Notice of Meeting

Surrey Pension Fund Board

Date & time	Place	Contact	Chief Executive
Thursday, 15 May 2014 at 9.30 am	Ashcombe Suite, County Hall, Kingston upon Thames, Surrey KT1 2DN	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 Tim Evans, 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 [14 FEBRUARY 2014] (Pages 1 - 10)

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 (*9 May 2014)*.
2. The deadline for public questions is seven days before the meeting (*8 May 2014)*.
3. The deadline for petitions was 14 days before the meeting, and no petitions have been received.

5 ACTION TRACKING (Pages 11 - 14)

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

6 MANAGER ISSUES AND INVESTMENT PERFORMANCE (Pages 15 - 36)

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.

7 PRIVATE EQUITY INVESTMENT PERFORMANCE REVIEW (Pages 37 - 44)

The Surrey Pension Fund has a commitment to invest 5% of the fund in private equity. This is achieved by investing in funds of funds and directly managed funds, managed by a number of private equity specialists.

The Pension Fund Board reviews the private equity strategy annually. This report is the 2013/14 review.

8	**PENSION FUND BUSINESS PLAN 2013/14: OUTTURN REPORT AND FINAL 2014/15 PLAN** The 2001 Myners Report recommended that local authority pension funds approve an annual business plan in respect of the objectives required for the ensuing year. Business planning is regarded as an important tool, assisting in the identification of how service delivery can be maximised within resource constraints. This report sets out the outturn of the annual business plan for 2013/14.	(Pages 45 - 74)
9	**ACTUARIAL VALUATION 2013: OUTCOME** Report setting out the final outcome of the 2013 triennial actuarial valuation in respect of the Surrey County Council Pension Fund.	(Pages 75 - 156)
10	**PENSION FUND RISK REGISTER** 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.	(Pages 157 - 162)
11	**REVISED STATEMENT OF INVESTMENT PRINCIPLES** With adjustments to governance practices within the Pension Fund, it is necessary to approve a revised Statement of Investment Principles (SIP).	(Pages 163 - 178)
12	**KEY PERFORMANCE INDICATORS** 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.	(Pages 179 - 192)
13	**PENSION FUND ADMINISTRATION SERVICE LEVEL AGREEMENT** A service level agreement between the County Council as Administering Authority for the Surrey Pension Fund and the Pensions Administration Team is set out for the Board to approve.	(Pages 193 - 198)
14	**CORPORATE GOVERNANCE SHARE VOTING** With the adoption of a share voting policy by the Pension Fund Board, this	(Pages 199 - 214)

report provides an assessment of the need for change of the existing Responsible Investment and Stewardship policy and a summary of the Fund's share voting process in Q4 2013/14.

15 LGPS REFORM: OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES (Pages 215 - 244)

On 21 June 2013, the Department for Communities and Local Government (DCLG) issued a call for evidence on the future structure of the Local Government Pension Scheme. A document was submitted on behalf of the Pension Fund Board, in consultation with the Chairman of the Pension Fund Board. On 1 May 2014, the Government published a further consultation document, which acknowledges the initiatives put in place by many administering authorities with regard to collaboration and the set up of collective investment vehicles.

16 NATIONAL CHANGES TO THE LGPS (Pages 245 - 252)

On 1 May 2014, a consultation was published by the Government following the Call for Evidence on the future structure of the LGPS, which was launched on 21 June 2013. The document reflects certain initiatives in terms of collaboration by various LGPS administering authorities that have been announced and implemented.

17 INVESTMENT STRATEGY REVIEW (Pages 253 - 306)

Following the actuarial valuation, Mercer has been requested to conduct an investment strategy review of the Surrey Pension Fund.

18 EXCLUSION OF THE PUBLIC

Recommendation: That under Section 100(A) of the Local Government Act 1972, the public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information under the paragraph 3 of Part 1 of Schedule 12A of the Act.

PART 2
IN PRIVATE

19 STANDARD LIFE GFS FUND (GLOBAL FOCUSED STRATEGIES) (Pages 307 - 340)

The Pension Fund Board is invited to consider making an allocation to Standard Life's Global Focused Strategies Fund (GFS), which has recently been launched.

Confidential: Not for publication under Paragraph 3
Information relating to the financial or business affairs of any particular person (including the authority holding that information)

20 PUBLICITY FOR PART TWO ITEMS

To consider whether the item considered under Part 2 of the agenda should be made available to the Press and public.

21 DATE OF NEXT MEETING

The next meeting of the Surrey Pension Fund Board will be on 19 September 2014.

David McNulty
Chief Executive
Published: 7 May 2014

MOBILE TECHNOLOGY AND FILMING – ACCEPTABLE USE

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Thank you for your co-operation

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MINUTES of the meeting of the **SURREY PENSION FUND BOARD** held at 9.30 am on 14 February 2014 at AXA Investment Management UK Ltd, 7 Newgate Street, London, EC1A 7NX.

These minutes are subject to confirmation by the Committee at its meeting on Thursday, 22 May 2014.

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

Ex officio Members:

Mr David Munro, Chairman of the County Council
Mrs Sally Ann B Marks, Vice Chairman of the County Council
Mr David Hodge, Leader of the Council
Mr Peter Martin, Deputy Leader

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
Sheila Little, Chief Finance Officer (Section 151 Officer)
Phil Triggs, Strategic Manager – Pension Fund & Treasury
Steve Turner, Partner, Mercer

1/14 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]

There were no apologies for absence.

2/14 MINUTES OF THE PREVIOUS MEETING: 15 NOVEMBER 2013 [Item 2]

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

3/14 DECLARATIONS OF INTEREST [Item 3]

Judith Glover declared a personal interest as she was in correspondence with CBRE on a property in her ward.

4/14 QUESTIONS AND PETITIONS [Item 4]

There were none.

5/14 ACTION TRACKER [Item 5]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. Many of the actions from previous meetings would be addressed at the current meeting.

Actions/Further Information to be Provided:
None.

Resolved:
That the actions tracker was noted and the committee agreed to remove page 22 of the tracker as the actions would be completed during the current meeting.

Next Steps:
None.

6/14 MANAGER ISSUES AND INVESTMENT PERFORMANCE [Item 6]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager – Pension Fund & Treasury introduced the report. He informed the Board that a full report on the P750 Fund would be brought to the Board at its May meeting **(Action Review ref: A1/14)**.
2. The Board considered the Freedom of Information (FOI) requests during the last quarter. There was a query whether all FOI responses were published on the Council's website. The Regulatory Committee Manager was asked to find out and report back **(Action Review ref: A2/14)**.

3. Officers confirmed that the dates listed for the November Board meeting and the AGM in the papers were correct. A number of Members stated that they were unable to make the meeting on 23 May and it was agreed to look for a different date **(Action Review ref: A3/14)**.

Ian Perkin joined the meeting.

4. The Strategic Manager – Pension Fund & Treasury informed the Board that he was working with Manifest to develop a summary report on share voting. This would categorise votes and include information on the more interesting votes. A first report would be provided to the next Board meeting **(Action Review ref: A4/14)**.
5. The Board debated the proposal to insure against ill health retirements and the options available for doing this, including self-insurance. The Board considered issues such as: the benefits of externalising the risk of ill health retirements; the additional complex administration to notionally separate and invest the assets ring fenced if the Fund was to self-insure; size of the risk to the Fund as a whole and the paternalistic remit of the Fund to smaller employers; requirement on the Board to mitigate risks. The Board took a vote and agreed to support recommendation 2 on the report.
6. Members queried how much Surrey County Council charges for loans and the Strategic Manager – Pension Fund & Treasury agreed to check and report back to the Board **(Action Review ref: A5/14)**.
7. The Strategic Manager noted that on page 40 of the Board papers, column 4 should be headed “Allocation at 31/1/2014”.

Actions/Further Information to be Provided:

i. A full report on the P750 Fund to be brought to the Board at its May meeting.
ii. Regulatory Committee Manager to find out if all FOI responses are published on the Council’s website and report back.
iii. To reschedule the meeting currently set for 23 May 2014.
iv. A first summary report on share voting to be brought to the next meeting of the Board.
v. The Strategic Manager – Pension Fund & Treasury agreed to check how much Surrey County Council charges for loans and report back to the Board.

Resolved:

i. That the report be **APPROVED**;
ii. That the purchase of an annual insurance policy with Legal & General to insure the fund against the cost of ill health retirements be **APPROVED**, subject to the County Council’s Head of Procurement confirming that it is not necessary to formally tender for an insurance provider.

Next Steps:

None.

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7/14 ACTUARIAL VALUATION 2013: OUTCOME [Item 7]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Chairman updated the Board by informing them that the Surrey Pension Fund Advisor had stated that as of 13 February 2014, the Surrey County Council Pension Fund had a funding level of 81%.
2. The Strategic Manager – Pension Fund & Treasury informed the Board that the Funding Strategy Statement would be circulated to employer organisations for feedback and a final version would be brought to the next meeting of the Board (Action Review ref: A6/14).
3. Members of the Board thanked officers for the good communications and reassurance to smaller employers and Borough/District Councils during the actuarial process.

Actions/Further Information to be Provided:

i. The final version of the Funding Strategy Statement to be brought to the next meeting of the Board.

Resolved:
That the report was **NOTED** and the 2013 actuarial valuation was **ADOPTED**.

Next Steps:
None.

8/14 PENSION FUND RISK REGISTER [Item 8]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager – Pension Fund and Treasury introduced the report, highlighting the newly identified risks and the additional columns which provides a revised likelihood once mitigating actions have been taken and a net risk score.

Actions/Further Information to be Provided:
None.

Resolved:
That the Risk Register be **NOTED**.

Next Steps:
None.

9/14 PENSION FUND BUSINESS PLAN 2014/15 [Item 9]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager – Pension Fund & Treasury introduced the report.
2. In response to a query, the Pensions Manager informed the Board that the final regulations on the revised Local Government Pension Scheme had not yet been published. However, a communications programme had been implemented with employers and Fund members.
3. Members suggested that the description of Action 5 under the heading "Communication" be amended to remove the word "positive".
4. Members praised the simple design of the Business Plan.

Actions/Further Information to be Provided:
None.

Resolved:
That, subject to the amendments discussed at the meeting, the Board **ADOPT** the Business Plan in respect of the 2014/15 financial year attached as Annex 1 to the report.

Next Steps:

i. Progress monitoring will take place and, if necessary, matters will be discussed at future Board meetings.
ii. Outturn report of the 2014/15 financial year to be presented at the first meeting of the Pension Fund Board in 2015/16.

10/14 REVISED STATEMENT OF INVESTMENT PRINCIPLES [Item 10]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Strategic Manager – Pension Fund & Treasury introduced the report and highlighted the cosmetic changes to the Statement of Investment Principles. He also noted that the "Commitment" column on page 159 of the papers refers to millions and that this would be amended to make it clear.

Actions/Further Information to be Provided:
None.

Resolved:
That the revised Statement of Investment Principles be **APPROVED**.

Next Steps:
None.

11/14 KEY PERFORMANCE INDICATORS [Item 11]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Pensions Manager introduced the report. He informed the Board that the data pending for the overall satisfaction score of employers had now come in and was 92%. This was a good result and above the set target of 80%. It was suggested that it was a particularly good score given the current environment as employers tend to confuse actuarial valuations with pensions administration.
2. The Chairman informed the Board that she had requested that the red downwards arrow against the indicator for investment returns is removed. The red arrow is misleading as the Fund had done very well in the past quarter and had only done a little less well than the previous quarter. The Fund was still achieving well over the benchmark.

Actions/Further Information to be Provided:
None.

Resolved:
That the KPI statement format be **APPROVED**.

Next Steps:
None.

12/14 REVIEW OF PENSION ABATEMENT POLICY [Item 12]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Pensions Manager introduced the report.
2. Members asked whether there were any equality issues with regard to requiring medical clearance before permitting the purchase of an additional pension. Officers responded that if a person has a life-threatening illness, it wouldn't make sense for it to be an equalities issue. The Board was also informed by the Pensions Manager that every Pension Fund he had worked for has required medical clearance before scheme members could purchase additional years/pension. The Pensions Manager informed the Board that it cost the scheme member £40 to undertake the medical check.
3. Officers clarified that recommendation 2 was not affected by the decision under item 6 to take out insurance against ill health retirements.

Actions/Further Information to be Provided:
None.

Resolved:

i. That a policy that continues with the existing practice of not abating the pension of a scheme member that is re-employed by a local government pension scheme employer be **ADOPTED**.
ii. That a policy that continues with the existing practice requiring a scheme member to receive medical clearance before being permitted to purchase an additional pension be **ADOPTED**.

Next Steps:
A further report will be submitted on the outcome of consultation with scheme employers to the next meeting of the Board.

13/14 PENSION FUND ADMINISTRATION STRATEGY [Item 13]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Pensions Manager introduced the report and highlighted the amendments made to the Pension Fund Administration Strategy following consultation with scheme employers.

Actions/Further Information to be Provided:
None.

Resolved:
That the Pension Fund Administration Strategy be **APPROVED**.

Next Steps:
None.

The Board adjourned at 10.55am for training and presentations. It reconvened at 2.06pm. Nick Skellett, Paul Baker and Sheila Little gave their apologies for the afternoon session.

14/14 INVESTMENT STRATEGY REVIEW [Item 14]

Declarations of Interest:
None.

Key Points Raised During the Discussion:

1. The Mercer representatives outlined the conclusions of its investment strategy review of the Surrey Pension Fund. It was explained that 5000 simulated projections of the future funding position had been undertaken with the use of a number of changing variables. This had created the funnel chart on page 8 of the annex. The simulations suggest that the funding position would reach 100% in 2021. However, it is accepted that assumptions will not necessarily bear out and so a deficit risk has been calculated. The Mercer representatives highlighted that the Pension Board and Officers needed to carefully consider the extent to which a deficit risk was tolerable and suggested ways in which it would be possible to (1) further diversify the Fund's sources of return and (2) better manage any deficit risk. The analysis represented showed the expected benefits of addressing these issues in combination. Simply diversifying the sources of return has minimal impact on reducing deficit risk.

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2. The Mercer representatives proposed that an investment strategy for once the Fund is 100% funded should be considered sooner rather than later as it would take one to two years for a new Strategy to be fully implemented. This would provide a "target" investment strategy for the future and provide a clear framework for helping to decide what changes to the current investment strategy should be made over time.

Mike Goodman left the meeting at 2.50pm.

3. The Mercer representatives explained that the potential target return from the revised strategy appeared low but that a high return would not be required if the Scheme was 100% funded. Members pointed out that the Scheme still needed to honour future liabilities. The Mercer representatives assured the Board that the Strategy would still be designed to have an expected return that supported that Actuarial funding assumptions so would continue to help maintain the affordability of financially supporting the Fund. They also suggested that the Fund should be less concerned about the level of real interest rates it locked into once it is 100% funded, if it was agreed to introduce improved risk management techniques to help better manage deficit risk.
4. The Mercer representatives stressed that there were many opportunities for long-term investors such as the LGPS to tap into.
5. A Member raised a concern about risks associated with infrastructure debt and derivatives. The Mercer representatives assured Members that large, established investment management firms had solid experience with these types of assets. The Chairman also responded that the Pension Fund Board did not know how to trade these assets (this would be delegated to an investment manager) but just needed to understand what they are.
6. The Mercer representatives reiterated that they were not recommending a big bang approach to changing the investment strategy but that any agreed change should be undertaken in stages.

Stuart Selleck left the meeting at 3.15pm.

7. The Chairman suggested that training on leveraged gilts and synthetic equities be given at the next meeting of the Board (**Action Review ref: A7/14**).

Actions/Further Information to be Provided:
None.

Resolved:

a. That a further report on the Investment Strategy Review be brought to the next meeting of the Pension Board for consideration (**Action Review ref: A8/14**);
b. That training on leveraged gilts and synthetic equities be provided at the next meeting of the Board.

Next Steps:
None.

15/14 DATE OF NEXT MEETING [Item 15]

The date of the next meeting would be rescheduled and the Members updated.

Meeting ended at: 3:20pm

Chairman

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Surrey Pension Fund Board – ACTION TRACKING

ACTIONS

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A5/14	14 Feb 14	Manager Issues and Investment Performance	The Strategic Manager – Pension Fund & Treasury agreed to check how much Surrey County Council charges for loans and report back to the Board.	Strategic Manager, Pension Fund & Treasury	The Strategic Manager – Pension Fund & Treasury to report back on 15 May 2014.

COMPLETED ACTIONS

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A1/13	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	On the agenda for 15 May 2014.
A2/13	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 was on the agenda for the meeting on 15 November 2013. A revised Pension Fund Administration Strategy is on the agenda for 14 February 2014. The Pensions Administrations Service Level Agreement is on the agenda for the meeting on 15 May 2014.
A1/14	14 Feb 14	Manager Issues and Investment Performance	A full report on the P750 Fund to be brought to the Board at its May meeting.	Strategic Manager, Pension Fund & Treasury	On the agenda for 15 May 2014.

Surrey Pension Fund Board – ACTION TRACKING

A2/14	14 Feb 14	Manager Issues and Investment Performance	Regulatory Committee Manager to find out if all FOI responses are published on the Council's website and report back.	Regulatory Committee Manager	The Council's Freedom of Information Officer gave the following response: "No we do not currently publish the responses although we are considering this as a possibility at some stage in the future. However, some responses are published if the request had been made via the whatdotheyknow.com website which publishes automatically both the request made and the response given. We do circulate details of all requests received to Cabinet Members and supply them with copies of responses if required. Many of the requests are specific to and only relevant to the requester and would not necessarily be of interest or use to others. I am aware that Services do consider the subject matter of requests and pro-actively publish information on the website as a result. To give some idea of the work that might be involved in setting up and administering a disclosure log of requests, we can confirm that for the first three months of this year we received over 200 requests per month. However, we do not receive many requests for the Surrey Pension Fund - most relate to our investments eg whether we invest in tobacco industries".
A3/14	14 Feb 14	Manager Issues and Investment Performance	To reschedule the meeting currently set for 23 May 2014.	Regulatory Committee Manager	This was rescheduled to 15 May 2014.
A4/14	14 Feb 14	Manager Issues and Investment Performance	A first summary report on share voting to be brought to the next meeting of the Board.	Strategic Manager, Pension Fund & Treasury	On the agenda for 15 May 2014.

Surrey Pension Fund Board – ACTION TRACKING

A6/14	14 Feb 14	Actuarial Valuation 2013: Outcome	The final version of the Funding Strategy Statement to be brought to the next meeting of the Board.	Strategic Manager, Pension Fund & Treasury	On the agenda for 15 May 2014.
A7/14	14 Feb 14	Investment Strategy Review	Training on leveraged gilts and synthetic equities to be provided at the next meeting of the Board.	Mercer	This will be covered on 15 May 2014.
A8/14	14 Feb 14	Investment Strategy Review	A further report on the Investment Strategy Review to be brought to the next meeting of the Pension Board for consideration.	Strategic Manager, Pension Fund & Treasury	On the agenda for 15 May 2014.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

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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. give consideration to the question of rebalancing, with the asset allocation being outside of the Fund's policy control limits; and
3. give consideration to making a USD 20m commitment to the Standard Life Secondary Opportunities Fund II (SOF II).

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
LGIM	Possible Rebalancing	Members are invited to discuss the question of rebalancing, with the asset allocation being outside of the Fund's policy control limits. The asset allocations at 31 March 2014 and 29 April 2014 are shown in Annex 1. The Fund's independent advisor has recommended that special attention be given to this question at the Board meeting.
Standard Life	P750 Fund SOF II Fund	Members are invited to give consideration to the Standard Life P750 Fund. This is the subject of a report within the agenda. A proposal for Standard Life's Secondary Opportunities Fund II (SOF II) is also set out within this report.
Baillie Gifford	Client meeting	Update included in minutes of external fund manager meetings held on 22 April 2014.
UBS	Client meeting	Update included in minutes of external fund manager meetings held on 22 April 2014.
Franklin Templeton	Client meeting	Update included in minutes of external fund manager meetings held on 22 April 2014.
Majedie	Client meeting	Update included in minutes of external fund manager meetings held on 22 April 2014.

2) Freedom of Information Requests

The table below summarises the Freedom of Information request responses provided by the Fund during the last quarter.

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Date	Requestor	Organisation	Request	Response
January	Individual	n/a	Full breakdown of all individual investments within every asset class.	Provided full response as at 31/12/13 on 20/01/14.

3) Future Pension Fund Board Meetings/Pension Fund AGM

The schedule of meetings for 2014 is as follows:

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

4) Stock Lending

In the quarter to 31 March 2014, stock lending earned a net income for the Fund of £54,258.

5) Share Voting

The Strategic Manager will present a report at the Board meeting.

6) Ill Health Insurance

At the Board meeting on 14 February 2014, it was agreed that an ill health insurance policy with Legal & General would be taken out in order to insure the fund and scheme employers against the cost of ill health retirement benefits. This agreement was subject to receiving confirmation from the County's Head of Procurement that it was not necessary to formally tender for an insurance provider as it was understood that Legal & General was the only provider of this type of insurance product.

Discussions with procurement and legal colleagues are ongoing with a view to securing a way forward that does not breach EU procurement regulations. Preliminary advice received is that the administering authority could publish a VEAT (voluntary ex ante transparency) notice for ten days, advising that it is the intention for the administering authority to enter into a contract with Legal & General. If there is a credible alternative provider, there would be 30 days in which to challenge the intention to contract with Legal & General without first tendering.

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Report of the Pension Fund & Treasury Manager

Internally Managed Cash

The internally managed cash balance of the Pension Fund was £0.3m as at 31 March 2014. The fund borrowed £4.5m from Surrey County Council at a rate of 0.58% on the 27 of March which was repaid on 7 April 2014.

Private Equity Opportunities

Standard Life Capital Partners is raising SL Capital Secondary Opportunities Fund II (SOF II), which will concentrate on secondary opportunities in small-cap or mid-market funds in Europe and North America. All interests targeted by the Fund will be at least 40% funded thereby ensuring good visibility on the underlying portfolio quality. The Fund target size is USD 200m, target return is 20% IRR and the management fee is 40 bps on net asset value (NAV). The Board approved a USD 20m stake in the original SOF Fund on 20 September 2013.

It is recommended that the Surrey Pension Fund give consideration to making a USD 20m commitment to the Standard Life Secondary Opportunities Fund II (SOF II).

Actuarial Update

The triennial actuarial valuation as at 31 March 2013 is now complete. Officers have received a final actuarial report that assessed the funding level at 31 March 2013 at 72.3%, up from 72.0% at 31 March 2010. The actuary report and rates & adjustment certificate is included in a separate report included on the Board meeting agenda.

Governance Strategies and Policies

All outstanding papers have now been drafted and presented to the Board, including the Pensions Administration Service Level Agreement and Share Voting Reporting Framework, both of which are included as part of this meeting's agenda.

The list of strategies, policies and reporting frameworks approved by the Board since its first meeting on 31 May 2013 are as follows:

1. Business Plan Reporting Framework
2. Communication Policy Statement
3. Funding Strategy Statement
4. Governance Compliance Statement
5. Governance Policy Statement
6. Investment Performance Reporting Framework
7. Key Performance Indicator Reporting Framework
8. Knowledge and Skills Framework
9. Pension Abatement Policy
10. Pension Fund Administration Policy
11. Pension Fund Service Level Agreement (subject to approval on 15/5/14)
12. Private Equity Reporting Framework
13. Responsible Investment and Stewardship Policy
14. Risk Register Reporting Framework
15. Share Voting Reporting Framework (subject to approval on 15/5/14)
16. Statement of Investment Principles
17. Stewardship Code
18. Stock Lending Policy

Fund Manager Meetings on 22 April 2014

Notes of the fund manager meetings of 22 April 2014 are included as Annex 2.

6

Report of the Pension Fund & Treasury Manager

Financial and Performance Report

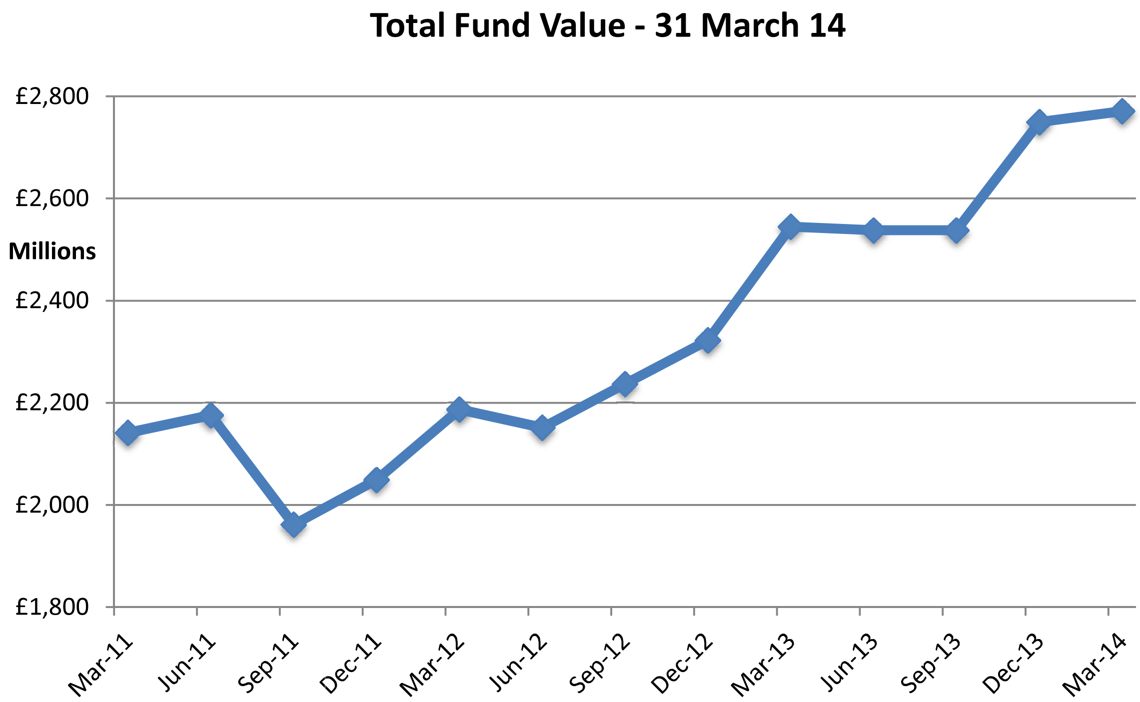
1. Market Value

The value of the Fund was £2,771.1m at 31 March 2014 compared with £2,749.5m at 31 December 2013. Investment performance for the period was +1.0%.

The increase is attributed as follows:

	£m
Market Value at 31/12/2013	**2,749.5**
Contributions less benefits and net transfer values	8.8
Investment income received	10.2
Investment expenses paid	-6.0*
Market movements	8.6
Market Value at 31/03/2014	**2,771.1**
Market Value at 29/04/2014 (estimated)	**2,786.4**

**Includes a significant proportion of manager fees for the previous quarter as well as Q4 fees. The full value of Q4 fees is shown in section 5.*



2. Fund Performance

Summary of Quarterly Results

Overall, the total fund returned +1.0% in Q4 2013/14 just below the SCC customised benchmark of 1.1%.

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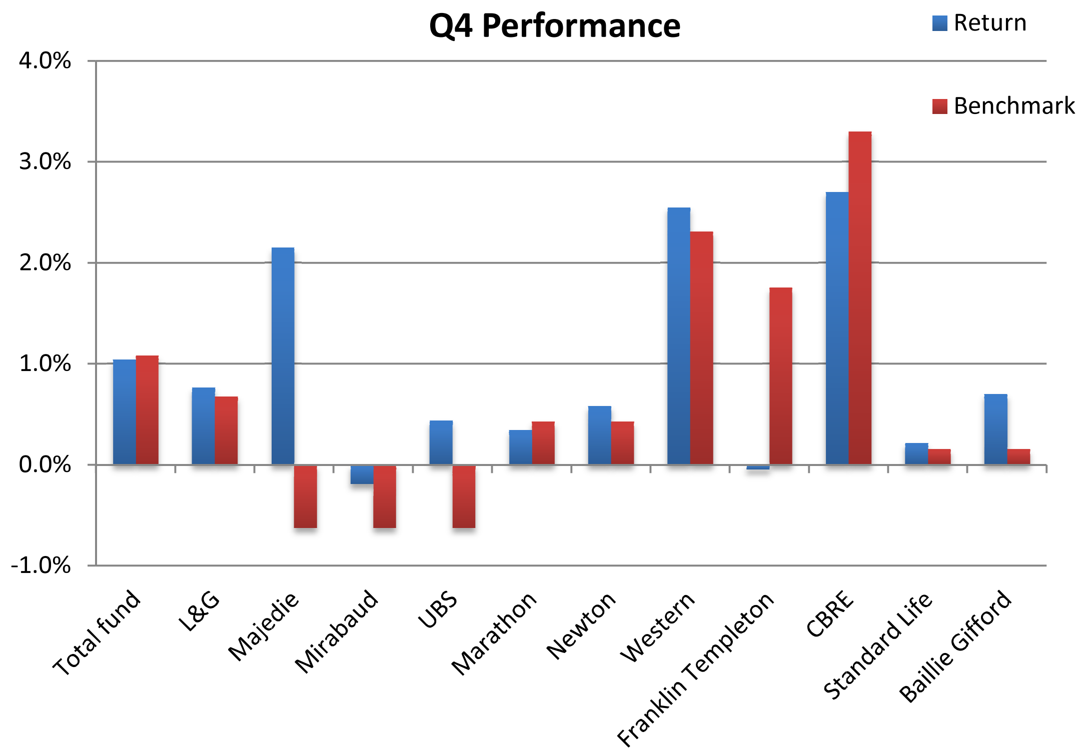
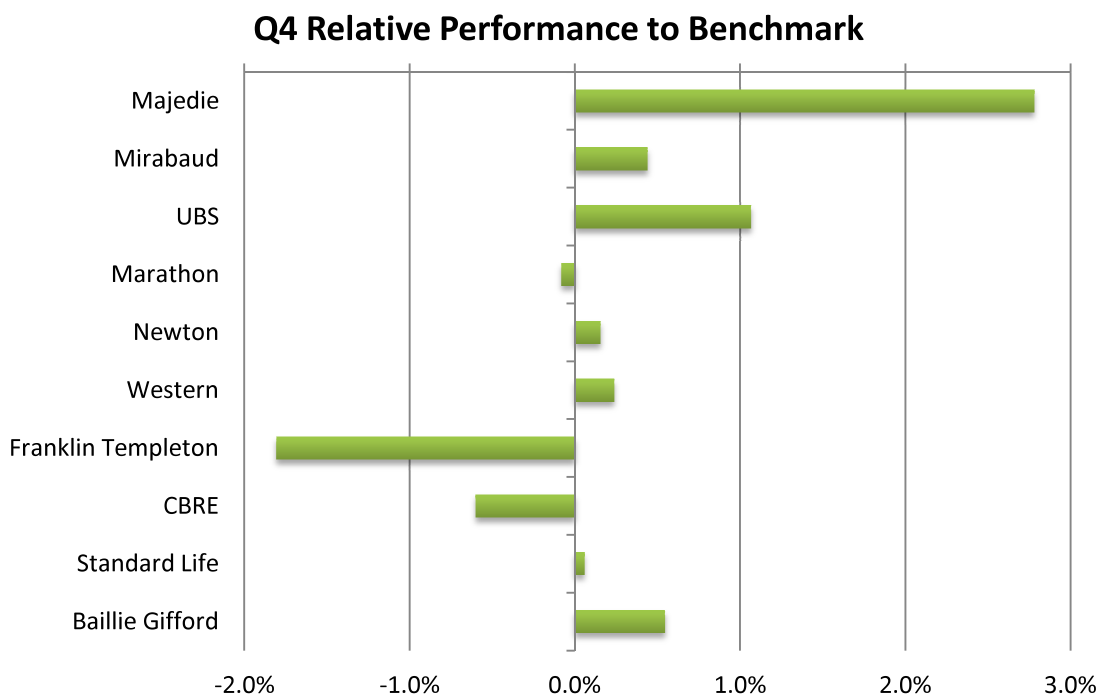




Both Baillie Gifford and Standard Life are absolute return funds with a benchmark based upon short term cash holdings.

The UK property market provided the largest absolute return for the fund over the quarter with CBRE recording +2.7%. Western and Majedie both reported absolute returns above 2%, with Majedie outperforming substantially in a flat to declining market environment

6 The table below shows manager performance for 2013/14 Q4 against manager specific benchmarks using custodian data.

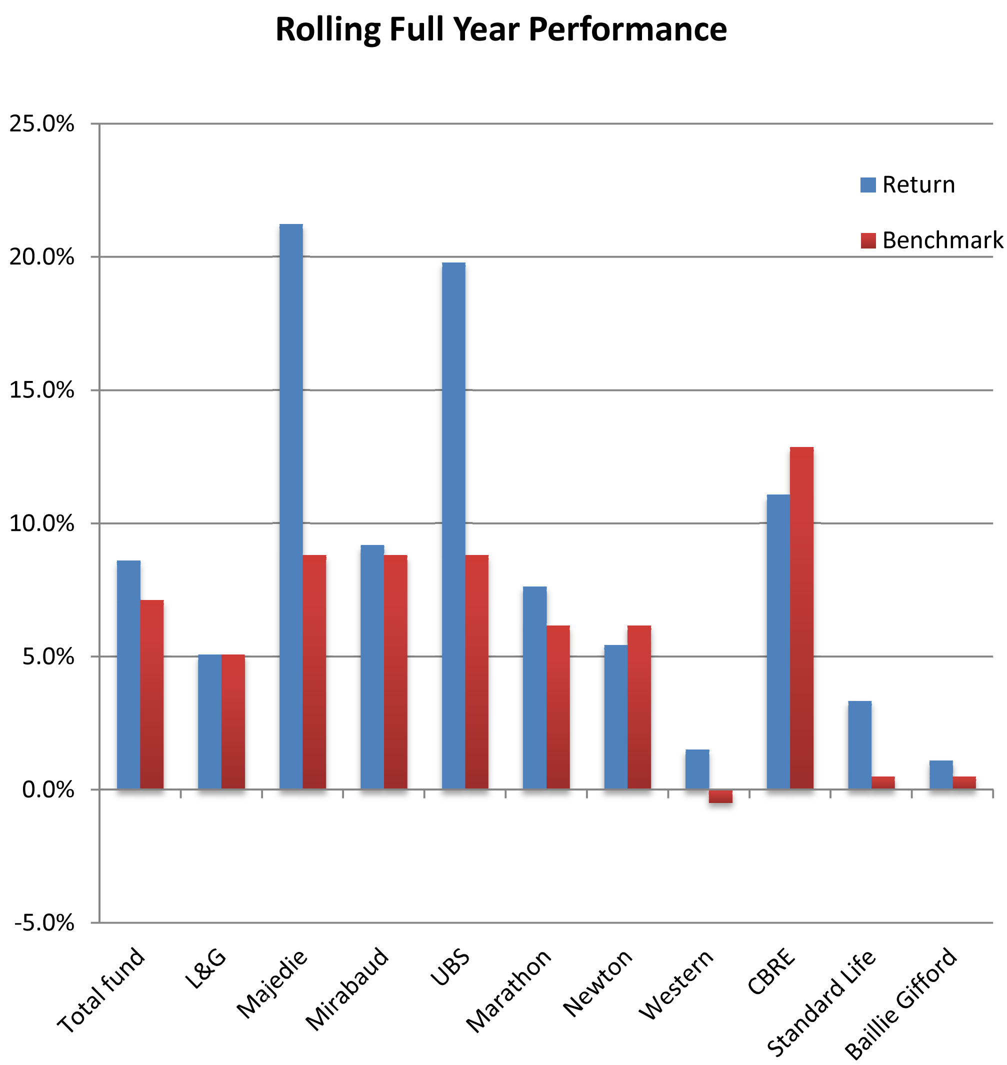
Manager	**Performance %**	**Benchmark %**
Total fund	1.0	1.1
L&G	0.8	0.7
Majedie	2.1	-0.6
Mirabaud	-0.2	-0.6
UBS	0.4	-0.6
Marathon	0.3	0.4
Newton	0.6	0.4
Western	2.5	2.3
Franklin Templeton	-0.1	1.8
CBRE	2.7	3.3
Standard Life	0.2	0.2
Baillie Gifford	0.7	0.2

Franklin Templeton is measured against a US Dollar denominated benchmark which is then converted back to Sterling. This can cause a disparity between performance and benchmark.

Summary of Full Year Results

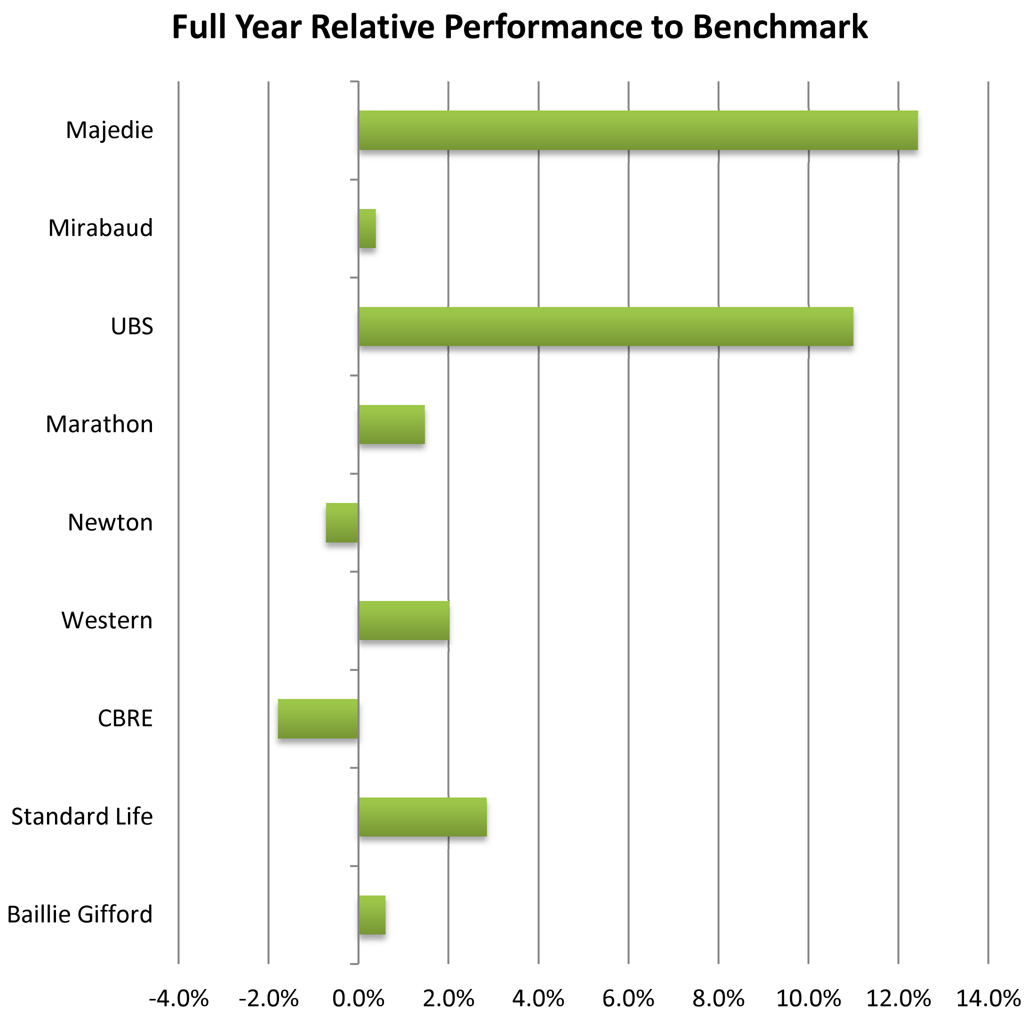
Over the past 12 months to 31 March 2014, the Fund returned +8.6% overall, surpassing the benchmark return of +7.1%.

6



UK Equities provided substantial investment returns over the last year with significant above benchmark returns from active UK equity managers UBS and Majedie. The property market rallied strongly in 2014 leading to double digit returns from CBRE.

6



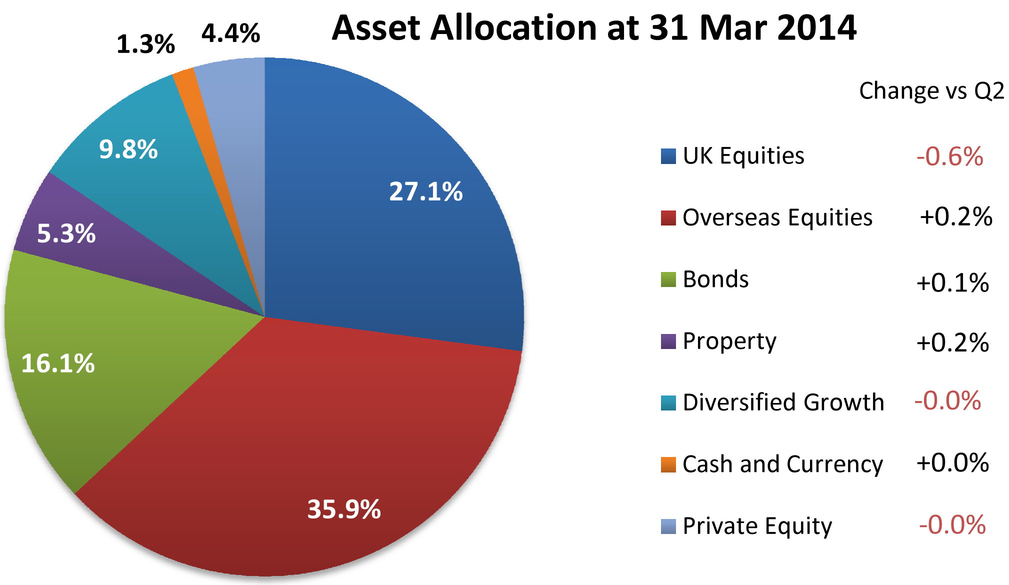
The table below shows manger performance for the year to 31 March 2014 against manager specific benchmarks using custodian data.

Manager	**Performance %**	**Benchmark %**
Total fund	8.6	7.1
L&G	5.1	5.1
Majedie	21.2	8.8
Mirabaud	9.2	8.8
UBS	19.8	8.8
Marathon	7.6	6.2
Newton	5.4	6.2
Western	1.5	-0.5
CBRE	11.1	12.9
Standard Life	3.3	0.5
Baillie Gifford	1.1	0.5

6

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.



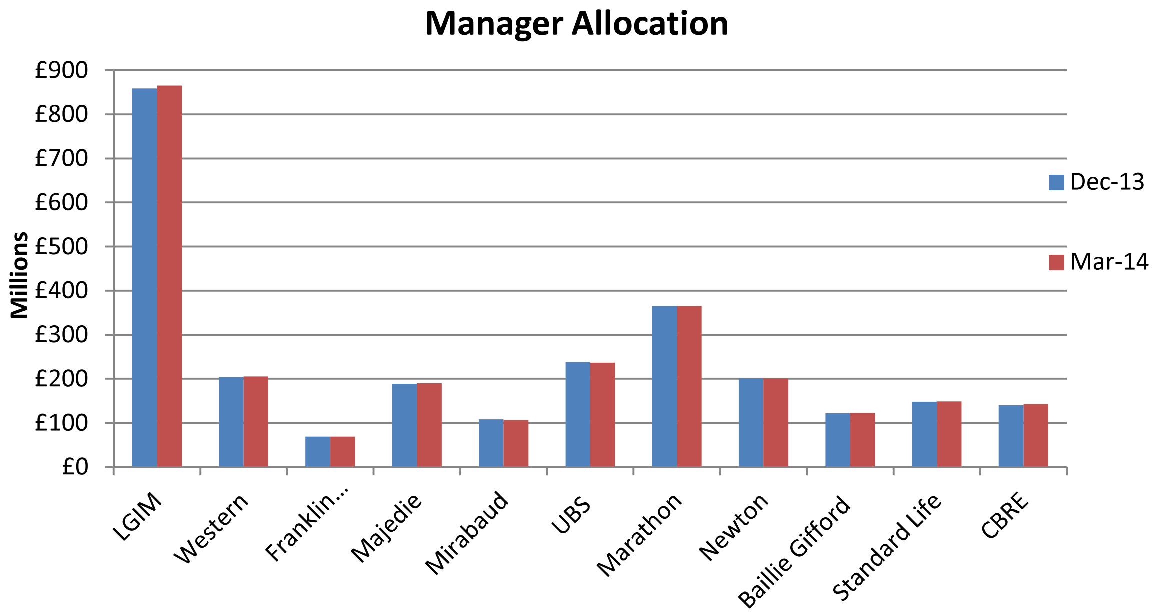
The table below compares the actual asset allocation as at 31 Mar 2014 against target asset weightings.

	TOTAL FUND	Actual	Target	Last Quarter	
	£m	%	%	£m	%
Fixed Interest					
UK Government	104.6	3.8	5.0	121.0	4.4
UK Non-Government	118.6	4.3	7.6	159.5	5.8
Overseas	60.2	2.2	0.0	0.0	0.0
Total Return	68.8	2.5	2.7	68.8	2.5
Index Linked	94.7	3.4	3.8	89.9	3.3
Equities					
UK	751.2	27.1	27.5	761.8	27.7
Overseas	996.0	35.9	32.3	982.2	35.7
Property Unit Trusts	145.8	5.3	6.6	138.5	5.0
Diversified growth	270.9	9.8	9.5	269.7	9.8
Cash	30.2	1.1	0.0	24.0	0.9
Currency hedge	7.7	0.3	0.0	12.7	0.5
Private Equity	122.5	4.4	5.0	121.4	4.4
TOTAL	**2,771.1**	**100.0**	**100.0**	**2,749.5**	**100.0**

6

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 31 March 2014. This excludes the internal cash and private equity portfolio.

Investment Manager	Asset Class	Market Value £m	Actual Allocation %	Target Allocation %
LGIM	Multi-Asset	865.1	32.6	33.0
Western	Bonds	205.7	7.8	8.3
Franklin Templeton	Bonds	68.8	2.6	2.8
Majedie	UK Equity	190.1	7.1	7.0
Mirabaud	UK Equity	106.8	4.0	4.0
UBS	UK Equity	236.6	8.9	8.0
Marathon	Global Equity	365.0	13.8	12.0
Newton	Global Equity	200.9	7.6	8.0
Baillie Gifford	Diversified Growth	122.5	4.6	4.0
Standard Life	Diversified Growth	148.4	5.6	6.0
CBRE	Property	143.1	5.4	7.0
	Residual Cash	0.1	0.0	0
TOTAL		**2,652.9**	**100.0**	**100.0**

6

5. Fees

The following table shows a breakdown of fees due for Q4 2013/14.

Manager	MV 31/03/14 £m	Manager Fee Q4 £	Annualised Average Fee %
LGIM	865.1	186,487	0.09
Western	205.7	119,502	0.23
Franklin Templeton*	68.8	120,437	0.70
Majedie	190.1	185,536	0.39
Mirabaud	106.8	182,060	0.68
UBS	236.6	71,200	0.12
Marathon**	365	998,090	1.09
Newton	200.9	135,076	0.27
Baillie Gifford*	122.5	237,710	0.78
Standard Life*	148.4	253,448	0.68
CBRE	143.1	73,851	0.21
Total		**£2,563,396**	**0.39**

*Estimated
** Includes performance fee

CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

6

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.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
1. Asset Allocation Policy and Actual as at 31 March 2014 and 29 April 2014
2. Notes from fund manager meetings held on 22 April 2014

Sources/background papers:
None

Annex 1

Asset Allocation Update

The table shows the actual managed asset allocation as at 31 March 2014 against the target allocation. The allocation for 29 April 2014 is shown overleaf.

6

	Category	Allocation Policy %	Allocation at 31/03/2014	Variance %
Equities		**63.0**	**67.3**	**+4.3**
UK				
Legal and General	*Passive*	*10.0*	*8.5*	*-1.5*
Majedie	*Concentrated Active*	*7.0*	*7.1*	*+0.1*
Mirabaud	*Concentrated Active*	*4.0*	*4.0*	*+0.0*
UBS	*Core Active*	*8.0*	*8.9*	*+0.9*
Overseas				
Legal and General	*Passive*	*14.0*	*17.4*	*+3.4*
Marathon	*Concentrated Active*	*12.0*	*13.8*	*+1.8*
Newton	*Core Active*	*8.0*	*7.6*	*-0.4*
Property		**7.0**	**5.4**	**-1.6**
CBRE	*Core Active*	*7.0*	*5.4*	*-1.6*
Alternatives		**10.0**	**10.2**	**+0.2**
Standard Life	*Diversified growth*	*6.0*	*5.6*	*-0.4*
Baillie Gifford	*Diversified growth*	*4.0*	*4.6*	*+0.6*
Bonds		**20.0**	**17.1**	**-2.9**
Fixed interest gilts				
Legal and General	*Passive*	*2.5*	*1.5*	*-1.0*
Western	*Core Active*	*2.75*	*2.5*	*-0.3*
Index linked gilts				
Legal and General	*Passive*	*4.0*	*3.5*	*-0.5*
Western	*Core Active*	*0.0*	*0.1*	*+0.1*
Corporate bonds				
Legal and General	*Passive*	*2.5*	*1.7*	*-0.8*
Western	*Core Active*	*5.5*	*5.2*	*-0.3*
Total Return				
Franklin Templeton	*Unconstrained*	*2.75*	*2.6*	*-0.2*
Total		**100.00**	**100.00**	

6

Asset Allocation Update

The table shows the actual managed asset allocation as at 29 Apr 2014 against the policy.

	Category	Allocation Policy %	Allocation at 29/04/2014	Variance %
Equities		**63.0**	**67.1**	**+4.1**
UK				
Legal and General	*Passive*	*10.0*	*8.4*	*-1.6*
Majedie	*Concentrated Active*	*7.0*	*7.2*	*+0.2*
Mirabaud	*Concentrated Active*	*4.0*	*4.0*	*0.0*
UBS	*Core Active*	*8.0*	*8.9*	*+0.9*
Overseas				
Legal and General	*Passive*	*14.0*	*17.2*	*+3.2*
Marathon	*Concentrated Active*	*12.0*	*13.8*	*+1.8*
Newton	*Core Active*	*8.0*	*7.6*	*-0.4*
Property		**7.0**	**5.4**	**-1.6**
CBRE	*Core Active*	*7.0*	*5.4*	*-1.6*
Alternatives		**10.0**	**10.2**	**+0.2**
Standard Life	*Diversified growth*	*6.0*	*5.6*	*-0.4*
Baillie Gifford	*Diversified growth*	*4.0*	*4.6*	*+0.6*
Bonds		**20.0**	**17.3**	**-2.7**
Fixed interest gilts				
Legal and General	*Passive*	*2.5*	*1.6*	*-0.9*
Western	*Core Active*	*2.75*	*2.5*	*-0.3*
Index linked gilts				
Legal and General	*Passive*	*4.0*	*3.5*	*-0.5*
Western	*Core Active*	*0.0*	*0.1*	*+0.1*
Corporate bonds				
Legal and General	*Passive*	*2.5*	*1.7*	*-0.8*
Western	*Core Active*	*5.5*	*5.3*	*-0.2*
Total Return				
Franklin Templeton	*Unconstrained*	*2.75*	*2.6*	*-0.2*
Total		**100.00**	**100.00**	

Annex 2

6

Notes from Meetings with Fund Managers: 22 April 2014

Hosted by UBS

Manager	Attending
Baillie Gifford	Anthony Dickson Mike Brooks
UBS	Digby Armstrong Richard West
Franklin Templeton	Chris Orr Sonal Desai
Majedie	Simon Hazlitt

Baillie Gifford

1. Met with Anthony Dickson and Mike Brooks from Baillie Gifford (BG).

6

2. BG reported a fairly flat performance for the past twelve months. The main driver of downside performance during this period was a weighting in emerging market bonds. There was significant volatility in emerging markets as the prospect and then the actual tapering of quantitative easing caused substantial outflows from emerging markets.

