and portfolio composition • Portfolio tailoring • Fee saving	• Need for in-house or outsourced credit expertise • Requires large sums of capital • Portfolio concentration especially in the early years	£150m+
Mandate investment	• Delegated control of investments • Investment selection and management undertaken by a dedicated manager • Access to manager proprietary deal flow • Control of portfolio design and composition leading to portfolio tailoring potential	• Potential for agency risks in the absence of dedicated portfolio manager support/resourcing • Potential for agency risks • Higher fees than direct investing • Portfolio concentration especially in the early years	£75m+
Unlisted funds	• Investment selection and management undertaken by a dedicated manager • Access to proprietary manager deal flow • Can accommodate smaller investments • Portfolio monitoring and reporting access	• Higher fees • Acquisition risk • Potential for strategy drift • Potential lack of long term track record • Manager reliance gives rise to agency risk	£75m

Implementation considerations
Indicative fund terms

	Manager A	Manager B
Type of strategy	Infrastructure Senior Debt, UK Only Pooled fund	Infrastructure Senior Debt, UK Only Pooled fund
Return targets	LIBOR + 2.85% (gross)	LIBOR + 2.50-2.75% (net)
Management fees	No fees on committed but undrawn capital 0.25% p.a. on drawn capital	0.45% p.a. on committed capital during Investment Period 0.25% p.a. on Invested Capital thereafter
Drawdown period	12 month maximum	5 year maximum
Market capacity	$15 billion+	$30 billion+
Typical lock up period	10 years	10 years with rolling 5 year extension options thereafter

APPENDICES

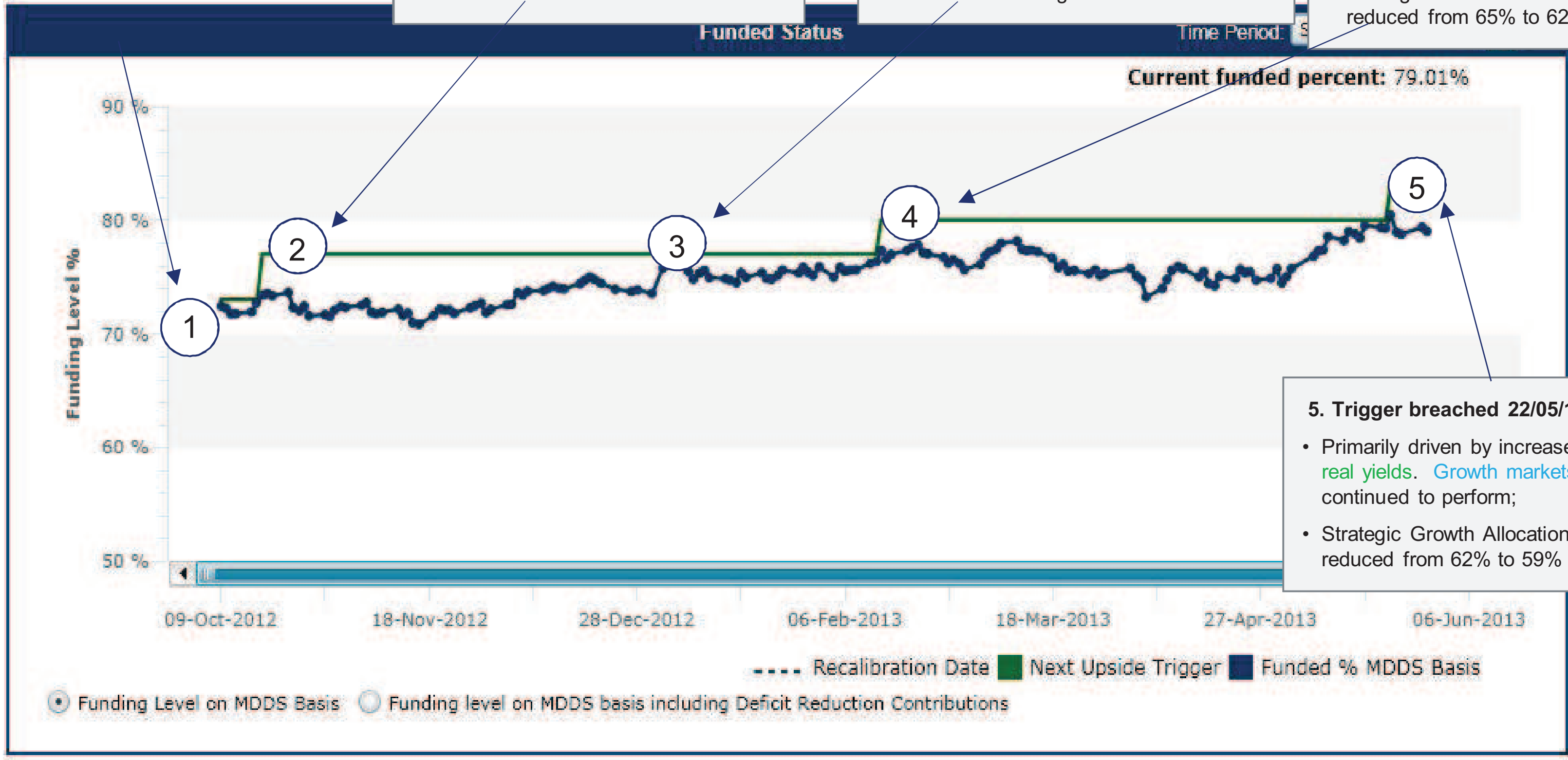
Affordable de-risking
Banking improvements in the funding to help de-risk

1. Trigger breached 09/10/12
- Increasing real yields and growth markets;
- Strategic Growth Allocation reduced to 68% from 70%

2. Trigger breached 17/10/12
- Primarily result of increase in real yields;
- Strategic Growth Allocation reduced from 68% to 65%

3. Funding level spike 03/01/13
- Primarily result of one day increase in real yields;
- Trigger not quite breached, growth allocation unchanged

4. Trigger breached 13/02/13
- Primarily driven by increase in real yields. Growth markets also performed strongly;
- Strategic Growth Allocation reduced from 65% to 62%



5. Trigger breached 22/05/13
- Primarily driven by increase in real yields. Growth markets continued to perform;
- Strategic Growth Allocation reduced from 62% to 59%

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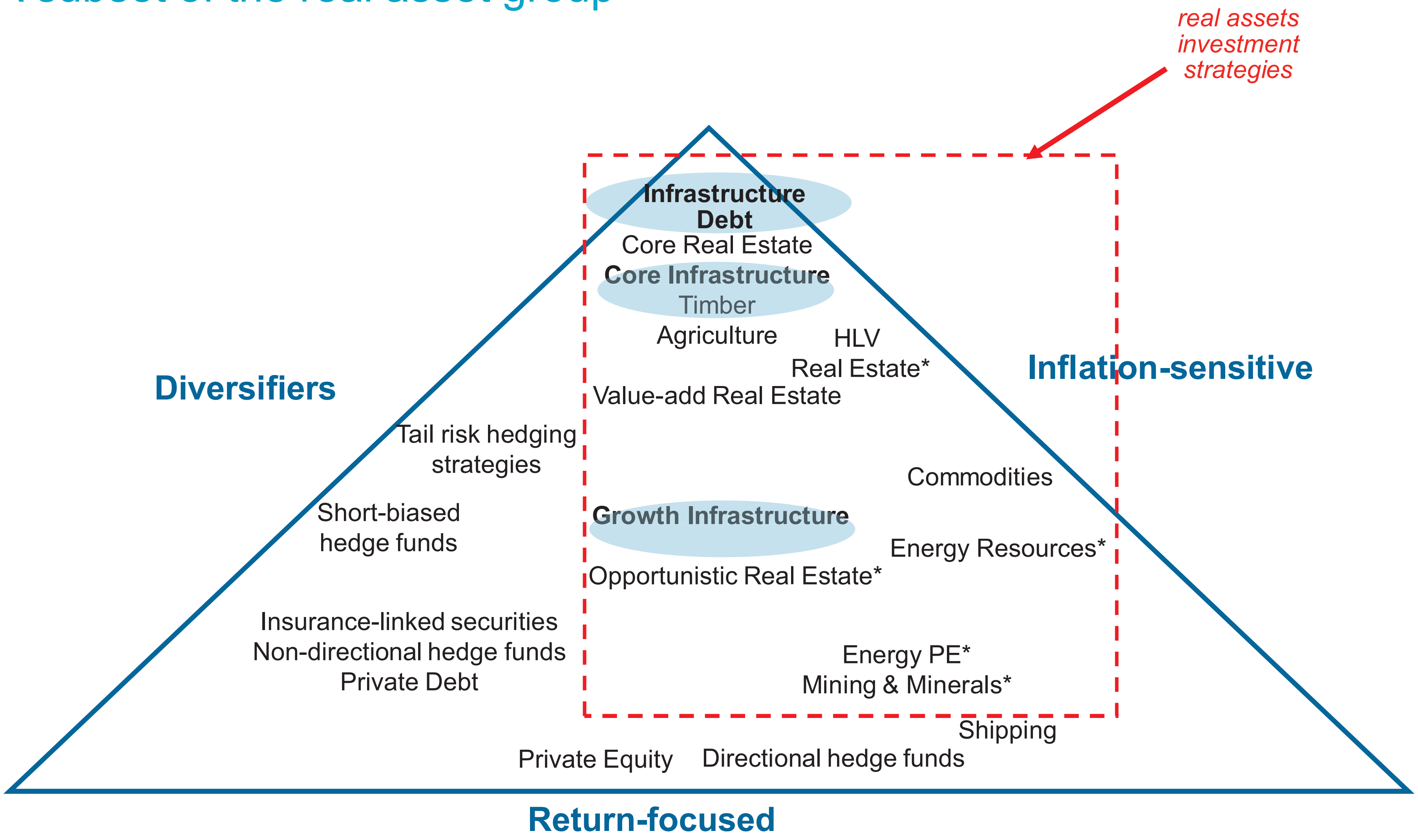
- For this client, the funding level has increased from 72% at inception to 79% at end of period;
- De-risked through numerous triggers, Growth portfolio allocation reduced from 70% to 59%;

The Fund could look to dynamically de-risk to move to the lowest risk investment strategy that would still support the funding assumptions

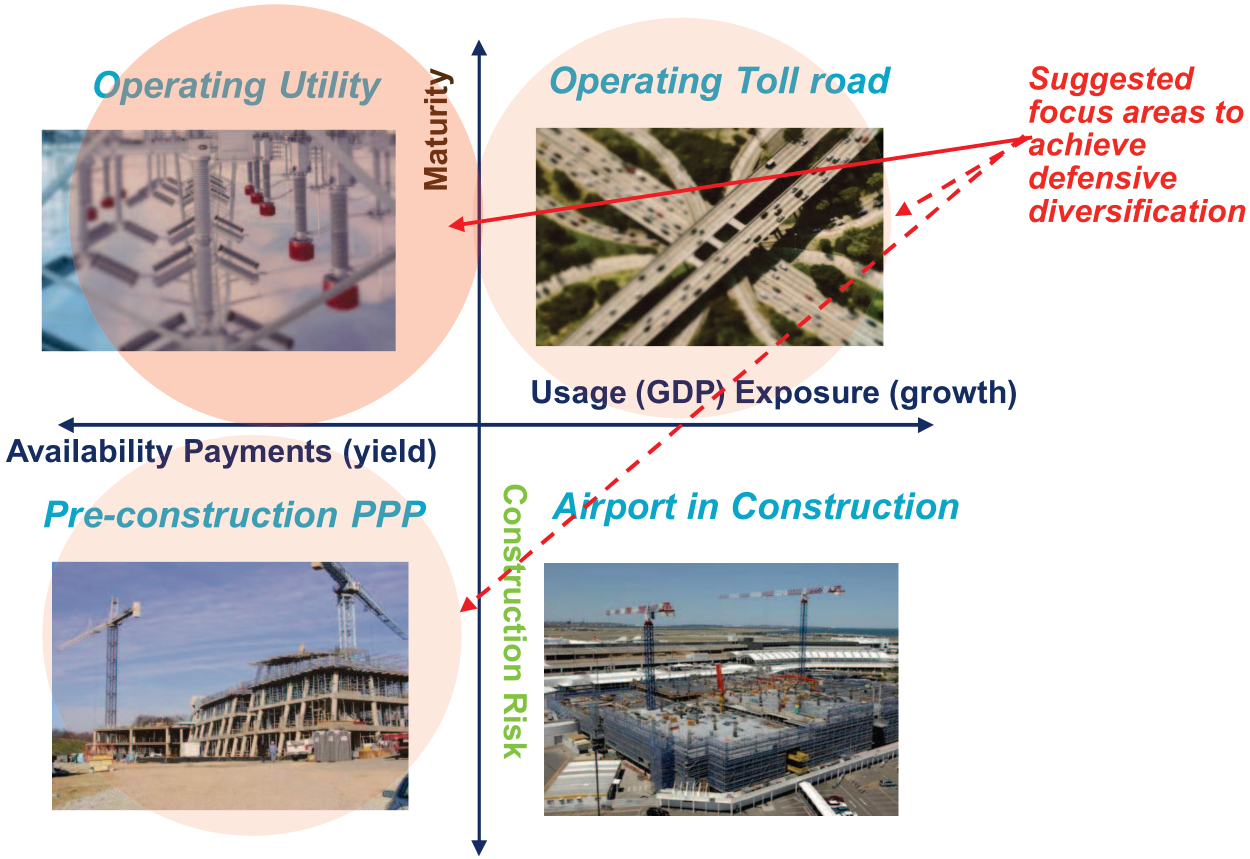
Positioning the asset class
A subset of the real asset group



Current market opportunity
The infrastructure debt funding gap

- Demand for infrastructure is significant
  - $500-$600 billion estimated annual need among OECD members
  - $40 trillion or 2.4% of world GDP to be invested in infrastructure to 2030
- Historically banks have been main provider of infrastructure debt (providing up to 90% of debt); post financial crisis, numerous factors are limiting bank participation
  - Basel III and balance sheet repair
  - lower risk appetite
  - “take-and-hold” model
  - refinancing wall
- Other sources of liquidity that were popular prior to the financial crisis (bonds wrapped by mono-lines, CLOs, hedge funds) are no longer in the market
- …leaving a key role for other institutional investors

Asset class overview
A range of risk profiles



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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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Variance vs Allocation £m (31/08/2013)			
Asset Type	**Total**	**Passive (L&G)**	**Active**
Equity	84.3	24.8	59.5
UK	-24.8	-44.6	19.8
O'Seas	109.0	69.4	39.6
Property	-39.6		
Alternatives	12.4		
Bonds	-57.0	-49.6	-7.4
Gilts	-9.9	-22.3	12.4
Index Linked	-5.0	-9.9	5.0
Corporate	-39.6	-17.3	-22.3
Unconstrained	-2.5		-2.5

Standard Life Exposure (31/08/2013)		
Asset Type	**Value £m**	**Committment £m**
Investment Funds	**142.4**	**50.0**
GARS -Diversified Growth Fund	142.4	
(Potential) GARS -Diversified Growth Fund		50.0
Private Equity Funds	**19.2**	**37.6**
Standard Life ESP II	4.5	0.7
Standard Life ESP 2006	9.8	2.1
Standard Life ESP 2008	4.5	8.2
Standard Life ESF	0.5	14.2
(Potential) Standard Life Secondary Opportunities		12.4
	161.6	**87.6**
Grand Total		**249.2**
% of Overall Fund		**9.7%**

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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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Surrey Pension Fund Board – ACTION TRACKING

ACTIONS

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A1	31 May 13	Pension Fund Business Plan 2013/14	Outturn report of the 2013/14 financial year to be presented at the first meeting of the Pension Fund Board in 2014/15.	Strategic Manager, Pension Fund & Treasury	Scheduled for 23 May 2014.
A2	20 Sept 13	Manager Issues and Investment Performance	The Pensions Administration Strategy and the Pensions Administration Service Level Agreement to be presented to the Board on 15 November 2013.	Pensions Manager	The Pension Fund Administration Strategy is on the agenda for the meeting on 15 November 2013. The Pensions Administrations Service Level Agreement will be on the agenda for the meeting on 14 February 2014.
A6	20 Sept 13	Liability Management, Infrastructure Debt	To schedule a discussion on equity derivatives.	Strategic Manager, Pension Fund & Treasury	To be scheduled.

Surrey Pension Fund Board – ACTION TRACKING

COMPLETED ACTIONS

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A3	20 Sept 13	Pension Fund Risk Register	Officers to evaluate the residual risk following mitigating actions and include this as a column within the Risk Register.	Strategic Manager, Pension Fund & Treasury	This has been addressed in the Pension Fund Risk Register report on the agenda for the meeting on 15 November 2013.
A4	20 Sept 13	Revised Statement of Investment Principles	Regulatory Committee Manager to respond to a Member regarding the composition of Local Committees.	Regulatory Committee Manager	An email was sent on 30 October 2013. Completed
A5	20 Sept 13	LGPS: Call for Evidence	A further report to the Surrey Pension Fund Board following proposals due to be published before the end of 2013.	Strategic Manager, Pension Fund & Treasury	A report is on the agenda for the meeting on 15 November 2013.

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 NOVEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **PENSION FUND ADMINISTRATION STRATEGY**

SUMMARY OF ISSUE:

A Pension Fund Administration Strategy is set out in Annex 1 for the Board to approve as a basis for consultation with scheme employers.

RECOMMENDATIONS:

It is recommended that:

The Pension Fund Board approves the Strategy as set out Annex 1 for consultation with scheme employers.

