## Notice of Meeting

# Surrey Pension Fund Board

| Date & time | Place | Contact | Chief Executive |
| --- | --- | --- | --- |
| Friday, 14 November 2014 at 9.30 am | G30, County Hall, Kingston upon Thames, Surrey KT1 2DN | Cheryl Hardman<br>Room 122, County Hall<br>Tel 020 8541 9075<br><br>cherylh@surreycc.gov.uk | David McNulty |

**If you would like a copy of this agenda or the attached papers in another format, eg large print or braille, or another language please either call 020 8541 9122, write to Democratic Services, Room 122, County Hall, Penrhyn Road, Kingston upon Thames, Surrey KT1 2DN, Minicom 020 8541 8914, fax 020 8541 9009, or email cherylh@surreycc.gov.uk.**

**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: 19 SEPTEMBER 2014** (Pages 1 - 12)

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 (*10 November 2014).*
2. The deadline for public questions is seven days before the meeting (*7 November 2014).*
3. The deadline for petitions was 14 days before the meeting, and no petitions have been received.

**5 ACTION TRACKING** (Pages 13 - 16)

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 17 - 104)

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** **REVISED STATEMENT OF INVESTMENT PRINCIPLES** (Pages 105 - 120)

With adjustments to asset allocation within the Pension Fund, it is necessary to approve a revised Statement of Investment Principles (SIP).

**8** **CORE BELIEF STATEMENT** (Pages 121 - 126)

The adoption of a core belief statement is regarded as good practice for the Pension Fund.

**9** **CLASS ACTIONS** (Pages 127 - 132)

This report outlines the possibility of procuring services surrounding US and non US Class Action monitoring and corporate litigation.

**10** **PENSION FUND RISK REGISTER** (Pages 133 - 138)

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.

**11** **KEY PERFORMANCE INDICATORS** (Pages 139 - 144)

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.

**12** **LOCAL GOVERNMENT PENSIONS SCHEME: DRAFT GOVERNANCE REGULATIONS** (Pages 145 - 172)

The report explains the planned changes to the governance of the Local Government Pension Scheme (LGPS) as a result of the Public Service Pensions Act 2013 and draft Regulations recently issued. A key requirement is for a proposed new local Pension Scrutiny Board to monitor compliance with rules and standards.

**13** **DATE OF NEXT MEETING**

The next meeting of the Surrey Pension Fund Board will be on 13 February 2015.

The Surrey Pension Fund AGM will be on 21 November 2014.

**David McNulty**
**Chief Executive**
Published: 6 November 2014

**MOBILE TECHNOLOGY AND FILMING – ACCEPTABLE USE**

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*Thank you for your co-operation*

**MINUTES** of the meeting of the **SURREY PENSION FUND BOARD** held at 9.30 am on 19 September 2014 at Ashcombe Suite, 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 |

**Substitute Members:**

Mr John Orrick

**In attendance**

Cheryl Hardman, Regulatory Committee Manager
John Harrison, Surrey Pension Fund Advisor
Kevin Kilburn, Deputy Chief Finance Officer (Section 151 Officer representative)
Alex Moylan, Senior Accountant
Phil Triggs, Strategic Finance Manager – Pensions and Treasury
Steve Turner, Partner, Mercer

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**37/14 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]**

Apologies were received from John Orrick.

Sheila Little (Section 151 Officer) had also sent her apologies and had asked Kevin Kilburn to attend on her behalf.

The Chairman outlined the new management structure for the pension's administration team and informed the Board that Paul Baker (Pensions Manager) was retiring. The Board asked that its thanks for the services provided by Paul Baker be recorded.

**38/14 MINUTES OF THE PREVIOUS MEETING: 15 MAY 2014 [Item 2]**

A Member suggested that the draft Minute 32/14, resolution a) be amended:

"That the Pension Fund Board agrees 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 (LDI) strategy *framework*. *If implemented, t*his 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%".

Subject to this amendment, the Minutes were agreed as an accurate record of the meeting.

**39/14 DECLARATIONS OF INTEREST [Item 3]**

There were none.

**40/14 QUESTIONS AND PETITIONS [Item 4]**

There were none.

**41/14 ACTION TRACKING [Item 5]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**
1. In relation to A10/14 (private equity performance), the Strategic Finance Manager – Pensions and Treasury informed the Board that the cash flow analysis was being worked on and would be included with the papers for the next meeting.
2. In relation to A12/14 (training needs analysis), the Strategic Finance Manager – Pensions and Treasury informed the Board that the analysis was underway and the results would be brought to the meeting in November 2014. Members were asked to fill in the survey and arrange to complete the test.
3. In relation to A16/14 (Statement of Investment Principles), the Board was informed that the amended Statement was on the agenda at item 10.
4. In relation to A18/14 (Service Level Agreement), the Board was informed that the Service Level Agreement had been published on the Pension Fund website.

5. In relation to A21/14 (training), the Strategic Finance Manager – Pensions and Treasury explained that the training on synthetic equities was to be scheduled for a future meeting.

**Actions/Further Information to be Provided:**
None.

**Resolved:**
That the actions tracker was noted and the committee agreed to remove the completed actions from the tracker.

**Next Steps:**
None

**42/14 INVESTMENT STRATEGY REVIEW [Item 6]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**

1. The Chairman explained that this report had been marked to follow on the agenda and had been circulated the day before the Board meeting because the informal presentations on leveraged gilts to the Board had only recently taken place on 12 September 2014. Time had then been required to consider the information provided and prepare the report, which recommended the appointment of LGIM as the Fund's liability hedging manager.
2. A recap was provided on the rationale for why the Fund was considering putting in place a risk management framework.
3. A discussion took place on the potential benefits of the additional flexibility that could be provided by Schroders (in terms of capital efficiency and higher degree of leverage) and versus the merits of using LGIM, and the competitive nature of their proposal. On balance, it was considered that the higher degree of leverage that could be provided by Schroders was not necessarily needed. The leverage that could be provided via LGIM was sufficient and considered more in line with a "keep things simple" approach.
4. The Chairman stressed that the report and recommendation were from officers but that the Board was under no obligation to agree with the recommendation. In response to queries about the figure of £90m, which was the proposed amount of capital to be initially invested in the mandate, the Chairman explained that this simply reflected the current value of the passively managed Index-Linked gilts portfolio with LGIM.
5. A Member questioned if there was merit in deferring a decision on which manager to appoint until the next Board meeting. The Board was reminded of the comprehensive discussions and previous training sessions that had taken place on risk management and, as a result, it was agreed not to defer at this stage.

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6. There was a query about the description of the LGIM solution as an 'insurance policy'. The Mercer representative explained that the investment with LGIM would technically be written as a unit-linked 'insurance' contract, as was the case with the existing assets by LGIM on behalf of the Fund. It was noted that the Fund had received legal advice from Sackers regarding the suitability of the proposed structures from the LDI managers being considered. All the managers could implement a structure that was consistent with the relevant LGPS investment regulations, including LGIM. Taking all things into consideration, the Mercer representative confirmed that he supported the officers' recommendation to appoint LGIM for the mandate. Their overall fee proposal was the most competitive and there were clear arguments to support the expectation that it would be most straight-forward to use LGIM in terms of initial implementation and ongoing management of the mandate.

**EXCLUSION OF THE PUBLIC**

**RESOLVED:** 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 paragraph 3 of Part 1 of Schedule 12A of the Act.

**PART 2**
**IN PRIVATE**

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

7. The Board asked a number of questions regarding the confidential annex to the report, which were answered by the officers and advisors present.

**The Board meeting adjourned at 10.20am for training and reconvened in public session at 10.45am.**

**Actions/Further Information to be Provided:**
None.

**Resolved:**
That the Pension Fund Board **APPROVES**:

i. The setting up of a framework for a liability driven investment (LDI) strategy with the establishment of a leveraged gilt portfolio. This will be funded by the existing passive and index-linked gilts held with Legal & General, amounting to a maximum of £90m.
ii. The appointment of Legal & General Investment Management with the intention of eventually implementing an LDI strategy. This will serve as a platform for future strategy requirements as the Fund approaches a full funding level. The appointment should be subject to final full due diligence being completed in terms of the legality of the LGIM solution within the LGPS regulations.
iii. The level of liability protection may be increased as the funding level moves further towards 100% with triggers set for consideration of these future decisions, and further Board training to be provided.

**Next Steps:**
None

**The Board meeting adjourned at 10.48am for training and reconvened at 11.30am.**

## 43/14 MANAGER ISSUES AND INVESTMENT PERFORMANCE [Item 7]

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**

1. The Strategic Finance Manager – Pensions and Treasury introduced the report. In response to a question about the cost of the transfer from equities run by LGIM to the Standard Life GFS Fund, the officer explained that the transfer had occurred at mid-price and so there had been no direct transaction charge.
2. The Strategic Finance Manager – Pensions and Treasury explained that Pitchbook was a private company that gathers information via Freedom of Information requests and sells on the data.
3. The Strategic Finance Manager – Pensions and Treasury informed the Board that a report on the ill health insurance policy would be brought to the November meeting (**Action Review ref: A22/14**).
4. The Board discussed the potential private equity opportunities with Capital Dynamics and Goldman Sachs. Historically, the Fund had looked at opportunities in Private Equity from the stable of managers it previously invested in. Members queried how the figures being recommended for commitment in the private equity opportunities had been identified. The Strategic Finance Manager – Pensions and Treasury explained that the figures follow the pattern of the last 10-12 years of being reasonable and affordable and within the cash flow of the pension fund. After discussion, it was agreed that a wider review of the Fund's Private Equity holdings and future strategy for this part of the portfolio should be considered before committing additional monies to this asset class. Within this, Mercer would identify the top tier private equity managers and address whether the Pension Fund receives appropriate returns for the fees charged, what kinds of funds complement what the Pension Fund already invests in, and the value from existing managers compared to their peer group (**Action Review ref: A23/14**).
5. Members queried whether Board Members were expected to attend investment manager meetings and, if so, could they be arranged so that they did not clash with other Council meetings. The Chairman and Advisors assured the Members that these were regular monitoring meetings which Board Members had an open invitation to attend but it is not essential that they do. The Surrey Pension Fund Advisor informed the Board that some Boards never meet investment managers and some Boards spend over half of their time meeting investment managers. The balance sought by the Surrey Pension Fund Board was closer to the optimum.
6. A Member asked whether online training was available. The Chairman informed her that CIPFA provides online training and she would send her some information.

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**The Board meeting adjourned at 12.30pm for lunch and reconvened at 1pm.**

*The Chairman left the meeting at 1.05pm and the Vice-Chairman took the Chair.*

7. The Strategic Manager – Pensions and Treasury presented the Financial and Performance Report.

*The Chairman returned to the meeting at 1.10pm and took the Chair.*

8. The Surrey Pension Fund Advisor presented the summary of meetings with Fund Managers on 17 September which had been circulated with the late supplementary agenda. The Mercer representative informed the Board that the decision to invest more capital with CBRE had, so far, proven to be a good decision. It had helped reduce exposure to the European property markets and increased investments in the UK property market which had performed well. The Chairman expressed discomfort with having 100% of the Fund's property portfolio invested in the UK and recommended support for changing the wording in the Surrey mandate to CBRE. The Board agreed with this proposal.
9. The Surrey Pension Fund Advisor informed the Board that while Newton had outperformed the benchmark when reviewing the past three years' performance (albeit below target) this was primarily due to good performance in just one year. It was noted that the house remains very cautious in its outlook. While this would be expected to help a manager outperform in a falling market there were some concerns that this could lead to missed opportunities. After discussion, it was considered appropriate to review the role of Newton and compare them against alternative managers. The diversification merits relative to Marathon would also need to be considered, when identifying alternative managers. It was suggested that Mercer identify a range of alternative global equity managers and invite Newton to pitch against them. The Mercer representative agreed but explained that it would first be necessary to check how to do this so that the process is consistent with OJEU regulations (**Action Review ref: A24/14**).
10. A Member suggested that the Pension Fund has a big spread of fund managers and asked if it would be appropriate to shorten the list. The Surrey Pension Advisor informed the Board that the number of managers was almost exactly in line with the average for the LGPS.
11. The Surrey Pension Advisor informed the Board that he had concerns regarding Mirabaud and the performance achieved for the Fund. He expressed concern that Mirabaud does not take enough notice of what is going on in the markets in its portfolio management decisions. The Board concurred with the concerns and agreed to terminate Mirabaud's contract with immediate effect and temporarily move the 4% allocation from Mirabaud to a passive portfolio with Legal & General.

**Actions/Further Information to be Provided:**

a. A report on the ill health insurance policy to be brought to the November meeting of the Board.
b. Mercer to undertake a review of the Fund's Private Equity holdings and report back to the Board.

c. Mercer to provide a report identifying a range of potential alternative global equity managers to the November meeting.

**Resolved:**

i. That the Pension Fund Board approves the report and the decisions as laid out;
ii. That the Pension Fund Board defers a decision on making a £7m commitment each year for 2014/15, 2015/16 and 2016/17 to the Capital Dynamics LGPS Collective Private Equity Vehicle;
iii. That the Pension Fund Board defers a decision on making a USD 20m commitment to the Goldman Sachs Private Equity Manager (PEM) Fund;
iv. That the Pension Fund Board amends the wording in the Surrey mandate to CBRE to allow investment in global property;
v. That the Pension Fund Board instructs officers to terminate Surrey's mandate with Mirabaud and instruct LGIM to manage the 4% allocation in passive equities on a temporary basis, subject to further review.

**Next Steps:**
None

**44/14 SURREY PENSION FUND ACCOUNTS 2013/14 [Item 8]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**

1. The Strategic Finance Manager – Pensions and Treasury introduced the report and thanked the Senior Accountant for his work on preparing the accounts. The Deputy Chief Finance Officer highlighted that the accounts had been closed two months earlier than usual.
2. The Strategic Finance Manager – Pensions and Treasury confirmed that retention from auto-enrolment had been higher than expected.
3. The Strategic Finance Manager – Pensions and Treasury agreed to circulate information on how many pension fund members are taking up the 50:50 offer and whether the age profile of the membership had changed with the introduction of auto-enrolment (**Action Review ref: A25/14**).

**Actions/Further Information to be Provided:**
The Strategic Finance Manager – Pensions and Treasury to circulate information on how many pension fund members are taking up the 50:50 offer and whether the age profile of the membership had changed with the introduction of auto-enrolment.

**Resolved:**

i. That the Pension Fund Board NOTES and APPROVES the financial statements;
ii. That the Pension Fund Board NOTES the content of the Audit Findings for Surrey Pension Fund Report;
iii. That the Pension Fund Board NOTES the Letter of Representation;
iv. That the Pension Fund Board NOTES the External Auditor's Report.

**Next Steps:**
None

**45/14 PENSION FUND RISK REGISTER [Item 9]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**
1. The Strategic Finance Manager – Pensions and Treasury introduced the report and explained that the risk register had been reviewed and streamlined as requested at the previous Board meeting.
2. With regard to Risk 6 (Changes to LGPS regulations), the Strategic Finance Manager – Pensions and Treasury informed the Board that following publication of the regulations, this risk would be downgraded to amber or possibly green.
3. With regard to Risk 17 (implementation of proposed changes to LGPS), the Strategic Finance Manager – Pensions and Treasury reminded the Board that it had requested this to be added to the register.
4. A Member pointed out that the valuation mentioned in Risk 1 should be updated to read 2016.

**Actions/Further Information to be Provided:**
None.

**Resolved:**
That the revised Risk Register was NOTED.

**Next Steps:**
None

**46/14 REVISED STATEMENT OF INVESTMENT PRINCIPLES [Item 10]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**
1. The Strategic Finance Manager – Pensions and Treasury introduced the report and outlined the changes since the previous meeting.
2. A Member pointed out that 31 March 2013 is used to show the Funds private equity investments and that this was now 18 months old. He also requested that the date on which investment managers were appointed be included under Section 5.

**Actions/Further Information to be Provided:**
None.

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

**Next Steps:**
None

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**47/14 KEY PERFORMANCE INDICATORS [Item 11]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**

1. The Strategic Finance Manager – Pensions and Treasury introduced the report and explained that performance in some areas of pension administration had fallen because of the need to allocate resources to the implementation of the new 2014 scheme. He had been assured that normal administration activity was now resuming and performance improving.
2. A Member queried whether the targets for death benefits were too low given that targets are being passed. The Chairman stressed that it was not realistic to have a higher target.
3. The Surrey Pension Fund Advisor suggested that all the targets were relevant apart from the target to improve the funding level to 100%. He suggested that this was impossible in the short term. The Strategic Finance Manager – Pensions and Treasury stated that it would be at least eight years before the Pension Fund is near to being 100% funded.

**Actions/Further Information to be Provided:**
None.

**Resolved:**
That the Pension Fund Board NOTE the KPI statement.

**Next Steps:**
None

**48/14 CORPORATE GOVERNANCE SHARE VOTING [Item 12]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**

1. The Strategic Finance Manager – Pensions and Treasury introduced the report and explained that share voting could generate a great deal of work, which was substantially reduced with the assistance of a governance consultant. He highlighted paragraph 15 to indicate how successful protest votes have been.