3. BG had underestimated the extent to which funds would flee from emerging markets over this period. Emerging markets were still considered attractive and BG retains a sizable exposure to emerging market bonds. However, the risks of emerging markets vary significantly between countries so BG added individual country focus on top of index weighted assets.

4. The additional country specific exposure was within South and Central America with purchases of bonds from Mexico, Peru and Brazil. BG were also keen to hold the bonds in local currency and so did not plan to hedge this exposure.

5. The overall macro outlook for BG was that global growth would be toward the lower end of expectations and that the end of quantitative easing (QE) will cause significant bouts of volatility. This view was held against recent rapid rises in many asset valuations. The risks in the market were not being well rewarded.

6. BG aimed to position the portfolio for stable low growth rather than chase returns on expensive asset classes. The spread for high yield bonds was down to 3.5% against a historical average of over 5%, so BG significantly reduced this exposure as spreads were unlikely to shorten further.

7. BG increased the platinum and palladium holding, from the view that the current market price meant a number of South African platinum mines were operating at a loss and recent unrest and strikes would only exacerbate this.

8. The expected volatility would allow BG to re-enter certain asset classes or markets as long as funds were readily available, but holding cash would be a drag on performance. BG increased the allocation to the low risk area of structured finance mortgage backed paper to provide some yield, but there is sufficient liquidity to allow for movements into other asset classes when appropriate.

UBS

1. Digby Armstrong and Richard West presented.

2. UBS reported that the rapid increase in equity prices over the previous twelve months had left to a significant reduction in stocks trading at a discount to the perceived fair value.

3. The cyclical stocks that had formed a core element of the portfolio, such as Dixons, IAG and Lloyds were considered overvalued and UBS were investing the profits of such investments in large cap defensive stocks which had underperformed versus medium sized companies. 6

4. UBS was overweight resource stocks in both oil and gas and mining following recent price weaknesses and a better capital allocation outlook.

5. The largest positive position was BP, the price of which has been volatile over the last quarter, partly as a result of BP's significant shareholding of Rosneft (the Russian oil major) and partly over lingering fears of the legal costs following the oil spill in the Gulf of Mexico. UBS was confident in the management and in the belief that the legal ramifications were overestimated.

Franklin Templeton

1. Met with Chris Orr and with Sonal Desai (Sonal via conference call) from Franklin Templeton (FT).

6

2. FT considered the market reaction to the announcement of tapering the Federal Reserve QE programme was overdone and without appropriate consideration. There was considered no net withdrawal of liquidity from the global market as the Fed’s taper was offset by measures taken by the European Central Bank and the Bank of Japan.

3. Negative events in a number of emerging economies, for example, Turkey or South Africa, led to widespread sell offs from all emerging economies. FT was an active purchaser of emerging market debt, but only specific economies.

4. FT took additional positions in Malaysia, South Korea, Singapore and Mexico, all of which stood to benefit from a recovery in the US economy and more specifically a boost in US consumer spending.

5. FT were positive on the German economy as a recipient of US spending, but German Bunds offered poor value. FT invested in peripheral European countries whose economic cycles were closely linked to that of Germany, which offered much better value. These included Sweden, Poland and Hungary.

6. The duration of the FT portfolio is very short, with an average duration of 1.4 years. This is in expectation of interest rates rises so that short dated debt can be rolled over to long term upon maturity.

7. In response to questioning over China, FT were not convinced that the Chinese economy was at major risk of a banking or growth collapse. The huge fiscal stimulus at the beginning of the financial crisis may result in loans made by local and central government being written off but that these levels would be manageable.

8. FT held positions in Ukraine and Russian debt, the main concern for Ukraine was regarding liquidity as opposed to solvency but that the actions of the IMF have significantly reduced concerns over a potential default.

Majedie

1. Met with Simon Hazlitt from Majedie

2. Simon explained the change in focus for Majedie's portfolio away from more cyclical momentum stocks to a defensive positioning, with stocks with defensive characteristics more relating to an individual company's valuation rather than a sector bias.

3. The key risk that Majedie highlighted was that they may misjudge the timing of any market correction and so may underperform a rising market.

4. Performance over the last quarter was driven in part by a long held weighting in European telecommunications stocks, with an expectation of improvements in the regulatory environment to encourage investment to bring European communications standards toward that of the US.

5. Majedie recently increased a position in Centrica, political issues have dampened the stock price, and there was significant potential for cost cuttings and management improvements to boost profitability.

6. Belief in new management was the basis for an investment in Finmeccanica, the Italian aerospace company, which was poorly run, with allegations of fraud and corruption. The new Italian Prime Minister recently appointed a new chief executive.

7. Simon explained that there was disagreement within Majedie over the positioning on companies with large emerging market exposure, especially in relation to the valuations of the large mining contingent of the FTSE and also on the extent of a Chinese economic slowdown. Majedie were significantly underweight the mining sector.

8. Majedie were overweight healthcare, including importantly AstraZeneca and GlaxoSmithKline, who had both been the subject of merger and acquisition news on the morning of the meeting with a large upside in stock price.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **PRIVATE EQUITY INVESTMENT PERFORMANCE REVIEW**

SUMMARY OF ISSUE:

The Surrey Pension Fund has a commitment to invest 5% of the fund in private equity. This is achieved by investing in funds of funds and directly managed funds, managed by a number of private equity specialists.

The Pension Fund Board reviews the private equity strategy annually. This report is the 2013/14 review.

RECOMMENDATIONS:

It is recommended that:

1 The Board note the current position on the Fund's Private Equity investment performance.

2 The Fund continue to commit to follow on funds of the existing private equity managers as they become available and subject to each case going to the Pension Fund Board for approval.

REASON FOR RECOMMENDATIONS:

A solid framework of review is required in order to benefit from this long term asset category.

DETAILS:

Background

1 Private Equity investment can be characterised by investment in start-ups and early stage companies in order to provide development capital, or capital for management buy-outs (MBO) and management buy-ins (MBI). Many of these small companies that are seeking private equity or venture capital investment are regarded as high risk and cannot raise capital via public listings on the stock markets or borrowing from banks.

2 In return for taking the extra risk, private equity investors look for substantial equity and significant influence in the company, possibly through a seat on the company board. Sometimes they provide management and financial administration support to their investee companies. They will look for an exit through a sell on, trade sale or a flotation of the company within two to five years. Private equity investments are a means of achieving diversification, enhancing returns, and spreading risk.

7

Choosing Private Equity Investments

3 There are a number of different options for investing in private equity:

- direct investments;
- direct investments via a specialist manager;
- investment in a fund or limited partnership;
- investment in a fund of funds;
- and investment in a listed trust.

4 Surrey's current strategy is to invest via Limited Partnerships (LP) or Fund of Funds (FoF). Factors to consider when making the decision on which FoF or LP to choose include:

- performance track record;
- people;
- investment philosophy;
- and strategy.

The latter includes an assessment of business alliances, deal flow, sector knowledge, market knowledge and, in the case of FoFs, the ability to access good opportunities.

Governance Arrangements

5 Private equity managers provide formal quarterly reports. The Pension Fund and Treasury manager aims to meet with the private equity managers on at least an annual basis to discuss strategy and returns, and also aims to attend all Fund AGMs when they are held.

Performance Measurement

6 Private equity performance is measured either by the multiple of capital appreciation (ratio of final realised value to initial cost) or the Internal Rate of Return (IRR), which is more commonly used by institutional investors. IRR is a money-weighted return expressed as a percentage and uses the present sum of cash drawdowns (money invested), the present value of distributions (money returned from investments) and the current value of unrealised investments and determines the effective annualised return of the investment.

7 Whilst investing in private equity within a portfolio is a way for long-term investors to diversify their risk (although taking on illiquidity risk) and enhance returns, public and private equity markets are somewhat correlated over the long term. The correlation between public market returns and private equity is estimated to be around 0.7 over the long term. Global private equity has delivered returns of 15.2%, 6.9% and 21.7% for the three, five and ten-year periods to 30 June 2013. This compares with annualised returns of 10.7%, 6.1% and 6.0% for the MSCI World Index over the same time periods (source: Prequin, MSCI).

8 An estimate of the IRR of the whole of the Surrey private equity programme gives a return of 14.9% since April 2001, when the first of the current funds was set up. It is known that in the 13 years to 31 March 2014, the FTSE All Share Index returned 2.7% p.a. The target level of return sought was the FTSE All Share plus 2% over the life of the funds, so estimates would suggest that the target has been exceeded.

Surrey Pension Fund Private Equity Strategy

9 The Surrey Pension Fund first invested in Private Equity in 1986, initially investing directly in companies on the advice of a specialist manager. More recently the Fund has invested in Private Equity funds, primarily in the UK but also in Europe and globally, the latter predominantly in the US but with increasing emphasis on Europe and the Far East. 7

10 The previous Investment Advisory Group (IAG) considered its overall strategy on Private Equity in October 2000 in the light of an Asset Liability Modelling (ALM) study conclusion that investment be increased to between 3% and 5% of the Fund. This strategy was revisited in December 2008, when it was agreed to invest in follow-on funds offered by the Fund's stable of private equity managers.

11 The overall strategy is designed to diversify by manager, vintage year (year of investment), sector, geographically and by investment stage. Decisions on individual private equity investments are delegated to the Chief Financial Officer after approval by the Pension Fund Board. The current strategy is as follows:

- Core UK holdings via ISIS private equity partners
- Investment in UK through HG Capital funds
- Investment in Europe through Standard Life Capital Partners Fund of Funds
- Investment in Global (predominantly US but with increasing emphasis on Europe and Far East) private equity through Goldman Sachs and Blackrock (formerly Merrill Lynch) backed Fund of Funds
- Investment in Capital Dynamics US solar Fund, which was a new commitment made in 2011/2012

7

Current Position

12 Private Equity investment in Funds involves a commitment (a potential obligation to invest) and subsequent draw downs of cash. Typically, draw downs might average only 75% of the commitment, as Funds may raise more commitments than they invest. The fund is invested both in Fund of Funds (i.e. a selection of funds chosen by a fund manager) and individual funds. The Fund of Funds route is generally less risky for overseas investment, but also enables access to Funds that might not be available to single institutions.

13 The private equity strategy ensures compliance with best practice through diversification and the Surrey Fund meets all the CIPFA/Myners principles in this respect. The Fund has made follow on investments in new funds raised by the managers selected. In practice, managers will raise new funds every three years or so. The last follow on commitments were made in September 2013 to Standard Life and Capital Dynamics.

14 The detailed position on commitments and cash invested at 31 March 2014 is shown in Annex 1 and is summarised as follows:

	Value £m	**% of Fund**
Total Commitment	274.4	9.9
Investment (drawn)	167.0	6.0
Commitment Outstanding	107.4	3.9
Distributions Received	93.8	3.4
Fair Value of Remaining Investments	122.5	4.4
Distributions + Remaining Investments	216.3	7.8
Implied Gain	49.3	1.8
Estimated IRR	14.9%	
Total Surrey Pension Fund Value	2,771.1	

Where relevant valuations converted to £ equivalent as at 31 March 2014

15 Based on a current market value of £2,771.1m as at 31 March 2014, 9.9% of the Fund is committed to private equity investments. However, the actual level of investment (based on the Fair Value of the remaining investments) is around 4.4% of the Fund.

16 A schedule of the private equity investments at 31 March 2014 is shown in Annex 1.

CONSULTATION:

18 The Chairman elect of the Pension Fund has been consulted on the report.

RISK MANAGEMENT AND IMPLICATIONS:

20 Risk related issues are contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

21 Financial and value for money implications are contained within the report. 7

CHIEF FINANCE OFFICER COMMENTARY

22 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered, and that private equity has been a good performing asset class for the pension fund.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

24 The review of the Fund's private equity programme will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

26 The following next steps are planned:

- Review of the strategy by Pension Fund Board.
- Consideration of a further investment opportunity by Pension Fund Board (separate report re Standard Life SOF II).

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Schedule of Private Equity investments

Sources/background papers:
Private equity manager reports

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Manager	Investment	Vintage Year	Paid in Capital £000s	Outstanding Commitment £000s	Total Commitment £000s	Distributions Received £000s	Fair Value of Remaining Investments £000s	Total Value Distributions + Fair Value £000s	Total Value vs Paid in Capital	IRR	Date of Valuation
UK Funds											
HG Capital	MUST 4	2002	2,350	650	3,000	1,899	63	1,962	0.8	25.0%	31/12/2013
HG Capital	HG 5	2006	7,752	498	8,250	7,838	5,405	13,243	1.7	14.6%	31/12/2013
HG Capital	HG 6	2009	9,010	990	10,000	2,857	6,806	9,663	1.1	5.5%	31/12/2013
HG Capital	HG7	2013	2,214	12,786	15,000	0	1,940	1,940	0.9	n/a	
ISIS	ISIS III	2003	12,362	1,638	14,000	28,421	177	28,598	2.3	23.9%	31/12/2012
ISIS	ISIS IV	2007	11,522	3,478	15,000	9,061	8,058	17,119	1.5	16.0%	31/12/2012
ISIS	ISIS Growth	2013	2,115	7,885	10,000	0	1,608	1,608	0.8	n/a	31/12/2012
Darwin	Leisure Property	2013	20,000	0	20,000	0	20,000	20,000	1.0	n/a	
								0			
Euro Funds								0			
Standard Life	ESP II	2004	8,060	202	8,262	7,671	3,635	11,306	1.4	n/a	31/12/2013
Standard Life	ESP 2006 B	2006	10,824	1,568	12,392	3,229	9,054	12,283	1.1	n/a	31/12/2013
Standard Life	ESP 2008	2008	6,249	6,143	12,392	547	6,322	6,869	1.1	n/a	31/12/2013
Standard Life	ESF	2011	2,458	12,000	14,458	0	1,880	1,880	0.8	n/a	31/12/2013
Standard Life	SOF	2013	0	16,523	16,523	0	0	0	n/a	n/a	
Dollar Funds											
BlackRock	Vesey Street I	2001	2,849	150	2,999	4,522	584	5,106	1.8	13.6%	31/12/2013
BlackRock	Vesey Street II	2003	2,804	195	2,999	3,128	1,899	5,027	1.8	11.3%	31/12/2013
BlackRock	Vesey Street III	2005	9,237	1,260	10,496	4,389	7,113	11,502	1.2	3.8%	31/12/2013
Goldman Sachs	GS PEP 2000 LP	2000	6,087	-389	5,698	9,003	1,084	10,087	1.7	14.3%	31/12/2013
Goldman Sachs	GS PEP 2004 LP	2004	6,214	-216	5,998	4,935	3,939	8,874	1.4	5.9%	31/12/2013
Goldman Sachs	GS PEP 2005 LP	2006	9,756	440	10,196	4,124	6,681	10,805	1.1	-0.7%	31/12/2013
Goldman Sachs	GS PEP X LP	2008	7,669	3,127	10,796	1,455	7,934	9,389	1.2	2.4%	31/12/2013
Goldman Sachs	GS PEP XI LP	2011	4,059	19,932	23,991	112.34	3,547	3,659	0.9	n/a	31/12/2013
Goldman Sachs	GS Vintage VI	2013	1,200	10,796	11,996	0	1,572	1,572	1.3	n/a	31/12/2013
Capital Dynamics	US Solar	2011	12,410	2,585	14,995	630	12,513	13,143	1.1	n/a	31/12/2013
Capital Dynamics	Clean Energy	2012	9,821	5,173	14,995		10,681	10,681	1.1	n/a	
TOTAL			**167,022**	**107,414**	**274,436**	**93,821**	**122,495**	**216,316**	**1.3**		

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **PENSION FUND BUSINESS PLAN 2013/14: OUTTURN REPORT AND FINAL 2014/15 PLAN**

8

SUMMARY OF ISSUE:

The 2001 Myners Report recommended that local authority pension funds approve an annual business plan in respect of the objectives required for the ensuing year. Business planning is regarded as an important tool, assisting in the identification of how service delivery can be maximised within resource constraints. This report sets out the outturn of the annual business plan for 2013/14.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1 note the progress made with regard to the Business Plan objectives shown in Annex 1 in respect of the 2013/14 financial year.

2 approve the final version of the 2014/15 business plan shown in Annex 2.

REASON FOR RECOMMENDATIONS:

A business plan is required by best practice in order to set relevant targets and monitor progress. Monitoring the outturn against the objectives set is an essential part of the planning and monitoring processes.

DETAILS:

Background

1 At the Board meeting of 31 May 2013, the Pension Fund Board approved a business plan for 2013/14, identifying the key issues affecting the Pension Fund over the medium term and a timetable of activities needed to help achieve the strategic objectives. The business plan listed the investment and pension administration tasks to be carried out during 2013/14, and the target date when these should be achieved.

2 The 2013/14 business plan is shown as Annex 1.

3 The current 2014/15 business plan with changes requested at the 14 February 2014 Board meeting is shown as Annex 2.

Outturn 2013/14

4 This report sets out the outturn results of the business plan implementation, setting out each individual action required and the results of the year's work of the Pension Fund staff.

Outturn: Administration

5 Action 1: Chief Finance Officer (CFO) and Pension Fund Board to receive key performance indicators report on a quarterly basis.

Outcome: **Achieved.** All reports were sent to the CFO and committee clerk within the stated time limit of eight days before the Pension Fund Board meeting. There were no instances of failures to meet these targets.

6 Action 2: Pension Fund Board to receive the Pension Fund Annual Report by 30 September 2013.

Outcome: **Achieved.** The Pension Fund Annual Report was posted onto the Fund's website in mid September 2013 with a hard copy provided to the Board on 20 September 2013.

7 Action 3: Ensure that any complaints against action or inaction by pension staff are dealt with in a timely manner.

Outcome: **Achieved.** There were no complaints against pensions staff. There were three pension appeals, all of which related to failure of the employer to grant retirement on ill health grounds. Two are still ongoing and the third was resolved in favour of the scheme member.

8 Action 4: Review the content of the pension fund website to ensure it is relevant and kept up-to-date.

Outcome: **Achieved.** A new pensions website has been set up and has been updated with all relevant information about the new LGPS 2014. It also includes a modeller that enables active members to estimate what their retirement benefits will be under the new LGPS 2014 scheme.

9 Action 5: Prepare groundwork for the new LGPS 2014 scheme.

Outcome: **Achieved.** The Pensions Manager will present a verbal report at the 15 May 2014 Board meeting with a view to providing a further written report including membership analysis once the new LGPS 2014 scheme has "bedded" in.

Outturn: Communication

10 Action 1: Production of a newsletter to pensioners in April each year.

Outcome: **Achieved.** A letter to all pensioners of the Surrey Pension Fund was sent on 22 April 2014

11 Action 2: Timely production of benefit statements.

Outcome: **Achieved.** Benefit statements were issued to all current active members in September 2013 and to deferred members in August 2013.

12 Action 3: Ensure communication material complies with current legislation and effectively communicates the benefits of the scheme. Ensure communication material is amended to comply with the requirements of the new LGPS 2014

Outcome: **Achieved.** Standard booklets, information sheets and pro forma documentation have been updated to comply with the new LGPS 2014 scheme requirements. Members of the Pensions Team have hosted new scheme employer workshops and held 84 presentations at 26 different locations in Surrey to 2,184 scheme members. 8

13 Action 4: Communication on a timely basis of material scheme changes to Pension Fund Board, employer bodies and members.

Outcome: **Achieved.** The Board considered the Call for Evidence for the future of the LGPS at the meeting on 15 November 2013 and will also consider a subsequent report at the 15 May 2014 meeting. All Board reports are available for scrutiny by employer bodies and members via the Council's 'my council' portal. Newsletters and information have been made available on the pension fund website.

14 Action 5: Prepare Pension Fund Annual Meeting (November) and receive feedback from employers.

Outcome: **Achieved.** The Fund held a successful annual meeting on 22 November 2013, attended by the actuary who was available for one-to-one sessions with employer representatives following the formal meeting.

Outturn: Actuarial/Funding

15 Action 1: Prepare data and information required by Hymans for 2013 actuarial valuation and provide employers with interim and final results.

Outcome: **Achieved.** All member data were submitted to the actuary within the target deadline. The valuation was delivered on time with highly valued assistance and cooperation from the Fund's actuaries, Barry McKay and Julie West from Hymans. Officers would like to acknowledge the huge efforts and commitment from Hymans in achieving this target. The final valuation was reported to the Pension Fund Board on 14 February 2014. Subsequent negotiations were completed prior to the 31 March 2014 deadline, apart from one employer which was finally agreed on 23 April 2014. A draft Funding Strategy Statement was sent to all employers for consultation with a final draft to be approved at 15 May 2014 Board meeting. Every member organisation has received a confirmed schedule of employer contribution rates and deficit contributions in respect of the next three years.

16 Action 2: Receive feedback and agreement from employers (scheduled and admitted bodies) in run up to valuation on assumptions used in actuarial valuation process.

Outcome: **Achieved.** The Fund's actuary presented to a meeting of the Surrey Treasurers Association on 8 November 2013 and to organisational employers' representatives at the Fund's annual meeting held on 22 November 2013.

17 Action 3: Provide employers with IAS19/FRS17 funding statements when requested.

8

Outcome: **Achieved.** Individual FRS17/IAS19 reports (2012/13 accounts closure) were commissioned and provided to all employer bodies as required in line with individual deadlines.

18 Action 4: Monitor and reconcile contributions schedule for the County Council and scheme employers.

Outcome: **Achieved.** Contributing authorities to the Fund are closely monitored as to the accuracy and completeness of their monthly contribution receipts. Late or inaccurate payments were always followed up immediately. There are no outstanding issues with member bodies.

19 Action 5: Member training covering funding issues.

Outcome: **Achieved.** Regular quarterly training for the Board is carried out and various external conferences and seminars attended by Board members and officers.

Outturn: Pension Fund Board Members

20 Action 1: Review decision-making process to ensure decisions are made effectively.

Outcome: **Pending.** A questionnaire designed for the assessment of the Board's governance and decision-making processes was sent to Board members on 1 May 2014. It is shown as Annex 3. The results will be discussed within the forum of the Board meeting on 15 May 2014.

21 Action 2: Review Pension Fund Board member training requirements and implement training plan as appropriate

Outcome: **Pending.** The Board approved a Knowledge and Skills framework at its meeting on 31 May 2013. Regular quarterly training for the Board is provided and various external conferences and seminars are attended by Board members. It is suggested that members discuss this item within the forum of the meeting on 15 May 2014.

22 Action 3: Agree a framework for Pension Fund Board member training.

Outcome: **Achieved.** The Board approved its Knowledge and Skills Framework at the meeting of 31 May 2013. Training was provided at every Board meeting in the financial year.

23 Action 4: Ensure that meeting papers are issued at least seven days prior to meeting.

Outcome: **Achieved.** Board agendas and reports were sent out on a timely basis within 7-day target, except for one instance, a report (investment strategy review) for the 14 February 2014 meeting, which was distributed by e-mail just prior to the meeting as a result of last minute drafting.

24 Action 5: Finalise corporate governance in line with revised Myners/CIPFA principles to ensure 100% compliance.

Outcome: **Achieved.** The Fund reviewed and approved all governance documents apart from the Pension Fund Service Level Agreement, which will be considered at the meeting on 15 May 2014. The latest draft of the Statement of Investment Principles incorporating the Fund's stated compliance with Myners/CIPFA principles will also be considered at the 15 May 2014 Board meeting. 8

Outturn: Financial and Risk Management

25 Action 1: Monitor pension fund expenses for next financial year with the target of unit cost in lowest quartile.

Outcome: **Achieved.** This is monitored on a regular basis and also reported to the Board as a key performance indicator.

26 Action 2: Produce Annual Statement of Accounts.

Outcome: **Achieved.** This was produced on time (2012/13 accounts and financial statements) according to the Council's closedown timetable deadlines with no external audit qualifications.

27 Action 3: Produce Annual Pension Fund Report.

Outcome: **Achieved.** The Pension Fund Annual Report was posted onto the Fund's website in September 2013. It was used as the basis for the Local Government Chronicle (LGC) Large Pension Fund of the Year Award 2013, with the Fund being shortlisted.

28 Action 4: Carry out risk assessment of the management of the fund for 2013/14.

Outcome: **Achieved.** An evaluation of the Fund's risk assessments with risk control procedures was presented at every Board meeting in the financial year and will be a regular agenda item at future meetings.

29 Action 5: To implement a system of disaster recovery/business continuity in the event of major disaster.

Outcome: **Pending.** This is currently being assessed in the 2014/15 year.

8

Outturn: Investment

30 Action 1: Ongoing consideration of the CIPFA/Myners principles.

Outcome: **Ongoing.** Work has now commenced on the pending Government Regulations on LGPS governance and the proposed Scrutiny Board.

31 Action 2: Review of investment manager arrangements.

Outcome: **Achieved.** Franklin Templeton was appointed as the Fund's absolute return fixed income manager. Work is continuing on a strategy review, further diversification possibilities and de-risking as the funding level approaches 100%.

32 Action 3: Review asset allocation with consultant and independent advisor.

Outcome: **Pending.** An asset allocation review is underway with necessary training provided to Board members at meetings and in one-to-one sessions.

33 Action 4: Discuss/meet with all investment managers and report to Pension Fund Board.

Outcome: **Achieved.** Meetings have been held with all investment managers in every quarter during the year and the minutes reported to the Board with the independent advisor's verbal commentary at Board meetings.

34 Action 5: Review the Statement of Investment Principles (SIP)

Outcome: **Achieved.** A revised version of the SIP was approved at the 14 February 2014 Board meeting and an updated version to the 15 May 2014 Board meeting.

35 Action 6: Pension Fund Board to receive quarterly monitoring reports.

Outcome: **Achieved**. Performance review reports are considered by the Board every quarter.

CONSULTATION:

36 The Chairman of the Pension Fund Board has been consulted on the outturn report and has offered full support in respect of the achievements, and with regard to specific areas where progress is still ongoing.

RISK MANAGEMENT AND IMPLICATIONS:

37 Risk related issues are specifically discussed within the report where relevant.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

38 Financial and value for money issues are specifically discussed within the report where relevant.

CHIEF FINANCE OFFICER COMMENTARY

39 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed within the outturn report and that the document will provide the Board and officers with a useful update as to the achievement of the business plan's objectives, and a useful tool for the monitoring of progress.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

8

EQUALITIES AND DIVERSITY

41 The outturn report will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT:

43 The following next steps are planned:

- Continuation of the current year's work programme in line with the 2014/15 business plan.
- Progress monitoring will take place and, if necessary, matters will be discussed at future Board meetings.
- Outturn report of the 2014/15 financial year to be presented at the first meeting of the Pension Fund Board in 2015/16.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Annex 1: Business Plan 2013/14
Annex 2: Business Plan 2014/15
Annex 3: Board review assessment questionnaire

Sources/background papers:
None

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Surrey Pension Fund
Business Plan and Actions for 2013/14

Administration			
Objective(s) - to ensure scheme is run in accordance with the rules; in accordance with agreed service standards; and compliance with Regulations - to deal with and rectify any errors and complaints in a timely way			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Chief Finance Officer and Pension Fund Board to receive key performance indicators report on a quarterly basis	Ongoing with reports due two weeks after quarter end: Mar, Jun, Sep and Dec and then Board meetings	Phil Triggs/Paul Baker
2	Pension Fund Board to receive the Pension Fund Annual Report	By 30 September 2013	Phil Triggs
3	Ensure that any complaints against action or inaction by pension staff are dealt with in a timely manner.	Ongoing	Paul Baker
4	Review the content of the pension fund website to ensure it is relevant and kept up to date.	Ongoing	Paul Baker/Phil Triggs
5	Prepare groundwork for new LGPS 2014 Scheme	By 1 April 2014	Paul Baker/Phil Triggs

Communication			
Objective(s) - to convey the security of the Scheme - to ensure members understand and appreciate the value of their benefits			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Production of a newsletter to pensioners in April each year	April 2013	Paul Baker
2	Timely production of benefit statements	Active members by 30 Sep 2013 Preserved members by 30 June 2013 Councillors by 31 Aug 2013	Paul Baker
3	Ensure communication material complies with current legislation and effectively communicates the benefits of the scheme. Ensure communication material is amended to comply with the requirements of the new LGPS 2014	Ongoing By April 2014	Paul Baker
4	Communication on a timely basis of material scheme changes to Pension Fund Board, employer bodies and members	Ongoing	Phil Triggs/Paul Baker
5	Prepare Pension Fund Annual Meeting (Nov) and receive positive feedback from employers	22 November 2013	Phil Triggs/Paul Baker

Actuarial/Funding

Objective(s)

- to monitor the funding level of the Scheme including formal valuation every 3 years
- to monitor and reconcile contribution payments to the Scheme by the employers and scheme members
- to understand legislative changes which will impact on funding

Action	**Description**	**Timescale**	**Primary Responsibility**
1	Prepare data and information required by Hymans for 2013 actuarial valuation and provide employers with interim and final results	Data: 31 July 2013 Interim results: Nov 2013 Final Results: March 2014	Phil Triggs/Paul Baker
2	Receive feedback and agreement from employers (scheduled and admitted bodies) in run up to valuation on assumptions used in actuarial valuation process	31 March 2013	Phil Triggs
3	Provide employers with IAS19/FRS17 funding statements when requested	Scheduled bodies: Mar 2013 Colleges: July 2013 Academies: August 2013	Phil Triggs
4	Monitor and reconcile contributions schedule for the County Council and scheme employers	Ongoing	Phil Triggs
5	Member training covering funding issues	Ongoing	Phil Triggs

Surrey Pension Fund Board Members			
Objective(s) - to train and develop all members to enable them to perform duties effectively - to meet quarterly and to include investment advisor and independent advisors as required - to run meetings efficiently and to ensure decisions are made clearly and effectively			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Review decision making process to ensure decisions are made effectively	Ongoing with new Pension Fund Board	Board Members
2	Review Pension Fund Board member training requirements and implement training plan as appropriate	Ongoing	Phil Triggs
3	Agree a framework for Pension Fund Board member training	31 May 2013	Phil Triggs
4	Ensure that meeting papers are issued at least seven days prior to meeting	Ongoing	Phil Triggs
5	Finalise corporate governance in line with revised Myners/CIPFA principles to ensure 100% compliance	Ongoing 2013/14	Phil Triggs

Financial & Risk Management			
Objective(s) - To properly record financial transactions to and from the Scheme and produce annual accounts within 6 months of year end - Manage advisers fees against budgets - Assess the risk associated with the management of the Scheme			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Monitor pension fund expenses for next financial year with the target of unit cost in lowest quartile	Ongoing 2013/14	Phil Triggs
2	Produce Annual Statement of Accounts	24 May 2013	Phil Triggs
3	Produce Pension Fund Annual Report	30 September 2013	Phil Triggs
4	Carry out risk assessment of the management of the fund for 2014/15	31 March 2014	Phil Triggs
5	To implement a system of disaster recovery/business continuity in the event of major disaster	Ongoing 2013/14	Phil Triggs/Paul Baker

Investment			
Objective(s) - Periodically review investment strategy and benchmarks - Monitor performance against benchmarks - Meet with investment managers to discuss performance			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Ongoing consideration of CIPFA/Myners principles	Ongoing 2013/14	Phil Triggs
2	Review of investment manager arrangements	March 2014	Phil Triggs
3	Review asset allocation with consultant and independent advisor	March 2014	Phil Triggs
4	Discuss/meet with all investment managers and report to Pension Fund Board	Quarterly 2013/14	Phil Triggs
5	Review SIP	March 2014	Phil Triggs
6	Pension Fund Board to receive quarterly monitoring reports	Quarterly 2013/14	Phil Triggs

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Surrey Pension Fund
Business Plan and Actions for 2014/15

Administration			
Objective(s) - to ensure scheme is run in accordance with the rules; in accordance with agreed service standards; and compliance with Regulations - to deal with and rectify any errors and complaints in a timely way			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Chief Finance Officer and Pension Fund Board to receive key performance indicators report on a quarterly basis	Ongoing with reports due at each Board meeting	Phil Triggs/Paul Baker
2	Pension Fund Board to receive the Pension Fund Annual Report	By 30 September 2014	Phil Triggs
3	Ensure that any complaints against action or inaction by pension staff are dealt with in a timely manner	Ongoing	Paul Baker
4	Review the content of the pension fund website to ensure it is relevant and kept up to date.	Ongoing	Paul Baker/Phil Triggs
5	Implement new LGPS 2014 Scheme which takes effect on 1 April 2014	Progress report to Pension Fund Board meeting of 15 May 2014	Paul Baker/Phil Triggs

Communication			
Objective(s) - to convey the security of the Scheme - to ensure members understand and appreciate the value of their benefits			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Production of a newsletter to pensioners in April each year	April 2014	Paul Baker
2	Timely production of benefit statements	Active members by 30 Sep 2014 Preserved members by 30 June 2014 Councillors by 31 Aug 2014	Paul Baker
3	Ensure communication material complies with current legislation and effectively communicates the benefits of the scheme Ensure communication material is amended to comply with the requirements of the new LGPS 2014	Ongoing Include in progress report to Board meeting on 15 May 2014	Paul Baker
4	Communication on a timely basis of material scheme changes to Pension Fund Board, employer bodies and members	Ongoing	Phil Triggs/Paul Baker
5	Prepare Pension Fund Annual Meeting (Nov) and receive feedback from employers	21 November 2014	Phil Triggs/Paul Baker

Actuarial/Funding			
Objective(s) - to monitor the funding level of the Scheme including formal valuation every 3 years - to monitor and reconcile contribution payments to the Scheme by the employers and scheme members - to understand legislative changes which will impact on funding			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Conclude 2013 actuarial valuation	31 March 2014	Phil Triggs/Paul Baker
2	Receive satisfaction survey feedback from employers (scheduled and admitted bodies)	30 April 2014	Phil Triggs
3	Provide employers with IAS19/FRS17 funding statements when requested	Scheduled bodies: Mar 2014 Colleges: July 2014 Academies: August 2014	Phil Triggs
4	Monitor and reconcile contributions schedule for the County Council and scheme employers	Ongoing	Phil Triggs
5	Member training covering funding issues	Ongoing	Phil Triggs

Surrey Pension Fund Board Members

Objective(s)

- to train and develop all members to enable them to perform duties effectively
- to meet quarterly and to include investment advisor and independent advisors as required
- to run meetings efficiently and to ensure decisions are made clearly and effectively

Action	Description	Timescale	Primary Responsibility
1	Review decision making process to ensure decisions are made effectively	Ongoing with new Pension Fund Board	Board Members
2	Review Pension Fund Board member training requirements and implement training plan as appropriate	Ongoing	Phil Triggs
3	Agree annual plan for Pension Fund Board member training	15 May 2014	Phil Triggs
4	Ensure that meeting papers are issued at least seven days prior to meeting	Ongoing	Phil Triggs
5	Ensure that governance remains in line with revised Myners/CIPFA principles to ensure 100% compliance	Ongoing 2014/15	Phil Triggs

Financial & Risk Management			
Objective(s) - To properly record financial transactions to and from the Scheme and produce annual report and accounts within six months of year end - Manage advisers fees against budgets - Assess the risk associated with the management of the Scheme			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Monitor pension fund expenses for next financial year with the target of unit cost in lowest quartile	Ongoing 2014/15	Phil Triggs
2	Produce Annual Statement of Accounts	30 June 2014	Phil Triggs
3	Produce Pension Fund Annual Report	30 September 2014	Phil Triggs
4	Ensure ongoing risk assessments of the management of the fund for 2014/15	Ongoing and reported to every Board meeting	Phil Triggs
5	To implement a system of disaster recovery/business continuity in the event of major disaster	Ongoing 2014/15	Phil Triggs/Paul Baker

Investment			
Objective(s) - Periodically review investment strategy and benchmarks - Monitor performance against benchmarks - Meet with investment managers to discuss performance			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Ongoing consideration of CIPFA/Myners principles	Ongoing 2014/15	Phil Triggs
2	Review of investment manager arrangements	March 2015	Phil Triggs
3	Review asset allocation with consultant and independent advisor	March 2015	Phil Triggs
4	Discuss/meet with all investment managers and report to Pension Fund Board	Quarterly 2014/15	Phil Triggs
5	Review SIP	March 2015	Phil Triggs
6	Pension Fund Board to receive quarterly monitoring reports	Quarterly 2014/15	Phil Triggs
7	Respond to national initiatives on pension fund merger/collaboration and report to the Pension Fund Board as necessary	Ongoing 2014/15	Phil Triggs

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Surrey Pension Fund

Pension Fund Board Effectiveness

Self Assessment Questionnaire

2014

8

What is the aim of this document?

The purpose of this document is to obtain feedback from the Pension Fund Board, in order to achieve a better understanding of the effectiveness of the Board and to identify any areas for improvement. Board members will be asked to complete the self-assessment annually.

We have set out a series of questions intended to rate the effectiveness of different areas of the Board. The final column allows you to rate the effectiveness of the Board in each particular area using the scoring system below:

1.	strongly agree
2.	agree
3.	neither agree nor disagree
4.	disagree
5.	strongly disagree

Please answer the questions and return the questionnaire to Phil Triggs by **13th May 2014** by either:

- email a scanned copy to phil.triggs@surreycc.gov.uk
- post
- drop in

Should you have any comments, suggestions, or ideas, including whether any other areas should be assessed, please let us know by completing the "comments" box at the end of the questionnaire.

1. How effective is the Board's organisational structure?

To be completed by all Board members	Strongly agree				Strongly disagree
❖ Taken as a group, the Board has the right background, experience, collective knowledge and skills to appropriately carry out the Board's responsibilities	1	2	3	4	5
❖ The Board has the right number of people to allow for effective and timely decision-making	1	2	3	4	5
❖ The mix of the Board membership is appropriate	1	2	3	4	5
❖ The roles, terms of reference and responsibilities of the Board are appropriate and well understood	1	2	3	4	5
❖ The Board's approach to developing and maintaining its level of knowledge and understanding is appropriate	1	2	3	4	5
❖ Meetings allow sufficient focus on the "big picture" strategic issues (such as funding and investment strategy)	1	2	3	4	5
❖ Board members are open, honest and effective in their communication with each other	1	2	3	4	5
❖ All Board members have appropriate opportunities to contribute in meetings	1	2	3	4	5
❖ The Board has the right level of access to the Pension Fund officers	1	2	3	4	5
❖ The members of the Board have access to people with up-to-date investment knowledge, and these skills, qualities and expertise are put to good use	1	2	3	4	5
❖ The Board receives adequate support from the officers and external advisors	1	2	3	4	5
❖ The Chairman of the Board provides appropriate leadership and conducts meetings in a way which encourages wide debate of the issues	1	2	3	4	5
❖ The Chairman effectively drives accountability and measurement into the Board.	1	2	3	4	5
❖ The Board meetings are well organised, efficient and effective	1	2	3	4	5
❖ The frequency of Board meetings is appropriate	1	2	3	4	5
❖ The Board meetings are well attended	1	2	3	4	5
❖ The Board meetings are of appropriate length to allow discussion of relevant issues consistent with the Board's responsibilities	1	2	3	4	5

8

Are there any ways to improve the way we organise ourselves?
Other Comments:

8

2. How effective is our Board on Governance and Investment Strategy?

To be completed by all Board members	Strongly agree 1	2	3	4	Strongly disagree 5
❖ The Board's governance framework is appropriate and well documented	1	2	3	4	5
❖ The Board spends adequate time on key strategic investment issues	1	2	3	4	5
❖ The Board has sufficient time and resource to monitor the effectiveness of the Board's investment manager arrangements and has appropriate review mechanisms in place	1	2	3	4	5
❖ Meetings are conducted in a way which encourages wide debate of the issues and timely decision making	1	2	3	4	5
❖ The Board considers compliance with the Myners/CIPFA principles on investment	1	2	3	4	5
❖ The Board adequately monitors the performance of the Fund's administration function	1	2	3	4	5
❖ The Board ensures that the Fund's risk assessments are adequate and reviews these regularly	1	2	3	4	5
❖ The Board has a clear view on the Fund's long-term funding objective	1	2	3	4	5
❖ Meeting packs are complete, are received with enough lead time, and include the right information to allow meaningful discussion	1	2	3	4	5
❖ Minutes of Board meetings reflect activities, actions and recommendations discussed at meetings	1	2	3	4	5
❖ The Board reviews the statement of investment principles (SIP) on a regular basis	1	2	3	4	5

Are there any ways to improve our governance and the way we manage our assets and liabilities?

Other Comments:

8

Please let us know if you have any further comments or suggestions for areas that should be included in future.
Please include details of any additional training you feel would be useful
Signed by: Date:

8

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **ACTUARIAL VALUATION 2013: OUTCOME**

SUMMARY OF ISSUE:

Report setting out the final outcome of the 2013 triennial actuarial valuation in respect of the Surrey County Council Pension Fund

9

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1 note the report and adopt the 2013 Actuarial Valuation and Rates & Adjustments Certificate.

2 approve the final version of the Funding Strategy Statement.

REASON FOR RECOMMENDATIONS:

An actuarial valuation is a statutory requirement for the pension fund.

DETAILS:

Background

1 The Surrey County Council Pension Fund has a funding objective:

"To achieve and then maintain a funding target that requires assets equal to 100% of the present value of benefits based on completed service including provision for the effects of future salary growth and inflation up to retirement."

2 In order to achieve this objective, it is necessary to assess the fund's financial position on a periodic basis and implement future contribution rates with a view to achieving the desired status of 100% funding. LGPS pension funds are actuarially valued on a triennial basis and the fund's actuary, Hymans Robertson, has just completed the fund's valuation as at 31 March 2013.

3 Negotiations with all employer bodies have been successfully concluded.

4 This report sets out the final outcome of the valuation with the final version of the actuary's report and certificate included as Annex 1 to this report.

Valuation Results: Deficit and Funding Level

5 At 31 March 2013, the pension fund had a funding level of 72.3%, i.e., the Fund's assets of the fund are adequate to meet 72.3% of the future liabilities.

Individual Employer Contribution Rates

6 While the fund is managed as a whole, it is effectively a number of sub-funds for each individual employer. This means that each employer contributes according to a contribution rate that specifically reflects the individual employer's membership profile. Under guidance from the actuary, we have continued to set deficit recovery contributions as monetary amounts. Employee contributions are payable in addition to the employer contributions.

7 Where there are prospects of early retirement, thus giving rise to additional short-term costs in the form of immediate access to pension benefits, this will result in an element of actuarial strain (but specifically not including any redundancy cost). Additional contributions will be paid on top of the rates indicated in respect of early retirements where appropriate.

9

Process

8 The process commenced from 1 April 2013 with the preparation and transfer of actuarial data to the actuary. The actuary was very complimentary on the quality of the Surrey Pension Fund data, advising officers of a quality rating of over 99% accuracy. Such a high standard makes the actuary's work far easier in terms of the process required to produce an accurate assessment and meaningful contribution rates and deficit payments required to tackle the overall fund deficit. Acknowledgement should be made of the Pensions Administration Team's work over the years in terms of ensuring high quality data is held in respect of the Fund's membership.

9 One outcome of the valuation was the disbanding of the pooling arrangements in respect of parish councils and other admitted bodies. Whilst such a pooling system would work with a complete merger of all parish councils' pension liabilities, if one parish council was required to withdraw from the pool, the contributions paid may have borne little resemblance to the individual pension liabilities that had built up. On production of the initial actuarial results just before Christmas, the Fund was advised by the actuary to take the decision that each employer must pay contributions according to their own liability profile, and this was advised to the affected employers.

10 All employers were advised of new rates from 2 January 2014 onwards. Staff worked diligently in terms of dealing with many queries and feedback. The pension fund is statutorily bound to take into account the financial circumstances of every employer and staff were able to refer specific instances back to the actuary with some flexibility offered where relevant and appropriate. All negotiations were complete by 31 March 2014, apart from one instance where agreement was reached with an employer on 23 April 2014.

Future Funding Plan

11 The Pensions Fund's funding plan is set out in the Funding Strategy Statement (FSS) in Annex 2. Individual employer funding plans and each employer's contribution rates have been determined in accordance with the FSS.

12 Depending on each employer's individual circumstances, different approaches to the funding of benefits will be adopted, as part of the FSS consultation process. For the vast majority of employers, the two main features of the funding plan are that contribution rates should be assessed on the basis of recovery of the deficit over a period of 20 years. The increase in contributions is being phased where appropriate. The contribution rates will continue to be reviewed triennially.

13 The employer bodies of the Fund were consulted on 20 March 2014 with a final draft of the Funding Strategy Statement sent to all relevant employers. Comments and feedback were invited and, where appropriate, such feedback has been incorporated into a final FSS statement. 9

CONSULTATION:

14 The Chairman of the Pension Fund Board has been consulted on the proposed changes and has offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

15 Risk related issues are contained within the actuary's report in Annex 1 and the FSS in Annex 2.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

16 The costs of the actuarial valuation will be funded from the administrative expenses of the pension fund.

CHIEF FINANCE OFFICER COMMENTARY

17 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed within the report and its appendices, and that the actuarial report will provide the Pension Fund with a solid framework in which to achieve a full funding status over the long term.

LEGAL IMPLICATIONS – MONITORING OFFICER

18 The actuarial report is a statutorily required document.

EQUALITIES AND DIVERSITY

19 The report will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT:

21 The following next steps are planned:

- Commencement of the 2014/15 year's work programme in line with the actuarial assumptions.
- Final Actuarial Report and Funding Strategy Statement to be posted onto the Pension Fund website.
- Progress monitoring will take place and, if necessary, matters will be discussed at future Board meetings.
- Next actuarial valuation to take place as at 31 March 2016.

9

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Annex 1: Actuarial Report 2013 and Rates & Adjustments Certificate
Annex 2: Funding Strategy Statement

Sources/background papers:
None

Hymans Robertson LLP has carried out an actuarial valuation of the Surrey Pension Fund ("the Fund") as at 31 March 2013, details of which are set out in the report dated 31 March 2014 ("the Report"), addressed to Surrey County Council ("the Client"). The Report was prepared for the sole use and benefit of our Client and not for any other party; and Hymans Robertson LLP makes no representation or warranties to any third party as to the accuracy or completeness of the Report.

The Report was not prepared for any third party and it will not address the particular interests or concerns of any such third party. The Report is intended to advise our Client on the past service funding position of the Fund at 31 March 2013 and employer contribution rates from April 2014, and should not be considered a substitute for specific advice in relation to other individual circumstances.

As this Report has not been prepared for a third party, no reliance by any party will be placed on the Report. It follows that there is no duty or liability by Hymans Robertson LLP (or its members, partners, officers, employees and agents) to any party other than the named Client. Hymans Robertson LLP therefore disclaims all liability and responsibility arising from any reliance on or use of the Report by any person having access to the Report or by anyone who may be informed of the contents of the Report.

9

Surrey Pension Fund
2013 Actuarial Valuation
Valuation Report

HYMANS ROBERTSON

April 2014

9

Contents

PAGE

1 Executive summary

We have carried out an actuarial valuation of the Surrey Pension Fund ('the Fund') as at 31 March 2013. The results are presented in this report and are briefly summarised below.

Funding position

The table below summarises the financial position of the Fund at 31 March 2013 in respect of benefits earned by members up to this date.

Past Service Position	31 March 2010 (£m)	31 March 2013 (£m)
Past Service Liabilities	2,699	3,538
Market Value of Assets	1,944	2,559
Surplus / (Deficit)	(755)	(980)
Funding Level	**72.0%**	**72.3%**

Both the assets and the liabilities have increased by around 30% over the inter-valuation period, which means the deficit has also grown by around 30%.

The increase in deficit reflects the adverse conditions which the Fund has had to contend with since the previous valuation. In particular, the decrease in the real gilt yield has increased the value placed on the Fund's liabilities.

Contribution rates

The table below summarises the average employer contribution rate that would be required, based on this triennial valuation.

Contribution Rates	31 March 2010 (% of pay)	31 March 2013 (% of pay)
Employer future service rate (incl. expenses)	16.3%	19.9%
Past Service Adjustment (20 year spread)	8.9%	10.8%
Total employer contribution rate (incl. expenses)	25.2%	30.7%
Employee contribution rate	6.7%	6.4%
Expenses	0.4%	0.4%

Again, the increase in the total employer contribution rate is primarily due to the decrease in the real gilt yields which has increased both the employer future service rate and the past service adjustment.

The common contribution rate is a theoretical figure – an average across the whole Fund. In practice, each employer that participates in the Fund has its own underlying funding position and circumstances, giving rise to its own contribution rate requirement. The minimum contributions to be paid by each employer from 1 April 2014 to 31 March 2017 are shown in the Rates and Adjustment Certificate in **Appendix G**.

2 Introduction

Purpose

The main purposes of this valuation are:

- to assess the extent to which the Administering Authority's funding objectives were met at 31 March 2013;
- to identify the future contributions payable by the employers that participate in the Fund in order to meet the Administering Authority's funding objectives;
- to enable completion of all relevant certificates and statements in connection with all relevant regulations;
- to comment on the main risks to the Fund that may result in future volatility in the funding position or to employers' contributions.

Component reports

This document is an "aggregate" report, i.e. it is the culmination of various "component" reports and discussions, in particular:

- The data report;
- The Discussion Document (dated 01 October 2013 which outlined the preliminary assumption proposals and whole fund results;
- The formal agreement by the Administering Authority of the actuarial assumptions used in this document, at a meeting dated 04 October 2013;
- The stabilisation modelling carried out for certain employers, as detailed in our report and presentation to the Administering Authority of 12 August 2013;
- The Funding Strategy Statement, confirming the different contribution rate setting approaches for different types of employer or in different circumstances.

Note that not all of these documents may be in the public domain.

3 Assumptions

Actuarial assumptions

Assumptions must be made about the factors affecting the Fund's finances in the future. Broadly speaking, our assumptions fall into two categories – financial and demographic.

Demographic assumptions typically try to forecast **when** benefits will come into payment and what form these will take. For example, when members will retire (e.g. at their normal retirement age or earlier), how long they will then survive and whether a dependant's pension will be paid.

Financial assumptions typically try to anticipate the **size** of these benefits. For example, how large members' final salaries will be at retirement and how their pensions will increase over time. In addition, the financial assumptions also help us to estimate how much all these benefits will cost the Fund in today's money.

Financial assumptions

A summary of the main financial assumptions adopted for the valuation of members' benefits are shown below.

	31 March 2010		31 March 2013	
Financial assumptions	**Nominal**	**Real**	**Nominal**	**Real**
Discount Rate	6.1%	2.8%	4.6%	2.1%
Salary Increases*	5.3%**	2.0%	3.8%	1.3%
Price Inflation / Pension Increases	3.3%	-	2.5%	-

** Plus an allowance for promotional pay increases.*

***1% p.a. for 2010/11 and 2011/12, reverting to 5.3% p.a. thereafter.*

Discount rate

The funding valuation is effectively a planning exercise, to assess the funds needed to meet the benefits as they fall due. In order to place a current value on the future benefit payments from the Fund, an assumption about future investment returns is required in order to "discount" future benefit payments back to the valuation date at a suitable rate.

For a funding valuation such as this, the discount rate is set by taking into account the Fund's current and expected future investment strategy and, in particular, how this strategy is expected to outperform the returns from Government bonds over the long term. The additional margin for returns in excess of that available on Government bonds is called the Asset Outperformance Assumption (AOA).

The selection of an appropriate AOA is a matter of judgement and the degree of risk inherent in the Fund's investment strategy should always be considered as fully as possible.

Although there has been a downward shift in the expected returns on risky assets since the 2010 valuation, we believe the expected returns in excess of the returns on government bonds to be broadly unchanged since 2010. Therefore, we are satisfied that an AOA of 1.6% p.a. is a prudent assumption for the purposes of this valuation. This results in a discount rate of 4.6% p.a.

Price inflation / pension increases

Due to further analysis of the CPI index since 2010, we expect the average long term difference between RPI and CPI to be 0.8% p.a. compared with 0.5% p.a. at the 2010 valuation.