REASON FOR RECOMMENDATIONS:

The creation of a Pension Administration Strategy will provide greater clarity for the administering authority and scheme employers in relation to their roles and responsibilities in administering the LGPS. This in turn will help maintain good working relationships and efficient administration.

DETAILS:

Background

1 Regulation 65 of the Local Government Pension Scheme (Administration) Regulations 2008 permits an administering authority to publish a written statement of the authority's policies in relation to such matters as it considers appropriate in a Pensions Administration Strategy.

Monitoring and Review

2 The Pension Administration Strategy will be kept under review and will be brought for approval to future Board meetings when any material revision is required. In any event, as a minimum, it will be reviewed every two years.

CONSULTATION:

3 The Chairman of the Pension Fund has been consulted on the proposed document and has offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

4 There are no risk related issues contained within the report's proposals.

6

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

5 There are no financial and value for money implications.

CHIEF FINANCE OFFICER COMMENTARY

6 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the proposed Administration Strategy offers a clear structure, reflecting best practice with regard to the administration function.

LEGAL IMPLICATIONS – MONITORING OFFICER

7 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

8 The approval of the administration strategy will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

9 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

10 The following next steps are planned:

- If the administration strategy is approved by the board, consultation with scheme employers will begin.
- A further report will be submitted on the outcome of the consultation at the next board meeting.

Contact Officer:
Paul Baker (Pensions Manager)
020 8541 8057
paul.baker@surreycc.gov.uk

Consulted:
Pension Fund Board Chairman

Annexes:
Pension Administration Strategy

Sources/background papers:
None

Surrey Pension Fund Administration Strategy

1. Legislative Framework

1.1 This strategy statement has been prepared by Surrey County Council as the administering authority to the Surrey Pension Fund in accordance with Regulation 65 of the Local Government Pension Scheme (Administration) Regulations 2008.

2. Review

2.1 This strategy will be kept under review and will be revised, after consultation with scheme employers, following any material changes in legislation or policies that relate to the strategy.

3. Purpose

3.1 The purpose of the strategy is to establish levels of performance and procedures for liaison and communication for both the administering authority (AA) and the employers participating in the fund with a view to maintaining good working relationships, transparency and efficient administration.

4. Employer Duties & Responsibilities

4.1 The employer should nominate a person or persons to liaise with the AA on pension administration matters.

4.2 The employer should ensure that any information passed on behalf of the employer to the AA or any requests for information made on behalf of the employer to the AA are undertaken by a duly authorised officer of the employer.

4.3 The employer should notify the AA in respect of the following changes in a scheme member's status and within the required timescale by completing the appropriate pension form or secure on-line submission:

- New Joiner
  Within one month of joining.

- Change in member's details e.g. hours, maternity etc
  Within one month of the change.

- Retirements
  Two months prior to the date of retirement. It is however recognised that there will be occasions where this time limit cannot be met, for example, because the member has retired with little or no notice or details of pensionable pay cannot be provided until the member has left employment.

- Death in Service
  Within five working days of the member's death.

- Leavers
  Within one month of the member leaving.

- TUPE transfer of scheme members
  At least two months before the transfer date. This is to allow adequate time for pension protection to be put in place as appropriate.

6

4.4 The employer must determine the pension contribution rate at which its employees should contribute to the scheme from 1 April each year and, where there is a change to the member's pensionable pay during the year, from that date. Where an employee holds more than one post, the employer must determine the rate applicable for each post.

4.5 The employer will ensure that member and employer contributions are deducted at the correct rate, including contributions due on leave of absence with reduced or no pay, maternity leave and any additional contributions the member has requested to pay.

4.6 The employer will ensure that any member's additional voluntary contributions are paid to the investment manager within one week of them being deducted from the member's pay.

4.7 The employer must, no later than 30 April each year, provide the AA with year-end information to 31 March in an approved format in respect of each post the member holds.

4.8 The employer is responsible for exercising the discretionary powers given to employers by the LGPS regulations. The employer is also responsible for publishing its policy in respect of these discretions to its employees and forwarding a copy to the AA.

4.9 The AA is not required to verify the accuracy of any information provided by the employer for the purpose of calculating benefits under the provisions of the Local Government Pension Scheme. Therefore, employers should ensure that all information provided is accurate.

4.10 Any over-payment resulting from inaccurate information supplied by the employer may be recovered from the employer if it cannot be recovered from the scheme member.

4.11 In the event of the AA being fined by The Pensions Regulator, this fine may be passed on to the relevant employer where that employer's action or inaction resulted in the fine.

4.12 The employer must nominate a person to hear complaints made under Stage 1 of the Internal Disputes Resolution Procedure and should provide this person's name, job title, and office address. When an amendment to these details is made, a notification of the change should be sent to the AA immediately.

4.13 The employer must obtain the approval of the AA as to its choice of registered medical practitioner for the purposes of awarding ill health retirement under the Scheme regulations.

4.14 The employer must pay to the AA any cost identified by the AA as a result of the employing authority's decision to release any pension benefits prior to a member's normal retirement age. Such payments should be made within 30 days from the date of receipt of an invoice issued by the AA or such longer period as agreed by the AA.

4.15 The employer must also pay to the AA any charge identified by the AA as a result of the employing authority's decision to award any additional benefits to a scheme member in accordance with its statement of policy regarding the exercise of certain discretionary functions. Such payments should be made within 30 days from the date of receipt of an invoice issued by the AA or such longer period as agreed by the AA. 6

5. Administering Authority Duties & Responsibilities

New Joiners

5.1 *Confirmation letter of scheme admittance to all members.*
Within 20 days

5.2 *Transfers from previous pension schemes.*
Within 20 days

Existing Active Members

5.3 *Annual Benefit Statement*
By 30 September providing year end data has been received from the employer

5.4 *Benefit estimates to employers*
Within ten days of receipt of request

5.5 *Retirements*
Within ten days of retirement

5.6 *Death in Service*
Death Benefits and dependants' pensions
Within five days

Early Leavers

5.7 *Deferred Benefit statement*
Within one month of leaving

5.8 *Refunds*
Within ten days

5.9 *Transfer to new pension scheme*
Within 20 days

Deferred Benefit Members

5.10 *Annual Benefit Statement*
By 30 June

5.11 *Benefits put into payment*
Within ten days

5.12 *Death Benefits and dependants' pensions*
Within five days

6

Pensioner Members

5.13 *Changes in personal details*
Payroll record updated before next payroll run

5.14 *Death benefits and dependants' pensions*
Within five days

*The timescales for completing the tasks above are measured from the date the AA is in receipt of all the relevant information required to complete the task is expressed in "working days"

Communication

5.15 The AA will provide employers with the necessary forms and documents for it to carry out its pension administration responsibilities. These forms to be available in paper and electronic format, where appropriate.

5.16 The AA will provide a guide to the Local Government Pension Scheme for scheme members for employer to issue.

5.17 The AA will provide a joiner pack to new scheme members.

5.18 The AA will issue a newsletter for active scheme members at least once a year

5.19 The AA will issue regular employer newsletters and provide training at County Hall for employers to comply with their pension administration responsibilities.

5.20 The AA will enable scheme members and employers to visit Pension Services during normal working hours from 8.30am to 5.30pm.

5.21 The AA will maintain a Pension Fund Website which will include:

- General information on the LGPS
- Copies of all the publications of the pension fund including newsletters, scheme guides, strategy statements, annual reports and accounts.
- Standard forms to be used by employers when providing information to the pensions team

5.22 The AA will arrange a Pension Fund Annual General meeting for employers and produce an annual report.

6. Unsatisfactory Performance by an Employer

6.1 Where an employer materially or consistently fails to operate in accordance with the standards laid down in this strategy, which results in additional administration costs being incurred by the AA, the AA may issue a written notice to the employer requiring that these extra costs are met by the employer. Steps to recover additional administration costs would normally only be pursued after support and training had been offered by the AA to address the underperformance.

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 NOVEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **KEY PERFORMANCE INDICATORS**

SUMMARY OF ISSUE:

In line with best practice, Pension Fund Board members will be supplied with Pension Fund key performance indicators (KPIs) on a quarterly basis, covering investment and administration practices.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Board discuss and approve the KPI statement format as shown in Annex 1.

REASON FOR RECOMMENDATIONS:

To comply with best practice.

DETAILS:

Requirement

1 In line with best practice, future Pension Fund Board meetings will be supplied with a schedule of Pension Fund key performance indicators (KPIs), covering investment and administration practices.

Key Performance Indicators

2 The KPIs cover the following areas:

- Funding level
- Death benefit administration
- Retirement administration
- Benefit statements
- New joiners
- Transfers in and out
- Material posted on website
- Employer and member satisfaction
- Investment performance
- Data quality
- Contributions monitoring
- Audit
- Overall administration cost

3 The KPI schedule is shown as Annex 1.

4 Periods covered in the schedule range from one month, three months and twelve months.

5 Members are invited to discuss the performances set out in the schedule.

CONSULTATION:

7

6 The Chairman of the Pension Fund has been consulted on the proposed change and has offered full support regarding the content and structure of the information.

RISK MANAGEMENT AND IMPLICATIONS:

7 There are no risk related issues contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

8 There are no financial and value for money implications.

CHIEF FINANCE OFFICER COMMENTARY

9 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the proposed KPI model offers an effective framework for the monitoring of the essential pension fund KPIs.

LEGAL IMPLICATIONS – MONITORING OFFICER

10 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

11 The reporting of such information will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

12 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

13 The following next steps are planned:

- Continued improvement in the indicators.
- Further refinement and additions of useful data.

Contact Officer:

Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
020 8541 9894
phil.triggs@surreycc.gov.uk

Consulted:

Pension Fund Board Chairman.

Annexes:

Schedule of Key Performance Indicators

Sources/background papers:

None

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KPI - DETAILED ACTIONS, TIMESCALE AND REPORTING REQUIREMENTS: To 30 September 2013 **Annex 1**

7

No	Description	Target	Lead Officer	Actual (Score and RAG)	Reporting Period	Previous Score	Date Last Reported	Improvement/Deterioration
1	FUNDING							
	IMPROVE FUNDING LEVEL Funding level to increase from current levels of 72%	**100%**	PT	**72.3%**	31/03/13	**72.0%**	31/12/10	0.30%
2	PPENSION ADMINISTRATION							
	DEATH BENEFITS Notify potential beneficiary of lump sum death grant within 5 days	**95%**	PB	**100.00%**	3 months to 30 Jun 13	**100.00%**	3 months to 31 Mar 13	0.00%
	Write to dependant and provide relevant claim form within 5 days of notification of death	**90%**		**98.15%**	3 months to 30 Jun 13	**96.08%**	3 months to 31 Mar 13	2.07%
	Pay death grant within 5 days of receipt of relevant documentation	**90%**		**100.00%**	3 months to 30 Jun 13	**100.00%**	3 months to 31 Mar 13	0.00%
	Issue notification of dependant's pension within 5 days of receipt of relevant claim forms	**90%**		**100.00%**	3 months to 30 Jun 13	**100.00%**	3 months to 31 Mar 13	0.00%
	RETIREMENTS Retirement options to members within 10 days	**90%**	PB	**92.66%**	3 months to 30 Jun 13	**94.19%**	3 months to 31 Mar 13	-1.53%
	New retirement benefits processed for payment following receipt of election within 10 days	**95%**		**97.89%**	3 months to 30 Jun 13	**99.63%**	3 months to 31 Mar 13	-1.74%
	BENEFIT STATEMENTS ABS issued to 95% of eligible active members by 30th September	**95%**	PB	**100.00%**	3 months to 30 Jun 13	**Pending**	3 months to 31 Mar 13	
	DBS issued to 85% of eligible deferred members by 30th June	**95%**		**100% issued by 26/09/13**	3 months to 30 Jun 13	**Pending**	3 months to 31 Mar 13	
	NEW JOINERS New starters processed within 20 days	**85%**	PB	**96.39%**	3 months to 30 Jun 13	**98.85%**	3 months to 31 Mar 13	-2.46%
	TRANSFERS IN Non LGPS transfers-in quotations processed within 20 days	**85%**	PB	**99.07%**	3 months to 30 Jun 13	**100.00%**	3 months to 31 Mar 13	-0.93%
	Non LGPS transfers-in payments processed within 20 days	**85%**		**99.07%**	3 months to 30 Jun 13	**100.00%**	3 months to 31 Mar 13	-0.93%
	TRANSFERS OUT Non LGPS transfers-out quotations processed within 20 days	**85%**	PB	**100.00%**	3 months to 30 Jun 13	**94.29%**	3 months to 31 Mar 13	5.71%
	Non LGPS transfers out payments processed within 20 days	**85%**		**100.00%**	3 months to 30 Jun 13	**94.29%**	3 months to 31 Mar 13	5.71%
	MATERIAL POSTED ON WEBSITE All relevant Communications Material will be posted onto website within one week of being signed off	**95%**	PB	**Achieved**	3 months to 30 Jun 13	**Achieved**	3 months to 31 Mar 13	
3	CUSTOMER SERVICE							
	EMPLOYER SATISFACTION/SURVEY Overall satisfaction score for employers to be 80%	**80%**	PT/PB	**Data pending**	12 months to 31 Mar 14	**Data pending**	12 months to 31 Mar 13	
	MEMBER SATISFACTION/SURVEY Overall satisfaction score for members to be 80%	**80%**	PB	**97%**	12 months to 31 Mar 14	**Data pending**	12 months to 31 Mar 13	
4	INVESTMENT PERFORMANCE							
	INVESTMENT RETURNS/OVERALL FUND PERFORMANCE Returns to at least match the benchmark	**Benchmark**	PT	**BENCHMARK 12.5%**	12 months to 30 Sep 13	**BENCHMARK 12.7%**	12 months to 30 Jun 13	-0.90%
				ACTUAL 15.7%	12 months to 30 Sep 13	**ACTUAL 16.8%**	12 months to 3 Jun 13	
5	DATA							
	DATA QUALITY Data quality within the Fund should be at least 90% accurate.	**90%**	PB	**99%**	12 months to 31 Mar 13	**Not available**	12 months to 31 Mar 12	
6	CONTRIBUTIONS							
	CONTRIBUTIONS RECEIVED **Pension Fund** 98% (total value) of contributions to be received by 21st day of the ensuing period.	**98%**	PT	**98%**	Oct-13	**99%**	Jul-13	-1.00%
7	AUDIT							
	CLEAN AUDIT REPORT Receive an unqualified audit opinion from the external auditors	**Clean Report**	PT/PB	**Achieved**	12 months to 31 Mar 13	**Achieved**	12 months to 31 Mar 12	
	Annual audit returns no significant findings	**No significant findings**		**Achieved**		**Achieved**		
8	COST							
	COST PER MEMBER Administration cost per member to remain in lowest CIPFA benchmarking quartile	**< lowest quartile**	PT/PB	**Achieved**	12 months to 31 Mar 13	**Achieved**	12 months to 31 Mar 12	

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 NOVEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **PENSION FUND RISK REGISTER**

8

SUMMARY OF ISSUE:

Surrey County Council, as administering authority for the Surrey Pension Fund, is responsible for the delivery of benefit promises made to members of the Surrey Pension Fund. It achieves this by setting objectives and goals with varying timeframes. Risks lie in failing to meet the intended goals.

Risks that are established as an issue must be identified and evaluated via a risk register. The risks must be prioritised with existing controls or new controls implemented to mitigate the risks. This should be recorded in a risk register, which needs monitoring on a quarterly basis.

RECOMMENDATIONS:

It is recommended that:

1. Members assess the Risk Register in Annex 1, making any suggestions for amendment/additions as necessary.

REASON FOR RECOMMENDATIONS:

A solid framework of risk management is required in order to manage the considerable risk environment surrounding the governance and investment of the pension fund.

DETAILS:

Background

1 A review of the current risk register for the Pension Fund will give the Pension Fund Board the opportunity to influence and drive the Pension Fund risk management process for 2013-2014.

Risk Management Process

2 The risk management policy of the Surrey Pension Fund is to adopt best practice in the identification, evaluation and control of risks in order to ensure that the risks are recognised, and then either eliminated or reduced to an manageable level. If neither of these options is possible, then means to mitigate the implications of the risks should be established.

3 The Pension Fund & Treasury Manager has identified a number of risks associated with the Pension Fund. The risks are grouped as follows:

- Investment
- Financial
- Funding
- Operational
- Governance

4 Each of the risk areas has been assessed in terms of its impact on the Fund as a whole, on the fund employers, and on the reputation of the Pension Board and Surrey County Council as the administering authority. Assessment has also been given as to the likelihood of the risk.

8

7 Each of the three areas of impact identified above is assessed on a scale of one to four, with four implying the highest level of impact. The likelihood of the risk description is then applied to the combined impact score, which produces an overall risk score. Depending on the score, the risks are then identified as Red, Amber or Green.

8 To comply with best practice, a revised scoring process has been implemented, which will reassess the risk scores after the mitigating action taken to control and reduce the risks. The risk register has been revised to include a revised impact score and net risk score as a result of those mitigating actions.

9 The revised schedule is included as Annex 1. The previously approved schedule in the original format is shown as Annex 2.

Review

10 The risk register will be reviewed on a quarterly basis.

CONSULTATION:

11 The Chairman of the Pension Fund Board has been consulted and has offered full support for the quarterly scrutiny process.

RISK MANAGEMENT AND IMPLICATIONS:

12 The risk related issues are contained within the report's Annex 1.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

13 There are no expected additional costs from compiling, maintaining and monitoring a risk register.

CHIEF FINANCE OFFICER COMMENTARY

14 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the risk register will provide officers with a suitable platform for the monitoring and control of pension fund risks.