**Actions/Further Information to be Provided:**
None.

**Resolved:**
That the Pension Fund Board NOTE the report.

**Next Steps:**
None

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**49/14 LOCAL GOVERNMENT PENSION SCHEME: DRAFT GOVERNANCE REGULATIONS [Item 13]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**

1. The Strategic Finance Manager – Pensions and Treasury introduced the report and highlighted the confusion generated from the requirement to create a 'Pension Board' to oversee or scrutinise the work of the Scheme Manager. In the case of Surrey Pension Fund, the Scheme Manager is the administering authority as currently defined by LGPS regulations, ie Surrey County Council for the Surrey Pension Fund. The Surrey Pension Fund Board has delegated authority to take decisions pertaining to the running of the pension fund. It was suggested that the two bodies needed names which made it clear what their responsibilities are. The Government were not supportive of calling the new Board a 'scrutiny' Board. Suggestions included renaming the Surrey Pension Fund Board or naming the new Board as the Review Board or Governance Board.
2. It was agreed that it would be difficult to combine the two Boards.
3. The Strategic Finance Manager – Pensions and Treasury stated that a report would be taken to Council to create the new Board once the regulations have been published.
4. The Strategic Finance Manager – Pensions and Treasury informed the Board that Hymans had suggested that the new overview Board could take responsibility for some matters such as share voting but his preference was for the existing Board to retain responsibility for all facets of the pension fund and for the new body to have a review/scrutiny role.

**Actions/Further Information to be Provided:**
None.

**Resolved:**

i. That the Pension Fund Board NOTES the report;
ii. That the Pension Fund Board NOTES the response to the consultation from the Surrey Pension Fund.

**Next Steps:**
None

**50/14 LGPS REFORM: OPPORTUNITIES FOR COLLABORATION, COST SAVINGS AND EFFICIENCIES [Item 14]**

**Declarations of Interest:**
None.

**Key Points Raised During the Discussion:**

1. The Chairman introduced the report. Members congratulated officers on the response to the consultation.

**Actions/Further Information to be Provided:**
None.

**Resolved:**

i. That the Pension Fund Board NOTES the report;
ii. That the Pension Fund Board NOTES the consultation sent by Surrey Pension Fund with views expressed by members within the Board meeting of 15 May 2014.

**Next Steps:**
None

**51/14 DATE OF NEXT MEETING [Item 15]**

The date of the next meeting was noted.

Meeting ended at: 2.40 pm

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**Chairman**

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SURREY
COUNTY COUNCIL

**Surrey Pension Fund Board**
**14 November 2014**

# ACTION TRACKER

**PURPOSE OF REPORT:**

For Members to consider and comment on the Board's action tracker.

**INTRODUCTION:**

An action tracker recording actions and recommendations from previous meetings is attached as **Annex A**, and the Board is asked to review progress on the items listed.

**RECOMMENDATION:**

The Committee is asked to monitor progress on the implementation of recommendations from previous meetings (Annex A).

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**REPORT CONTACT**: Cheryl Hardman, Regulatory Committee Manager
020 8541 9075
cherylh@surreycc.gov.uk

**Sources/background papers:** None

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# Surrey Pension Fund Board – ACTION TRACKING

***ACTIONS***

| Number | Meeting Date | Item | Recommendation / Action | Action by whom | Action update |
|---|---|---|---|---|---|
| A12/14 | 15 May 14 | Pension Fund Business Plan 2013/14: Outturn Report and Final 2014/15 Plan | A training needs analysis to be conducted later in the year. | Strategic Manager, Pension Fund & Treasury | A training needs analysis was circulated by email on 14 August 2014. Progress is highlighted in the papers for the 14 November 2014 meeting. The results will be brought to the February 2015 meeting. |
| A21/14 | 15 May 14 | Investment Strategy Review | The Board to receive training on synthetic equities. | Strategic Manager, Pension Fund & Treasury | To be scheduled for February 2015.<br>Training on infrastructure and multi credit scheduled for November 2014. |

***COMPLETED ACTIONS***

| Number | Meeting Date | Item | Recommendation / Action | Action by whom | Action update |
|---|---|---|---|---|---|
| A10/14 | 15 May 14 | Private Equity Investment Performance Review | Future reports on private equity performance to present a cash flow analysis of how payments are received over time. | Strategic Manager, Pension Fund & Treasury | To review at the meeting on 14 November 2014. |
| A16/14 | 15 May 14 | Revised Statement of Investment Principles | The Statement of Investment Principles to be amended as agreed at the meeting. | Strategic Manager, Pension Fund & Treasury | This was addressed at the meeting of the Board on 19 September 2014. |
| A18/14 | 15 May 14 | Pension Fund Administration Service Level Agreement | The Service Level Agreement to be published on the Pension Fund website. | Pensions Manager | Officers confirmed that this had been published at the meeting on 19 September 2014. |
| A22/14 | 19 Sept 14 | Manager Issues and Investment Performance | A report on the ill health insurance policy to be brought to the November meeting of the Board. | Strategic Manager, Pension Fund & Treasury | Scheduled for the 14 November 2014 meeting. |

# Surrey Pension Fund Board – ACTION TRACKING

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|---|---|---|---|---|---|
| A23/14 | 19 Sept 14 | Manager Issues and Investment Performance | Mercer to undertake a review of the Fund's Private Equity holdings and report back to the Board. | Mercer | Scheduled for the 14 November 2014 meeting. |
| A24/14 | 19 Sept 14 | Manager Issues and Investment Performance | Mercer to provide a report identifying a range of potential alternative global equity managers to the November meeting. | Mercer | Scheduled for the 14 November 2014 meeting. |
| A25/14 | 19 Sept 14 | Manager Issues and Investment Performance | The Strategic Manager – Pensions and Treasury to circulate information on how many pension fund members are taking up the 50:50 offer and whether the age profile of the membership had changed with the introduction of auto-enrolment. | Strategic Manager – Pensions and Treasury | Scheduled for the 14 November 2014 meeting. |

**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE:** **14 NOVEMBER 2014**

**LEAD OFFICER:** **SHEILA LITTLE, DIRECTOR OF FINANCE**

6

**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. Note the report.
2. Consider the options concerning the UK Equities portfolio previously managed by Mirabaud, and make a recommendation for implementation.
3. Consider the options concerning the Global Equities portfolio currently managed by Newton, and make a recommendation for implementation.

## 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 |
|---|---|---|
| L&G | Possible Rebalancing | The asset allocation is within the Fund's policy control limits. The asset allocations at 30 September 2014 and 31 October 2014 are shown in Annex 1. |
| Standard Life | Global Focused Strategies | Members agreed to allocate £60m to Standard Life's Global Focused Strategies Fund at the Board meeting on 15 May 2014. This was achieved on 12 June 2014 with a transfer from equities run by Legal and General Investment Management to the Standard Life GFS Fund. A report of an initial meeting with Standard Life on 7 November 2014 will be circulated prior to the Board meeting on 14 November 2014. |
| Mirabaud | UK Equities Portfolio | At its meeting on 19 September 2014, the Board agreed to terminate Mirabaud's contract with immediate effect and temporarily move the 4% allocation from Mirabaud to a UK Equities passive portfolio with Legal & General. Officers immediately contacted Mirabaud to let them know of the Board's decision and make arrangements with both managers for the transfer of the funds. An in specie transfer with a net valuation of £98,437,899 from Mirabaud at 8 October 2014 valuation date was placed into LGIM's N – UK Equity Index Passive Fund on 9 October 2014. Officers wrote to Mirabaud to acknowledge the long association and thank them for their work over the past years. Board members will be invited to discuss the future possible options for this portfolio. |
| CBRE | Contract change | The Pension Fund Board resolved at the 19 September 2014 meeting to amend the wording in the CBRE contract to allow investment in global property. CBRE are currently working on this change, specifically the benchmark requirements for such a mandate. Officers will report to the 13 February 2015 meeting. |
| Franklin Templeton | Client meeting | Update included in minutes of external fund manager meetings held on 7 November 2014. |
| UBS | Client meeting | Update included in minutes of external fund manager meetings held on 7 November 2014. |
| Marathon | Client meeting | Update included in minutes of external fund manager meetings held on 7 November 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 | Organisation | Request | Response |
|---|---|---|---|
| 09/08/2014 | Private Individual | Disclosure of correspondence relating to a complaint made to the fund by the individual about treatment received from an organisation with which the Fund had invested. | Disclosure where appropriate within FOI legislation of correspondence between officers in SCC and with other organisations. |
| 26/08/2014 | Inframation Group (Infrastructure Research) | Infrastructure investments held by the pension fund. | Summary of private equity funds, considered as infrastructure based: Capital Dynamics US Solar & Clean Energy and Infrastructure |
| 31/08/2014 | SP Capital IQ (Market Research) | Private equity investments held by the pension fund. | Summary portfolios of the private equity portfolio as at 31/12/2013 and 31/03/2014. |
| 15/09/2014 | Pitchbook (Private Equity Research) | Private equity investments held by the pension fund. | Summary portfolios of the private equity portfolio as at 31/12/2013 and 31/03/2014. |
| 30/09/2014 | Pitchbook (Private Equity Research) | Investment memorandum and due diligence materials for private equity from 1 March 2014 to 27 August 2014. | This request was subject to a partial exemption under section 41 and 43 (1) & (2) for information provided in confidence and commercial sensitivity. The minutes and reports from the May Board Meeting were provided. |

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**3) Future Pension Fund Board Meetings/Pension Fund AGM**

The schedule of meetings for 2014 and 2015 is as follows:

- 14 Nov 2014: Board meeting hosted at County Hall.
- 21 Nov 2014: Pension Fund Annual Meeting hosted at County Hall.
- 13 February 2015: Board meeting hosted at County Hall.
- 15 May 2015: Board meeting hosted at County Hall.
- 11 September 2015: Board meeting hosted at County Hall.
- 13 November 2015: Board meeting hosted at County Hall.

**4) Stock Lending**

In the quarter to 30 September 2014, stock lending earned a net income for the Fund of £59,351 with an average value on loan equal to £123.6m

**5) Share Voting**

Given the far lower volume of voting this quarter in comparison with the first two quarters of 2014, the Strategic Manager will present a report at the 13 February 2015 Board meeting, comprising voting activity for the two consecutive quarters ending 31 December 2014.

**6) LGPS 2014 Scheme: 50/50 Take Up**

At the Board meeting of 19 September 2014, the Strategic Finance Manager agreed to circulate information on how many pension fund members are taking up the newly established 50/50 offer and whether the age profile of the membership had changed with the introduction of auto-enrolment.

Across the entire Surrey fund, there are 45 active members who have taken this option since 1 April 2014. It is not possible to assess the impact on overall contributions yet because with the LGPS CARE scheme cannot supply any data until after year end. Suffice to say, the current 50/50 take up of 45 active members is not regarded as a material impact.

The age profile of the membership (for Surrey County Council alone) has reduced with the introduction of auto-enrolment. The average age of actives in the 2013 actuarial valuation was 51.6 years and, after auto enrolment, this has now reduced to 46.5 years.

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7) **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 took place with a view to securing a way forward that does not breach EU procurement regulations. Accordingly, the Council published a VEAT (voluntary ex ante transparency) notice, advising of the intention of the administering authority to enter into a contract with Legal & General. This notice was published on 3 September 2014. Within the 30-day time window, no credible alternative provider has been in contact to challenge the intention to contract with Legal & General without first tendering.

However, given the delays that resulted as a result of the lengthy procurement advice, it will be necessary to reassess the data on which prices were agreed with Legal and General. It is recommended that officers commence this process and report to the 13 February 2015 committee with a view to commencing on 1 April 2015.

8) **Private Equity**

A schedule of the private equity investments was presented to the Board at the meeting of 19 September 2014. Latest information was taken from the global custodian position reports and, where appropriate, information provided from the private equity managers themselves. Officers were requested to present a summary of the annual cash flows and this is shown in Annex 2 with a commentary for the period 1 April 1999 to 31 March 2014.

Mercer has provided a commentary on the Fund's private equity portfolios and fund managers and this is shown as Annex 3.

9) **Internally Managed Cash**

The internally managed cash balance of the Pension Fund was £0.5m as at 30 September 2014.

10) **Liability Driven Investment Framework**

The Board meeting of 19 September 2014 recommended the setting up of a framework for a liability driven investment (LDI) strategy with the establishment of a leveraged gilt portfolio to be run by Legal & General Investment Management. This will be funded by the existing passive and index-linked gilts held with Legal & General, amounting to a maximum of £90m. The appointment was subject to final full due diligence being completed in terms of the legality of the LGIM solution within the LGPS regulations. The Director of Finance and Strategic Finance Manager met with the Monitoring Officer on 29 October 2014 in order to complete the final full diligence before contracts were signed with Legal & General Investment Management on the same day.

The contracts that have been signed only relate to the restructuring of the physical gilts. It should be noted that no investment will be taking place yet in the leveraged gilt structure. The switch into the leveraged gilt structure will take place based on yield triggers (still to be decided), assuming real yields get back to 0%. Such moves into leverage will be the subject of future report and recommendations to the Board. The Liability Driven Investment framework by means of the Fund's existing assets of £90m was set up on 3 November 2014.

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In order to minimise the costs of the overall restructuring, LGIM implemented a move of the Fund's index-linked gilt holdings (in an All Stocks fund) into a series of single stock index-linked gilt holdings (e.g. a 2068 index-linked gilt etc). This was done in a way to broadly match the liability profile of the Fund. The reason for this is that the leveraged gilt portfolio that the Fund will be ultimately targeting will invest in leveraged versions of the single stock funds. Restructuring now into the unleveraged versions of the single stock funds will make it quicker and cheaper to move into the leveraged structure when the trigger point is hit. This will be the most cost effective way for ultimately moving to the leveraged gilt structure.

Overall, the process can be described as getting the portfolio "in shape" to efficiently move towards the target leveraged gilt structure, while also benefiting from increased inflation hedging. The above will also slightly increase the Scheme's duration exposure (not materially so however) before the leveraged gilt structure. Now this initial restructuring has taken place, the Fund will be able to finalise the structure of the target leveraged gilt portfolio and documentation for the proposed yield trigger. Thus, the level of liability protection may be increased as the funding level moves further towards 100% with triggers set for consideration of these future decisions, and further Board training to be provided.

Further negotiations with L&G by Mercer resulted in a reduced fee structure for the single stock gilt funds (noting this was not part of their original proposal). In particular, they have proposed a fee of 0.0275% per annum of assets invested which compares favourably with the current fee for gilts of 0.04% per annum. This is estimated to equate to an annual cost saving of £17,700 relative to the current arrangements.

**11) Mirabaud Portfolio: UK Equities**

At its meeting on 19 September 2014, the Board agreed to terminate Mirabaud's contract with immediate effect and temporarily move the 4% allocation from Mirabaud to a passive portfolio with Legal & General. An in specie transfer with a net valuation of £98,437,899 from Mirabaud (as at 8 October 2014) was placed into LGIM's N – UK Equity Index Passive Fund on 9 October 2014.

Members requested Mercer to provide options as to the future management of the Mirabaud portfolio. Mercer since provided a report as to the range of available options and this is attached as Annex 4 to this report.

## 12) Newton Portfolio: Global Equities

At the Board meeting of 19 September 2014, members considered the past performance of Newton Investment Management against their benchmark target. It was agreed that Mercer would identify a range of alternative global equity managers and invite Newton to pitch against them, subject to further discussion at the next Board meeting.

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Mercer has provided a report on the options available and this is attached as Annex 5 to this report.

## 13) Governance Strategies and Policies

The share voting framework and share voting policy was due for revision at this meeting, following publication of the changes to the UK Corporate Governance Code due to be published at the start of October 2014. However, advice from our consultant on the substantial changes required will necessitate deferment of this revised share voting policy presentation to the 13 February 2015 meeting.

## 14) Members' Knowledge Assessment

This will be deferred to the 13 February 2015 meeting in order to allow sufficient time for members to complete the necessary outstanding paperwork and assessments.

## 15) Fund Manager Meetings of 7 November 2014

Notes of the fund manager meetings of 7 November 2014 will be circulated prior to the Board meeting on 14 November.

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**Report of the Strategic Finance Manager**

**Financial and Performance Report**

## 1. Funding Level

**Table 1**

| **Past Service Position** | **30 Sep 2014 £m** |
|---|---|
| **Past Service Liabilities** | 3,776 |
| **Market Value of Assets** | 2,894 |
| **Deficit** | (882) |
| | |
| **Funding Level** | 76.6% |

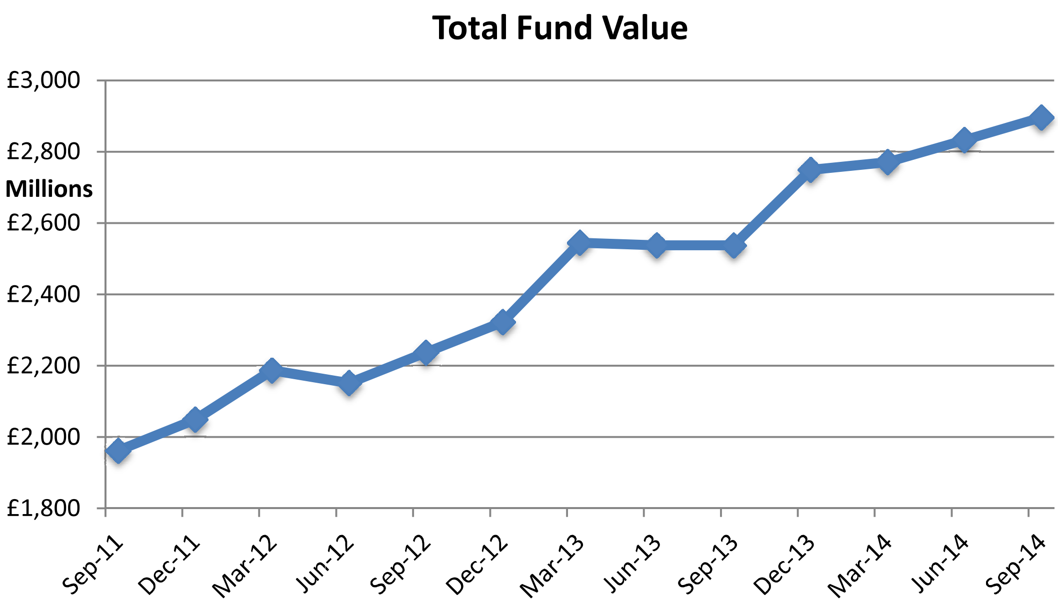
The funding level at the latest formal valuation at 31 March 2013 was 72.3%. As at 30 September 2014 the funding level had increased to 76.6%, a significant improvement from 2013, but a decline from 79.8% as at 30 June 2014. Downward pressure on bond yields has led to the reduction in the discount rate, which is now back to the same level as for the formal valuation. Using equal assumptions the funding level is now 4.3% higher than as at 31 March 2013.