At the previous valuation, the assumption for RPI was derived from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. At this valuation, we have adopted a similar approach.

Salary increases

The long term assumption for salary increases is RPI plus 0.5% p.a. This translates to CPI plus 1.3% p.a. This is a change in approach from 2010 where we assumed 1% p.a. for 2 years and RPI plus 1.5% p.a. thereafter.

We have set a lower long term rate of salary growth to reflect both short term pay constraints and the belief that general economic growth and hence pay growth may be at a lower level than historically experienced for a prolonged period of time.

Note that this assumption is made in respect of the general level of salary increases (e.g. as a result of inflation and other macroeconomic factors). We also make a separate allowance for expected pay rises granted in the future as a result of promotion. This assumption takes the form of a set of tables which model the expected promotional pay awards based on each member's age and class. Please see **Appendix E** for further details.

Longevity

The main demographic assumption to which the valuation results are most sensitive is that relating to the longevity of the Fund's members. For this valuation, we have adopted assumptions which give the following sample average future life expectancies for members:

	Actives & Deferreds		Current Pensioners	
Assumed life expectancy at age 65	**Male**	**Female**	**Male**	**Female**
2010 valuation - baseline	20.3	22.2	20.2	21.8
2010 valuation - improvements	23.9	25.9	21.9	23.6
2013 valuation - baseline	20.2	22.9	20.3	22.6
2013 valuation - improvements	24.5	26.9	22.5	24.6

Further details of the mortality assumptions adopted for this valuation can be found in **Appendix E**. Note that the figures for actives and deferreds assume that they are aged 45 at the valuation date.

Assets

We have taken the assets of the Fund into account at their market value as indicated in the audited accounts for the period ended 31 March 2013. We have also included an allowance for the expected future payments to be received in relation to the Magistrates bulk transfer as these have been included in the market value of assets as provided from the audited accounts.

In our opinion, the basis for placing a value on members' benefits is consistent with that for valuing the assets - both are related to market conditions at the valuation date.

Demographic assumptions

We are in the unique position of having a very large local authority data set from which to derive our other demographic assumptions. We have analysed the trends and patterns that are present in the membership of local authority funds and tailor our demographic assumptions to reflect LGPS experience.

Details of these assumptions are set out in Appendix E. Further commentary on these was included in the Discussion Document.

Further comments on the assumptions

As required for Local Government Pension Scheme valuations, our proposed approach to this valuation must include a degree of prudence. This has been achieved by explicitly allowing for a margin of prudence in the AOA.

For the avoidance of doubt, we believe that all other proposed assumptions represent the “best estimate” of future experience. This effectively means that there is a 50% chance that future experience will be better or worse than the chosen assumption.

Taken as a whole, we believe that our proposed assumptions are more prudent than the best estimate. The assessed liability value on a “neutral” best estimate (not prudent) basis would perhaps be 20%, lower than the figures shown here.

4 Results

The Administering Authority has prepared a Funding Strategy Statement which sets out its funding objectives for the Fund. In broad terms, the main 'past service' objective is to hold sufficient assets in the Fund to meet the assessed cost of members' past service benefits and the main 'future service' objective is to maintain a relatively stable employer contribution rate. These objectives are potentially conflicting.

Past service

In assessing the extent to which the past service funding objective was met at the valuation date, we have used the actuarial assumptions described in the previous section of this report and funding method described in **Appendix C**. The table below compares the value of the assets and liabilities at 31 March 2013. The 31 March 2010 results are also shown for reference.

The results are presented in the form of a "funding level", this is the ratio of the market value of assets to the assessed cost of members' past service benefits ("liabilities").

A funding level of 100% would correspond to the funding objective being met at the valuation date.

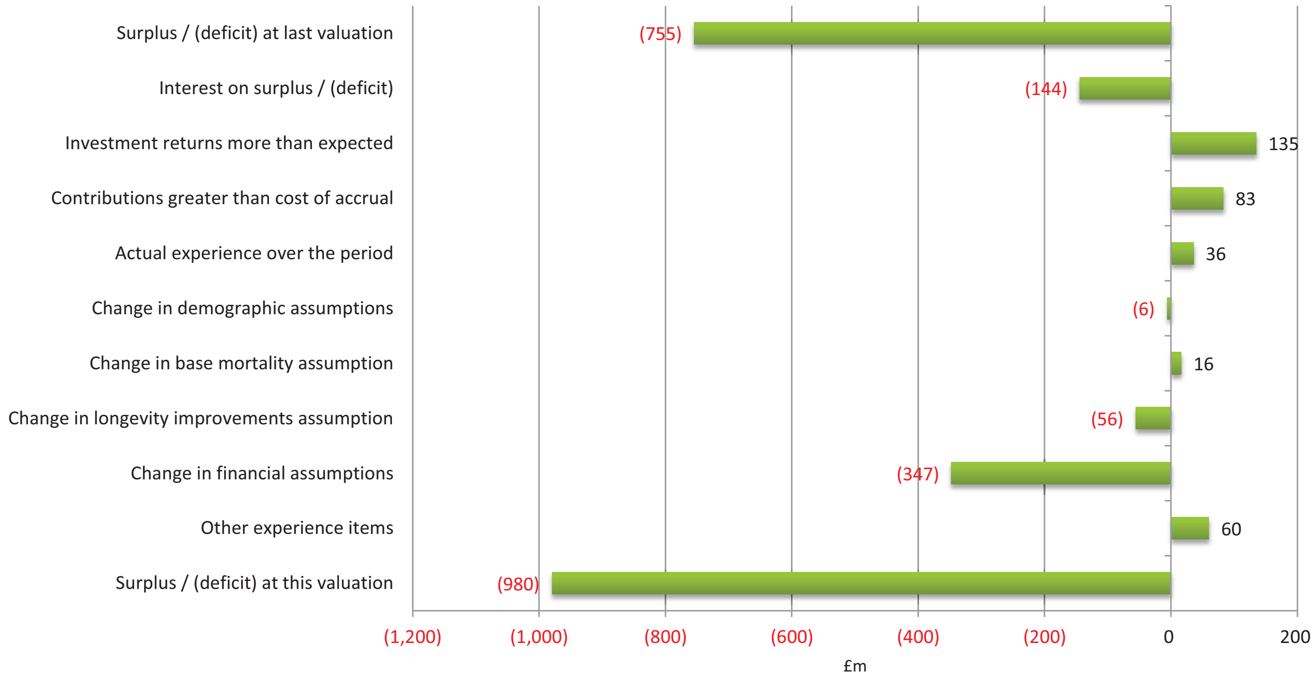
Valuation Date	31 March 2010	31 March 2013
Past Service Position	***(£m)***	**(£m)**
Past Service Liabilities		
Employees	1,111	1,347
Deferred Pensioners	503	684
Pensioners	1,084	1,508
Total Liabilities	2,699	3,538
Market Value of Assets	1,944	2,559
Surplus / (Deficit)	**(755)**	**(980)**
Funding Level	**72.0%**	**72.3%**

The main funding objective was not met: there was a shortfall of assets to the assessed cost of members' benefits of £980m.

Summary of changes to the funding position

The chart below illustrates the factors that caused the funding position to improve between 31 March 2010 and 31 March 2013:

9



Further comments on some of the items in this chart:

- There is an interest cost of £144.3m. This is broadly three years of compound interest at 6.1% p.a. applied to the previous valuation deficit of £755m. This has been partially offset by additional contributions of £83m.
- Investment returns being more than expected since 2010 lead to a gain of £135m. This is roughly the difference between the actual three-year return (roughly 26%) and expected three-year return (roughly 19%) applied to the whole fund assets from the previous valuation of £1,944m, with a further allowance made for cashflows during the period.
- The impact of the change in demographic assumptions has been a loss of around £6m.
- The change in mortality assumptions (baseline and improvements) has given rise to a loss of £40m. This is mainly due to the change in assumed longevity improvements, which allows for people living longer in the future.
- The change in financial conditions between the previous valuation has led to a loss of £347m. This is due to a decrease in the real discount rate between 2010 and 2013. This has been partially offset by the 0.8% p.a. increase in our assumption of the gap between RPI and CPI.
- Other experience items, such as changes in the membership data and actual experience, have served to decrease the deficit at this valuation by around £96m.
- Note that the benefit changes that come into effect as at 1 April 2014 do not change the funding position as all past service benefits to 31 March 2014 are protected.

Future service

We have calculated the average long-term contribution rate that the Fund employers would need to pay to meet the estimated cost of members' benefits that will be earned after 31 March 2013 (the 'future service contribution rate'). Again, we have used the assumptions set out in the previous section of this report and the method set out in **Appendix C**. The resulting contribution rate is that which should (if the actuarial assumptions about the future are borne out in practice) ensure that the Administering Authority's main future service funding objective is met. The table below details this future service contribution rate for 31 March 2013 and shows the 31 March 2010 for comparison.

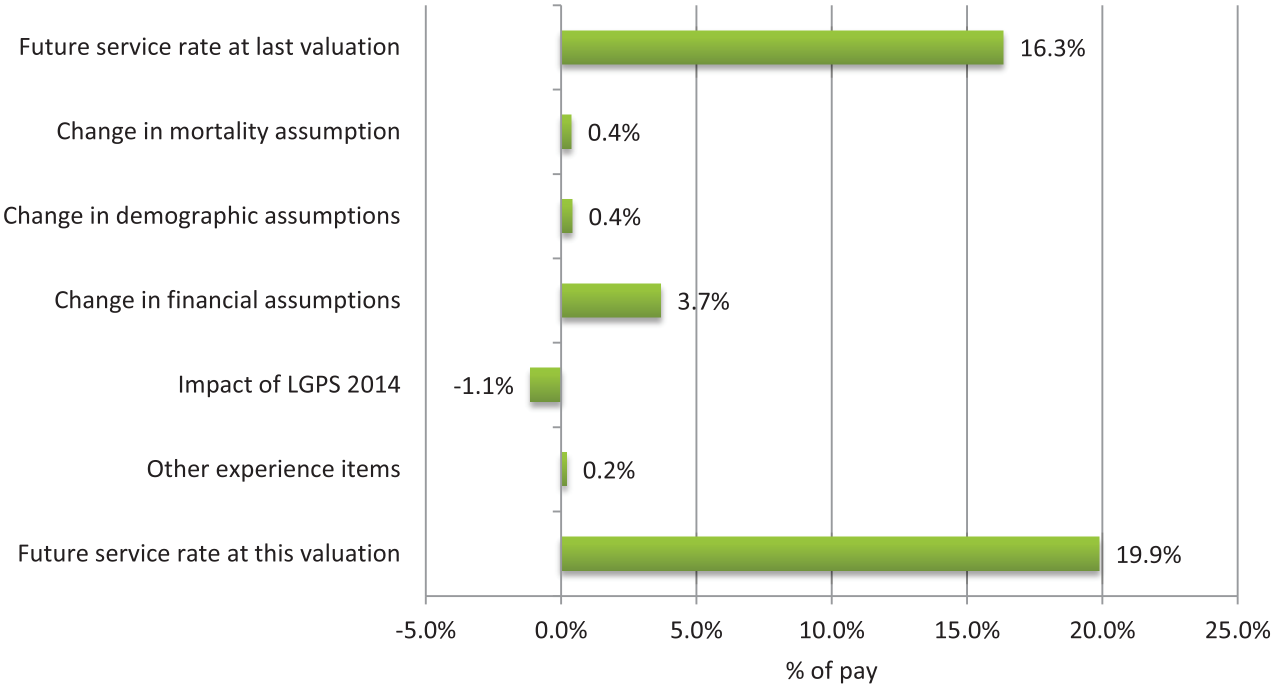
Valuation Date	31 March 2010	31 March 2013
Future service rate	**% of pay**	**% of pay**
Employer future service rate (excl. expenses)	16.0%	19.5%
Expenses	0.4%	0.4%
Total employer future service rate (incl. expenses)	**16.3%**	**19.9%**
Employee contribution rate	6.7%	6.4%

Note that the employee contribution rate includes any additional contributions being paid by employees as at 31 March 2013 into the Fund. This future service contribution rate makes no allowance for the past service deficit in the Fund described above.

The average future service rate for Fund employers is 19.9% of pay. This rate is calculated as at 31 March 2013 and therefore forms part of the total contribution rate payable by employers from 1 April 2014. Note this rate makes an allowance for changes to the benefit structure that take effect from 1 April 2014. In practice, a future service rate for each employer has been calculated which is based on their particular circumstances and membership profile. The rate above is an average future service rate for the Fund as a whole.

Summary of changes to the future service rate

The chart below illustrates the factors that caused the future service rate to increase between 31 March 2010 and 31 March 2013:



As can be seen from this chart, the factors that have had the biggest impact on the future service rate between 2010 and 2013 are broadly similar to those discussed for the past service position.

In addition to this, the impact of the LGPS 2014 scheme has resulted in a reduction in contribution rate of 1.1% of payroll.

Total common contribution rate payable

The total (or "common") contribution rate payable is the average future service rate for Fund employers plus an additional amount to recover the deficit and bring the funding level back to 100% over a period of 20 years, as set out in the Funding Strategy Statement. This additional amount is referred to as the past service adjustment.

The common contribution rate based on the funding position as at 31 March 2013 is detailed below along with the results for 31 March 2010:

Valuation Date	31 March 2010	31 March 2013
Total contribution rate	**% of pay**	**% of pay**
Future service rate (incl. expenses)	16.3%	19.9%
Past service adjustment (20 year spread)	8.9%	10.8%
Total employer contribution rate	**25.2%**	**30.7%**

This does not represent the rate which any one employer is actually required to pay, nor is it the average of the actual employer rates. The actual employer contributions payable from 1 April 2014 are given in **Appendix G**, and these have been devised in line with the Funding Strategy Statement: see **section 6.**

5 Risk Assessment

The valuation results depend critically on the actuarial assumptions that are made about the future of the Fund. If all of the assumptions made at this valuation were exactly borne out in practice then the results presented in this document would represent the true cost of the Fund as it currently stands at 31 March 2013.

However, no one can predict the future with certainty and it is unlikely that future experience will exactly match all of our assumptions. The future therefore presents a variety of risks to the Fund and these should be considered as part of the valuation process. In particular:

- The main risks to the financial health of the Fund should be **identified**.
- Where possible, the financial significance of these risks should be **quantified**.
- Consideration should be given as to how these risks can then be **controlled** or **mitigated**.
- These risks should then be **monitored** to assess whether any mitigation is actually working.

This section investigates the potential implications of the actuarial assumptions not being borne out in practice.

Set out below is a brief assessment of the main risks and their effect on the valuation results, beginning with a look at the effect of changing the main assumptions and then focusing on the two most significant risks – namely investment risk and longevity risk.

Sensitivity of valuation results to changes in assumptions

The table below gives an indication of the sensitivity of the valuation results to small changes in some of the main assumptions used.

		Impact	
Assumption	**Change**	**Deficit (£m)**	**Future service rate (% of pay)**
Discount rate	Increases by 0.5%	Falls by £309m	Falls by 3%
Salary increases	Increases by 0.5%	Rises by £95m	Rises by 2%
Price inflation / pension increases	Increases by 0.5%	Rises by £242m	Rises by 2%
Life expectancy	Increases by 1 year	Rises by £106m	Rises by 1%

This is not an exhaustive list of the assumptions used in the valuation. For example, changes to the assumed level of withdrawals and ill health retirements will also have an effect on the valuation results. However, the table contains those assumptions that typically are of most interest and have the biggest impact.

Note that the table shows the effect of changes to each assumption in isolation. In reality, it is perfectly possible for the experience of the Fund to deviate from more than one of our assumptions simultaneously and so the precise effect on the funding position is therefore more complex.

9

Investment risk

Sensitivity of valuation results to market conditions and investment performance

As the assets of the Fund are taken at their market value, volatility in investment performance can have an immediate and tangible effect on the funding level and deficit. This is particularly relevant because the Fund is invested predominantly in riskier assets such as equities and equity-type investments (e.g. property). A rise or fall in the level of equity markets has a direct impact on the financial position of the Fund, which may seem obvious.

Less obvious is the effect of anticipated investment performance on the Fund's liabilities (and future service cost). Here it is the returns available on government bonds that are of crucial importance, as the discount rate that we use to place a value on the Fund's liabilities is based on gilt yields at the valuation date plus a margin of 1.6% p.a.

The table below shows how the funding level (top), deficit (middle, in £m) and total contribution rate (bottom, as % of pay) would vary if investment conditions at 31 March 2013 had been different. The level of the FTSE 100 Price index is taken as a suitable proxy for asset performance whilst the index-linked gilt yield is taken as a yardstick for the valuation of liabilities.

Index Linked Gilt Yield	FTSE 100 Price Index: 5912	6412	6912
-0.10%	70% (1,010) 29.9%	75% (852) 28.2%	80% (694) 26.4%
-0.30%	68% (1,137) 32.4%	72% (980) 30.7%	77% (822) 28.9%
-0.50%	65% (1,270) 35.0%	70% (1,112) 33.3%	74% (954) 31.6%

The shaded box contains the results for this valuation. Note that this does not take account of the performance of all asset classes held by the Fund (e.g. overseas equities, property, bonds, cash etc.) but it does serve to highlight, in broad terms, the sensitivity of the valuation results to investment conditions at the valuation date.

Note that the scenarios illustrated above are by no means exhaustive. They should not be taken as the limit of how extreme future investment experience could be. The discount rate assumption adopted at this valuation is expected to be appropriate over the long term. Short term volatility of equity markets does not invalidate this assumption.

Longevity risk

The valuation results are also very sensitive to unexpected changes in future longevity. All else being equal, if longevity improves in the future at a faster pace than allowed for in the valuation assumptions, the funding level will decline and the required employer contribution rates will increase.

Recent medical advances, changes in lifestyle and a greater awareness of health-related matters have resulted in life expectancy amongst pension fund members improving in recent years at a faster pace than was originally foreseen. It is unknown whether and to what extent such improvements will continue in the future.

For the purposes of this valuation, we have selected assumptions that we believe make an appropriate allowance for future improvements in longevity, based on the actual experience of the Fund since the previous valuation.

The table below shows how the valuation results at 31 March 2013 are affected by adopting different longevity assumptions.

	Impact	
Longevity assumption	Deficit (£m)	Future service rate
2013 valuation (with improvements)	(980)	19.9%
2013 valuation (further improvements)	(1,127)	20.9%
1 year extra	(1,238)	21.7%

The shaded box contains the results for this valuation.

Full details of the longevity improvements adopted at this valuation are set out in **Appendix E**.

9

The “further improvements” are a more cautious set of improvements that, in the short term, assume the ‘cohort effect’ of strong improvements in life expectancy currently being observed amongst a generation born around the early and mid 1930s will continue to strengthen for a few more years before tailing off. This is known as “non-peaked”.

The “1 year extra” figures relative to a further year of life expectancies beyond those assumed in “further improvements”.

Again, the range of assumptions shown here is by no means exhaustive and should not be considered as the limits of how extreme future longevity experience could be.

Other risks to consider

The table below summarises the effect that changes in some of the other valuation assumptions and risk factors would have on the funding position. Note that these are probably unlikely to have a large financial impact on the Fund and therefore the analysis is qualitative rather than quantitative.

	Impact	
Factor	Funding level	Future service rate
Greater level of ill health retirement	Decreases	Marginal
Reduced level of withdrawals	Decreases	Marginal
Rise in average age of employee members	Marginal effect	Increases
Lower take up of 50:50 option	No impact	Increases

One further risk to consider is the possibility of future changes to Regulations that could materially affect the benefits that members become entitled to. It is difficult to predict the nature of any such changes but it is not inconceivable that they could affect not just the cost of benefits earned after the change but could also have a retrospective effect on the past service position (as the move from RPI to CPI-based pension increases already has).

Managing the risks

Whilst there are certain things, such as the performance of investment markets or the life expectancy of members, that are not directly within the control of the pension fund, that does not mean that nothing can be done to understand them further and to mitigate their effect. Although these risks are difficult (or impossible) to eliminate, steps can be taken to manage them.

Ways in which some of these risks can be managed could be:

- Set aside a specific reserve to act as a cushion against adverse future experience (possibly by selecting a set of actuarial assumptions that are deliberately more prudent).
- Take steps internally to monitor the decisions taken by members and employers (e.g. relating to early / ill health retirements or salary increases) in a bid to curtail any adverse impact on the Fund.
- Pooling certain employers together at the valuation and then setting a single (pooled) contribution rate that they will all pay. This can help to stabilise contribution rates (at the expense of cross-subsidy between the employers in the pool during the period between valuations).
- Carrying out a review of the future security of the Fund's employers (i.e. assessing the strength of employer covenants).
- Carry out a bespoke analysis of the longevity of Fund members and monitor how this changes over time, so that the longevity assumptions at the valuation provide as close a fit as possible to the particular experience of the Fund.
- Undertake an asset-liability modelling exercise that investigates the effect on the Fund of possible investment scenarios that may arise in the future. An assessment can then be made as to whether long term, secure employers in the Fund can stabilise their future contribution rates (thus introducing more certainty into their future budgets) without jeopardising the long-term health of the Fund.
- Monitoring different employer characteristics in order to build up a picture of the risks posed. Examples include membership movements, cash flow positions and employer events such as cessations.

The Fund is intending to purchase ill health liability insurance to mitigate the risk of an ill health retirement impacting on solvency and funding level of an individual employer.

We would be delighted to set out in more detail the risks that affect the Fund and discuss with you possible strategies for managing them.

6 Related issues

The Fund's valuation operates within a broader framework, and this document should therefore be considered alongside the following:

- the Funding Strategy Statement, which in particular highlights how different types of employer in different circumstances have their contributions calculated;
- the Statement of Investment Principles (e.g. the discount rate must be consistent with the Fund's asset strategy);
- the general governance of the Fund, such as meetings of the Pensions Committee, decisions delegated to officers, the Fund's business plan, etc;
- the Fund's risk register;
- the register of Fund employers.

Further recommendations

Valuation frequency

Under the provisions of the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2016. In light of the uncertainty of future financial conditions, we recommend that the financial position of the Fund (and for individual employers in some cases) is monitored by means of interim funding reviews in the period up to this next formal valuation. This will give early warning of changes to funding positions and possible contribution rate changes.

Investment strategy and risk management

We recommend that the Administering Authority continues to regularly review its investment strategy and ongoing risk management programme.

New employers joining the Fund

Any new employers or admission bodies joining the Fund should be referred to the Fund actuary for individual calculation as to the required level of contribution.

Additional payments

Employers may make voluntary additional contributions to recover any shortfall over a shorter period, subject to agreement with the Administering Authority and after receiving the relevant actuarial advice.

Further sums should be paid to the Fund by employers to meet the capital costs of any unreduced early retirements, reduced early retirements before age 60 and/or augmentation (i.e. additional membership or additional pension) using the methods and factors issued by me from time to time or as otherwise agreed.

In addition, payments may be required to be made to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those allowed for within our assumptions.

Cessations and bulk transfers

Any Admission Body who ceases to participate in the Fund should be referred to us in accordance with Regulation 38 of the Administration Regulations.

Any bulk movement of scheme members:

- involving 10 or more scheme members being transferred from or to another LGPS fund, or
- involving 2 or more scheme members being transferred from or to a non-LGPS pension arrangement should be referred to us to consider the impact on the Fund.

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7 Reliances and limitations

Scope

This document has been requested by and is provided to Surrey County Council in its capacity as Administering Authority to the Surrey Pension Fund. It has been prepared by Hymans Robertson LLP to fulfil the statutory obligations in accordance with regulation 36 of the Administration Regulations. None of the figures should be used for accounting purposes (e.g. under FRS17 or IAS19) or for any other purpose (e.g. a termination valuation under Regulation 38(1)).

This document should not be released or otherwise disclosed to any third party without our prior written consent, in which case it should be released in its entirety. Hymans Robertson LLP accepts no liability to any other party unless we have expressly accepted such liability.

The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. We have previously issued a separate report confirming that the data provided is fit for the purposes of this valuation and have commented on the quality of the data provided. The data used in our calculations is as per our report of 4 February 2014. 9

Actuarial Standards

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with where material:

- TAS R – Reporting;
- TAS D – Data;
- TAS M – Modelling; and
- Pensions TAS.

Barry McKay

Fellow of the Institute and Faculty of Actuaries

31 March 2014

Julie West

Fellow of the Institute and Faculty of Actuaries

31 March 2014

[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work, including the information and advice contained in this report.

Appendix A: About the pension fund

For more details please refer to the Fund's Funding Strategy Statement.

The purpose of the Fund is to provide retirement and death benefits to its members. It is part of the Local Government Pension Scheme (LGPS) and is a multi-employer defined benefit pension scheme.

Defined benefit pension scheme

In a defined benefit scheme such as this, the nature of retirement benefits that members are entitled to is known in advance. For example, it is known that members will receive a pension on retirement that is linked to their salary and pensionable service according to a pre-determined formula.

However, the precise cost to the Fund of providing these benefits is **not** known in advance. The estimated cost of these benefits represents a liability to the Fund and assets must be set aside to meet this. The relationship between the value of the liabilities and the value of the assets must be regularly assessed and monitored to ensure that the Fund can fulfil its core objective of providing its members with the retirement benefits that they have been promised.

Liabilities

The Fund's liabilities are the benefits that will be paid in the future to its members (and their dependants).

The precise timing and amount of these benefit payments will depend on future experience, such as when members will retire, how long they will live for in retirement and what economic conditions will be like both before and after retirement. Because these factors are not known in advance, assumptions must be made about future experience. The valuation of these liabilities must be regularly updated to reflect the degree to which actual experience has been in line with these assumptions.

Assets

The Fund's assets arise from the contributions paid by its members and their employers and the investment returns that they generate. The way these assets are invested is of fundamental importance to the Fund. The selection, monitoring and evolution of the Fund's investment strategy are key responsibilities of the Administering Authority.

As the estimated cost of the Fund's liabilities is regularly re-assessed, this effectively means that the amount of assets required to meet them is a moving target. As a result, at any given time the Fund may be technically in surplus or in deficit.

A contribution strategy must be put in place which ensures that each of the Fund's employers pays money into the Fund at a rate which will target the cost of its share of the liabilities in respect of benefits already earned by members and those that will be earned in the future.

The long-term nature of the Fund

The pension fund is a long-term commitment. Even if it were to stop admitting new members today, it would still be paying out benefits to existing members and dependants for many decades to come. It is therefore essential that the various funding and investment decisions that are taken now recognise this and come together to form a coherent long-term strategy.

In order to assist with these decisions, the Regulations require the Administering Authority to obtain a formal valuation of the Fund every three years. Along with the Funding Strategy Statement, this valuation will help determine the funding objectives that will apply from 1 April 2014.

Appendix B: Summary of the Fund's benefits

Provided below is a brief summary of the non-discretionary benefits that we have taken into account for active members at this valuation. This shouldn't be taken as a comprehensive statement of the exact benefits to be paid. For further details please see the Regulations.

Provision	Benefit Structure To 31 March 2008	Benefit Structure From 1 April 2008	Benefit Structure From 1 April 2014
Normal retirement age (NRA)	Age 65.	Age 65.	Equal to the individual member's State Pension Age (minimum 65).
Earliest retirement age (ERA) on which immediate unreduced benefits can be paid on voluntary retirement	As per NRA (age 65). Protections apply to active members in the scheme immediately prior to 1 October 2006 who would have been entitled to immediate payment of unreduced benefits prior to 65, due to: The benefits relating to various segments of scheme membership are protected as set out in Schedule 2 to the Local Government Pension Scheme (Transitional Provisions) Regulations 2008 and associated GAD guidance.		As per NRA (minimum age 65). Protections apply to active members in the scheme for pensions earned up to 1 April 2014, due to: a) Accrued benefits relating to pre April 2014 service at age 65. b) Continued 'Rule of 85' protection for qualifying members. c) Members within 10 yrs of existing NRA at 1/4/12 – no change to when they can retire and no decrease in pension they receive at existing NRA.
Member contributions	Officers - 6% of pensionable pay Manual Workers – 5% of pensionable pay if has protected lower rates rights or 6% for post 31 March 1998 entrants or former entrants with no protected rights.	Banded rates (5.5%-7.5%) depending upon level of full-time equivalent pay. A mechanism for sharing any increased scheme costs between employers and scheme members is included in the LGPS regulations.	Banded rates (5.5%-12.5%) depending upon level of actual pay. A mechanism for sharing any increased scheme costs between employers and scheme members will be included in the LGPS regulations in due course.
Pensionable pay	All salary, wages, fees and other payments in respect of the employment, excluding non-contractual overtime and some other specified amounts. Some scheme members may be covered by special agreements.		Pay including non-contractual overtime and additional hours.
Final pay	The pensionable pay in the year up to the date of leaving the scheme. Alternative methods used in some cases, e.g. where there has been a break in service or a drop in pensionable pay. Will be required for the statutory underpin and in respect of the final salary link that may apply in respect of certain members of the CARE scheme who have pre April 2014 accrual.		n/a

Provision	Benefit Structure To 31 March 2008	Benefit Structure From 1 April 2008	Benefit Structure From 1 April 2014
Period of scheme membership	Total years and days of service during which a member contributes to the Fund. (e.g. transfers from other pension arrangements, augmentation, or from April 2008 the award of additional pension). For part time members, the membership is proportionate with regard to their contractual hours and a full time equivalent). Additional periods may be granted dependent on member circumstances.		n/a
Normal retirement benefits at NRA	Annual Retirement Pension - 1/80th of final pay for each year of scheme membership. Lump Sum Retirement Grant - 3/80th of final pay for each year of scheme membership. Additional lump sum can be provided by commutation of pension (within overriding limits) on a basis of £12 additional lump sum for each £1 of pension surrendered.	Annual Retirement Pension - 1/60th of final pay for each year of scheme membership. Lump Sum Retirement Grant – none except by commutation of pension.	Scheme membership from 1 April 2014: Annual Retirement Pension - 1/49th of pensionable pay (or assumed pensionable pay) for each year of scheme membership. Lump Sum Retirement Grant - None except by commutation of pension
Option to increase retirement lump sum benefit	In addition to the standard retirement grant any lump sum is to be provided by commutation of pension. The terms for the conversion of pension in to lump sum is £12 of lump sum for every £1 of annual pension surrendered.	No automatic lump sum. Any lump sum is to be provided by commutation of pension. The terms for the conversion of pension in to lump sum is £12 of lump sum for every £1 of annual pension surrendered.	No automatic lump sum. Any lump sum is to be provided by commutation of pension. The terms for the conversion of pension in to lump sum is £12 of lump sum for every £1 of annual pension surrendered.
Voluntary early retirement benefits (non ill-health)	On retirement after age 60, subject to reduction on account of early payment in some circumstances (in accordance with ERA protections).		On retirement after age 55, subject to reduction on account of early payment in some circumstances (in accordance with ERA protections).

Provision	Benefit Structure To 31 March 2008	Benefit Structure From 1 April 2008	Benefit Structure From 1 April 2014
Employer's consent early retirement benefits (non ill-health)	On retirement after age 55 with employer's consent. Benefits paid on redundancy or efficiency grounds are paid with no actuarial reduction. Otherwise, benefits are subject to reduction on account of early payment, unless this is waived by the employer.		Benefits paid on redundancy or efficiency grounds are paid with no actuarial reduction. Otherwise, benefits are subject to reduction on account of early payment, unless this is waived by the employer.
Ill-health benefits	As a result of permanent ill-health or incapacity. Immediate payment of unreduced benefits. Enhancement to scheme membership, dependent on actual membership. Enhancement seldom more than 6 years 243 days.	As a result of permanent ill-health or incapacity and a reduced likelihood of obtaining gainful employment (local government or otherwise) before age 65. Immediate payment of unreduced benefits. Enhancement to scheme membership, dependent on severity of ill health. 100% of prospective membership to age 65 where no likelihood of undertaking any gainful employment prior to age 65; 25% of prospective membership to age 65 where likelihood of obtaining gainful employment after 3 years of leaving, but before age 65; or 0% of prospective membership where there is a likelihood of undertaking gainful employment within 3 years of leaving employment	As a result of permanent ill-health or incapacity and a reduced likelihood of obtaining gainful employment (local government or otherwise) before NRA. Immediate payment of unreduced benefits. Enhanced to scheme membership, dependent on severity of ill health. 100% of prospective membership to age 65 where no likelihood of undertaking any gainful employment prior to age 65; 25% of prospective membership to age 65 where likelihood of obtaining gainful employment after 3 years of leaving, but before age 65; or 0% of prospective membership where there is a likelihood of undertaking gainful employment within 3 years of leaving employment

Provision	Benefit Structure To 31 March 2008	Benefit Structure From 1 April 2008	Benefit Structure From 1 April 2014
Flexible retirement	After 5th April 2006, a member who has attained the age of 50, with his employer's consent, reduces the hours he works, or the grade in which he is employed, may elect in writing to the appropriate administering authority that such benefits may, with his employer's consent, be paid to him notwithstanding that he has not retired from that employment. Benefits are paid immediately and subject to actuarial reduction unless the reduction is waived by the employer.	A member who has attained the age of 55 and who, with his employer's consent, reduces the hours he works, or the grade in which he is employed, may make a request in writing to the appropriate administering authority to receive **all or part** of his benefits, Benefits are paid immediately and subject to actuarial reduction unless the reduction is waived by the employer.	
Pension increases	All pensions in payment, deferred pensions and dependant's pensions other than benefits arising from the payment of additional voluntary contributions are increased annually. Pensions are increased partially under the Pensions (Increases) Act and partially in accordance with statutory requirements (depending on the proportions relating to pre 88 GMP, post 88 GMP and excess over GMP).		
Death after retirement	A spouse's or civil partner's pension of one half of the member's pension (generally post 1 April 1972 service for widowers' pension and post 6 April 1988 for civil partners) is payable; plus If the member dies within five years of retiring and before age 75 the balance of five years' pension payments will be paid in the form of a lump sum; plus Children's pensions may also be payable.	A spouse's, civil partner's or nominated cohabiting partner's pension payable at a rate of 1/160th of the member's total membership multiplied by final pay (generally post 1 April 1972 service for widowers' pension and post 6 April 1988 for civil partners and nominated cohabiting partners) is payable; plus If the member dies within ten years of retiring and before age 75 the balance of ten years' pension payments will be paid in the form of a lump sum; plus Children's pensions may also be payable.	

Provision	Benefit Structure To 31 March 2008	Benefit Structure From 1 April 2008	Benefit Structure From 1 April 2014
Death in service	A lump sum of two times final pay; plus A spouse's or civil partner's pension of one half of the ill-health retirement pension that would have been paid to the scheme member if he had retired on the day of death (generally post 1 April 1972 service for widowers' pension and post 6 April 1988 for civil partners); plus Children's pensions may also be payable.	A lump sum of three times final pay; plus A spouse's, civil partner's or cohabiting partner's pension payable at a rate of 1/160th of the member's total (augmented to age 65) membership (generally post 1 April 1972 service for widowers' pension and post 6 April 1988 for civil partners and nominated cohabiting partners), multiplied by final pay; plus Children's pensions may also be payable.	
Leaving service options	If the member has completed three months' or more scheme membership, deferred benefits with calculation and payment conditions similar to general retirement provisions ; or A transfer payment to either a new employer's scheme or a suitable insurance policy, equivalent in value to the deferred pension; or If the member has completed less than three months' scheme membership, a return of the member's contributions with interest, less a State Scheme premium deduction and less tax at the rate of 20%.		If the member has completed two years or more scheme membership, deferred benefits with calculation and payment conditions similar to general retirement provisions ; or A transfer payment to either a new employer's scheme or a suitable insurance policy, equivalent in value to the deferred pension; or If the member has completed less than two years scheme membership, a return of the member's contributions with interest, less a State Scheme premium deduction and less tax at the rate of 20%.
State pension scheme	The Fund is contracted-out of the State Second Pension and the benefits payable to each member are guaranteed to be not less than those required to enable the Fund to be contracted-out.		
Assumed pensionable pay	n/a		This applies in cases of reduced contractual pay (CPP) resulting from sickness, child related and reserve forces absence, whereby the amount added to the CPP is the assumed pensionable pay rather than the reduced rate of pay actually received.
50/50 option	n/a		Optional arrangement allowing 50% of main benefits to be accrued on a 50% contribution rate.

Note: Certain categories of members of the Fund are entitled to benefits that differ from those summarised above.

Discretionary benefits

The LGPS Regulations give employers a number of discretionary powers. The effect on benefits or contributions as a result of the use of these provisions as currently contained within the Local Government Pension Scheme Regulations has been allowed for in this valuation to the extent that this is reflected in the membership data provided. No allowance has been made for the future use of discretionary powers that will be contained within the scheme from 1 April 2014.

Appendix C: About the valuation

For more details please refer the Fund's Funding Strategy Statement.

It is important to realise that the actual cost of the pension fund (i.e. how much money it will ultimately have to pay out to its members in the form of benefits) is currently unknown. This cost will not be known with certainty until the last benefit is paid to the last pensioner. The core purpose of this valuation is to estimate what this cost will be, so that the Fund can then develop a strategy to meet it.

Such a valuation can only ever be an estimate – as the future cannot be predicted with certainty. However, as actuaries, we can use our understanding of the Fund and the factors that affect it to determine an anticipated cost which is as sensible and realistic as possible. A decision can then be made as to how much is set aside now to meet this anticipated cost. The pace of this funding can vary according to the level of prudence that is built into the valuation method and assumptions.

For this valuation, as for the previous valuation, our calculations identify separately the expected cost of members' benefits in respect of scheme membership completed before the valuation date ("past service") and that which is expected to be completed after the valuation date ("future service").

Past service

The principal measurement here is the comparison at the valuation date of the assets (taken at market value) and the value placed on the Fund's liabilities (calculated using a market-based approach). By maintaining a link to the market in both cases, this helps ensure that the assets and liabilities are valued in a consistent manner. Our calculation of the Fund's liabilities also explicitly allows for expected future pay and pension increases.

The funding level is the ratio of assets to liabilities at the valuation date. A funding level of less/more than 100% implies that there is a deficit/surplus in the Fund at the valuation date.

The funding target is to eliminate any deficit (or surplus) over a specified period and therefore get back to a funding level of 100%. To do so, additional contributions may be required to be paid into the Fund, either via lump sums or by increasing the employer's contribution rate. These additional contributions are known as the past service adjustment.

Future service

In addition to benefits that have already been earned by members prior to the valuation date, employee members will continue to earn new benefits in the future. The cost of these new benefits must be met by both employers and employees. The employers' share of this cost is known as the future service contribution rate.

For the valuation results for the Fund as a whole, we have calculated the future service rate as the cost of benefits being earned by members over the year following the valuation, taking account of expected future salary increases until retirement. If new entrants are admitted to the Fund to the extent that the overall membership profile remains broadly unchanged (and if the actuarial assumptions are unchanged) then the future service rate should be reasonably stable.

This funding method we have used is known as the Projected Unit Method. As well as the whole fund, it is appropriate for individual employers that continue to admit new entrants to the Fund.

However, some participating employers may have a policy of not admitting new entrants. In this case, the membership profile will inevitably begin to age. Under these circumstances, the Projected Unit Method is arguably no longer appropriate and will not promote sufficient stability in the future service rate. For these employers, we will adopt a funding method known as the Attained Age Method, which effectively looks at the cost of benefits that members will earn over the entirety of their remaining working lifetime (rather than just the year following the valuation).

Combining this future service rate with any past service adjustment required to repay a deficit (or reduce a surplus) gives us the total contribution rate. The total rate for the Fund as a whole is known as the common contribution rate. This is really just a notional figure. In practice, each individual employer will have a contribution rate which reflects their own particular circumstances.

The sensitivity of valuation results

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The aim of this valuation is not only to determine these important figures but also to demonstrate their sensitivity to a number of key influences. This will promote an understanding of how the expected cost of the Fund may change in response to uncertain future events (e.g. changes in life expectancy or investment returns). Please refer to **section 5** for details of the sensitivity analysis.

Appendix D: Data

This section contains a summary of the membership, investment and accounting data provided by the Administering Authority for the purposes of this valuation (the corresponding membership and investment data from the previous valuation is also shown for reference). For further details of the data, and the checks and amendments performed in the course of this valuation, please refer to our separate report.

Membership data – whole fund

Employee members

	31 March 2010		31 March 2013	
	Number	Pensionable Pay* (£000)	Number	Pensionable Pay* (£000)
Total employee membership	28,651	494,833	29,722	489,043

*actual pay (not full-time equivalent)

Deferred pensioners

	31 March 2010		31 March 2013	
	Number	Deferred pension (£000)	Number	Deferred pension (£000)
Total deferred membership	25,659	30,392	30,189	36,797

The deferred pension shown includes revaluation up to and including the 2013 Pension Increase Order. The figures above also include any “status 2” and “status 9” members at the valuation date.

Current pensioners, spouses and children

	31 March 2010		31 March 2013	
	Number	Pension (£000)	Number	Pension (£000)
Members	15,332	71,237	17,644	88,035
Dependants	2,503	6,754	2,728	7,719
Children	164	246	184	327
Total pensioner members	**17,999**	**78,237**	**20,556**	**96,081**

Note that the membership numbers in the table above refer to the number of records provided to us and so will include an element of double-counting in respect of any members who are in receipt (or potentially in receipt of) more than one benefit.

Membership Profile	Average Age (years)		FWL (years)	
	2010	2013	2010	2013
Employees	51.6	51.5	7.5	8.9
Deferred Pensioners	50.3	50.4	-	-
Pensioners	67.3	67.8	-	-

The average ages are weighted by liability.

The expected future working lifetime (FWL) indicates the anticipated length of time that the average employee member will remain as a contributor to the Fund. Note that it allows for the possibility of members leaving, retiring early or dying before retirement.

Membership data – individual employers

Employer code	Employer Name	Employees		Deferreds		Pensioners	
		Number	Actual Pay (£000)	Number	Pension (£000)	Number	Pension (£000)
00003	Claygate Parish Council	1	*	0	0	0	0
00004	Bisley Parish Council	1	*	0	0	0	0
00005	Frensham Parish Council	1	*	0	0	0	0
00006	Worplesdon Parish Council	1	*	0	0	0	0
00007	Tongham Parish Council	1	*	0	0	0	0
00008	Windlesham Parish Council	4	*	1	*	3	*
00010	West End Parish Council	1	*	2	*	0	0
00011	Haslemere Town Council	2	*	1	*	3	*
00012	Nonsuch Park J.M.C	4	*	0	0	7	51
00013	Mid Southern Water	0	0	4	*	54	407
00014	Merton & Sutton Joint C B	6	103	3	*	20	29
00016	Cranleigh Parish Council	4	*	3	*	9	29
00017	Warlingham Parish Council	1	*	0	0	0	0
00018	Horley Town Council	4	*	3	*	7	17
00019	Surrey Probation Committee	0	0	0	0	0	0
00020	Surrey Probation Board	0	0	0	0	0	0
00021	West Surrey Water Board	0	0	0	0	2	*
00023	Surrey Magistrates Courts	0	0	130	324	159	791
00025	Godstone Parish Council	2	*	0	0	0	0
00026	East Horsley Parish Council	1	*	1	*	0	0
00027	Compton Parish Council	0	0	0	0	1	*
00028	PEPER HAROW SCHOOL	0	0	4	*	10	55
00029	Godalming Joint Burial Committee	0	0	1	*	4	*
00030	Effingham Parish council	0	0	1	*	0	0
00032	Lingfield Parish Council	1	*	0	0	0	0
00033	Southlands College	0	0	5	*	11	28
00034	Surrey Valuation Tribunal	1	*	1	*	4	*
00037	North Surrey Water Company	0	0	0	0	3	*
00038	East Surrey Water Company	0	0	0	0	0	0
00044	Hanover Housing Association	91	2,435	255	774	221	859
00045	Surrey County Council	19,402	258,409	19,558	17,434	10,905	44,729
00046	Meath Homes	0	0	0	0	1	*
00070	Ash Parish Council	7	113	11	21	9	26
00073	University Of Surrey	567	11,081	1,007	1,067	758	2,540
00074	Surrey Police Committee m	0	0	79	107	197	511
00075	HASLEMERE SC/SHOTTERMILL	0	0	1	*	0	0
00076	South East Regional Arts	0	0	3	*	7	20
00089	SE Employers Assn	0	0	1	*	6	58
00091	Epsom & Walton Downs Cons	5	*	3	*	5	*
00092	J.S.Jeffries Swimming Pool	0	0	8	30	2	*
00093	Reigate Grammar School	65	1,397	20	61	22	98
00094	Moor House School	28	513	66	95	38	162
00095	The Royal Grammar School	22	645	19	35	27	101
00096	Sir William Perkins's School	11	316	4	*	15	48
00327	Oxted Parish Council	1	*	0	0	0	0
00328	Chiddingfold Parish Council	1	*	0	0	0	0
00329	Chaldon Village Council	1	*	0	0	0	0
00330	Whiteleaf Village Council	1	*	0	0	0	0
00347	The Royal School, Hindhead	0	0	0	0	1	*
00359	Elmbridge Borough Council	350	8,942	401	960	691	3,996
00360	Elmbridge Housing Trust	12	428	25	139	26	251
00361	Epsom & Ewell Borough Council	245	6,090	287	558	449	2,470
00379	Guildford Borough Council	701	17,840	1,005	1,782	756	4,456
00390	S.A.D.A.S	10	258	27	46	2	*
00436	Mole Valley District Council	226	5,903	332	745	429	2,536
00470	N SY JNT SEWRGE BRD (CLO	0	0	0	0	1	*
00481	Reigate & Banstead Borough Council	362	9,803	477	1,256	735	4,547
00494	Runnymede Borough Council	356	8,738	344	675	450	2,611
00501	Cleves Junior	48	462	11	3	0	0
00502	Thomas Knyvett Academy	27	373	13	14	0	0

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Employer code	Employer Name	Employees Number	Employees Actual Pay (£000)	Deferreds Number	Deferreds Pension (£000)	Pensioners Number	Pensioners Pension (£000)
00503	Howard of Effingham Academy	72	1,237	8	9	2	*
00504	Sunbury Manor	44	801	11	13	2	*
00505	Glyn School	65	940	8	7	0	0
00506	Weydon School	50	640	13	10	0	0
00507	Collingwood	106	1,342	23	21	5	*
00508	George Abbot	92	1,453	12	12	7	24
00509	South Farnham	45	357	26	7	0	0
00510	Magna Carta	53	821	7	3	1	*
00511	Rodborough Technology College	46	605	6	10	6	28
00512	Rydens	56	918	6	7	1	*
00513	Thamesmead	45	698	6	3	1	*
00514	The Raleigh	49	264	9	5	1	*
00515	Woolmer Hill Technology College	24	365	7	6	0	0
00516	Epsom and Ewell High School Academy	27	479	5	*	1	*
00517	The Beacon School	42	809	0	0	1	*
00518	Peper Harow Foundation	0	0	14	34	8	150
00519	Fullbrook School Academy	45	706	10	14	5	*
00520	Rosebery School Academy	58	784	6	3	2	*
00521	Blenheim High School Academy	58	912	7	4	2	*
00522	Hinchley Wood School	54	897	3	*	0	0
00523	Goldsworth School	41	300	0	0	0	0
00524	The Bishop Wand	41	536	1	*	2	*
00525	Cobham Free School	5	*	0	0	0	0
00526	Danetree Junior School	27	260	2	*	0	0
00527	Matthew Arnold School	68	962	5	*	0	0
00528	Wishmore Cross	42	493	3	*	0	0
00529	Warlingham School	80	1,153	4	*	1	*
00530	Weyfield Primary Academy	41	340	2	*	0	0
00531	Guildford County Academy	48	610	0	0	0	0
00532	Gordons School Academy Trust	21	268	1	*	0	0
00536	Spelthorne Borough Council	279	6,975	335	726	519	3,089
00547	Surrey Heath Borough Council	205	5,643	285	866	395	2,619
00553	Tandridge District Council	259	7,270	222	418	372	2,605
00584	Waverley Borough Council	372	9,121	400	1,089	606	4,028
00603	Woking Borough Council	329	8,257	466	905	596	3,797
00604	Woking Meals Service	0	0	1	*	3	*
00679	Godalming Town Council	5	*	1	*	4	*
00740	Achieve Lifestyle	31	415	2	*	0	0
00741	Riverside Housing Group	2	*	1	*	0	0
00742	Look Ahead Housing and Care Ltd	2	*	0	0	0	0
00743	Guildford Freedom Leisure	66	1,279	5	*	1	*
00744	Woking Freedom Leisure	103	801	2	*	0	0
00745	IESE - Improvement and Efficiency South East	17	894	1	*	0	0
00761	SIAD	0	0	5	*	10	30
00802	National Care Standards Commn	0	0	4	*	2	*
00803	Raven Housing Trust	49	1,308	30	131	44	262
00804	S W T Countryside Services Ltd	10	268	5	*	10	96
00805	Surrey Community Dev Trust	0	0	0	0	1	*
00806	Hoppa	6	144	6	4	9	13
00807	Carillion Highway Maintance Ltd	0	0	1	*	6	29
00808	Ringway Highway Services	0	0	0	0	2	*
00809	SERCO LTD	22	416	15	10	6	18
00810	CSCI	0	0	8	55	5	*
00811	VT Four S	101	3,164	109	330	70	728
00812	G Burlegh and Sons	4	*	2	*	2	*
00813	Childhood First	4	*	0	0	1	*
00814	East Surrey Rural Transport Partnership	0	0	0	0	1	*
00815	Mole Valley Housing Association	26	665	22	62	21	82
00816	Ability	5	*	0	0	0	0
00818	Fusion Lifestyle	21	295	8	6	4	*
00819	Commision for Social Care Inspection	2	*	1	*	2	*

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Employer code	Employer Name	Employees Number	Employees Actual Pay (£000)	Deferreds Number	Deferreds Pension (£000)	Pensioners Number	Pensioners Pension (£000)
00820	Skanska Construction UK Ltd (Streetlighting)	12	396	0	0	2	*
00821	Surrey Sports Park	6	258	9	25	1	*
00822	May Gurney	8	200	2	*	2	*
00823	Mansell Construction Services Ltd	2	*	0	0	0	0
00824	Morrison Facilities Services Ltd	10	255	0	0	1	*
00825	Pinnacle Housing Limited	9	235	0	0	0	0
00826	Caring Daycare Limited	9	132	3	*	0	0
00891	Accent Peerless Ltd	9	233	32	159	40	311
00895	Witley Parish Council	3	*	2	*	2	*
00896	Surrey Assoc. for Visual Impairment	15	364	19	37	14	53
00897	Bramley Parish Council	1	*	1	*	1	*
00900	Glyn A D T Tech. School	0	0	1	*	0	0
00901	Guildford County School	0	0	0	0	3	*
00902	Collingwood College	0	0	4	*	9	12
00903	St John The Baptist School	0	0	1	*	0	0
00906	Sir William Perkins School	0	0	6	5	8	14
00907	Epsom & Ewell High School	0	0	5	*	2	*
00908	Heathside School	0	0	5	*	3	*
00909	Hawkedale School	9	61	14	6	4	*
00911	Stoneleigh First School	0	0	2	*	3	*
00912	The Beacon School	0	0	22	21	10	30
00913	Rosebery School	0	0	6	6	3	*
00914	De Stafford School	1	*	26	20	13	25
00917	N.E.S.C.O.T	192	2,798	364	378	167	541
00918	Brooklands College	126	2,440	162	235	117	368
00919	St. Paul's Catholic College	36	635	42	32	16	21
00920	Esher College	44	881	45	36	19	82
00921	Farnham College	0	0	27	17	5	*
00922	Godalming College	60	1,017	95	59	37	81
00923	Merrist Wood College	0	0	73	62	25	75
00924	Reigate College	72	1,103	65	48	15	58
00925	Spelthorne College	0	0	16	10	16	19
00926	Strodes College	56	904	36	36	24	49
00927	East Surrey College	126	2,385	222	233	124	316
00928	Woking College	25	348	20	13	22	46
00929	Guildford College of F E	271	5,828	359	455	161	635
00930	Pewley Down School	0	0	1	*	0	0
00931	Holy Trinity School	0	0	0	0	1	*
00932	Parkmead Infant School	0	0	1	*	2	*
00933	Yattenden School	0	0	2	*	0	0
00935	Send Parish Council	1	*	0	0	1	*
00936	South East Arts Board	0	0	35	78	10	46
00937	Farnham Town Council	13	303	6	15	4	*
00938	Shere Parish Council	0	0	0	0	1	*
00939	Shalford Parish Council	0	0	0	0	1	*
00940	Salesian School	0	0	3	*	6	11
00941	Sayes Court Junior School	0	0	1	*	0	0
00942	Northmead School	24	293	10	3	6	7
00943	St Thomas Of Canterbury	0	0	0	0	3	*
00945	Burstow Primary School	0	0	2	*	2	*
00946	Binscombe Middle School	0	0	2	*	1	*
00947	Burpham Primary School	0	0	5	*	1	*
00948	The Winston Churchill Sc	0	0	3	*	1	*
00949	Fullbrook School	0	0	35	44	12	34
00950	Wallace Fields Junior School	0	0	3	*	5	*
00951	Tadworth Primary School	0	0	3	*	0	0
00952	Whyteleafe School	0	0	3	*	0	0
00954	Hinchley Wood School	0	0	31	20	9	19
00955	Godstone Village School	0	0	1	*	0	0
00956	Bushy Hill Junior School	0	0	0	0	1	*

Employer code	Employer Name	Employees		Deferreds		Pensioners	
		Number	Actual Pay (£000)	Number	Pension (£000)	Number	Pension (£000)
00958	Cleves Junior School	0	0	0	0	1	*
00959	Blenheim High School	0	0	31	11	8	5
00960	Leatherhead Trinity School	80	904	47	16	3	*
00961	St Mary's C of E Junior School	35	232	17	5	3	*
00966	Surrey Police Authority	2,028	52,183	1,601	2,871	603	2,473
00974	UCCA	0	0	106	171	58	210
00975	UCCA	0	0	107	131	37	132
00976	University College of Creative Arts	541	11,837	168	267	58	314
00980	The Princess Alice Hospice	2	*	1	*	3	*
00985	Woking Community Transport	0	0	6	5	17	48
00986	Rosebery Housing Association	2	*	6	46	19	118
00994	Spelthorne Housing Assn	0	0	2	*	6	17
00995	APEX/A2 Housing Group Ltd	4	*	7	54	21	208

* Where there are 5 or less members, the data has been removed for data protection purposes.