LEGAL IMPLICATIONS – MONITORING OFFICER

15 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

16 The creation of a risk register will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

17 There are no potential implications for council priorities and policy areas.

8

WHAT HAPPENS NEXT

18 The following next steps are planned:

- Monitoring by officers and reporting every quarter.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
020 8541 9894
Phil.triggs@surreycc.gov.uk

Consulted:
Pension Fund Board members.

Annexes:
List the annexes attached to this report.
Annex 1: Pension Fund Risk Register
Annex 2: Previous register in original format

Sources/background papers:
None

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Risk Group	Risk Ref.	Previous	Risk Description	Impact				Likelihood	Total risk score	Mitigation actions	Revised Likelihood	Net risk score
				Fund	Employers	Reputation	Total					
Funding	1	14	Pensioners living longer	4	5	1	10	5	50	TREAT- 1) Hymans Robertson use long term longevity projections in the actuarial valuation process. 2) SCC has joined Club Vita, which looks at mortality rates that are employer specific.	5	50
Funding	2	2	Bond yields fall leading to a increase in value of liabilities	4	4	3	11	4	44	TREAT-1) IAS19 data is received annually and provides an early warning of any potential problems. 2) Early consultation with the actuary will take place with regard to the 2013 valuation.	3	33
Governance	3	6	Failure to take difficult decisions inhibits effective Fund management	3	2	4	9	4	36	TREAT-1) Ensure activity analysis encourages decision making on objective empirical evidence rather than emotion. Ensure that basis of decision making is grounded in ALM Study/SIP/FSS/Governance statement and that appropriate advice is sought.	3	27
Funding	4	7	Pay & price inflation is significantly more or less than anticipated	4	4	1	9	5	45	TREAT- 1) Fund employers should monitor own experience. 2) Assumptions made on pay and price inflation (for the purposes of IAS19/FRS17 and actuarial valuations) should be long term assumptions. 3) The fund holds investment in index linked bonds to mitigate some of the risk.	3	27
Operational	5	New	Rise in ill health retirements impact employer organisations	1	4	1	6	4	24	TREAT- 1) Possibility of insuring against the cost and impact (paper included in Board agenda of 15 November 2013).	4	24
Governance	6	4	Changes to LGPS regulations	4	3	1	8	4	32	TREAT-1) Fundamental change to LGPS regulations to be implemented from 1 April 2014. 2) Impact on contributions and cashflows will need to be considered during the 2013 valuation process.	3	24
Investment	7	8	Investment Managers fail to achieve performance targets over the longer term	4	4	4	12	3	36	TREAT- 1) The Investment Management Agreements clearly state SCC's expectations in terms of performance targets. 2) Investment manager performance is reviewed on a quarterly basis. 3) The Pension Fund Board should be positioned to move quickly if it is felt that targets will not be met. 4) Having LGIM as a rebalancing/transition manager facilitates quick changes. 5) The Fund's investment management structure is highly diversified, which lessens the impact of manager risk compared with less diversified structures.	2	24
Investment	8	9	Inappropriate long-term investment strategy	4	4	4	12	3	36	TREAT- 1) Use of investment consultants to monitor investment strategy. 2) Separate source of advice from Fund's independent advisor. 3) Setting of Fund specfic benchmark relevant to the current position of fund liabilities. 4) Overall asset allocation regularly monitored by Pension Fund Board. 5) Fund manager targets set based on market benchmarks or absolute return measures.	2	24
Financial	9	10	The effect of a possible increase in employer contribution rates on service delivery	4	4	4	12	3	36	TREAT- 1) Stabilisation of contribution rates for long term secure employers as laid out in the Funding Strategy Statement. 2) Phasing of contribution increases for other employers. 3) Suitable deficit recovery periods.	2	24
Financial	10	20	Financial loss of cash investments from fraudulent activity	4	4	4	12	3	36	TOLERATE - 1) Policies & procedures are in place which are regularly reviewed to ensure risk of investment loss is minimised. Governance arrangements are in place in respect of the Pension Fund. External advisors assist in the development of the Investment Strategy. Fund Managers have to provide SAS 70 or similar (statement of internal controls).	2	24
Investment	11	1	Investment markets fail to perform in line with expectations	4	4	3	11	3	33	TREAT-1) The Full actuarial valuation takes place every three years. Moreover, IAS19 data is received annually and provides an early warning of any potential problems. 2) The asset outperformance assumption of 1.6% is achievable over the long term when compared with historical data.	2	22
Operational	12	16	Financial failure of a fund manager leads to increase costs and service impairment	4	3	4	11	3	33	TREAT- 1) Fund is reliant upon current adequate contract management activity. 2) Fund is reliant upon alternative suppliers at similar price being found promptly. 3) Fund is reliant on LGIM as transition manager.	2	22
Funding	13	5	Impact of government policy on the employer workforce	3	3	1	7	4	28	TREAT- 1) Hymans Robertson use prudent assumptions on future of workforce. Employers to flag up potential for major bulk transfers. The potential for a significant reduction in the workforce as a result of the pressures that the public sector is under may have an additional impact on the Fund. 2) Need to make worst case assumptions about diminishing workforce when carrying out the actuarial valuation.	3	21
Investment	14	13	Fall in equity markets leading to deterioration in funding levels and increased contribution requirements from employers	4	3	3	10	3	30	TREAT- 1) About 40% of fund made up of bonds, property funds, diversified growth funds and private equity, limiting exposure to listed equities. 2) The investment strategy is continously monitored and periodically reviewed to ensure optimal asset allocalltion reflecting the continued belief that in the long-term equities are the best asset class.	2	20
Financial	15	17	Counterparty risk within the SCC treasury management operation	2	2	4	8	3	24	TOLERATE - 1) A separate bank account for the pension fund has been in operation since 1 April 2011. Since then the fund has held cash investment separate from SCC. 2) Lending limits with banks are set at levels that are appropriate given credit ratings. 3) The current pension fund treasury strategy is based on that of SCC.	2	16
Operational	16	24	Poor data quality results in poor information and decision making	2	2	4	8	3	24	TOLERATE 1) Northern Trust provides 3rd party validation of performance and valuation data. 2) Pension Fund team and pension board members are able to integrgate data to ensure accuracy.	2	16
Operational	17	11	Insufficient attention to social, ethical & environmental risks leads to reputational damage and/or financial loss	1	1	3	5	4	20	TREAT-1) Review SIP in relation to published best practice (e.g. UN Principles for responsible investment) 2) Ensure fund managers are encouraged to engage and to follow the requirements of the published SIP. 3) The Fund is now a member of the Local Authority Pension Fund Forum, which raises officer awareness of ESG issues and facilitates engagement with fund managers.	3	15
Financial	18	27	An employer ceases to exist with insufficient funding or adequacy of bond	3	1	1	5	4	20	TOLERATE- 1) Admitted body contribution rates are set at a level that is intended to reflect 100% funding. The terms of admission agreements/bonds provide for regular review of bond adequacy.	3	15
Operational	19	3	Concentration of knowledge in small number of officers and risk of departure of key staff	2	3	2	7	3	21	TREAT-1) 'How to' notes in place. 2) Development of team members & succession planning needs to be improved. 3) Officers and members of the Pension Fund Board will be mindful of the proposed CIPFA Knowledge and Skills Framework when setting objectives and establishing training needs.	2	14
Funding	20	15	Employer bodies transferring out of the pension fund or employer bodies closing to new membership	1	4	1	6	3	18	TOLERATE- 1) Maintain knowledge of employer plans. 2) Impact of any one employer leaving is minimal (other than SCC). 3) Admitted bodies represent approximately 7% of annual contributions paid. 4) Contributions rates and deficit recovery periods reflect the employer covenant.	2	12
Governance	21	18	Change in membership of Pension Fund Board leads to dilution of member knowledge and understanding	4	1	1	6	4	24	TREAT- 1) Succession planning process to be implemented. 2) Ongoing training of Pension Fund Board members. 3) Pension Fund Board new member induction programme. 4) Training to be based on the requirements of CIPFA Knowledge and Skills Framework and the results of the test undertaken in 2012. New Board members to take the test.	2	12
Operational	22	19	Inaccurate information in public domain leads to damage to reputation and loss of confidence	1	1	4	6	3	18	TOLERATE- 1) Ensure that all requests for information (Freedom of Information, Member & Public questions at Council, etc) are managed appropriately and that Part 2 items remain so. 2) Maintain constructive relationships with employing bodies to ensure that news is well managed.	2	12
Operational	23	29	Financial failure of third party supplier results in service impairment and financial loss	2	2	2	6	3	18	TOLERATE-1) Performance of third parties (other than fund managers) monitored. 2) Review of Northern Trust took place in January 2009, ahead of decision on whether to retain (Jan 2009) - a fee reduction was secured in 2011). 3) Actuarial and investment consultancies are provided by two different providers.	2	12
Operational	24	30	Procurement processes may be challenged if seen to be non-compliant with OJEU rules. Unsuccessful fund managers may seek compensation following non compliant process	1	1	4	6	3	18	TOLERATE - Ensure that assessment criteria remains robust and that full feedback is given at all stages of the procurement process.	2	12
Investment	25	12	Asset reallocations in volatile markets may lock in past losses	4	4	3	11	2	22	TREAT- 1) LGIM rebalances the Fund's asset allocation on a monthly basis (within tolerance ranges). 2) Pension Fund Board takes a long term view of strategic asset allocation. 3) Pension Fund Board acts on advice from external parties.	1	11
Governance	26	22	Failure to comply with legislative requirements e.g. SIP/FSS/Governance Policy/FoI	4	1	4	9	2	18	TOLERATE -1) Publication of all documents on external website. 2) Managers expected to comply with SIP and IMA. 3) Pension Board self-assessment to ensure awareness of all relevant documents. 4) Annual audit review.	1	9
Financial	27	23	Inaccurate cash flow forecasts for Treasury Management leads to shortfalls on cash levels & redemptions necessary to ensure that funds available	2	1	1	4	2	8	TOLERATE- 1) Borrowing limits with banks are set at levels that are more than adequate should cash be required at short notice. 2) Cashflow analysis of pension fund undertaken at regular intervals.	2	8
Operational	28	25	Poor specification leads to shortfall against expectations	2	3	3	8	2	16	TOLERATE- 1) Ensure all expectations communicated effectively (e.g. consultant RFP) and that contracts are clear.	1	8
Financial	29	26	Incorrect, failed or late drawdown payments made (& interest accrued)	4	1	2	7	2	14	TOLERATE- 1) Treasury manager receives drawdown notices as soon as received and incorporates into cashflow planning.	1	7
Financial	30	28	Incorrect, failed or late employee/employer contributions payments received	1	4	1	6	2	12	TOLERATE- 1) Monthly monitoring of pensions contributions against expectation. 2) Reminders sent to employers when they fail to meet payment deadline. 3) Scope to report persistent late payment to OPRA.	1	6
Operational	31	31	Unauthorised access to offices leads to theft of intellectual property and confidential information	1	1	4	6	2	12	TOLERATE- 1) Clear desk policy. Ensure all sensitive data is locked away. Challenge any unknown visitors.	1	6
Governance	32	21	Transition from IAG to Pension Fund Board with full committee status creates operational difficulties due to increased membership and remit	2	1	2	5	2	10	TREAT - 1) Terms of Reference for new Board completed. 2) Pension Board new member induction programme. 3) Additional support from Democratic Services.	1	5

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Risk Group	Risk Ref.	Previous	Risk Description	Impact				Likelihood	Total risk score	Mitigation actions
				Fund	Employers	Reputation	Total			
Investment	1	1	Investment markets fail to perform in line with expectations	4	4	4	12	3	36	TREAT-1) The Full actuarial valuation takes place every three years. Moreover, IAS19 data is received annually and provides an early warning of any potential problems. 2) The asset outperformance assumption of 1.6% is achievable over the long term when compared with historical data.
Funding	2	2	Bond yields fall leading to a increase in value of liabilities	4	4	4	12	3	36	TREAT-1) IAS19 data is received annually and provides an early warning of any potential problems. 2) Early consultation with the actuary will take place with regard to the 2013 valuation.
Operational	3	3	Concentration of knowledge in small number of officers and risk of departure of key staff	2	3	3	8	4	32	TREAT-1) 'How to' notes in place. 2) Development of team members & succession planning needs to be improved. 3) Officers and members of the Pension Fund Board will be mindful of the proposed CIPFA Knowledge and Skills Framework when setting objectives and establishing training needs.
Governance	4	4	Changes to LGPS regulations	4	3	1	8	4	32	TREAT-1) Fundamental change to LGPS regulations to be implemented from 1 April 2014. 2) Impact on contributions and cashflows will need to be considered during the 2013 valuation process.
Funding	5	5	Impact of government policy on the employer workforce	3	3	1	7	4	28	TREAT- 1) Hymans Robertson use prudent assumptions on future of workforce. Employers to flag up potential for major bulk transfers. The potential for a significant reduction in the workforce as a result of the pressures that the public sector is under may have an additional impact on the Fund. 2) Need to make worst case assumptions about diminishing workforce when carrying out the actuarial valuation.
Governance	6	6	Failure to take difficult decisions inhibits effective Fund management	3	2	2	7	4	28	TREAT-1) Ensure activity analysis encourages decision making on objective empirical evidence rather than emotion. Ensure that basis of decision making is grounded in ALM Study/SIP/FSS/Governance statement and that appropriate advice is sought.
Funding	7	7	Pay & price inflation is significantly more or less than anticipated	4	4	1	9	3	27	TREAT- 1) Fund employers should monitor own experience. 2) Assumptions made on pay and price inflation (for the purposes of IAS19/FRS17 and actuarial valuations) should be long term assumptions. 3) The fund holds investment in index-linked bonds to mitigate some of the risk.
Investment	8	8	Investment Managers fail to achieve performance targets over the longer term	4	4	4	12	2	24	TREAT- 1) The Investment Management Agreements clearly state SCC's expectations in terms of performance targets. 2) Investment manager performance is reviewed on a quarterly basis. 3) The Pension Fund Board should be positioned to move quickly if it is felt that targets will not be met. 4) Having LGIM as a rebalancing/transition manager facilitates quick changes. 5) The Fund's investment management structure is highly diversified, which lessens the impact of manager risk compared with less diversified structures.
Investment	9	NEW	Inappropriate long-term investment strategy	4	4	4	12	2	24	TREAT- 1) Use of investment consultants to monitor investment strategy. 2) Separate source of advice from Fund's independent advisor. 3) Setting of Fund specfic benchmark relevant to the current position of fund liabilities. 4) Overall asset allocation regularly monitored by Pension Fund Board. 5) Fund manager targets set based on market benchmarks or absolute return measures.
Financial	10	9	The effect of a possible increase in employer contribution rates on service delivery	4	4	4	12	2	24	TREAT- 1) Stabilisation of contribution rates for long term secure employers as laid out in the Funding Strategy Statement. 2) Phasing of contribution increases for other employers. 3) Suitable deficit recovery periods.
Operational	11	10	Insufficient attention to social, ethical & environmental risks leads to reputational damage and/or financial loss	1	1	4	6	4	24	TREAT-1) Review SIP in relation to published best practice (e.g. UN Principles for responsible investment) 2) Ensure fund managers are encouraged to engage and to follow the requirements of the published SIP. 3) The Fund is now a member of the Local Authority Pension Fund Forum, which raises officer awareness of ESG issues and facilitates engagement with fund managers.
Investment	12	11	Asset reallocations in volatile markets may lock in past losses	4	4	3	11	2	22	TREAT- 1) LGIM rebalances the Fund's asset allocation on a monthly basis (within tolerance ranges). 2) Pension Fund Board takes a long term view of strategic asset allocation. 3) Pension Fund Board acts on advice from external parties.
Investment	13	NEW	Fall in equity markets leading to deterioration in funding levels and increased contribution requirements from employers	4	3	3	10	2	20	TREAT: 1) About 40% of fund made up of bonds, property funds, diversified growth funds and private equity, limiting exposure to listed equities. 2) The investment strategy is continously monitored and periodically reviewed to ensure optimal asset allocalltion reflecting the continued belief that in the long-term equities are the best asset class.
Funding	14	12	Pensioners living longer	2	3	1	6	3	18	TREAT- 1) Hymans Robertson use long term longevity projections in the actuarial valuation process. 2) SCC has joined Club Vita, which looks at mortality rates that are employer specific.
Funding	15	13	Employer bodies transferring out of the pension fund or employer bodies closing to new membership	1	4	1	6	3	18	TOLERATE- 1) Maintain knowledge of employer plans. 2) Impact of any one employer leaving is minimal (other than SCC). 3) Admitted bodies represent approximately 7% of annual contributions paid. 4) Contributions rates and deficit recovery periods reflect the employer covenant.
Operational	16	14	Financial failure of a fund manager leads to increase costs and service impairment	2	3	3	8	2	16	TREAT- 1) Fund is reliant upon current adequate contract management activity. 2) Fund is reliant upon alternative suppliers at similar price being found promptly. 3) Fund is reliant on LGIM as transition manager.
Financial	17	15	Counterparty risk within the SCC treasury management operation	2	1	4	7	2	14	TOLERATE - 1) A separate bank account for the pension fund has been in operation since 1 April 2011. Since then the fund has held cash investment separate from SCC. 2) Lending limits with banks are set at levels that are appropriate given credit ratings. 3) The current pension fund treasury strategy is based on that of SCC.
Governance	18	18	Change in membership of Pension Fund Board leads to dilution of member knowledge and understanding	1	1	1	3	4	12	TREAT- 1) Succession planning process to be implemented. 2) Ongoing training of Pension Fund Board members. 3) Pension Fudn Board new member induction programme. 4) Training to be based on the requirements of CIPFA Knowledge and Skills Framework and the results of the test undertaken in 2012. New Board members to take the test.
Operational	19	19	Inaccurate information in public domain leads to damage to reputation and loss of confidence	1	1	4	6	2	12	TOLERATE- 1) Ensure that all requests for information (Freedom of Information, Member & Public questions at Council, etc) are managed appropriately and that Part 2 items remain so. 2) Maintain constructive relationships with employing bodies to ensure that news is well managed.
Financial	20	16	Financial loss of cash investments from fraudulent activity	4	4	4	12	1	12	TOLERATE - 1) Policies & procedures are in place which are regularly reviewed to ensure risk of investment loss is minimised. Governance arrangements are in place in respect of the Pension Fund. External advisors assist in the development of the Investment Strategy. Fund Managers have to provide SAS 70 or similar (statement of internal controls).
Governance	21	NEW	Transition from IAG to Pension Fund Board with full committee status creates operational difficulties due to increased membership and remit	2	1	2	5	2	10	TREAT - 1) Terms of Reference for new Board completed. 2) Pension Board new member induction programme. 3) Additional support from Democratic Services.
Governance	22	19	Failure to comply with legislative requirements e.g. SIP/FSS/Governance Policy/FoI	4	1	4	9	1	9	TOLERATE -1) Publication of all documents on external website. 2) Managers expected to comply with SIP and IMA. 3) Pension Board self-assessment to ensure awareness of all relevant documents. 4) Annual audit review.
Financial	23	21	Inaccurate cash flow forecasts for Treasury Management leads to shortfalls on cash levels & redemptions necessary to ensure that funds available	2	1	1	4	2	8	TOLERATE- 1) Borrowing limits with banks are set at levels that are more than adequate should cash be required at short notice. 2) Cashflow analysis of pension fund undertaken at regular intervals.
Operational	24	23	Poor data quality results in poor information and decision making	2	2	4	8	1	8	TOLERATE 1) Northern Trust provides 3rd party validation of performance and valuation data. 2) Pension Fund team and pension board members are able to integrgate data to ensure accuracy.
Operational	25	24	Poor specification leads to shortfall against expectations	2	3	3	8	1	8	TOLERATE- 1) Ensure all expectations communicated effectively (e.g. consultant RFP) and that contracts are clear.
Financial	26	25	Incorrect, failed or late drawdown payments made (& interest accrued)	4	1	2	7	1	7	TOLERATE- 1) Treasury manager receives drawdown notices as soon as received and incorporates into cashflow planning.
Financial	27	27	An employer ceases to exist with insufficient funding or adequacy of bond	1	1	1	3	2	6	TOLERATE- 1) Admitted body contribution rates are set at a level that is intended to reflect 100% funding. The terms of admission agreements/bonds provide for regular review of bond adequacy.
Financial	28	25	Incorrect, failed or late employee/employer contributions payments received	1	4	1	6	1	6	TOLERATE- 1) Monthly monitoring of pensions contributions against expectation. 2) Reminders sent to employers when they fail to meet payment deadline. 3) Scope to report persistent late payment to OPRA.
Operational	29	29	Financail failure of third party supplier results in service impairment and financial loss	2	2	2	6	1	6	TOLERATE-1) Performance of third parties (other than fund managers) monitored. 2) Review of Northern Trust took place in January 2009, ahead of decision on whether to retain (Jan 2009) - a fee reduction was secured in 2011). 3) Actuarial and investment consultancies are provided by two different providers.
Operational	30	30	Procurement processes may be challenged if seen to be non-compliant with OJEU rules. Unsuccessful fund managers may seek compensation following non compliant process	1	1	4	6	1	6	TOLERATE - Ensure that assessment criteria remains robust and that full feedback is given at all stages of the procurement process.
Operational	31	28	Unauthorised access to offices leads to theft of intellectual property and confidential information	1	1	4	6	1	6	TOLERATE- 1) Clear desk policy. Ensure all sensitive data is locked away. Challenge any unknown visitors.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 NOVEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **REVISED STATEMENT OF INVESTMENT PRINCIPLES**