## 2. Market Value

The value of the Fund was £2,893.8m at 30 September 2014 compared with £2,833.0m at 30 June 2014. Investment performance for the period was +1.4%.

The increase is attributed as follows:

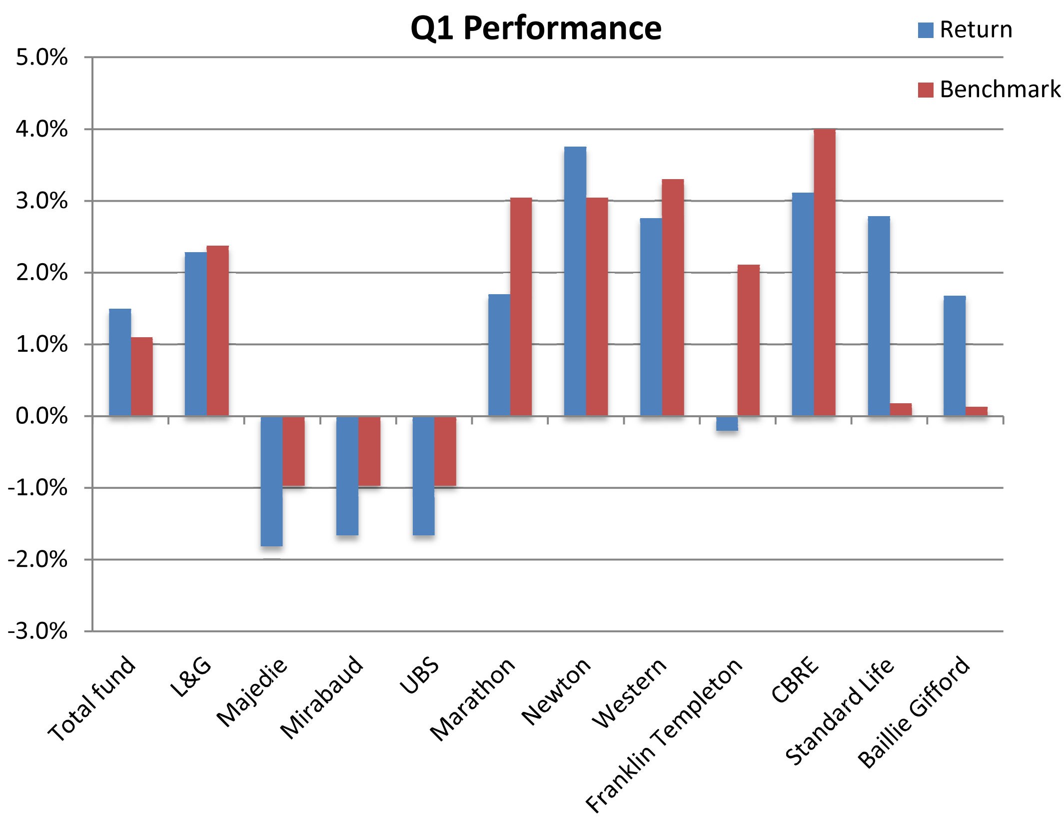
| | **£m** |
|---|---|
| **Market Value at 30/06/2014** | **2,833.0** |
| Contributions less benefits and net transfer values | 11.5 |
| Investment income received | 12.9 |
| Investment expenses paid | -2.2 |
| Market movements | 38.6 |
| **Market Value at 30/09/2014** | **2,893.8** |
| **Market Value at 31/10/2014 (estimated)** | **2,835.3** |




3. **Fund Performance**

**Summary of Quarterly Results (gross of investment fees)**

Overall, the total fund returned +1.5% in Q2 2014/15, in comparison with the Fund's customised benchmark of +1.1%.




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

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Equity returns for the last quarter were mixed; all three active UK managers underperformed versus a declining benchmark. However, overseas equity fared better over the period with Newton returning +3.8% against the benchmark return of +3.0%.

Property continues to provide strong absolute returns with CBRE reporting +3.1% for the quarter.

The table below shows manager performance for 2014/15 Q2 (net of investment manager fees) against manager specific benchmarks using Northern Trust data.

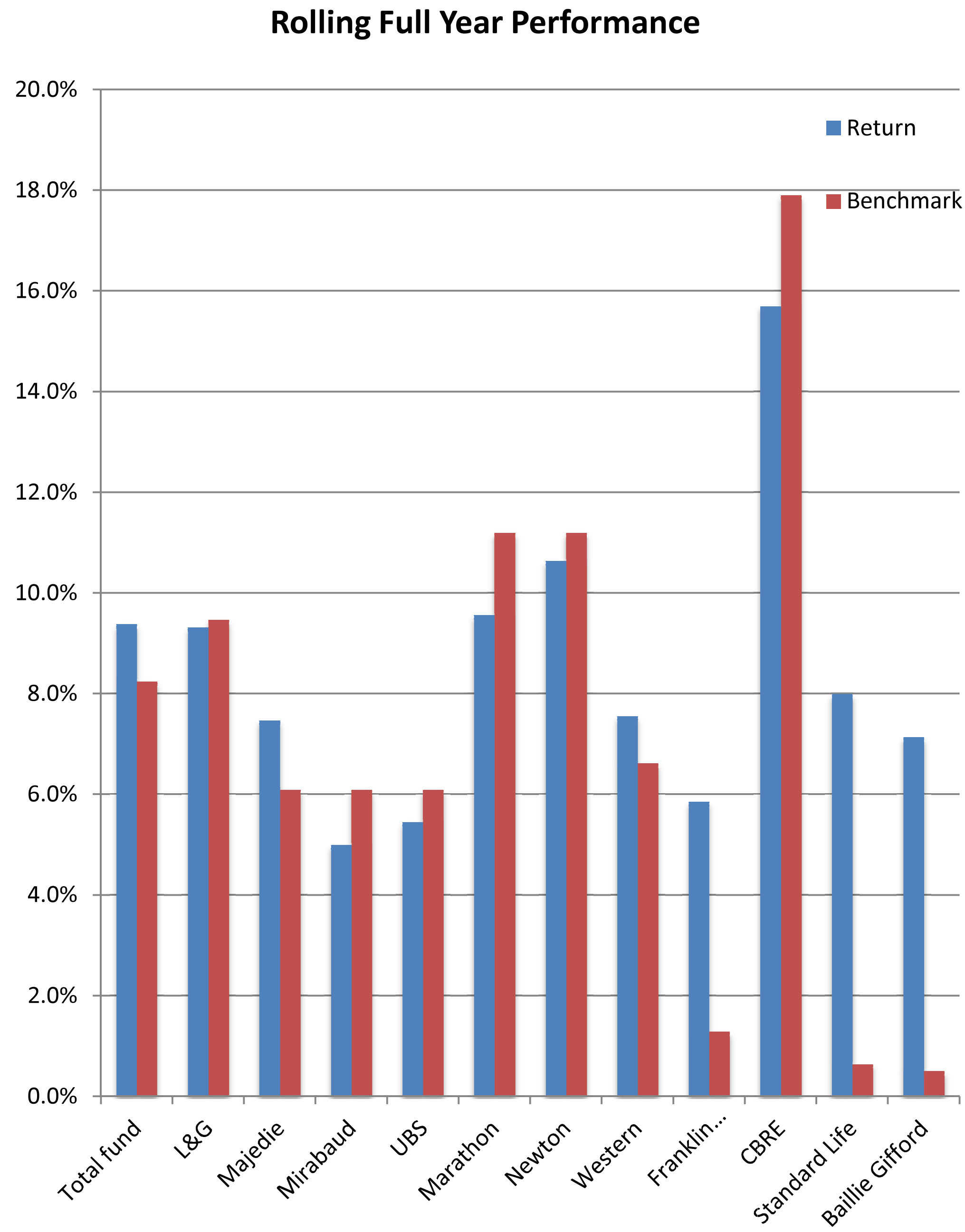
| Manager | Performance % | Benchmark % | Relative % |
|---|---|---|---|
| Total fund | 1.5 | 1.1 | 0.4 |
| L&G | 2.3 | 2.4 | -0.1 |
| Majedie | -1.8 | -1.0 | -0.8 |
| Mirabaud | -1.7 | -1.0 | -0.7 |
| UBS | -1.7 | -1.0 | -0.7 |
| Marathon | 1.7 | 3.0 | -1.3 |
| Newton | 3.8 | 3.0 | 0.8 |
| Western | 2.8 | 3.3 | -0.5 |
| Franklin Templeton | -0.2 | 2.1 | -2.3 |
| CBRE | 3.1 | 4.0 | -0.9 |
| Standard Life | 2.8 | 0.2 | 2.6 |
| Baillie Gifford | 1.7 | 0.1 | 1.6 |

*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 given large currency movements.*

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

**Summary of Full Year Results (gross of investment fees)**

During the course of the previous 12 months to 30 September 2014, the Fund returned +9.4% overall, an outperformance of 1.1% against the customised benchmark of +8.2%.




Property provided the largest absolute return for the last 12 months with CBRE reporting +15.7% yet still below the benchmark of +17.9%. The stellar performances of the previous year's Q2 for UK equity dropped out of the rolling year to be replaced by a lacklustre Q2 in 2014/15 with annual benchmark returns of +6.0%.

Bond yields have trended lower during the last year which provided a boost to the fixed income section of the portfolio. Western reported +7.6% over the year ahead of benchmark of +6.6%.



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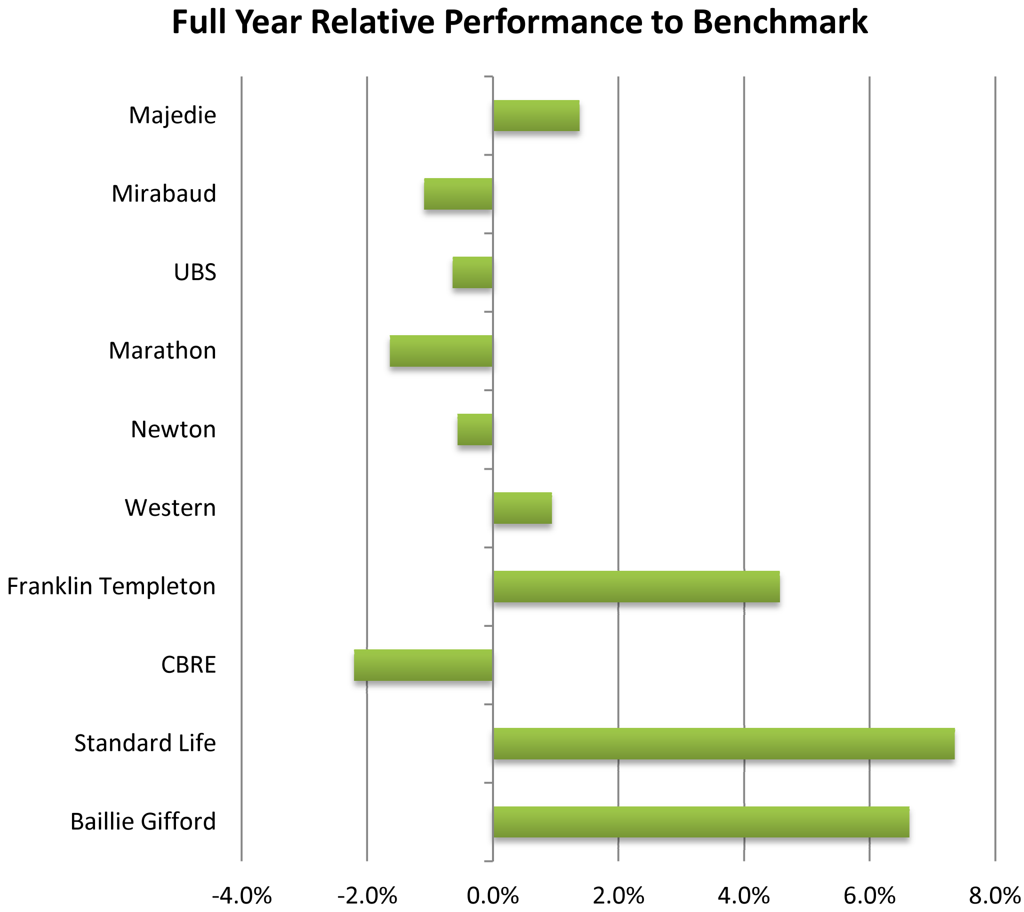


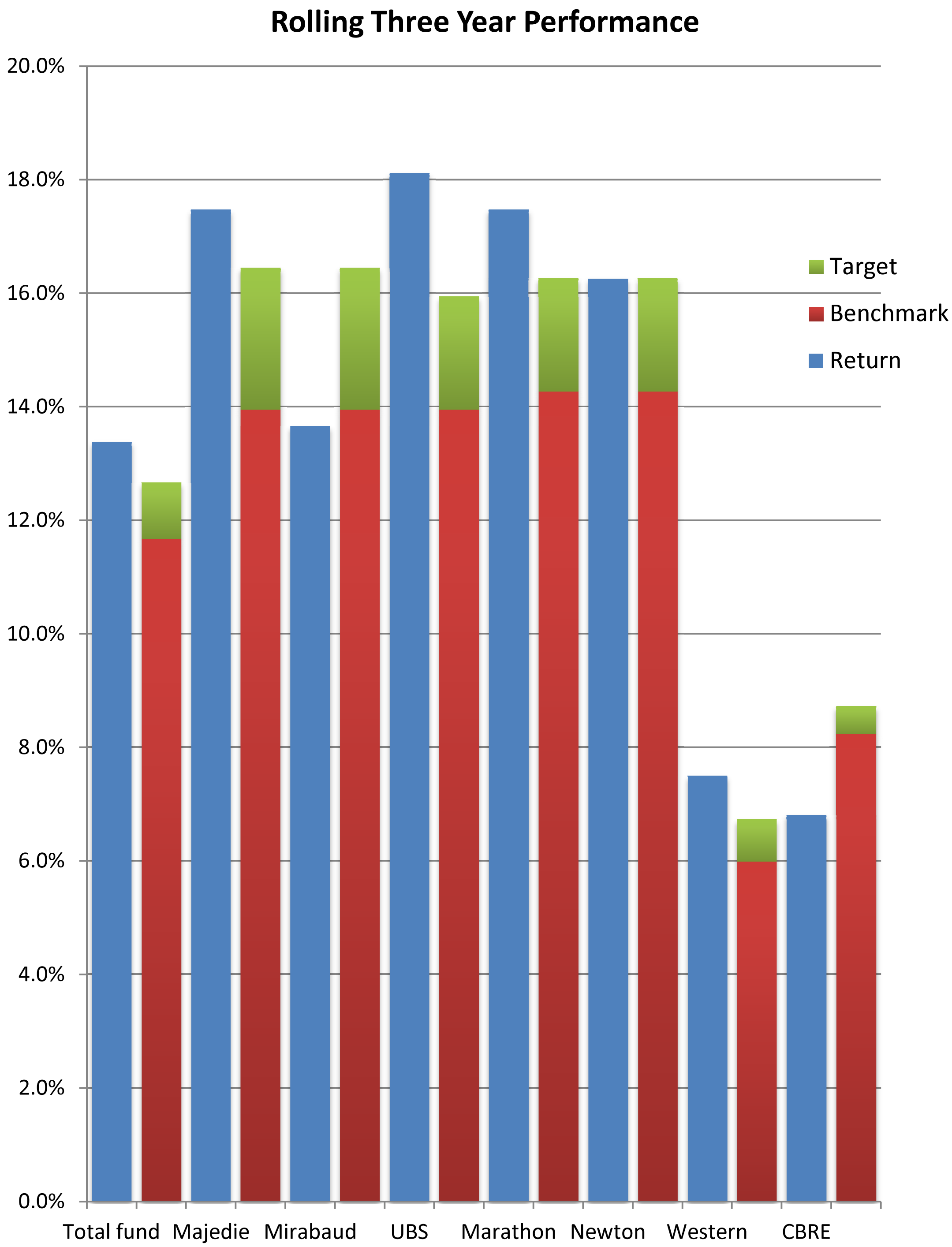

The table below shows manger performance for the year to 30 September 2014 against manager specific benchmarks using custodian data.

