

MINUTES of the meeting of the **SURREY PENSION FUND BOARD** held at 9.30 am on 14 November 2014 at G30, County Hall, Kingston upon Thames, Surrey KT1 2DN.

These minutes are subject to confirmation by the Committee at its next meeting.

Elected Members:

- * Ms Denise Le Gal (Chairman)
- * Mr Nick Skellett CBE (Vice-Chairman)
- * Mr W D Barker OBE
- * Mr Tim Evans
- * 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

Jason Bailey, Pension Services Manager
Cheryl Hardman, Regulatory Committee Manager
John Harrison, Surrey Pension Fund Advisor
Sheila Little, Director of Finance (Section 151 Officer)
Alex Moylan, Senior Accountant
Phil Triggs, Strategic Finance Manager – Pensions & Treasury
Steve Turner, Partner, Mercer

52/14 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]

Ian Perkin and Sheila Little (Director of Finance) informed the Board that they would need to leave at lunchtime for other engagements.

A number of Members would be late due to heavy traffic.

53/14 MINUTES OF THE PREVIOUS MEETING: 19 SEPTEMBER 2014 [Item 2]

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

54/14 DECLARATIONS OF INTEREST [Item 3]

There were no declarations of interest from the Board. John Harrison (Surrey Pension Fund Advisor) offered a standing declaration of his role at UBS.

55/14 QUESTIONS AND PETITIONS [Item 4]

There were none.

56/14 ACTION TRACKING [Item 5]

Declarations of Interest:

None.

Key points raised during the discussion:

1. In relation to A12/14 (training needs analysis), the Strategic Finance Manager – Pensions & Treasury informed the Board that there were still some outstanding questionnaires to be completed. The Board was reminded that the questionnaire needed to be completed even if they had filled in a previous version. A report would be brought to the February meeting.

Actions/Further information to be provided:

None.

Resolved:

That the action tracker was noted and the committee agreed to remove the completed actions from the tracker.

Next steps:

None.

57/14 MANAGER ISSUES AND INVESTMENT PERFORMANCE [Item 6]

Declarations of Interest:

None.

Key points raised during the discussion:

1. The Strategic Finance Manager – Pensions & Treasury introduced the report.
2. The Board was informed that the 2016 dates for the Board had been agreed and would be circulated separately (**Action Review ref.: A26/14**).

Judith Glover arrived at 9.44am.

3. The Strategic Finance Manager – Pensions & Treasury explained the necessity to reassess the data on which prices were agreed with Legal & General before reporting back to committee in February 2015. The Board supported the process.

John Orrick arrived and Phil Walker left the meeting at 9.48am.

4. Members asked for information on the profit achieved by Mirabaud on the investments made with them during the period of the contract. Officers agreed to calculate the sum and provide the Board with the information (**Action Review ref.: A27/14**).
5. Members queried whether the recent ruling by the Employment Appeal Tribunal would have any impact on the Pension Fund. The Director of Finance informed the Board that she had been looking at the issue from a Surrey County Council perspective but did not believe that there would be any significant impact on the Pension Fund. The Employers Representative stated that the Police and Crime Commissioner's Office had concerns that the ruling would have a significant impact on the Police Service with a knock-on impact on the Pension Fund.
6. The Surrey Pension Fund Advisor introduced the notes of the meetings with Fund Managers on 7 November 2014.

Tim Evans arrived and Phil Walker rejoined the meeting at 9.56am.

7. The Board went on to discuss whether the accounting scandal and potential litigation at Tesco would have any impact on stocks.

Tony Elias arrived as 10.05am.

8. The Board discussed the differing views of investment managers on the potential for emerging markets.
9. The Strategic Finance Manager – Pensions & Treasury highlighted the private equity cash flow analysis as requested previously by Members.

EXCLUSION OF THE PUBLIC

RESOLVED: That under Section 100A 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 paragraph 3 of Part 1 of Schedule 12A of the Act.