SUMMARY OF ISSUE:

With the three additions to the private equity portfolio, it is necessary to approve a revised Statement of Investment Principles (SIP).

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1 Approve the revised Statement of Investment Principles shown in Annex 1.

REASON FOR RECOMMENDATIONS:

The Pension Fund Board must approve all working documents produced for the Pension Fund.

DETAILS:

Background

1 In accordance with Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, as an administering authority, the Council must prepare and maintain a written statement of the principles governing its decisions on the investment of the pension. It also has to review the policy from time to time and revise it if considered necessary following such a review, as is recommended here in the light of additions to the Fund's portfolio.

Revised Statement

2 The revised Statement of Investment Principles (SIP) is shown as Annex 1.

Monitoring and Review

3 The SIP is kept under constant review and will be submitted for approval to future Board meetings when any revision is required.

CONSULTATION:

4 The Chairman of the Pension Fund has been consulted on the revised draft and has offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

5 There are no risk related issues contained within the report's proposals.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

6 There are no financial and value for money implications.

CHIEF FINANCE OFFICER COMMENTARY

7 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the proposed SIP offers a clear structure, reflecting the current investment strategies approved by the Pension Fund Board.

LEGAL IMPLICATIONS – MONITORING OFFICER

9

8 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

9 The approval of the SIP will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

10 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

11 The following next steps are planned:

- Adoption of the revised SIP
- SIP is kept under review

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
020 8541 9894
phil.triggs@surreycc.gov.uk

Consulted:
Pension Fund Board Chairman

Annexes:
Revised Statement of Investment Principles

Sources/background papers:
None

Statement of Investment Principles 2013/14

Statement of Investment Principles

1. Overall Responsibility

The County Council is the designated statutory body responsible for administering the Surrey Pension Fund on behalf of the constituent Scheduled and Admitted Bodies. The Council is responsible for setting investment policy, appointing suitable persons to implement that policy and carrying out regular reviews and monitoring of investments. The content of this Statement reflects the County Council's compliance with the requirements of the Myners Review of Institutional Investment, which can be found at Annex 2.

The Local Government Pension Scheme (England and Wales) (Amendment) (No 2) Regulations 2005 came into effect on 14 December 2005. The Regulations provide the statutory framework within which LGPS administering authorities are required to publish a governance policy statement.

A copy of the Surrey Pension Fund's current governance policy statement can be found on the County Council's website. **www.surreypensionfund.org**

Investment policy and associated monitoring and review are delegated to the Surrey Pension Fund Board, which is made up of:

- six nominated members of the County Council;
- two representatives from the Borough/District Councils nominated by the Surrey Local Government Association;
- one representative from the external employers;
- one representative of the members of the Fund.

The Pension Fund Board is advised by a representative of the Fund's professional investment advisor, an independent advisor, the Chief Finance Officer and the Strategic Finance Manager (Pension Fund and Treasury).

The Pension Fund Board meets on a quarterly basis.

2. Investment Objectives

The Pension Fund Board seeks to ensure that the Pension Fund has sufficient assets to be able to meets its long term obligations to pay pensions to the Fund's members, i.e., over the long term to be at or above a 100% funding level. It also has an objective to maintain employer contribution rates as reasonably stable and affordable as possible. In order to meet these objectives, a number of secondary objectives have been agreed:

i) To have a clearly articulated strategy for achieving and maintaining a fully funded position over a suitable long term time horizon; the Board recognises that funding levels can be volatile from year to year depending as they do both on investment market levels and on estimates of liability values, so the long-term strategy needs to be capable of steering a steady course through changing market environments.

ii) To have a strategic asset allocation that is both well diversified and expected to provide long term investment returns in excess of the anticipated rise in the Fund's liabilities.

iii) To appoint managers that the Board believes can consistently achieve the performance objectives set and to give each appointed manager a clearly defined benchmark and performance objective against which they can be judged.

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iv) To ensure investment risk is monitored regularly both in absolute terms (the risk of losing money) and relative to the Fund's liabilities (the risk of funding shortfalls); the Board will have regard to best practice in managing risk.

v) To have sufficient liquid resources available to meet the Fund's ongoing obligations.

vi) To achieve an overall Fund return 1% per annum in excess of the overall benchmark over rolling three-year periods.

3. Investment Style and Management

The Board has delegated day-to-day management of various parts of the Fund to external fund managers each of which has been given an explicit benchmark and performance objective. The Board retains responsibility for ensuring the mix of managers and by implication the overall asset allocation is suitable for the long-term objectives defined above.

The Board has appointed two different types of manager: 'Index Relative' who seek to achieve a return relative to a market index within a specified asset type and 'Absolute Return' who seek to achieve a desired return outcome by moving between different asset types.

Index Relative managers

The managers in this category have been set differing performance targets and will take accordingly differing levels of risk relative to the benchmark index they are given.

Passive mandates seek to replicate the market index as closely as possible and are expected to take very little relative risk. Typically, such portfolios will have the largest number of individual holdings each of which will be close to the index weighting. The expected performance should be within 0.5% of the index return in any year.

Core active mandates seek to achieve a performance between 0.75% per annum and 2% per annum ahead of the relevant market index. Typically, core active mandates have diversified portfolios and take medium levels of relative risk. Most managers will only be appointed to manage a single asset class (for example, global equities, bonds or property).

Concentrated active mandates seek to outperform their relevant index by 3% per annum or more and take larger relative risks by owning a smaller number of individual holdings. The Pension Fund Board usually confines such mandates to specialist managers in regional equities.

Absolute Return managers

The managers in this category are all expected to achieve returns well ahead of cash or inflation in the long-term.

Diversified Growth managers use a very broad range of asset classes and actively vary allocations between asset types depending on investment market conditions. They will also use derivatives from time to time to limit the scope for large falls in value. The expected returns from such mandates will be close to the long term return from equity markets but with much less volatility.

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Absolute return managers also seek to achieve good long term returns with dampened down volatility, but typically they are focused on a particular investment area. The desired outcome is similar to Diversified Growth mandates but with possibly greater variability across mandate types and usually with a much smaller amount invested in each capability.

Fees

The level of fees paid to managers varies greatly according to the complexity of the mandate and the geographic area involved. Fees are usually expressed as a proportion of assets under management. There may also be additional performance related fee charges.

Fees for passive mandates tend to be very low, particularly in developed markets where information is readily available. Fees are higher for mandates that require greater manager skill. Typically a concentrated active mandate will have a higher fee rate than a core active manager and a small absolute return mandate will have a higher fee rate than a larger diversified growth mandate.

Current Manager Structure

The table below shows the current asset allocation and manager structure of the Fund.

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	Category	Allocation Policy %	Fund %	Control Range% +/-
Equities			**63.0**	**+/-3.0**
UK			29.0	
Legal and General	*Passive*	*10.0*		
Majedie	*Concentrated Active*	*7.0*		
Mirabaud	*Concentrated Active*	*4.0*		
UBS	*Core Active*	*8.0*		
Overseas			34.0	
Legal and General	*Passive*	*14.0*		
Marathon	*Concentrated Active*	*12.0*		
Newton	*Core Active*	*8.0*		
Property			**7.0**	**+/-3.0**
CBRE	*Core Active*	7.0		
Alternatives			***10.0***	**+/-3.0**
Standard Life	*Diversified growth*	*6.0*		
Baillie Gifford	*Diversified growth*	*4.0*		
Bonds			**20.0**	**+/-3.0**
Fixed interest gilts			5.25	
Legal and General	*Passive*	*2.5*		
Western	*Core Active*	*2.75*		
Index linked gilts			4.0	
Legal and General	*Passive*	*4.0*		
Corporate bonds			8.0	
Legal and General	*Passive*	*2.5*		
Western	*Core Active*	*5.5*		
Total Return			*2.75*	
Franklin Templeton	*Unconstrained*	*2.75*		
Total			**100.0**	

The Fund also has a commitment to invest up to 5% of the fund in private equity. This allocation is achieved by investing both in fund of funds and direct funds, managed by a number of private equity specialists. The investments are funded through cash flow. The Pension Fund Board reviews the private equity strategy on an annual basis and makes commitments in order to achieve the target commitment level of 5% of the Fund.

Fees paid to managers vary due to the levels of risk taken and the geographic areas in which the manager is invested. Fees are generally expressed as a proportion of assets under management. Performance fees are in place for a number of the Fund's managers. The following table shows the Fund's private equity investments as at 31 March 2013.

9

Name	Currency	Inception	Commitment
UK Funds			**£/€/$**
HG Capital MUST 3	£	2001	2.0
HG Capital MUST 4	£	2002	3.0
HG Capital 5	£	2006	10.0
HG Capital 6	£	2009	10.0
HG Capital 7	£	2013	15.0
ISIS II	£	1999-2002	12.0
ISIS III	£	2003	14.0
ISIS IV	£	2007	15.0
ISIS Growth Fund	£	2013	10.0
Darwin Property Fund	£	2013	20.0
Euro Fund of Funds			
Standard Life ESP II	€	2004	10.0
Standard Life ESP 2006	€	2006	15.0
Standard Life ESP 2008	€	2008	15.0
Standard Life ESF	€	2011	17.5
Standard Life SOF	$	2013	20.0
US Fund of Funds			
Blackrock Div PEP I	$	2001	5.0
Blackrock Div PEP II	$	2003	5.0
Blackrock Div EP III	$	2005	17.5
GSAM PEP 2000	$	2000	10.0
GSAM PEP 2004	$	2004	10.0
GSAM PEP 2005	$	2006	17.0
GSAM PEP X	$	2008	18.0
GSAM PEP XI	$	2011	18.0
GSAM Vintage Fund VI	$	2013	20.0
US Funds			
Capital Dynamics US Solar Fund	$	2011	25.0
Capital Dynamics Energy/Infra	$	2013	25.0

4. Policy on Kinds of Investment

The Pension Fund Board, having regard to funding levels, cash needs and risk tolerance, determines the overall Fund asset mix. The following table shows the strategic asset allocation benchmark for both the managed Fund (i.e. excluding private equity) and the total fund:

9

	Target Allocation exc. Private Equity	Target Allocation inc. Private Equity
Bonds	%	
Gilts	5.25	5.0
Corporate Bonds	8.0	7.6
Index-Linked gilts	4.0	3.8
Unconstrained	2.75	2.6
Property	7.0	6.7
Total Bonds/Property	27.0	25.7
UK Equity	29.0	27.5
Overseas Equity	34.0	32.3
Global	30.0	28.5
Emerging markets	4.0	3.8
Total Equity	63.0	59.8
Diversified Growth	10.0	9.5
Private Equity	n/a	5.0
TOTAL	100.0	100.0

Acceptable asset classes are:

- UK Equities
- UK Fixed Interest
- UK Index Linked Gilts
- UK Property through pooled funds
- Overseas Equities, major classes being:
  - North America
  - Europe
  - Pacific Rim including Japan
  - Emerging Markets
- Global Bonds
- Overseas Index Linked Stocks
- Unquoted Equities via Pooled Funds
- Emerging Market Equities via Pooled Funds, unless specifically authorised
- Direct investment in private equity funds or fund of funds

The use of derivatives and other financial instruments is permitted within pre-agreed limits for specific purposes such as asset allocation switches and currency hedging. Underwriting is permitted provided that the underlying stock is suitable on investment grounds and complies with existing investment criteria. Stock lending is only permitted subject to specific approval.

There are statutory limits on the proportion of the Fund that can be invested in certain types of investment as determined by the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013.

9

5. Investment Performance Targets and Benchmarks

Manager	**Portfolio**	**Benchmark Index**	**Performance Target**
UBS	UK Equities	FTSE All Share	+2.0% p.a. (gross of fees) over rolling 3-year periods
Mirabaud	UK Equities	FTSE All Share	+2.5% p.a. (gross of fees) over rolling 3-year periods
Marathon	Global Equities	MSCI AC World	+2.0% p.a. (gross of fees) over rolling 3-year periods
Majedie	UK Equities – Long Only UK Equities – Directional Long/Short	FTSE All Share FTSE All Share	+2.5% p.a. (gross of fees) over rolling 3-year periods Absolute return focused, but aims to out-perform the FTSE All Share Index by an unspecified amount over the long term
Newton	Global Equities	MSCI AC World	+2.0% p.a. (gross of fees) over rolling 3-year periods
Western	Fixed Income	70.0%: Markit i Boxx £ Non-Gilts ex-BBB All Stocks 30.0%: FTSE A UK Gilts – All Stocks	+0.75% p.a. (gross of fees) over rolling 3-year periods
Franklin Templeton	Unconstrained Global Fixed Income	Barclays Multiverse Index	+4% to 7% p.a. (gross of fees) over rolling 3-year periods
LGIM	Multi-Asset Equities and Bonds	Combination of indices as per agreed mandate	To track the performance of the respective indices within a lower level of tracking deviation (gross of fees) over rolling 3-year periods
CBRE	Property	IPD UK All Balanced Funds	+0.5% p.a. (gross of fees) over rolling 3-year periods
Baillie Gifford	Diversified Growth	UK Base Rate	+3.5% p.a. (net of fees) over rolling 5-year periods
Standard Life	Diversified Growth	6 month LIBOR	+5.0% p.a. (gross of fees) over rolling 5-year periods
Internal	Private Equity	MSCI World Index	+5% p.a. (net of fees) over the life o the contract
Internal	Cash	LIBID 7-day rate	LIBID 7 day rate

The over-riding aim is to run the Pension Fund in accordance within the relevant legislation and subject to the following performance target: “to outperform the Surrey benchmark by 1% per annum over rolling 3-year periods, with a maximum underperformance of -2% in any one year.”