| Manager | Performance % | Benchmark % | Relative % |
|---|---|---|---|
| Total fund | 9.4 | 8.2 | 1.2 |
| L&G | 9.3 | 9.5 | -0.2 |
| Majedie | 7.5 | 6.1 | 1.4 |
| Mirabaud | 5.0 | 6.1 | -1.1 |
| UBS | 5.4 | 6.1 | -0.7 |
| Marathon | 9.6 | 11.2 | -1.6 |
| Newton | 10.6 | 11.2 | -0.6 |
| Western | 7.6 | 6.6 | 1.0 |
| Franklin Templeton | 5.9 | 1.3 | 4.6 |
| CBRE | 15.7 | 17.9 | -2.2 |
| Standard Life | 8.0 | 0.6 | 7.4 |
| Baillie Gifford | 7.1 | 0.5 | 6.6 |

*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 given large currency movements.*

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

**Summary of Rolling Three Year Performance (gross of investment fees)**

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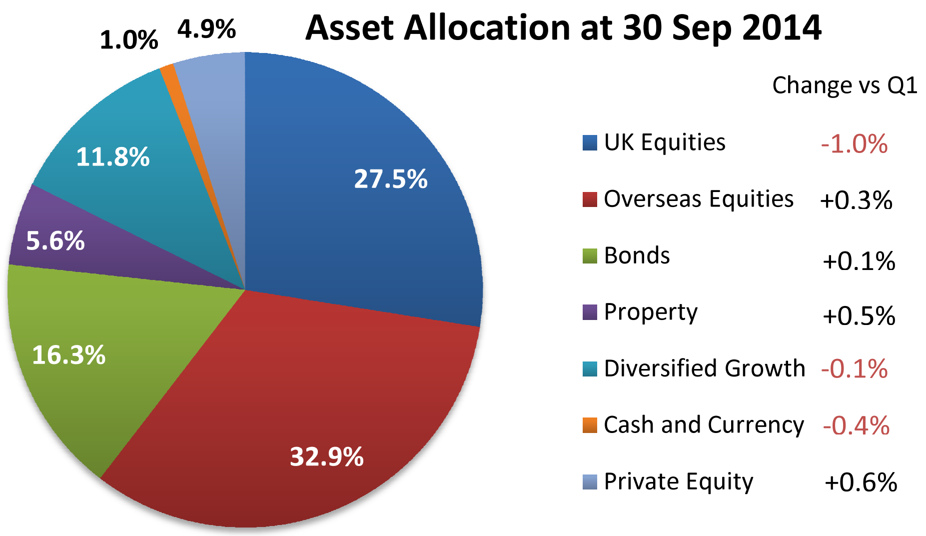
The below table shows the annualised performance by manager for the previous three years.

| Manager | Performance % | Benchmark % | Target % | Relative % |
|---|---|---|---|---|
| Total fund | 13.4 | 11.7 | 12.7 | 0.7 |
| L&G | 12.4 | 12.5 | 12.5 | -0.1 |
| Majedie | 17.5 | 13.9 | 16.4 | 1.1 |
| Mirabaud | 13.7 | 13.9 | 16.4 | -2.7 |
| UBS | 18.1 | 13.9 | 15.9 | 2.2 |
| Marathon | 17.5 | 14.3 | 16.3 | 1.2 |
| Newton | 16.3 | 14.3 | 16.3 | 0.0 |
| Western | 7.5 | 6.0 | 6.7 | 0.8 |
| CBRE | 6.8 | 8.2 | 8.7 | -1.9 |

## 4. Asset Allocation

The graph and table below summarise the asset allocation of the fund as at the 30 September 2014.



The table below compares the actual asset allocation as at 30 September 2014 against target asset weightings.

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| | TOTAL FUND | Actual | Target | Last Quarter | |
|---|---|---|---|---|---|
| | £m | % | % | £m | % |
| **Fixed Interest** | | | | | |
| UK Government | 108.7 | 3.8 | 4.6 | 105.2 | 3.7 |
| UK Non-Government | 125.2 | 4.3 | 7.1 | 122.8 | 4.3 |
| Overseas | 62.6 | 2.2 | 0.0 | 61.9 | 2.2 |
| Total Return | 70.4 | 2.4 | 2.4 | 70.6 | 2.5 |
| **Index Linked** | 104.1 | 3.6 | 3.5 | 98.0 | 3.5 |
| **Equities** | | | | | |
| UK | 795.6 | 27.5 | 27.5 | 806.5 | 28.5 |
| Overseas | 953.1 | 32.9 | 32.3 | 925.9 | 32.7 |
| **Property Unit Trusts** | 162.9 | 5.6 | 6.2 | 145.1 | 5.1 |
| **Diversified growth** | 341.4 | 11.8 | 11.4 | 335.8 | 11.9 |
| **Cash** | 33.4 | 1.2 | 0.0 | 34.0 | 1.2 |
| **Currency hedge** | -5.0 | -0.2 | 0.0 | 4.7 | 0.2 |
| **Private Equity** | 141.4 | 4.9 | 5.0 | 122.5 | 4.3 |
| **TOTAL** | **2,893.8** | **100.0** | **100.0** | **2,833.0** | **100.0** |

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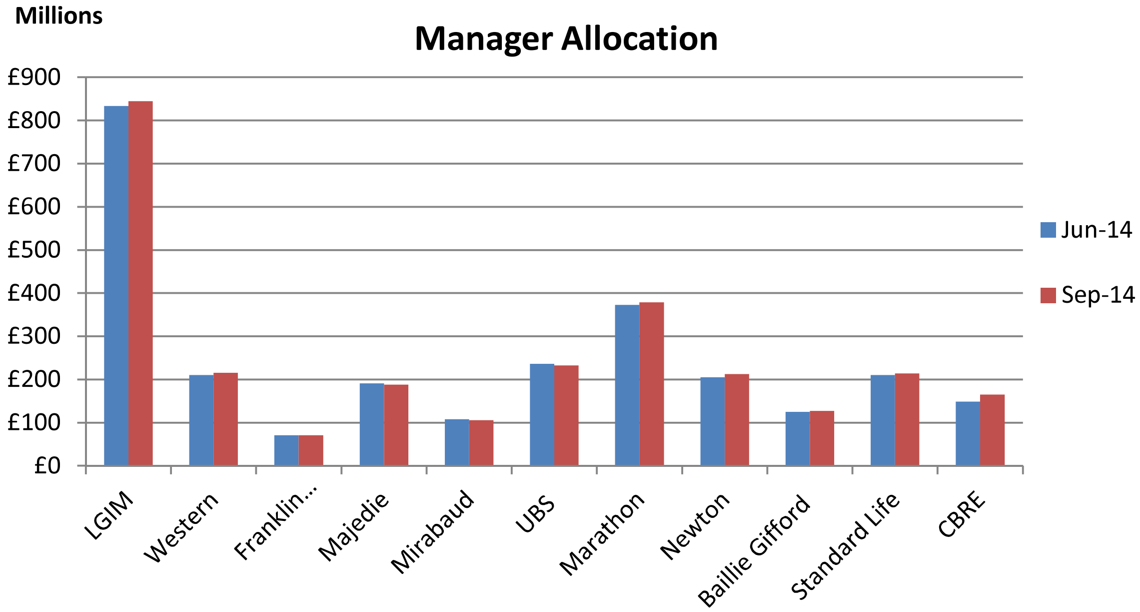
## 5. Manager Allocation

The graph below shows the current manager allocation.




The table below includes the actual and target manager allocation weightings for those investments managed through the custodian Northern Trust as at 30 September 2014. This excludes internal cash and private equity portfolio.

| Investment Manager | Asset Class | Market Value £m | Actual Allocation % | Target Allocation % |
|---|---|---|---|---|
| L&G | Multi-Asset | 844.6 | 30.9 | 31.7 |
| Western | Bonds | 215.7 | 7.8 | 8.3 |
| Franklin Templeton | Bonds | 70.4 | 2.6 | 2.6 |
| Majedie | UK Equity | 187.8 | 6.7 | 7.0 |
| Mirabaud | UK Equity | 105.9 | 3.8 | 4.0 |
| UBS | UK Equity | 232.3 | 8.4 | 8.0 |
| Marathon | Global Equity | 378.5 | 13.7 | 12.0 |
| Newton | Global Equity | 212.7 | 7.7 | 8.0 |
| Baillie Gifford | Diversified Growth | 127.4 | 4.6 | 4.0 |
| Standard Life | Diversified Growth | 214.0 | 7.8 | 8.0 |
| CBRE | Property | 165.0 | 6.0 | 6.5 |
| **TOTAL** | | **2,754.3** | **100.0** | **100.0** |

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## 6. Fees

The following table shows a breakdown of fees paid during Q2 2014/15

| Manager | Market Value 30/09/2014 £m | Manager Fee Q1 £ | Annualised Average Fee |
|---|---|---|---|
| L&G | 844.6 | 213,896 | 0.10% |
| Western | 215.7 | 122,605 | 0.23% |
| Franklin Templeton* | 70.4 | 122,659 | 0.70% |
| Majedie | 187.8 | 186,872 | 0.40% |
| Mirabaud | 105.9 | 184,357 | 0.70% |
| UBS | 232.3 | 70,782 | 0.12% |
| Marathon | 378.5 | 420,691 | 0.44% |
| Newton | 212.7 | 138,233 | 0.26% |
| Baillie Gifford* | 127.4 | 201,828 | 0.63% |
| Standard Life* | 214.0 | 376,359 | 0.70% |
| CBRE | 165.0 | 152,416 | 0.37% |
| **Total** | | **£2,190,698** | **0.32%** |

*Estimated

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## CONSULTATION:

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

## RISK MANAGEMENT AND IMPLICATIONS:

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

## FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

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

## DIRECTOR OF FINANCE COMMENTARY

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

## LEGAL IMPLICATIONS – MONITORING OFFICER

11 There are no legal implications or legislative requirements.

## EQUALITIES AND DIVERSITY

12 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

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

## WHAT HAPPENS NEXT

14 The following next steps are planned:

- Implementation of the various recommendation approvals.

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**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 30 September 2014 and 31 October 2014
2. Private Equity Cash Flow Analysis
3. Private equity analysis
4. UK Equity Manager options
5. Global Equity Manager options

**Sources/background papers:**
None

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**Annex 1**

**Asset Allocation Update**

The table shows the actual managed asset allocation as at 30 September 2014 against the target allocation. The allocation for 31 October 2014 is shown overleaf.

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| | Category | Allocation Policy % | Allocation at 30/09/2014 | Variance % |
|---|---|---|---|---|
| **Equities** | | **63.0** | **64.2** | **+1.2** |
| UK | | | | |
| *Legal and General* | *Passive* | *10.0* | *9.6* | *-0.4* |
| *Majedie* | *Concentrated Active* | *7.0* | *6.8* | *-0.2* |
| *Mirabaud* | *Concentrated Active* | *4.0* | *3.8* | *-0.2* |
| *UBS* | *Core Active* | *8.0* | *8.4* | *+0.4* |
| Overseas | | | | |
| *Legal and General* | *Passive* | *14.0* | *14.2* | *+0.2* |
| *Marathon* | *Concentrated Active* | *12.0* | *13.7* | *+1.7* |
| *Newton* | *Core Active* | *8.0* | *7.7* | *-0.3* |
| **Property** | | **6.5** | **6.0** | **-0.5** |
| *CBRE* | *Core Active* | *6.5* | *6.0* | *-0.5* |
| **Alternatives** | | **12.0** | **12.4** | **+0.4** |
| *Standard Life* | *Diversified growth* | *8.0* | *7.8* | *-0.2* |
| *Baillie Gifford* | *Diversified growth* | *4.0* | *4.6* | *+0.6* |
| **Bonds** | | **18.5** | **17.4** | **-1.1** |
| Fixed interest gilts | | | | |
| *Legal and General* | *Passive* | *2.1* | *1.6* | *-0.5* |
| *Western* | *Core Active* | *2.75* | *2.4* | *-0.4* |
| Index linked gilts | | | | |
| *Legal and General* | *Passive* | *3.7* | *3.6* | *-0.1* |
| *Western* | *Core Active* | *0.0* | *0.2* | *+0.2* |
| Corporate bonds | | | | |
| *Legal and General* | *Passive* | *1.9* | *1.8* | *-0.1* |
| *Western* | *Core Active* | *5.5* | *5.2* | *-0.3* |
| Total Return | | | | |
| *Franklin Templeton* | *Unconstrained* | *2.55* | *2.6* | *+0.1* |
| **Total** | | **100.0** | **100.0** | |

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**Asset Allocation Update**

The table shows the actual managed asset allocation as at 31 October 2014 against the policy.

| | Category | Allocation Policy % | Allocation at 31/10/2014 | Variance % |
|---|---|---|---|---|
| **Equities** | | **63.0** | **64.0** | **+1.0** |
| UK | | | | |
| *Legal and General* | *Passive* | *14.0* | *12.9* | *-1.1* |
| *Majedie* | *Concentrated Active* | *7.0* | *6.8* | *-0.2* |
| *UBS* | *Core Active* | *8.0* | *8.4* | *+0.4* |
| Overseas | | | | |
| *Legal and General* | *Passive* | *14.0* | *14.0* | *+0.0* |
| *Marathon* | *Concentrated Active* | *12.0* | *14.0* | *+2.0* |
| *Newton* | *Core Active* | *8.0* | *7.9* | *-0.1* |
| **Property** | | **6.5** | **6.1** | **-0.4** |
| *CBRE* | *Core Active* | *6.5* | *6.1* | *-0.4* |
| **Alternatives** | | **12.0** | **12.3** | **+0.3** |
| *Standard Life* | *Diversified growth* | *8.0* | *7.7* | *-0.3* |
| *Baillie Gifford* | *Diversified growth* | *4.0* | *4.6* | *+0.6* |
| **Bonds** | | **18.5** | **17.6** | **-0.9** |
| Fixed interest gilts | | | | |
| *Legal and General* | *Passive* | *2.1* | *1.6* | *-0.5* |
| *Western* | *Core Active* | *2.75* | *3.2* | *+0.4* |
| Index linked gilts | | | | |
| *Legal and General* | *Passive* | *3.7* | *3.7* | *0.0* |
| *Western* | *Core Active* | *0.0* | *0.3* | *+0.3* |
| Corporate bonds | | | | |
| *Legal and General* | *Passive* | *1.9* | *1.8* | *-0.1* |
| *Western* | *Core Active* | *5.5* | *4.5* | *-1.0* |
| Total Return | | | | |
| *Franklin Templeton* | *Unconstrained* | *2.55* | *2.5* | *0.0* |
| **Total** | | **100.0** | **100.0** | |

*Table 1* Private equity cashflow analysis - Net of all fees and expenses - For existing investments

| Financial Year | Drawdowns (Purchase) £000 | Distributions (Sales) £000 | Total (net of Purchase/Sales) £000 |
|---|---|---|---|
| 1999/2000 | -161 | 0 | -161 |
| 2000/2001 | -1,174 | 6 | -1,168 |
| 2001/2002 | -1,141 | 16 | -1,125 |
| 2002/2003 | -3,822 | 170 | -3,652 |
| 2003/2004 | -7,608 | 1,851 | -5,757 |
| 2004/2005 | -5,792 | 6,858 | 1,066 |
| 2005/2006 | -16,147 | 5,589 | -10,558 |
| 2006/2007 | -17,172 | 8,853 | -8,319 |
| 2007/2008 | -9,881 | 4,598 | -5,283 |
| 2008/2009 | -6,696 | 2,098 | -4,598 |
| 2009/2010 | -13,880 | 11,351 | -2,529 |
| 2010/2011 | -15,468 | 21,401 | 5,933 |
| 2011/2012 | -17,365 | 13,137 | -4,228 |
| 2012/2013 | -19,290 | 22,785 | 3,495 |
| 2013/2014 | -5,575 | 3,086 | -2,489 |
| Grand Total | -141,172 | 101,799 | -39,373 |

| *Table 2* | **Private Equity Portfolio** | **Public Market Equivalent (MSCI World Index)** |
|---|---|---|
| **Assessed Value as at 31 March 2014*** | **104,488** | **66,021** |
| **Calculated Internal Rate of Return (IRR)**** | **11.1%** | **5.8%** |

* The private equity assessed value is the estimated value attributed to unrealised private equity investments across the whole private equity portfolio
The public market equivalent was calculated by making a hypothetical investment into the MSCI World Index on the dates when cash drawdowns or distributions occurred.

** The IRR is a discount rate applied to the total cashflows in Table 1 as well as the final assessed value in table 2 to ensure that the net present value is zero.

These calculations are performed for each of the assessed values using the same cash in and out to get a comparison between private equity performance and public market performance.

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SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: 14 NOVEMBER 2014

LEAD OFFICER: SHEILA LITTLE, DIRECTOR OF FINANCE

SUBJECT: REVISED STATEMENT OF INVESTMENT PRINCIPLES



**SUMMARY OF ISSUE:**

With adjustments to asset allocation 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 fund. 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 changes made to the Fund's portfolio.

2 Such changes consist of the termination of Mirabaud (transfer of assets to temporary passive management) and the appointment of Legal & General to set up a LDI framework.

**Revised Statement**

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

**Monitoring and Review**

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

## CONSULTATION:

5 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:

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

7

## FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

7 There are no financial and value for money implications.

## DIRECTOR OF FINANCE COMMENTARY

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

## LEGAL IMPLICATIONS – MONITORING OFFICER

9 There are no legal implications or legislative requirements.

## EQUALITIES AND DIVERSITY

10 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

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

## WHAT HAPPENS NEXT

12 The following next steps are planned:

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

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

**Consulted:**
Pension Fund Board Chairman

**Annexes:**
Annex 1: Revised Statement of Investment Principles

**Sources/background papers:**
None

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# 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**

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.