Assets at 31 March 2013

A summary of the Fund's assets (excluding members' money-purchase Additional Voluntary Contributions) as at 31 March 2013 and 31 March 2010 is as follows:

Asset class	Market Value at 31 March 2010 (£000)	Allocation %	Market Value at 31 March 2013 (£000)	Allocation %
UK equities	707,888	36%	662,158	26%
UK fixed interest gilts	52,781	3%	102,904	4%
UK corporate bonds	146,207	8%	122,755	5%
UK index-linked gilts	24,541	1%	99,100	4%
Overseas equities	724,248	37%	1,241,851	49%
Overseas bonds	112,209	6%	122,204	5%
Property	109,721	6%	120,748	5%
Cash and net current assets	65,273	3%	86,995	3%
Total	**1,942,868**	100%	**2,558,715**	100%

Note that, for the purposes of determining the funding position at 31 March 2013, the asset value we have used also includes the present value of expected future early retirement strain payments (amounting to £0m).

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Accounting data – revenue account for the three years to 31 March 2013

Consolidated accounts (£000)	Year to 31 March 2011	31 March 2012	31 March 2013	Total
Income				
Employer - normal contributions	101,013	103,056	106,544	310,613
Employer - additional contributions	32	21	71	124
Employer - early retirement and augmentation strain contributions	5,926	3,594	2,899	12,419
Employee - normal contributions	32,149	31,158	31,253	94,560
Employee - additional contributions	813	753	627	2,193
Transfers In Received (including group and individual)	17,770	13,968	31,983	63,721
Other Income	0	0	0	0
Total Income	**157,703**	**152,550**	**173,376**	**483,629**
Expenditure				
Gross Retirement Pensions	79,664	86,143	94,191	259,998
Lump Sum Retirement Benefits	19,737	20,667	16,818	57,222
Death in Service Lump sum	2,641	2,946	2,840	8,427
Death in Deferment Lump Sum	0	0	0	0
Death in Retirement Lump Sum	0	0	0	0
Gross Refund of Contributions	18	15	29	62
Transfers out (including bulk and individual)	13,516	35,820	7,916	57,252
Fees and Expenses	1,863	1,761	1,911	5,535
Total Expenditure	**117,439**	**147,352**	**123,705**	**388,496**
Net Cashflow	**40,264**	**5,198**	**49,671**	**95,133**
Assets at start of year	**1,942,868**	**2,152,894**	**2,196,270**	**1,942,868**
Net cashflow	40,264	5,198	49,671	95,133
Change in value	169,762	38,178	312,774	520,714
Assets at end of year	**2,152,894**	**2,196,270**	**2,558,715**	**2,558,715**
Approximate rate of return on assets	**8.6%**	**1.8%**	**14.1%**	**26.2%**

Note that the figures above are based on the Fund accounts provided to us for the purposes of this valuation, which were fully audited at the time of our valuation calculations.

Appendix E: Assumptions

Financial assumptions

Financial assumptions	31 March 2010 (% p.a.)	31 March 2013 (% p.a.)
Discount rate	6.1%	4.6%
Price inflation	3.8%	3.3%
Pay increases*	5.3%	3.8%
Pension increases:	3.3%	2.5%
pension in excess of GMP	3.3%	2.5%
post-88 GMP	2.8%	2.5%
pre-88 GMP	0.0%	0.0%
Revaluation of deferred pension	3.3%	2.5%
Expenses	0.4%	0.4%

*An allowance is also made for promotional pay increases (see table below). Note that the assumption at 31 March 2013 is actually 1% p.a. for 2010/11 and 2011/12, reverting to 5.3% p.a. thereafter.

Mortality assumptions

Longevity assumptions	31 March 2013
Longevity - baseline	Vita curves
Longevity - improvements	
CMI Model version used	CMI_2010
Starting rates	CMI calibration based on data from Club Vita using the latest available data as at December 2011.
Long term rate of improvement	Period effects: 1.25% p.a. for men and women. Cohort effects: 0% p.a. for men and for women.
Period of convergence	Period effects: CMI model core values i.e. 10 years for ages 50 and below and 5 years for those aged 95 and above, with linear transition to 20 years for those aged between 60 and 80. Cohort effects: CMI core i.e. 40 years for those born in 1947 or later declining linearly to 5 years for those born in 1912 or earlier.
Proportion of convergence remaining at mid point	50%

We have suggested a longevity improvement assumption based on the latest industry standard and combined information from our longevity experts in Club Vita. The start point for the improvements has been based on observed death rates in the Club Vita data bank over the period.

In the short term we have assumed that the ‘cohort effect’ of strong improvements in life expectancy currently being observed amongst a generation born around the early and mid 1930s will start to tail off, resulting in life expectancy increasing less rapidly than has been seen over the last decade or two. This is known as ‘peaked’.

In the long term (post age 70) we have assumed that increases in life expectancy will stabilise at a rate of increase of 1 year per decade for men and women. This is equivalent to assuming that longer term mortality rates will fall at a rate of 1.25% p.a. for men and women.

Various scaling factors have been applied to the mortality tables to reflect the predicted longevity for each class of member and their dependants. Full details of these are available on request.

As a member of Club Vita, the longevity assumptions that have been adopted at this valuation are a bespoke set of VitaCurves that are specifically tailored to fit the membership profile of the Fund. These curves are based on the data you have provided us with for the purposes of this valuation. Full details of these are available on request.

Other demographic valuation assumptions

Retirements in ill health	Allowance has been made for ill-health retirements before Normal Pension Age (see table below).
Withdrawals	Allowance has been made for withdrawals from service (see table below).
Family details	A varying proportion of members are assumed to be married (or have an adult dependant) at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. Husbands are assumed to be 3 years older than wives.
Commutation	50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2008 (equivalent 75% for service from 1 April 2008).
50:50 option	10% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option.

The tables below show details of the assumptions actually used for specimen ages. The promotional pay scale is an annual average for all employees at each age. It is in addition to the allowance for general pay inflation described above. For membership movements, the percentages represent the probability that an individual at each age leaves service within the following twelve months.

Death in Service tables:

Rural

Age	Incidence per 1000 active members per annum			
	Male officers and Post 98	Male Manuals	Female officers and Post 98	Female Manuals
	Death	Death	Death	Death
20	0.21	0.27	0.12	0.15
25	0.21	0.27	0.12	0.15
30	0.26	0.32	0.18	0.22
35	0.30	0.37	0.30	0.37
40	0.51	0.64	0.48	0.60
45	0.85	1.07	0.77	0.97
50	1.36	1.71	1.13	1.42
55	2.13	2.68	1.49	1.87
60	3.83	4.82	1.90	2.39
65	6.38	8.03	2.44	3.07

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Ill Health Early Retirements tables

Tier 1

Rural

Age	Incidence for 1000 active members per annum							
	Male Officers & Post 98 Males		Male Manuals		Female Officers & Post 98 Females		Female Manuals	
	Ill Health		Ill Health		Ill Health		Ill Health	
	FT	PT	FT	PT	FT	PT	FT	PT
20	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
25	0.00	0.00	0.60	0.60	0.15	0.11	0.79	0.79
30	0.00	0.00	1.11	1.11	0.20	0.15	1.15	1.15
35	0.15	0.11	1.66	1.66	0.40	0.30	1.58	1.58
40	0.25	0.19	2.42	2.42	0.60	0.45	2.30	2.30
45	0.55	0.42	3.33	3.33	0.81	0.60	3.02	3.02
50	1.41	1.06	4.94	4.94	1.51	1.13	4.03	4.03
55	5.53	4.15	11.69	11.69	5.61	4.20	10.83	10.83
60	9.73	7.30	18.74	18.74	11.89	8.92	19.05	19.05
65	18.48	13.86	36.12	36.12	21.37	16.03	36.12	36.12

Tier 2

Rural

Age	Incidence for 1000 active members per annum							
	Male Officers & Post 98 Males		Male Manuals		Female Officers & Post 98 Females		Female Manuals	
	Ill Health		Ill Health		Ill Health		Ill Health	
	FT	PT	FT	PT	FT	PT	FT	PT
20	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
25	0.00	0.00	0.64	0.64	0.16	0.12	0.84	0.84
30	0.00	0.00	1.18	1.18	0.21	0.16	1.22	1.22
35	0.16	0.12	1.77	1.77	0.43	0.32	1.68	1.68
40	0.27	0.20	2.57	2.57	0.64	0.48	2.45	2.45
45	0.59	0.44	3.53	3.53	0.86	0.64	3.21	3.21
50	1.90	1.42	6.65	6.65	2.03	1.53	5.43	5.43
55	4.27	3.20	9.03	9.03	4.33	3.25	8.37	8.37
60	3.66	2.75	7.05	7.05	4.48	3.36	7.17	7.17
65	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Tier 3

Rural

Age	Incidence for 1000 active members per annum							
	Male Officers & Post 98 Males		Male Manuals		Female Officers & Post 98 Females		Female Manuals	
	Ill Health		Ill Health		Ill Health		Ill Health	
	FT	PT	FT	PT	FT	PT	FT	PT
20	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
25	0.00	0.00	0.48	0.38	0.09	0.07	0.55	0.44
30	0.09	0.07	0.77	0.62	0.15	0.12	0.77	0.61
35	0.12	0.10	1.16	0.93	0.30	0.24	1.11	0.88
40	0.21	0.17	1.61	1.29	0.39	0.31	1.53	1.22
45	0.48	0.38	2.32	1.86	0.62	0.50	1.96	1.56
50	0.26	0.21	0.68	0.54	0.24	0.20	0.58	0.46
55	0.37	0.30	0.77	0.61	0.45	0.36	0.76	0.61
60	0.21	0.17	0.42	0.33	0.25	0.20	0.42	0.33
65	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

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Withdrawal

Less than 2 years' service

Age	Incidence for 1000 active members per annum											
	Male Officers Withdrawals		Male Manuals Withdrawals		Female Officers Withdrawals		Female Manuals Withdrawals		Post 98 Males Withdrawals		Post 98 Females Withdrawals	
	FT	PT	FT	PT	FT	PT	FT	PT	FT	PT	FT	PT
20	304.04	506.74	304.04	506.74	288.39	400.55	288.39	400.55	557.41	1000.00	384.52	640.87
25	200.83	334.72	201.20	335.01	194.07	269.50	194.43	269.79	368.19	736.38	258.74	431.17
30	142.53	237.46	143.05	237.91	162.69	225.89	163.17	226.27	261.24	522.40	216.89	361.38
35	111.38	185.51	112.17	186.19	140.45	194.94	141.07	195.43	204.11	408.11	187.19	311.79
40	89.71	149.31	90.77	150.23	116.92	162.22	117.80	162.92	164.33	328.47	155.80	259.40
45	73.64	122.28	75.03	123.55	96.49	133.73	97.50	134.54	134.71	268.98	128.49	213.73
50	56.96	94.68	57.28	95.02	73.34	101.75	73.60	101.96	104.26	208.28	97.73	162.71
55	49.47	82.09	49.77	82.44	56.73	78.59	56.97	78.78	90.46	180.57	75.53	125.58
60	29.97	49.75	30.13	49.94	26.40	36.55	26.52	36.65	54.81	109.43	35.13	58.39

More than 2 years' service

Age	Incidence for 1000 active members per annum											
	Male Officers Withdrawals		Male Manuals Withdrawals		Female Officers Withdrawals		Female Manuals Withdrawals		Post 98 Males Withdrawals		Post 98 Females Withdrawals	
	FT	PT	FT	PT	FT	PT	FT	PT	FT	PT	FT	PT
20	119.85	199.76	119.85	199.76	113.69	157.90	113.69	157.90	219.73	439.46	151.58	252.63
25	79.17	131.95	79.31	132.06	76.50	106.24	76.64	106.35	145.14	290.28	101.99	169.97
30	56.18	93.60	56.39	93.78	64.13	89.05	64.32	89.20	102.98	205.93	85.50	142.46
35	43.90	73.12	44.22	73.40	55.37	76.84	55.61	77.04	80.46	160.88	73.79	122.91
40	35.36	58.85	35.79	59.22	46.09	63.95	46.44	64.22	64.78	129.48	61.42	102.26
45	29.03	48.18	29.59	48.71	38.04	52.72	38.44	53.04	53.10	106.03	50.65	84.25
50	22.45	37.31	22.58	37.46	28.91	40.11	29.01	40.19	41.10	82.10	38.52	64.14
55	19.50	32.35	19.62	32.50	22.36	30.98	22.46	31.06	35.66	71.18	29.77	49.50
60	11.82	19.60	11.88	19.69	10.41	14.41	10.46	14.45	21.61	43.14	13.85	23.02

Promotional salary scale

Age	Promotional Salary Scales							
	Male Officers & Post 98 Males		Male Manuals		Female Officers & Post 98 Females		Female Manuals	
	FT	PT	FT	PT	FT	PT	FT	PT
20	100	100	100	100	100	100	100	100
25	135	116	100	100	118	105	100	100
30	169	134	100	100	137	111	100	100
35	192	146	100	100	151	116	100	100
40	208	153	100	100	163	121	100	100
45	222	154	100	100	166	122	100	100
50	236	154	100	100	166	122	100	100
55	239	154	100	100	166	122	100	100
60	239	154	100	100	166	122	100	100
65	239	154	100	100	166	122	100	100

Appendix F: Events since valuation date

Post-valuation events

These valuation results are effectively a snapshot of the Fund as at 31 March 2013. Since that date, various events have had an effect on the financial position of the Fund. Whilst we have not explicitly altered the valuation results to allow for these events a short discussion of these "post-valuation events" can still be beneficial in understanding likelihood of meeting the various funding objectives.

Investment conditions since 31 March 2013

In the period since the valuation date, investment markets moved in the following manner:

- equity markets have risen
- bond yields have risen
- price inflation has risen

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The table below compares the initial valuation results presented in this report with those that would have applied if our assumptions had been based on current market conditions (i.e. assumptions as at 31 December 2013).

Assumptions as at:	*31 March 2013*	*31 December 2013*
Past Service Position	*(£m)*	*(£m)*
Total Liabilities	*3538*	*3407*
Market Value of Assets	*2559*	*2749*
Surplus / (Deficit)	***(980)***	***(658)***
Funding Level	*72.3%*	*80.7%*
Contribution rates	*% of pay*	*% of pay*
Future service rate	*19.9%*	*17.6%*
Past Service Adjustment (20 year spread)	*10.8%*	*7.3%*
Total contribution rate	*30.7%*	*24.9%*

Other events

Other than investment conditions changes above, I am not aware of any material changes or events occurring since the valuation date.

Appendix G: Rates and adjustments certificate

In accordance with regulation 36(1) of the Administration Regulations we have made an assessment of the contributions that should be paid into the Fund by participating employers for the period 1 April 2014 to 31 March 2017 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in the Funding Strategy Statement and our report on the actuarial valuation dated 31 March 2014.

The required minimum contribution rates are set out in the table below.

Signature:	Barry McKay	Julie West
Date:	31 March 2014	31 March 2014
Name:	Barry McKay	Julie West
Qualification:	Fellow of the Institute and Faculty of Actuaries	Fellow of the Institute and Faculty of Actuaries
Firm	Hymans Robertson LLP 20 Waterloo Street Glasgow G2 6DB	Hymans Robertson LLP 20 Waterloo Street Glasgow G2 6DB

Statement to the rates and adjustments certificate

The Common Rate of Contribution payable by each employing authority under regulation 36(4)(a) of the Administration Regulations for the period 1 April 2014 to 31 March 2017 is 30.7% of pensionable pay (as defined in Appendix B).

Individual Adjustments are required under regulation 36(4)(b) of the Administration Regulations for the period 1 April 2014 to 31 March 2017 resulting in Minimum Total Contribution Rates expressed as a percentage of pensionable pay are as set out below.

The contributions shown include expenses and the expected cost of lump sum death benefits but exclude early retirement strain and augmentation costs which are payable by Fund employers in addition.

Employer code	Employer name	Contributions currently being paid in 2013/14	Minimum Contributions for the Year Ending 31 March 2015	31 March 2016	31 March 2017
Scheduled Bodies					
359	Elmbridge Borough Council	14.5% plus £756,000	14.5% plus £988,000	14.5% plus £1,219,000	14.5% plus £1,451,000
361	Epsom & Ewell Borough Council[1]	15.5% plus £418,000	15.5% plus £589,000	15.5% plus £731,000	15.5% plus £873,000
379	Guildford Borough Council	14.6% plus £1,483,000	14.6% plus £2,286,000	14.6% plus £2,112,000	14.6% plus £2,424,000
436	Mole Valley District Council	15.5% plus £578,000	15.5% plus £686,000	15.5% plus £794,000	15.5% plus £902,000
481	Reigate & Banstead Borough Council	15.2% plus £1,167,000	15.2% plus £1,345,000	15.2% plus £1,522,000	15.2% plus £1,700,000
494	Runnymede Borough Council	16.3% plus £362,000	16.3% plus £513,000	16.3% plus £664,000	16.3% plus £815,000
536	Spelthorne Borough Council	15.8% plus £478,000	15.8% plus £657,000	15.8% plus £837,000	15.8% plus £1,016,000
45	Surrey County Council	14.8% plus £16,797,000	14.8% plus £19,453,000	14.8% plus £22,110,000	14.8% plus £24,766,000
547	Surrey Heath Borough Council	15.7% plus £381,000	15.7% plus £550,000	15.7% plus £718,000	15.7% plus £887,000
966	Surrey Police Authority	12.0% plus £1,026,000	17.7% plus £1,026,000	17.7% plus £1,026,000	17.7% plus £1,026,000
553	Tandridge District Council	16.5% plus £931,000	16.5% plus £1,051,000	16.5% plus £1,172,000	16.5% plus £1,292,000
584	Waverley Borough Council	16.5% plus £1,009,000	16.5% plus £1,430,000	16.5% plus £1,430,000	16.5% plus £1,430,000
603	Woking Borough Council	15.0% plus £1,360,000	15.0% plus £1,457,000	15.0% plus £1,553,000	15.0% plus £1,650,000
Other Scheduled Bodies					
70	Ash Parish Council	19.2% plus £25,530	21.6% plus £10,000	23.9% plus £10,000	26.3% plus £10,000
4	Bisley Parish Council	18.6%	21.7%	21.7%	21.7%
897	Bramley Parish Council	19.2% plus £1,543	17.3% plus £2,000	17.3% plus £2,000	17.3% plus £2,000
329	Chaldon Village Council	22.6%	28.6%	28.6%	28.6%
328	Chiddingfold Parish Council	22.6%	27.3%	27.3%	27.3%
3	Claygate Parish Council	18.7% plus £57	28.8% plus £3,000	28.8%	28.8%
16	Cranleigh Parish Council	19.2% plus £11,552	20.2% plus £9,000	21.2% plus £9,000	22.2% plus £9,000
26	East Horsley Parish Council	18.7% plus £89	27.0% plus £2,000	27.0% plus £2,000	27.0% plus £2,000
30	Effingham Parish council	18.7% plus £61	-	-	-
937	Farnham Town Council	19.2% plus £53,212	21.7% plus £8,000	21.7% plus £8,000	21.7% plus £8,000
5	Frensham Parish Council	18.7% plus £42	31.5% plus £1,000	31.5% plus £1,000	31.5% plus £1,000
679	Godalming Town Council	19.2% plus £21,320	19.0%	19.0%	19.0%
25	Godstone Parish Council	18.7% plus £73	28.9%	28.9%	28.9%
11	Haslemere Town Council	18.7% plus £210	13.9%	13.9%	13.9%
18	Horley Town Council	19.2% plus £16,186	21.2% plus £11,000	23.2% plus £11,000	25.2% plus £11,000
32	Lingfield Parish Council	18.7% plus £49	24.1% plus £1,000	24.1% plus £1,000	24.1%
14	Merton & Sutton Joint C B	19.2% plus £22,859	20.1% plus £20,000	21.0% plus £20,000	21.9% plus £20,000
327	Oxted Parish Council	14.7%	19.6%	19.6%	19.6%
935	Send Parish Council	19.2% plus £3,214	19.2%	19.2%	19.2%
938	Shere Parish Council	19.2% plus £7,433	£5,000	£5,000	£5,000
7	Tongham Parish Council	19.2% plus £1,863	22.6% plus £1,000	25.9% plus £1,000	29.3% plus £1,000
17	Warlingham Parish Council	18.7% plus £32	26.6%	26.6%	26.6%
10	West End Parish Council	18.7% plus £79	20.0% plus £1,000	20.0% plus £1,000	20.0% plus £1,000
8	Windlesham Parish Council	19.2% plus £18,206	19.3% plus £3,000	19.3% plus £3,000	19.3% plus £3,000
895	Witley Parish Council	19.2% plus £10,041	21.1% plus £8,000	23.1% plus £8,000	25.0% plus £8,000
330	Whiteleaf Village Council	15.7%	19.7%	19.7%	19.7%
6	Worplesdon Parish Council	18.7% plus £116	19.3% plus £1,000	19.3% plus £1,000	19.3% plus £1,000
Further Education Establishments					
918	Brooklands College	17.1% plus £165,000	20.6% plus £201,333	20.6% plus £237,667	20.6% plus £274,000
927	East Surrey College	16.1% plus £144,000	19.2% plus £180,333	19.2% plus £216,667	19.2% plus £253,000
920	Esher College	16.7% plus £24,000	21.0% plus £35,000	21.0% plus £35,000	21.0% plus £35,000
922	Godalming College[2]	16.7% plus £27,000	17.8% plus £26,600	20.5% plus £26,600	22.5% plus £26,600
929	Guildford College of F E	15.6% plus £488,000	18.8% plus £571,667	18.8% plus £655,333	18.8% plus £739,000
917	N.E.S.C.O.T	16.6% plus £326,000	21.4% plus £370,667	21.4% plus £415,333	21.4% plus £460,000
924	Reigate College	16.7% plus £28,000	22.5% plus £52,000	22.5% plus £52,000	22.5% plus £52,000
926	Strodes College	16.7% plus £20,000	19.8% plus £29,000	19.8% plus £29,000	19.8% plus £29,000
975	University of Creative Arts	16.0% plus £574,000	17.2% plus £808,000	18.4% plus £925,000	19.6% plus £925,000
928	Woking College	16.7% plus £11,000	21.2% plus £39,000	21.2% plus £39,000	21.2% plus £39,000

Employer code	Employer name	Contributions currently being paid in 2013/14	Minimum Contributions for the Year Ending 31 March 2015	31 March 2016	31 March 2017
Admission Bodies					
816	Ability	21.5%	21.5%	21.5%	21.5%
891	Accent Peerless Ltd	18.8% plus £375,000	25.8% plus £505,000	25.8% plus £505,000	25.8% plus £505,000
740	Achieve Lifestyle	16.3%	20.1% plus £8,000	20.1% plus £8,000	20.1% plus £8,000
995	A2 Housing Group	23.1% plus £197,000	26.4% plus £203,000	26.4% plus £203,000	26.4% plus £203,000
811	Babcock 4S	20.2% plus £465,000	24.2% plus £820,000	24.2% plus £820,000	24.2% plus £820,000
826	Caring Daycare Ltd	20.7%	21.3%	21.3%	21.3%
810	Care Quality Commission	21.0% plus £88,000	27.9% plus £104,000	27.9% plus £104,000	27.9% plus £104,000
813	Childhood First	24.3% plus £77,000	22.1% plus £149,000	22.1% plus £149,000	22.1% plus £149,000
814	East Surrey Rural Transport Partnership	-	£12,000	£12,000	£12,000
360	Elmbridge Housing Trust	20.0% plus £83,000	23.6% plus £60,000	23.6% plus £60,000	23.6% plus £60,000
743	Freedom Leisure (Guildford)	19.4%	19.9%	19.9%	19.9%
744	Freedom Leisure (Woking)	17.4%	19.6%	19.6%	19.6%
818	Fusion Lifestyle	17.7%	17.7%	17.7%	17.7%
812	G Burlegh and Sons[3]	18.2%	-	-	-
44	Hanover Housing Association	18.1% plus £1,331,000	22.5% plus £1,373,000	22.5% plus £1,373,000	22.5% plus £1,373,000
806	Hoppa	19.4% plus £8,000	25.9%	25.9%	25.9%
745	IESE - Improvement and Efficiency South East	21.5%	17.1%	17.1%	17.1%
823	Mansell Construction (Woking Housing Transfer)	25.4%	23.6%	23.6%	23.6%
822	May Gurney Ltd	20.9%	27.4% plus £62,000	27.4% plus £62,000	27.4% plus £62,000
815	Mole Valley Housing Association	20.7% plus £55,000	26.1% plus £55,000	26.1% plus £55,000	26.1% plus £55,000
94	Moor House School	16.8% plus £188,000	18.5% plus £188,000	20.2% plus £188,000	21.8% plus £188,000
824	Morrison FS Ltd (Woking Housing Transfer)	24.4%	23.9%	23.9%	23.9%
825	Pinnacle Housing (Woking Housing Transfer)	25.2%	23.4%	23.4%	23.4%
803	Raven Housing Trust	19.9% plus £111,000	24.3% plus £171,000	24.3% plus £171,000	24.3% plus £171,000
93	Reigate Grammar School	19.2% plus £104,000	22.4% plus £97,000	22.4% plus £97,000	22.4% plus £97,000
741	Riverside Group	20.1%	22.3%	22.3%	22.3%
986	Rosebery Housing Association	19.2% plus £12,000	21.9% plus £239,000	21.9% plus £239,000	21.9% plus £239,000
804	Surrey Wildlife Trust	22.1% plus £22,000	26.2% plus £50,000	26.2% plus £50,000	26.2% plus £50,000
809	SERCO LTD	18.3%	23.7% plus £7,000	23.7% plus £7,000	23.7% plus £7,000
96	Sir William Perkins's School	19.2% plus £29,000	26.7% plus £65,000	26.7% plus £65,000	26.7% plus £65,000
390	S.A.D.A.S	15.5% plus £19,000	20.4% plus £24,000	20.4% plus £24,000	20.4% plus £24,000
820	Skanska Construction UK Ltd (Streetlighting)	20.4%	24.3% plus £13,000	24.3% plus £13,000	24.3% plus £13,000
896	Surrey Assoc. for Visual Impairment	19.2% plus £108,000	19.2% plus £108,000	19.2% plus £108,000	19.2% plus £108,000
821	Surrey Sports Park	10.9%	18.4% plus £19,000	18.4% plus £19,000	18.4% plus £19,000
34	Surrey Valuation Tribunal	15.6% plus £11,000	17.0% plus £14,000	17.0% plus £14,000	17.0% plus £14,000
95	The Royal Grammar School	19.2% plus £60,000	25.1% plus £135,000	25.1% plus £135,000	25.1% plus £135,000
73	University Of Surrey	16.4% plus £1,153,000	19.9% plus £1,732,000	19.9% plus £1,732,000	19.9% plus £1,732,000
Academies					
501	Cleves School	24.6%	26.5%	28.4%	30.3%
502	Thomas Knyvett College	19.9%	21.6%	23.4%	25.1%
503	Howard of Effingham School	22.3%	23.9%	25.5%	27.0%
504	Sunbury Manor School	22.4%	24.0%	25.6%	27.2%
505	Glyn School	22.3%	24.4%	26.4%	28.5%
506	Weydon School	20.2%	21.8%	23.5%	25.1%
507	Collingwood College	21.6%	23.1%	24.6%	26.1%
508	George Abbot School	23.3%	24.8%	26.4%	27.9%
509	South Farnham School	21.5%	23.0%	24.4%	25.9%
510	Magna Carta School	24.2%	25.3%	26.3%	27.4%
511	Rodborough Technology College	27.4%	28.7%	30.0%	31.3%
512	Rydens Enterprise School	21.7%	23.1%	24.5%	25.8%
513	Thamesmead School	25.1%	26.5%	27.8%	29.2%
514	The Raleigh School	25.4%	26.5%	27.6%	28.6%
515	Woolmer Hill School	27.7%	29.4%	31.1%	32.8%
516	Epsom & Ewell High School	28.8%	28.1%	28.1%	28.1%
517	The Beacon School	32.7%	30.3%	30.3%	30.3%
519	Fullbrook School	28.5%	29.9%	31.4%	32.9%
520	Rosebery School	28.5%	26.9%	26.9%	26.9%
521	Blenheim High School	32.4%	33.2%	33.2%	33.2%
522	Hinchley Wood School[4]	31.8%	30.9%	30.9%	30.9%
523	Goldsworth Primary School	27.0%	24.1%	24.1%	24.1%
524	The Bishop Wand School	28.7%	27.2%	27.2%	27.2%
525	Cobham Free School	16.4%	16.2%	16.2%	16.2%
526	Danetree Junior School	23.0%	21.6%	21.6%	21.6%
527	Matthew Arnold School	28.1%	26.4%	26.4%	26.4%
528	Wishmore Cross Academy	25.1%	25.5%	25.5%	25.5%
529	Warlingham School	28.5%	29.5%	29.5%	29.5%
530	Weyfield Primary Academy	27.9%	25.8%	25.8%	25.8%
531	Guildford County School	27.6%	26.7%	26.7%	26.7%
532	Gordons School Academy Trust	31.7%	31.3%	31.3%	31.3%

[1] This includes payments of £92,000 each year towards the deficit of Nonsuch Park JMC and Epsom and Walter Downs Conservators.

[2] The college will pay 16.7% of payroll from April 2014 until August 2014 followed by 18.6% of payroll from September 2014 to March 2015.

[3] Contributions should be reassessed if the contract is extended after 31 December 2014.

[4] The academy will pay 28.6% of payroll from April 2015 until August 2015 followed by 30.9% of payroll from September 2015 to March 2016.

Employers with no contributing members					
Employer code	Employer name	Contributions currently being paid in 2013/14	Minimum Contributions for the Year Ending 31 March 2015	31 March 2016	31 March 2017
Admitted Bodies					
29	Godalming Joint Burial Committee	-	-	-	-
75	Haslemere SC/Shottermill	-	-	-	-
46	Meath Homes	-	-	-	-
13	Mid Southern Water	-	-	-	-
89	SE Employers Assn	-	-	-	-
936	South East Arts Board	-	-	-	-
76	South East Regional Arts	-	-	-	-
33	Southlands College	-	-	-	-
805	Surrey Community Dev Trust	-	-	-	-
23	Surrey Magistrates Courts	-	-	-	-
347	The Royal School, Hindhead	-	-	-	-
21	West Surrey Water Board	-	-	-	-
604	Woking Meals Service	-	-	-	-
Parish Councils					
27	Compton Parish Council	-	-	-	-
939	Shalford Parish Council	-	-	-	-

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Surrey Pension Fund: Funding Strategy Statement

1 Funding Strategy Statement

1.1 This is the Funding Strategy Statement (FSS) of the Surrey Pension Fund ("the Fund"), which is administered by Surrey County Council, ("the Administering Authority").

1.2 It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser. It is effective from 1 April 2014.

2 Surrey Pension Fund

2.1 The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the UK. The Administering Authority runs the LGPS Fund for the Surrey area, to ensure it: 9

- receives the correct contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth;
- uses the assets to pay Fund benefits to the members (when they retire, for the rest of their lives), and to their dependants (when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

2.3 The regulatory requirements for a FSS are set out in Appendix A.

2.3 The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

2.4 Key risks and controls are set out in Appendix C.

2.5 Detailed descriptions relating to employer contributions are given in Appendix D.

2.6 Actuarial assumptions are provided in Appendix E and a glossary in Appendix F.

3 Need for a Funding Strategy Statement

3.1 Employees' benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but not all, and certainly with no guarantee. Employees' contributions are fixed in those Regulations, at a level which covers only part of the cost of the benefits. Therefore, employers pay the balance of the cost of delivering the benefits to members and their dependants.

3.2 The FSS is a framework within which the Fund's actuary carries out triennial valuations. It focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and

- prudence in the funding basis.

3.3 The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies. The FSS forms part of a framework of which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate, confirming employer contribution rates for the next three years (see the appendix to the formal valuation report);
- the Fund's policies on admissions, cessations and bulk transfers;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service;
- the Fund's Statement of Investment Principles; and
- the Fund's Governance Statement and Governance Compliance Statement.

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4 Stakeholders

4.1 Members of the Fund (current/former employees, or dependants): the Fund needs to be sure it is collecting and holding enough money so that benefits are always paid in full currently and into the future;

4.2 Employers of the Fund (or those considering joining the Fund): an employer will want to know how contributions are calculated, that these are fair by comparison to other employers in the Fund, and in what circumstances they might need to pay more. Note that the FSS applies to all employers participating in the Fund;

4.3 Elected members whose council participates in the Fund: a member will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;

4.4 Council tax payers: the council will seek to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

5 Objectives of the FSS

5.1 The FSS sets out the objectives of the Fund's funding strategy:

- To achieve and then maintain a funding target that requires assets equal to 100% (ongoing basis) of the present value of benefits based on completed service including provision for the effects of future salary growth and inflation up to retirement;
- To ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due;
- To ensure that employer contribution rates are stable where appropriate;
- To minimise the long-term cash contributions which employers need to pay, by recognising the link between assets and liabilities, and adopting an investment strategy which balances risk and return, thus minimising the costs borne by stakeholders;
- To reflect the different characteristics of employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its liabilities over future years; and

- To use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

6 Calculating a contribution rate?

6.1 Employer contributions are normally made up of two elements:

- the estimated cost of future benefits being built up from year to year, referred to as the "*future service rate*"; plus
- an adjustment for the difference between the assets built up to date and the value of past service benefits, referred to as the "*past service adjustment*" or "past deficit recovery". If there is a deficit, the past service adjustment will be an increase in the employer's total contribution; if there is a surplus there may be a reduction in the employer's total contribution. Any past service adjustment will aim to return the employer to full funding over an appropriate period (the "deficit recovery period").

6.2 An employer's "funding level" is defined as the ratio of: 9

- the market value of the employer's share of assets, to
- the value placed by the actuary on the benefits built up to date for the employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

6.3 If this is less than 100%, then the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value. A larger deficit will give rise to higher employer contributions. If a deficit recovery is spread over a longer period then the annual employer cost is lower.

6.4 The Fund's actuary is required by the Regulations to report the *Common Contribution Rate*, for all employers collectively at each triennial valuation, combining the *future service rate and the past service adjustment outlined* above. This is based on actuarial assumptions about the likelihood, size and timing of benefit payments to be made from the Fund in the future, as outlined in Appendix E.

6.5 The Fund's actuary is also required to adjust the *Common Contribution Rate* for circumstances specific to each employer. It is this adjusted contribution rate which the employer is actually required to pay, and the rates for all employers are shown in the Fund's Rates and Adjustments Certificate.

6.6 In effect, the *Common Contribution Rate* is a notional quantity, as it is unlikely that any employer will pay that exact rate. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific circumstances.

6.7 Details of the outcome of the 2013 Actuarial Valuation can be found in the formal 2013 valuation report, including an analysis at Fund Level of the *Common Contribution Rate*. Further details of individual employer contribution rates can also be found in the formal report.

6.8 Employer covenant and likely term of membership are considered when setting contributions. Any costs of non ill-health early retirements must be paid by the employer. If an employer is approaching the end of its participation in the Fund then its contributions may be amended appropriately, so that the assets meet (as closely as possible) the value of its liabilities in the Fund when its participation ends.

6.9 Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. The Fund Actuary will take account of the higher rate at subsequent valuations.

7 Different types of employer participating in the Fund

7.1 Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate. There are currently more employers in the Fund than ever before, a significant part of this being due to new academies.

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7.2 In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: academy schools, contractors, housing associations, charities, etc.

7.3 The LGPS Regulations define various types of employer as follows:

- **Scheduled bodies:** councils and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so called because they are specified in a schedule to the LGPS Regulations. It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such academies, as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as "Scheduled Bodies", the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion over whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the Department for Communities and Local Government (DCLG) regarding the terms of academies' membership in LGPS Funds. Employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

- **Admission bodies:** other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer: **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer: **transferee admission bodies** ("TAB"). CABs will include housing associations and charities and TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund's admissions policy are not met.

7.4 The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher pension Fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;

- Contributions which Academies pay to the Fund will therefore not be available to pay for providing education;

- Other employers will provide various services to the local community, perhaps through housing associations, charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services.

7.5 It should also be borne in mind that:

- The Fund provides invaluable financial security to local families, namely, retired local community employees, and to their families after their death; 9

- The benefits are enshrined in statutory legislation with no local discretion to vary the structure;

- The Fund must have assets available to meet retirement and death benefits, which in turn means that employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund;

- Each employer will generally only pay for its own employees and ex-employees (and their dependants);

- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible;

- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result; and

- Council contributions to the Fund should be at a suitable level, to protect the interests of current and future council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in the future; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

7.6 Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees. For instance, where an employer is considered relatively low risk then the Fund may permit greater smoothing of contributions (such as stabilisation or a longer deficit recovery period relative to other employers) which will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come, and that lower levels of contributions now may mean higher contributions in the future.

7.7 On the other hand, an employer whose risk assessment indicates a less strong covenant will generally be required to pay higher contributions (for instance, with a more prudent funding basis or a shorter deficit recovery period). This is because of the higher probability that at some point it may fail to meet its pension contributions, with its deficit then falling to other Fund employers.

7.8 The Fund actively seeks employer input, including to its funding arrangements, through various means: see Appendix A (A2). More detailed descriptions relating to employer contributions are given in Appendix D.

8 Calculating contributions for individual employers

8.1 A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of methods which the Administering Authority may permit to improve the stability of employer contributions. These include, where circumstances permit:-

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- capping of employer contribution rate changes within a pre-determined range (“stabilisation”)
- the use of extended deficit recovery periods (up to a maximum of 20 years)
- the phasing in of contribution rises or reductions
- the pooling of contributions amongst employers with similar characteristics
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

8.2 The Administering Authority recognises that there may occasionally be circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case-by-case basis for employers.

8.3 Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than the theoretical contribution rate. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the choice of method,
- lower contributions in the short term may generate lower investment returns over the long term. Thus, deferring a certain amount of contribution will lead to higher contributions in the long-term, and
- it will take longer to reach full funding, all other things being equal.

8.4 Table 1 summarises how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

Table 1: The different approaches used for different employers

Type of employer	Scheduled Bodies			Community Admission Bodies and Designating Employers		Transferee Admission Bodies
Sub-type	**Local Authorities, Police**	**Colleges etc**	**Academies**	**Open to new entrants**	**Closed to new entrants**	**(all)**
Basis used	Ongoing, assumes long-term Fund participation (see Appendix E)			Ongoing, but may move to "gilts basis" - see Note (a)		Ongoing, assumes fixed contract term in the Fund (see Appendix E)
Future service rate	Projected Unit Credit approach (see Appendix D – D.2)				Attained Age approach (see Appendix D – D.2)	Projected Unit Credit approach (see Appendix D – D.2)
Stabilised rate?	Yes - see Note (b)	No	No	No	No	No
Maximum deficit recovery period – Note (c)	20 years	20 years	20 years	Future working lifetime	Future working lifetime	Outstanding contract term
Deficit recovery payments – Note (d)	Monetary amount	Monetary amount	% of payroll	Monetary amount	Monetary amount	Monetary amount
Treatment of surplus	Covered by stabilisation arrangement	Preferred approach: contributions kept at future service rate. However, reductions may be permitted by the Administering Authority				Preferred approach: contributions kept at future service rate. However, contractors may be permitted to reduce contributions by spreading the surplus over the remaining contract term
Phasing of contribution changes	Covered by stabilisation arrangement	At the discretion of the Administering Authority		None	None	None
Review of rates – Note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations					To be reviewed in last 3 years of contract
New employer	n/a	n/a	Note (g)	Note (h)		Notes (h) & (i)
Cessation of participation: cessation debt payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt principles applied would be as per Note (j).			Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (j).		Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising.

Note (a) (Basis for CABs and Designating Employers closed to new entrants)

In the circumstances where:

- the employer is a Designating Employer, or an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may vary the discount rate used to set employer contribution rate. In particular, contributions may be set for an employer to achieve full funding on a more prudent basis (e.g. using a discount rate set equal to gilt yields) by the time the agreement terminates or the last
9 active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Designating Employers and Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease or the Designating Employer alters its designation.

Note (b) (Stabilisation)

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" (and may therefore be paying less than their theoretical contribution rate) should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies to Surrey County Council, all District and Borough Councils and the Office of the Police and Crime Commissioner for Surrey.

This is subject to there being no material events which cause the employer to become ineligible, e.g., significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring).

On the basis of extensive modelling carried out for the 2013 valuation exercise, the stabilised details are as follows:

- Deficit contributions have been set to ensure that stabilised employers are paying no less than 80% by 2016/17 of deficit contributions calculated to ensure the Employer is fully funded in 20 years under the 2013 formal valuation assumptions.

- The future service component of the contribution rate has been fixed for all stabilised employers except the Office of the Police and Crime Commissioner for Surrey. This has been set at the market implied future service rate to ensure this employer is paying contributions above the assessed cost of benefits accruing.

The stabilisation criteria and limits will be reviewed at the 31 March 2016 valuation, to take effect from 1 April 2017. This will take into account the employer's membership profiles, the issues surrounding employer security, and other relevant factors.

Note (c) (Deficit Recovery Periods)

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2014 for the 2013 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example, where there were no new entrants.

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Where the stabilisation mechanism applies, the resulting employer contribution rate would be amended to comply.

For employers with no (or very few) active members at this valuation, the deficit should be recovered by a fixed monetary amount over a period to be agreed with the body or its successor, not to exceed 20 years.

The Administering Authority reserves the right to extend the deficit recovery period beyond that stated in Table 1 (not exceeding 20 years). This would be applied at the discretion of the Administering Authority subject to a satisfactory demonstration of employer security.

Note (d) (Deficit Recovery Payments)

Deficit recovery payments for each employer covering the three year period until the next valuation will generally be set as a monetary amount.

Note (e) (Phasing in of contribution changes)

All phasing is subject to the Administering Authority being satisfied as to the strength of the employer's covenant.

Note (f) (Regular Reviews)

Such reviews may be triggered by significant events including but not limited to:

- significant reductions in payroll,
- altered employer circumstances,
- Government restructuring affecting the employer's business, or
- failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

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Note (g) (New Academy employers)

At the time of writing, the Fund's policies on academies' funding issues are as follows:

a) The new academy will be regarded as a separate employer in its own right and will not be pooled with other employers in the Fund. The only exception is where the academy is part of a Multi Academy Trust (MAT) in which case the academy's figures will be calculated as below but can be combined with those of the other academies in the MAT;

b) The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status;

c) The new academy will be allocated an initial asset share from the ceding council's assets in the Fund. This asset share will be calculated using the estimated funding position of the ceding council at the date of academy conversion. The share will be based on the active members' funding level, having first allocated assets in the council's share to fully fund deferred and pensioner members. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion; and

d) The new academy's initial contribution rate will be calculated using market conditions, the council funding position and, membership data, all as at the day prior to conversion.

The Fund's policies on academies are subject to change in the light of any amendments to DCLG guidance. Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS.

Note (h) (New Admission Bodies)

With effect from 1 October 2012, the LGPS 2012 Miscellaneous Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date. Under these Regulations, all new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund;
- the current deficit.

For all new Transferee Admission Bodies, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis.

The Administering Authority will only consider requests from Community Admission Bodies (or other similar bodies, such as section 75 NHS partnerships) to join the Fund if they are sponsored by a Scheduled Body with tax raising powers, guaranteeing their liabilities and also providing a form of security as above.

The above approaches reduce the risk to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

Note (i) (New Transferee Admission Bodies)

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council or academy) to another organisation (a "contractor"). This involves the Transfer of Undertakings Protection of Employment (TUPE) of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees' Fund benefits. The contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see Note (j). 9

Employers which "outsource" have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. There are three different routes that such employers may wish to adopt. Clearly, as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) Pooling

Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which may be under the stabilisation approach.

ii) Letting employer retains pre-contract risks

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor's contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) Fixed contribution rate agreed

Under this option the contractor pays a fixed contribution rate and doesn't pay any cessation deficit.

Subject to an assessment of the strength of the employer and appropriate safeguards in place, the Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from;

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above;
- redundancy and early retirement decisions.

Note (j) (Admission Bodies Ceasing)

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund;
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- 9 The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of ongoing employers. The actuary will therefore adopt an approach, where possible, that protects remaining employers from the likelihood of any material loss emerging in future:

a) Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in Appendix E;

b) Alternatively, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee. At its absolute discretion the Administering Authority may agree to recover any outstanding amount via an increase in the Awarding Authority's contribution rate, over an agreed period, outside any stabilisation mechanism in place;

c) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

Under (a) and (c), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund would look to any bond, indemnity or guarantee in place for the employer.

In the event that the Fund is not able to recover the required payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

Pooling Employers

8.5 The Administering Authority can give consideration to setting up pools for employers with very similar characteristics. This will always be in line with its broader funding strategy. With the advice of the Actuary, the Administering Authority allows smaller employers of similar types to pool their contributions in order to smooth out the effects of costly events, e.g., ill-health retirements or deaths in service. 9

8.6 Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not usually permitted to participate in a pool. Transferee Admission Bodies are usually also ineligible for pooling. Smaller admitted bodies may be pooled with the letting employer, provided all parties (particularly the letting employer) agree.

8.7 Employers who are permitted to enter (or remain in) a pool at the 2013 valuation will not normally be advised of their individual contribution rate unless agreed by the Administering Authority. Schools generally are also pooled with their funding Council. However there may be exceptions for specialist or independent schools. Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

Additional flexibility in return for added security

8.8 The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority. Such flexibility includes a reduced rate of contribution, an extended deficit recovery period, or permission to join a pool with another body (e.g. the Local Authority).

8.9 Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value. The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan;
- whether the admission agreement is likely to be open or closed to new entrants.

Non ill health early retirement costs

8.10 It is assumed that members' benefits are payable from the earliest possible retirement age without incurring a reduction to their benefit. It should be noted that the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014. Employers are required to pay additional contributions (strain) wherever an employee retires before attaining this age. Therefore the actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

8.11 With the agreement of the Administering Authority the payment can be spread as follows:

Major Employing bodies:	up to 5 years
Community Admission Bodies and Designating Employers:	up to 3 years
Academies:	up to 3 years
Transferee Admission Bodies:	payable immediately.

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Ill health early retirement costs

8.12 Admitted Bodies will usually have an 'ill health allowance'. Scheduled Bodies may have this also, depending on their agreement terms with the Administering Authority. The Fund monitors each employer's ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer may be charged additional contributions to cover the additional liability. For small employers, a single ill health retirement may result in a significant increase to liabilities.

Ill health insurance

8.13 If an employer provides satisfactory evidence to the Administering Authority of a current insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged, and
- there is no need for monitoring of allowances.

8.14 The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy has ceased.

8.15 Currently, the Fund has agreed in principle to the taking out of ill health insurance in respect of all fund employers. Work is underway to implement this.

Employers with no remaining active members

8.16 In general, an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:

- The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro rata basis at successive formal valuations;

- The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation, the remaining assets would be apportioned pro rata by the Fund's actuary to the other employers in the Fund in proportion to each employer's assets.

8.17 In exceptional circumstances the Fund may permit an employer with no remaining active members to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases, as the employer would have no contributing members.

9 Investment Strategy

9.1 The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy. The Investment strategy is set by the administering authority, after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (SIP), which is available to members and employers. 9

9.2 The investment strategy is set for the long-term, but is reviewed regularly. Normally, a full review is carried out after each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile. The same investment strategy is currently followed for all employers.

Link between funding strategy and investment strategy

9.3 The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa. Therefore, the funding and investment strategies are inextricably linked.

Funding strategy reflecting the Fund's investment strategy

9.4 In the opinion of the Fund actuary, the proposed funding strategy is consistent with the current investment strategy of the Fund. The asset outperformance assumption contained in the discount rate is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government.

9.5 However, in the short term, such as the triennial assessments at formal valuations, there is scope for considerable volatility with a material chance that in the short term and even medium term, asset returns will fall short of this target. The stability measures in place will dampen, but not remove, the effect on employers' contributions. The Fund does not hold a contingency reserve to protect it against the volatility of investments.

9.6 The Actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

- Prudence: the Fund should have a reasonable expectation of being fully funded in the long term;
- Affordability: how much employers can afford;

- Stewardship: the assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position;
- Stability: employers should not see significant moves in their contribution rates from one year to the next, and this will help to provide a more stable budgeting environment.

9.7 The key problem is that objectives can often conflict. For example, minimising the long term cost of the scheme, i.e., keeping employer rates affordable, is best achieved by investing in higher returning assets, e.g., equities. However, equities are also very volatile, which can conflict with the objective to have stable contribution rates.

9.8 Therefore a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling (a set of calculation techniques applied by the Fund's actuary), to model the range of potential future solvency levels and contribution rates.

9.9 The Actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach. The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes, struck an appropriate balance between the above objectives. In particular, the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Fund. Whilst the current stabilisation mechanism is to remain in place until 2017, it should be noted that this will need to be reviewed following the 2016 valuation.

Monitoring of overall funding position

9.10 The Administering Authority monitors the relative funding position, i.e., changes in the relationship between asset values and the liabilities regularly. It reports this to the Pension Fund Board meetings.

A1 Why does the Fund need a Funding Strategy Statement (FSS)?

The Department for Communities and Local Government (DCLG) has stated that the purpose of the FSS is:

- *"to establish a **clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;*
- *to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*
- *to take a **prudent longer-term view** of funding those liabilities."*

These objectives are desirable individually, but may be mutually conflicting.