The overall Surrey benchmark is shown below in detail.

9

Type of funds	Level of Risk	Target Return Out-Performance p.a.
Passive (index-tracker)	Low	0 – 0.5%
Core Active	Medium	0.75% - 2.0%
Concentrated Active	High	2.0 - 2.5%
Diversified growth	Medium	3.5% - 5%
Unconstrained	Medium	4% - 7%
Total	Medium	1%

The performance target for the private equity Funds is to outperform returns on quoted UK Equities (FTSE All Share Index) by 2% per annum.

6 Risk Measurement and Management

There are a number of risks to which any investment is exposed. The Pension Fund Board recognises that, whilst increasing risk increases potential returns over a long period, it also increases the risk of a shortfall in returns relative to that required to cover the Fund’s liabilities as well as producing more short term volatility in the funding position.

In addition to targeting an appropriate overall level of investment risk, the Pension Fund Board seeks to spread risks across a range of different sources, believing that diversification limits the impact of any single risk. The Pension Fund Board aims to take on those risks for which a reward, in the form of excess returns, is expected over time.

The following risks are recognised and considered by the Pension Fund Board:

Mismatch risk: the primary risk upon which the Pension Fund Board focuses is the arising of a mismatch between the Fund's assets and its liabilities.

Sponsor Covenant risk: the financial capacity and willingness of the sponsoring employers to support the Fund is a key consideration of the Pension Fund Board and is reviewed on a regular basis.

Diversification risk: the Pension Fund Board recognises the risks that may arise from the lack of diversification of investments. Subject to managing the risk from a mismatch of assets and liabilities, the Pension Fund Board aims to ensure that the asset allocation policy results in an adequately diversified portfolio.

Concentration risk: the Pension Fund Board is also aware of concentration risk which arises, for example, when a high proportion of the Fund's assets are invested in securities, whether debt or equity, of the same or related issuers or in the same or similar industry sectors. The overall investment arrangements are intended to provide an appropriate spread of assets by type and spread of individual securities within each asset class.

Liquidity risk: the Pension Fund Board recognises that there is liquidity risk in holding assets that are not readily marketable and realisable. Given the long term investment horizon, the Pension Fund Board believes that a degree of liquidity risk is acceptable, given the potential return. The majority of the Fund's assets are realisable at short notice. 9

Manager risk: the Fund's assets are invested with a number of managers to provide appropriate diversification.

Regulatory and political risk: across all of the Fund's investments, there is the potential for adverse regulatory or political change. Regulatory risk arises from investing in a market environment where the regulatory regime may change. This may be compounded by political risk in those environments subject to unstable regimes. The Pension Fund Board will attempt to invest in a manner which seeks to minimise the impact of any such regulatory or political change should such a change occur.

Exchange rate risk: this risk arises from unhedged investment overseas. The Fund has a currency hedging policy in place: 50% of its exposure to the US dollar, Euro and Yen.

The documents governing the appointment of each investment manager include a number of guidelines which, among other things, are designed to ensure that only suitable investments are held by the Fund. The Investment Managers are prevented from investing in asset classes outside their mandate without the Pension Fund Board's prior consent.

Arrangements are in place to monitor the Fund's investments to help the Pension Fund Board check that nothing has occurred that would bring into question the continuing suitability of the current investments. To facilitate this, the Pension Fund Board meets with the Investment Managers from time to time, and receives regular reviews from the Investment Managers and its investment advisors.

The safe custody of the Fund's assets is delegated to professional custodians (either directly or via the use of pooled vehicles).

Should there be a material change in the Fund's circumstances, the Pension Fund Board will review whether and to what extent the investment arrangements should be altered; in particular whether the current risk exposure remains appropriate.

7 Policy on Balance Between Different Kinds of Investment

The Council has set target asset allocation ranges for each kind of investment within the overall benchmark. Fund Managers are required to report quarterly their current country, sector or asset allocation positions, whichever is relevant, against their strategy, and to seek approval for variations to their strategies.

8 Policy on Realisation of Investments

9 Fund Managers are required to maintain portfolios that consist of assets that are readily realisable. Any investment within an in-house or pooled fund, which is not readily tradable, requires specific approval.

9 Monitoring and Review

The target funding level is set triennially, consequent upon the actuarial review. The statutory requirement is to move towards 100% funding over a period of time, agreed with the Fund Actuary as the average expected future working lifetime of the scheme membership (20 years).

Investment strategy will be reviewed annually, with a major review taking place no later than every five years. The SIP will also be reviewed annually.

A review of investment management arrangements is carried out at least every three years. Investment management performance is reviewed annually upon receipt of the third party performance information.

The individual manager’s current activity and transactions are presented quarterly in discussion with the Pension Fund Board.

An Annual Meeting is held in November each year and is open to all Fund employers.

10 Stewardship and Responsible Investment

The Council wishes to have an active influence on issues of environmental, social or governance (ESG) concern with companies in which the Pension Fund is a shareholder. It will seek to codify its approach with Fund Managers and will use the services of specialist agencies as necessary to identify issues of concern. The Council requires the Fund Managers to take into account the implications of substantial “extra-financial” considerations, e.g., ESG or reputational issues that could bring a particular investment decision into the public arena.

Whilst the Fund has no specific policy on investing or divesting in stock with regard to ESG issues, in comparing potential investment decisions, and where differences in predicted returns are deemed immaterial, external fund managers could deploy ESG considerations in deciding upon selection.

The Pension Fund also holds expectations of its fund managers to hold companies to account on the highest standards of behaviour and reputational risk management which may damage long term performance, and for those issues to be part of their stock selection criteria.

The Fund wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles. Whilst work is being undertaken to bring the share voting process in-house, managers are delegated authority to exercise the Fund's voting rights, subject to seeking the Council's specific approval in respect of potentially contentious issues and report quarterly on action taken.

The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), a membership group of LGPS funds that campaigns on corporate governance issues, thus demonstrating a commitment to sustainable investment and the promotion of high standards of corporate governance and responsibility.

11 Custody

Managers are required to hold cash and stocks in an account managed by Northern Trust, the Fund's independent global custodian, or by agreement otherwise as appropriate. The Pension Fund aims to hold only a minimum working cash balance. A separate bank account is in place to hold any excess funds held by the administering authority for the purpose of day-to-day cash management of the pension fund.

12 Administration

Funds officers prepare a quarterly report to the Pension Fund Board, preparing the audited annual report and financial statements in line with statutory deadlines, and maintain an up to date record of cash balances at Surrey to ensure surplus cash is invested promptly and resources are available to meet the benefit outflow as it arises.

Annex 1

Myners Investment Principles – Compliance Statement

Principle 1: Effective Decision-making

Administering authorities should ensure that:

- decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and

- those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

9

✓ **Full compliance**

The Pension Fund Board is supported in its decision making role by the Chief Finance Officer and the Pension Fund and Treasury Manager.

Members of the Pension Fund Board participate in regular training delivered through a formal programme. Training is provided at every quarterly meeting.

Principle 2: Clear Objectives

An overall investment objective should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local taxpayers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisors and investment managers.

✓ **Full compliance**

The Fund's overall objectives are defined in the Funding Strategy Statement and are directly linked to the triennial actuarial valuation. The investment objectives are clearly stated in the Statement of Investment Principles.

The content of the Funding Strategy Statement reflects discussions held with individual scheme employers during the actuarial valuation process. Employers understand that contribution rates are set having given consideration to the key tenets of affordability, sustainability and stability but also with the understanding that any decisions made must be prudent. To this end, the strength of the employer covenant is considered when setting contribution rates.

Principle 3: Risk and liabilities

In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities. These include the implications for the local taxpayers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

✓ **Full compliance**

The Fund actuary reviews the funding position of each employer every three years and this valuation includes an assessment of the gap between the employer's share of the Fund assets and the liabilities specific to each employer. The strength of the employer covenant is considered when setting contribution rates.

The Fund's investment strategy is reviewed following each triennial valuation to ensure that the investment strategy will achieve the expected returns assumed during the valuation process.

As a member of Club Vita, a bespoke set of assumptions are specifically tailored to fit the membership profile of the Surrey Fund. The assumptions selected are intended to make an appropriate allowance for future improvements in longevity, based on the actual experience of the Fund.

9

Principle 4: Performance assessment

Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.

Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.

✓ **Full compliance**

Each manager's performance is measured regularly against targets, which are specified in the contract between the Fund and the manager. The Fund's global custodian produces performance data for each manager and for the Fund as a whole. The target outperformance for the Fund as a whole is specified within the Statement of Investment Principles. The Fund performance is also assessed with reference to the local authority peer group.

Performance data is reported to Pension Fund Board on a quarterly basis. Fund managers present to the Pension Fund Board on at least an annual basis and officers have at least one additional meeting per annum to discuss the portfolio composition, strategy and performance.

Consideration has been given to quantitative measures to assess the performance of the Pension Fund Board although options other than measuring meeting attendance are limited.

Principle 5: Responsible ownership

Administering authorities should:

- Adopt, or ensure their investment managers adopt, the Stewardship Code.
- Include a statement of their policy on responsible ownership in the statement of investment principles.
- Report periodically to scheme members on the discharge of such responsibilities.

✓ **Full compliance**

All new investment mandates will be expected to include a statement of a manager's adoption of the Stewardship Code.

The Council wishes to have an active influence on issues of environmental or ethical concern with companies in which the Pension Fund is a shareholder. It will seek to codify its approach with Fund Managers and will use the services of specialist agencies as necessary to identify issues of concern. The Council requires the Fund Managers to take into account the implications of substantial "extra-financial" considerations, e.g., environmental, social or reputational issues that could bring a particular investment decision into the public arena.

The Fund wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles. In addition, the Fund is a member of the Local Authority Pension Fund Forum (LAPFF), thus demonstrating a commitment to sustainable investment and the promotion of high standards of corporate governance and responsibility.

9

Many of the Fund's managers are signed up to the Principles of Responsible Investment (PRI), which provides a framework for investors to consider environmental, social and corporate governance issues when making investment decisions.

On an annual basis, those managers that are not signed up to the Stewardship Code and PRI are required to provide a statement on how far they do comply with the requirements and their reasons for not becoming a signatory.

Principle 6: Transparency and reporting

Administering authorities should:

- Act in a transparent manner, communicating with stakeholders on issues relating to their management of investments, its governance and risks, including performance against stated objectives
- Provide regular communication to scheme members in the form they consider most appropriate

✓ **Full compliance**

The Fund's annual report includes all of the Fund's policies including the governance policy statement, governance policy compliance statement, communications policy statement, Funding Strategy Statement and Statement of Investment Principles. The annual report can be found on the council's website together with standalone versions of each of these documents.

Quarterly reports to the Pension Fund Board on the management of the Fund's investments are publicly available on the council's committee administration website.

Pensions newsletters are sent to Fund members.

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 NOVEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **LGPS: CALL FOR EVIDENCE ON THE FUTURE STRUCTURE OF THE LOCAL GOVERNMENT PENSION SCHEME**

SUMMARY OF ISSUE:

The Department for Communities and Local Government has issued a call for evidence on the future structure of the Local Government Pension Scheme. This paper sets out the document that the Chief Finance Officer submitted on behalf of the Pension Fund Board, in consultation with the Chairman of the Pension Fund Board.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Board note the response.

REASON FOR RECOMMENDATIONS:

The outcome of this process will affect the way in which the Surrey Pension Fund is administered. Therefore, the Pension Fund Board should take a full part in the consultation process.

DETAILS:

Background

1 On 21 June 2013, the Department for Communities and Local Government issued a call for evidence on the future structure of the Local Government Pension Scheme.

2 The document set out high level and secondary objectives for reform. These are:

High level objectives
a) dealing with deficits
b) improving investment returns

Secondary objectives
a) reducing investment fees
b) improving the flexibility of investment strategies
c) providing for greater investment in infrastructure
d) improving the cost effectiveness of administration
e) providing access to higher quality staffing resources
f) providing more in-house investment resource

Surrey's Submission

3 The submission was submitted by the deadline date of 27 September 2013 and receipt was acknowledged by the department. This is included as Annex 1.

Latest Developments

4 The Chairman and officers will report on latest developments at the meeting.

CONSULTATION:

5 The Chairman of the Pension Fund has been consulted on the Call for Evidence and has offered full support for the narrative set out in this report.

RISK MANAGEMENT AND IMPLICATIONS:

6 There are various risk issues contained within the Call for Evidence document and the submission document.

10

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

7 Financial and value for money implications are set out within the submission document.

CHIEF FINANCE OFFICER COMMENTARY

8 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the submission document offered a clear path for the provision of evidence and opinion, reflecting the views of the Pension Fund Board.

LEGAL IMPLICATIONS – MONITORING OFFICER

9 A new future LGPS structure will give rise to various legal implications and legislative requirements, possibly from 2014 onwards.

EQUALITIES AND DIVERSITY

10 The response to the call for evidence will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

11 There are potential implications for council priorities and policy areas that will become clear if a new LGPS structure is proposed.

WHAT HAPPENS NEXT

12 The following next steps are planned:

- Further report to the Board following proposals due to be published before end of 2013.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
020 8541 9894
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Consulted:
Pension Fund Board Chairman

Annexes:
Surrey Pension Fund Response to the Call for Evidence on the Future Structure of the Local Government Pension Scheme 27 September 2013

Sources/background papers:
None

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SURREY
COUNTY COUNCIL

Ms Victoria Edwards
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Pension Fund & Treasury
G40, County Hall
Penrhyn Road
Kingston-upon-Thames
Surrey
KT1 2DN

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27 September 2013

Dear Ms Edwards

LGPS Call For Evidence

Surrey Pension Fund is one of the largest county council funds in England and Wales with almost 79,000 members, over 130 contributing employers and assets with a value of approximately £2.7bn.

The focus of Surrey Pension Fund remains steadfastly on strong governance leading to good investment decision making, above benchmark investment returns over the long term, and a 100% funding level. Surrey is currently held up by many as a national beacon of excellence in governance and we believe there are a number of features that have contributed to our prominence in the Local Government Pension Scheme (LGPS).

1. Governance Arrangements and Strong Chairmanship
The Surrey Pension Board has a membership of ten with strong chairmanship by a member of the Shadow LGPS Advisory Board. The Board has a wide range of experience from diverse backgrounds, including investment management, brokerage and company board membership. Many members of the Board have long service and this experience, together with a training policy, has helped build investment skills and knowledge.

2. Effective Investment and Administration Arrangements
The Surrey Pension Fund currently measures its average investment management fees for a well diversified, risk managed portfolio at 0.26% (26 basis points), markedly less than the LGPS average of 32 bps. The Fund's scale and resultant efficiencies have led to the 2012/13 administration costs being in the lowest quartile of LGPS funds. It has the capacity to buy in competitively priced external expertise, as well as relying on experienced in house staff. Recent decision making has shown the Board, officers and advisors to be swift decision takers and implementers.

3. Focus on Inclusion
Surrey Pension Fund's governance arrangements involve consistent communication with the 12 local authority employers and other employers in decision making through regular meetings and an effective communications policy. This enables long term decisions to be taken through a policy of inclusion and participation. A new website holds all the key current strategies and policies for ease of reference by stakeholders. www.surreypensionfund.org

The Surrey Pension Fund believes that good, long term decision making is the result of excellence in the governance structure, experienced and knowledgeable Board members, and a good team of advisors and officers. The Board aims for excellence via a low cost structure in the quest for the main objective of 100% funding.

Whilst appreciating that an element of restructuring could be appropriate for some of the smaller or less well funded LGPS schemes, this should not apply universally across the country. In cases of poorly managed funds, the introduction of special measures concerning the governance and decision making processes would be more appropriate, instead of a one size fits all solution.

Moreover, whilst responding fully to this call for evidence, the Surrey Pension Fund Board is working hard towards the introduction of the 2014 LGPS Scheme from 1 April 2014, the implementation of the 2013 Actuarial Valuation from the same date, adapting to a sharp growth in the number of employer organisations, changes in the scale of some current employer deficits and a low investment return/ low yield economic backdrop.

Responses to the questions raised in the Call for Evidence are set out below.

10

Q1: How can the LGPS best achieve a high level of accountability to local taxpayers and other interested parties, including through the availability of transparent and comparable data on costs and income, while adapting to become more efficient and to promote stronger investment performance.

A cornerstone of the current LGPS structure is the concept of local accountability and any alternative proposal would need to demonstrate the preservation of this accountability. Various alternative structures could certainly result in the loss of local decision making on matters such as investment risk, asset allocation and deficit recovery plans. Such decisions have a direct impact on local taxpayers and the concept of local accountability could be diluted or even fully eroded.

Democratic supervision is essential in maintaining the link between those who are guarantors of the LGPS, i.e., local authorities and council tax payers. The Surrey Pension Fund supports transparency of information on income, expenditure and investment management performance to enable valid comparisons to be made of each LGPS fund. Funds should be required to publicly publish standardised performance data so that these comparisons can be easily made.

Disclosure of funding levels and deficits using like-for-like assumptions is essential. Funds can currently justify varying actuarial approaches to setting contributions according to their unique liability profiles and the associated investment strategies. However, the existing wide range of actuarial assumptions used in liability calculations certainly cannot be justified.

Q2: Are the high level objectives listed (dealing with deficits and improving investment returns) those we should be focusing on and why? If not, what objectives should be the focus of reform and why? How should success against these objectives be measured?

This is agreed. Achieving a 100% funding level is the most important objective. Improving investment returns is one of the tools to achieve that objective.

Q3: What options for reform would best meet the high level objectives (dealing with deficits and improving investment returns) and why?