7

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 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. 7

***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.

**Fees**

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

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

**Current Manager Structure**

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

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| | Category | Allocation Policy % | Fund % | Control Range% +/- |
|---|---|---|---|---|
| **Equities** | | | **63.0** | **+/-3.0** |
| UK | | | 29.0 | |
| *Legal and General* | *Passive* | *14.0* | | |
| *Majedie* | *Concentrated Active* | *7.0* | | |
| *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** | | | **6.5** | **+/-3.0** |
| *CBRE* | *Core Active* | 6.5 | | |
| **Alternatives** | | | ***12.0*** | **+/-3.0** |
| *Standard Life* | *Diversified growth* | *8.0* | | |
| *Baillie Gifford* | *Diversified growth* | *4.0* | | |
| **Bonds** | | | **18.5** | **+/-3.0** |
| Fixed interest gilts | | | 2.75 | |
| *Western* | *Core Active* | *2.75* | | |
| Index linked gilts | | | 5.8 | |
| *Legal and General* | *Passive* | *5.8* | | |
| Corporate bonds | | | 7.4 | |
| *Legal and General* | *Passive* | *1.9* | | |
| *Western* | *Core Active* | *5.5* | | |
| Total Return | | | *2.55* | |
| *Franklin Templeton* | *Unconstrained* | *2.55* | | |
| **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. 7

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 I | $ | 2013 | 20.0 |
| Standard Life SOF II | $ | 2014 | 20.0 |
| | | | |
| **US Fund of Funds** | | | |
| Blackrock Div PEP I | $ | 2001 | 5.0 |
| Blackrock Div PEP II | $ | 2003 | 5.0 |
| Blackrock Div EP III | $ | 2005 | 17.5 |
| GSAM PEP 2000 | $ | 2000 | 10.0 |
| GSAM PEP 2004 | $ | 2004 | 10.0 |
| GSAM PEP 2005 | $ | 2006 | 17.0 |
| GSAM PEP X | $ | 2008 | 18.0 |
| GSAM PEP XI | $ | 2011 | 18.0 |
| GSAM Vintage Fund VI | $ | 2013 | 20.0 |
| **US Funds** | | | |
| Capital Dynamics US Solar Fund | $ | 2011 | 25.0 |
| Capital Dynamics Energy/Infra | $ | 2013 | 25.0 |

## 4. Policy on Kinds of Investment

7 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:

| | | Target Allocation exc. Private Equity | Target Allocation inc. Private Equity |
|---|---|---|---|
| Bonds | | % | |
| | Gilts | 2.75 | 2.6 |
| | Corporate Bonds | 7.4 | 7.1 |
| | Index-Linked gilts | 5.8 | 5.5 |
| | Unconstrained | 2.55 | 2.4 |
| Property | | 6.5 | 6.2 |
| Total Bonds/Property | | 25.0 | 23.8 |
| | | | |
| 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 | | 12.0 | 11.4 |
| | | | |
| 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.

7

Stock lending is permitted. The Pension Fund Board approved Northern Trust's appointment to operate the Pension Fund's lending programme in order to generate an additional income stream for the Pension Fund within approved risk parameters.

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 |
| Marathon | Global Equities | MSCI AC World | +2.0% p.a. (gross of fees) over rolling 3-year periods |
| Majedie | UK Equities – Long Only<br><br>UK Equities – Directional Long/Short | FTSE All Share<br><br>FTSE All Share | +2.5% p.a. (gross of fees) over rolling 3-year periods<br>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<br>30.0%: FTSE A UK Gilts – All Stocks | +0.75% p.a. (gross of fees) over rolling 3-year periods |
| Franklin Templeton | Unconstrained Global Fixed Income | Barclays Multiverse Index | +4% to 7% p.a. (gross of fees) over rolling 3-year periods |
| LGIM | Multi-Asset Equities and Bonds<br>N - UK Equity Index<br>RX - World (ex UK) Dev Equity Index<br>HN – World Emerging Markets Equity Index<br>CN - AAA-AA-A Bonds - All Stocks Index<br><br>Index-Linked Gilts | <br>FTSE All Share<br>FTSE AW – Dev'd World (ex UK)<br>FTSW AW – All Emerging<br>Markit iBoxx GBP Non Gilts ex BBB All stock<br>Portfolio of single stock funds structured | To track the performance of the respective indices within a lower level of tracking deviation (gross of fees) over rolling 3-year periods |

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| | | | |
|---|---|---|---|
| | | by reference to Fund liabilities | |
| 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 3-year periods |
| Standard Life | Diversified Growth GARS Split 70:30 GARS:GFS | 6 month LIBOR | +5.0% p.a. (gross of fees) over rolling 3-year periods |
| Standard Life | Diversified Growth GFS Split 70:30 GARS:GFS | 6 month LIBOR | +7.5% p.a. (gross of fees) over rolling 3-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.

| 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. 7

**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.

**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
7 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

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.

7

## 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.

Annex 1

# Myners Investment Principles – Compliance Statement

## Principle 1: Effective Decision-making

Administering authorities should ensure that:

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- 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.

## 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.

7

**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.

7

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.

**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:** **14 NOVEMBER 2014**

**LEAD OFFICER:** **SHEILA LITTLE, DIRECTOR OF FINANCE**

**SUBJECT:** **CORE BELIEF STATEMENT**

**SUMMARY OF ISSUE:**

The adoption of a core belief statement is regarded as good practice for the Pension Fund.

8

**RECOMMENDATIONS:**

It is recommended that the Pension Fund Board:

1 Discuss the draft statement with a view to possible amendments and final approval of the Core Belief Statement.

**REASON FOR RECOMMENDATIONS:**

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

**DETAILS:**

**Background**

1 This Core Belief Statement (CBS) is not a statutorily required document. Adoption of such a statement is regarded as good practice.

2 This statement describes the investment philosophy of the Surrey County Council as the administering authority for the Surrey Pension Fund.

3 These investment beliefs are the basis for decisions on setting investment strategy, formulating investment agreements, and many other key investment decisions.

4 The document is a useful record for Board members and officers on how the investment strategy has developed.

5 This document complements the Statement of Investment Principles (SIP) and will be of value to scheme members, employers and investment managers who wish to understand the Fund's approach to investing.

**Draft Statement**

6 The draft Core Belief Statement (CBS) is shown as Annex 1.

**Monitoring and Review**

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

## CONSULTATION:

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

## RISK MANAGEMENT AND IMPLICATIONS:

8

9 Risk related issues contained within the draft statement (paragraphs 1.4, 2.2, 2.3, and 3.1).

## FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

10 There are no financial and value for money implications involved in the adoption of this statement.

## DIRECTOR OF FINANCE COMMENTARY

11 The Director of Finance is satisfied that CBS offers a clear philosophy structure, reflecting the investment beliefs embraced by the Pension Fund Board.

## LEGAL IMPLICATIONS – MONITORING OFFICER

12 There are no legal implications or legislative requirements.

## EQUALITIES AND DIVERSITY

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

## OTHER IMPLICATIONS

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

## WHAT HAPPENS NEXT

15 The following next steps are planned:

- Adoption of the CBS
- CBS is kept under review

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

**Consulted:**
Pension Fund Board Chairman

**Annexes:**
Annex 1: Core Belief Statement

**Sources/background papers:**
None

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**Core Belief Statement**

This is the Core Belief Statement of the Surrey Pension Fund, which is administered by Surrey County Council (“the Administering Authority”).

The objective of the Statement is to set out the Fund’s key investment beliefs. These beliefs will form the foundation of discussions, and assist decisions, regarding the structure of the Fund, strategic asset allocation and the selection of investment managers.

**1 Investment Governance**



1.1 The Fund has access to the necessary skills, expertise and resources to manage the whole Fund, as well as internally managing a small proportion of the Fund’s assets, such as private equity and cash.

1.2 Investment consultants, independent advisors and officers are a source of expertise and research to inform and assist Pension Fund Board decisions.

1.3 The Fund is continuously improving its governance structure through bespoke training in order to implement tactical views more promptly, but acknowledges that achieving optimum market timing is very difficult.

1.4 There can be a first mover advantage in asset allocation and category selection, but it is difficult to identify and exploit such opportunities, and may require the Fund to be willing to take on unconventional risk, thus requiring Board members to have a full understanding of the risk.

**2 Long Term Approach**

2.1 The strength of the employers’ covenant and the cash flow positive nature of the Fund allow a long term deficit recovery period and enable the Fund to take a longer term view of investment strategy than most investors.

2.2 The most important aspect of risk is not the volatility of returns, but the risk of absolute loss, and of not meeting the objective of facilitating low, stable contribution rates for employers.

2.3 Illiquidity and volatility are shorter term risks which offer potential sources of additional compensation to the long term investor. Moreover, it is important to avoid being a forced seller in short term market setbacks.

2.4 Participation in economic growth is a major source of long term equity return.

2.5 Over the long term, equities are expected to outperform other liquid assets, particularly government bonds and cash.

2.6 Well governed companies that manage their business in a responsible manner will produce higher returns over the long term.

8

## 3 Appropriate Investments

3.1 Allocations to asset classes other than equities and government bonds (e.g., corporate bonds, private equity and property) offer the Fund other forms of risk premia (e.g., additional solvency risk/illiquidity risk).

3.2 Diversification across asset classes and asset types that have low correlation with each other will tend to reduce the volatility of the overall Fund return.

3.3 In general, allocations to bonds are made to achieve additional diversification. When the Fund approaches full funding level, it may also use bond based strategies to mitigate liability risks and thus dampen the volatility of the Fund's actuarial funding level.

## 4 Management Strategies

4.1 Passive, index-tracker style management provides low cost exposure to equities and bonds, and is especially attractive in efficient markets.

4.2 Active managers can add value over the long term, particularly in less efficient markets, and the Fund believes that, by following a rigorous approach, it is possible to identify managers who are likely to add value.

4.3 The Fund believes that the long term case for value investing is compelling, but that it may result in prolonged periods of over and underperformance in comparison to a style neutral approach.

4.4 Active management can be expensive but can provide additional performance. Fees should be aligned to the interests of the Fund rather than performance of the market.

4.5 Active management performance should be monitored over multi-year rolling cycles and assessed to confirm that the original investment process on appointment is being delivered and that continued appointment is appropriate.

4.6 Employing a range of management styles can reduce the volatility of overall Fund returns but can also reduce long term outperformance.

**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE:** **14 NOVEMBER 2014**

**LEAD OFFICER:** **SHEILA LITTLE, DIRECTOR OF FINANCE**

**SUBJECT:** **CLASS ACTIONS**

## SUMMARY OF ISSUE:

This report outlines the possibility of procuring services surrounding US and non US Class Action monitoring and corporate litigation.

## RECOMMENDATIONS:

9

It is recommended that:

1. 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 P.A.

2. Decisions to instruct Grant and Eisenhofer P.A (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 and Democratic Services.

## REASON FOR RECOMMENDATIONS:

Compensation awarded by the courts for class actions can only be shared out amongst registered class action claimants. The sums involved for a major institutional investor can be significant. It is within the fiduciary duty of the Pension Fund Board to ensure that this compensation income stream is maximised.

## DETAILS:

### Background

1 For some years, the Surrey Pension Fund has participated in the recovery of monies in respect of US companies only, where corporate fraud and/or mismanagement has been proved to have taken place, through securities litigation in the US courts. Under US law, investors who purchased shares on US markets, can take action through the US courts to seek compensation for losses suffered in all such cases of corporate fraud. The Surrey Pension Fund has an existing contractual relationship with Barrack, Rodos & Bacine (BR&B) with regard to litigation concerning US companies.

2 Some high profile corporate frauds have received worldwide media coverage, for example, Enron and WorldCom. Investors can suffer significant financial losses as a result of fraudulent activity arising from the deliberate failure by companies to disclose information that should have been disclosed. Not all frauds, however, involve such extreme examples of misappropriation of the company's assets.

3 All investors, whether institutional or private, who have suffered losses as a result of corporate fraud can register their claim as one of the 'class' of investors who have so suffered, hence the term class action. A key difference between the US and the UK is that under US law if a class action fails, the plaintiff investor is not liable for the legal costs incurred by the defendant company.

4 Class action claims can go back over a period of many years and, provided investors register their claim within the time limits laid down by the US legal system, UK institutional investors, such as the Surrey Fund, can benefit significantly from these class actions.

5 Failure to register an interest can be costly. Compensation awarded by the courts can only be shared out amongst registered claimants. The sums involved for a major institutional investor can amount to millions of US dollars. It is the fiduciary duty for institutional investors such as LGPS funds to ensure that all possible damages due to them under class actions in the US are pursued.

**Cases Within the US**

6 The Surrey Pension Fund has an existing contractual relationship with Barrack, Rodos & Bacine (BR&B), a US law firm specialising in securities litigation. BR&B has a proprietary monitoring system which identifies all those in which there is a potential claim. It monitors the progress of all claims until final settlement, which can take several years.

7 BR&B's service takes on the workload of monitoring the Pension Fund's entitlements from US class actions and is provided by BR&B free of charge. BR&B receives payment (awarded by the court) only if they are successful, as lead counsel, in a class action suit. BR&B are a conservative law firm, only seeking to be involved with the cases most likely to result in a justifiable payment of damages. They were joint lead counsel in the Worldcom case, in which $6.13bn was recovered for investors. Many of their clients are US state pension funds and they currently have many other UK LGPS funds using the monitoring service.

8 Any investor who has suffered losses, and who purchased on a US market, can seek to be the lead plaintiff in such cases and, under US law, this right is awarded to the investor with the biggest loss amongst those seeking the role. The litigation process is very lengthy, invariably taking several years to reach a court decision or settlement out of court.

**Cases Outside the US**

9 With regard to the possibility of engaging in cases outside of the US, it should be noted that there are significant differences between the systems in the US and the UK, most notably, the legal framework for dealing with cases where investors have suffered financial losses as a result of alleged fraudulent activity by companies in which they have invested.

10 Whereas BR&B will engage in class actions with only US companies, an alternative law firm Grant & Eisenhofer P.A. (G&E) will provide services for both US and non-US class actions. Such an appointment will enable officers to consider current, prospective UK cases.

11 To secure the G&E's US and non US corporate fraud and class action monitoring service free of charge from G&E, the Surrey Pension Fund would be required to authorise the Fund's global custodian (Northern Trust) to provide G&E with access to the Fund's transaction records for previous years, records of current holdings and all future dealings. 9

12 With regards to costs in US cases, G&E will be entitled to full reimbursement of costs and expenses from any successful award of damages. This is awarded by the US court. With regard to failed cases, no costs will be borne by the Surrey Pension Fund. For non-US class actions (which includes the UK), G&E will advance all costs and expenses which are incurred in the investigation and litigation of each case where G&E and the Surrey Pension Fund have agreed to commence litigation. If there is no award by the court, the Surrey Pension Fund will have no financial obligation in connection with the prosecution of the lawsuit, nor will it incur any expenses. All costs are met by G&E.

13 It is proposed that 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 Chairman, Strategic Finance Manager and Director of Legal and Democratic Services.

**CONSULTATION:**

14 The Chairman of the Pension Fund Board has been consulted and has offered full support for the appointment of a second law firm in order to facilitate the class action process for both US and non US firms.

**RISK MANAGEMENT AND IMPLICATIONS:**

15 With regard to the risk of unanticipated costs being incurred by the Fund, officers will ensure that the legal documentation will have the necessary due diligence applied prior to the commencement of any case. The Fund will be required to be protected from any external costs connected with a case. With regard to reputation risk, each case will need to be considered on its own merits. For example, recent opportunities for the Council to engage in class actions against the Royal Bank of Scotland were considered and declined on the basis that the reputational risk associated with litigation against a recovering UK bank owned by the UK Government was too great.

## FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

16 There are no expected costs as a result of engaging in class actions against US and non US companies with BR&B and G&E.

## DIRECTOR OF FINANCE COMMENTARY

17 The Director of Finance is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that engaging in such class actions will provide the possibility of additional income to the Surrey Pension Fund, satisfying the Fund's fiduciary responsibilities.

## LEGAL IMPLICATIONS – MONITORING OFFICER

18 The Monitoring Officer notes that G&E will represent the Pension Fund in any class action case on a "no-win, no fee" basis, so no additional costs will be borne by the Fund in engaging their services. In the event that litigation is being pursued in the English Courts, G&E would need to instruct a law firm in England to conduct the matter on their behalf and again G&E would be responsible for their costs. The Monitoring officer will provide advice to the Director of Finance when making any specific decision to engage in a class action and will also assist in due diligence on agreements with G&E. The Strategic Finance Manager has advised that BR&B and G&E are the only two firms currently working in the UK LGPS sector in these types of cases.



## EQUALITIES AND DIVERSITY

19 Engaging in class actions 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:

- Due diligence on the legal agreements with G&E.
- Assessment of future class action opportunities on a case by case basis.