PART TWO IN PRIVATE

THE FOLLOWING ITEMS OF BUSINESS WERE CONSIDERED IN PRIVATE BY THE COMMITTEE. HOWEVER, THE INFORMATION SET OUT BELOW IS NOT CONFIDENTIAL.

10. The Mercer representative presented an analysis of the Fund's private equity portfolios and fund managers. Members asked a number of questions and these were answered by officers and the Fund's advisors. It was suggested and agreed that the Board should meet with two private equity managers – one which takes a Fund of Funds approach and one which makes direct investments. This would help the Board to understand and compare the different investment approaches. It was agreed that Standard Life (incumbent manager) should be asked to present to discuss further the merits of a Fund of Funds approach. Further consideration would be given which single manager should be invited (**Action Review ref.: A28/14**).

PUBLICITY FOR PART TWO ITEMS

RESOLVED: That the items considered under Part Two of the agenda should remain confidential and not be made available to the press and public.

PART ONE IN PUBLIC

11. The Mercer representative provided an update on progress in setting up a framework for a liability driven investment (LDI) strategy. A paper was circulated and is attached to the Minutes as Annex 1. The Board discussed the proposed trigger level. It was suggested that a trigger be set now and reviewed at each Board meeting.
12. The Mercer representative assured the Board that if the LGPS has to move to a passive investment strategy, there should not be any impact on the setting up of this framework, given that the LDI assets are to be managed on a passive basis.
13. The Mercer representative presented a report on the range of options for the future management of the ex-Mirabaud portfolio. He recommended that the assets are reallocated to Majedie for the reasons set out in the confidential annex 4.
14. After discussion, the Board accepted this recommendation. However, it was recognised that this could be subject to further review given the anticipated announcement from government on passive investment within the LGPS and its impact on reallocating assets to an active investment manager.
15. The Mercer representative provided a report on the proposed alternative manager options regarding the Global Equities portfolio currently managed by Newton, as set out in the confidential annex 5.

EXCLUSION OF THE PUBLIC

RESOLVED: That under Section 100A 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 paragraph 3 of Part 1 of Schedule 12A of the Act.

PART TWO IN PRIVATE

THE FOLLOWING ITEMS OF BUSINESS WERE CONSIDERED IN PRIVATE BY THE COMMITTEE. HOWEVER, THE INFORMATION SET OUT BELOW IS NOT CONFIDENTIAL.

16. Members discussed the options regarding the Global Equities portfolio currently managed by Newton.
17. Members discussed the uncertainties in the global equities market given the anticipated announcement from government on passive investment within the LGPS and its impact on reallocating assets to an active investment manager.

PUBLICITY FOR PART TWO ITEMS

RESOLVED: That the items considered under Part Two of the agenda should remain confidential and not be made available to the press and public.

PART ONE IN PUBLIC

18. The Strategic Finance Manager – Pensions & Treasury introduced the Financial and Performance Report.

The Director of Finance left the meeting at 11.45am.

19. The Chairman informed the Board that the Pension Fund had been shortlisted for the Fund of the Year (above £2bn) award, the Strategic Finance Manager – Pensions & Treasury had been shortlisted for Finance Officer of the Year, and the Senior Accountant had been shortlisted for Emerging Pensions Manager of the Year at the Local Government Chronicle Investment Awards 2014.

Actions/Further information to be provided:

- a. The 2016 dates for the Surrey Pension Fund Board to be circulated in due course.
- b. Officers to provide the Board with information on the profit achieved by Mirabaud on the investments made with them during the period of the contract.
- c. The Board to meet with two private equity managers – one which takes a Fund of Funds approach and one which makes direct investments.

Resolved:

- i. To note the report.
- ii. To reallocate the assets previously managed by Mirabaud to Majedie, subject to the decision by Government with regard to passive investment becoming mandatory for the LGPS.
- iii. To review Newton further and receive presentations from the selected managers highlighted in the confidential annex 5.
- iv. That the yield trigger for the LDI strategy be set at 0%.

Next steps:

None.

The Board adjourned at 11.55am to meet a Fund Manager. The Board reconvened at 12.45pm, without Ian Perkin.

