Notice of Meeting

Surrey Pension Fund Committee

Date & time	Place	Contact	Chief Executive
Friday, 12 February 2016 at 9.30 am	Ashcombe Suite, County Hall, Kingston upon Thames, Surrey KT1 2DN	Democratic Services - 020 8541 9122 Room 122, County Hall Tel	David McNulty

We're on Twitter:
@SCCdemocracy

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 .

This meeting will be held in public. If you would like to attend and you have any special requirements, please contact Democratic Services - 020 8541 9122 on .

Elected Members
Ms Denise Le Gal (Chairman), Mr Alan Young (Vice-Chairman), Mr W D Barker OBE, Mr Tim Evans, Mr Stuart Selleck and Mrs Hazel Watson

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

AGENDA

1 **APOLOGIES FOR ABSENCE AND SUBSTITUTIONS**

2 **MINUTES OF THE PREVIOUS MEETING 13 NOVEMBER 2015** (Pages 1 - 20)

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 (*8 February 2016)*.
2. The deadline for public questions is seven days before the meeting (*5 February 2016)*.
3. The deadline for petitions was 14 days before the meeting, and no petitions have been received.

5 **ACTION TRACKING** (Pages 21 - 24)

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

6 **LOCAL GOVERNMENT PENSION SCHEME INVESTMENT REFORM: NATIONAL POOLING** (Pages 25 - 32)

At the summer Budget 2015, the Chancellor announced the intention to invite administering authorities to bring forward proposals for pooling Local Government Pension Scheme investments, to deliver significantly reduced costs while maintaining overall investment performance.

This report seeks the Committee's approval of recommendations, as set out in the papers.

7 **LOCAL GOVERNMENT PENSION SCHEME INVESTMENT REGULATIONS CONSULTATION** (Pages 33 - 48)

This report summarises the Government consultation on planned reforms to the Investment Regulations governing the LGPS in England and Wales.

8	**MANAGER ISSUES AND INVESTMENT PERFORMANCE** This report is a summary of all manager issues that need to be brought to the attention of the Pension Fund Committee, as well as manager investment performance.	(Pages 49 - 76)
9	**PENSION FUND BUSINESS PLAN 2016/17** The Myners Report recommended that local authority pension funds should approve an annual business plan in respect of the objectives required for the ensuing year. Business planning is regarded as an important tool, assisting in the identification of how service delivery can be maximised within resource constraints. The Pension Fund Committee is asked to consider and adopt the Business Plan included in the papers.	(Pages 77 - 88)
10	**PENSION FUND RISK REGISTER** The Committee is invited to review the risk register.	(Pages 89 - 94)
11	**CORPORATE GOVERNANCE SHARE VOTING** This report provides a summary of the Fund's share voting process in Q2 and Q3 2015/16 (1 July 2015 – 31 December 2015).	(Pages 95 - 108)
12	**KEY PERFORMANCE INDICATORS AND ADMINISTRATION UPDATE** In line with best practice, Pension Fund Committee members will be supplied with Pension Fund key performance indicators (KPIs) on a quarterly basis, covering investment and administration practices. This paper also includes an update on administration issues	(Pages 109 - 114)
13	**REVISED STATEMENT OF INVESTMENT PRINCIPLES** It is part of good governance that the Pension Fund Committee should review and approve its Statement of Investment Principles (SIP) and Core Belief Statement on a regular basis.	(Pages 115 - 134)
14	**EXCLUSION OF THE PUBLIC** **Recommendation:** That under Section 100(A) of the Local Government Act 1972, the public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information under the relevant paragraphs of Part 1 of Schedule 12A of the Act.	

PART TWO - IN PRIVATE

15	**CATEGORISING OF EMPLOYERS BY RISK AND COVENANT**	(Pages

STRENGTH 135 - 148)

The Committee are asked to consider the recommendations contained within the report.

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

16 PENSION ADMINISTRATION SYSTEM (Pages 149 - 164)

This report asks that the Committee consider recommendations relating to the pension administration database and processes.

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

PART ONE - IN PUBLIC

17 PUBLICITY FOR PART 2 ITEMS

To decide if any of the information discussed in Part 2 of the meeting should be shared with the press or public.

18 DATE OF NEXT MEETING

The next meeting of the Surrey Pension Fund Board will be on 25 February 2016.

David McNulty
Chief Executive
Published: 4 February 2016

MOBILE TECHNOLOGY AND FILMING – ACCEPTABLE USE

Those attending for the purpose of reporting on the meeting may use social media or mobile devices in silent mode to send electronic messages about the progress of the public parts of the meeting. To support this, County Hall has wifi available for visitors – please ask at reception for details.

Anyone is permitted to film, record or take photographs at council meetings. Please liaise with the council officer listed in the agenda prior to the start of the meeting so that those attending the meeting can be made aware of any filming taking place.