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

**Consulted:**
Pension Fund Board Chairman

**Annexes:**
List the annexes attached to this report.

**Sources/background papers:**
None

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**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE:** **14 NOVEMBER 2014**

**LEAD OFFICER:** **SHEILA LITTLE, DIRECTOR OF FINANCE**

**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. 10

## RECOMMENDATIONS:

It is recommended that:

1. Members assess the revised 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.

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

## CONSULTATION:

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

## RISK MANAGEMENT AND IMPLICATIONS:

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

## FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

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

## DIRECTOR OF FINANCE COMMENTARY

11 The Director of Finance 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

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

## EQUALITIES AND DIVERSITY

13 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

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

## WHAT HAPPENS NEXT

15 The following next steps are planned:

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

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

**Consulted:**
Pension Fund Board Chairman

**Annexes:**
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 | 1 | Bond yields fall leading to a increase in value of liabilities: a 0.1% reduction in the discount rate will increase the liability valuation by 2% | 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 2016 valuation. 3) Training on hedging this future cost provided to the Pension Fund Board. Current investment strategy review will address liability protection. | 4 | **48** |
| Funding | 2 | 2 | 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 | 3 | 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 | 4 | Mismatching of assets and liabilities, inappropriate long-term asset allocation or investment strategy, mistiming of investment strategy | 4 | 3 | 3 | 10 | 4 | **40** | TREAT- 1) Active investment strategy and asset allocation monitoring from Board, officers and consultants. 2) 2014/15 Investment strategy review is underway. 3) Separate source of advice from Fund's independent advisor. 4) Setting of Fund specfic benchmark relevant to the current position of fund liabilities. 5) Fund manager targets set and based on market benchmarks or absolute return measures. | 3 | **30** |
| Operational | 5 | 5 | Rise in ill health retirements impact employer organisations | 1 | 4 | 1 | 6 | 4 | **24** | TREAT- 1) Insuring against the cost and impact (approved at 14/02/14 meeting but not yet implemented). | 4 | **24** |
| Investment | 6 | 7 | Investment Managers fail to achieve performance targets over the longer term: a shortfall of 0.1% on the investment target | 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 | 2 | **24** |
| Financial | 7 | 8 | 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** |
| Operational | 8 | 9 | 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 | 9 | 10 | 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 | 3 | **21** |
| Investment | 10 | 11 | Investment markets fail to perform in line with expectations 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 equities, bonds, property funds, diversified growth funds and private equity, limiting exposure to one asset category. 2) The investment strategy is continously monitored and periodically reviewed to ensure optimal asset allocation. 3) Actuarial valuation and asset/liability study take place automatically every three years. 4) IAS19 data is received annually and provides an early warning of any potential problems. 5) The actuarial assumption regarding asset outperformance of 1.6% over gilts is regarded as achievable over the long term when | 2 | **20** |
| Funding | 11 | 12 | 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. | 2 | **18** |
| Governance | 12 | 13 | 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** |
| Funding | 13 | 14 | Structural changes in an employer's membership or an employer fully/partially closing the scheme. Employer bodies | 4 | 3 | 1 | 8 | 3 | **24** | TREAT- 1) Administering Authority actively monitors prospective changes in membership. 2) Maintain knowledge of employer future plans. 3) Contributions rates and deficit recovery periods set to reflect the strength of the employer covenant. 4) The terms of admission agreements/bonds provide for regular review of bond adequacy. 5) The Fund considers seeking a guarantor for new admitted bodies. | 2 | **16** |
| Operational | 14 | 15 | Poor data quality results in poor information and decision making | 2 | 2 | 4 | 8 | 3 | **24** | TOLERATE 1) Northern Trust provides 3rd party validation of performance and valuation data. 2) Pension Fund team and pension board members are able to integrgate data to ensure accuracy. | 2 | **16** |
| Operational | 15 | 16 | Insufficient attention to environmental, social and governance (ESG) leads to reputational damage | 1 | 1 | 3 | 5 | 4 | **20** | TREAT-1) Review SIP in relation to published best practice (e.g. Stewardship Code) 2) Ensure fund managers are encouraged to engage and to follow the requirements of the published SIP. 3) The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), which raises awareness of ESG issues and facilitates engagement with fund managers. 4) The Fund has approved a Stewardship Code and a share voting policy which provides specific guidance in the voting of company resolutions. | 3 | **15** |
| Governance | 16 | 17 | Implementation of proposed changes to the LGPS does not conform to plan or cannot be achieved within time scales | 1 | 2 | 4 | 7 | 3 | **21** | TREAT- 1) Officers consult and engage with DCLG, LGPS Advisory Board, consultants, peers, seeminars, conferences. 2) Officers engage in early planning for implemntation against agreed deadlines. | 2 | **14** |
| Operational | 17 | 18 | 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** |
| Governance | 18 | 6 | Changes to LGPS regulations | 3 | 2 | 1 | 6 | 3 | **18** | 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. | 2 | **12** |
| Governance | 19 | 19 | 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 | 20 | 20 | 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 | 21 | 21 | 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 | 22 | 22 | Procurement processes may be challenged if seen to be non-compliant with OJEU rules. Poor specifications lead to dispute. 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** |
| Governance | 23 | 23 | Failure to comply with legislative requirements e.g. SIP, FSS, Governance Policy, Freedom of Information requests | 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 | 24 | 24 | Counterparty risk within the SCC treasury management operation | 2 | 2 | 2 | 6 | 2 | **12** | TOLERATE - 1) A separate bank account exists for the pension fund 2) Lending limits with approved banks are set at prudent levels 3) The pension fund treasury management strategy is based on that of SCC. | 1 | **6** |
| Financial | 25 | 25 | 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** |
| Financial | 26 | 26 | Inaccurate cash flow forecasts or drawdown payments lead to shortfalls on cash levels and borrowing becomes necessary to ensure that funds are 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. | 1 | **4** |

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**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE:** **14 NOVEMBER 2014**

**LEAD OFFICER:** **SHEILA LITTLE, DIRECTOR OF FINANCE**

**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 to 30 September 2014 is shown as Annex 1.

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

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

## CONSULTATION:

6 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:

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

## FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

8 There are no financial and value for money implications.

## DIRECTOR OF FINANCE COMMENTARY

11

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

## LEGAL IMPLICATIONS – MONITORING OFFICER

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

## EQUALITIES AND DIVERSITY

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

## OTHER IMPLICATIONS

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

## WHAT HAPPENS NEXT

13 The following next steps are planned:

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

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

**Consulted:**
Pension Fund Board Chairman.

**Annexes:**
Annex 1: Schedule of Key Performance Indicators

**Sources/background papers:**
None

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**KPI - DETAILED ACTIONS, TIMESCALE AND REPORTING REQUIREMENTS: To 30 September 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**<br>Funding level to increase from current levels of 72% | **100%** | PT | **76.6%** | 30/09/14 | **79.8%** | 30/06/14 | -3.20% |
| 2 | PENSION ADMINISTRATION | | | | | | | |
| | **DEATH BENEFITS**<br>Notify potential beneficiary of lump sum death grant within 5 days | **95%** | JB | **100.0%** | 3 months to 30 Sep 14 | **100.0%** | 3 months to 30 June 14 | 0.00% |
| | Write to dependant and provide relevant claim form within 5 days of notification of death | **90%** | | **90.4%** | 3 months to 30 Sep 14 | **91.5%** | 3 months to 30 June 14 | -1.10% |
| | Pay death grant within 5 days of receipt of relevant documentation | **90%** | | **100.0%** | 3 months to 30 Sep 14 | **90.0%** | 3 months to 30 June 14 | 10.00% |
| | Issue notification of dependant's pension within 5 days of receipt of relevant claim forms | **90%** | | **100.0%** | 3 months to 30 Sep 14 | **90.0%** | 3 months to 30 June 14 | 10.00% |
| | **RETIREMENTS**<br>Retirement options to members within 10 days | **90%** | JB | **82.4%** | 3 months to 30 Sep 14 | **83.7%** | 3 months to 30 June 14 | -1.30% |
| | New retirement benefits processed for payment following receipt of election within 10 days | **95%** | | **98.1%** | 3 months to 30 Sep 14 | **95.7%** | 3 months to 30 June 14 | 2.40% |
| | **BENEFIT STATEMENTS**<br>ABS issued to 95% of eligible active members by 30th September | **95%** | JB | **Not achieved** | 3 months to 30 Sep 14 | **100.0%** | 3 months to 30 June 13 | |
| | DBS issued to 85% of eligible deferred members by 30th June | **95%** | | **100% issued by 30/06/14** | 3 months to 30 Sep 14 | **100% issued by 26/09/13** | 3 months to 30 June 13 | |
| | **NEW JOINERS**<br>New starters processed within 20 days | **90%** | JB | **98.8%** | 3 months to 30 Sep 14 | **98.8%** | 3 months to 30 June 14 | -0.03% |
| | **TRANSFERS IN**<br>Non LGPS transfers-in quotations processed within 20 days | **90%** | JB | **97.2%** | 3 months to 30 Sep 14 | **100.0%** | 3 months to 30 June 14 | -2.80% |
| | Non LGPS transfers-in payments processed within 20 days | **90%** | | **100.0%** | 3 months to 30 Sep 14 | **100.0%** | 3 months to 30 June 14 | 0.00% |
| | **TRANSFERS OUT**<br>Non LGPS transfers-out quotations processed within 20 days | **90%** | JB | **97.0%** | 3 months to 30 Sep 14 | **100.0%** | 3 months to 30 June 14 | -3.00% |
| | Non LGPS transfers out payments processed within 20 days | **90%** | | **100.0%** | 3 months to 30 Sep 14 | **100.0%** | 3 months to 30 June 14 | 0.00% |
| | **MATERIAL POSTED ON WEBSITE**<br>Relevant Communications Material will be posted onto website within one week of being signed off | **95%** | JB | **100%** | 3 months to 30 Sep 14 | **100%** | 3 months to 30 June 14 | |
| 3 | CUSTOMER SERVICE | | | | | | | |
| | **EMPLOYER SATISFACTION/SURVEY**<br>Overall satisfaction score for employers to be 80% | **80%** | PT/JB | **Not available** | At Sep 14 | **92%** | At May 14 | |
| | **MEMBER SATISFACTION/SURVEY**<br>Overall satisfaction score for members to be 80% | **80%** | JB | **85%** | 3 months to 30 Sep 14 | **95%** | 3 months to 31 Mar 14 | |
| 4 | INVESTMENT PERFORMANCE | | | | | | | |
| | **INVESTMENT RETURNS/OVERALL FUND PERFORMANCE**<br>Returns to at least match the benchmark | **Benchmark** | PT | **BENCHMARK 8.2%** | 12 months to 30 Sep 14 | **BENCHMARK 11.3%** | 12 months to 30 June 14 | |
| | | | | **ACTUAL 9.4%** | 12 months to 30 Sep 14 | **ACTUAL 10.6%** | 12 months to 30 June 14 | |
| 5 | DATA | | | | | | | |
| | **DATA QUALITY**<br>Data quality within the Fund should be at least 90% accurate. | **90%** | JB | **99%** | 12 months to 31 Mar 14 | **99%** | 12 months to 31 Mar 14 | |
| 6 | CONTRIBUTIONS | | | | | | | |
| | **CONTRIBUTIONS RECEIVED**<br>**Pension Fund** 98% (total value) of contributions to be received by 21st day of the ensuing period. | **98%** | PT | **98%** | Sep-14 | **98%** | Jun-14 | 0.00% |
| 7 | AUDIT | | | | | | | |
| | **CLEAN AUDIT REPORT**<br>Receive an unqualified audit opinion from the external auditors | **Clean Report** | PT/JB | **Achieved** | 12 months to 31 Mar 14 | **Achieved** | 12 months to 31 Mar 13 | |
| | Annual audit returns no significant findings | **No significant findings** | | **Achieved** | | **Achieved** | | |
| 8 | COST | | | | | | | |
| | **COST PER MEMBER**<br>Administration cost per member to remain in lowest CIPFA benchmarking quartile | **< lowest quartile** | PT/JB | **Achieved** | 12 months to 31 Mar 14 | **Achieved** | 12 months to 31 Mar 13 | |

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**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE:** **14 NOVEMBER 2014**

**LEAD OFFICER:** **SHEILA LITTLE, DIRECTOR OF FINANCE**

**SUBJECT:** **LOCAL GOVERNMENT PENSION SCHEME: DRAFT GOVERNANCE REGULATIONS**

**SUMMARY OF ISSUE:**

The report explains the planned changes to the governance of the Local Government Pension Scheme (LGPS) as a result of the Public Service Pensions Act 2013 and draft Regulations recently issued. A key requirement is for a proposed new local Pension Scrutiny Board to monitor compliance with rules and standards.

**RECOMMENDATIONS:**

It is recommended that the Pension Fund Board:

1 Note the report.

2 Note the draft response to the consultation from the Surrey Pension Fund Board with a view to recommending any additions/amendments/deletions as appropriate.

**REASON FOR RECOMMENDATIONS:**

The Pension Fund Board must be aware of all governance Regulations for the administration of the Pension Fund.

**DETAILS:**

**Background**

1 The changes introduced by the Public Service Pensions Act 2013 Act are aimed at achieving a more coherent and consistent system to provide assurance that benefits are paid, contributions are received and the Code of Practice is followed in accordance within the law and subject to good practice. The new arrangements are due to be in place by 1 April 2015.

2 The recently published draft Regulations are shown as Annex 1.

**Consultations Published by the Department**

3 In June 2014, the Department of Communities and Local Government (DCLG) issued a discussion paper on LGPS Governance and published draft Regulations on scheme governance for consultation. These draft Regulations set out the requirements to establish a Scheme Review Board and include how this body will be established and a framework for membership and role.

4 A new consultation for revised Final Regulations has been received on 10 October 2014. These draft regulations are subject to yet another consultation with a closing date of 21 November 2014. This second consultation relates to the implementation of the local Pension Board and national Scheme Advisory Board, as well as the initial consultation on the cost management provisions, including the appointment of a national scheme actuary.

5 There are changes to the latest draft and the first set that were issued in June 2014.

- The proposed restriction on elected members being employer or member representatives is to be removed. Previously, elected members (of any authority) were not permitted to sit on the local Pension Board. This will now be permissible, albeit this has been introduced with the proviso that any elected member or officer of the Administering Authority who is “responsible for the discharge” of any LGPS function cannot be a member of the new Review Board. Administering Authorities will have their own flexibility to draft the terms of reference of the new Review Board.

- The Review Board’s constitution (around voting rights, payment of expenses etc) will be left to local discretion as opposed to having to comply with the 1972 Local Government Act, and

- The Regulations’ reference to “establish” in relation to a local pension board means reporting to a council on changes to the constitution by 1 April 2015 and not a first meeting of the board by that date, or even necessarily actual appointments of anybody to that board.

6 A new provision outlines that a local Pension Board has the power to do anything which is “calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions”. This is regarded as a legal point to provide sufficient flexibility for the local Board to actually properly carry out their functions.

7 The following aspects have not been included even though they were mentioned in the initial consultation: AGMs, public equality, joint Pension Boards (i.e. cross border), knowledge and understanding for pension committees.

8 It appears that it is intended that the actual Regulations will come into force with effect from 1 January 2015. Though it is disappointing that a further consultation is required, it is understandable, given the fundamental shift in approach for elected members. There is also a draft guidance due (from the LGA), relating to these provisions that will be issued for consultation soon. Creation of the Boards is still aimed at 1 April 2015. It has been suggested that funds should be given a period of grace to fill all the positions on the board and train members.

**Consultation**

9 The Regulations are still in draft form and a draft response to the latest consultation is shown as Annex 2. The deadline for response is 21 November 2014. Any changes to the current council committee arrangements will need to be achieved by means of an amendment to the Council’s Constitution and approved by full Council before 1 April 2015.

**Next Steps**

10 A report recommending the new constitutional arrangements which need to be in place by 1 April 2015 will be taken to full Council. This will include proposals on membership of the Scrutiny Board, Terms of Reference, delegations, frequency of meetings and decision-making powers. The Pension Fund Board will be kept appraised of progress.

## CONSULTATION:

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

## RISK MANAGEMENT AND IMPLICATIONS:

12 Risk related issues are contained within the report, most notably the very short timescale between enacted Regulations and required date of implementation, official guidance that was drafted before the final Regulations have been published, and still no final Regulations yet published.

## FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

13 Financial and value for money implications will be discussed in future reports once a clear guidance has been published.

## DIRECTOR OF FINANCE COMMENTARY

14 The Director of Finance will ensure that all material, financial and business issues and possibility of risks will be considered when a report is presented to full Council.

## LEGAL IMPLICATIONS – MONITORING OFFICER

15 Legal implications or legislative requirements associated with this initiative will be addressed in the full Council report.

## EQUALITIES AND DIVERSITY

16 Equalities and diversity implications associated with this initiative will be addressed in future reports.

## OTHER IMPLICATIONS

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

## WHAT HAPPENS NEXT

18 The following next steps are planned:

- A report recommending the formation of a new Board to go to full Council.