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2012) and to its Statement of Investment Principles. 9

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to "consultation with such persons as the authority considers appropriate", and should include "a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers".

In practice, the consultation process for this FSS was as follows:

a) A draft version of the FSS has been issued to all participating employers in March 2014 for comment.

b) Comments required within 30 days;

c) Following the end of the consultation period, the FSS has been updated as required and then published in April 2014.

A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website at www.surreypensionfund.org
- A copy sent by post and mail to each participating employer in the Fund;
- A copy sent to the employee and pensioner Pension Fund Board representative;
- A copy included in the annual report and accounts of the Fund;
- Copies sent to investment managers and independent advisers;

- Copies made available on request.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2016.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

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In any event, changes to the FSS would need agreement by the Surrey Pension Fund Board and would be included in the relevant Committee Meeting minutes.

A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example, there are a number of separate statements published by the Fund including the Statement of Investment Principles, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at www.surreypensionfund.org

Appendix B: Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to play their part.

B1 The Administering Authority should:-

- operate the Fund as per the LGPS Regulations;
- make proper arrangements for the effective governance of the Fund through the Surrey Pension Fund Board (SPFB);
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
- collect employer and employee contributions, and investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due; 9
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles (SIP) and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the Fund's actuary;
- prepare and maintain a FSS and a SIP, after consultation;
- notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the fund's performance and funding and amend the FSS/SIP as necessary and appropriate.

B2 The Individual Employer should:-

- deduct contributions from employees' pay correctly;
- liaise regularly with the Administering Authority to ensure correct data and records are held in respect of employees' benefits;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

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B3 The Fund Actuary should:-

- prepare valuations, including setting employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
- advise on the termination of Admission Bodies' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties:-

- investment advisers (either internal or external) should ensure the Fund's SIP remains appropriate, and consistent with this FSS;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the SIP;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures.

C1 Types of risk

The Administering Authority has an active risk management programme in place. The measures that it has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc. Analyse progress at three yearly valuations for all employers. Inter-valuation roll-forward of liabilities between valuations at whole Fund level. Review of advisor performance undertaken on an annual basis.
Inappropriate long-term investment strategy.	Overall investment strategy options considered as an integral part of the funding strategy. Use of asset liability modelling to measure four key outcomes. Chosen option considered to provide the best balance. Full training provided to Pension Fund Board members and officers.
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	Stabilisation modelling at whole Fund level allows for the probability of this within a longer term context. Inter-valuation monitoring, as above. Some investment in bonds helps to mitigate this risk.

Risk	Summary of Control Mechanisms
Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.
Pay and price inflation significantly more than anticipated.	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Inter-valuation monitoring, as above, gives early warning. Some investment in index-linked bonds also helps to mitigate this risk. Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	An explicit stabilisation mechanism for eligible employers has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions through deficit spreading and phasing in of contributions.
Orphaned employers give rise to added costs for the Fund	The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future. If it occurs, the Actuary calculates the added cost spread pro rata among all employers.

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C3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy.The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation. The Fund also sets life expectancy assumptions using ClubVita, which is a specialised longevity company and provides life expectancy assumptions based on the profile of the Fund's own membership.

Risk	Summary of Control Mechanisms
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees leading to the possibility of there not being sufficient liquid funds available to pay liabilities as they fall due.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay for deficit contributions. Between valuations regularly monitor level of active members on both a total Fund basis and by individual employer. Regularly monitor how cash flow positive the Fund is. Regularly review investment strategy.
Deteriorating patterns of early retirements	Employers are charged the extra cost of non ill-health retirements following each individual decision. Employer ill health retirement experience is monitored. The Pension Fund Board decided to participate in ill health insurance at its meeting on 14 February 2014 and this procurement process is under way.
Reductions in payroll causing insufficient deficit recovery payments	In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows: Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (b) to Table 1. For other employers, review of contributions is permitted in general between valuations (see Note (f) to Table 1) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.

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C4 Regulatory risks

Risk	Summary of Control Mechanisms
Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pension reform.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. The results of the most recent reforms have been built into the 2013 valuation. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.

Failure to collect and account for contributions from employers and employees on time	Regular monthly monitoring and reconciliation of Fund contributions received, including a detailed analysis of individual employer contributions and employee contributions by pay banding. Robust debt management processes are in place to recover any late payments
Loss of funds through fraud or misappropriation	Procedures and processes are in place and applied in relation to eg: checking for "ghost" scheme members; multiple levels of authorisation for claims and fund payments plus secondary checking of lump sum payments. Procedures are documented and staff are trained and managed in carrying these out. The Fund's internal auditors carry out regular reviews.

C5 Governance risks

Risk	**Summary of Control Mechanisms**
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data. The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations Deficit contributions may be expressed as monetary amounts.
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way	The Administering Authority maintains close contact with its specialist advisers. Advice is delivered via formal meetings involving Elected Members, and recorded appropriately. Actuarial advice is subject to professional requirements such as peer review.
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.	The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes. Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.

Risk	Summary of Control Mechanisms
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see Notes (h) and (j) to Table 1). Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. Vetting prospective employers before admission. Where permitted under the regulations requiring a bond to protect the Fund from various risks. Requiring new Community Admission Bodies to have a guarantor. Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to Table 1). Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to Table 1).
Failure to comply with the Myners' Investment Principles	Compliance as detailed in the Statement of Investment Principles is kept under review.
Lack of relevant expertise, knowledge and skills at officer and member level in relation to administering the LGPS	Training needs assessments for the Administering Authority are carried out and an annual training plan produced and delivered. The Fund subscribes to the CIPFA Knowledge and Skills Framework for the LGPS and makes this information available to all members of the Pension Fund Board and relevant officers. Appropriately qualified external advisers and consultants are used as appropriate.
Failure to hold personal data securely and keep pension records up-to-date and accurate	Personal data and scanned documents relating to scheme members are maintained in an online system via individual password access for those that need to maintain and access this information. Procedures for maintaining pension records are documented and the process is monitored and managed within the Pensions Administration team. Procedures are regularly reviewed by the Fund's internal auditors.

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The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the “future service rate”; plus

b) an adjustment for the funding position of accrued benefits relative to the Fund’s solvency target, “*past service adjustment*”. If there is a surplus there may be a reduction in the employer’s contribution rate. If there is a deficit there will be an increase in the employer’s contribution rate,
 with the surplus or deficit spread over an appropriate period. The aim is to return the employer to full funding over that period.

The Fund’s actuary is required by the regulations to report the *Common Contribution Rate*[1], for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay; it is in effect an average rate across all employers in the Fund.

The Fund’s actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed “peculiar” to an individual employer[2]. It is the adjusted contribution rate which employers are actually required to pay. The sorts of “peculiar” factors which are considered are discussed below.

In effect, the *Common Contribution Rate* is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific past service deficit spreading and increased employer contribution phasing periods.

D2 How is the Future Service Rate calculated?

The future service element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members’ **future** service in the Fund. This is based upon the cost (in excess of members’ contributions) of the benefits which employee members earn from their service each year.

The future service rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The calculation is on the “ongoing” valuation basis (see Appendix E), but where it is considered appropriate to do so the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a more prudent basis.

The approach used to calculate each employer’s future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies and Designating Employers that may have the power not to automatically admit all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

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[1] See LGPS (Administration) Regulations 36(5).

[2] See LGPS (Administration) Regulations 36(7).

a) Employers which admit new entrants

These rates will be derived using the “Projected Unit Method” of valuation with a one year period, i.e. only considering the cost of the next year’s benefit accrual and contribution income. If future experience is in line with assumptions, and the employer’s membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise over time.

b) Employers which do not admit new entrants

To give more long term stability to such employers’ contributions, the “Attained Age” funding method is normally adopted. This measures benefit accrual and contribution income over the whole future anticipated working lifetimes of current active employee members.

Both approaches include expenses of administration to the extent that they are borne by the Fund, and include allowances for benefits payable on death in service and ill health retirement.

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D3 How is the Solvency / Funding Level calculated?

The Fund’s actuary is required to report on the “solvency” of the whole Fund in a valuation which should be carried out at least once every three years. As part of this valuation, the actuary will calculate the solvency position of each employer.

‘Solvency” is defined to be the ratio of the market value of the employer’s asset share to the value placed on accrued benefits on the Fund actuary’s chosen assumptions. This quantity is known as a funding level.

For the value of the employer’s asset share, see D5 below.

For the value of benefits, the Fund actuary agrees the assumptions to be used with the Administering Authority – see Appendix E. These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer’s current and former employees, based on pensionable service to the valuation date only (i.e. ignoring further benefits to be built up in the future).

The Fund operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined.

D4 What affects a given employer’s valuation results?

- past contributions relative to the cost of benefits accrued;
- different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
- differences in the valuation basis on the value placed on the employer’s liabilities;
- different deficit/surplus spreading periods or phasing of contribution changes;
- differences between actual and assumed rises in pensionable pay;
- differences between actual and assumed increases to pensions in payment and deferred pensions;
- differences between actual and assumed retirements on grounds of ill-health from active status;
- differences between actual and assumed amounts of pension ceasing on death;
- additional costs of any non ill-health retirements relative to any extra payments made;

over the period between each triennial valuation.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers, to the extent that employers in effect share the same investment strategy. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. The process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial
9 technique known as "analysis of surplus".

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification. The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree. Consideration will be given to moving to a unitised fund in the medium term.

E1 What are the actuarial assumptions?

These are expectations of future experience used to place a value on future benefit payments ("the liabilities"). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

Changes in assumptions will affect the measured value of future service accrual and past service liabilities, and hence the measured value of the past service deficit. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more prudent basis will give lower liability values and lower employer costs. A more prudent basis will give higher liability values and higher employer costs.

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E2 What basis is used by the Fund?

The Fund's standard funding basis is described as the "ongoing basis", which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term, a more prudent basis applies: see Note (a) to Table 1.

E3 What assumptions are made in the ongoing basis?

a) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund's investments. This "discount rate" assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds ("gilts"). There is, however, no guarantee that Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2013 and setting contribution rates effective from 1 April 2014, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.6% per annum greater than gilt yields at the time of the valuation (this is the same as that used at the 2010 valuation). In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

b) Salary growth

Pay for public sector employees is currently subject to restriction by the UK Government until 2016. Although this "pay freeze" does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards. Based on long term historical analysis of the membership in LGPS funds, the salary increase assumption at the 2013 valuation has been set to 0.5% above the retail prices index (RPI) per annum. This is a change from the previous valuation, which assumed a two year restriction at 1% per annum followed by longer term growth at RPI plus 1.5% per annum.

c) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. This change was allowed for in the valuation calculations as at 31 March 2010. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

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As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the "formula effect" of the difference between RPI and CPI. At this valuation, we have proposed a reduction of 0.8% per annum. This is a larger reduction than at 2010, which will serve to reduce the value placed on the Fund's liabilities (all other things being equal).

d) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the Club Vita's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with the CMI model of "medium cohort" and a 1.25% per annum minimum underpin to future reductions in mortality rates. This is a higher allowance for future improvements than was made in 2010.

The combined effect of the above changes from the 2010 valuation approach is to add around one year of life expectancy on average. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members' benefits.

e) General

The same financial assumptions are adopted for all employers, in deriving the past service deficit and the future service rate. These calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

Actuarial assumptions/basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of **liabilities**. The main assumptions will relate to the **discount rate**, salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value.
Administering Authority	The council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
Admission Bodies	Employers which voluntarily participate in the Fund, so that their employees and ex-employees are **members**. There will be an Admission Agreement setting out the employer's obligations.
Common contribution rate	The Fund-wide **future service rate** plus **past service adjustment**. It should be noted that this will differ from the actual contributions payable by individual **employers**.
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Deficit	The shortfall between the assets value and the **liabilities** value. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which is assumed to be met by future contributions).
Deficit repair/recovery period	The target length of time over which the current **deficit** is intended to be paid off. A shorter period will give rise to a higher annual **past service adjustment** (deficit repair contribution), and vice versa.
Designating Employer	Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund.
Discount rate	The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day allowing for future expected investment return. This is necessary to provide a **liabilities** value which is consistent with the present day value of the assets, to calculate the **deficit**. A lower discount rate gives a higher liabilities value, and vice versa. It is similarly used in the calculation of the **future service rate** and the **common contribution rate**.
Employer	An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **liabilities** values for each employer are individually tracked, together with its **future service rate** at each **valuation**.
Funding level	The ratio of assets value to **liabilities** value.

Future service rate	The actuarially calculated cost of each year's build-up of pension by the current active **members**, excluding members' contributions but including Fund administrative expenses. This is calculated using a chosen set of **actuarial assumptions**.
Gilt	A UK Government bond, ie, a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's.
Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority, but can sometimes be another type of employer such as an Academy.
Liabilities	The actuarially calculated present value of all pension entitlements of all **members** of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the **deficit**. It is calculated on a chosen set of **actuarial assumptions**.
LGPS	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Maturity	A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.
Members	Individuals who have built up (and still building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).
Past service adjustment	The part of the employer's annual contribution which relates to past service **deficit** repair.

Pooling	Employers may be grouped together for the purpose of calculating contribution rates, so that their combined membership and asset shares are used to calculate a single contribution rate applicable to all employers in the pool. A pool may still require each individual employer to ultimately pay for its own share of **deficit**, or (if formally agreed) it may allow **deficits** to be passed from one employer to another.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's **members**, ie current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also.
Rates and Adjustments Certificate	A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal **valuation**. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).
Solvency	In a funding context, this usually refers to a 100% **funding level**, i.e., where the assets value equals the **liabilities** value.
Stabilisation	Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large tax-raising employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these.
Theoretical contribution rate	The employer's contribution rate, both **future service rate** and **past service adjustment**, which would be calculated on the standard **actuarial basis**, before any allowance for **stabilisation** or other agreed adjustment.
Valuation	An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is carried out every three years (last done as at 31 March 2013), but can be updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term gilt yields at that date.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **PENSION FUND RISK REGISTER**

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 2014-2015.

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 a 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.

5 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 (between one and five) 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.

10

6 To comply with best practice, a 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 includes a revised impact score and net risk score as a result of those mitigating actions.

7 The latest schedule is included as Annex 1. There are four new entries onto the schedule, as shown with the indicator 'New'.

8 Within the residual red risks, cost ranges are provided on the implications where possible.

Review

9 The risk register will continue to be reviewed on a quarterly basis.

CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

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

CHIEF FINANCE OFFICER COMMENTARY

13 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

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

EQUALITIES AND DIVERSITY

15 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

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

10

WHAT HAPPENS NEXT

17 The following next steps are planned:

- Monitoring by officers and reporting to the Board every quarter.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board members.

Annexes:
List the annexes attached to this report.
Annex 1: Pension Fund Risk Register

Sources/background papers:
None

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Risk Group	Risk Ref.	Previous	Risk Description	Impact: Fund	Impact: Employers	Impact: Reputation	Impact: Total	Likelihood	Total risk score	Mitigation actions	Revised Likelihood	Net risk score
Funding	1	2	Bond yields fall leading to a increase in value of liabilities: a 0.1% reduction in the discount rate will increase the liability	4	4	4	12	4	48	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) Training on hedging this future cost provided to the Pension Fund Board. Curent investment strategy review will address liability protection.	4	48
Funding	2	3	Pay & price inflation is significantly more or less than anticipated: an increase in CPI inflation by 0.1% will increase the liability valuation by 1.4%	4	4	4	12	4	48	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. 4) Training on hedging this future cost provided to the Pension Fund Board. Current investment strategy review will address liability protection.	4	48
Funding	3	1	Pensioners living longer: adding one year to life expectancy will increase the future service rate by 0.8%	4	4	1	9	5	45	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	45
Funding	4	15	Deterioration in funding because of a mismatch of assets and liabilities	4	3	3	10	4	40	TREAT- 1) Active monitoring from Board, officers and consultants. 2) Investment strategy review is underway.	3	30
Funding	5	4	Impact of increases to employer contributions following the actuarial valuation	3	3	3	9	3	27	TREAT- 1) Officers to consult and engage with employer organisations in conjunction with the actuary. 2) Actuary will assist where approprate with stabilisation and phasing in processes.	3	27
Funding	6	5	Structural changes in an employer's membership or an employer fully/partially closing	4	3	1	8	3	24	TREAT- 1) Administering Authority actively monitors prospective changes in membership.	3	24
Operational	7	6	Rise in ill health retirements impact employer organisations	1	4	1	6	4	24	TREAT- 1) Insuring against the cost and impact (approved at 14/2/14 meeting but not yet implemented).	4	24
Governance	8	7	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) Fund will respond to consultations.	3	24
Investment	9	8	Investment Managers fail to achieve performance targets over the longer term: a shortfall of 0.1% on the investment target will result in an annual impact of	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	10	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	11	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	12	11	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	13	12	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	14	13	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	15	14	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
Funding	16	16	Falling active payrolls lead to insufficient deficit recovery payments	4	4	2	10	3	30	TREAT- 1) Deficit payments calculated as monetary amounts.	2	20
Investment	17	17	Fall in equity markets leading to deterioration in funding levels and increased contribution requirements from employers	4	3	3	10	3	30	TREAT- 1) Proportion of asset allocation 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. Investment strategy review is currently underway in 2014/15.	2	20
Governance	18	18	Failure to take difficult decisions inhibits effective Fund management	3	2	4	9	3	27	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.	2	18
Financial	19	19	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	20	20	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 intergrate data to ensure accuracy.	2	16
Operational	21	21	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	22	22	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. 2) The terms of admission agreements/bonds provide for regular review of bond adequacy. 3) Fund will consider seeking a guarantor.	3	15
Operational	23	23	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	24	24	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	25	25	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	26	26	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	27	27	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	28	28	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	29	29	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	30	30	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	31	31	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	32	32	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	33	33	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	34	34	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	35	35	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	36	36	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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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **REVISED STATEMENT OF INVESTMENT PRINCIPLES**

SUMMARY OF ISSUE:

With adjustments to governance practices within the Pension Fund, 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. There are no changes to specific investment parameters, but the opportunity has been taken to revise the section dealing with the CIPFA/Myners principles. It should be noted that the Fund complies fully in all areas.

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

8 There are no legal implications or legislative requirements.

11

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)

Consulted:
Pension Fund Board Chairman

Annexes:
Revised Statement of Investment Principles

Sources/background papers:
None

Statement of Investment Principles 2014/15

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** 11

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.

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
11 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.

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. 11

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.

11

	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.

Name	Currency	Inception	Commitment
UK Funds			**£/€/$m**
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

11

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:

11

	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.

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 Templet	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 N - UK Equity Index RX - World (ex UK) Dev Equity Index HN – World Emerging Markets Equity Index AA - All Stocks Gilts Index CN - AAA-AA-A Bonds - All Stocks Index Y - All Stocks Index-Linked Gilts	 FTSE All Share FTSE AW – Dev'd World (ex UK) FTSW AW – All Emerging FTSE A UK Gilts All Stocks Markit iBoxx GBP Non Gilts ex BBB All stock FTSE A Index-Linked All Stocks	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 of the contract
Internal	Cash	LIBID 7-day rate	LIBID 7 day rate

The overriding 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.

11

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.

11

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

11

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. Share voting is undertaken in-house, after consultation with fund managers, and consultation with the Pension Fund Board on potentially contentious issues. A quarterly report will be posted to the Fund website.

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.

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.

✓ **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.

11

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's 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.

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 quarterly against benchmark 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 officers or the Pension Fund Board on at least an annual basis and officers hold four additional meetings with managers per quarter 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 and the success of the Board's implemented strategies 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.

All of the Fund's managers are signed up to the Stewardship Code, which provides a framework for investors to consider environmental, social and corporate governance issues when making investment decisions.

11

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, responsible investment and stewardship policy, 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 all Fund members.

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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 note the KPI statement 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 Slight deteriorations in performance over the quarter on the pensions administration (benefits, retirement and transfers) are explained by the resource required to introduce the new LGPS 2014 scheme that took effect from 1 April 2014.

6 The reduction in annual out-performance over benchmark over the quarter is explained by the dropping out of the significant Q4 2012/13 return from the annual performance return with a lower Q4 2013/14 return in replacement.

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

Internal Audit Report: Pensions Administration

8 The latest internal audit report on the administration service is shown as Annex 2. The findings of the audit support the audit opinion of **Effective** and there were no recommendations arising from the review.

CONSULTATION:

9 The Chairman of the Pension Fund has been consulted and has offered full support regarding the content, structure and performances achieved set out in the schedule.

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

11 There are no financial and value for money implications.

CHIEF FINANCE OFFICER COMMENTARY

12 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

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

EQUALITIES AND DIVERSITY

14 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

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

WHAT HAPPENS NEXT

16 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)

Consulted:
Pension Fund Board Chairman.

Annexes:
Annex 1: Schedule of Key Performance Indicators
Annex 2: Internal Audit report on Pensions Administration

Sources/background papers:
None

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KPI - DETAILED ACTIONS, TIMESCALE AND REPORTING REQUIREMENTS: To 31 March 2014 Annex 1

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	PENSION ADMINISTRATION							
	DEATH BENEFITS Notify potential beneficiary of lump sum death grant within 5 days	**95%**	PB	**100.00%**	3 months to 31 Mar 14	**100.00%**	3 months to 31 Dec 13	0.00%
	Write to dependant and provide relevant claim form within 5 days of notification of death	**90%**	PB	**94.55%**	3 months to 31 Mar 14	**99.16%**	3 months to 31 Dec 13	-4.61%
	Pay death grant within 5 days of receipt of relevant documentation	**90%**	PB	**100.00%**	3 months to 31 Mar 14	**97.22%**	3 months to 31 Dec 13	2.78%
	Issue notification of dependant's pension within 5 days of receipt of relevant claim forms	**90%**	PB	**100.00%**	3 months to 31 Mar 14	**97.22%**	3 months to 31 Dec 13	2.78%
	RETIREMENTS Retirement options to members within 10 days	**90%**	PB	**95.93%**	3 months to 31 Mar 14	**95.76%**	3 months to 31 Dec 13	0.17%
	New retirement benefits processed for payment following receipt of election within 10 days	**95%**	PB	**97.67%**	3 months to 31 Mar 14	**99.22%**	3 months to 31 Dec 13	-1.55%
	BENEFIT STATEMENTS ABS issued to 95% of eligible active members by 30th September	**95%**	PB	**100.00%**	3 months to 31 Mar 14	**100.00%**	3 months to 31 Dec 13	
	DBS issued to 85% of eligible deferred members by 30th June	**95%**	PB	**100% issued by 26/09/13**	3 months to 31 Mar 14	**100% issued by 26/09/13**	3 months to 31 Dec 13	
	NEW JOINERS New starters processed within 20 days	**90%**	PB	**98.36%**	3 months to 31 Mar 14	**98.02%**	3 months to 31 Dec 13	0.34%
	TRANSFERS IN Non LGPS transfers-in quotations processed within 20 days	**90%**	PB	**98.77%**	3 months to 31 Mar 14	**100.00%**	3 months to 31 Dec 13	-1.23%
	Non LGPS transfers-in payments processed within 20 days	**90%**	PB	**98.77%**	3 months to 31 Mar 14	**100.00%**	3 months to 31 Dec 13	-1.23%
	TRANSFERS OUT Non LGPS transfers-out quotations processed within 20 days	**90%**	PB	**100.00%**	3 months to 31 Mar 14	**100.00%**	3 months to 31 Dec 13	0.00%
	Non LGPS transfers out payments processed within 20 days	**90%**	PB	**100.00%**	3 months to 31 Mar 14	**100.00%**	3 months to 31 Dec 13	0.00%
	MATERIAL POSTED ON WEBSITE Relevant Communications Material will be posted onto website within one week of being signed off	**95%**	PB	**100%**	3 months to 31 Mar 14	**100%**	3 months to 31 Dec 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	**97%**	12 months to 31 Mar 13	
4	INVESTMENT PERFORMANCE							
	INVESTMENT RETURNS/OVERALL FUND PERFORMANCE Returns to at least match the benchmark	**Benchmark**	PT	**BENCHMARK 7.1%**	12 months to 31 Mar 14	**BENCHMARK 12.5%**	12 months to 31 Dec 13	
				ACTUAL 8.6%	12 months to 31 Mar 14	**ACTUAL 15.7%**	12 months to 31 Dec 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	**99%**	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%**	Mar-14	**98%**	Dec-13	0.00%
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**	PT/PB	**Achieved**	12 months to 31 Mar 13	**Achieved**	12 months to 31 Mar 12	
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

SURREY COUNTY COUNCIL
INTERNAL AUDIT REPORT

Review of Pension Administration

2013/14

Prepared for: Carmel Millar, Head of Human Resources and Organisational Development

Prepared by: Revinder Hothi, Auditor

Sue Lewry-Jones
Chief Internal Auditor
Chief Executive's Office
County Hall
Kingston upon Thames
Surrey KT1 2EA

March 2014

Additional circulation list:

Pensions Manager	Paul Baker
Pensions Operations Manager	Jason Bailey
Strategic Director	Julie Fisher
Service Finance Manager	Philip Triggs
Section 151 Officer	Sheila Little
Cabinet Member (Business Services)	Denise Le Gal
Chairman of the Council Overview and Scrutiny Committee	Nick Skellet
Risk and Governance Manager	Cath Edwards
Audit and Governance Committee	All
External Auditor	Grant Thornton UK LLP

Glossary:

SCC - Surrey County Council

LGPS - Local Government Pension Scheme

Altair - SCC Pensions Administration Software

SAP - Surrey County Council Accounting Software

Audit opinions:

Effective — Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.

Some Improvement Needed — A few specific control weaknesses were noted; generally however, controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.

Major Improvement Needed — Numerous specific control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and objectives should be met.

Unsatisfactory — Controls evaluated are not adequate, appropriate, or effective to provide reasonable assurance that risks are being managed and objectives should be met.

1. INTRODUCTION

1.1 Local Government Pension Scheme (LGPS) is one of the largest public sector pension schemes in the UK with 4.6 million members. It is a nationwide scheme that is considered to be a valuable part of the pay and reward package for employees working either in local government or other employers participating in the scheme.

1.2 The Surrey Pension scheme is administered locally for participating employers through 99 regional pension funds in the country and the Surrey Pension Fund administered by Surrey County Council (SCC) is one of them. Pension payments in 2012/13 had an annual cost of £94m to over 20k pensioners. The Local Government Employers who work with local authorities, regional employers and other bodies to lead and create solutions on pay, pensions and the employment contract, provide a National LGPS website on their behalf.

1.3 The Surrey Pensions Fund has a membership of 75,851 consisting of 30,023 current employees, 28,256 deferred pensioners and 20,572 pensioners as shown in the Surrey Pension Fund 2012/13 Annual Report.

1.4 Legislation was introduced in the Pensions Act 2008 to encourage people to save for their retirement. All employers in the UK are required to automatically enrol their workers into a workplace pension subject to the individuals meeting certain requirements. Surrey County Council being one of the largest employers was allotted an automatic enrolment date of 1 April 2013. The other 120 employers in the Surrey Pension Fund will have their own staging dates according to the number of employees they employ spanning from April 2013 until October 2017. In addition the Pensions team manages the pension records for the Firefighters' Pension Scheme.

1.5 A review of Pension Administration was included as part of the 2013/14 Annual Internal Audit Plan and was undertaken in line with the Terms of Reference included at Annex A. This report sets out the findings of the review.

2. WORK UNDERTAKEN

2.1 Discussions were held with key staff associated with the day-to-day operations of the scheme. The systems in operation were reviewed. Documents were examined and a sample of members in the scheme selected for audit testing purposes.

2.2 Testing was carried out to provide assurance regarding lump sum payments, independent reconciliation of pension contributions, segregation of duties and the auto enrolment process.

3. OVERALL AUDIT OPINION AND RECOMMENDATIONS SUMMARY

3.1 **Opinion**: The findings of the audit support the audit opinion of: **Effective**

3.2 Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.

3.3 **Recommendations analysis:** There were no recommendations arising from this review.

4. MANAGEMENT SUMMARY

4.1 On 1 April 2013, all Surrey County Council employees who were not already members of the LGPS were automatically enrolled into the pension scheme, subject to meeting the following criteria;

- earn over £9,440 a year
- aged 22 or over and
- under the State Pension age.

4.2 Prior to automatic enrolment SCC had a total of 19,743 employees in the LGPS. 1,652 eligible employees were auto enrolled on 1 April 2013 of which 642 employees have since opted out. Testing suggests auto enrolment is appropriately administered.

4.3 No significant findings have been identified during the course of this work. The controls over pension administration for both Surrey LGPS and fire fighters in Surrey Pension Scheme payment and accounting are evaluated as adequate, appropriate and effective.

4.4 In view of the findings of the Internal Audit review, which are set out in more detail in section 5 below the audit opinion is: **Effective.**

5. FINDINGS

Deduction Rates

Findings

5.1 The information relating to deductions from payroll is held on SAP, the County's accounting and payroll system. Deductions of pension contributions are coded and automatically calculated by SAP for SCC employees. Data, including contribution rates is interfaced from SAP to Altair.

5.2 A sample of 15 individuals' contribution rates, five from the fire service and 10 from the rest of SCC were tested to confirm that the correct rate of deduction had been applied. Testing identified one employee who commenced employment in January 2014 that has a SAP payroll record but no record on Altair. Discussions with the Pension Administration officers indicate this is due to timing of the interface. This will be processed in the next monthly interface from SAP.

Checking and Authorisation in the Pensions Administration Team

Findings

5.3 The auditor examined a sample of 13 transactions including pension changes, lump sum payments and transfers to confirm that changes are subject to satisfactory checking and authorisation prior to final processing. All vouchers are duly authorised, three separate officers are assigned responsibility for the preparing, checking and authorising of payments. A segregation of duties and authorisation process prior to payment is in operation and evidenced. Copies of payment calculations and the associated approval are saved in Altair against the individuals' records.

Pension Fund Transfers and Payments

Findings

5.4 A sample of ten new pensioners were tested to confirm that consistent checks are made on new starters and to ensure accuracy of data between SAP and Altair. A 'New Starter Checklist' has been completed for nine records and data was accurate between the systems.

5.5 The auditor found one new pensioner had not been set up on Altair. The individual is entitled to a widow's pension under the 1954 Pension Scheme Regulations. Altair is unable to automatically complete the calculations to create a record. This type of pension is a rare occurrence and the record will be created manually by a Pension Administration officer.

5.6 The results provide assurance regarding the accuracy of pension data between the two systems.

Change in Working Hours

Findings

5.7 The auditor tested a sample of five individuals who had changed their working hours during the course of 2013/14 to ensure the changes had been correctly recorded on SAP and Altair. Testing identified two records where the working hours recorded were inconsistent between the systems. However, the auditor is assured that inconsistencies are identified and updated when the change of hours interface from SAP to Altair is processed. Further checking is undertaken by the Pension Administration team at year end including checks on leaver status, pensionable pay to contributions and working hours history identifying any unusual changes in employee working hours.

Auto-enrolment

Findings

5.8 On 1 April 2013, all Surrey County Council employees who were not already members of the LGPS were automatically enrolled into the pension scheme, subject to meeting the following criteria;

- earn over £9,440 a year
- aged 22 or over and
- under the State Pension age.

5.9 Prior to automatic enrolment SCC had a total of 19,743 employees in the LGPS. 1,652 eligible employees were auto enrolled on 1 April 2013 of which 642 employees have since opted out.

5.10 The auditor tested a sample of 10 individuals who have opted out of the Pension scheme. All 10 records agreed between Altair and SAP providing assurance that individuals who have opted out are correctly recorded on Altair and deductions are not made from the payroll.

12

5.11 Employee services undertake a monthly manual exercise to identify individuals who meet the automatic enrolment requirements. The information is held on a spreadsheet which is uploaded onto Altair by the Pension Administration team to ensure auto enrolment is processed on a rolling basis. The auditor extracted a SAP report of individuals who had reached the eligibility criteria for auto enrolment since 2 April 2013.

5.12 A sample of 5 individuals were tested to provide assurance the process is accurately identifying individuals to auto enrol into the LGPS. All records tested were either enrolled in the pension scheme or had opted out.

5.13 The auto-enrolment process is to be repeated every three years with eligible post holders including those who have previously opted out of the scheme, being auto enrolled again. For SCC this will be on 1 April 2016.

5.14 A revised LGPS will be implemented with effect from 1 April 2014. The new LGPS will be a Career Average Revalued Earnings scheme with an accrual rate of 1/49th and a revaluation rate of Consumer Prices Index. This area will be included as part of the Audit Plan for 2014/15.

6. ACKNOWLEDGEMENT

6.1 The assistance and cooperation of all the officers involved in the completion of this audit is greatly appreciated.

Annex A

TERMS OF REFERENCE

Review of Pension Administration 2013/14

BACKGROUND

Local Government Pension Scheme (LGPS) is one of the largest public sector pension schemes in the UK with 4.6 million members. It is a nationwide scheme that is considered to be a valuable part of the pay and reward package for employees working either in local government or other employers participating in the scheme. The scheme is administered locally for participating employers through 99 regional pension funds in the country and Surrey Pension Fund (SPF) administered by Surrey County Council (SCC) is one of them. The Local Government Employers (LGE) who work with local authorities, regional employers and other bodies to lead and create solutions on pay, pensions and the employment contract, provide a National LGPS website on their behalf.

PURPOSE OF THE AUDIT

The main objective of this review is to ascertain and provide assurance on whether or not the internal controls in place for the administration of pension contributions and payments are sufficiently robust.

The review will determine the adequacy of specific controls in the following areas:

- arrangements in place for setting up new joiners to Surrey's LGPS and the Surrey Fire Pension scheme;
- the deduction of contributions for both schemes;
- monitoring the receipt and accounting for pensions contributions from SCC and admitted bodies;
- the transfer of data changes from SAP to ALTAIR;
- checking and authorising the various changes to and payment of pensions by the Pensions Administration Team;
- the accuracy of information being transferred between Altair and SAP systems;
- arrangements for making amendments to records in the Pension System (Altair) and the pension payroll (SAP);
- the authorisation of the BACs runs

WORK TO BE UNDERTAKEN

The audit included annual testing required for Internal Audit's own assurance providing responsibilities on the sound operation of key financial controls.

OUTCOMES

The findings from this review will form a report to Surrey County Council management with an overall audit opinion on the effectiveness of systems in place and recommendations for improvement if required. Subject to availability of resources, and the agreement of the auditee, the audit will also seek to obtain an overview of arrangements in place for:

- Data quality and security;
- Equality and diversity;

12

- Value for money;
- Business continuity; and
- Risk management

The outcome of any work undertaken will be used to inform our future audit planning processes and also contribute to an overall opinion on the adequacy of arrangements across the council in these areas.

REPORTING ARRANGEMENTS

Auditor:	Revinder Hothi, Auditor
Supervisor:	Diane Mackay, Performance Manager
Report to:	Carmel Millar
Audit Ref:	KF20 / 2013/14

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **PENSION FUND ADMINISTRATION SERVICE LEVEL AGREEMENT**

13

SUMMARY OF ISSUE:

A service level agreement between the County Council as Administering Authority for the Surrey Pension Fund and the Pensions Administration Team is set out for the Board to approve.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Board approve the Service Level Agreement as set out Annex 1.

REASON FOR RECOMMENDATIONS:

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

DETAILS:

Background

1 Regulation 65 of the Local Government Pension Scheme (Administration) Regulations 2008 permits an administering authority to prepare, publish and keep under review a written statement of the authority's policies in relation to such matters as it considers appropriate including a service level agreement setting out the levels of performance which the administering authority is expected to achieve in carrying out their Scheme functions.

Monitoring and Review

2 The service level agreement is kept under constant review and will be brought for approval to future Board meetings when any revision is required.

CONSULTATION:

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

13

RISK MANAGEMENT AND IMPLICATIONS:

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

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 service level agreement offers a clear structure, reflecting best practice with regard to the investment and administration functions.

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 service level agreement 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:

- Adoption of the service level agreement.
- The document will be kept under review.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Service Level Agreement

Sources/background papers:
None

SERVICE LEVEL AGREEMENT BETWEEN THE PENSION INVESTMENT/ADMINISTRATION TEAMS AND SURREY COUNTY COUNCIL AS THE ADMINISTERING AUTHORITY TO THE SURREY PENSION FUND

Surrey County Council is the administering authority for Surrey County Council Pension Fund. As such, Surrey has certain statutory responsibilities to the employer organisations for the administration of the Local Government Pension Scheme (LGPS) in Surrey. This includes the County Council itself, the eleven Districts and Boroughs and over 100 other employers of the Pension Fund.

The administering authority has ultimate responsibility for interpreting and implementing statutory LGPS regulations, which includes taking decisions around fund investments, for receiving monies due and paying monies owing from the Fund and for making sure that it has robust systems and processes in place to ensure that the scheme is administered in line with scheme regulations and within prescribed levels of performance.

This document has been prepared as a service level agreement between the administering authority and the Pensions Administration Team and sets out service standards for the level of service that the team will provide to ensure that the administering authority achieves its statutory responsibilities.

1 Administration of the LGPS

The Pension Administration Team will:

1.1 Maintain a member database of all current, deferred and retired members (including their dependants) of the scheme along with historical data relating to former scheme members who have a right to claim a refund of contributions but have not elected to do so (frozen refunds), and former members who no longer have a liability within the Fund (benefits transferred out of the scheme).

1.2 Provide an efficient, effective and courteous administration service.

1.3 Calculate member benefits in accordance with scheme regulations.

1.4 Provide a pension payroll service to all retired scheme members and their dependants.

1.5 Ensure that pension payments are made on the correct date and that all lump sum payments are made as soon as possible following the retirement of the scheme member.

1.6 Provide current and deferred members with an annual benefit statement.

1.7 Ensure that all new scheme members receive a welcome pack and a formal notification of membership.

1.8 Notify all retired scheme members of the annual increase to their pension.

1.9 Provide a payslip to retired members of the scheme.

1.10 Provide a P60 to every retired scheme member within HMRC deadlines.

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1.11 Perform other administrative tasks in line with the service standards laid down in the Administration Strategy agreed with Fund employers.

2 Scheme Communications

The Pensions Administration team will:

2.1 Maintain and update a website for all members of the LGPS.

2.2 Inform all scheme members of significant changes to the LGPS by way of newsletters.

2.3 Produce, publish and maintain a suite of scheme guides and factsheets to assist scheme members in understanding their pension rights and options.

2.4 Offer pension surgeries, presentations and open days to be held across the county.

2.5 Respond to letters and emails within ten working days.

3 Complaints Procedures

The Pensions Administration team will:

3.1 Put things right if they go wrong and will investigate any complaint received within ten working days.

3.2 If the team is unable to resolve a complaint, the member has a right to appeal under the Internal Disputes Resolution Procedure (IDRP) which is an appeal process set out in the regulations.

4.0 **General**

The Pension Administration team will:

4.1 Deal with member enquiries in a professional, polite and friendly way and offer guidance to scheme members as appropriate without giving financial advice.

4.2 Make available confidential interview facilities as required.

4.3 Maintain and report on performance statistics.

5 Key Performance Indicators

5.1 There are various key performance indicators by which the teams will measure their investment/administrative performance. A schedule will be presented to the Pension Fund Board every quarter.

6 Investment/Accounting

The Investment/Accounting Team will:

6.1 Maintain accurate accounting records of all fund related transactions and produce accurate closing accounting records at the year-end in accordance with the County Council's accounts closing timetable.

6.2 Provide an efficient, effective and courteous service.

6.3 Produce quarterly Board reports in accordance with agreed committee deadlines. 13

6.4 Provide employer bodies with timely accounting and other reports as required.

6.5 Provide employer bodies with triennial valuation information as well as early warning reports between formal valuations if appropriate.

6.6 Invest available pension assets to generate investment returns in accordance with regulations and professional advice.

6.7 Perform any other investment/accounting administrative tasks.

7 Review of the Service Level Agreement

7.1 The Service Level Agreement will be kept under annual review by the administering authority.

7.2 Employers are welcome to discuss any aspect of the Service Level Agreement with the administering authority at any time.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **CORPORATE GOVERNANCE SHARE VOTING**

SUMMARY OF ISSUE:

With the adoption of a share voting policy by the Pension Fund Board, this report provides an assessment of the need for change of the existing Responsible Investment and Stewardship policy and a summary of the Fund's share voting process in Q4 2013/14.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1 Note the report.

2 Approve the existing Responsible Investment and Stewardship Policy for 2014/15 shown as Annex 2.

REASON FOR RECOMMENDATIONS:

The Pension Fund Board must approve all pension fund working documents.

DETAILS:

Background

1 The informed use of shareholder votes, whilst not a legal duty, is a responsibility of shareholders and an implicit fiduciary duty of pension fund trustees and officers to whom they may delegate this function. Such a responsibility requires the adoption of an approved share voting policy and the advice of a consultant skilled in this particular field.

2 The Surrey Pension Fund appointed Manifest in 2013 to provide consultancy advice on share voting and the whole spectrum of company corporate governance. Manifest has assisted in ensuring that the Fund's stewardship policy reflects the most up-to-date standards and officers learn of the latest developments and can reflect these developments in the Fund's share voting policy and the Statement of Investment Principles (SIP).

Responsible Investment and Stewardship Policy

3 Officers would normally submit a revised policy for 2014/15 (reflecting the latest corporate developments) to the Board for approval. However, the Financial Reporting Council (FRC) is currently consulting on its two-yearly review of changes to the UK Corporate Governance Code. This review follows earlier consultations on directors' remuneration, risk management, internal control and the going concern basis of accounting.

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4 The proposed changes to the UK Corporate Governance Code, due to be published later in 2014, are that:

- greater emphasis be placed on ensuring that remuneration policies are designed with the long-term success of the company in mind, and that the lead responsibility for doing so rests with the remuneration committee;
- companies should put in place arrangements that will enable them to recover or withhold variable pay when appropriate to do so, and should consider appropriate vesting and holding periods for deferred remuneration;
- companies should explain when publishing AGM results how they intend to engage with shareholders when a significant percentage of them have voted against any resolution;
- companies should state in their financial statements whether they consider it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to their ability to continue to do so;
- companies should robustly assess their principal risks and explain how they are being managed and mitigated;
- companies should state whether they believe they will be able to continue in operation and meet their liabilities taking account of their current position and principal risks, and specify the period covered by this statement and why they consider it appropriate. It is expected that the period assessed will be significantly longer than 12 months; and
- companies should monitor their risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report.

5 The FRC view the role of the company board as being to ensure the sustained success of their company and exercise responsible stewardship on behalf of their shareholders. To do this effectively, they need to understand and manage the risks to the future health of the company. The remuneration of executives on the Board must also incentivise them to put the company's wellbeing before their own. The proposals above, which reflect the views of investors and others on earlier consultations, are intended to encourage boards to focus on the longer term, and increase their accountability to shareholders.

6 Subject to the outcome of the consultation, which closes on 27 June 2014, the proposed changes will apply to financial years beginning on or after 1 October 2014. It is recommended that the Board approve a revised policy (probably at the November 2014 meeting) when these changes have been published.

Meetings Voted: Q4 2013/14

7 Table 1 shows that 51 meetings were voted in total, comprising 41 annual general meetings (AGMs) and ten other meetings. The European peak AGM season (Scandinavia in particular) starts earlier than in most other markets, as does that of South Korea, which explains the position of Europe (Developed) and Asia & Oceania (Developed) at the top of the list. A list of the abbreviations used in Table 1 is shown as Annex 1. 14

Table 1: Meetings Voted Q4 2013/14

Region	Meeting Type					Total
	AGM	EGM	GM	OGM	Court	
Europe (Developed)	13	1	-	-	-	14
Asia & Oceania (Developed)	11	1	-	-	-	12
UK & Ireland	6	1	2	-	1	10
North America	7	-	-	-	-	7
Europe (Emerging)	2	1	-	-	-	3
Japan	2	-	-	-	-	2
Africa	-	-	-	1	-	1
South & Central America	-	1	-	-	-	1
Asia & Oceania (Emerging)	-	1	-	-	-	1
Total	41	6	2	1	1	51

Resolutions

8 Table 2 shows the total number of resolutions voted by region, broken down by meeting type. This clearly shows the high volume of voting decisions that AGMs bring compared with other meeting types. In Table 1, AGMs comprise around 80% of the meetings, but Table 2 shows AGMs account for 97% of the resolutions. During Quarter 1, 692 resolutions were voted, with the bulk of these in Europe (Developed) and the UK & Ireland regions (440).

Table 2: Resolutions Voted Q4 2013/14

Region	Meeting Type					Total
	AGM	EGM	GM	OGM	Court	
Europe (Developed)	322	2	-	-	-	324
UK & Ireland	109	1	5	-	1	116
Asia & Oceania (Developed)	110	1	-	-	-	111
North America	84	-	-	-	-	84
Europe (Emerging)	32	1	-	-	-	33
Japan	19	-	-	-	-	19
Africa	-	-	-	2	-	2
South & Central America	-	2	-	-	-	2
Asia & Oceania (Emerging)	-	1	-	-	-	1
Total	676	8	5	2	1	692

9 Month by month during Quarter 4 2013/14 and especially during Quarter 1 of 2014/15, the peak of annual voting activity becomes increasingly apparent as an increasing number of AGMs are held. Whilst the number of meetings is significant, the number of resolutions (i.e., actual voting decisions) is even more marked. Table 3 evidences the effect of the European (Developed) and South Korean peak season starting in March, with nearly 74% of all the voting decisions falling in March.

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Table 3: Resolutions Voted Per Month Q4 2013/14

Event	January	February	March	Total
AGM	46	121	509	676
EGM	3	4	1	8
GM	4	1	-	5
OGM	-	-	2	2
Court	1	-	-	1
Total	54	126	512	692

Voting Patterns

10 This section examines some patterns of voting by resolution category and voting policy. Table 4 categorises each resolution according to the governance considerations to which they relate. Nearly half the resolutions relate to the company Board, which includes director election resolutions, the single most numerous resolution type at AGMs and the least contentious in terms of Surrey's voting policy.

11 The table shows how many resolutions in which Surrey's votes were cast were in opposition to the recommendation of company management, and what proportion of the total this represents. The resolution category where Surrey has voted against management most frequently is Remuneration, where 29 of the 70 votes have been cast against management.

Table 4: Votes Against Management By Resolution Category Q4 2013/14

Resolution Category	Total Resolutions	Voted Against Management	% Against Management
Board	340	32	9.4%
Shareholder Rights	96	16	16.7%
Audit & Reporting	84	10	11.9%
Capital	75	10	13.3%
Remuneration	70	29	41.4%
Sustainability	14	3	21.4%
Other	9	3	33.3%
Corporate Actions	4	0	0.0%
Grand Total	692	103	14.9%

Shareholder Proposed Resolutions

12 There were 43 resolutions proposed by shareholders. The majority of these (31) related to shareholder rights in some way. Of these, 17 were at the meeting of Danske Bank, which serves as a very good case study in the variety in topic and importance that shareholder proposed resolutions can bring. At one end of the scale, there was a proposal to remove Ole Anderson (Chairman) as director of the company, citing poor financial performance of the company and poor appointment decisions. At the other, a proposal requesting refreshments provided at the AGM should match the potential financial outlook for the coming year.

13 Many of the shareholder proposals related to issues (especially those relating to information and transaction transparency) which the board had already addressed. One interesting issue was the request that Danish language reporting be guaranteed for at least five years, this in response to the fact that Danske Bank had proposed only reporting in English, due to the fact that it carries out virtually all of its main business in English despite being a Danish bank.

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14 Shareholder proposed resolutions often attract relatively high levels of votes against management, especially where the matter at hand is one on which investors have strong views. The tabling of a shareholder proposal is one way in which shareholders can put pressure on a company, by highlighting an issue and potentially garnering public support for their cause. The flipside danger is of course the possibility of a very public rejection of the question by other shareholders. Surrey has consistently supported proposals which would have the effect of enhancing shareholder rights.

Table 5: Shareholder Proposed Resolutions Q4 2013/14

Resolution Sub-category	Shareholder Proposals	Voted Against Management	% Against Management
Other Articles of Association	16	1	6.3%
Other	7	3	42.9%
Shareholder Rights	6	6	100.0%
General Meeting Procedures	5	0	0.0%
Meeting Formalities	4	1	25.0%
Directors – Elect	1	0	0.0%
Directors – Remove	1	0	0.0%
Ethical Business Practices	1	0	0.0%
Share Buybacks & Return of Capital	1	1	100.0%
Sustainability Reporting	1	1	100.0%
Grand Total	43	13	30.2%

Remuneration

15 Table 6 sets out Surrey's voting record with regard to remuneration. Clearly, the most common remuneration related resolution for Surrey to oppose is the Remuneration Report. The relevant aspects of Surrey's share voting policy against which companies are most frequently coming up short on Remuneration Report votes are:

- where the upper limit on bonus is too high: (Thomas Cook, Compass Group and TUI Travel);
- where the Manifest Executive Remuneration Assessment grade is unacceptably low (Intuit Inc, Franklin Resources Inc, Analog Devices Inc, Varian Medical Systems, Emerson Electric and Accenture);
- long term incentives not being sufficiently long term in time horizon (Intuit Inc, Varian Medical Systems, Emerson Electric, Costco Wholesale Corporation and Accenture); and

14

- where bonuses have been paid despite a loss being recorded by the company (Chemring Group, Thomas Cook and Enterprise Inns).

Table 6: Remuneration Q4 2013/14

Resolution Category	Total Resolutions	Voted Against Management	% Against Management
Remuneration Report	31	17	54.8%
Remuneration (Other)	14	3	21.4%
Remuneration Amount (Total, Collective)	13	7	53.9%
Policy (Long-term Incentives)	6	2	33.3%
Non-executive Remuneration	4	0	0.0%
Policy (Other Component)	1	0	0.0%
Policy (Short-term Incentives)	1	0	0.0%
Total	70	29	41.4%

Monitoring and Review

16 The share voting policy is kept under constant review and will be submitted for approval to a future Board meeting when the current proposed revisions to the Corporate Governance Code have been published.

CONSULTATION:

17 The Chairman of the Pension Fund has been consulted on the current position and has offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

19 There are no financial and value for money implications.

CHIEF FINANCE OFFICER COMMENTARY

20 The Chief Finance Officer is satisfied that the share voting policy offers an effective framework for the sound share voting of the pension fund, subject to the proposed revision to be presented to the Board when possible.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

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

OTHER IMPLICATIONS

14

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

WHAT HAPPENS NEXT

24 The following next steps are planned:

- Adoption and implementation of the share voting policy
- Policy is kept under review

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:

Annex 1: List of abbreviations

Annex 2: Responsible Investment and Stewardship Policy

Sources/background papers:
None

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AGM

An Annual General Meeting of shareholders, normally required by law.

EGM

An Extraordinary General Meeting of shareholders, where a meeting is required to conduct business of an urgent or extraordinary nature. Such business may require a special quorum or approval level.

GM

A General Meeting of shareholders, often used interchangeably with the term EGM or OGM, depending on the term used by the issuer in question.

OGM

An Ordinary General Meeting of shareholders, which is a meeting at which ordinary business is to be conducted (i.e. business which does not require a special quorum or approval level).

Court

A meeting of shareholders which is convened by a Court as opposed to by management. This is often used in the UK in order to effect a scheme of arrangement during a corporate transaction.

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Responsible Investment and Stewardship Policy

1 Introduction

1.1 Surrey Pension Fund (the Fund) aims to be an informed and responsible long-term shareholder of the companies in which it invests. The Fund has a commitment to encourage responsible corporate behaviour, which is based upon the belief that active oversight and stewardship of companies encourages good long-term value and performance. The Fund has a duty to protect and enhance the value of its investments, thereby acting in the best interests of the Fund's beneficiaries.

1.2 The Fund takes seriously its responsibility to ensure that its voting rights are exercised in an informed, constructive and considered manner.