58/14 REVISED STATEMENT OF INVESTMENT PRINCIPLES [Item 7]

Declarations of Interest:

None.

Key points raised during the discussion:

1. The Strategic Finance Manager – Pensions & Treasury introduced the report and outlined the revisions since the previous meeting.

Actions/Further information to be provided:

None.

Resolved:

That the revised Statement of Investment Principles be APPROVED.

Next steps:

None.

59/14 CORE BELIEF STATEMENT [Item 8]

Declarations of Interest:

None.

Key points raised during the discussion:

1. The Strategic Finance Manager – Pensions & Treasury introduced the report. He clarified that the Core Belief Statement was not a statutorily required document but that it was best practice. He explained that those Boards which agree with all parts of the Core Belief Statement will operate effectively. Where there are disagreements, the Board is likely to be dysfunctional.
2. Members felt that the Statement would be useful for people joining the Board and should also be used as a check for decisions.
3. There was support for having a Core Belief Statement.
4. It was agreed that in paragraph 2.1 the word 'present' be added prior to 'cash flow'.
5. It was agreed that either 'The Fund believes' be added to the start of each paragraph or removed from paragraph 4.3.
6. It was agreed that a further belief statement be added: 'A well-balanced portfolio has an appropriate mix of passive and active investments'.

Actions/Further information to be provided:

None.

Resolved:

That the Core Belief Statement be APPROVED subject to the amendments listed above.

Next steps:

None.

The Board adjourned for lunch at 1pm and reconvened at 2.05pm without Tony Elias.

60/14 CLASS ACTIONS [Item 9]

Declarations of Interest:

None.

Key points raised during the discussion:

1. The Strategic Finance Manager – Pensions & Treasury introduced the report.
2. Members queried what would happen if both of the law firms that the Pension Fund is contracted with want to take action on the same cases. The Strategic Finance Manager – Pensions & Treasury informed the Board that a decision would be made on the merits of the case.

Actions/Further information to be provided:

None.

Resolved:

- i. That the Surrey Pension Fund Board AGREES to the signing up for the US and non US class action monitoring and securities and corporate litigation services with Grant & Eisenhofer PA.
- ii. That decisions to instruct Grant & Eisenhofer PA (and the Fund's existing firm of class action US attorneys) on any individual cases should be decided on their merits, taking into account all risks, with a decision made by the Director of Finance in consultation with the Pension Fund Board Chairman, Strategic Finance Manager and Director of Legal & Democratic Services.

Next steps:

None.

61/14 PENSION FUND RISK REGISTER [Item 10]

Declarations of Interest:

None.

Key points raised during the discussion:

1. The Strategic Finance Manager – Pensions & Treasury introduced the report.

Actions/Further information to be provided:

None.

Resolved:

That the revised Risk Register be NOTED.

Next steps:

None.

62/14 KEY PERFORMANCE INDICATORS [Item 11]

Declarations of Interest:

None.

Key points raised during the discussion:

1. The Pensions Services Manager introduced the report and explained that recent staffing changes within the pensions administration team and the impact of the 2014 scheme changes had led to some recent short-term deterioration in performance.

Actions/Further information to be provided:

None.

Resolved:

That the Key Performance Indicators statement be NOTED.

Next steps:

None.

63/14 LOCAL GOVERNMENT PENSIONS SCHEME: DRAFT GOVERNANCE REGULATIONS [Item 12]

Declarations of Interest:

None.

Key points raised during the discussion:

1. The Strategic Finance Manager – Pensions & Treasury introduced the report. A proposed structure for the Review Board would be brought to the February 2015 meeting of the Board.

Actions/Further information to be provided:

None.

Resolved:

- i. That the report be NOTED.
- ii. That the draft response to the consultation from the Surrey Pension Fund Board be NOTED.

Next steps:

None.

64/14 DATE OF NEXT MEETING [Item 13]

The dates of the next meeting and the AGM were noted.