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

**Consulted:**
Pension Fund Board Chairman

**Annexes:**
Annex 1: Second draft LGPS Governance Regulations
Annex 2: Suggested response to latest consultation process by the Surrey Pension Fund

**Sources/background papers:**
None

Department for Communities and Local Government

# The Local Government Pension Scheme (Amendment) (Governance) Regulations 2014

# Better Governance and Improved Accountability in the Local Government Pension Scheme

Consultation

October 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, complete the form at http://forms.communities.gov.uk/ or write to us at:

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October 2014

ISBN: 978-1-4098-4304-7

# The Consultation Process and How to Respond

## Scope of the consultation

| | |
|---|---|
| **Topic of this consultation:** | The Local Government Pension Scheme (Amendment) (Governance) Regulations 2014.<br><br>1. The intention of these draft regulations is to ensure that the Local Government Pension Scheme in England and Wales is managed well at both national and local levels. They also set out proposals for how the future costs of the scheme to employers and taxpayers will be controlled. Similar arrangements are being introduced for all major public service pension schemes.<br><br>2. A national scheme advisory board would advise the Department on changes to the scheme's regulations, for example to reflect changes in costs. In addition, each of the 89 administering authorities in England and Wales would establish a local pension board to assist them in managing the Scheme at a local level.<br><br>3. The Department would need to ensure that any increases or decreases in the cost of the scheme of two percentage points or more would be offset, for example, by varying the rate at which scheme members' benefits build up. This would protect employers and taxpayers against unexpected increases in pension costs.<br><br>4. In addition, the proposed national scheme advisory board would aim to ensure that the total pension contributions paid by employers and employees were within one percentage point of 19.5% of pensionable pay and that employee contributions were one third of the overall costs. The national board could make recommendations to the Department on changes to the scheme to achieve these targets.<br><br>5. A more detailed explanation of the arrangements described at paragraphs 3 and 4 above can be found at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf |
| **Scope of this consultation:** | This consultation seeks responses from interested parties on a new Part 3 (Governance) of the Local Government Pension Scheme Regulations 2013 ("the Principal 2013 Regulations") which came into force on 1 April 2014. In addition to the proposed provisions on cost control, the draft regulations at **Annex A** also includes regulations on Scheme governance that were the subject of a consultation earlier in June at |

| | |
|---|---|
| | https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/322356/consultation_letter_on_June_2014_governance_regulations_final_version-23_june_-with_ISBN.pdf .<br><br>The closing date for comments on those draft regulations was 15 August, but this consultation now provides a second opportunity to comment on those provisions alongside what is now being proposed on cost control. However, it should be noted that in the light of discussions with the shadow scheme advisory board and comments from other scheme interested parties, the draft regulations relating to the local pension boards and the Scheme Advisory Board consulted on earlier have been revised. Comments are therefore invited on the complete set of draft regulations at **Annex A**<br><br>The comments received in response to the June consultation will be taken into account with those received in response to this consultation. |
| **Geographical scope:** | England and Wales. |
| **Impact Assessment:** | These Regulations have no impact on business or the voluntary sector. |

## 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 responsible for the consultation:** | The Secretary of State for Communities and Local Government is responsible for policy and the consultation exercise. |
| **Duration:** | The consultation period will be 6 weeks ending on 21 November 2014. As timing allows, account will be taken of representations made after the close of the consultation. |
| **Compliance with "Principles of Consultation":** | This consultation complies with the "Principles of Consultation" . The consultation will be for 6 weeks. This reflects the extensive discussions already held with key interested parties on the development of policy in this area and the extent to which the regulations need to comply with Treasury directions and regulations that have already been subject to consultation. |

## Background

| | |
|---|---|
| **Getting to this stage:** | The Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission to review public service pensions and to make recommendations on how they can be made sustainable and affordable in the long term, and fair to both public sector workers and the taxpayer.<br><br>Since 1996, the cost of the Local Government Pension Scheme to employers and taxpayers has increased from £1.3 billion to £5.9 billion in 2010/11. The proposals in this consultation on scheme governance and cost management are a key element of the Government's reform agenda and will ensure that those who pay the Scheme's costs are fully protected against the rising costs associated with improving longevity. Fairness to the taxpayer is at the heart of the agenda.<br><br>The recommendations made by Lord Hutton were accepted by the Government and were carried forward into the Public Service Pensions Act 2013 ("the 2013 Act"). A key objective of the 2013 Act is to ensure a fair balance of risks between scheme members and the taxpayer. To achieve this, the Government has established an employer cost cap mechanism to provide backstop protection to the taxpayer and to ensure that the risks associated with pension provision are shared more fairly between employers and scheme members. Details of how the employer cost cap is to be calculated, maintained and the process to be followed when the employer cost cap is breached can be found at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf<br><br>In addition to making provision for the employer cost cap, the regulations also make provision for the agreement reached with the Government by the Local Government Association and local government trade unions to provide greater control over the contribution rates actually paid by employers and scheme members. Details of how this element of the proposed cost control arrangement is intended to work can be found at Chapter 5 of the above pdf document. |

# How to respond

1. You should respond to this consultation by **21 November 2014**.

2. You can respond by email to Robert.Ellis@communities.gsi.gov.uk.
When responding, please ensure you have the words "LGPS Governance Regulations 2014" in the email subject line.

Alternatively you can write to:

LGPS Governance Regulations 2014
Department for Communities and Local Government
Workforce Pay & Pensions
2nd Floor
South East Quarter
Fry Building
2 Marsham Street
LONDON SW1P 4DF

3. When responding, 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.

## Additional copies

4. This consultation paper is available on the Department for Communities and Local Government website at: https://www.gov.uk/government/organisations/department-for-communities-and-local-government

## Confidentiality and data protection

5. 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).

6. 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.

7. DCLG 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

8. Questions about any issues raised in the document can be sent to the address given at paragraph 2 above.

9. A copy of the principles on which this consultation is being conducted is at http://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

or write to:

DCLG Consultation Co-ordinator, Department for Communities and Local Government, Fry Building, 2 Marsham Street, London SW1P 4DF.

# Contents

# Chapter 1

## Introduction

1.1 This document, in accordance with section 21 of the 2013 Act, commences a period of consultation on the new governance provisions, including cost control arrangements, for the Local Government Pension Scheme. Your comments are invited on the set of draft regulations at **Annex A.**

1.2 **The closing date for responses is 21 November 2014**.

### Background and context

1.3 This consultation represents another step in the process of reform that began with the Government's commitment to review the efficiency, effectiveness and sustainability of public service pension schemes.

1.4 A key aim of the reform process is to ensure a fair balance of risks between scheme members and the taxpayer. To achieve this, section 12 of the 2013 Act requires schemes to set a rate, expressed as a percentage of pensionable earnings of members of the scheme, to be used for the purposes of measuring changes in the cost of the scheme.

1.5 The 2013 Act also provides for costs to be measured via regular actuarial valuations and for the establishment of an employer cost cap mechanism to ensure that these costs remain sustainable and fair to taxpayers. Treasury Directions and Regulations specify how valuations are to be carried out and how the employer cost cap mechanism is to operate. In the case of the Local Government Pension Scheme, the employer cost cap will be calculated by a Scheme actuary appointed by the Secretary of State under these regulations based on the 2013 model fund valuation and in accordance with Treasury Directions.

1.6 Copies of the relevant Treasury Directions, regulations and accompanying policy paper can be found at https://www.gov.uk/government/publications/public-service-pensions-actuarial-valuations-and-the-employer-cost-cap-mechanism.

1.7 In addition to the Treasury employer cost cap process, provision is also to be made for the internal cost management process agreed between Government, the Local Government Association and local government trade unions. Unlike the Treasury's employer cost cap process which will monitor changes in the value of benefits in the new Scheme over time, the aim of the internal process is to stabilise the actual contribution rates paid by employers and members in respect of the new Scheme within the overall target cost of 19.5% of pensionable paybill with the target yield from scheme members' contributions being one third of the overall cost.

1.8 A detailed explanation of how the internal element of the proposed cost control arrangement is intended to work and the role of the Local Government Pension Scheme Advisory Board in both processes can be found at Chapter 5 of the

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document at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf

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## Consultation responses

1.9 The consultation period is 6 weeks.

1.10. To allow for the fullest response to proposed Scheme regulations, every attempt will be made to include any late submissions.

1.11. Your comments should therefore be sent by 21 November 2014 to Department for Communities and Local Government, Workforce Pay & Pensions, 2nd Floor, Fry Building, South East Quarter, 2 Marsham Street, London SW1P 4DF and marked "LGPS Governance Regulations 2014". Electronic responses can be sent to Robert.Ellis@communities.gsi.gov.uk.

# Chapter 2

## Proposals for consultation

2.1. The Regulations are being made under the powers conferred by the 2013 Act. Section 3(5) of the 2013 Act requires the consent of Treasury before the Regulations can be made.

### Preliminary Provisions

2.2 **Regulation 1** covers the citation, commencement, interpretation and extent of the Regulations. The Regulations will apply to the Scheme in England and Wales and for the most part will come into operation on 1 April 2015.

2.3 **Regulations 2 to 8** amend the Principal 2013 Regulations.

2.4 **Regulation 8** inserts new regulations 105, 106,107, 108, 109, 110, 111, 112, 113, 114, 115 and 116 into the Principal 2013 Regulations. These provisions are described in detail immediately below, but in the case of regulations 105 to 113, only to the extent where they differ from the earlier consultation on Scheme governance.

### Main Provisions

2.5 **New Regulation 106(6)** has been added to ensure that local pension boards are not unduly restricted in the way they choose to discharge their functions under the regulations.

2.6. To reflect concerns expressed by the Shadow Scheme Advisory Board and other scheme interested parties, **Regulation 107** has been amended to allow elected members to become members of a local pension board. However, **Regulation 107(3)** qualifies this provision by not allowing elected members or officers of an administering authority who are responsible for the discharge of any function under the Principal 2013 Regulations (apart from being a member of the Scheme Advisory Board or a local pension board) to become a member of that authority's local pension board.

2.7. **Regulation 110(3)** now extends the responsibility of the Scheme Advisory Board to include "connected schemes". Those elements of the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 ("the Transitional Regulations")that concern members who receive entitlement to benefits calculated in accordance with those regulations is regarded as such a connected scheme and this amendment will ensure that the Scheme Advisory Board is able to advise local pension boards on both the Principal 2013 Regulations and the Transitional Regulations

2.8. **New Regulation 110(5)** confers the same wider power described at paragraph 2.5 above on the Scheme Advisory Board.

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2.9. In addition to being responsible for appointing the Chairman of the Scheme Advisory Board, **Regulation 111(1)** has now been amended to make the Secretary of State responsible for appointing members of the Board. Previously, members of the Board were to be appointed by the Chairman and approved by the Secretary of State.

2.10. **New Regulation 111(4)** allows the Chairman of the Scheme Advisory Board ,with the agreement of the Board, to appoint a maximum of three non-voting advisory members to sit on the Board. **Regulation 111(5)** confers a power for the terms and conditions of such advisory members to be determined.

2.11. **Regulation 111(6)** has been amended to the effect that the Chairman's decision to appoint non-Board members as members of any sub-committee is now subject to the agreement of the Board.

### Scheme actuary (Regulation 114)

2.12 **New Regulation 114** confers power on the Secretary of State to appoint a Scheme actuary to carry out valuations of the Scheme in accordance with Treasury Directions. The Scheme actuary must, in the opinion of the Secretary of State, be appropriately qualified to carry out a valuation of the Scheme. **Regulation 114(4)** requires administering authorities to provide the Scheme actuary with any data that is reasonably required where this is in accordance with directions made by Treasury under section 11 of the 2013 Act.

2.13. Having considered the role of the scheme actuary under **Regulations 115** and **116** and, in particular, the need for data collection and analysis at national scheme level, the Department proposes to appoint the Government Actuary's Department as the Scheme actuary under Regulation **114.** Subject to the outcome of the consultation, the appointment would be confirmed in a letter from the Secretary of State to the Government Actuary's Department.

### Employer cost cap (Regulation 115)

2.14 **New Regulation 115(1)** will set the Scheme's employer cost cap. At this stage, the employer cost cap has not been finalised but during the period of this consultation, a draft valuation report prepared by the Government Actuary's Department in accordance with the Treasury's Public Service Pensions (Valuations and Employer Cost cap) Direction 2014 will be issued to you for information. The draft report will include the proposed employer cost cap figure.

2.15.The number of assumptions underlying the calculation of the proposed employer cost cap are set out in the Treasury Direction and cannot be varied. But where appropriate, other scheme specific assumptions must be determined by the Secretary of State after consultation with such persons as he considers appropriate. In this case, consultation on the scheme specific assumptions with the shadow scheme advisory board is considered to be appropriate.

2.16. Subject to any comments on the proposed employer cost cap included in the draft valuation report and the views of the shadow board on the scheme specific assumptions, the final figure will be introduced into **Regulation 115(1)** when the regulations are made.

2.17.**Regulation 115(2)** provides that where the cost of the Scheme following a Scheme valuation under Treasury Directions exceeds the margins specified in Treasury regulations, the Secretary of State must follow the procedure set out in **Regulation 115(3)** for reaching agreement on the steps to be taken to bring costs back to the employer cost cap. At present, the margins specified in Treasury regulations are 2% either side of the Scheme's employer cost cap.

2.18.**Regulation 115(3)** sets out the procedure for reaching agreement under **Regulation 115(2).** This requires the Secretary of State to consult the Local Government Pension Scheme Advisory Board on proposals to bring the Scheme's costs back to the employer cost cap and for all members of the Board to reach an agreed position. The period of consultation is at the Secretary of State's discretion.

2.19**. Regulation 115(4)** provides that if the agreement required by **Regulation 115(3)** is not reached within 3 months of the end of the consultation period, the Secretary of State must take steps to achieve the target cost by adjusting the rate at which benefits accrue under Regulations 23(4) or (5) of the Principal 2013 Regulations.

### Scheme advisory board – additional functions (Regulation 116)

2.20. **Regulation 116(1)** requires the Local Government Pension Scheme Advisory Board to obtain a Scheme cost assessment from the Scheme actuary. The assessment must include the overall cost of the Scheme and the proportions of that cost being met by Scheme employers and members as at the date of each actuarial valuation under Regulation 62(1)(a) of the Principal 2013 Regulations.

2.21 Except where either **Regulation 115(5) and (6)** applies, **Regulation 116(2)** enables the Local Government Pension Scheme Advisory Board following a Scheme cost assessment, to make recommendations to the Secretary of State to bring the overall cost of the Scheme back to the target overall cost.

2.22. **Regulation 116(3)** provides that where the Scheme cost assessment shows that the proportion of the overall cost of the Scheme is above or below the target proportion defined at **Regulation 116(7)**, the Local Government Pension Scheme Advisory Board may make recommendations to the Secretary of State to bring that proportion back to the target proportion.

2.23. Prior to any Scheme cost assessment, **Regulation 116(4)** requires the Local Government Pension Scheme Advisory Board to publish its policy on the recommendations it may make to the Secretary of State under **Regulation 116(2) and (3)**. It is envisaged that the policy statement could include a set of trigger points as well as the circumstances when recommendations must or may be made.

2.24. **Regulation 116(5)** switches off the internal Local Government Pension Scheme Advisory Board process during any period when the employer cost cap under **Regulation 115** has been breached. This reflects Government policy that the employer cost cap process will always take precedence over any internal cost management process. **(see Chapter 3 for connected policy question)**

2.25**. Regulation 116(6)** provides that the Local Government Pension Scheme Advisory Board must make recommendations to the Secretary of State where the overall cost of the Scheme exceeds the target overall cost by 2% or more.

2.26**. Regulation 116)7)** defines certain terms used in this regulation including :-

**"the overall cost of the Scheme"** the total cost as calculated by the Scheme actuary as part of a Scheme cost assessment based on assumptions and a methodology determined by the Local Government Pension Scheme Advisory Board.

**"the target overall cost"** set at 19.5% of the pensionable earnings of members of the Scheme, and

**"the target proportion"** set at Scheme employers meeting two thirds and members meeting one third of the overall cost of the Scheme.

2.27**. Regulation 116(8)** requires each administering authority to provide the Scheme actuary with any data required to carry out valuations and produce reports for the purposes of this Regulation in accordance with directions from the Local Government Pension Scheme Advisory Board.

2.28**. Regulation 116(9)** requires the Local Government Pension Scheme Advisory Board to publish a report, including the items listed at **Regulation 116(9)(a) to (d)**, within 23 months of obtaining a Scheme cost assessment unless the Board is prevented from making recommendations to the Secretary of State by the provisions in **Regulation 116(5).**

2.29. **Regulation 116(10)** requires a copy of the report published under **Regulation 116(9)** to be sent to the Secretary of State and Scheme actuary by the Local Government Pension Scheme Advisory Board.

2.30**. Regulation 116(11)** has been amended to extend the period required for the Secretary of State to publish his response to the report published by the Local Government Pension Scheme Advisory Board from 3 to 6 months of receiving the Scheme Advisory Board's report. We believe that this represents a more appropriate timescale.

# Annex A

STATUTORY INSTRUMENTS

**2014 No. 0000**

**PUBLIC SERVICE PENSIONS, ENGLAND AND WALES**

# The Local Government Pension Scheme (Amendment) (Governance) Regulations 2014

| | |
|---|---|
| *Made - - - -* | *2014* |
| *Laid before Parliament* | *2014* |
| *Coming into force - -* | *2015* |

These Regulations are made in exercise of the powers conferred by sections 1, 3, 5(7), 7(2), 12(6) and 12(7) of, and Schedule 3 to, the Public Service Pensions Act 2013([1]).

In accordance with section 21 of that Act, the Secretary of State has consulted the representatives of such persons as appeared to the Secretary of State to be likely to be affected by these Regulations.

In accordance with section 3(5) of that Act, these Regulations are made with the consent of the Treasury.

The Secretary of State makes the following Regulations:

**Citation, interpretation, commencement and extent**

**1.**—(1) These Regulations may be cited as the Local Government Pension Scheme (Amendment) (Governance) Regulations 2014.

(2) In these Regulations "the Principal Regulations" means the Local Government Pension Scheme Regulations 2013([2]).