1.3 The fund complies with the Myners Principles of investment management and the UK Stewardship Code, the seven principles of which are shown below at section 5.

1.4 The Fund will review its Responsible Investment and Engagement Policy annually at the same time it reviews its Statement of Investment Principles. The Fund's officers will carry out this review and propose any changes to the Investment Committee for consideration

2 Scope

2.1 The Fund aims to vote its shares in all markets wherever practicable. However, due to the relative size of its holdings, we will focus our attention on the quality of our major asset holdings, i.e., UK, EU, US, Far East and emerging markets assets.

2.2 The Fund supports the 'comply or explain' principles of The United Kingdom Corporate Governance Code (the Code) and will seek to take all relevant disclosures into account when exercising its votes. While the Fund expects companies to take appropriate steps to comply with the Code, we recognise that departure from best practice may be justified in certain circumstances. In these situations, the Fund expects a considered explanation from the company.

2.3 Corporate governance principles and standards vary from market to market and so the Fund's voting policy allows for some flexibility and discretion with due consideration to local circumstances.

3 General Principles

3.1 In general, the Fund aims to support corporate management in their stewardship role. This document sets out the Fund's high level voting principles and the circumstances where the Fund may override support for company management proposals. In general, where the Fund cannot support management it will positively abstain or withhold a vote but, in certain cases, reserves the right to vote against company management.

3.2 In ordinary circumstances, the Fund delegates individual corporate engagement activity to its investment managers. The Fund will, however, consider engaging on a collective basis with other investors on issues of mutual interest.

14

4 Voting Policy

4.1 Audit & Accountability

The audit process affords investors significant protections by ensuring that management has effective internal controls and financial reporting systems.

Auditor independence may be compromised if the same firm has audited the company for a long time (three years or more) or where the firm earns significant fees from non-audit services. In order to help maintain auditor objectivity we would expect companies to consider submitting the audit function to periodic tender and to disclose their policy on tendering, including when the audit was last put to tender.

- **Approval of Financial Statements**

Where there is a qualified audit statement, or restatements of annual results made in the previous year (apart from where adapting to new regulations), or where there are concerns of fundamental significance, the Fund will consider approval on a case by case basis.

- **Removal of Auditors**

Surrey Pension Fund will normally vote with management on proposals for the removal of auditors, unless the proposal is for alleged financial irregularities. In this instance, the Fund will judge on a case by case basis.

- **Extra Financial Reporting**

Companies should have regard to the environmental and societal risks and impacts of their operations as these can have a material impact on shareholder returns over a variety of time horizons. We believe that it is good management practice to assess and report on material "Extra Financial" risks associated with the governance of environmental and sustainability issues; where we consider that disclosure on these risks is inadequate the Fund will withhold its vote on the annual report or, where available, the sustainability report.

4.2 The Board & Committees

- **Nomination & Succession Planning**

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. The board should have plans in place for orderly succession and the policies relating to this should be disclosed in the Company's annual report.

- **Committee Independence**

Audit, Remuneration and Nomination Committees are key components of effective governance for companies. These Committees should be composed entirely of independent non-executive directors; the Fund may therefore abstain from a director's election if they are an executive or non-independent director on the Remuneration Committee.

- **Separation of Chairman & CEO**

The Fund believes the roles of Chairman and CEO should be separate. There may be individual circumstances where it is necessary to combine the roles for a specified purpose or over a period of time in which case we will take account of the explanations provided. In all other circumstances, the Fund will abstain on the election of the Chairman.

- **Board Balance & Diversity**

Companies should seek to ensure that their boards are balanced for appropriate skills, competence and experience. Diversity of gender and experience are equally important and we expect to see clear disclosure from companies about their efforts to address gender imbalance and, in particular, how they aim to reach at least 30% female representation.

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- **Notice Periods**

Director notice periods are significantly important. Where an executive director's notice period exceeds 12 months or where severance pay exceeds an equivalent of twelve months, the Fund may abstain from voting.

- **Removal of Directors**

Where there is a proposal to remove a director, the Fund will vote against it unless the proposal has Board support and it is uncontested by the individual concerned. Where the proposal is contested by the individual concerned, the Fund will consider its position on a case by case basis.

4.3 Executive Remuneration

Executive remuneration should be determined by a formal procedure which is independent of the executives in question. The remuneration committee, in addition to demonstrating independent membership should have written terms of reference and receive independent advice which is wholly separate from other corporate activities such as, for example, audit or HR.

There should be comprehensive, transparent and comprehensible disclosure of directors pay and policy. Policy in particular should fully explain the aims and objectives of reward strategies in the context of corporate objectives.

- **Approval of Long Term Incentive Schemes**

The Fund's policy on executive remuneration is that companies should develop equitable reward systems that genuinely incentivise directors to deliver sustainable, long-term shareholder value, avoiding reward for results over the short term. The Fund wishes to encourage companies to move away from "one-size-fits-all" performance conditions and to introduce objective performance conditions related to the company's long-term strategy. Discretionary share options and other Long Term Incentive Plans can, subject to appropriate safeguards, be acceptable elements of a director's remuneration.

The Fund will vote in favour of executive reward plans when:

- The company has a remuneration structure that encourages participation across the workforce.
- There is a capital commitment on the part of executive participants at the inception of the scheme.
- Where the exercise of options or the vesting of shares for executive participants is based on performance targets which reflect outstanding and sustainable performance and which are insulated from a particular treatment in the accounts or general market factors.
- Where disclosure is adequate to enable the assessment of rewards under the scheme and the cost to the company.

- Where the performance period for any long term scheme is five years or more.
- Where the participants are not eligible for multiple share-based incentives.
- Where the scheme does not have the potential to involve the issuing of shares which will unduly dilute existing holdings or involve a change in control of the company.

14 The Fund will abstain from supporting an all employee share scheme where non-executives are also permitted to participate.

4.4 Shareholders' Rights & Capital Structures

Surrey will consider resolutions relating to shareholder rights on a case by case basis. The following outlines the principles that we expect our companies to adhere to:

- **Pre-emption right for issues of new capital**

The Fund does not support resolutions that are inconsistent with rules of the Pre-emption Group.

- **"One Share One Vote"**

The Fund does not support issues of shares with restricted or differential voting rights, nor any action which effectively restricts the voting rights of shares held by it.

- **Share Repurchases**

The Fund will normally vote in favour of an authority for share repurchases, provided that it complies with the Listing Rule guidelines (e.g. limit of 15% of issued share capital) and that directors demonstrate that this is the most appropriate use of a company's cash resources. Companies should adopt equal financial treatment for all shareholders. The Fund therefore supports measures that limit the company's ability to buy back shares from a particular shareholder at higher-than-market prices.

4.5 Mergers & Acquisitions

Surrey supports mergers and acquisitions that enhance shareholder returns in the longer term and encourages companies to disclose fully relevant information and provide for separate resolutions on all issues which require the shareholders to vote, for example, the effect of a merger on the compensation and remuneration packages of the individual Board members.

Due to the investment implications of M&A activity, the fund will liaise with its portfolio managers prior to making a final voting decision in support of takeovers.

Companies should seek shareholder approval on any action which alters the fundamental relationship between shareholders and the Board. This includes anti-takeover measures.

4.6 Article Changes

The Fund does not support proposed changes to Articles of Association and/or constitutional documents that reduce shareholder rights or do not reflect generally accepted good governance practices.

4.7 Political & Charitable Donations

The Fund considers that making of donations to political parties is not an appropriate use of shareholders' fund and so will vote against any authority to make such donations.

Charitable donations are acceptable if they are reasonable and further the company's wider corporate social responsibilities. The Fund encourages the issue of a policy statement by companies relating to such donations and full disclosure of the amounts given to the main beneficiaries. 14

4.8 Shareholder Resolutions

All such proposals will be reviewed on a case-by-case basis. We will generally support requests for improved corporate disclosure, notably relating to sustainability reporting. In other circumstances the fund will generally vote against shareholder resolutions not supported by management.

4.9 Other Business

Where a resolution proposes moving to an unregulated market or de-listing, the Fund will consider issues on a case by case basis. Schemes of arrangement, significant transactions and bundled resolutions are also considered on a case by case basis.

Where a resolution is proposed to allow for any other business to be conducted at the meeting without prior shareholder notification, the Fund will not support such resolutions.

5 The Principles of the UK Stewardship Code

In order to conform with the principles of the UK Stewardship Code, institutional investors, such as the Surrey County Council Pension Fund, should:

1. Publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. Have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
3. Monitor their investee companies.
4. Establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
5. Be willing to act collectively with other investors where appropriate.
6. Have a clear policy on voting and disclosure of voting activity.
7. Report periodically on their stewardship and voting activities.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **LGPS REFORM: OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES**

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SUMMARY OF ISSUE:

On 21 June 2013, the Department for Communities and Local Government (DCLG) issued a call for evidence on the future structure of the Local Government Pension Scheme. A document was submitted on behalf of the Pension Fund Board, in consultation with the Chairman of the Pension Fund Board. On 1 May 2014, the Government published a further consultation document, which acknowledges the initiatives put in place by many administering authorities with regard to collaboration and the set up of collective investment vehicles.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1 Note the report.

2 Authorise officers to respond to the consultation with views expressed within the forum of the Board meeting.

REASON FOR RECOMMENDATIONS:

The Pension Fund Board must be aware of all prospects for collaborative working surrounding the investment of the Pension Fund.

DETAILS:

Background

1 Following the call for evidence, the DCLG consulted on fundamental changes to the 89 Local Government pension schemes funds in England and Wales. Further consultation by the Government was announced and published on 1 May 2014.

2 The consultation is shown as Annex 1.

Summary of Document

3 The document can be summarised as follows:

- It points to increasing costs of employer contributions, administration and investment in the LGPS.

- It acknowledges the Shadow Board's comments on the need to look at both costs and deficits and points to the fact that the Board is looking at options for managing deficits and will be developing a short list of options.

- It acknowledges the value of achieving scale and points to work already being done in the LGPS: frameworks, mergers, the London Collective Investment Vehicle.

- It acknowledges that safeguarding local accountability is important.

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Proposals Made in the Document

4 The proposals can be summarised as follows:

- To move to using collective investment vehicles (CIVs). The Hymans analysis showed potential cost savings from moving to CIVs, but these savings would take a decade to realise. Within the report, there is little by way of detail on how the CIVs will work and there will be questions about what kind of CIV, how many, which asset classes and the level of the mandatory nature (if any). The document does acknowledge that the current investment regulations will need changing.

- To move to greater use of passive management for listed assets. The Hymans analysis shows the LGPS scheme as a whole has not outperformed the benchmark, so there is little risk to performance and savings could be made quickly. Again, it asks how this could be done: compulsorily or through a minimum percentage held in passive. A comply or explain approach is also possible.

What the Document does not say

5 The document does not mention the following points.

- There is nothing mentioned regarding timescales, although the document indicates 'momentum'.

- There is nothing on legislation required to make these changes. It would appear that DCLG lawyers have advised that all of the proposals require only secondary legislation. Surprise has been expressed at this, not from a legality point of view, but rather the idea that such radical changes would be made by way of secondary regulations.

South East 7

6 The Pension Fund authorities within the South East 7 (Surrey, East Sussex, West Sussex, Hampshire and Kent) have assessed options to collaborate together with regard to asset and liability management. A separate paper on this initiative is included in the 15 May Board agenda.

Consultation

7 The consultation will last for ten weeks, opening on 1 May 2014 and closing on 11 July 2014. Board members are requested to offer their views at the Board meeting, given there will not be another meeting before the deadline date.

CONSULTATION:

8 The Chairman of the Pension Fund Board has been consulted on the report. 15

RISK MANAGEMENT AND IMPLICATIONS:

9 Risk related issues are contained within the report, most notably the lack of any definite timescale and no clear view on the legislative process to be employed.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

10 Financial and value for money implications will be discussed in future reports once a clear direction ahead has been established.

CHIEF FINANCE OFFICER COMMENTARY

11 The Chief Finance Officer will ensure that all material, financial and business issues and possibility of risks will be considered and addressed in responding to this consultation and, in particular, the option of collaboration and collective investment vehicles will be subject to further investigation and reports to the Board.

LEGAL IMPLICATIONS – MONITORING OFFICER

12 Legal implications or legislative requirements associated with this initiative will be addressed in future reports.

EQUALITIES AND DIVERSITY

13 Equalities and diversity implications associated with this initiative will be addressed in future reports.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

15 The following next steps are planned:

- Officers to respond to the consultation process
- Future reports to the Pension Fund Board

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Consultation document:
LGPS reform: opportunities for collaboration, cost savings and efficiencies

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Sources/background papers:
None

Department for Communities and Local Government

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Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies

Consultation

May 2014
Department for Communities and Local Government

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This document/publication is also available on our website at www.gov.uk/dclg

If you have any enquiries regarding this document/publication, email contactus@communities.gov.uk or write to us at:

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Contents

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1. The consultation process and how to respond

Scope of the consultation

Topic of this consultation:	The structure of the Local Government Pension Scheme and opportunities to reduce administration and investment management costs.
Scope of this consultation:	The consultation sets out the evidence for proposals for reforms to the Local Government Pension Scheme and opportunities to deliver savings of £660 million a year for local taxpayers. The Government seeks respondents' views on the proposals set out in section four, and asks respondents to consider how if adopted, these reforms might be implemented most effectively.
Geographical scope:	This consultation applies to England and Wales.
Impact Assessment:	It is not possible to provide an impact assessment at this stage as the detailed mechanism needed to implement the proposed reforms is still being developed.

Basic Information

To:	The consultation is aimed at all parties with an interest in the Local Government Pension Scheme and in particular those listed on the Government's website: https://www.gov.uk/government/publications/local-government-pension-scheme-regulations-information-on-who-should-be-consulted
Body/bodies responsible for the consultation:	Secretary of State, Department for Communities and Local Government. The consultation will be administered by the Workforce, Pay and Pensions division.
Duration:	The consultation will last for 10 weeks, opening on 1 May and closing on 11 July 2014.
Enquiries:	Enquires should be sent to Victoria Edwards. Please email LGPSReform@communities.gsi.gov.uk or call 0303 444 4057.
How to respond:	Responses to this consultation should be submitted to LGPSReform@communities.gsi.gov.uk by **11 July 2014**. Electronic responses are preferred. However, you can also write to: Victoria Edwards

	Department for Communities and Local Government Zone 5/F5, Eland House Bressenden Place London, SW1E 5DU Please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please give a summary of the people and organisations it represents and where relevant, who else you have consulted in reaching your conclusions.
After the consultation:	The responses to the consultation will be analysed and a Government response published. Should any legislative changes be needed, a further consultation will follow.
Agreement with the Consultation Principles:	This consultation has been drafted in accordance with the Consultation Principles.

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Background

Getting to this stage:	This consultation has been developed drawing on three sources of evidence: • A call for evidence on the future structure of the Local Government Pension Scheme, which ran from 21 June to 27 September 2013. 133 responses were received and analysed, helping to inform this consultation. • An analysis of the responses to the call for evidence provided by the Shadow Scheme Advisory Board. • Supplementary cost-benefits analysis of proposals for reform commissioned from Hymans Robertson using the Contestable Policy Fund. The commission did not extend to making recommendations. The Shadow Board's analysis, the Hymans Robertson report and the Government's response to the call for evidence are all available on the Government's website: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.
Previous engagement:	As outlined above, this consultation follows a call for evidence that gave anyone with an interest in the Scheme the opportunity to inform the Government's thinking on potential structural reform. The call for evidence was run in conjunction with the Local Government Association and the responses were shared with the Shadow Scheme Advisory Board, which provided the Minister for Local Government with their recommendations and analysis of the responses. The call for evidence also drew on a round table event that took place on 16 May 2013 with representatives of administering

	authorities, employers, trade unions, the actuarial profession and academia. This event discussed the potential for increased co-operation within the Scheme, including the possibility of structural change to the existing 89 funds.

Additional copies

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1.1 This consultation paper is available on the Government's website at: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies

Confidentiality and data protection

1.2 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

1.3 If you want the information that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act 2000, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, in itself, be regarded as binding on the Department.

1.4 The Department will process your personal data in accordance with the Data Protection Act 1998 and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties. Individual responses will not be acknowledged unless specifically requested.

Help with queries

1.5 Questions about the policy issues raised in the document can be sent to LGPSReform@communities.gsi.gov.uk.

1.6 A copy of the Consultation Principles is at www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance. Are you satisfied that this consultation has followed these principles? If not or you have any other observations about how we can improve the process please email: consultationcoordinator@communities.gsi.gov.uk

1.7 Alternatively, you can write to:

DCLG Consultation Co-ordinator,
Zone 8/J6, Eland House,
Bressenden Place
London SW1E 5DU.

2. Introduction and background

Introduction

2.1 The Government believes that there is scope for significant savings, of £660 million per year, to be achieved through reform of the Local Government Pension Scheme. To that end, from 21 June to 27 September 2013, the Government ran a call for evidence on structural reform of the Local Government Pension Scheme. The paper asked respondents to consider what might be done to improve fund performance and drive efficiencies across the Scheme. 15

2.2 This consultation represents the next step in reform of the Scheme, building on the responses to the call for evidence and further cost benefit analysis of potential options for reform. It sets out the Government's preferred approach to reform and seeks views on the proposals.

Background

2.3 With assets of £178 billion in 2012-13, the Local Government Pension Scheme is one of the largest funded pension schemes in Europe. Several thousand employers participate in the Scheme, which has a total of 4.68 million active, deferred and pensioner members.[1] The Department for Communities and Local Government is responsible for the regulatory framework governing the Scheme in England and Wales.

2.4 The Scheme is managed through 89 funds which broadly correspond to the county councils following the 1974 local government reorganisation as well as each of the 33 London Boroughs. In most cases, the fund administering authorities are upper tier local authorities such as a county or unitary council, but there are also some administering authorities established specifically to manage their fund, for example the Environment Agency Pension Fund and the London Pension Fund Authority. The fund authorities have individual governance and working arrangements. Each fund has its own funding level, cash-flow and balance of active, deferred and pensioner members, which it takes into account when adopting its investment strategy, which is normally agreed by the councillors on the fund authority's pensions committee.

2.5 Employer contributions to the Scheme, the majority of which are funded by taxpayers, were more than £6 billion in 2012-13. The costs of managing and administering the scheme were estimated as being £536 million in 2012-13.[2] However, the actual costs are likely to be rather higher; the investment costs alone have recently been estimated as in excess of £790 million.[3] While investment returns and the costs of providing

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[1] Scheme asset value and membership figures taken from Department for Communities and Local Government statistical data set - Local government pension scheme funds summary data: 2012 to 2013 https://www.gov.uk/government/statistical-data-sets/local-government-pension-scheme-funds-summary-data-2012-to-2013

[2] Local government pension scheme funds summary data: 2012 to 2013

[3] Department for Communities and Local Government: Local Government Pension Scheme structure analysis, Hymans Robertson p.11. https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies

benefits are the most significant drivers of the overall financial position of funds, management costs also have an impact on funding levels and thus the pension contributions made by employers and scheme members.

2.6 Under the Public Service Pensions Act 2013, there will be a requirement for a national scheme advisory board, as well as a local board for each of the 89 funds. The regulations that will establish national and local governance arrangements have not yet been made and the Department will be consulting on these issues shortly. In the meantime, scheme employers and the trade unions have established a Shadow Board, which has been considering a number of issues connected with the Scheme, including its efficient management and administration. In addition, the Minister for Local Government has asked the Shadow Board to consider how the transparency of the funds might be improved.

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Getting to this stage

2.7 In 2010, the Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission. The purpose of the Commission was to review public service pensions and to make recommendations on how they might be made more sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers.

2.8 Lord Hutton's final report was published on 10 March 2011 and formed the basis for major reforms to all public service pension schemes. The new Local Government Pension Scheme which came into effect on 1 April 2014 is the first scheme to be introduced that follows Lord Hutton's principles for reform as enacted in the Public Service Pensions Act 2013.

2.9 Lord Hutton highlighted the collaborative approach being taken by funds within the Local Government Pension Scheme and recommended that the benefits of co-operative working between local government pension funds and opportunities to achieve efficiencies in administration more generally should be investigated further.[4]

Recommendation 23: Central and local government should closely monitor the benefits associated with the current co-operative projects within the Local Government Pension Scheme, with a view to encouraging the extension of this approach, if appropriate, across all local authorities. Government should also examine closely the potential for the unfunded public service schemes to realise greater efficiencies in the administration of pensions by sharing contracts and combining support services, including considering outsourcing.

2.10 More generally, Lord Hutton went on to comment about the need for change and improved scheme data. At paragraph 6.1 he said:[5]

[4] Independent Public Service Pensions Commission: Final Report p.17 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207720/hutton_final_100311.pdf

[5] Independent Public Service Pensions Commission: Final Report p.122

In its interim report, the Commission noted the debate around public service pensions is hampered by a lack of consensus on key facts and figures and a lack of readily available and relevant data. There are also inconsistent standards of governance across schemes. Consequently it is difficult for scheme members, taxpayers and commentators to be confident that schemes are being effectively and efficiently run. It also makes it more difficult to compare between and within schemes and to identify and apply best practice for managing and improving schemes.

2.11 The Department therefore co-hosted a round-table event to consider these issues with the Local Government Association in May 2013. There were 25 attendees from administering authorities, employers, trade unions, the actuarial profession and academia. The discussion centred on the possible aims of reform, the potential benefits of structural change and the work required to provide robust evidence to analyse the emerging options and establish a starting point and target. 15

2.12 The objectives for reform identified at the round-table fed into a call for evidence on the future structure of the Scheme, which ran from 21 June to 27 September 2013. This asked respondents to set out the data required to enable a reliable comparison of fund performance and to consider how the administration, management and structure of the Scheme might be reformed to address the objectives identified at the round-table event. These objectives included reduced fund deficits and improved investment returns, as well as reduced investment fees and administration costs, greater flexibility of investment, especially in infrastructure and more use of better in-house investment management.

2.13 133 responses were received to the call for evidence and these submissions have been analysed to inform this consultation. A separate response to the call for evidence has been published and is available at: https://www.gov.uk/government/consultations/call-for-evidence-on-the-future-structure-of-the-local-government-pension-scheme. The Shadow Scheme Advisory Board has also reviewed the responses to the call for evidence and submitted recommendations to the Minister for Local Government. Its findings have been considered in the development of this consultation and are available via a link on its webpage or from the Shadow Board's website: http://www.lgpsboard.org/index.php/structure-reform/board-analysis-menu.

2.14 To support the call for evidence, the Minister for Local Government and the Minister for the Cabinet Office commissioned additional analysis using the Contestable Policy Fund. The Fund gives Ministers direct access to external policy advice through a centrally managed match fund, allowing Ministers to draw directly on the thinking, evidence and insight of external experts. Following a competitive tender process, Hymans Robertson were selected to establish the aggregate performance of the Scheme by asset class and to provide a detailed cost-benefit analysis of three potential options for reform:

- Establishing one common investment vehicle for all funds;
- Creating five to ten common investment vehicles for fund assets
- Merging the existing structure into five to ten funds.

2.15 The analysis set out the costs and benefits of each option; the time required to realise savings; the practical and legal barriers to implementation and how they might be addressed. Hymans Robertson's findings have been reflected in this consultation, alongside the call for evidence responses and analysis by the Shadow Scheme Advisory Board. A copy of the Hymans Robertson report, which did not extend to making recommendations, is available on the Government's website: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies

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3. The case for change

Summary of the proposals

3.1 Having considered the responses to the call for evidence, as well as the Shadow Board's recommendations and the Hymans Robertson report, the Government believes that the following steps are needed to help ensure that the Scheme remains affordable in the long term for both employers and members. The proposals aim to balance the opportunities from aggregation and scale whilst maintaining local accountability. 15

3.2 The package of proposals set out in this document include:

- Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs.
- Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market.
- Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme.
- A proposal not to pursue fund mergers at this time.

3.3 Hymans Robertson's analysis, which was based on detailed, standardised data, demonstrated that the significant savings could be achieved by the Scheme if all of the funds adopt the following proposals in full. The Government is interested in exploring these proposals further with a view to maximising value for money for taxpayers, Scheme employers and fund authorities.

Proposal	**Estimated Annual saving**
Moving to passive fund management of all listed assets, accessed through a common investment vehicle.	£420 million
Ending the use of "fund of funds" arrangements in favour of a common investment vehicle for alternative assets	£240 million

3.4 The saving of £420 million associated with moving to passive management of listed assets is comprised of two elements:

- Reduction in investment fees: £230 million
- Reduction in transaction costs: £190 million

The performance that is reported by the Local Government Pension Scheme funds is net of these transaction costs.

3.5 The savings associated with passive fund management can be achieved quickly, within one to two years. The annual savings arising from using common investment vehicles for alternative assets would build gradually, with the full annual savings reached over 10 years, as existing contracts came to an end.

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3.6 This package of proposals provides a clear opportunity to substantially reduce the investment costs of the Scheme. They are most effective when adopted by all 89 funds and the Government proposes to implement them together. Indeed, the passive management of listed assets could be most easily facilitated through a common investment vehicle.

3.7 In addition, the cost of investment has been estimated to be considerably higher than previously reported. Recognising the need for more reliable and comparable performance and cost data, the Government will continue to work with the Shadow Scheme Advisory Board to improve the transparency of fund data as set out in paragraph 5.3.

3.8 The remainder of this section sets out the objectives and rationale for reform and the evidence underpinning the approach taken. A more detailed explanation of the proposals for reform is provided in section four.

The objective of reform

3.9 The cost of the Local Government Pension Scheme has risen considerably since the 1990s, with the increased costs falling predominantly on Scheme employers and local taxpayers. In England alone, the cost to Scheme employers has almost quadrupled from £1.5 billion in 1997-98 to £5.7 billion in 2012-13. Indeed, when the Welsh funds are also considered, the total cost to employers is around £6.2 billion a year.[6] The Government has already taken action to reduce the cost of the Scheme and make it more sustainable and affordable to employers and taxpayers in the long term. For example, the new 2014 Scheme with a revised benefit structure came into effect on 1 April, helping to reduce and rebalance the cost between members and employers. However, it is clear from examining the aggregate data on the Scheme which has come to light as part of this review, that there is more that can be done to improve the sustainability of the funds.

3.10 At present, the funds report that administration and investment management costs are £536 million per year, of which £409 million is attributed to investment. Indeed, the reported cost of investment in cash terms has continued to rise in recent years: from £340 million in 2010-11; to £381 million in 2011-12; and £409 million in 2012-13.[7] In fact, using more detailed and standardised data CEM Benchmarking Incorporated, as sub-contractors to Hymans Robertson, identified that the fees for investment management of the Scheme could be much higher than reported, at in excess of £790 million. Some of the fees for investment management are not fully transparent to the funds and are therefore difficult to quantify. In practice, the actual cost of investment to the funds is likely to be even higher than £790 million, as their analysis did not include other costs in their calculation such as transaction costs and performance related fees on alternative assets.

3.11 Coupled with the responses to the call for evidence, Hymans Robertson's analysis has provided a system review, shedding light on the aggregate performance of the Scheme by asset class, as well as the transactions and processes that underpin the

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[6] Local government pension scheme funds summary data: 2012 to 2013
[7] Local government pension scheme funds summary data: 2012 to 2013

costs of investment. The work carried out by CEM Benchmarking Incorporated found that while funds were paying investment fees comparable with a peer group of funds of much larger size with similar mandates, there remained considerable scope for savings through a more efficient approach to investment.

3.12 The priorities of reducing fund deficits and improving investment returns set out in the call for evidence are underpinned by one overarching objective: that the Scheme remains sustainable and affordable for employers, taxpayers and members in the long term. Having considered this new aggregate view of the funds, the evidence indicates that there are opportunities to reduce costs without damaging overall Scheme performance. The Government therefore believes that it is right to consider opportunities to reduce costs and deliver value for money for employers and taxpayers, in pursuit of the overarching objective of a more sustainable and affordable Scheme.

Reducing fund costs or tackling deficits?

3.13 Although the call for evidence was developed around the primary objectives of reducing fund deficits and improving investment returns, very few responses set out ideas for managing deficits in a different way. The Shadow Scheme Advisory Board argued that more thinking could be done to consider how deficits might be addressed in the longer term. Its sixth recommendation stated[8]:

The Board will support the Government by (a) developing a shortlist of feasible options for managing deficits and (b) conducting further research on the costs and benefits of the key options for reform.

3.14 The Government agrees that opportunities to improve funding levels should continue to be explored and looks forward to considering the Shadow Board's proposals for alternative ways of managing deficits. **Respondents to this consultation are also invited to submit any feasible proposals for the reduction of fund deficits.**

3.15 While very few submissions effectively tackled deficit reduction, both public and private sector respondents recognised that the Scheme may benefit from addressing the secondary aim of reducing investment costs, partly by managing investments more efficiently. Taking action to reduce the cost of running the Scheme will help to meet this objective by increasing the funding available for investment. In the longer term, this should help to improve the funding level of the Scheme and reduce the pressure on employer contribution rates. This consultation therefore focuses on the cost savings to be found through collaboration and more efficient investment.

Achieving scale to reduce fund costs

3.16 There is already a growing consensus across the Local Government Pension Scheme that there are opportunities to deliver further efficiencies and savings for local taxpayers through collaboration. When the call for evidence was launched, funds in

[8] Call for Evidence on the Future Structure of the Local Government Pension Scheme: The Local Government Pension Scheme Shadow Scheme Advisory Board analysis and recommendations, p.4 http://www.lgpsboard.org/images/CFE/20140115SSABreportFINAL

15

Wales, Scotland and London had already begun to research the benefits of scale and explore the relative merits of mergers and common investment vehicles. Similarly, shared administration arrangements had been established in a number of areas including across Kensington and Chelsea, Hammersmith and Fulham, and Westminster; as well as in Northamptonshire and Cambridgeshire.

3.17 Several responses to the call for evidence cited earlier reports or academic research into the benefits of fund size, drawing heavily on the exploratory work of Scotland, Wales and London, as well as the international experience of countries including Australia and Canada.[9] On balance, these reports found that there was no clear link between investment returns and fund size. However, they did show that there were significant benefits to scale, such as lower investment and administration costs, easier access to alternative asset classes like private equity and hedge funds, and improved governance. This view was also reached by the Shadow Board in its analysis of the call for evidence responses, which argued that:[10]

> The evidence appears to show indirect benefits of larger fund sizes, although any direct link between fund size and investment return in the Local Government Pension Scheme is inconclusive.

3.18 Although managed as 89 funds, with an asset value of £178 billion the Local Government Pension Scheme clearly has the potential to achieve the benefits of scale realised by larger funds. Whilst many of the funds have gone some way to achieving this by using procurement frameworks or establishing joint-working arrangements, there is more that can be done. This consultation will set out how using common investment vehicles and passive management for listed assets can in the long term lead to savings of over £660 million a year for the Scheme.

Achieving efficiencies and safeguarding local accountability

3.19 The call for evidence asked interested parties to suggest options for reform that would best meet the primary and secondary objectives set out in paragraph 2.12 above. A range of tools and approaches to achieving greater economies of scale were suggested, with fund mergers, common investment vehicles, and existing collaborations such as procurement frameworks all discussed extensively.

3.20 Two themes were discussed consistently when respondents sought to evaluate the merits of the main proposals for reform:

- The potential cost and time required for implementation;
- The importance of local accountability.

Costs and benefits of the proposals

3.21 Around half of the responses discussed the cost effectiveness of merging funds and how this might be implemented. Many argued that while savings could be achieved as a result of economies of scale, more analysis was needed to ensure that the benefits

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[9] A list of the most commonly referenced papers can be found on the Shadow Scheme Advisory Board's web-pages: http://www.lgpsboard.org/index.php/structure-reform/responses-public-view

[10] The Local Government Pension Scheme Shadow Scheme Advisory Board analysis and recommendations, p.3

of mergers outweighed the cost and time required to implement them successfully.

3.22 Analysis was undertaken by Hymans Robertson who evaluated the costs and benefits of three options for reform over 10 years. They found that although significant savings could be realised over the period by amalgamating into five funds, merger could take around 18 months longer to implement than common investment vehicles; the delay in the emergence of savings leading to a significant reduction in the net present value of savings over 10 years. The report also showed that the savings achieved by pooling assets into two common investment vehicles would be slightly higher than if 10 were used.[11]

Possible model for reform	Net present value of savings over 10 years (£ billions)
Assets pooled into two common investment vehicles	£2.8
Assets pooled in 10 common investment vehicles	£2.6
Fund assets and liabilities merged into five funds	£1.9

3.23 The calculations shown exclude the impact of the reduced transaction costs, which Hymans Robertson showed would also help to deliver additional savings of £1.9 billion for the Scheme over 10 years.

3.24 A number of fund authorities also submitted evidence of the benefits to their fund of procurement frameworks such as the National LGPS Frameworks. A procurement framework provides authorities with a short list of organisations who can bid for contracts, reducing the time and cost of running a more substantial process.

National LGPS Frameworks' response to the call for evidence cited one fund who had used their actuarial framework to secure services at a procurement cost of £4,000 instead of the estimated £30,000-£40,000 required for a full procurement process. If this same rate of savings applies to Global Custodian procurements, with costs again reduced by 90 per cent, the Framework believes savings of £90,000 per fund can be found.

3.25 Although there are clear benefits to using frameworks, the scale of savings achievable does not match those possible through more substantial reform such as common investment vehicles. However, the Government believes that there is still a role for procurement frameworks to play in delivering savings for the Scheme and is keen to see this opportunity taken up by more of the funds.

Local accountability

3.26 Most call for evidence responses stressed the importance of local accountability and the direct link to elected councillors, which would be lost if funds were merged. At present the authority's Councillors, usually through the pensions committee, are asked to agree the fund's investment strategy. The authority then publishes an annual report which details the costs and investment performance of the fund, enabling the public to assess how effective the investment strategy has been. Some respondents argued that this allows local taxpayers to hold the fund and local councillors to account. As one fund authority stated:

[11] Local Government Pension Scheme structure analysis; Hymans Robertson p.6.

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"There is a clear, democratic link to local voters and businesses through elected members sitting on pensions committees…

The regulatory requirements to produce an annual report and accounts and policy statements…ensure that key information on the management of funds is held in the public domain. This approach ensures local and national accountability.

The Pensions Committee believes that a forced merger of funds could only weaken accountability and the democratic link."

3.27 However, a smaller number of respondents queried the benefit of this link, emphasising the importance of Myners Principle 1 – that administering authorities should ensure that investment decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make effective decisions and monitor their implementation.[12] Although Councillors on the committee receive training, there is a risk that they have neither a background in finance nor the time to invest in developing the knowledge required to a sufficient depth. In addition, some suggested that the frequent turnover of Pensions Committee members as a result of the electoral cycle made it difficult to ensure a long term view of the investment strategy.

3.28 The ability to set a tailored investment strategy and determine the asset allocation locally was seen as vital amongst respondents from both the public and private sectors. This is perceived as an important tool for managing each fund's unique funding position and cash-flow requirements. Several respondents also emphasised the importance of local accountability as a means to ensuring the representation of Scheme members and employers. As one Scheme employer set out in their response to the call for evidence:

The existing arrangements in English County Council and London Funds promote and facilitate a clear link between the relevant individual Fund and employing bodies… As the public sector continues to fragment the number of scheduled/ admitted bodies will increase making all the more important a genuinely "local", as presently exists, link between employers and Funds.

3.29 Under a fund merger, asset allocation would need to take place at the new, larger fund authority level. However, common investment vehicles offer greater flexibility and can be established with the asset allocation made either centrally within the vehicle, or by the local fund authority.

3.30 Around 15 responses to the call for evidence stressed that common investment vehicles could achieve the benefits of scale attributed to fund mergers, without the associated disruption, implementation time, cost or loss of local accountability. As one fund outlined when talking of pooling assets in common investment funds:

[12] Pensions Regulator – adaptation of Myners principles for the Local Government Pension Scheme http://www.thepensionsregulator.gov.uk/docs/igg-myners-principles-update.pdf

This approach might realise significant scale benefits more speedily and with less disruption, while still retaining local accountability and decision making on key matters such as deficit recovery plans and asset allocation.

3.31 Having considered the responses to the call for evidence and Hymans Robertson's analysis, the Government has decided not to consult on fund mergers at this time. However, there remains a strong case for achieving economies of scale through the use of common investment vehicles.

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4. Proposals for reform

Proposal 1: Common investment vehicles

The case for change

4.1 Using common or collective investment vehicles to aggregate the Scheme's investments and moving to passive investment of listed assets has the potential to
15 deliver significant savings of over £660 million per year, through reduced investment and other costs for all asset classes in the Scheme. These savings were set out by Hymans Robertson, whose report showed that it was likely that the economies of scale from aggregation would be best accessed through common investment vehicles.

4.2 Further savings arise from the efficient structure offered by a common investment vehicle. Within any common investment vehicle or pooled fund, money will flow in and out as investors purchase and redeem units in the fund. If those buying and selling units within a pool can be matched, fund managers will not need to sell assets to meet redemption requests and as such the volume of transactions can be minimised, improving cost efficiency.

4.3 Common investment vehicles may also deliver savings by reducing the use of "fund of funds" to access alternative assets, such as hedge funds, private equity, property and infrastructure. Fund of funds are used to achieve the scale required for individual funds to make investments they may not be able to access directly. However, this introduces an additional layer of fees, increasing the total cost of investment. Setting up a common investment vehicle would help funds achieve the scale required to invest, without the high costs associated with a "fund of funds".

4.4 Hymans Robertson found that investment fees for alternative assets were particularly high compared to other asset classes, accounting for less than 10 per cent of the Scheme's assets, but for at least 40 per cent of fees.[13] The firm's analysis showed that savings of up to £240 million per year could be achieved by ending the use of "fund of funds" across the Scheme, provided that the existing contracts were permitted to run their full course in order to avoid potentially significant termination costs. Consequently, although some savings would begin to accrue straight away, this annual total would be reached over 10 years.[14]

4.5 The wider benefits of common investment vehicles include improved transparency. As the funds would be subject to the same investment costs and asset managers, the effect of asset allocation and local decision making would become more transparent, revealed in part by the variation in investment returns. This should provide the Department, fund authorities and taxpayers with an opportunity to compare the effectiveness of a fund's asset allocation. In addition, the vehicle could provide a platform for the operation of national framework agreements, helping to minimise the cost of procurement and other administrative costs of investment such as actuarial and custodial services.

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[13] Local Government Pension Scheme structure analysis; Hymans Robertson p.11
[14] Local Government Pension Scheme structure analysis; Hymans Robertson p.7

4.6 A common investment vehicle for alternative assets could also help to improve governance by providing an independent assessment of alternative investment strategies, particularly for local infrastructure investment. A pooled vehicle could make it easier for funds to invest in infrastructure when appropriate opportunities arise, by providing a cost effective way to realise the scale needed.

4.7 As discussed in paragraph 3.28, local determination of a fund's asset allocation was seen as a vital consideration amongst respondents to the call for evidence. A common investment vehicle could be designed to allow asset allocation to remain at local fund authority level, consistent with ensuring that decisions are taken in line with existing local accountabilities. 15

Proposal for reform

4.8 The Government believes that there are clear advantages to funds in pooling their assets in common investment vehicles for all asset classes, but that all asset allocation decisions should remain with the fund authorities.

4.9 Hymans Robertson's analysis demonstrated that there were slightly higher returns over ten years if the funds were organised through one common investment vehicle for listed assets and a second for alternatives, rather than a greater number. This evidence suggests that savings will be maximised by the creation of two vehicles: a single common investment vehicle for listed assets organised by asset class (for example, UK equity, European equity, UK bonds and so on), and a second vehicle for alternative assets.

4.10 Concentrating the Scheme into two common investment vehicles may increase its exposure to risk. Several public and private sector responses to the call for evidence also stressed that capacity constraints may begin to apply if a fund became too large. As one fund authority stated in their response to the call for evidence:

> Furthermore there may be issues about capacity – the best fund managers may be closed to new business, and even if indeed the capacity exists, they may be reluctant to have too much business from a single client (as that creates business risks).

4.11 However, the Government believes that the exposure to risk should be mitigated if the asset allocation remains as diversified as it is at present. The Hymans Robertson report noted that the issue of capacity constraint would not apply to the common investment vehicle for listed assets if it were invested in passive funds.

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

Further considerations

A. Changes to the investment regulations

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4.12 The current investment regulations place restrictions on the amount of a fund that can be invested in certain types of vehicle, for example limited partnerships in aggregate are subject to a limit of 30 per cent. In addition, while some types of common investment vehicle are listed within the regulations, others are not. Squire Sanders, as subcontractor to Hymans Robertson, indicated that secondary legislation could be used to reform the investment regulations, removing the anomalies created between different types of vehicle and any ambiguity about the funds' ability to invest substantially in common investment vehicles.

4.13 The Government recognises that the investment regulations are in need of review. The Department will consult separately on reforms to these regulations, including any changes required to facilitate investment in common investment vehicles. **However, any initial thoughts would be welcome in response to this consultation.**

B. The type of common investment vehicle

4.14 The term collective or common investment vehicle can be used very broadly and take different forms. At this time, the Government would like to seek views on the specific type of common investment vehicle to be used, but anticipates that the following principles might underpin the design:

- Pooling of assets, possibly on a unitised or share basis;
- Safeguards for individual funds, for example through Financial Conduct Authority authorisation;
- Governance arrangements considered as part of wider governance reforms arising from 2013 Public Service Pensions Act;
- Strategic asset allocation remains with individual funds; and
- An option for other funded public service pension schemes to participate in the common investment vehicles if they wish.

4.15 There are a number of types of common investment vehicle available that might fulfil some or all of these principles. One such model currently under review is the tax transparent Authorised Contractual Scheme.[15] However, careful consideration of the governance arrangements for any common investment vehicle would be needed before any more detailed proposals are developed.

Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

Proposal 2: Passive fund management of listed assets

4.16 There are two main types of investment approach, which can be used individually or in combination.

- Passive management typically invests assets to mirror a market in order to deliver a

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[15] More information can be found on the Financial Conduct Authority's website: http://www.fca.org.uk/firms/firm-types/collective-investment-schemes/authorised-contractual-schemes

return comparable with the overall performance of the market being tracked.

- An actively managed fund employs a professional fund manager or investment research team to make discretionary investment decisions on its behalf.

4.17 The Local Government Pension Scheme makes use of both of these approaches, although active management is used more extensively than passive. By applying their expertise, it is hoped that active managers will deliver a level of return in excess of the market's performance, although this comes at a much higher cost than passive management. A few funds gave examples of how they had benefited from active management in their response to the call for evidence. 15

For example, the active manager of one fund had outperformed their performance benchmark by 3.2 per cent since 2007 and by 5.7 per cent in the last three years.

4.18 However, Hymans Robertson cite evidence from defined benefit pensions funds in the United States which shows that for equities, returns are explained predominantly by market movements and asset allocation policy, with active management playing no role[16].

The case for change

4.19 There are some risks associated with paying for active management, since not all active managers will be able to achieve returns higher than the market rate. Hymans Robertson was therefore asked to examine the performance of the Scheme in aggregate to see whether the funds' overall performance was benefiting from active management.

4.20 Hymans Robertson considered the performance before fees of equities and bonds in aggregate across the Scheme over the 10 years to March 2013. This new analysis, evaluating the funds' investment as one Scheme, showed that there was no clear evidence that the Scheme as a whole had outperformed the market in the long term. They concluded that listed assets such as bonds and equities could have been managed passively without affecting the Scheme's overall performance.

Equity market [17]	**UK**	**North America**	**Europe excluding UK**	**Japan**	**Developed Pacific excluding Japan**	**Emerging Markets**
FTSE Index	10.7	9.5	11.4	7.4	16.4	18.2
Aggregate Local Government Pension Scheme	10.8	8.4	11.6	7.5	17.3	17.1
Excess active return gross of fees	0.1	-1.1	0.2	0.1	0.9	-1.1

[16] Local Government Pension Scheme structure analysis; Hymans Robertson, p.19. Data based on 'Rehabilitating the Role of Active Management for Pension Funds' by Michel Aglietta, Marie Briere, Sandra Rigot and Ombretta Signori.
[17] Local Government Pension Scheme structure analysis, Hymans Robertson, table 9 p.20. Sources: State Street Investment Analytics (The WM Company), CEM Benchmarking Inc. *This is Hymans Robertson's estimate of the extra cost which reflects the low fees that the Local Government Pension Scheme in aggregate pay for active management of UK equities. The global cost premium is estimated by CEM as 0.56%

Extra cost (per annum) of active	0.34*	0.27	0.20	n/a	0.49	0.53

4.21 This analysis of investment return is specific to the performance of the Local Government Pension Scheme in aggregate.

4.22 In their report, Hymans Robertson quantified the fees savings achievable from moving to passive management of listed assets as £230 million per annum, assuming that all funds participated.[18]

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4.23 In addition to the savings arising from lower fees, a move to passive management will also reduce the level of asset turnover. This occurs as investment managers buy and sell assets within an asset class. Both passive and active managers buy and sell assets, but turnover is generally much higher, and therefore more costly, under active management. Hymans Robertson estimated that if all of the Scheme's UK and overseas equities had been managed passively in the financial year 2012-13, turnover costs would have been around £190 million lower.[19]

4.24 Hymans Robertson also conducted a detailed analysis of the transition methodology and costs to move to passive management of all listed assets. They identified that the cost of transition could be around £215 million.[20] These transition costs are approximately equal to the savings achieved from reduced turnover costs in just one year.

4.25 Their analysis of transition also concluded that any market disruption will be limited as there is no proposed change to asset allocation. Hymans Robertson suggested that a single coordinated but phased transition would minimise market impact.

Proposals for reform

4.26 The Hymans Robertson report concluded that if the Scheme acts collectively and moves all listed assets into passive management, investment fees and turnover costs could be reduced by up to £420 million per year. This represents a significant saving for the funds, employers and local taxpayers which would begin to accrue within two years of moving to passive management of listed assets.

4.27 Having considered this analysis, the Government believes that funds should make greater use of passive management for all listed assets such as bonds and equities. Alternative assets such as property, infrastructure or private equity would continue to be managed actively through a separate common investment vehicle.

Further consideration

A. <u>Take up of passive management</u>

4.28 A number of the responses to the call for evidence emphasised that a small movement in investment performance has the potential to have a more significant impact on the Scheme's finances than the savings achievable from investment management fees. It is therefore important that full consideration is given to the

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[18] Local Government Pension Scheme structure analysis; Hymans Robertson p.7
[19] Local Government Pension Scheme structure analysis; Hymans Robertson p.7
[20] Local Government Pension Scheme structure analysis; Hymans Robertson p.17

impact of a move to passive management on overall Scheme performance.

4.29 The Government acknowledges that, as set out in paragraph 4.17, there are funds who feel they have benefited from active management. However, Hymans Robertson's analysis of the savings associated with moving to passive management of listed assets is underpinned by a full consideration of investment performance by asset class across the Local Government Pension Scheme. This analysis shows that a move to passive management would not have damaged returns across the Scheme as, in aggregate, the funds' investment performance has replicated the market in much the same way as passive investment. 15

4.30 The Government therefore wishes to explore how to secure value for money for taxpayers, Scheme members and employers through effective use of passive management, while not adversely affecting investment returns. There is a range of options open to Government and the funds to achieve this:

- Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.
- Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.
- Fund authorities could be required to manage listed assets passively on a "comply or explain" basis.
- Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report

Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

5. Additional considerations

Data transparency

5.1 Although all of the funds publish annual reports setting out their costs and investment returns, a theme common to the majority of responses to the call for evidence was the need for greater transparency and more comparable data. As one fund outlined in its response to the call for evidence:

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> There is currently insufficient information available to permit a robust comparison of different Local Government Pension Scheme funds. This includes data on investment performance, investment management costs, pension administration costs, and actuarial information. All of this data should already be available within each Local Government Pension Scheme fund but there needs to be a central repository to collate and analyse the information and ensure that it is comparable.

5.2 Moving to a common investment vehicle will help to facilitate this transparency, as the investment fees derived from a common vehicle will be more comparable. It will also help to highlight the effect of asset allocation and fund decision making. Since the funds would be investing through the same vehicles, the effect of asset allocation will be more easily seen from the resulting variation in investment returns. The common investment vehicles would also allow greater clarity over variations between asset allocations and actuarial discount rates.

5.3 However, it is clear that further improvements are needed to ensure published Scheme data is comparable between funds. The Minister for Local Government has asked the Shadow Board to look at data transparency in more detail and it has already made progress in this area, bringing together all of the funds' annual reports on its website. The Government is keen to support the Shadow Board in this work and looks forward to working with it to ensure more comparable data is available in the future.

Procurement frameworks

5.4 As set out in paragraph 3.24, there are clear advantages and savings to making use of the National LGPS Frameworks. The frameworks provide funds with the opportunity to reduce the cost and time associated with procurement. By developing a short list of approved candidates, the frameworks can help funds reduce the time taken to procure a service from six to nine months to a matter of weeks, as well as offering standardised terms and conditions. In addition to offering savings to the funds, the small fee paid by funds to access the framework helps to ensure that the model is self-financing in the long term.

5.5 At present, frameworks have been established by the National LGPS Framework for investment consultancy, global custody and benefit and actuarial services. The Government believes that funds can deliver further savings, using these frameworks to procure a range of services including actuarial and investment advice. Funds should give serious consideration to making greater use of these frameworks. In addition, common investment vehicles could be used as a platform from which to operate such frameworks.

Administration

5.6 The question of how to improve the cost effectiveness of administration was posed in the call for evidence as a secondary objective for structural reform. Around 12 submissions suggested that larger funds were able to achieve lower administration costs. Some fund authorities and pensions administrators set out the benefits they had seen from aggregating administration services, arguing that significant savings could be achieve from reduced staff and accommodation costs, greater automation, member and employer self service and I.T cost reductions. For example, as a shared service for fund authorities set out in their response: 15

Local Government Shared Services ("LGSS") Pensions Service is a collaborative venture between two Scheme funds established in October 2010, which has already saved £500k per annum in pensions administration.

5.7 However, while these savings are valuable to the Scheme, they are small in comparison to the cost reductions associated with greater passive management of listed assets and the use of common investment vehicles. In addition, as some respondents stressed, the administration of the Scheme is already facing a period of significant change with the introduction of the 2014 Scheme from 1 April 2014.

5.8 Having considered these factors, the Government has decided not to consult on administration reform at this time. However, the call for evidence has highlighted the scope for potential administrative efficiencies as well as the associated risks. At this stage, the Government proposes to allow the administration arrangements for the 2014 Scheme to mature before considering reform any further.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **NATIONAL CHANGES TO THE LGPS**

SUMMARY OF ISSUE:

On 1 May 2014, a consultation was published by the Government following the Call for Evidence on the future structure of the LGPS, which was launched on 21 June 2013. The document reflects certain initiatives in terms of collaboration by various LGPS administering authorities that have been announced and implemented.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1 Note the report.

REASON FOR RECOMMENDATIONS:

The Pension Fund Board must be aware of all strategies and prospects of collaborative working surrounding the running of the Pension Fund.

DETAILS:

Background

1 Following the call for evidence, the DCLG consulted on fundamental changes to the 89 Local Government pension schemes funds in England and Wales. An announcement from the Minister in the form of a consultation document was made on 1 May 2014. The document is lacking in terms of a prescriptive approach or definitive timelines.

Possible Outcome

2 Since the debate first commenced last year, there has been considerable speculation as to the likelihood of a mandatory merger of funds or, alternatively, the non-mandatory option of existing funds collaborating with the formation of common investment vehicles (CIVs) across England and Wales. Following the publication of the 1 May 2014 document, it would appear that mandatory merger of the LGPS funds is no longer an option and the collaboration route along with collective investment vehicles is the preferred choice.

3 There have been many alliances formed and strategies agreed between LGPS administering authorities as to collaborative working with the objective of benefitting from economies of scale and reducing overall costs.