Meeting ended at: 2.30 pm

Chairman

SURREY PENSION FUND RISK MANAGEMENT UPDATE

NOVEMBER 2014

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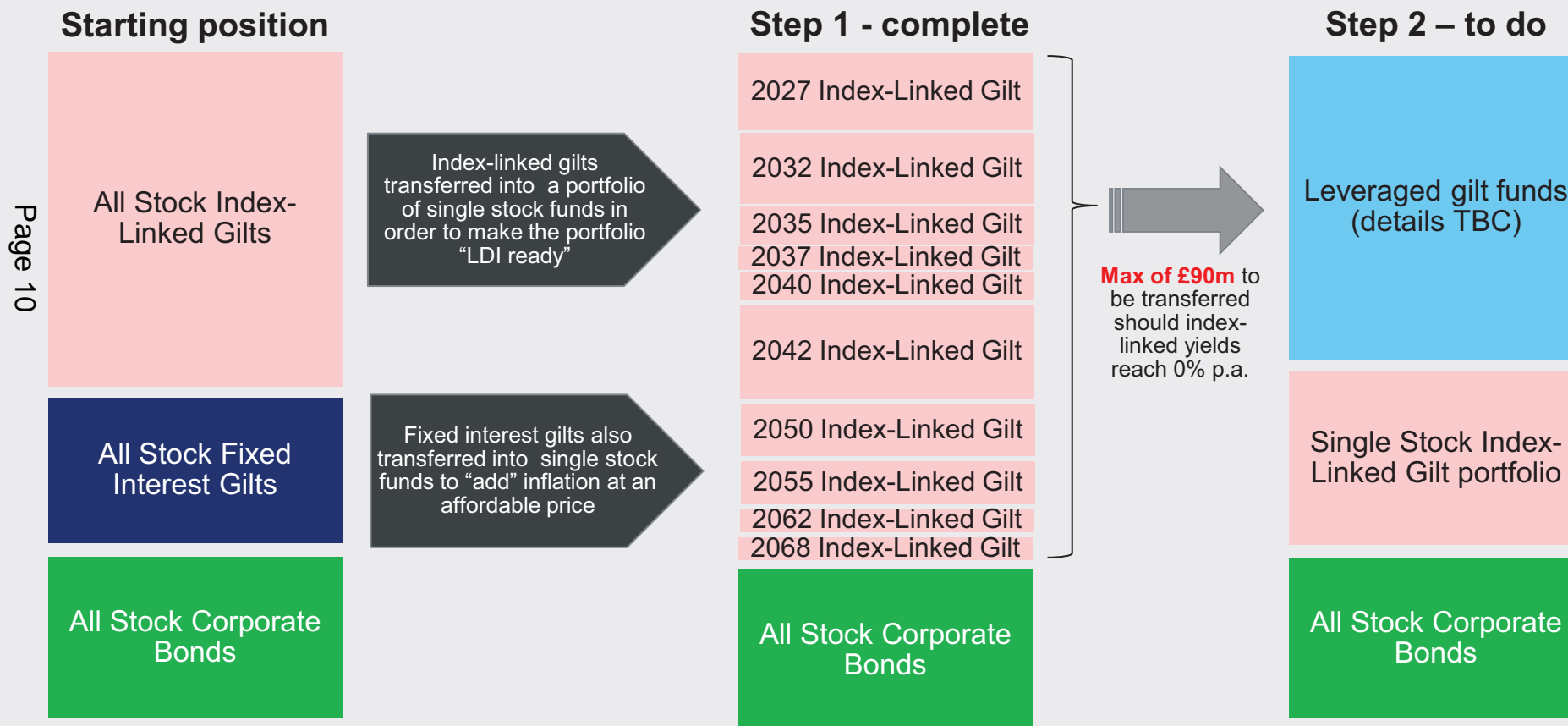
Minute Item 57/14