Deficits

The various alternative frameworks for fund mergers will have absolutely no effect on funding deficits and could significantly increase the range of funding deficits across the participating employers within a single fund. Permutations will exist amongst employers in a single fund who are regarded as having a strong or weak covenant, being well or poorly funded, and operating on a long or short time horizon. Whatever the eventual framework, deficits will need to be closely managed with additional contributions and above benchmark investment performance from growth assets. Monitoring the individual positions of each employer could become unmanageable if much larger funds are created where each fund could potentially have a thousand plus employers.

Investment returns

For most existing LGPS funds, a common investment strategy will suffice. However, within an alternative larger scale structure, there could be increasing diversity amongst employers due to outsourcing and the resultant better or worse funding levels. Well funded employers may be able to reduce investment risk now, while poorly funded employers may not be able to reduce risk so easily. A single investment strategy will not fit all, and a move to multi-investment strategies will be necessary. The various permutations of risk appetite will require selection of one of a selection of best-fit investment strategies.

10

Diseconomies of scale could emerge with large scale frameworks, especially with the use of external active managers, and a greater use of passive funds could result. Aside from the super fund type structures, a degree of collaboration on investment between funds could enjoy the benefits of reduced market impact and diversified risk, whilst benefitting from lower expense ratios.

There is conflicting evidence with respect to the effect of scheme size on performance in the global pension fund industry. The current larger LGPS schemes generating superior returns have done so through increased allocation to alternative investments at favourably negotiated terms, whilst using internal staff to manage active equity strategies. Asset allocation (active or passive, liquid or illiquid, traditional or alternatives) and the composition and remuneration of the in house investment professionals will be key decisions in new larger structures.

Evidence from other countries suggests that some degree of scale could improve overall net of fees investment performance. However, there is no definitive proof that bigger is better. Indeed, some of the smaller LGPS funds perform extremely well. Moreover, there is also much negative experience associated with large funds overseas. The Surrey Pension Fund would prefer to continue within its existing framework.

Q4: To what extent would the options you have proposed under Q3 meet any or all of the secondary objectives? Are there any other secondary objectives that should be included and why?

Reductions in investment fees

Surrey currently pays a low average fee of less than 26bps which produced an annual out-performance of 4.1% above its benchmark in the year to 30 June 2013. With a history of excellence in external manager selection, Surrey sees no incentive to switch to a mandatory alternative framework.

Collective investment vehicles (without fund merger) could possibly further reduce Surrey's low fees by increasing scale to investment mandates offered to investment managers. Such possible reductions could also arise noticeably when investing in the alternative asset space, as the fees for these asset classes are comparatively high when investing relatively small amounts.

Improving the flexibility of investment strategies

Surrey Pension Fund is in favour of having the option to invest via a collective investment vehicle. Such a vehicle would have the scale necessary to achieve the attractive fees for access to the best investments, but at the same time funds would be free to hire or retain their own investment managers. A collective investment vehicle could also provide access to liability management strategies, such as managing the exposure of liabilities to interest rate or inflation changes. This would provide funds the opportunity to improve the flexibility of investment strategies.

Infrastructure

Infrastructure projects must be relevant to the investment and funding objectives of the fund. LGPS funds can be a valid source of funding for infrastructure projects, but the long term tie up and lack of liquidity must fit in with the fund's liability profile. Alternative LGPS structures,
10 specifically the large super fund, are not necessary to enable investment in infrastructure. The pooling of infrastructure assets in common investment funds will enable access to infrastructure investment at reasonable fee levels.

Cost Effectiveness of Administration

Various initiatives currently exist with regard to reducing administration costs, including various forms of shared services, voluntary mergers of individual fund administration staffing, and funds competitively tendering for the provision of other funds' administration services. The Surrey Pension Fund Administration has recently merged with that of East Sussex with proven economies generated, resulting in lower unit costs. All of these initiatives have not had to rely on any structural change in the way that Funds are currently administered. It could be argued that the cost effectiveness of administration should not be included within the criteria for change necessity.

Higher Quality Staffing Resources

With larger structures, attracting and retaining in house talented investment professionals paid at private sector rates (possibly above local authority chief executive/director level) will prove very challenging, given that the new funds would almost certainly be run by existing LGPS administering authorities.

In House Investment Resources

A collective investment vehicle could employ staff with investment expertise, possibly leading to a degree of replacement of external management and possibly better investment returns and lower costs. As mentioned above, the level of appropriate salaries with a collective investment vehicle competing with the private sector for the same skill set will be an issue.

Q5: What data is required in order to better assess the current position of the LGPS, the individual Scheme fund authorities and the options proposed under this call for evidence? How could such data be best produced, collated and analysed?

There is currently no suggestion that costs arising from a structural change (set up costs for the alternative frameworks and fund transition costs) would be borne by anyone apart from the LGPS funds themselves. Thus, a valid business case for change must be made, with precise and consistent costings for the current and proposed structures. The project cost, benefits and a viable payback period must be demonstrated.

Accurate LGPS cost information is required, especially with regard to administration and investment management costs. Currently, there is a very wide range from lowest to highest unit costs and inaccurate data is considered part of the reason for this discrepancy. Poor and inconsistent costings, especially with regard to the different treatment of pooled fund and fund of funds fees, will continue to cause inaccurate and unfair comparisons to be made between funds.

Yours sincerely

Phil Triggs
Strategic Finance Manager
Pensions and Treasury
Tel: 020 8541 9894

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 NOVEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **ILL HEALTH RETIREMENT INSURANCE**

SUMMARY OF ISSUE:

When a scheme member is retired early due to permanent ill health, the member's accrued pension benefits are paid immediately without reduction and, in the majority of cases, with an enhancement to benefits.

The cost of providing an ill health pension can be substantial and therefore a significant financial risk to fund employers. Legal and General have developed an insurance product to insure against this risk which can be taken out by individual employers or on a whole fund basis. This report seeks approval from the Pension Fund Board to insure against the financial risk of ill health retirements on a whole fund basis.

RECOMMENDATIONS:

It is recommended that:

1. The Pension Fund Board approve the purchase of an annual insurance policy with Legal & General to insure the fund against the cost of ill health retirements, subject to the County Council's Head of Procurement confirming that it is not necessary to formally tender for an insurance provider.

REASON FOR RECOMMENDATIONS:

The costs associated with ill health retirement (IHR) can be substantial and can have serious financial implications for individual employers and potentially for the fund. Insuring against ill health retirement costs will help to manage this risk. The new LGPS coming into effect from April 2014 will increase the pension accrual from a 1/60th to a 1/49th. This will mean that the individual cost of ill health retirements will also therefore increase. Moreover, Legal & General have recently significantly reduced their premium rates from 0.85% to 0.63%. Therefore, it now appears to be an appropriate to time to consider insuring against ill health retirement costs.

Purchasing a policy on a whole fund basis rather than each employer taking out a policy on an individual basis is considered preferable as it will result in lower premiums and easier administration.
The administering authority is also best placed to understand the risks faced by its individual fund employers. Many of the smaller fund employers are likely to have a limited understanding of pension risk. Insuring on a whole fund basis demonstrates a paternal approach to employers by assisting them to reduce the risk of being liable for ill health retirement costs which they may be unable to meet and which could, ultimately, fall on other employers in the fund to meet.

DETAILS:

Background

1 To qualify for IHR benefits, the Local Government Pension Scheme Regulations require that an employer's independent registered medical practitioner (IRMP) certifies that a scheme member is permanently incapable of discharging efficiently the duties of his/her current employment and has a reduced likelihood of undertaking any gainful employment before reaching normal retirement age (NRA), which is currently age 65. If this criterion is satisfied, the member's accrued pension benefits are paid immediately. The duration of payment and level of enhancement depends on the severity of the member's medical condition as follows:

2. **Tier 1**
If the IRMP certifies that the member has no reasonable prospect of being capable of undertaking any gainful employment before his/her NRA, the pension is paid for life and enhanced by adding to the member's existing membership the period between the date of leaving employment and NRA.

Tier 2
If the IRMP certifies that, although the member is not capable of undertaking gainful employment within three years of leaving employment, it is likely that the member will be capable of undertaking any gainful employment before normal retirement age, the pension is paid for life and enhanced by adding to the member's existing membership 25% of the period between the date of leaving employment and NRA.

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Tier 3
If the IRMP certifies that it is likely that the member will be capable of undertaking gainful employment within three years of leaving employment, the pension is not enhanced and only paid for up to three years or, if earlier, until the member obtains gainful employment or reaches NRA.

3. The experience of the fund over the past five years, as indicated in the following table, is that there are far more Tier 1 ill health retirements than tier 2 or tier 3.

	13/14*	12/13	11/12	10/11	09/10	08/09
Tier 1	16	24	35	25	31	23
Tier 2	2	1	4	7	8	11
Tier 3	5	6	4	3	3	5

* Half year results to 30 September

4. Analysis of pension fund data reveals that in individual cases of Tier 1 ill health retirements, costs could be as high as £600,000 amongst some of the fund's admitted bodies, £800,000 amongst academies and up to a £1,000,000 in the case of the county council. These cases are exceptions rather than the rule, but it does highlight the potential risks that one single ill health retirement could bring to an employer. Although the average cost of an ill health retirement across the fund is £89,000, it still represents a substantial increase to any employer's pension liabilities, particularly so for the smaller employers.

The Insurance Policy

5. The insurance policy offered by Legal & General is renewable annually. It has been developed in partnership with Hymans Robertson, the fund's actuary. Hymans will deal with some of the administration associated with managing the policy and will also receive a commission from Legal & General of 5% of the premiums paid. The standard intermediary commission is 10%.

6. The policy is renewable annually and can be used to insure the whole fund or alternatively for individual employers to take out a policy directly with Legal & General. The premium rates are lower if a policy is taken out for the whole fund rather than by individual employers.

7. Hymans conducted a procurement exercise and were satisfied that Legal & General was the only provider of this type of insurance product. Hymans have provided a due diligence report detailing the reasons that they chose Legal & General, which is attached as Annex 1. The rules governing procurement are complex for local authorities and, whilst we are satisfied that Hymans and Legal & General are best placed to provide this arrangement, before contractually committing the county council, advice will be obtained from the Head of Procurement.

8. There are currently two other county council funds that have purchased whole fund insurance and 272 employers from ten other funds that have purchased individual policies with Legal & General.

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9. The policy will provide for reimbursement of the total cost of all tier 1 and tier 2 ill health retirements. This will consist of the cost of paying the accrued benefits earlier than anticipated and the cost of enhancing the members' period of scheme membership as explained in paragraph 2 above. The policy will not cover tier 3 IHR as the cost for these retirements is not considered financially material as they are only paid for a maximum of three years and do not receive any enhancement of benefits.

10. If the policy is purchased on a whole fund basis, then the policy will reimburse the fund directly. If individual employers were to purchase the policy, then each employer will be reimbursed and the fund will then invoice the employer for the IHR cost.

11. The policy also incorporates an Employee Assistance Program (EAP) which is a facility currently already provided by many employers. As this facility is provided free of charge as part of the insurance policy, employers who currently pay for an EAP may be able to save money by using the Legal & General scheme. Also, some employers who were unable to provide such a facility to their employees previously, because they could not afford to do so, will now be able to if they wish.

12. Although an EAP is provided in the policy irrespective of whether the policy is taken out on a whole fund basis or by employers individually, the EAP in the whole fund policy provides more benefits.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

13. The premium payable to Legal & General if the policy was taken out on a whole fund basis would be 0.63% of the pensionable payroll of all the employers contributing to the fund. Based on the pensionable payroll of the whole fund in 2012/2013 of £489m, the resulting premium would have been £3.08m.

14. The following table provides a comparison over the last five years of what premiums would have been paid had the policy been in place compared with the pension strain costs that have actually been incurred.

Financial Year Ending	Total Payroll	Annual Premium @ 0.63%	Total Tier 1 and 2 strain	Strain & Premium Difference	Equivalent premium rate
31/03/2013	£489 m	£3.08 m	£2.30 m	-£0.78 m	0.47%
31/03/2012	£465 m	£2.93 m	£3.79 m	+£0.86 m	0.82%
31/03/2011	£460 m	£2.90 m	£2.98 m	+£0.08 m	0.65%
31/03/2010	£495 m	£3.12 m	£1.38 m	-£1.74 m	0.28%
31/03/2009	£468 m	£2.95 m	£1.72 m	-£1.23 m	0.37%
Total	£2,377 m	£14.98 m	£12.17 m	-£2.81 m	0.51%

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15. Although the premium of 0.63% takes account of the increase in pension accrual from 1/60th to 1/49th from April 2014, the actual pension strain costs quoted in the table do not take account of this increase.

16. If the policy was not taken out on a whole fund basis, but instead employers took out the policy individually, the premiums would be higher at 0.85% of pensionable payroll.

17. Purchasing a policy for the whole fund will not only result in lower premium rates but will also reduce the complexity and cost of administering the policy as Legal & General will only be dealing with one single policy holder rather than potentially up to 133 individual fund employers with separate policies.

18. Fund employers will incur no additional cost if the insurance policy is purchased. The 0.63% premium will be taken from each employer's normal employer pension contribution. This therefore means that slightly less of each employer's pension contribution will be invested. The fund actuary has advised that the resulted reduction in annual investment return would be approximately 0.15%, which will not have a material effect on funding positions.

CONSULTATION:

17 The Chairman of the Pension Fund Board has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

18 The purpose of purchasing the insurance policy is to reduce the risk that employers may have to pay substantial pension costs as a result of their employees being retired on health grounds.

19 The cost of the insurance premium will be met from the employer's pension contribution which otherwise would have been used to earn an investment return. The relatively small loss of investment return is not considered material when weighed against the benefits of having the insurance cover in place.

SECTION 151 OFFICER COMMENTARY

20 The Section 151 Officer (Chief Finance Officer) is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that insuring against ill health retirement costs will help manage and mitigate against the risk materially affecting the assets of fund employers.

LEGAL IMPLICATIONS – MONITORING OFFICER

21 The Head of Procurement will provide advice as to whether or not the County Council can purchase the insurance policy with Legal & General without breaching procurement regulations. 11

EQUALITIES AND DIVERSITY

22 Taking out an insurance policy to meet the cost of ill health retirements will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONNS

23 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT:

24 The following next steps are planned:

- Obtain confirmation from the Head of Procurement that the council would not breach any procurement regulations by taking out the insurance policy with Legal & General.
- Liaise with Legal & General and Hymans to agree an implementation date and confirm administrative process.
- Send a briefing note to all employers.
- Review annually in the light of ill health retirement experience and premium rates offered on renewal.

Contact Officer:
Paul Baker, Pensions Manager, Business Services
020 8541 8057
paul.baker@surreycc.gov.uk

Consulted:
Pension Fund Board Chairman

Annexes:
Annex 1: Hyman's Due Diligence Report

Sources/background papers:
None

11

1 Introduction

The Problem

Following the legislative changes in April 2008 to the rules governing Ill-health Early Retirements (IHERs) for the Local Government Pension Schemes (LGPS), an existing client raised serious concerns over the enhanced benefits for IHERs that was now available to members. In particular, the potential costs for its smaller employers and the effect this could have on the fund if the employer is unable to meet their liabilities. Hymans Robertson met with the client to find a workable solution to the potentially catastrophic effects that IHERs could have on both the employer and the fund.

The first step was to understand the IHER process, achieved by speaking to the client's Humans Resources team at length and, from there, reaching the conclusion that an insurance product could be built around the existing rules and regulations to reduce the impact of that IHER could have. However, at the time there were no suitable insurance products in the market to match the unique benefits in the public sector.

The Solution

Hymans Robertson undertook a review of the insurance market with the aim of co-developing an insurance proposition to meet the significantly enhanced strain costs for an IHER in the LGPS.

This report summarises the process Hymans Robertson underwent when developing the Ill-health Liability Insurance policy. 11

Why Hymans Robertson?

Hymans Robertson currently provides Actuarial and/or Investment advice to around 47 Local Authorities already and is therefore well experienced in delivering an authoritative and respected opinion that will stand public scrutiny.

With a team of dedicated professionals with a wide range of experience between them, Hymans Robertson is ideally placed to undertake a broad analysis of the relevant market to identify the most suitable insurer for this product.

We believe that we offer a unique and innovative approach to our client's problems with a skillset to match.

2 The Insurer Selection Process

In order to find an insurer to partner with us for this unique product, Hymans Robertson undertook a review of the insurance market.

In conducting our review to determine the most appropriate insurance partner to co-develop a suitable product, the following list of criteria was used to select an appropriate provider:

- Competitive and consistent pricing;
- The ability to provide terms to mirror the LGPS IHER regulations;
- A track record for good service, particularly effective and speedy claims handling and a commitment to treating customers fairly;
- A long-term commitment to the group risk market; and

- Financial strength and stability.

After identifying that the only existing products in the market were catered to meet the very different needs of the private sector, the first stage of our review process was to obtain terms for the LGPS from a panel of insurers who we felt to be competitive in the market, who had the capacity to underwrite this type of contract and had a long-term commitment to the market coupled with financial strength and security.

The second stage was to negotiate with the interested providers to improve their terms, ensuring that these would match the terms and conditions of the IHER regulations.

Thirdly, we assessed the policy conditions offered by each provider and, based on the criteria set out below, made our final recommendation.

3 Why Legal & General?

The Decision

After discussions with multiple insurers, Legal & General was and remains the only provider that was able to meet the rules and requirements of IHERs for the LGPS, designing an insurance policy that made a lump-sum, non-
11 rehabilitation payment in the event of a valid tier 1 or tier 2 IHER to mitigate the strain cost (up to the maximum of £4.5 million per person) from an IHER.