Use of mobile devices, including for the purpose of recording or filming a meeting, is subject to no interruptions, distractions or interference being caused to the PA or Induction Loop systems, or any general disturbance to proceedings. The Chairman may ask for mobile devices to be switched off in these circumstances.

It is requested that if you are not using your mobile device for any of the activities outlined above, it be switched off or placed in silent mode during the meeting to prevent interruptions and interference with PA and Induction Loop systems.

Thank you for your co-operation

This page is intentionally left blank

MINUTES of the meeting of the **SURREY PENSION FUND COMMITTEE** held at 9.30 am on 13 November 2015 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 Alan Young (Vice-Chairman)
* Mr W D Barker OBE
* Mr Tim Evans
* Mr Stuart Selleck
Mrs Hazel Watson

Ex officio Members:

Mr David Munro
Mrs Sally Ann B Marks, Chairman of the County Council
Mr David Hodge, Leader of the Council
Mr Peter Martin, Deputy Leader and Cabinet Member for Economic Prosperity

Co-opted Members:

* Mr Tony Elias, Borough/District Representative
* Ian Perkin, Office of the Surrey Police and Crime Commissioner
* District Councillor Peter Stanyard, Borough/District representative
Philip Walker, Employees

In attendance

Cheryl Hardman, Regulatory Committee Manager
John Harrison, Surrey Pension Fund Advisor
Nick Harrison, Chairman – Local Pension Board
Sheila Little, Director of Finance (Section 151 Officer)
Neil Mason, Senior Advisor (Pension Fund)
Alex Moylan, Senior Accountant
Phil Triggs, Strategic Finance Manager (Pension Fund & Treasury)
Steve Turner, Partner, Mercer

66/15 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]

Apologies for absence were received from Phil Walker and Hazel Watson.

67/15 MINUTES OF THE PREVIOUS MEETING: 18 SEPTEMBER 2015 [Item 2]

The Surrey Pension Fund Advisor suggested that run-off of private equity would go on for 10-15 years rather than 20-30 years.

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

68/15 DECLARATIONS OF INTEREST [Item 3]

There were no declarations of disclosable pecuniary interest.

69/15 QUESTIONS AND PETITIONS [Item 4]

A question was received from local resident, Steve McDonald. The question and response was tabled and is attached to the Minutes as **Annex 1**.

Mr McDonald asked a supplementary question related to his first question. He highlighted the contribution of burning fossil fuels on the earth's climate and the level of investment by the Local Government Pension Scheme in fossil fuels. He suggested that such investments did not fit with local government's social and environmental principles and asked that the Surrey Pension Fund Committee stop further investment in fossil fuels while starting disinvestment from fossil fuel companies.

The Chairman responded by highlighting the committee's annual review of its Responsible Investment and Stewardship Policy. She informed the meeting that the Surrey Pension Fund was a member of Local Authority Pension Fund Forum which gives local authority pension funds a collective voice and clout to negotiate and engage with companies. She noted that Shell had recently pulled out of drilling in the Arctic and suggested that this was partly due to the influence of the Forum. She asked, if the Surrey Pension Fund was to disinvest, where it should draw the line eg should transport and retail companies also be avoided. Also, if the Fund disinvests it no longer has the ability to influence or negotiate with those companies. Finally, the Chairman pointed out the Surrey Pension Fund Committee's fiduciary duty to the Fund's members.

70/15 ACTION TRACKING [Item 5]

Declarations of interest:
None

Key points raised during the discussion:

1. In relation to A5/15 (assessment one to ones), the Chairman reported that she had now met with the most recent members of the committee to discuss their assessment results.
2. In relation to A12/15 (pooling options), the Strategic Finance Manager (Pension Fund & Treasury) informed the committee that the consultation document had not yet been published but that a full report would be brought to committee in February 2016.

3. In relation to A14/15 (cash flow), the Strategic Finance Manager (Pension Fund & Treasury) stated that this was dealt with under item 6 Manager Issues and Investment Performance.
4. In relation to A15/15 (investment consultants), this would be arranged in the new year.

Actions/further information to be provided:
None.