STEVE TURNER

RESTRUCTURING L&G GILT PORTFOLIO

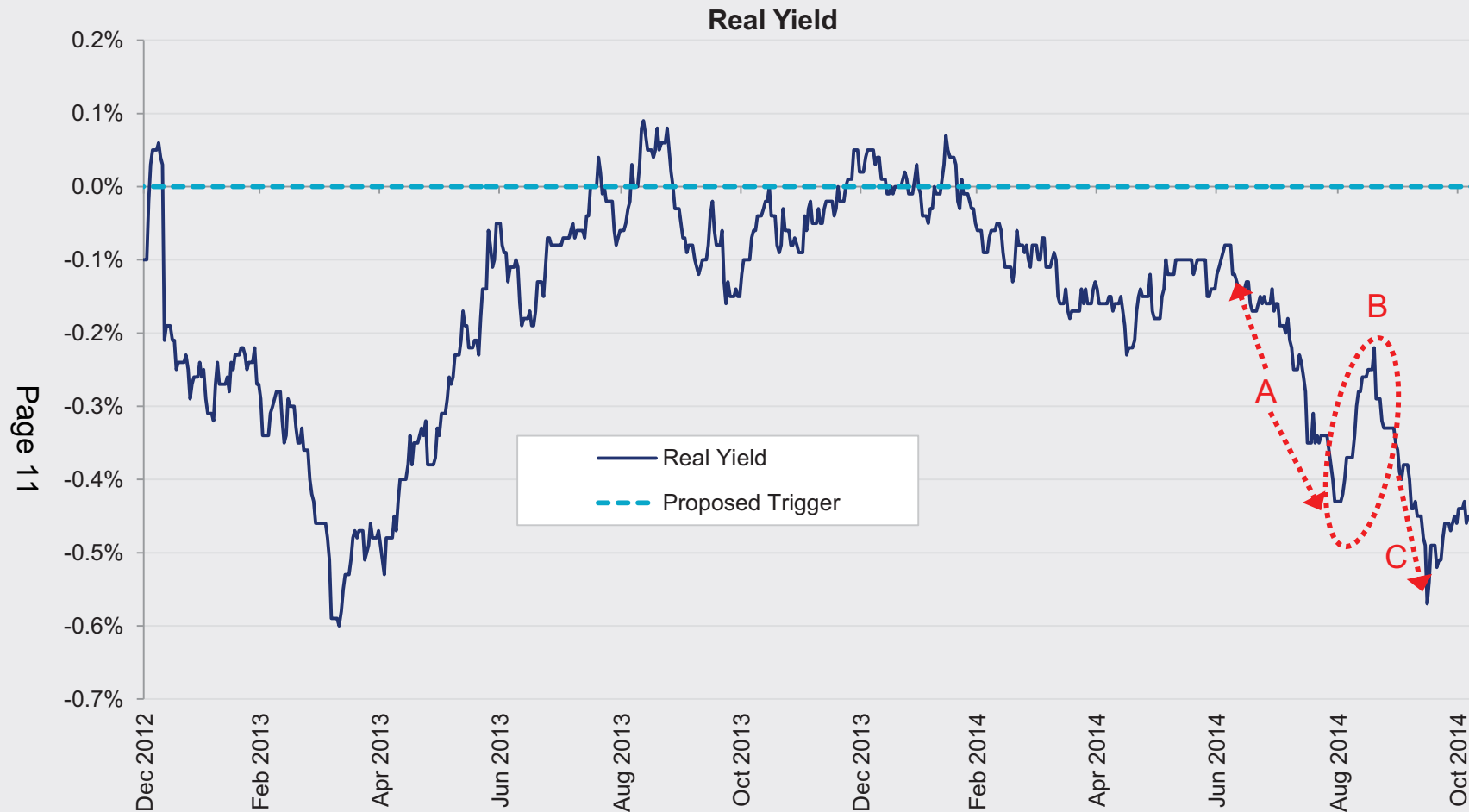
OVERVIEW OF THE IMPLEMENTATION PLAN

We have been working with L&G to develop an implementation plan which is illustrated below. We have provided advice on Step 1 and L&G implemented this trade on 3 November 2014. The next step will be to structure the initial LDI portfolio and to agree the details of the proposed yield trigger.