Financial Statistics as at 2008

Legal & General Group PLC

- IGD Capital Surplus - £1.8bn.
- Solvency Cover - +169%.

Group Protection

- Legal & General was the third largest provider of Group Protection in 2008 with over 80 years experience and a £300 million annual premium turnover.
- Managing over 7,400 policies with a dedicated business unit.
- Legal & General's market share for Group Life grew from 17% in 2004 to 25% in 2008, placing them as the second largest provider in the market with an annual premium turnover of c£200 million.
- Legal & General was the third largest provider of Group Income Protection in 2008.

Financial Strength Ratings in 2009

Standard & Poor's – AA[1].

Moody's – Aa1[2].

AM Best – A+.

[1] As at 2012, Standard & Poor's rating: Long term – A // Short term – A-1
[2] As at 2012, Moody's rating: Long term – A3 // Short term – P2

Awards

Cover Excellence Award – 2007 Group Critical Illness.

Cover Excellence Award – 2008 Group Critical Illness.

Cover Excellence Award – 2008 Best Service.

Winner of the 2009 Group Life Award.

Winner of the Rehabilitation First 2009 Award.

Authorised and Regulated by:

Financial Conduct Authority.

Claims Management

- A good reputation within the market for good claims handling and high service standards.
- A dedicated claims management team with a proven track record of speedy claims handling.
- Commitment to treating customers fairly.[3]
- In 2008, Legal & General had the following number of claims submitted:
    - Group Life Assurance – 1,796 claims - £141.42 million paid out.
    - Group Income Protection – 529 claims – with a capitalised figure of £31.02 million.

The Two Tiers of Ill-health Benefit:

Tier 1 – is equal to the employee's full expected pension which is the value of their accrued benefits in the LGPS at the point of ill health early retirement PLUS 100% of the employee's potential future accrual to normal retirement date.

Tier 2 – is equal to the value of the employee's accrued benefits in the LGPS at the point of ill health early retirement PLUS 25% of the employee's potential future accrual to normal retirement age.

[3] http://www.legalandgeneralgroup.com/about-us/our-policies/customer-experience-tcf/

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 NOVEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **MANAGER ISSUES AND INVESTMENT PERFORMANCE**

SUMMARY OF ISSUE:

This report is a summary of all manager issues that need to be brought to the attention of the Pension Fund Board, as well as manager investment performance.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1. approve the report and the decisions as laid out;
2. formally approve that the Surrey Pension Fund make a USD 25m commitment to the Global Clean Energy and Infrastructure Fund;
3. formally approve that the Surrey Pension Fund make a £20m commitment to the Darwin Property Fund.

REASON FOR RECOMMENDATIONS:

In order to achieve best possible performance alongside optimal risk.

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DETAILS:

1) Manager Issues during the Quarter

Manager	Issue	Status/Action Required
CBRE	Revised Investment Management Agreement (IMA)	Officers have received a revised IMA following the change to the manager benchmark outperformance requirement. This has been signed and returned.
LGIM	Possible Rebalancing	Members are invited to discuss the question of rebalancing in line asset allocation being outside of the policy control limits. The asset allocation at 30 September 2013 and 31 October 2013 are shown in Annex 1.
Standard Life	Secondary Opportunities Fund	Officers submitted the necessary signed paperwork within the necessary deadlines for the Secondary Opportunities Fund. Confirmation of acceptance by Standard Life has been received by officers.
Capital Dynamics	Clean Energy and Infrastructure Fund	Officers submitted the necessary signed paperwork within the necessary deadlines for the Clean Energy and Infrastructure Fund. Confirmation of acceptance by Capital Dynamics has been received by officers. Formal acceptance by the Board is required and included as part of this report's recommendations.
Darwin	Property Fund	Officers submitted the necessary signed paperwork within the necessary deadlines for the Property Fund. Confirmation of acceptance by Darwin has been received by officers. Formal acceptance by the Board is required and included as part of this report's recommendations.
Majedie	Client meeting	Update included in minutes of external fund manager meetings held on 7 November 2013. Notes to be distributed on day of Board meeting.
Baillie Gifford	Client meeting	Update included in minutes of external fund manager meetings held on 7 November 2013. Notes to be distributed on day of Board meeting.
UBS	Client meeting	Update included in minutes of external fund manager meetings held on 7 November 2013. Notes to be distributed on day of Board meeting.

Western	Client meeting	Update included in minutes of external fund manager meetings held on 7 November 2013. Notes to be distributed on day of Board meeting.
Franklin Templeton	Presentation	Managers will be presenting at the Board meeting on 15 November 2013.
Mirabaud	Presentation	Managers will be presenting at the Board meeting on 15 November 2013.

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2) Freedom of Information Requests

The table below summarises the Freedom of Information request responses provided by the Fund since the last meeting.

Date	Requestor	Organisation	Request	Response
July -13	Company	Investor Data Services	Investment Management Association comparative disclosure tables from March 2000 to June 2013 including manager fees and individual broker names	Limited response from September 2007 to March 2013 with fees and broker names redacted
July-13	Company	Proxy Insight Ltd	Proxy voting records for 2012/13 calendar year	Provided as requested

3) Future Pension Fund Board Meetings/Pension Fund AGM

The schedule of meetings for 2013 and 2014 is as follows:

- 15 Nov 2013: Board meeting hosted at County Hall.
- 22 Nov 2013: Pension Fund Annual Meeting hosted at County Hall.
- 14 Feb 2014: Board meeting hosted at County Hall.
- 23 May 2014: Board meeting hosted at County Hall.
- 19 Sep 2014: Board meeting hosted at County Hall
- 21 Nov 2014: Board meeting hosted at County Hall.

4) Auto Enrolment

Auto enrolment statistics at 31 July 2013 are set out below

LGPS Auto Enrolment Statistics as at 31 July 2013

Number Auto Enrolled	1,795
Number Opted Out	632
Total Remaining in Scheme	1,163
Total Annual Pay	£19.2m
Total Employer Contributions	£3.3m
Total Employee Contributions	£1.1m
Total	£4.4m

The actuary has assessed the auto-enrolment effect on the overall long term cash flow and maturity implications. In summary, it will help cash flow but will not have a significant impact on maturity.

Current net cash flow is around £35m to £40m per annum. This excludes investment income and is simply the difference between income (contributions and transfers in) and expenditure (benefits paid and transfers out). This ignores exceptional events, for example, the Probation transfer.

The contribution income seems to be holding up well and is still increasing by about £3m per annum. However, benefits paid are increasing at a faster rate of around £7m per annum. Broadly, if this trend continues, the Fund will become close to cash flow neutral in around ten years.

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The impact of auto-enrolment is relatively small and would serve to increase this time horizon by around a year or two, allowing for a similar retention from the other councils and employers once their members are also auto-enrolled.

In relation to maturity, this will have little impact in the short term as these members will not have any past service and so the active liability will remain much the same. Over time, these auto-enrolled members will build up some benefits and increase the active liability but this will not be material, i.e., it may add about £5m to £6m of active liability per annum which the actuary regards as relatively insignificant.

5) Stock Lending

Northern Trust (NT) have issued a final contract with regard to the stock lending process. This has been scrutinised by the Fund's advisor and negotiations with NT concluded. The stock lending programme is due to start from 11 November 2013.

Report of the Pension Fund & Treasury Manager

Internally Managed Cash

The internally managed cash balances of the Pension Fund are currently around £3.7m currently financed via a temporary three-month £20m loan at 0.6% interest. It is anticipated that the cash flow positive nature of pensions operations will replenish the Fund's cash position by 31 January 2014.

Private Equity Opportunities

There are no opportunities to report this quarter.

Actuarial Update

The process of data transfer to the Fund's actuary for the triennial actuarial valuation as at 31 March 2013 is now complete. Officers have received an initial actuarial report that assessed the funding level at 31 March 2013 at 72.3%, up from 72.0% at 31 March 2010.

The actuary will make a presentation of his initial findings at the Board meeting on 15 November 2013. The actuary will also attend the Pension Fund Annual Meeting on 22 November 2013.

The Pension Fund and Treasury Manager has been in regular contact with the Surrey Treasurers Association to keep them appraised of progress. A meeting for the Surrey District and Borough Councils was hosted at County Hall on 8 November 2013 with the actuary in attendance.

The Pension Fund and Treasury Manager will officially report on the final actuarial results and report at the Pension Board meeting of 14 February 2014.

Governance Strategies and Policies

All outstanding papers have now been drafted and presented to the Board, apart from the Pensions Administration Service Level Agreement. This will be presented to the Board for the 14 February 2014 meeting. The Pensions Administration Strategy is part of the 15 November 2013 agenda.

Fund Manager Meetings on 7 November 2013

Notes of the fund manager meetings of 7 November 2013 will be distributed on the day of the Board meeting on 15 November 2013.

LGC Fund of the Year

Two submissions for the LGC Awards 2013 under the categories Large Fund of the Year and Corporate Governance have been lodged. The results will be announced on 11 December 2013. Surrey won the LGC Award for Medium Fund of the Year in 2010.

Report of the Pension Fund & Treasury Manager

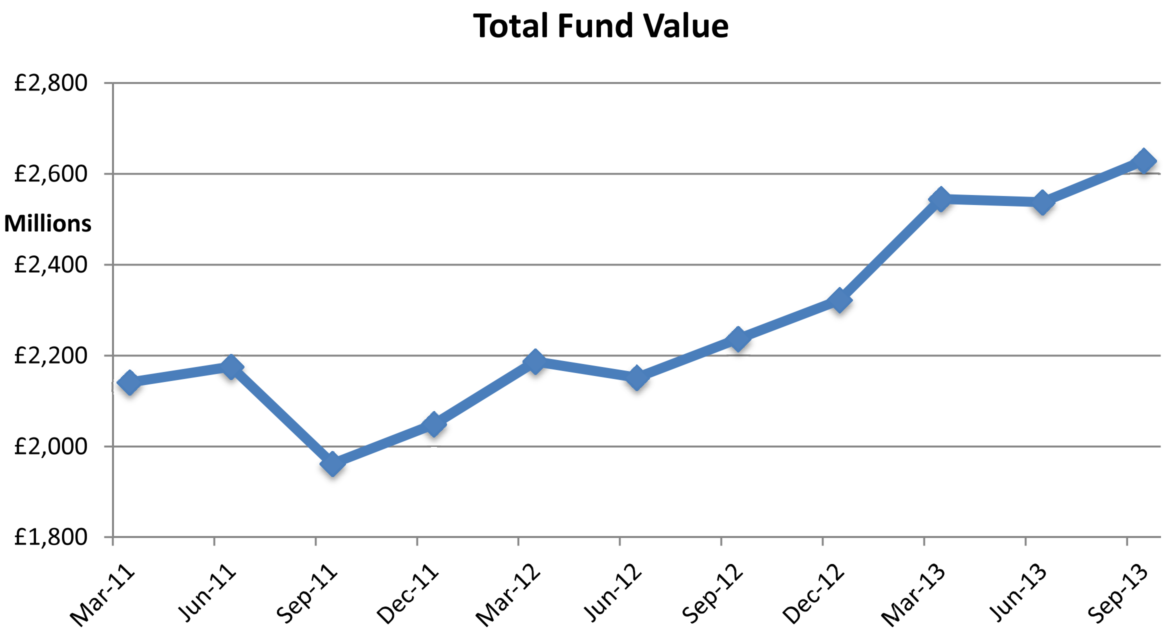
Financial and Performance Report

1. Market Value

The value of the Fund was £2,629.1m at 30 September 2013 compared with £2,537.5m at 30 June 2013. Investment performance was +3.3%

The increase is attributed as follows:

	£m
MARKET VALUE AT 30/06/2013	**2,537.5**
Contributions less benefits and net transfer values	6.6
Investment income received	17.4
Investment expenses paid	-1.6
Market Movements	69.9
Market Value at 30/09/2013	**2,629.1**
Estimated Market Value at 31/10/2013	**2,706.4**



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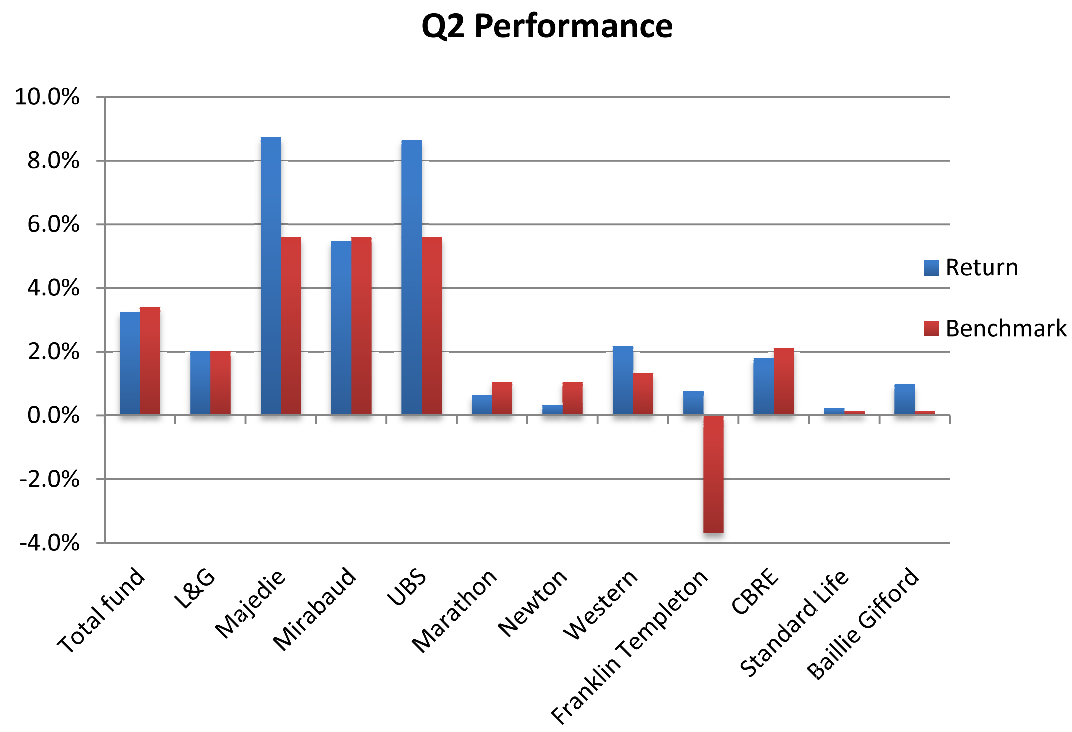
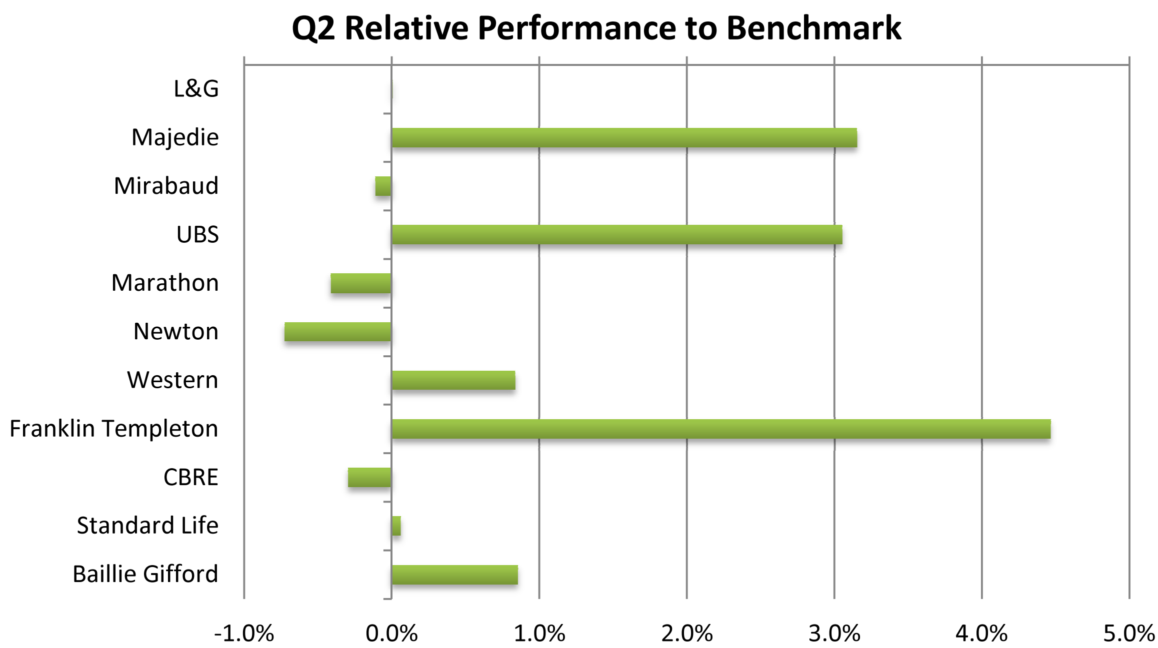
2. Fund Performance

Summary of Quarterly Results

Overall, the total fund returned +3.3% in Q2 2013/14 just below benchmark return of 3.4%





Relative to their specific benchmark, Franklin Templeton secured the highest performance for Q2, alongside continued strong performance by UBS and Majedie, both recording over 3% relative quarterly outperformance.