4 Most notable of these initiatives is the London Borough Partnership and the formation of a CIV applicable to London, led by LB Wandsworth and the City of London Corporation. With regard to the counties, the most prominent alliances have been formed by Devon and Cornwall, Cambridgeshire and Northamptonshire and the Thames Valley (Oxon, Bucks and Berks).

5 The principle behind this partnership is that is it a sounder strategy to encourage a “collaboration of the willing” with good governance and funding/investment strategies to implement a self-designed reform, rather than have a Government designed solution imposed on unwilling recipients.

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South East 7

6 The Pension Fund authorities within the South East 7 (Surrey, East Sussex, West Sussex, Hampshire and Kent) have assessed options to collaborate together with regard to asset and liability management. Such an initiative could generate scale economies with combined assets valued at circa £12bn. An idea of the Minister’s agreed direction would be necessary prior to any work being commenced.

7 An initial paper prepared for the South East 7 is shown as Annex 1. For collaboration to work effectively within the South East 7, close working relationships and agreements will be needed from all participants.

8 Officers will continue to work on proposals and the partnership will be the subject of future reports to the Pension Fund Board.

CONSULTATION:

9 The Chairman of the Pension Fund has been consulted on the report and has offered full support for the proposals, subject to investigative work and future reports to the Pension Fund Board.

RISK MANAGEMENT AND IMPLICATIONS:

10 Risk related issues are contained within the report, the most notable of which is the lack of clear direction and timelines offered by the Government’s consultation document.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

11 Financial and value for money implications will be discussed in future reports once a clear direction ahead has been established.

CHIEF FINANCE OFFICER COMMENTARY

12 The Chief Finance Officer is satisfied that, as far as the current information available allows, all material, financial and business issues and possibility of risks have been considered and addressed and that the possible option of collaboration offers a possible solution, allowing a still independent approach concerning funding and investment strategies to be followed by the five separate administering authorities.

LEGAL IMPLICATIONS – MONITORING OFFICER

13 Legal implications or legislative requirements associated with this initiative will be addressed in future reports.

EQUALITIES AND DIVERSITY

14 Equalities and diversity implications associated with this initiative will be addressed in future reports.

OTHER IMPLICATIONS

15 There are no potential implications for council priorities and policy areas. 16

WHAT HAPPENS NEXT

16 The following next steps are planned:

- Further investigation and future reports to the Pension Fund Board

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Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Initial Report to the South East 7

Sources/background papers:
None

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Annex 1

NATIONAL CHANGES TO LOCAL GOVERNMENT PENSION FUNDS

BRIEFING NOTE/GENERIC REPORT

Introduction

1. During 2013, Government consulted on some fundamental changes to the 89 Local Government pension schemes funds in England and Wales. Further consultation is expected shortly following research Government commissioned on three potential collaborative models for consideration:

- A common investment vehicle at England and Wales level, with asset allocation strategies still determined by the local pension funds;
- 5-10 common investment vehicles across England and Wales, for example based on aggregate fund size or geographical areas, again with asset allocation strategies decided by local governance structures;
- A much more centralised approach with 5-10 merged funds across England and Wales. These may be based on fund size or regional areas (as above). Decision-making would be taken by new governance arrangements at the merged fund level.

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Our Views

2. We welcome a debate on how to improve efficiency in the LGPS. During the current economic climate more than ever each Fund must show good value to local taxpayers.

3. Investment Manager fee levels have received attention in the press as a concern. But the notion that low fees for Investment Managers is good and high ones bad is simplistic. Ensuring fees are strongly linked to Fund performance, so that taxpayers benefit if fees rise as more pension liabilities will be met from good investment returns rather than their taxes, is more important than measuring absolute management cost.

4. Reasons against a full blown merger of funds approach are:

- ***Costs*** - one of the primary considerations when considering a merger of Funds is the costs involved. The prospect of merger to 'regional' funds is both complex and the transition would be costly with a long lead-in time. Even if there are longer term benefits (which is far from generally acknowledged), in the current climate the short term costs may not be practical.

- ***Undermining the local Funding Strategy*** – We have a strategy for our approach to investment that reflects the appetite for risk. We can also take a long term view, due to our good funding position and the covenant of employers within the Fund, and this flows through to our investment strategy and the contribution rates set. Not all funds have this benefit – needing the cash sooner to pay for pensions and needing to take higher risks. Merging funds regionally and having less autonomy means you may end up with the 'wrong' asset allocation for the profile amount and liabilities you face locally.

- ***Loss of Autonomy*** - Local democratic oversight would be much less in evidence via a small number of extremely large funds and if there is a strongly performing local fund what is being added?

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- ***Increased Risk*** – currently one of the advantages of having numerous individual funds with their own decision making is that risk is diversified across all Funds. Should funds be merged, producing for example six or seven large regional Funds of £10bn+ assets, should any single Fund falter the funding level for a large proportion of the LGPS liabilities would suffer. Put simply, much larger eggs would be in far fewer baskets.

- ***Deficits not improved*** **-** one of the key objectives of the structural reform is around "Dealing with deficits". But a merger would have no impact on funding positions for any employers within merged Funds. In short, if you merge two funds with £500m deficits, you now have one fund with a £1bn fund deficit – probably with a lot of short term distraction away from investment returns- so where did you gain?

South East 7 Initiative

5. As a response to the Government's proposals, the Pension Fund authorities within the South East 7 have been looking to work together to pool their pension fund asset management. This would allow each authority to maintain control of its strategic asset allocation whilst benefitting from significant economies of scale from a combined fund worth in the region of £11bn-£12bn. This is in its early stages, and would critically depend on the direction of Government policy before any firm commitment to proceed from the authorities concerned can be made. The principle behind this work is that is it better to encourage like-minded authorities, with sound governance and funding arrangements, to preserve these advantages by permitting a self-designed reform rather than have a Government imposed solution.

6. It is envisaged that there is a chance to pool the asset management function across the south east, creating a pathway for collaboration, opportunities for new investment classes and cost reductions. The initiative recognises Government's legitimate right to set aspirations for improvement but is also aligned to localism – tailoring pension funds to the needs of the participant authorities to strengthen their employer covenants. A simple collaboration model could work by allowing individual administering authorities to retain ownership of their assets invested via a pool, exercising their own fiduciary responsibilities and strategic asset allocation whilst reaping benefits from collaboration such as economies of scale and reduced procurement costs.

7. Table 1 below shows how the authorities compare. The fund would cover over 300,000 active, deferred and pensioner members and so would have a strong 'critical mass'.

8. It is too early to say what the national average funding level under the 2013 valuation is, but the crude average among the Funds who use Hymans Robertson as their actuary is around 75% (without adjusting for variations in underlying assumptions). The typical funding level across the country in 2010 was around 75%. It appears therefore that the South East Funds shows up well in comparison (see table 1). It should be noted that the assumptions that underpin funding levels for different counties may vary, for example the discount rate which is also given in the table.

TABLE 1: PENSION FUND DATA

Fund	West Sussex	East Sussex	Surrey	Kent	Hampshire	NationalAverage*
Funding level in 2013	86.4%	81.2%	72.3%	82.8%	80%	75%
Assets	2,370	2,344	2,559	3,786	4,341	n/a
Liabilities	2,741	2,885	3,538	4,570	5,428	n/a
Discount rate	4.6%	4.6%	4.6%	6.0%	5.5%	variable
Actuary	Hymans Robertson	Hymans Robertson	Hymans Robertson	Barnham Waddington	Aon Hewitt	Hymans clients

*Initial estimate based on Hymans Robertson clients

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Conclusion

9. If mergers take place, this will clearly be the focus of considerable governance and officer attention in the short term, detracting the focus from performance. Given our good performance as a Fund, the case for major change needs to be overwhelming proved to proceed – something we don't believe has been demonstrated.

10. Whilst some Funds are clearly performing less well than those across the South East, we would urge against any solution that 'throws the baby out with the bathwater'. A one size fits all solution, such as a large scale merger of funds, risks the dangers outlined above and losing the good skills and performance demonstrated by the high funding levels emerging from the 2013 Valuation across the South East Funds.

11. The five Authorities have sought to work together to map out a viable framework of joint working consistent with Government views to date. This is a process that inevitable can be challenging with different ideas on the vision and the way ahead. For collaboration to work effectively across five Funds, clearly agreement will need to be reached with all to participate in a suitable model, including the right size for a more collective approach. Without sight of Government's (overdue) proposal, this is difficult to anticipate in detail. Once Government has set out its aims, in the consultation paper due out, this work can continue with more urgency.

Recommendations

12. The report is noted

13. If Government indicates it wishes to proceed with full scale reform of the LGPS funds, the Pensions Panel support this initiative and any resource needed to develop a subsequent business case. This is subject to 'no change' not being an option available to maintain the existing Fund management and governance arrangement as the first preference, and the South East 7 proposal as outlined being in keeping with any Government's intention for enhanced collaboration.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **15 MAY 2014**

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

SUBJECT: **INVESTMENT STRATEGY REVIEW**

SUMMARY OF ISSUE:

Following the actuarial valuation, Mercer has been requested to conduct an investment strategy review of the Surrey Pension Fund.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1. Give consideration to investing in a more risk aware manner relative to the Fund's liabilities with a view to the establishment of a liability driven investment strategy (LDI) portfolio. This should be set up on a relatively small scale initially with the level of liability protection increased as and when the funding level moves towards 100%.

2. Give consideration to setting up a framework for a leveraged gilt portfolio.

3. Give consideration to introducing more diversified sources of return with a view to introducing Infrastructure Debt as a new asset category and increasing the existing allocation to diversified growth funds (DGF).

4. Give consideration to setting up a framework for a synthetic equity portfolio.

5. Give consideration to implementing such changes in the short term, thus preparing a platform for the future strategy requirements, with the ultimate view to locking in some of the improvement in the funding level that has been seen since the valuation date of 31 March 2013.

6. Receive ongoing training and Board reports in order to facilitate a definitive decision making process on these strategy issues at future Board meetings.

REASON FOR RECOMMENDATIONS:

The Pension Fund Board must monitor and adapt its investment strategy according to its liability profile in a changing market environment.

DETAILS:

Background

1 This report provides both a summary of the deliberations that need to be considered by the Pension Fund Board in order that Members can review the current investment strategy in light of the 2013 Triennial Actuarial Valuation outcome and the current investment climate, with a year having elapsed since that valuation.

2 The triennial valuation cycle provides a good point at which to review the investment strategy as we have a current valuation of the liabilities of the Fund. The changes in funding level between one triennial valuation and the next is effectively the best measure of how the Fund's liabilities are developing with respect to changing bond yields in the market, and how the investment strategy (investing primarily in active growth assets) has performed, relative to expectations, in those same investment markets.

17

3 The Fund's current investment strategy was agreed by the previous Investment Advisory Group (IAG) in early 2012. At that time, the most critical concerns of the IAG were primarily that a revised investment strategy should seek to provide a reduction in investment return volatility, following the asset valuation falls seen in late 2008 and early 2009.

4 It should be noted that currently, the expected return (based on best estimate assumptions) on the Fund's assets in circa 3.2% per annum over gilts. The actuary assumes an excess return on 1.6% over gilts for the purposes of the actuarial valuation.

Revised Strategy

5 At the Board meeting of 14 February 2014, Mercer presented an investment review and this is included as Annex 1 to this report. The Strategic Finance Manager has since had one-to-one meetings with Board members to go over the specific points made in that presentation. Mercer will present the next stage of the review and additional training at the meeting of 15 May 2014. This document is included as Annex 2 to this report.

Liability Driven Investment

6 Mercer has recommended that the Fund establish a liability driven investment strategy (LDI) portfolio.

7 LDI is an investment style that seeks to match the movements in the value of a Fund's liabilities with a basket of investments whose value will be affected by prevailing bond yields in exactly the same way as the value of the Fund's liabilities. Due to the historic low yields at present, an attempt to match all of the Fund's liabilities would be considered very expensive; however, the decision to match a scheme's inflation-linked liabilities is much more attractive, especially for the LGPS as there are direct inflation linkages to the pension liabilities.

8 Despite the current low yields and the resultant expensive switch, Mercer's advice is that it is time to set up such a LDI structure, given the level of training and due diligence required (a year's lead in is a reasonable expectation), so setting up this mechanism now could put the Fund in a better position where it could react relatively swiftly to capture what would be considered attractive future de-risking opportunities. Without the appropriate structure in place, the opportunity to de-risk when opportune could easily be missed. An opportunity to de-risk after the valuation of 2007 was generally missed by LGPS authorities.

9 The risk in not taking any action is that de-risking opportunities could be overlooked at the opportune time, i.e., as the funding level approaches its 100% target, and at the point when markets could be regarded as having the potential to experience levels of volatility.

Infrastructure Debt

10 There are benefits for LGPS funds to take on infrastructure investments. On the upside, infrastructure has the potential to offer stable, transparent and inflation-linked cashflows in order to address the inflation-indexed liabilities of the fund. The major drawback of the asset class is the illiquid nature of the investment, and the fact that funds are tied up for the long term. 17

Diversified Growth Funds

11 Further venture into DGF will assist with further return diversification and improved risk management. A separate report in the 15 May 2014 Board agenda discusses the possibility of the Fund partaking in the new Global Focused Strategies Fund launched by Standard Life.

Leveraged Gilt Portfolio

12 A leveraged gilt portfolio will provide protection against future movement in interest rates and inflation.

13 There will be an emphasis on putting the platform in first with a view to building up the allocation over time, based on funding improvements and also as real yields increase.

Synthetic Equities

14 It is likely that further commitments to protection assets will be funded from passive equity portfolios. A synthetic equity portfolio will bridge this gap and retain the commitment to active growth assets left by this transfer.

Further Reports and Training

15 Further training on leveraged gilt portfolios and derivatives will be provided at the 15 May 2014 Board meeting and at future meetings. Members will be invited to discuss with further reports due next time, subject to the outcome of those discussions.

CONSULTATION:

16 The Chairman of the Pension Fund has been consulted on the revised investment strategy and, subject to Board members being fully trained and having sufficient understanding of the principles involved, will take a consensus view at the Board meeting. Members being further trained in order to approve such a strategy when required is supported.

RISK MANAGEMENT AND IMPLICATIONS:

17 The risk related issues are addressed in the Mercer report in Annex 1.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

18 The financial and value for money implications are addressed within the Mercer report in Annex 1.

17

CHIEF FINANCE OFFICER COMMENTARY

19 The Chief Finance Officer is satisfied that all material, financial and business issues have been considered and addressed, and is aware of all risks and benefits associated with the review. Training needs should be addressed further prior to any decisions on the implementation of the proposed strategy review recommendations. Members should be well informed and trained on the proposed structure for the way ahead and satisfied that the changes are relevant to the requirements of the Pension Fund.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

21 The investment strategy review will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

23 The following next steps are planned:

- Decision on adoption of the principles of the investment strategy review.
- Further training provided to Board members at future meetings.
- Further reports to the Board at future meetings.
- Officers implement changes required as a result of specific Board recommendations.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Annex 1: Mercer report of 14 February 2014
Annex 2: Mercer report of 15 May 2014

Sources/background papers:
None

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SURREY PENSION FUND
INVESTMENT STRATEGY REVIEW

February 2014

Steve Turner & **Marc Devereux**
Partner **Principal**

MARSH & McLENNAN COMPANIES

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A change in investment strategy will incur transaction costs.

It should be noted that our analysis is sensitive to the inputs; for example the assumed level of expected returns, risk and correlations to the various asset classes and liabilities. There can be no guarantee that the assumptions will be borne out in practice.

Agenda

- Summary
- Current Investment Policy & Risk
- Destination
- Strategy Analysis
- Timing considerations
- Additional considerations

Summary

Reviewing Investment Strategy – 5 "D" Principles

1

- **Determine - the current level and sources of expected return and risk relative to the liabilities**
  - Expected return is currently gilts +3.2%; 83% of this is dependent on equity market returns.
  - Deficit risk is high. 1 in 20 worst case deficit could be greater than £1.5bn to £2bn from 2016 onwards. Current investment policy provides very little liability protection.

2

- **Destination – its important to know "where you want to get to"**
  - Aim to restore the deficit through investment returns and agreed contributions to achieve 100% funded status but also consider what investment policy the Fund would have when fully funded. Provides a framework for identifying what policy changes should be made that are consistent with now and the future.

3

- **Diversify – look to capture multiple drivers of return but don't diversify for the sake of it. Global opportunity set**
  - Proposed main areas of focus for diversifying the sources of return are Infrastructure Debt and increasing the allocation to DGF. Ideas in Emerging Markets, Multi-Asset Credit and Alternative Indexation are also highlighted for completeness.

4

- **Don't forget the liabilities**
  - Size and volatility of the liabilities is a major source of risk. This can only be effectively managed by investing in a more risk aware manner relative to the liabilities. It is possible to adopt an investment policy that materially reduces deficit risk, whilst maintaining the same level of expected return (with more diversification). The level of complexity involved with various options does vary though.

5

- Be **Dynamic when considering the "timing" considerations of making investment policy changes**
  - Given the strong rise in equity markets over the last 5 years (and 2013 in particular), we think there is strong case for diversifying away from equities given current market conditions. This should be subject to on-going review.
  - We believe that there are compelling reasons to increase the level of liability protection, without "hoping" that real yields increase from current levels. Emphasis should be on "getting the plumbing in place" to be able to react quickly to be able to increase the level of liability protection should the funding level and market conditions improve in the future.

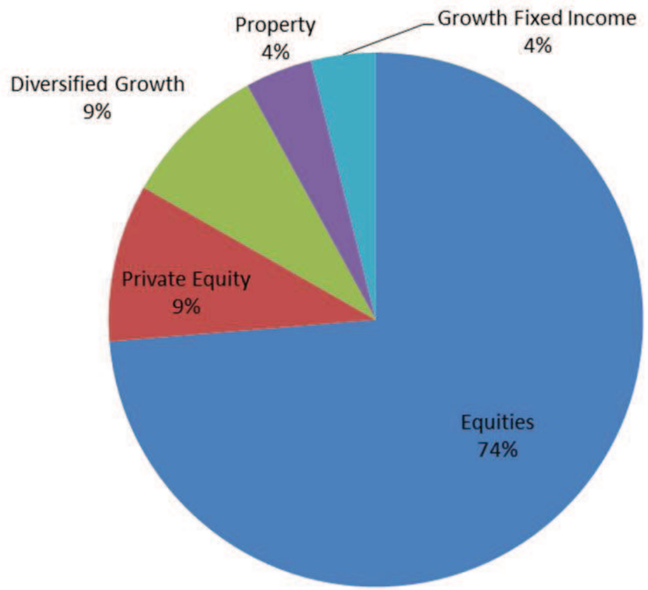
Current Investment Policy & Risk

Current investment policy

Asset Class	Benchmark Allocation (%)
Growth Assets	**91.2**
Equities (inc. currency hedging)	59.8
Private Equity	5.0
Diversified Growth	9.5
Property	6.6
Growth Fixed Income*	10.3
Protection Assets	**8.8**
Gilts	8.8
Total	**100.0**

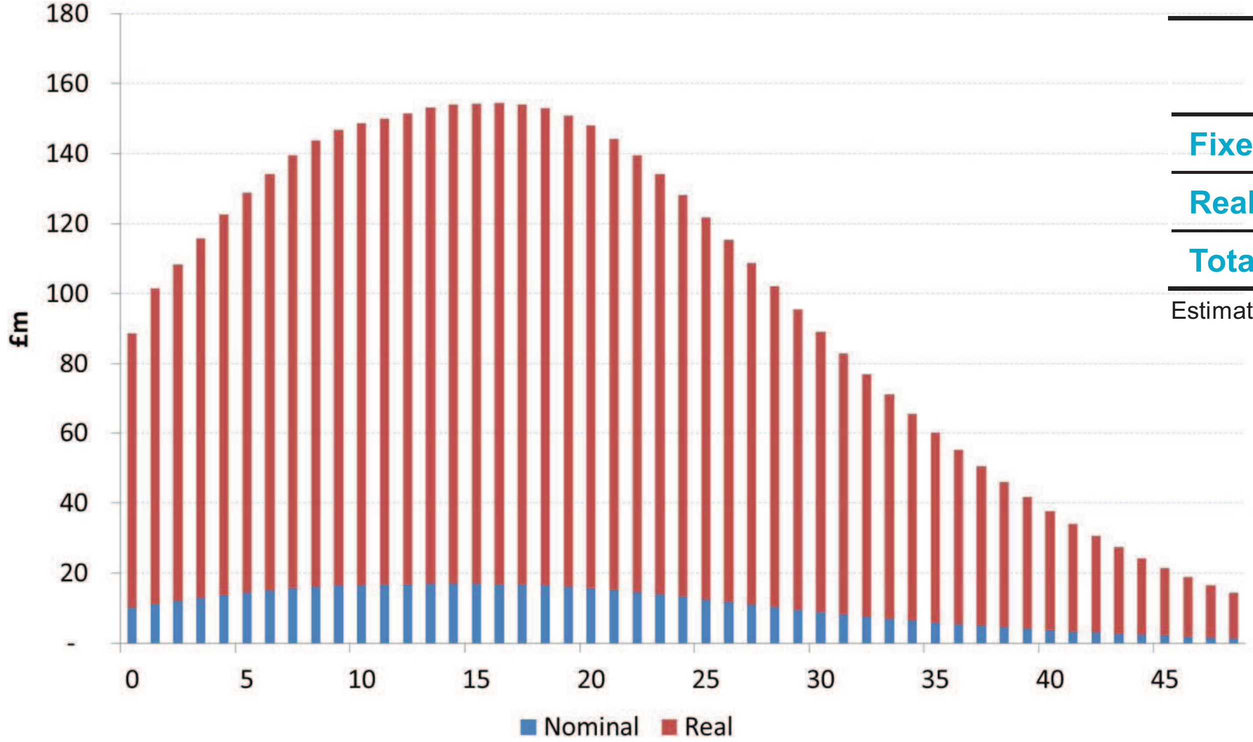
*Includes the corporate bond and total return bond allocations

Sources of excess return



- Currently, the expected return (based on best estimate assumptions) on the Fund's assets is c.3.2% p.a. over gilts.
- The Actuary assumes an excess return of 1.6% p.a. over gilts for the purposes of the actuarial valuation.
- Growth assets make up over 90% of the portfolio by allocation; equities (including private equity) account for 83% of the expected excess return.
- The funding level as at 31 March 2013 was 72.3% (broadly similar to the 2010 valuation) but the deficit has increased by c.30% to £980m.

Liability Benchmark Portfolio ("LBP")

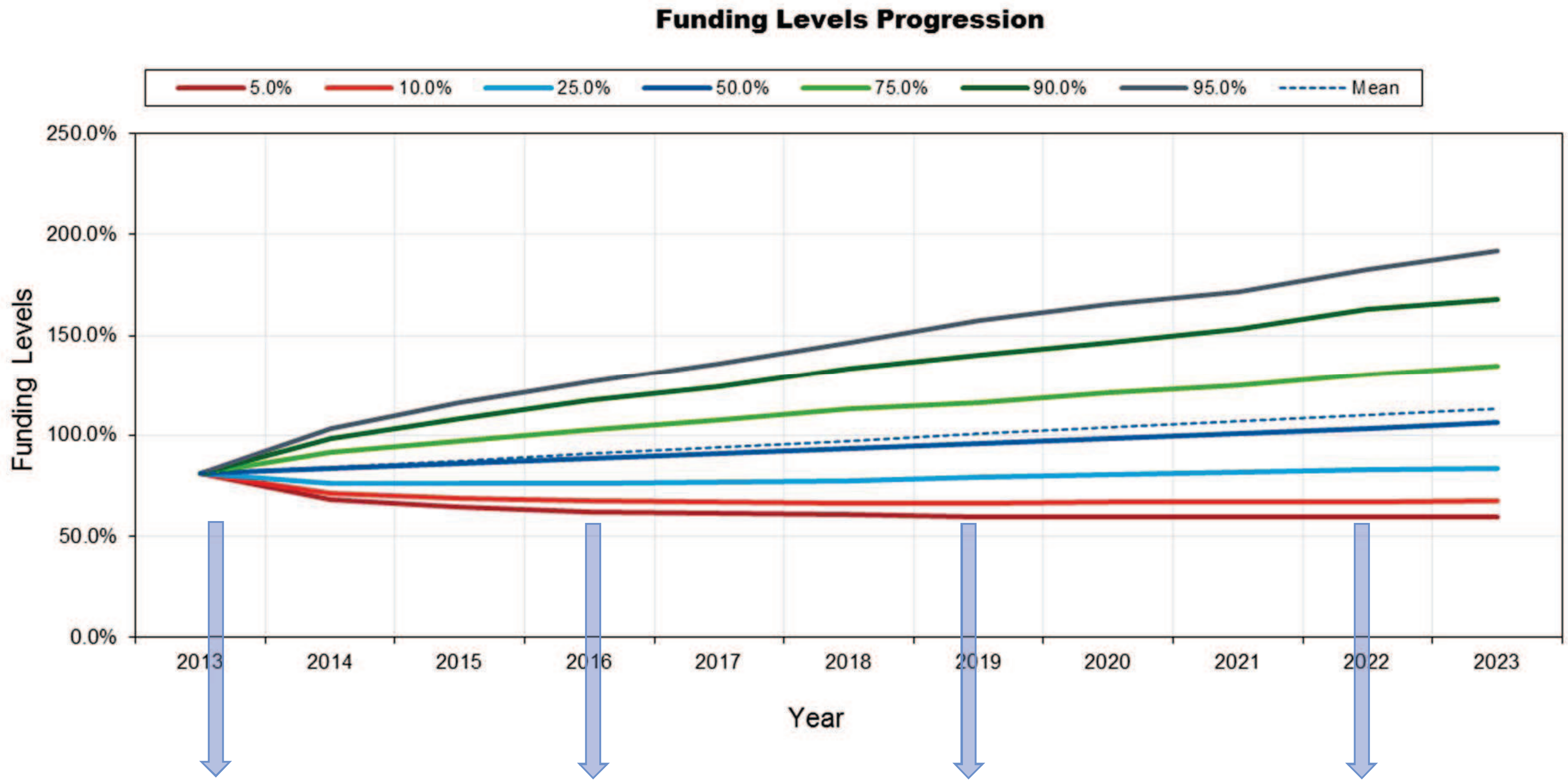


	Allocation (%)	Duration (yrs)
Fixed	10.6	19.2
Real RPI	89.4	20.0
Total	**100.0**	**19.9**

Estimate only

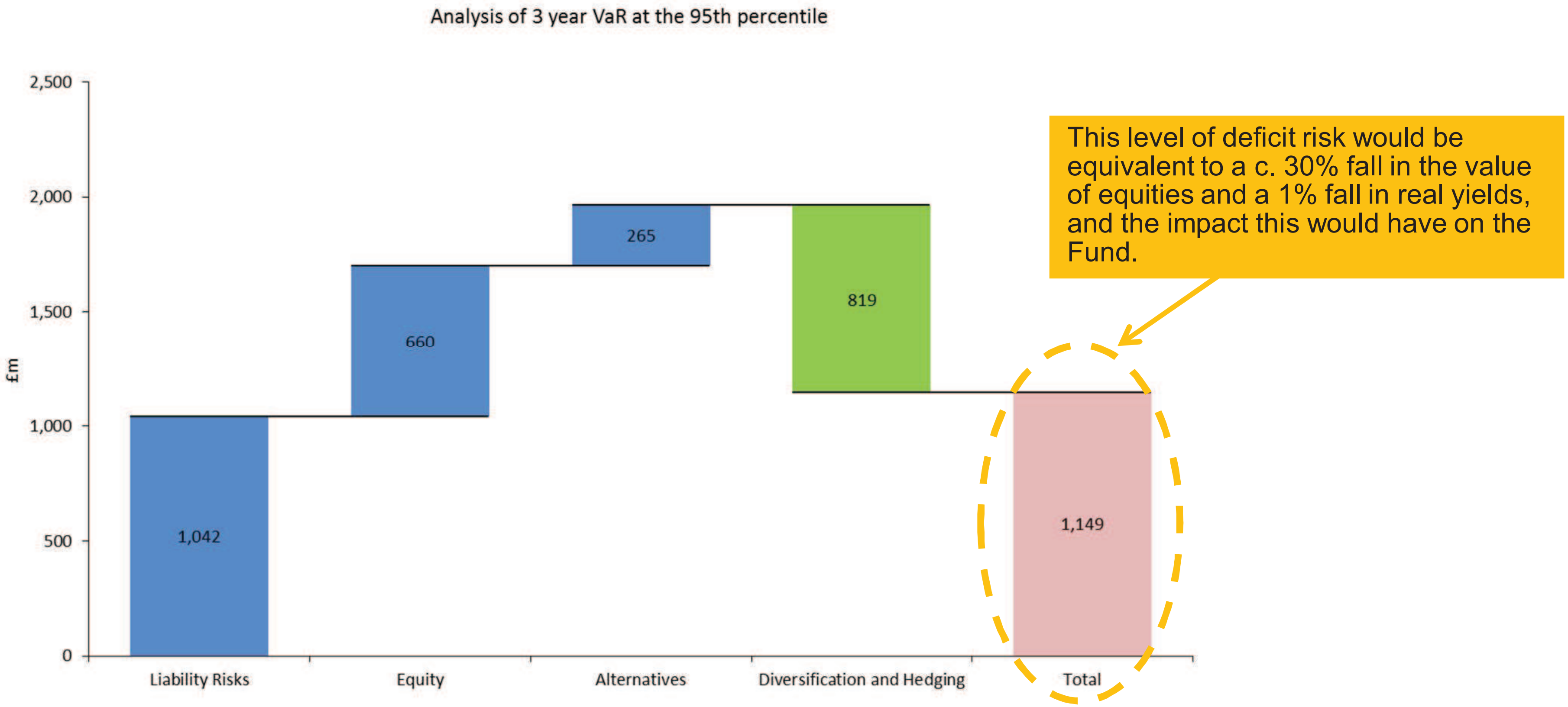
- The LBP represents the theoretical least risk (this does not mean "no" risk) investment portfolio to match the interest rate and inflation related characteristics of the liabilities. The LBP acts a reference point / benchmark on which investment risk can be assessed relative to the liabilities.
- Around 90% of the LBP is real i.e. linked to inflation expectations.
- The average weighted term to payment, or duration, is around 20 years. This means that a 1% fall in interest rates would lead to an increase in the liabilities of around 20% (and vice versa).
- Based on the initial valuation results, we estimate the funding level as at 30 September 2013 was c. 81%.

Funding level projection - based on current policy and estimated funding position as at 30 September 2013



	2013	2016	2019	2022
Expected Funding Level (%)	81	88	96	104
Expected Deficit (£m)	610	413	165	-171
95% Worst Case Deficit (£m)	n/a	1,562	2,020	2,416

Deficit risk



- The chart above shows that there is a 1 in 20 chance that the deficit could be **£1,149m higher than expected in three years time**. (estimated potential 1in 20 deficit is £1,562m)
- The two largest risks facing the Fund are from changes to interest rates and inflation expectations (which we refer to as liability risks) and equities.
- The magnitude of the risk is significant given: (1) the low level of protection assets and current deficit; and (2) the high reliance on equities.
- Focus of any potential strategy changes should therefore be on diversifying away from equities as a source of return and a more "risk-aware" approach to investing, relative to the liabilities.

Destination

Destination
Where do you want to get to?

Objectives

1. Get to 100% funding via investment returns and agreed contributions
2. Look to maintain 100% funding to the extent possible, given actuarial assumptions
3. Important to identify what this investment policy looks like now. This then provides a framework for the policy changes that should be made
4. Scope to introduce more return diversification and introduce risk management “plumbing” to help reduce deficit risk

Destination
What this could look like

Current Policy

Growth Assets	91.2%
Gilts (no gearing)	8.8%
Liability Protection	6%
Expected Return (best estimate basis)	Gilts +3.2%
Deficit Risk	£1,149m

- Currently focused on return; equity dominated; low liability protection
- High level of deficit volatility

Put in place a plan to get here

Ensure any changes are consistent with the "Destination"

Policy for when 100% funded

Growth Assets	65%*
Gilts (2x geared)	35%
Liability Protection	70%
Required Return (actuarial funding basis)	Gilts +1.6%
Deficit Risk	£577m

- More balanced investment policy
- Greater funding level stability and confidence for contribution affordability

*Based on Actuary's indication that 70-60% in growth assets is needed to support a Gilts +1.6% discount rate. The allocation could be 45% on Mercer "best estimate" return assumptions (this should be viewed as indicative only). Further discussion may be required with the Actuary to explore the extent to which a lower risk investment policy could be adopted.

Strategy Analysis

Proposed areas of focus

- Based on discussions so far between Officers, the Fund's Independent Advisor and Mercer
- The aim is to help assess the impact of further return diversification and improved risk management (emphasis on putting the "plumbing in place" first, with a view to building up over time, based on funding improvements and/or if real yields increase)

1	2	3
Switching existing physical gilts to a leveraged gilt structure	**Diversify growth assets further. Consider Infrastructure Debt and additional allocation to DGFs**	**Replace physical equities with derivative based exposure and use capital to increase allocation to protection assets**
Rationale **Would help address low level of liability protection without reducing expected return**	**Rationale** **Based on previous discussions and training on Infrastructure Debt and familiarity with DGFs**	**Rationale** **Similar to (1), but could have a potentially bigger impact on risk reduction**

- We consider each of these key components in more detail (and in combination).

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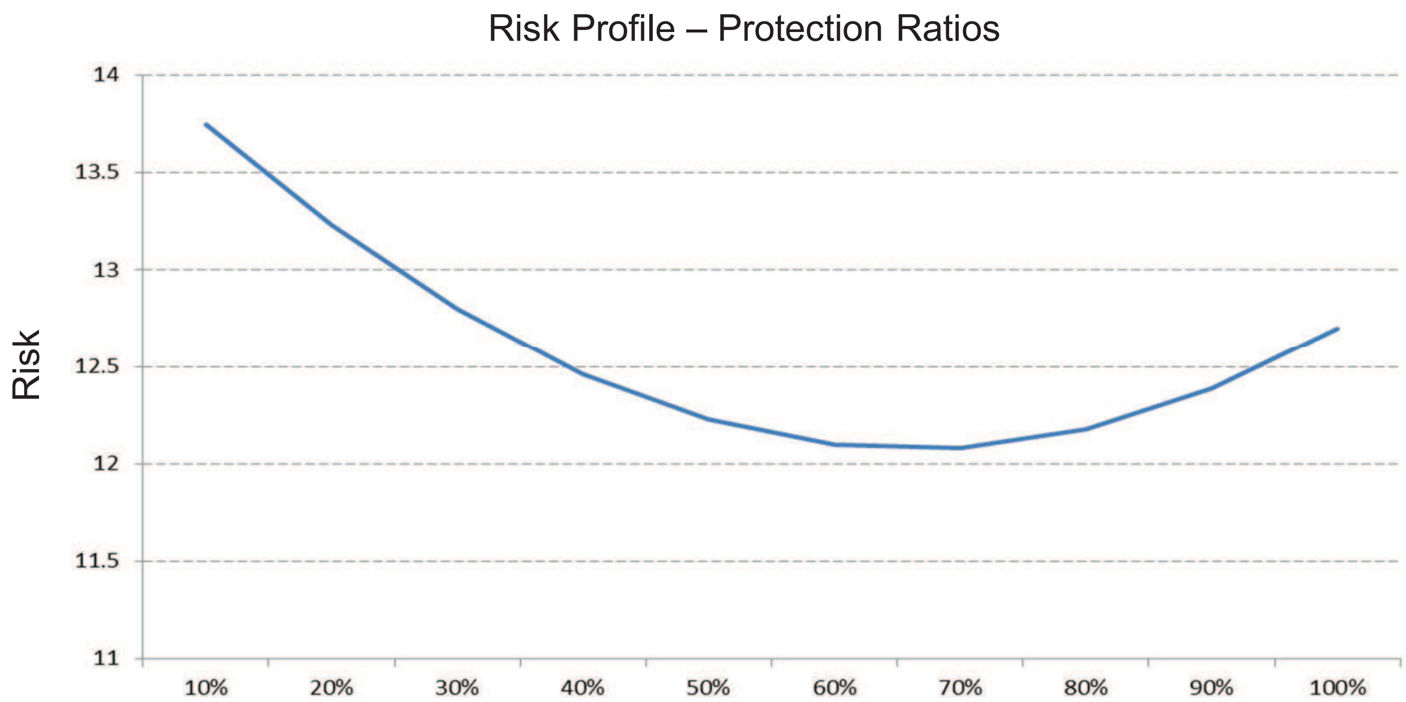
Summary of analysis

	Current Policy	1) Leveraged Gilts	2) Diversification	3) Synthetic Equity	Combined	Potential Target
Growth Assets	**91.2**	**91.2**	**91.2**	**91.2**	**91.2**	**65.0**
Listed Equities (%)	59.8	59.8	49.8	59.8	49.8	23.6
Private Equity (%)	5.0	5.0	5.0	5.0	5.0	5.0
Diversified Growth (%)	9.5	9.5	14.5	9.5	14.5	14.5
Property (%)	6.6	6.6	6.6	6.6	6.6	6.6
Corporate Bonds (%)	7.6	7.6	7.6	7.6	7.6	7.6
Total Return Bonds (%)	2.7	2.7	2.7	2.7	2.7	2.7
Infrastructure Debt (%)			5.0		5.0	5.0
Protection Assets	**8.8**	**8.8**	**8.8**	**8.8**	**8.8**	**35.0**
Gilts	8.8	26.4	8.8	38.6	70.0	70.0
Short cash exposure resulting from leverage	-	3x Leveraged -17.6	-	-29.8	-61.2	**-35.0**
Total (%)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Expected Return Over Gilts (%p.a.)	**3.2**	**3.2**	**3.1**	**3.2**	**3.1**	**2.1**
3 Year Deficit Risk 95th Percentile (£m)	**1,149**	**1,048**	**1,102**	**995**	**797**	**577**

Based on Mercer's capital market assumptions – see Appendix

£352m reduction in risk

Liability Protection Ratio Analysis
What should this be?



- The chart shows the impact of increasing the liability protection ratio as a % of assets from the current strategy (c. 9% of assets or 6% of liabilities) up to 100%. The impact is not linear and we can see that there is an optimal protection ratio at the lowest point on the curve.
- The optimal protection hedge ratio for the current allocation is between 60-70%. The reason that this is not 100% is because there is some correlation between the growth assets and interest/inflation rates.
- The optimal hedge ratio is dependant on the allocation to growth assets as these assets have a small correlation to the liabilities.

Summary of analysis
Notes

- **Current**
  - We have modelled the current portfolio including the allocation to private equity. The expected return from this portfolio is c. 3.2% p.a. with a deficit risk of £1,149m.
- **Leveraged Gilts**
  - This portfolio utilises the current exposure to gilts (8.8%) and leverages it 3 times to gain economic exposure of 26.4%. This change results in a reduction in the deficit risk of c. £101m.
- **Diversification**
  - The diversified portfolio reduces the equity exposure by 10% and increases the exposure to DGFs by 5%. This portfolio also introduces an allocation to Infrastructure Debt. The impact on the deficit risk from this portfolio is relatively small (c. £47m) but will help reduce the reliance on equities for return (reduces from 83% to 74%)
- **Synthetic Equity**
  - Exposure to equities can be gained using derivatives which would free up some capital to invest in protection assets. In this portfolio, 29.8% of total assets have been replicated using synthetic equity, with the resulting cash used to supplement the current allocation to protection assets. The resultant reduction in deficit risk is c. £154m.
- **Combined**
  - The combined portfolio utilises all three of the investment themes above to create a portfolio that synthesises equity exposure and leverages the resultant capital to achieve a liability protection ratio of 70% of assets. The portfolio also diversifies the equity exposure as highlighted above. By combining all of the above themes, the Fund is able to achieve a reduction in deficit risk of c. £352m (down to £797m from £1,149m), whilst still broadly maintaining the same level of expected return
- **Target**
  - This is an example “Destination” portfolio for when the Fund reaches 100% funding. We are not suggesting that the Fund moves to the target portfolio in the near term, but rather factors in the potential to move towards the portfolio over time. As can be seen, the deficit risk is approximately half that of the current portfolio. The expected return is still expected to be consistent with the Actuarial Valuation assumptions.

Timing Considerations

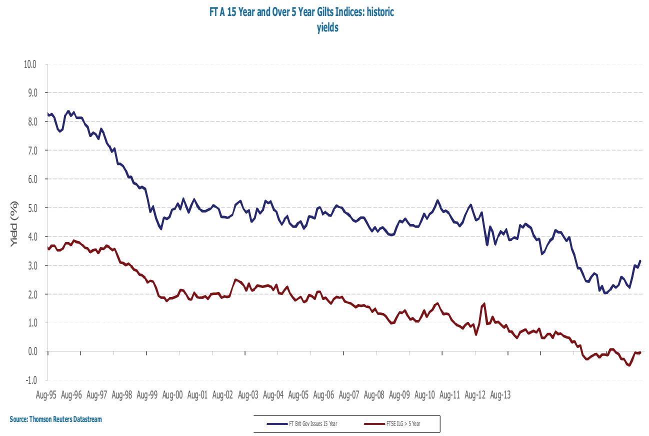
Timing considerations – equity markets

Is now a good time to reduce equity exposure?

- Since the end of 2008, both global and UK equity markets have almost doubled in value. This rate of growth should not be expected to continue.
- Following these rises, a number of developed equity markets including the US and UK are close to all time highs.
- Our Dynamic Asset Allocation ("DAA") view is still positive on equities relative to other asset classes, although our conviction has diminished following strong returns in 2013.
- **We would be comfortable for the Fund to "bank" some of the gains from equity returns by diversifying into other asset classes.**
- It should also be noted that the Fund would still retain a significant proportion of assets in equities should diversification take place.

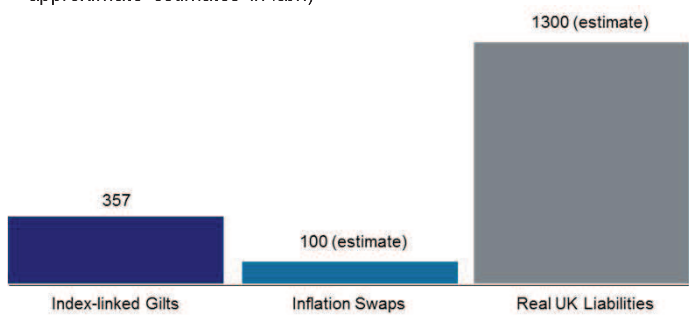
Is now a good time to increase liability protection?

1. Long-term decline in ILG yields



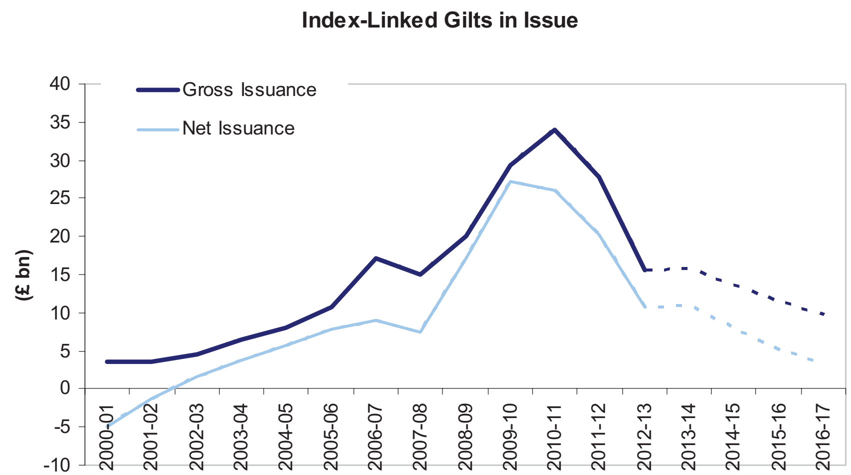
2. Demand for ILG exposure outstrips supply

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



Source: DMO

3. Net issuance of ILGs is expected to fall



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

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

Strong case to increase liability protection level given :

(1) increase in funding level since valuation

(2) the magnitude of the deficit risk

(3) to get the “plumbing in place” to be able to swiftly capture de-risking opportunities in the future

Liability protection implementation considerations

Overview of main approaches

SIMPLICTY

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

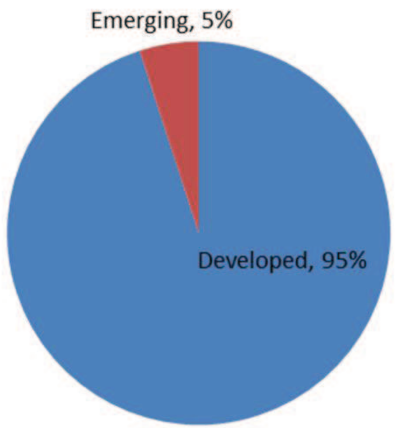
COMPLEXITY

No single right answer – driven by beliefs and risk tolerance

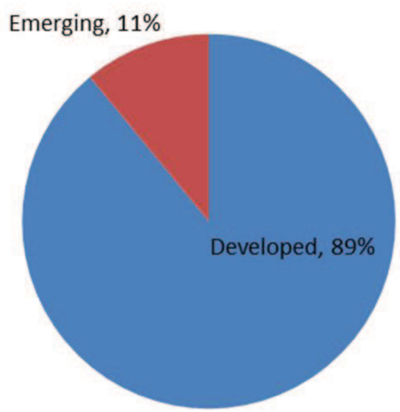
Additional considerations

Emerging Market Equities (“EME”)

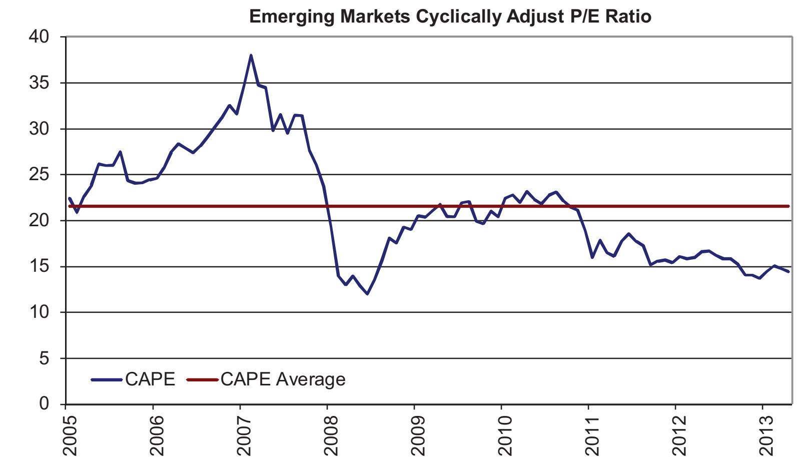
Surrey Combined Equity Portfolio est.