MOVING TO LEVERAGED GILT STRUCTURE

PROPOSED GILT TRIGGER



A – ECB set the deposit rate to -0.1% in June. This resulted in a flee to UK Government Bonds which has led to yields falling.

B – Around the Scottish referendum there was further volatility, with some respite once it became apparent that the “no vote” would win.

C – Towards the end of September, there was a sell-off in return seeking assets as economic data and forecast deteriorated. As such, investors displayed a ‘flight to quality’ which lead to a further fall in yields.

RESTRUCTURING THE L&G GILT PORTFOLIO

REVIEW OF THE TRANSITION

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L&G Fund	Previous allocation (Date: 22 nd October 2014)		New allocation (Date: 3 November 2014)	
	£m	%	£m	%
All Stocks Fixed Interest Gilts	43.8	30.2	-	-
All Stocks Index-Linked Gilts	101.5	69.8	-	-
2027 Index Linked Gilts	-	-	26.2	18.2
2032 Index-Linked Gilt	-	-	22.6	15.7
2035 Index-Linked Gilt	-	-	11.6	8.1
2037 Index-Linked Gilt	-	-	7.2	5.0
2040 Index-Linked Gilt	-	-	8.2	5.7
2042 Index-Linked Gilt	-	-	28.0	19.5
2050 Index-Linked Gilt	-	-	15.4	10.7
2055 Index-Linked Gilt	-	-	13.1	9.1
2062 Index-Linked Gilt	-	-	6.9	4.8
2068 Index-Linked Gilt	-	-	4.6	3.2
Total L&G gilts	£145.3m	100%	£143.8m	100%
Interest rate hedge ratio	-	5%	-	6%
Inflation hedge ratio	-	4%	-	6%

Source: L&G (asset values), Mercer (hedge ratios).

REVISED FEE BASIS

L&G Passive Funds	Previous fee basis		Revised fee basis	
	% p.a.	Estimated fee p.a.	% p.a.	Estimated fee p.a.
UK equity	0.0425%	£115,000	0.04%	£110,000
Global equity	0.11%	£375,000	0.08%	£270,000
Emerging Market equity	0.25%	£100,000	0.175%	£70,000
Corporate bonds	0.08%	£40,000	0.08%	£40,000
Gilts	0.04%	£60,000	0.0275%	£40,000
Estimated total	0.08%	£690,000	0.06%	£530,000

Source: L&G (fee basis), Mercer (estimated fee based on an total L&G assets of £840m)
 Note: Fee estimates have been rounded for illustration

- ✓ The new fee basis leads to a material reduction in on-going fees
- ✓ Estimated saving of £140,000 p.a. on the passive equity exposure
- ✓ Estimated saving of £20,000 p.a. on the passive gilt holdings (further discount from L&G)
- ✓ Total estimated saving of £160,000 p.a. (before implementing the pooled leveraged gilt strategy)

SUMMARY & NEXT STEPS

Summary

- ✓ The gilt portfolio has now been restructured and is “LDI ready”.
- ✓ The revised L&G fee basis has led to an estimated reduction in investment manager fees of £160,000 per annum.
- ✓ The current bond portfolio provides a 6% interest rate hedge ratio and a 6% inflation hedge ratio (and the “shape” of this exposure now better matches the liabilities).

Next steps

The key next steps are to agree the detailed asset allocation for the LDI strategy and the associated yield trigger. Discussions with L&G are well underway and we will report back to the Board with our advice in due course.

I look forward to discussing the contents of this report with the Board.

Steve Turner
Mercer Limited

APPENDIX

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INTRODUCTION TO SOME IMPORTANT TERMINOLOGY

Jargon	What it means	Change in market conditions	Impact on liabilities
Interest rates	Discount rate	↑	↓
		↓	↑
Inflation	Increase in pension payments	↑	↑
		↓	↓

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IMPORTANT TERMINOLOGY

Nominal interest rates: the yield on fixed-interest gilts that represent the change in interest rates.