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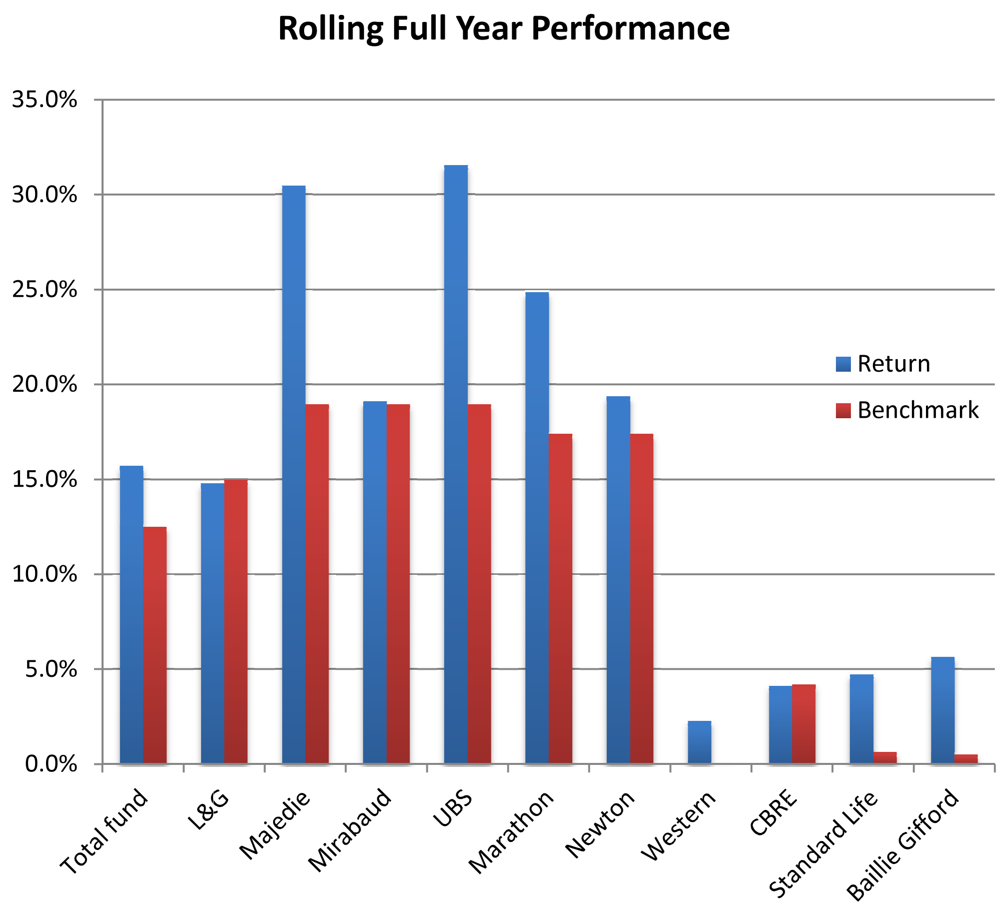
The below table shows manger performance for Q2 against manager specific benchmarks using custodian data.

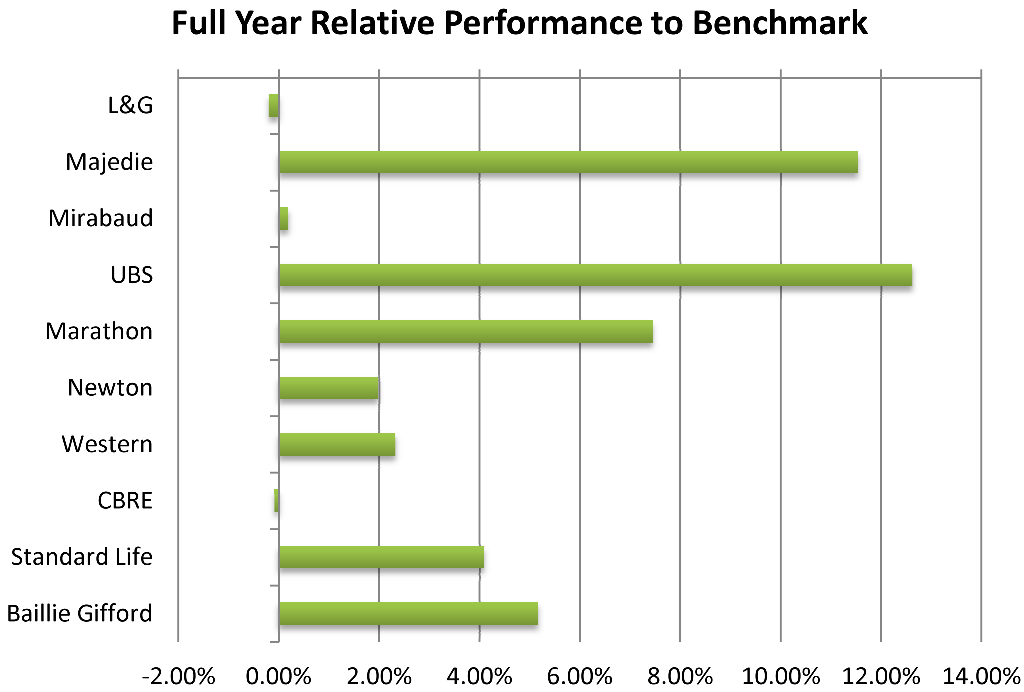
Manager	Performance %	Benchmark %
Total Fund	3.3	3.4
L&G	2.0	2.0
Majedie	8.7	5.6
Mirabaud	5.5	5.6
UBS	8.6	5.6
Marathon	0.6	1.1
Newton	0.3	1.1
Western	2.2	1.3
Franklin Templeton	0.8	-3.7
CBRE	1.8	2.1
Standard Life	0.2	0.1
Baillie Gifford	1.0	0.1

Summary of Full Year Results

Over the past 12 months to 30 September 2013, the Fund returned 15.7% overall surpassing the benchmark return of 12.5%.



Equities provided substantial investment returns over the period with significant above benchmark returns from active UK equity managers UBS and Majedie. Overseas equity through both passive and active management produced strong returns during the previous year.



The below table shows manger performance for the year to 30 September 2013 against manager specific benchmarks using custodian data.

Manager	**Performance %**	**Benchmark %**
Total Fund	15.7	12.5
L&G	14.8	15.0
Majedie	30.5	18.9
Mirabaud	19.1	18.9
UBS	31.5	18.9
Marathon	24.8	17.4
Newton	19.4	17.4
Western	2.3	0.0
CBRE	4.1	4.2
Standard Life	4.7	0.6
Baillie Gifford	5.7	0.5

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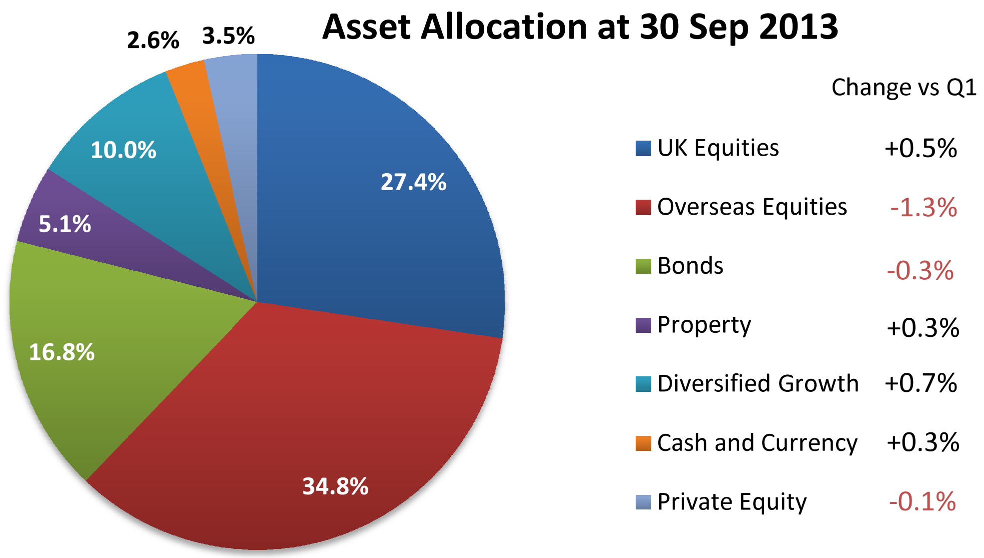
3. Asset Allocation

The graph and table below summarise the asset allocation of the managed elements of the fund, excluding private equity holdings and internally held cash balances.



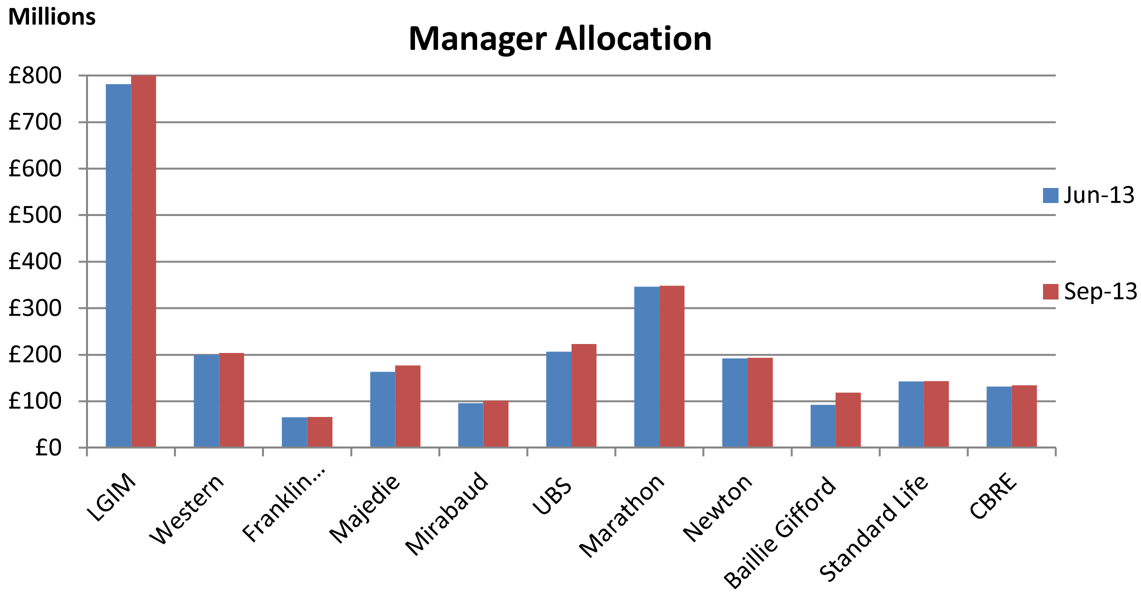
The table below compares the actual asset allocation as at 30 June 2013 against that target asset weightings.

	TOTAL FUND	Actual	Target	Last Quarter	
	£m	**%**	**%**	**£m**	**%**
Fixed Interest					
UK Government	119.1	4.4	5.0	108.3	4.2
UK Non-Government	159.5	6.1	7.6	165.9	6.5
Overseas	0.0	0.0	0.0	4.6	0.2
Total Return	66.4	2.5	2.7	65.9	2.6
Index Linked	96.4	3.7	3.8	90.1	3.6
Equities					
UK	719.2	27.4	27.5	680.7	26.8
Overseas	915.1	34.8	32.3	915.8	36.1
Property Unit Trusts	132.8	5.1	6.6	121.4	4.8
Diversified growth	262.0	10.0	9.5	235.6	9.3
Cash	49.3	1.9	0.0	65.7	2.6
Currency hedge	18.2	0.6	0.0	-7.6	-0.3
Private Equity	91.1	3.5	5.0	91.1	3.6
TOTAL	**2,629.1**	**100.0**	**100.0**	**2,537.5**	**100.0**

This table includes private equity and cash held by investment managers separately.

4. Manager Allocation

The graph below shows the current manager allocation.



The table below includes the actual and target manager allocation weightings for those investments managed through the custodian Northern Trust as at 30 September 2013. This excludes the internal cash and private equity portfolio.

Investment Manager	Asset Class	Market Value £m	Actual Allocation %	Target Allocation %
LGIM	Multi-Asset	817.8	32.3	33.0
Western	Bonds	203.9	8.1	8.25
Franklin Templeton	Bonds	66.4	2.6	2.75
Majedie	UK Equity	177.2	7.0	7.0
Mirabaud	UK Equity	101.6	4.0	4.0
UBS	UK Equity	223.3	8.8	8.0
Marathon	Global Equity	348.2	13.8	12.0
Newton	Global Equity	193.5	7.7	8.0
Baillie Gifford	Diversified Growth	118.8	4.7	4.0
Standard Life	Diversified Growth	143.2	5.7	6.0
CBRE	Property	134.2	5.3	7.0
	Residual Cash	0.9	0.0	0.0
TOTAL		**2,529.0**	**100.0**	**100.0**

5. Fees

The following table shows a breakdown of fees due for Q2 2013/14.

Manager	MV 30/06/13 £m	Fee Q2 £	Annualised Average Fee %
LGIM	817.8	179,692	0.09
Western	203.9	118,340	0.23
Franklin Templeton	66.4	84,444	0.51
Majedie**	177.2	599,917	1.35
Mirabaud*	101.6	152,238	0.59
UBS**	223.3	1,169,261	2.09
Marathon	348.2	334,289	0.47
Newton	193.5	121,641	0.25
Baillie Gifford*	118.8	139,677	0.47
Standard Life*	143.2	251,746	0.70
CBRE*	134.2	66,465	0.20
Total		**3,217,711**	**0.52**

*Estimated
**Includes annual performance fee

CONSULTATION:

6 The Chairman of the Pension Fund Board has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

7 Risk related issues have been discussed and are contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

8 Financial and value for money implications are discussed within the report.

CHIEF FINANCE OFFICER COMMENTARY

9 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

10 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

11 The approval of the various options will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

12 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

13 The following next steps are planned:

- Implementation of the various recommendation approvals.

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Consulted:
Pension Fund Board Chairman

Annexes:
1. Asset Allocation Policy and Actual as at 30 September 2013 and 31 October 2013

Sources/background papers:
None

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Asset Allocation Update

The table shows the actual managed asset allocation as at 30 September 2013 against the target allocation. The allocation for 31 October is shown overleaf.

	Category	Allocation Policy %	Allocation at 30/09/2013*	Variance %
Equities		**63.0**	**66.7**	**+3.7**
UK				
Legal and General	*Passive*	*10.0*	*8.5*	*-1.5*
Majedie	*Concentrated Active*	*7.0*	*7.0*	*0.0*
Mirabaud	*Concentrated Active*	*4.0*	*4.0*	*0.0*
UBS	*Core Active*	*8.0*	*8.8*	*+0.8*
Overseas				
Legal and General	*Passive*	*14.0*	*16.9*	*+2.9*
Marathon	*Concentrated Active*	*12.0*	*13.8*	*+1.8*
Newton	*Core Active*	*8.0*	*7.7*	*-0.3*
Property		**7.0**	**5.4**	**-1.6**
CBRE	*Core Active*	*7.0*	*5.4*	*-1.6*
Alternatives		**10.0**	**10.4**	**+0.4**
Standard Life	*Diversified growth*	*6.0*	*5.7*	*-0.3*
Baillie Gifford	*Diversified growth*	*4.0*	*4.7*	*+0.7*
Bonds		**20.0**	**17.5**	**-2.5**
Fixed interest gilts				
Legal and General	*Passive*	*2.5*	*1.6*	*-0.9*
Western	*Core Active*	*2.75*	*3.3*	*+0.6*
Index linked gilts				
Legal and General	*Passive*	*4.0*	*3.6*	*-0.4*
Western	*Core Active*	*0.0*	*0.0*	*0.0*
Corporate bonds				
Legal and General	*Passive*	*2.5*	*1.8*	*-0.7*
Western	*Core Active*	*5.5*	*4.6*	*-0.9*
Total Return				
Franklin Templeton	*Unconstrained*	*2.75*	*2.6*	*-0.2*
Total		**100.00**	**100.00**	

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Asset Allocation Update

The table shows the actual managed asset allocation as at 31 October 2013 against the target allocation.

	Category	Allocation Policy %	Allocation at 31/10/2013*	Variance %
Equities		**63.0**	**67.1**	**+4.1**
UK				
Legal and General	*Passive*	*10.0*	*8.3*	*-1.7*
Majedie	*Concentrated Active*	*7.0*	*7.2*	*+0.2*
Mirabaud	*Concentrated Active*	*4.0*	*4.1*	*+0.1*
UBS	*Core Active*	*8.0*	*8.9*	*+0.9*
Overseas				
Legal and General	*Passive*	*14.0*	*16.9*	*+2.9*
Marathon	*Concentrated Active*	*12.0*	*13.9*	*+1.9*
Newton	*Core Active*	*8.0*	*7.8*	*-0.2*
Property		**7.0**	**5.2**	**-1.8**
CBRE	*Core Active*	*7.0*	*5.2*	*-1.8*
Alternatives		**10.0**	**10.1**	**+0.1**
Standard Life	*Diversified growth*	*6.0*	*5.5*	*-0.5*
Baillie Gifford	*Diversified growth*	*4.0*	*4.6*	*0.6*
Bonds		**20.0**	**17.6**	**-2.4**
Fixed interest gilts				
Legal and General	*Passive*	*2.5*	*1.6*	*-0.9*
Western	*Core Active*	*2.75*	*3.3*	*+0.6*
Index linked gilts				
Legal and General	*Passive*	*4.0*	*3.6*	*-0.4*
Western	*Core Active*	*0.0*	*0.2*	*+0.2*
Corporate bonds				
Legal and General	*Passive*	*2.5*	*1.8*	*-0.7*
Western	*Core Active*	*5.5*	*4.5*	*-1.0*
Total Return				
Franklin Templeton	*Unconstrained*	*2.75*	*2.6*	*-0.2*
Total		**100.00**	**100.00**	

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