Global Market



Attractive Valuations

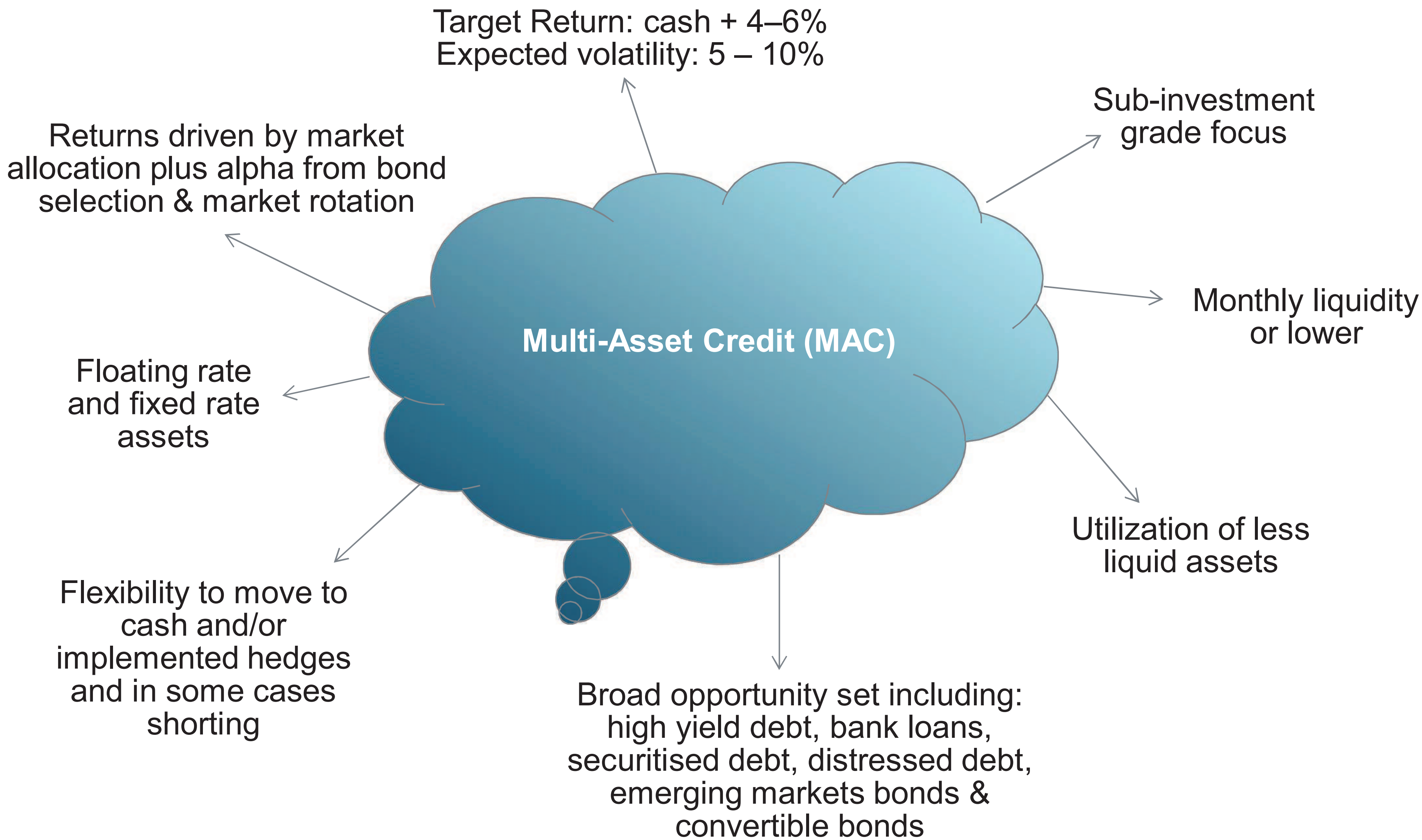


Source: Thomson Reuters Datastream, IBES

- The Fund’s exposure to Emerging Market equities is materially underweight versus the global index
- We would recommend that the Fund targets an allocation in line with the global market (11%)
- EME have significantly underperformed Developed Markets since the start of 2013 (by around 30%)
- Underperformance could continue in the short to medium term but we see current market conditions as being a good “entry point” to phase in an increased allocation
- Current exposure is passively managed. We prefer active management given the diversity and risks (e.g. geo-political) involved with EME
- The Fund could also consider a direct allocation to Frontier markets

Multi-Asset Credit

“Best ideas” approach to capturing the credit risk premium



Multi-Asset Credit
Importance of Asset Allocation

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
US HY CCC (Distressed) 60.99	EM LC Sov 22.97	EM HC Sov 10.25	US HY CCC (Distressed) 18.60	EM LC Sov 18.11	EM LC Sov -5.22	US HY CCC (Distressed) 96.79	US HY CCC (Distressed) 18.42	EM HC Sov 7.35	European HY 27.45
European HY 26.40	US HY CCC (Distressed) 15.75	European HY 6.80	Global CB 17.94	Global CB 11.26	Global Corporates -8.63	European HY 76.35	EM LC Sov 15.68	ABS 6.95	US HY CCC (Distressed) 20.27
Global CB 24.57	European HY 14.73	EM LC Sov 6.27	EM LC Sov 15.22	Global Corporates 6.73	EM HC Sov -12.03	Loans 51.62	European HY 14.72	US HY BB-B 5.43	EM HC Sov 17.44
US HY BB-B 22.95	EM HC Sov 11.62	Loans 5.06	US HY BB-B 10.68	ABS 6.43	ABS -14.78	Multi-Asset Credit 46.75	US HY BB-B 14.50	Global Corporates 4.32	EM LC Sov 16.76
EM HC Sov 22.21	US HY BB-B 9.93	Multi-Asset Credit 3.91	Multi-Asset Credit 9.98	EM HC Sov 6.16	US HY BB-B -23.71	US HY BB-B 46.14	EM HC Sov 12.24	Multi-Asset Credit 2.18	US HY BB-B 14.71
Multi-Asset Credit 19.00	Multi-Asset Credit 9.59	US HY BB-B 3.33	EM HC Sov 9.86	Multi-Asset Credit 3.71	Multi-Asset Credit -23.81	Global CB 41.37	Multi-Asset Credit 12.00	Loans 1.51	Multi-Asset Credit 13.84
EM LC Sov 16.92	Global Corporates 9.46	Global CB 0.06	ABS 9.50	US HY BB-B 2.72	Loans -29.05	EM HC Sov 29.82	Global CB 11.76	US HY CCC (Distressed) -1.40	Global CB 13.30
Global Corporates 14.34	Global CB 9.14	US HY CCC (Distressed) -0.56	European HY 8.90	Loans 2.08	Global CB -31.67	EM LC Sov 21.98	Loans 10.13	EM LC Sov -1.75	Global Corporates 11.18
Loans 9.83	ABS 8.79	ABS -1.51	Global Corporates 7.23	US HY CCC (Distressed) 0.42	European HY -33.53	ABS 21.27	ABS 6.35	European HY -2.55	Loans 9.60
ABS 6.41	Loans 5.22	Global Corporates -3.56	Loans 6.74	European HY -2.09	US HY CCC (Distressed) -38.30	Global Corporates 19.18	Global Corporates 5.83	Global CB -7.03	ABS 8.58

EM LC Sov: JP Morgan GBI EM GD, EM HC Sov: JP Morgan EMBI GD, European HY: BofA Merrill Lynch European High Yield, US HY BB-B:BofA Merrill Lynch US High Yield BB-B, US HY CCC (Distressed):BofA Merrill Lynch US High Yield CCC, Global Corporates:Barclays Global Aggregate Corporate, ABS:Barclays Global Aggregate Securitized Asset Backed, Loans:S&P Leverage Loans, Global CB:UBS Global Convertibles

Multi-Asset Credit: static allocations comprising: JP Morgan GBI EM GD 5%, JP Morgan EMBI GD 5%, BoA Merrill Lynch US High Yield BB-B 30%, BoA Merrill Lynch European High Yield 10%, BoA Merrill Lynch US High Yield CCC 5%, , Barclays Global Aggregate Securitized Asset Backed 7.5%, S&P Leverage Loans 27.5%, Citigroup US 6 month T-Bill 5%, UBS Global Convertibles 5%

Provides a governance friendly method of accessing a diverse range of credit opportunities in a dynamic way

Alternative Indexation

Why consider?
Around 1/3 of the Fund's total assets (or 38% of total equities) are invested on an index-tracking basis

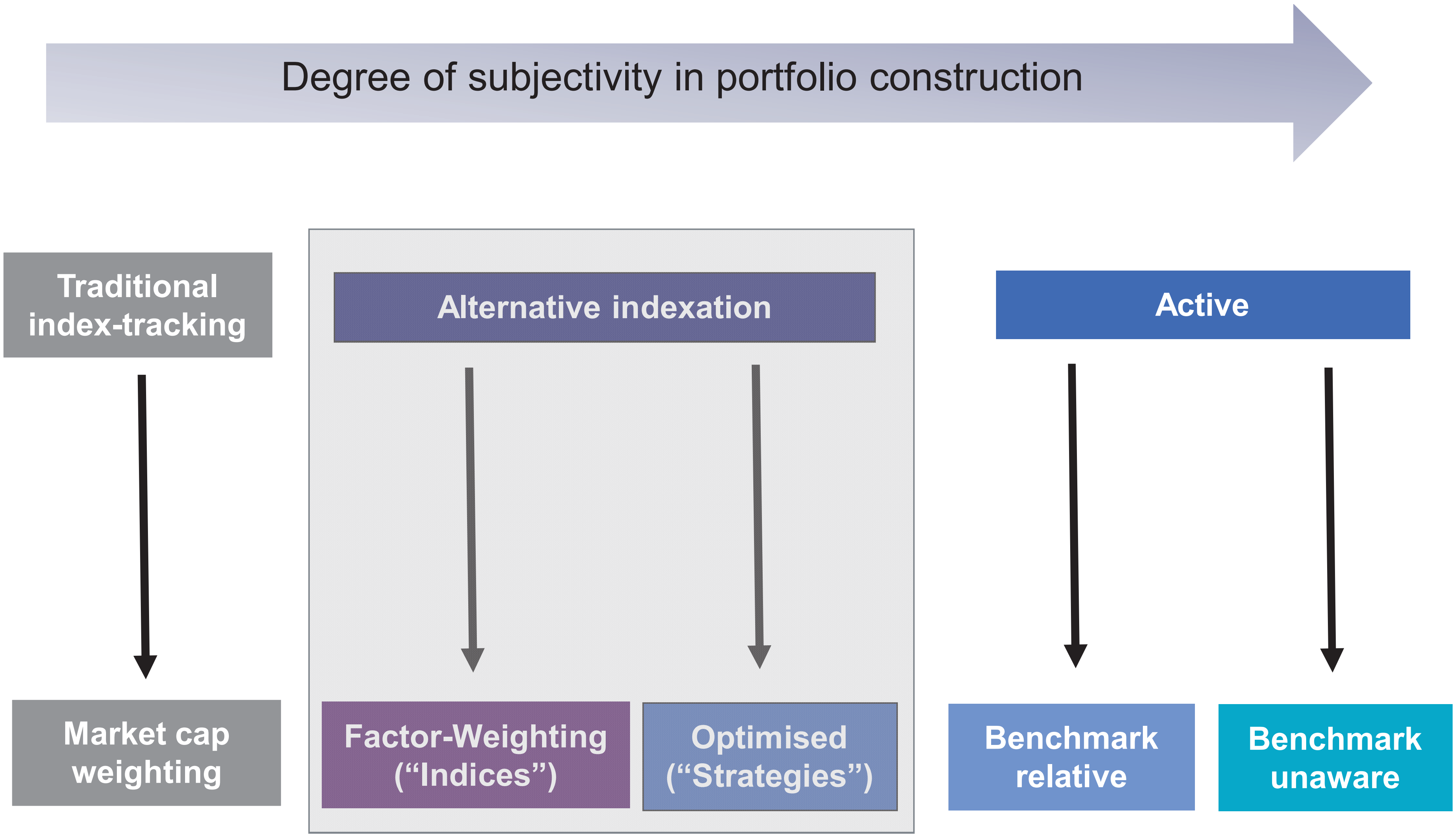
Market cap-weighted indices have become the standard measure of performance for almost all equity markets

- The reasons for this are clear – market cap-weighted indices have a number of advantages in their favour:
  - Objective and transparent construction approach
  - Representative of the available opportunity set for investors
  - Large investment capacity – the only portfolio that can be invested in by all market participants
  - Straightforward and cost-effective to track (negligible rebalancing and very little turnover)

Why consider a different approach to market-cap benchmarks?

1. Bias to past success
   - While financial theory would suggest a share price is today's sum of the future expected income from that share, it is clear that the shape of the index is driven heavily by past success
2. Market cap-weighted indices are prone to concentrations of risk
   - For example, Japan reaching half of the world index in 1989; the TMT sectors reaching around a third of the world index in early 2000
3. Market cap-weighted indices are prone to mis-pricings and asset price bubbles
   - It is widely recognised that markets do not always behave rationally and can, at times, be dominated by sentiment

Approaches to equity investing: overview

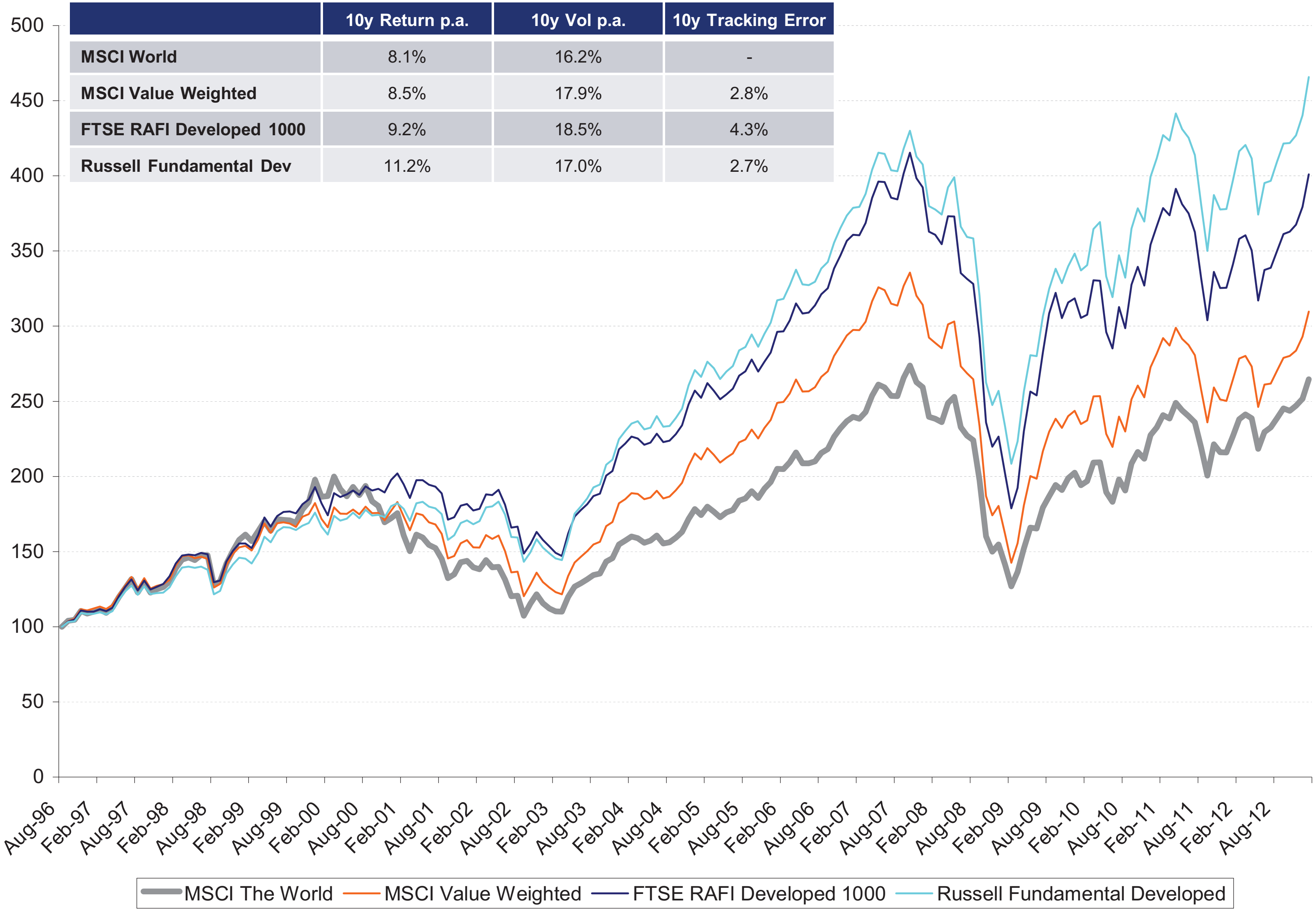


Fundamental Indexation
Overview

- **Characteristics**
  - Based on a “fundamental” measure of a company’s size, e.g. sales, dividends, cash-flow, book value etc.
  - Broad exposure to given equity market
  - Regional and sector biases (relative to market cap) will fluctuate over time
  - Relatively low portfolio turnover
  - Pattern of performance can differ materially from market cap index
- **Fundamental indices can be thought of as offering cheap value exposure**
- **No strong view on which fundamental factors are used, although there are important differences** (Russell do not use book value; MSCI do not use dividends)
- **However, we have a marginal preference for FTSE RAFI and Russell indices**
  - FTSE RAFI and Russell start with a broader universe of stocks than MSCI
  - But: MSCI has lower license fees (3bps vs. 6bps)
- **Passive pooled funds are available from Mercer’s preferred providers**

Fundamental Indexation
Performance analysis

	10y Return p.a.	10y Vol p.a.	10y Tracking Error
MSCI World	8.1%	16.2%	-
MSCI Value Weighted	8.5%	17.9%	2.8%
FTSE RAFI Developed 1000	9.2%	18.5%	4.3%
Russell Fundamental Dev	11.2%	17.0%	2.7%



Source: Datastream / Bloomberg; total returns in USD; performance/risk statistics are to 31 December 2012

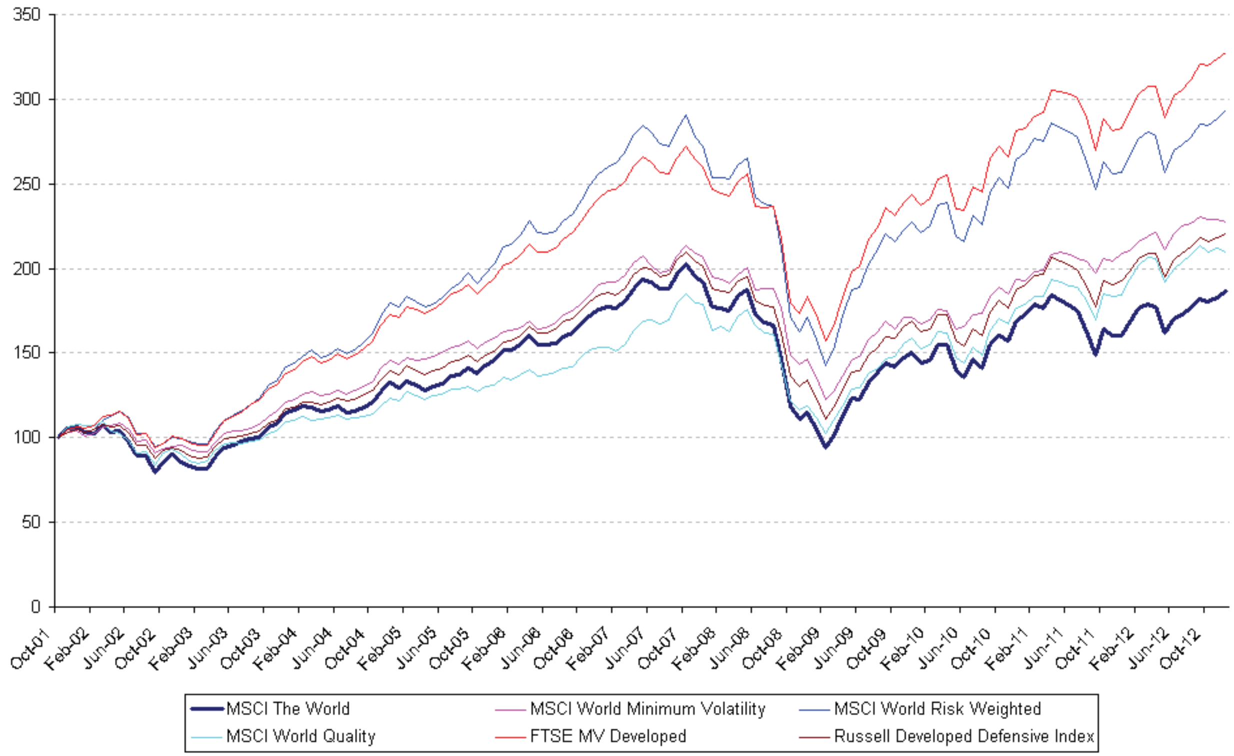
Low Volatility Indices
Overview

- **Broad construction methodology**
  - Optimised to produce the lowest volatility for a given set of constraints
- **Strong preference for active low volatility strategies**
  - More sophisticated management of risk
  - Portfolio oversight
  - Incorporation of alpha/value signals
  - Ongoing development of approach
  - But passive strategies can be useful for benchmarking
- **Deep pool of active strategies**
  - Over 30 global strategies in targeted volatility strategies
  - 3 rated preferred provider (a further 15 are known)
  - Many with long term track records

	MSCI The World	MSCI World Minimum Volatility	Analytic Investors Global Low Volatility	Acadian Global Managed Volatility Equity
5 year volatility %	20.90%	14.38%	13.01%	13.16%
5 year return %	-0.60%	1.95%	2.88%	2.42%

Low Volatility Indices
Performance analysis

	10y Return p.a.	10y Vol p.a.	10y Tracking Error (%)
MSCI World	8.1%	16.2%	
MSCI World Minimum Vol	9.1%	11.6%	6.8%
MSCI World Risk Weighted	11.4%	15.3%	3.3%
MSCI World Quality	8.8%	13.7%	5.4%
FTSE MV Developed	12.7%	13.4%	4.4%
Russell Developed Defensive	9.1%	13.6%	3.4%



Source: Datastream / Bloomberg; total returns in USD; performance/risk statistics are to 31 December 2012

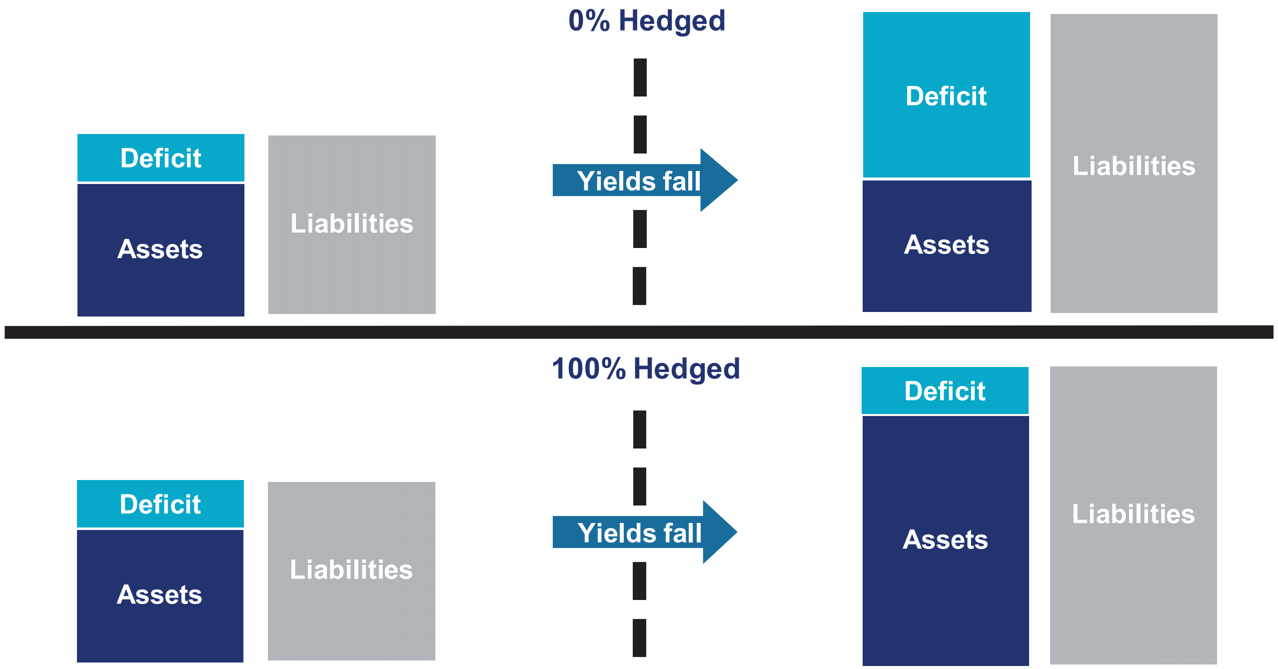
Alternative Indexation
Conclusions

- Market cap based indices continue to be a reasonable way of investing in equity markets but do have some fundamental flaws which are not always well appreciated by investors
- The range of alternative indices is growing fast although investor take-up to date has been moderate
- Fundamental indexation is essentially a cheap way of accessing the “value premium”
- The Fund currently has meaningful exposure to “value” through existing managers, in particular, UBS (expected to be a persistent bias) and Majedie (“dynamic” tilt), representing around 25% of the equity assets. Other managers such as Marathon could also have meaningful “value” tilts at times as well
- In our view, accessing the equity risk premium via a low volatility equity mandate would be the most “additive” way of diversifying away from market cap. A passive approach is available but we prefer strategies with some active manager oversight
  - We think its reasonable to assume that low volatility equities could achieve broadly the same return as market cap equities but with around 20% less risk
  - Would act as a useful “counter-balance” if the allocation to Emerging Market equities is increased
  - Would suggest an allocation of around 20% of total equity assets, subject to other considerations

Appendix

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 Plan did not have any interest rate hedging, then a fall in interest rates results in a rise in liabilities, whilst the assets remain unchanged, thus increasing the deficit. If the Plan had 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.



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LDI
Hedging instruments

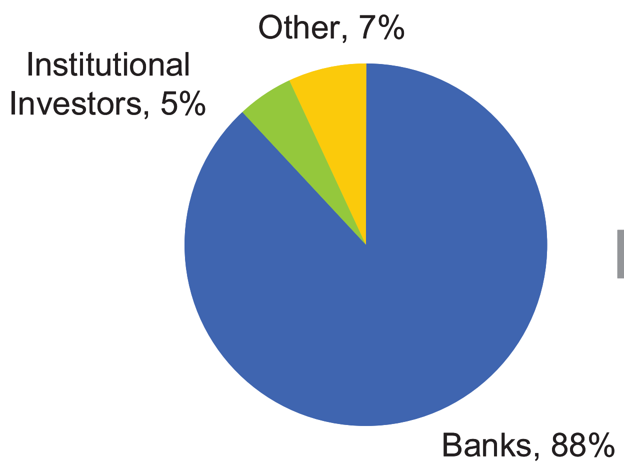
Index-Linked Gilts	Network Rail Bonds	Overnight Cash	Money Market	Funded instruments
Fixed-Interest Gilts	Corporate Bonds	ABS	Covered Bonds	
Interest Rate Swaps	Inflation Swaps	Gilt Repos	Total Return Swaps	Most common
LPI Swaps	Asset Swaps	Equity Options	Swaptions	Unfunded instruments
CDS	Futures	Forwards	Spread Locks	

Why is Private Debt attractive?
Bank deleveraging continues across Europe

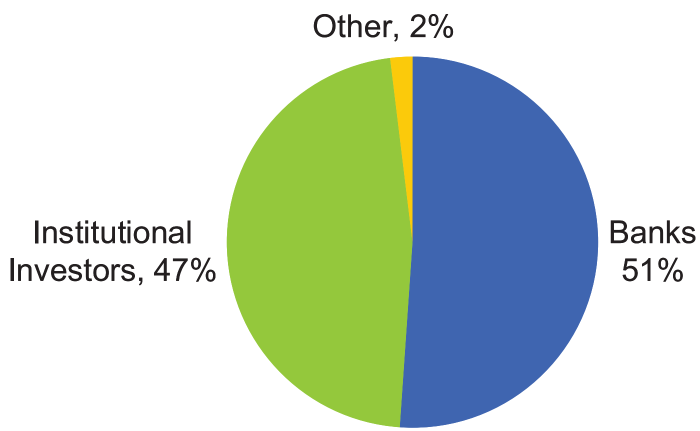
- Financial crisis
  - Reduction in bank lending
  - Loan maturities and distressed owners of assets
  - Scarcity of debt capital created attractive terms for investors
  - With more security than equity

- Now
  - More debt capital in market
  - But banks still not lending sufficiently
  - European banks in particular remain highly leveraged

% of Loan Market - 1999



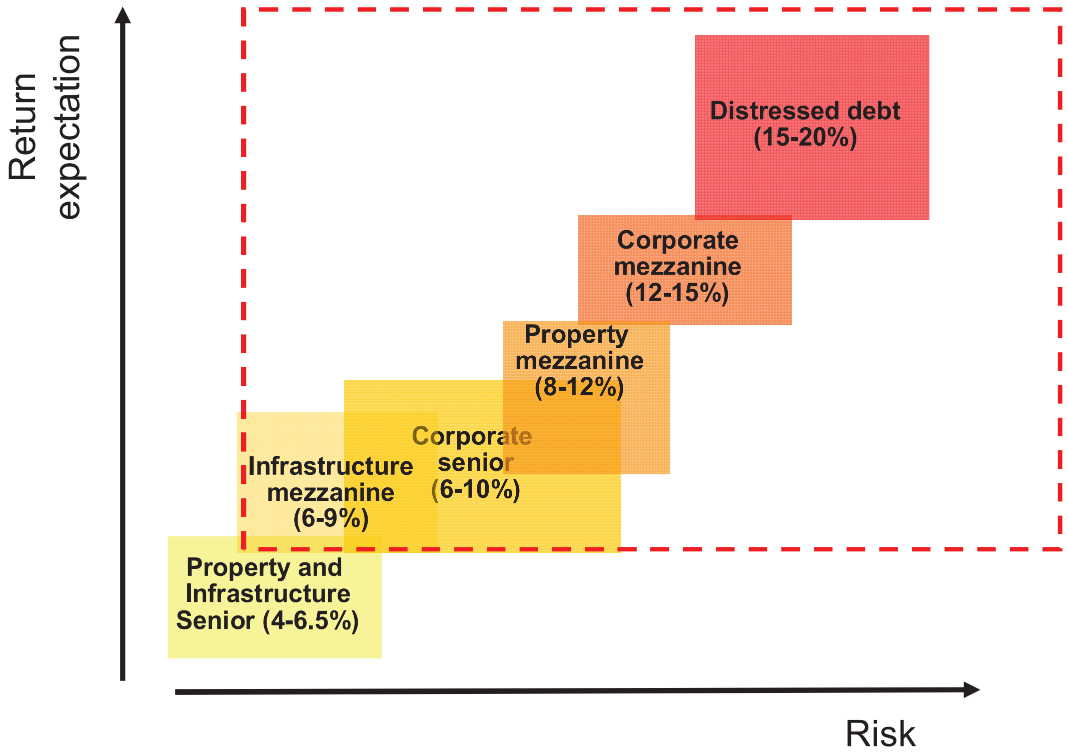
% of Loan Market - 2012



(1) Source: Ares Management; S&P U.S. / Europe Leveraged Lending Review Q3 2012

Private Debt
A strategically attractive opportunity

Private debt strategies which are better suited to growth portfolios



Credit Profile

On the whole the private debt market is sub-investment grade and on par with high yield but with higher expected returns given the illiquidity

Return Profile

Return potential can vary from around 3% - 15%+ depending on the type, issue and issuer

Funds usually have absolute return targets

Payment schedule can vary depending on class of debt. European debt is typically floating rate

Other Information

Liquidity: illiquid compared to public debt

Holding Period: capital is usually locked up for 4-10 years thus significantly shorter than private equity

Key risks: Illiquidity, credit risk, sourcing (adequate access to deal flow), high level of research required

A compelling diversifier to equities currently offering attractive risk-adjusted returns, ideally suited to LGPS funds

Mercer Assumptions

Mercer Central Assumptions	Expected Return %pa	Absolute Volatility %pa	Liabilities	Index-Linked Gilts (20-year duration)	Fixed Interest Gilts (20-year duration)	AA Index-Linked Bonds (20-year duration)	AA Fixed Interest Bonds (20-year duration)	Cash	ILGs (>5s)	FIGs (all)	FIGs (>15)	UK £ Credit(all)	UK £ Credit(>10)	Conventional Property	HLV Property	Hedge Funds	Commodities	Infrastructure (Debt)	Infrastructure (Listed Equity)	Infrastructure (Unlisted Equity)	Private Equity	Equities	Equities (Currency Hedged)	Emerging Markets	High Yield	Pure Credit	Minimum Variance Equities	Small Cap Equities	Emerging Markets Debt - Local Currency
Liabilities	2.8%	10.4%	**1.0**																										
Index-Linked Gilts (20-year duration)	2.8%	12.0%	1.0	**1.0**																									
Fixed Interest Gilts (20-year duration)	2.8%	13.2%	0.7	0.6	**1.0**																								
AA Index-Linked Bonds (20-year duration)	3.4%	15.5%	0.6	0.6	0.2	**1.0**																							
AA Fixed Interest Bonds (20-year duration)	3.4%	13.2%	0.6	0.6	0.8	0.6	**1.0**																						
Cash	2.8%	1.9%	0.1	0.1	0.1	-0.1	-0.0	**1.0**																					
ILGs (>5s)	2.8%	10.9%	0.9	0.9	0.6	0.5	0.5	0.1	**1.0**																				
FIGs (all)	2.8%	6.7%	0.7	0.6	0.9	0.1	0.7	0.2	0.7	**1.0**																			
FIGs (>15)	2.8%	10.7%	0.7	0.7	1.0	0.2	0.7	0.1	0.7	1.0	**1.0**																		
UK £ Credit(all)	3.6%	6.6%	0.5	0.5	0.6	0.4	0.7	0.2	0.5	0.7	0.7	**1.0**																	
UK £ Credit(>10)	3.6%	8.9%	0.7	0.6	0.8	0.4	0.8	0.1	0.6	0.8	0.9	0.9	**1.0**																
Conventional Property	4.8%	10.7%	-0.1	-0.0	-0.1	0.0	-0.0	-0.1	0.0	-0.2	-0.1	0.0	-0.0	**1.0**															
HLV Property	4.4%	8.5%	-0.1	-0.0	-0.1	0.0	-0.0	-0.1	0.0	-0.2	-0.1	0.0	-0.0	1.0	**1.0**														
Diversified Growth Funds	4.8%	10.9%	0.1	0.1	0.0	0.1	0.1	0.2	0.1	0.1	0.0	0.1	0.1	-0.1	-0.1	**1.0**													
Commodities	2.8%	23.0%	-0.1	-0.1	-0.3	0.0	-0.3	0.1	-0.1	-0.3	-0.3	-0.1	-0.2	0.1	0.1	0.2	**1.0**												
Infrastructure (Debt)	5.8%	12.7%	0.6	0.6	0.3	0.7	0.6	-0.0	0.5	0.2	0.3	0.3	0.4	-0.2	-0.2	0.1	-0.1	**1.0**											
Infrastructure (Listed Equity)	6.2%	18.7%	0.3	0.3	0.1	0.4	0.4	-0.0	0.3	0.1	0.1	0.3	0.3	0.1	0.1	0.5	0.1	0.2	**1.0**										
Infrastructure (Unlisted Equity)	8.2%	29.7%	0.2	0.2	-0.0	0.4	0.3	-0.0	0.2	-0.1	-0.1	0.2	0.2	0.2	0.2	0.4	0.2	0.2	1.0	**1.0**									
Private Equity	9.0%	36.8%	0.1	0.2	-0.0	0.4	0.2	-0.1	0.2	-0.1	-0.1	0.2	0.2	0.2	0.2	0.4	0.2	0.2	1.0	1.0	**1.0**								
Equities	6.8%	16.9%	0.2	0.2	0.1	0.4	0.3	-0.0	0.3	0.0	0.1	0.3	0.3	0.2	0.2	0.4	0.1	0.2	1.0	1.0	1.0	**1.0**							
Equities (Currency Hedged)	6.8%	16.5%	0.2	0.2	0.1	0.5	0.3	0.0	0.2	-0.0	0.0	0.3	0.3	0.2	0.2	0.3	0.1	0.2	1.0	1.0	1.0	1.0	**1.0**						
Emerging Markets	8.6%	28.4%	0.1	0.1	-0.0	0.3	0.2	0.0	0.1	-0.1	-0.1	0.2	0.2	0.1	0.1	0.5	0.2	0.2	0.8	0.8	0.8	0.8	0.7	**1.0**					
High Yield	5.0%	11.3%	0.1	0.1	-0.1	0.4	0.2	-0.1	0.1	-0.1	-0.1	0.3	0.2	0.0	0.0	0.3	0.2	0.3	0.6	0.6	0.6	0.6	0.6	0.6	**1.0**				
Pure Credit	0.8%	6.6%	-0.2	-0.1	-0.4	0.7	0.2	-0.2	-0.2	-0.5	-0.4	0.0	-0.1	0.1	0.1	0.1	0.2	0.4	0.3	0.4	0.4	0.4	0.4	0.3	0.4	**1.0**			
Minimum Variance Equities	6.0%	14.3%	0.3	0.3	0.2	0.3	0.3	-0.0	0.3	0.1	0.2	0.3	0.3	0.1	0.1	0.5	0.1	0.2	0.9	0.9	0.9	0.9	0.8	0.7	0.5	0.2	**1.0**		
Small Cap Equities	7.4%	19.6%	0.1	0.1	-0.0	0.4	0.2	-0.1	0.2	-0.1	-0.1	0.2	0.2	0.2	0.2	0.5	0.2	0.2	1.0	1.0	1.0	1.0	0.9	0.8	0.6	0.4	0.9	**1.0**	
Emerging Markets Debt - Local Currency	5.4%	14.7%	0.2	0.2	0.1	0.2	0.1	0.0	0.2	0.1	0.1	0.3	0.2	-0.2	-0.2	0.6	0.1	0.1	0.5	0.5	0.5	0.5	0.4	0.5	0.4	0.1	0.6	0.5	**1.0**

SURREY PENSION FUND

SYNTHETIC EQUITY

1. Introduction

1.1. Synthetic equity (or equity replacement) strategies involve gaining equity exposure through the use of derivative contracts rather than by physically investing in equities. The main methods used to achieve this primarily involve using the following:

- Total return swaps; and
- Equity index futures.

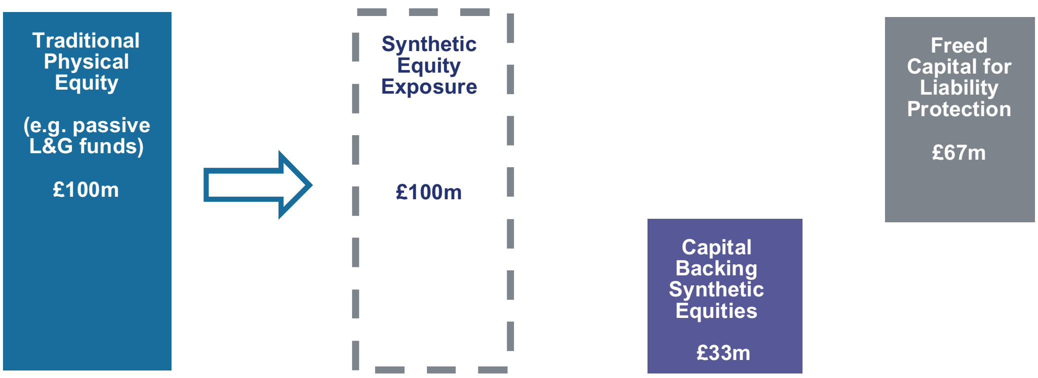
Equity options can also be used and are mentioned in this paper for completeness. In practice though, the above instruments are more likely to be used.

1.2. This paper provides information on “synthetic” equities and the potential opportunities offered by this form of equity exposure which could prove appropriate to the Fund.

1.3. LGPS funds are able to invest in such structures by holding the above mentioned derivatives in bespoke pooled fund structures. We have experience of implementing such a structure for another LGPS fund in the last twelve months. We would also note that the Fund already uses derivative instruments (and has done for some time now) primarily through the currency hedging mandate with Legal & General and within some of the specific investment manager mandates (e.g. the Standard Life GARS Fund makes extensive use of derivatives).

1.4. The key benefit of synthetic equity exposure is that it can free up cash, which can provide liquidity or be used to purchase liability hedging protection elsewhere. The purchase of such protection can occur without seeing a material reduction to equity exposure. This provides the twin benefits of (1) maintaining the expected return on the Fund’s assets and (2) freeing up capital that can be used to help reduce the volatility of the Fund’s deficit, which, as we have illustrated in the investment review, is significant .

1.5. The diagram below shows how a traditional (physical) asset allocation can be substituted for an asset allocation containing more physical bond or cash assets and synthetic equity exposure.



1.6. The equity market exposure provided on a "synthetic" basis can be considered to be effectively the same as that achieved via an index-tracking mandate (i.e. the returns captured would be expected to be in line with an index). Given that the Fund has a material part of its equity assets managed on an index-tracking basis, this part of the portfolio would be the logical source of assets for a synthetic equity structure.

1.7. This paper provides a high level overview of the key terms associated with derivative investments and the different methods by which synthetic equity exposure can be achieved.

1.8. We do not cover implementation in this paper. If the Fund wanted to implement a synthetic equity solution, an investment manager would be needed to manage the derivative contracts as well as some of the proceeds realised by the sales of physical equities. One of the Fund's existing managers, for example, Legal & General, is likely to be able to manage such a mandate, although it would also be sensible to consider other potential candidates (if required). The actual choice of which derivative instrument should
17 be used would depend on a number of issues (e.g. prevailing market conditions, pricing etc) and would need to be based on clear advice which Mercer would be able to provide.

Glossary of Key Terms

Derivative: Financial instrument, the value of which is dependent on the value of an underlying index, asset or currency.

Includes futures, forwards, options and swaps

Future: contract to buy or sell an asset at an agreed price at a specified date in the future. Traded on an organised exchange.

Forward: contract to buy or sell an asset at an agreed price at a specified date in the future. Traded directly with a bank counterparty.

Option: contract gives the holder the right, but not the obligation, to buy or sell an asset at a certain price on or before a certain date.

Swap: contract to exchange the cash flows or returns from one asset for cash flows or returns from another.

2. Equity replacement strategies

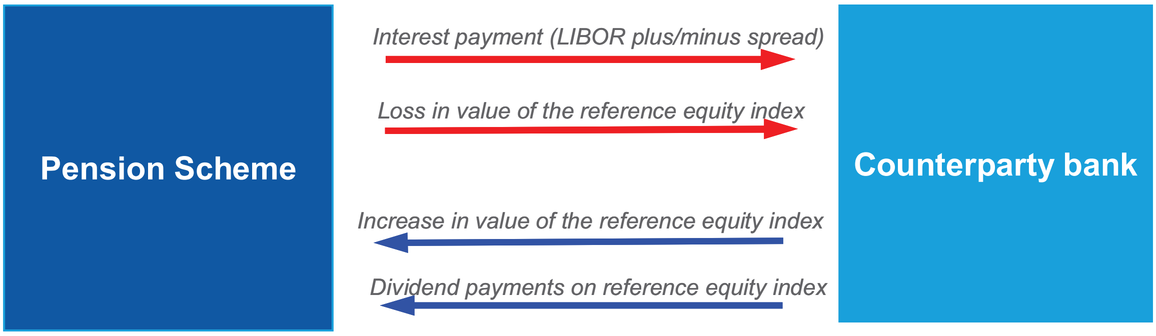
2.1. Having sold physical equities, derivative contracts can be employed to re-introduce equity exposure whilst retaining the majority of the cash proceeds (some cash will need to be posted as security against the derivative contracts).

2.2. There are a range of alternatives available through which this equity exposure may be achieved, the main ones being total return swaps, equity index futures and equity options.

2.3. The common feature of these derivatives is that they enable the Fund to gain equity exposure synthetically, in exchange for payment of an interest rate which can be earned on the physical assets realised from the sale of physical equities.

Equity Total Return Swap

2.4. An equity index total return swap can be illustrated as follows:



2.5. The variable (or floating) interest rate payable is generally determined by reference to either the 3 month or the 6 month London Interbank Offer Rate ("LIBOR").

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2.6. The "reference asset" can be based on any equity index agreed with a counterparty bank. Then, under a Total Return Swap contract, the counterparty bank pays all dividend payments on the reference asset, plus any capital gains (positive price changes to the index) over the payment period to the Fund. The Fund pays LIBOR plus/minus a spread as well as any negative price changes to the index.

Equity Futures and Forwards

2.7. Futures are economically very similar to total return swaps. They are standardised contracts under which one party agrees to buy an asset at a set price at some specified future maturity date. The future price is a function of the current asset price, the current rate of interest and dividend yields. In this case, the asset is an equity index such as FTSE 100 or the S&P 500. Buying futures on such an equity index gives exposure to the performance of that equity index since the futures price will usually move closely in line with the actual level of the index.

2.8. Futures typically have maturities of up to 3 months and therefore require the manager to "roll" the futures on a regular basis. By adopting a rolling futures strategy, under which the investment manager sells futures which are close to the maturity date and buys newly issued longer-dated futures, an investor can gain exposure to the equity index performance without having to physically hold the underlying equities.

2.9. The pricing of both equity index futures and forwards is very similar. The distinction between futures and forwards is important only from an operational perspective (documentation, counterparty risk management etc).

2.10. In terms of income there are two important differences between buying the future or forward contract and holding the physical assets:

- The buyer of the future or forward contract does not have to "fund" his exposure so they can earn interest on the cash which would have been spent by the buyer of the underlying physical asset.

- However, the buyer of the underlying physical equities will receive any dividends due during the term of the contract.

2.11. In practical terms, equity futures (and usually forwards) are "cash settled", so the buyer pays (or receives) the difference between the level of the index at maturity and the agreed "forward" price. In other words, the assets themselves are not usually exchanged.

Equity Options

2.12. An alternative approach to gaining equity exposure synthetically is to use an equity option strategy.

2.13. A call option gives the holder the right to buy at a specified price at some point in the future, while a put option gives the holder the right to sell the associated asset for a specified amount.

2.14. The Fund would buy or write a combination of call (the right to buy an equity index at a predetermined price in the future) and put (the right to sell an equity index at a predetermined price in the future) options. The predetermined price/level at which the right to buy or sell is set is known as the option "Strike". An option is described as "in the money" if it would result in a pay out if it could be exercised at the current market price. A call option is "in the money" if the underlying price exceeds the strike price while a put option is "in the money" if the underlying price is less than the strike price.

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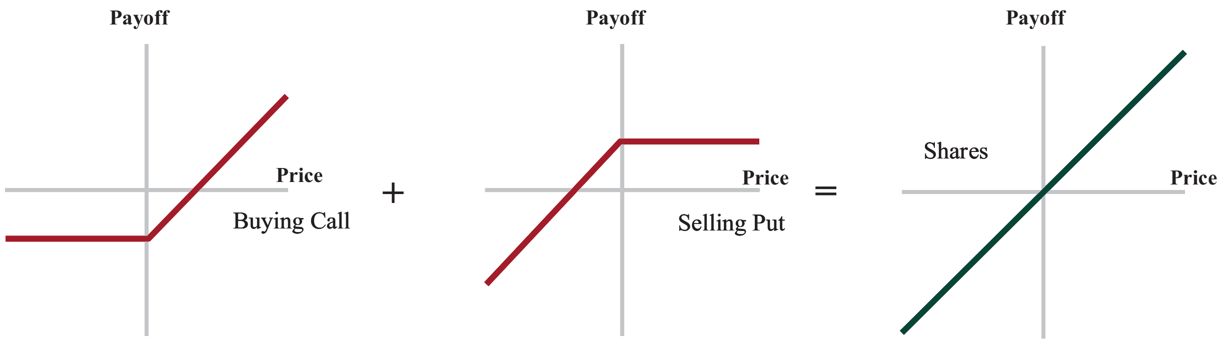
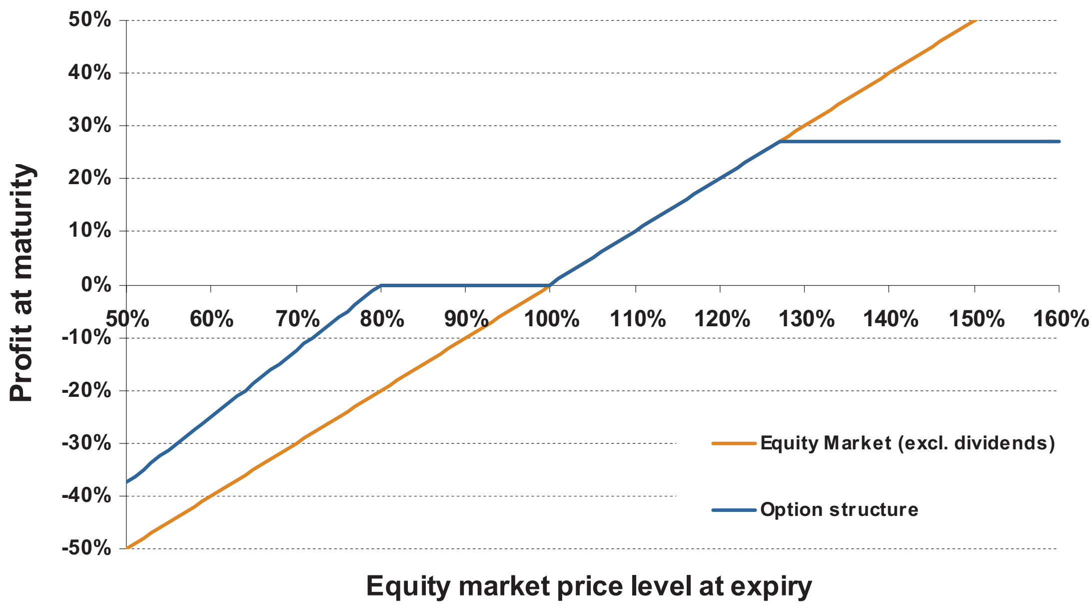
2.15. By buying the call option the investor will have exposure to rising markets and the selling of the put option exposes an investor to falling markets. The net result is similar to holding equities on an outright basis as illustrated bv the diagrams below:



2.16. One advantage of using equity options is that they can be used to change the pay-off profile of the equity portfolio.

2.17. A traditional collar is a common strategy which uses options to limit downside risk. Such a strategy provides the Fund's equity portfolio with a degree of downside protection, in return for forgoing upside beyond a certain level; which enables the Fund to lock in an equity return within a known range. This strategy is shown diagrammatically below:



2.18. In the above example the Fund would be protected against negative equity market falls equal to 20%. However, any subsequent equity index falls (in excess of this amount) would impact on the Fund's returns.

2.19. In addition, the Fund would limit the upside potential of the equity portfolio. The premium received from the sale of this upside, would be used to pay the premium for the protection on the downside. This would mean that the strategy would be implemented at zero-cost to the Fund.

2.20. A "collar" structure might be expected to be broadly symmetrical around the 100% price level but in practice the downside risk can be more significant than the potential upside. Protecting against downside is usually more expensive than sacrificing some upside.

2.21. It is generally possible to enter into equity options for much longer maturities than swaps and futures. Buying a call option and selling a put option provides the similar economic exposure to buying the underlying asset outright.

3. Summary

3.1. In summary the main advantages of synthetic equity investment are summarised below:

- Relatively low cost: may be even cheaper than passive management if pricing is close to "fair value";
- Allows rapid implementation of equity rebalancing or equity sales;
- Frees up assets for other investment opportunities, in particular for the development of a liability hedging programme;
- Generally low counterparty risk whether using exchange traded instruments or trading directly with bank counterparties;
- Futures on major equity indices are among the most liquid financial instruments in existence and transaction costs are therefore low.

3.2. As shown in our recent investment strategy analysis, the volatility of the funding level and deficit risk for the Fund is high (as with most LGPS funds). For example, the 3 year deficit risk (1 in 20 probability) was shown to be in the order of £1.1bn. This is primarily due to the fact that the current investment policy provides little protection against liability related risks (i.e. changes in long-term interest rates and inflation expectations). Simply diversifying the assets away from equities will not lead to a meaningful reduction in investment risk relative to the liabilities due to the magnitide and dominance of the liability related risks.

3.3. However, the need to maintain an investment policy with a relatively high expected return remains in order to help make-up the deficit and maintain the affordability of the Fund. The key atttraction for the Fund of a synthetic equity strucuture is that it would provide a way of maintaining braodly the same level of equity exposure, whilst freeing up capital to start a liability protection strategy.

3.4. Some disadvantages and considerations for using derivative exposure as an alternative to physical investment are outlined below, for further information please see Appendix:

- Futures trading requires cash for variation margining plus initial margin (i.e. collateral);
- Trading forwards or Total Return Swap may require complex derivative documentation;

- Use of short dated contracts involves “roll” risks and costs whilst contractual terms of longer dated instruments may be less favourable;

- Limitations on the choice of reference index (for example FTSE 350 is easily traded but FTSE All Share is less so).

3.5. Whilst equity index futures, total return swaps and options are economically very similar, there are a number of differences between the approaches of which some are highlighted in this paper.

3.6. We would be happy to talk through these issues further with the Fund at a future meeting. Further training could be provided by an investment manager, which we would be happy to help arrange.

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Steve Turner
Partner

March 2014

Appendix

Risks and differences between Swaps, Futures & Options

Whilst equity index futures, total return swaps and options are economically very similar, there are a number of differences between the approaches:

Counterparty

Futures are exchange traded, meaning they are standardised contracts bought and sold over a central exchange. In the same way as the underlying equities, there is a central counterparty to each trade in the form of a clearing house, largely removing the risk of counterparty defaults. In contrast, total return swaps and (most) options are OTC (over the counter) contracts, transacted directly with or between investment banks. This introduces more counterparty risk (reduced by the payment of collateral when losses occur) and also reinvestment risk in the event of counterparty default.

The risk introduced by counterparty default is likely to be less of a concern under an equity total return swap. This is down to the fact that in a scenario where a major counterparty bank were to default (likely to coincide with poorly performing equity markets), the Fund is more likely to owe the counterparty money under the equity swaps, however, under this scenario reinvestment risk still remains.

Collateral

Futures contracts will require the Fund to post initial margin irrespective of whether the market has moved. Additionally, as markets move against the Fund further margin payments would be required by the exchange to maintain these positions. By contrast, the total return swaps and equity options require no (or very little) initial collateral but will be marked-to-market on an ongoing basis with collateral required to be posted to cover this exposure.

Another key difference between exchange traded (futures) and OTC (swaps and options) contracts is the types of acceptable collateral. Under exchange traded options the Fund will have to post cash, whereas under OTC it will be dependent on the agreement between the Fund and the counterparty bank, which would typically include cash and gilts or higher-rated corporate bonds.

Maturity

Futures typically have maturities of up to 3 months, total return swaps typically have maturities of up to 5 years and options could potentially have maturities of up to 10 years. Using the longest maturity contracts reduces reinvestment risk. Relative attractiveness will also change for different maturities.

Currency risk

Futures contracts are only offered in local currency, therefore requiring separate currency hedging arrangements if necessary. Swaps, forwards and options may be tailored to provide equity exposure in the currency required by the Fund and therefore would not require additional currency hedging.

Indices covered

It is possible to transact futures on all the major country indices (e.g. S&P500, FTSE100, Eurostoxx50 & Nikkei 225). However, futures do not generally cover global indices and rarely cover smaller companies. Under total return swaps and equity options, more flexibility is available to tailor the exposures to meet the specific requirements.

Leverage

In the context of the Fund, leverage would relate to the use of derivatives to take on greater exposure to markets than would be possible using physical instruments only (i.e. use Total Return Swap to maintain equity exposures whilst selling its existing equity holdings to fund the purchase of index-linked gilts).

Although the introduction of leverage introduces new operational risks (for example the need to maintain adequate cash as collateral) the overall financial risk to the Fund is reduced. This is because the sale of physical equities to fund the purchase of liability matching instruments (index-linked gilts) would reduce the interest rate and inflation risk.

Roll Risk

Future contracts need to be rolled on a frequent basis.

17 When a Total Return Swap expires, assuming equity exposure is still desired, there is a risk that the terms of entering a new Total Return Swap (or buying physical equities if preferred) will be unfavourable, or potentially in extreme scenarios that new Total Return Swaps or futures are not available at all. These circumstances would point to very poor economic and market conditions prevailing. These risks are hard to quantify, but could lead to transaction costs and “out of market” risks.

Concentration risk

Total Return Swaps are based on quoted indices which have a limited number of constituent companies and a specified allocation to those companies based on market capitalisation. Under such an arrangement the Fund would have no direct exposure to companies outside the index and would lose an element of diversification as a result.

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