Real interest rates: the yield on index-linked gilts that represent the change in interest rates and inflation

Duration: a term used to describe how sensitive the present value of a liability, or an asset, is to changes in the interest rate

- Duration is expressed in years. The higher the duration the greater the sensitivity to changes in interest rates
- For example a duration of 20 years means that for every 1% p.a. change in interest rate, the value of the asset / liability will change by approximately 20%.

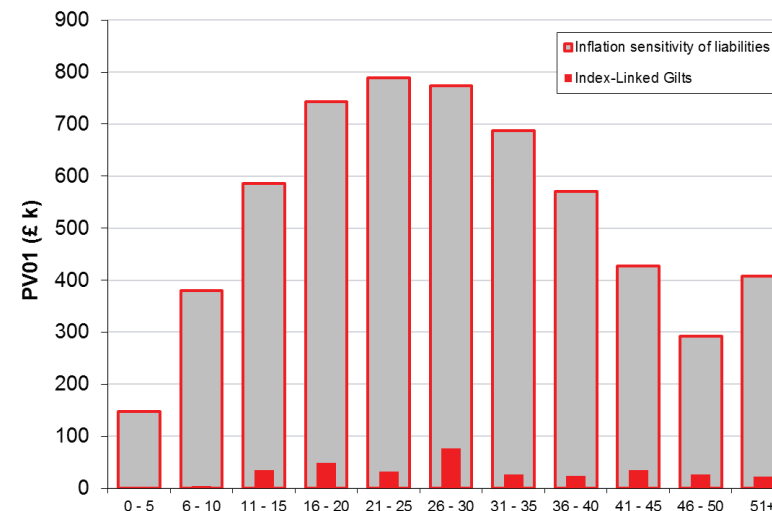
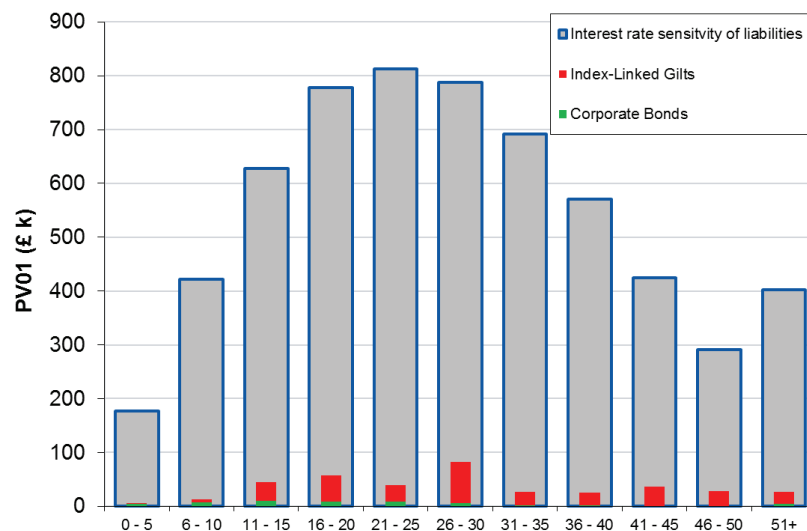
PV01: the value change in the assets or liabilities as a result of a 0.01% uniform change in long term interest rates

IE01: the value change in the assets or liabilities as a result of a 0.01% uniform change in inflation expectations

RESTRUCTURING THE BOND PORTFOLIO

UPDATED HEDGING POSITION

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		Total Interest Rate	Total Inflation
Assets	PV01 (£'000) - A	386	331
Liabilities	PV01 (£'000) - L	5,984	5,805
Hedge ratio (of liabilities)	A/L	6%	6%

Note: The hedge ratio is expressed on an estimated value of the liabilities on the current funding basis. The analysis above indicates that if interest rates were to fall/rise by 0.01% then the deficit would rise/fall by c.£5.6m. Similarly, the analysis shows that if inflation were to fall/rise by 0.01% then the deficit would also fall/rise by c.£5.5m. **The overall hedge ratio is estimated to be 6%.**

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