(3) These Regulations come in to force as follows—

(a) on 1st January 2015, this regulation and regulations 2, 7 and 8—

(i) so far as they insert regulation 105 (delegation) into the Principal Regulations,

([1]) 2013 c. 25
([2]) S.I. 2013/2356.

(ii) so far as they insert regulation 106 (local pension boards: establishment) into the Principal Regulations for the purposes of the obtaining of approval from the Secretary of State under paragraph (2) of that regulation, and

(iii) so far as they insert regulations 107 (local pensions boards: membership), 108 (local pensions boards: conflicts of interest), 110 (scheme advisory board: membership) and 111 (scheme advisory board: conflict of interest) for the purposes of appointment of members of local pension boards and the Local Government Pension Scheme Advisory Board; and

(b) on 1st April 2015—

(i) this regulation and regulations 2, 7 and 8 so far as not already commenced, and

(ii) the remainder of these Regulations.

(4) These Regulations extend to England and Wales.

**Amendment of the Local Government Pension Scheme Regulations 2013**

**2.** The Principal Regulations are amended in accordance with regulations 3 to 8.

**3.** Omit regulation 53(4) (scheme managers: establishment of pension board).

**4.** Omit regulation 63 (aggregate Scheme costs).

**5.** Omit regulation 65 (aggregate Scheme costs: revised certificates).

**6.** In regulation 66 (supply of copies of valuations, certificates etc) for "regulations 62 (actuarial valuations of pension funds), 64 (special circumstances where revised actuarial valuations and certificates must be obtained) or 65 (aggregate Scheme costs: revised certificates)" substitute "regulations 62 (actuarial valuation of pension funds) or 64 (special circumstances where revised actuarial valuations and certificates must be obtained)".

**7.** In Schedule 1 (interpretation)—

(a) after the entry for "local government service" insert—

""Local Government Pension Scheme Advisory Board" means a board established under regulation 110 (Scheme advisory board: establishment);

"local pension board" means a board established under regulation 106 (local pension boards: establishment);" and

(b) after the entry for "the Scheme" insert—

""Scheme actuary" means the actuary appointed under regulation 114 (Scheme actuary);".

**8.** After regulation 104([3]) insert—

"PART 3

Governance

**Delegation**

**105.**—(1) The Secretary of State may delegate any functions under these Regulations.

(2) Administering authorities may delegate any functions under these Regulations including this power to delegate.

([3]) Regulation 104 was inserted by S.I. 2014/1146.

### Local pension boards: establishment

**106.**—(1) Each administering authority shall no later than 1st April 2015 establish a pension board ("a local pension board") responsible for assisting it—

(a) to secure compliance with—

(i) these Regulations,

(ii) any other legislation relating to the governance and administration of the Scheme and any connected scheme, and

(iii) any requirements imposed by the Pensions Regulator in relation to the Scheme; and

(b) to ensure the effective and efficient governance and administration of the Scheme.

(2) Where the Scheme manager is a committee of a local authority the local pension board may be the same committee if approval in writing has been obtained from the Secretary of State.

(3) Approval under paragraph (2) may be given subject to such conditions as the Secretary of State thinks fit.

(4) The Secretary of State may withdraw an approval if such conditions are not met or if in the opinion of the Secretary of State it is no longer appropriate for the local pension board to be the same committee.

(5) An administering authority may determine the procedures applicable to a local pension board, including as to voting rights, the establishment of sub-committees, formation of joint committees and payment of expenses.

(6) A local pension board shall have the power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.

(7) The expenses of a local pension board are to be regarded as part of the costs of administration of the fund held by the administering authority.

### Local pension boards: membership

**107.**—(1) Subject to paragraphs (2) and (3) each administering authority shall determine—

(a) the membership of the local pension board;

(b) the manner in which members of the local pension board may be appointed and removed;

(c) the terms of appointment of members of the local pension board.

(2) A local pension board must include an equal number, which is no less than 4 in total, of employer representatives and member representatives([4]) and for these purposes the administering authority must be satisfied that—

(a) a person to be appointed as an employer representative has relevant experience and the capacity to represent employers on the local pension board; and

(b) a person to be appointed as a member representative has relevant experience and the capacity to represent members on the local pension board.

(3) No officer or elected member of an administering authority who is responsible for the discharge of any function under these regulations (apart from any function relating to local pension boards or the Local Government Pension Scheme Advisory Board) may be a member of a local pension board.

### Local pension boards: conflict of interest

**108.**—(1) Each administering authority must be satisfied that any person to be appointed as a member of a local pension board does not have a conflict of interest([5]).

(2) An administering authority must be satisfied from time to time that none of the members of a local pension board has a conflict of interest.

([4]) See section 5(6) of the Public Service Pensions Act 2013 for definitions of these terms.
([5]) See section 5(5) of the Public Service Pensions Act 2013 for the meaning of "conflict of interest".

(3) A person who is to be appointed as a member of a local pension board by an administering authority must provide that authority with such information as the authority reasonably requires for the purposes of paragraph (1).

(4) A person who is a member of a local pension board must provide the administering authority which made the appointment with such information as that authority reasonably requires for the purposes of paragraph (2).

**Local pension boards: guidance**

**109.** An administering authority must have regard to guidance issued by the Secretary of State in relation to local pension boards.

**Scheme advisory board: establishment**

**110.**—(1) A scheme advisory board ("the Local Government Pension Scheme Advisory Board") is established.

(2) The Local Government Pension Scheme Advisory Board is responsible for providing advice to the Secretary of State on the desirability of making changes to the Scheme.

(3) The Local Government Pension Scheme Advisory Board is also responsible for providing advice to administering authorities and local pension boards in relation to the effective and efficient administration and management of the Scheme and any connected scheme and their pension funds.

(4) Subject to these Regulations, the Local Government Pension Scheme Advisory Board may determine its own procedures including as to voting rights, the establishment of sub-committees, formation of joint committees and the payment of remuneration and expenses.

(5) The Local Government Pension Scheme Advisory Board shall have the power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.

**Scheme advisory board: membership**

**111.**—(1) The Local Government Pension Scheme Advisory Board is to consist of a Chairman and at least 2, and no more than 12 members appointed by the Secretary of State.

(2) When deciding whether to make appointments under paragraph (1), the Secretary of State must have regard to the desirability of there being equal representation of persons representing the interests of Scheme employers and persons representing the interests of members.

(3) A member of the Local Government Pension Scheme Advisory Board is to hold and vacate office in accordance with the terms of that member's appointment.

(4) The Chairman of the Local Government Pension Scheme Advisory Board may, with the agreement of the Board, appoint a maximum of 3 persons to be non-voting advisory members of the Board.

(5) An advisory member of the Local Government Pension Scheme Advisory Board is to hold and vacate that position in accordance with the terms of that member's appointment.

(6) The Chairman of the Local Government Pension Scheme Advisory Board may, with the agreement of the Board, appoint persons who are not members of the Local Government Pension Scheme Advisory Board to be members of sub-committees of that Board.

(7) A member of a sub-committee of the Local Government Pension Scheme Advisory Board is to hold and vacate office in accordance with the terms of that member's appointment.

### Scheme advisory board: conflict of interest

**112.**—(1) Before appointing any person to be a member of the Local Government Pension Scheme Advisory Board, the Secretary of State must be satisfied that the person does not have a conflict of interest([6]).

(2) The Secretary of State must be satisfied from time to time that none of the members of the Local Government Pension Scheme Advisory Board has a conflict of interest.

(3) A person who is to be appointed as a member of the Local Government Pension Scheme Advisory Board must provide the Secretary of State with such information as the Secretary of State reasonably requires for the purposes of paragraph (1).

(4) A person who is a member of the Local Government Pension Scheme Advisory Board must provide the Secretary of State with such information as the Secretary of State reasonably requires for the purposes of paragraph (2).

### Scheme advisory board: funding

**113.**—(1) The expenses of the Local Government Pension Scheme Advisory Board are to be treated as administration costs of the Scheme and are to be defrayed by the administering authorities within the Scheme in such proportions as are determined by the Board.

(2) The Local Government Pension Scheme Advisory Board must identify the amount to be paid by each administering authority towards its annual costs based on—

(a) its annual budget approved by the Secretary of State; and

(b) the number of persons for which the administering authority is the appropriate administering authority.

(3) An administering authority must pay the amount it is required to pay under this regulation at such time or times as the Local Government Pension Scheme Advisory Board may determine.

### Scheme actuary

**114.**—(1) The Secretary of State must appoint an actuary as Scheme actuary to carry out valuations of the Scheme in accordance with Treasury directions made under section 11 of the Public Service Pensions Act 2013([7]) (“the Treasury directions”).

(2) The person appointed as Scheme actuary under paragraph (1) must, in the opinion of the Secretary of State, be appropriately qualified to carry out a valuation of the Scheme.

(3) The Secretary of State must secure that the Scheme actuary carries out actuarial valuations of the assets and liabilities of the Scheme on the dates specified in regulation 62(1)(a) (actuarial valuations of pension funds) and prepare valuation reports in accordance with the Treasury directions, within a time-frame which enables the requirements in those directions to be met.

(4) Administering authorities must provide the Scheme actuary with any data that the Scheme actuary reasonably requires, in accordance with the Treasury directions, in order to carry out a valuation and prepare a report on the valuation.

### Employer cost cap

**115.**—(1) The employer cost cap for the Scheme is []% of pensionable earnings of members of the Scheme.

(2) Where the cost of the Scheme, calculated following a valuation in accordance with Treasury directions under section 11 of the Public Service Pensions Act 2013 is more than the margins specified in regulations made under section 12(5) of the Public Service Pensions Act 2013([8]) (“the Cost Cap

([6]) See section 7(5) of the Public Service Pensions Act 2013 for the meaning of “conflict of interest”.
([7]) 2013 c. 25.
([8]) 2013 c. 25; see regulation 3 of S.I. 2014/575.

Regulations") above or below the employer cost cap, the Secretary of State must follow the procedure specified in paragraph (3) for reaching agreement with administering authorities, employers and members (or representatives of employers and members) as to the steps required to achieve the target cost specified in the Cost Cap Regulations.

(3) The procedure specified for the purposes of section 12(6)(a) of the Public Service Pensions Act 2013 is consultation for such period as the Secretary of State considers appropriate with the Local Government Pension Scheme Advisory Board with a view to reaching an agreement endorsed by all members of that Board.

(4) If, following such consultation, agreement is not reached within 3 months of the end of the consultation period, the Secretary of State must take steps to adjust the rate at which benefits accrue under regulation 23(4) or (5) (active member's pension accounts) so that the target cost for the Scheme is achieved.

**Scheme advisory board: additional functions**

**116.**—(1) The Local Government Pension Scheme Advisory Board ("the Board") must obtain a Scheme cost assessment from the Scheme actuary detailing the overall cost of the Scheme and the proportions of that cost being met by Scheme employers and members on the dates specified in regulation 62(1)(a) (actuarial valuations of pension funds).

(2) Subject to paragraphs (5) and (6), where the overall cost of the Scheme is above or below the target overall cost, the Board may make recommendations to the Secretary of State as to the steps to take to bring the overall cost of the Scheme back to the target overall cost.

(3) Where the proportion of the overall cost of the Scheme which is met by contributions by employers is above or below the target proportion, the Board may make recommendations to the Secretary of State as to the steps to take to bring the proportion of the overall cost of the Scheme which is met by contributions by employers and members back to the target proportion.

(4) The Board must, before obtaining a Scheme cost assessment under paragraph (1), prepare and publish a statement setting out its policy concerning recommendations to the Secretary of State about he steps to be taken to bring the overall cost of the Scheme back to the target overall cost and the proportions of that cost met by Scheme employers and members, back to the target proportion.

(5) The Board must not make recommendations under paragraph (2) if steps are required to be taken under regulation 115 (employer cost cap).

(6) Subject to paragraph (5) the Board must make recommendations under paragraph (2) if the overall cost of the Scheme is above or below the target overall cost by 2% or more of pensionable earnings of members.

(7) In this regulation—

"the overall cost of the Scheme" means the total cost as calculated by the Scheme actuary as part of a Scheme cost assessment making use of the data provided under regulation 114(4) (Scheme actuary) according to such methodology and assumptions as are determined by the Board;

"the target overall cost" is 19.5% of the pensionable earnings of members of the Scheme;

"the target proportion" means Scheme employers meeting two-thirds and members meeting one-third of the overall cost of the Scheme.

(8) Each administering authority must provide the Scheme actuary with any data that the Scheme actuary requires in order to carry out any valuations and produce reports in accordance with directions from the Board for the purposes of this regulation.

(9) Unless the Board is prevented by paragraph (5) from making recommendations under this regulation, it must, within 23 months of the date on which a Scheme cost assessment is obtained under paragraph (1), publish a report setting out—

(a) the overall cost of the Scheme;

(b) the proportions of the overall costs of the Scheme met by employers and members;

(c) the assumptions and methodology used by the Scheme actuary; and

(d) any recommendations made to the Secretary of State under this regulation.

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(10) The Board must send a copy of a report published under paragraph (9) to the Secretary of State and the Scheme actuary.

(11) The Secretary of State must publish a response to a report received under paragraph (10) within six months of receipt of that report.

We consent to the making of these Regulations

*Names*
Date Two of the Lords Commissioners of Her Majesty's Treasury

Signed by authority of the Secretary of State for Communities and Local Government

*Name*
Parliamentary Under Secretary of State
Date Department for Communities and Local Government

**EXPLANATORY NOTE**

*(This note is not part of the Regulations)*

These Regulations amend the Local Government Pension Scheme Regulations 2013 ("the 2013 Regulations") to make provision in respect of governance of the Scheme.

Regulation 1 commences the substantive provisions from 1st January 2015 for the purposes of making appointments to local pension boards and the Scheme Advisory Board, and brings the provisions fully into force from 1st April 2015.

Regulations 3 to 7 make minor amendments to the 2013 Regulations consequential to the substantive provisions.

Regulation 5 inserts a new Part 3 into the 2013 Regulations.

New regulation 105 permits the Secretary of State to delegate functions under the 2013 Regulations. It permits administering authorities to delegate their functions and also for any delegated function to be sub-delegated.

New regulations 106 to 109 make provision for each administering authority to establish a local pension board to assist it to comply with its legal obligations relating to the Scheme. Where a local authority discharges its pension functions through a committee, it can, with the approval of the Secretary of State appoint that existing committee to be the local pension board. Local pension boards must have equal representation of employer representatives and member representatives who must not be officers or councillors of the administering authority responsible for the discharge of local government pension functions.

Regulations 110 to 113 establish the Local Government Pension Scheme Advisory Board to advise the Secretary of State, administering authorities and local pension boards in relation to the Scheme. Provision is made for the appointment of members to the Board and for its funding.

Regulation 114 requires the Secretary of State to appoint a Scheme actuary to carry out valuations of the Scheme.

Regulation 115 sets the employer cost cap and requires the Secretary of State to seek agreement from those affected as to the changes to the design of the Scheme necessary to bring costs back to that level if valuation reports indicate that costs have varied by more than a margin specified in regulations made by the Treasury. If agreement can not be reached the Secretary of State must make amendments to the Scheme to vary the rate of accrual of benefits to bring the costs of the Scheme back to the employer cost cap level.

Regulation 116 confers additional functions on the Local Government Pension Scheme Advisory Board to monitor the overall costs of the Scheme and the proportion of those costs met by employers and members respectively and to make recommendations to the Secretary of State for changes to the Scheme where overall costs or respective proportions met by employer or member contributions vary from the initial costs.

**Annex 2**

**LGPS Governance Draft Regulations: Further Consultation**

**Suggested Draft Response: Surrey Pension Fund Board**

**1) Local Pension Board Membership**

Previously, elected members (of any authority) were not permitted to sit on the Local Pension Board. In the latest draft Regulations, this will now be permissible, albeit introduced with the proviso that any elected member or officer of the Administering Authority who is "responsible for the discharge" of any LGPS function cannot be a member of the Board.

**Whilst Surrey does not think it necessary to have a Local Pension Board, we welcome this amendment, although this appears to leave it open for other employer or scheme member representatives who are part of the existing Pension Fund Board membership to also be on the Local Pension Board (subject to requirements such as ensuring there is no conflict of interest). Surrey feels it should be made clear that any member of the existing decision-making Pensions Board or Committee should not be able to sit on the Local Pension Board in tandem.**

**2) Local Authority Board Terms of Reference**

Administering Authorities will have their own flexibility to draft the terms of reference, rather than being required to fit within section 270 of the Local Government Act 1972.

**Surrey welcomes this flexibility.**

**3) Powers of the Local Pension Board**

The amended Regulations outline that a local Pension Board will have the power to do anything which is "calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions".

**Surrey welcomes this power which will provide flexibility for the Local Pension Board to properly carry out its functions.**

**4) Areas no longer included within the Regulations**

The following are no longer included even though they were mentioned in the initial consultation covering letter:

- AGMs
- Public equality
- Joint Pension Boards (i.e. cross border)
- Knowledge and understanding for pension committees

**Surrey welcomes this revised approach which gives individual LGPS schemes flexibility to decide itself on these various issues without an unnecessary, rigid approach prescribed by statutory instrument.**

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**5) Effective Date of the Regulations**

It appears that it is intended that the Regulations will come into force with effect from 1 January 2015 with establishment of the Local Pension Board being required by 1 April 2015.

**Surrey regards it as disappointing that this further consultation is required but concedes it is understandable, given the fundamental shift in approach for elected members. Surrey regards the establishment of the Local Pension Board as being realistic before 1 April 2015.**