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

71/15 MANAGER ISSUES AND INVESTMENT PERFORMANCE [Item 6]

Declarations of interest:
None

Key points raised during the discussion:
1. The Strategic Finance Manager (Pension Fund & Treasury) introduced the report, tabling the notes from the external fund manager meetings on 9 November 2015 (attached as **Annex 2** to the minutes).
2. The Senior Advisor (Pension Fund) gave a verbal summary of the meeting of the Local Pension Board on 12 October 2015.
3. In response to a question about whether there is a limit to the amount of stock lending that is allowed, the Strategic Finance Manager (Pension Fund & Treasury) confirmed that there was a limit.
4. A member of the committee enquired whether the second paragraph on Internally Managed Cash (p19) would be accurate in the long term. The Strategic Finance Manager (Pension Fund & Treasury) confirmed that the Fund would be cash positive for the next few years as it generates more cash than it pays out in benefits.
5. The Surrey Pension Fund Advisor suggested that the real yield trigger be treated as commercially sensitive in future. It was agreed that officers would consider how to take this forward **(Action Review A16/15)**.
6. The committee discussed the impact of the second Markets in Financial Instruments Directive which will reclassify all local authorities as retail clients. The Chairman confirmed that the Shadow Advisor Board was against this reclassification. Members felt it important to convey to the Financial Conduct Authority the huge administrative burden and additional cost for financial services firms and local authority pension funds. The Chairman agreed that the cost should be addressed but did not feel that too much time should be spent calculating that cost at the present time.
7. Members queried why KPMG had been appointed to look at the separation of the Pension Fund from the Host Authority. The Surrey Pension Fund Advisor explained that KPMG had been getting involved in governance related activity. The Director of Finance also highlighted KPMG's experience in auditing.

2

8. The Strategic Finance Manager (Pension Fund & Treasury) gave an update on national asset pooling and Surrey's activities. He confirmed that positive progress had been made with Cumbria and East Riding. Talks were ongoing with six other local authorities and talks with three others were in the pipeline. While the Funds were geographically distant to Surrey, they have good governance records and good relationships could be developed. A full paper and draft proposal would be brought to the committee in February 2016. Members agreed that regular private updates would be welcomed **(Action Review A17/15)**. The Chairman asked the committee for its opinions on taking on a small poorly governed Fund to help it improve and pointed out that this would not have a huge impact on overall returns. This was generally approved of and it was felt that more than one small Fund could be supported in this way. There was concern that pooling could lead to big philosophical shifts for some Funds as different Funds take different investment approaches eg some manage investments predominantly inhouse while others outsource all investment management. There was also concern that democratic accountability will be diluted with pooling. It was felt that a more informed discussion was required. The Director of Finance confirmed that an engagement plan will be developed to keep Fund members informed.
9. The committee noted the £79m increase in liabilities and discussed the options for valuing liabilities in different ways. The Senior Advisor (Pension Fund) highlighted that there are a number of different actuarial methodologies favoured by different actuarial firms. The Surrey Pension Fund Advisor and Mercer representative supported a change to using CPI+3%. It was agreed that the committee should receive a report in February 2016 outlining the CPI model, economic model and gilts model and detailing the risks and opportunities involved **(Action Review A18/15)**.
10. The Vice-Chairman highlighted the performance of Franklin Templeton and UBS and asked for some further context. The Surrey Pension Fund Advisor summarised the main points from the notes of his meetings with external fund manages **(attached at Annex 2)**. In response to a question about whether the benchmark for Franklin Templeton should be changed, the Surrey Pension Fund Advisor agreed that it could be benchmarked in a different way given its approach and expected returns but that it is a pooled fund and so the benchmark for the pooled fund has been adopted. The Chairman queried whether Western Asset Management's performance should be of concern given the upcoming transfer of assets into a multi asset credit portfolio to be managed by Western. The Surrey Pension Fund Advisor stated that the Fund should not delay the transfer but keep performance under review.

Actions/further information to be provided:

i. Officers to consider how to present the real yield trigger at future meetings of the committee.
ii. Officers to provide regular private updates to the committee on national asset pooling.
iii. Director of Finance and Strategic Finance Manager (Pension Fund & Treasury) to bring a report in February 2016 outlining the CPI model, economic model and gilts model and detailing the risk s and opportunities involved.

Resolved:
That the report was **NOTED**.

72/15 KEY PERFORMANCE INDICATORS AND ADMINISTRATION UPDATE [Item 7]

Declarations of interest:
None

Key points raised during the discussion:

1. The Senior Advisor (Pension Fund) introduced the report and highlighted deterioration across a number of administration areas. Discussions were being held with the team to check progress with actions planned to address the problems and timescales. The Service Level Agreement with Orbis was also being reviewed. The Chairman requested that someone from Pensions Administration attend committee meetings in future.

Actions/further information to be provided:
None.

Resolved:
That the report was **NOTED**.

73/15 SCHEME ADVISORY BOARD BENCHMARKING EXERCISE [Item 8]

Declarations of interest:
None

Key points raised during the discussion:

1. The Senior Advisor (Pension Fund) introduced the report and suggested that the KPIs were a useful tool to assess Funds across the Local Government Pension Scheme.

Actions/further information to be provided:
None.

Resolved:
That the report was **NOTED**.

74/15 PENSION FUND RISK REGISTER [Item 9]

Declarations of interest:
None

Key points raised during the discussion:

1. The Strategic Finance Manager (Pension Fund & Treasury) tabled an updated Risk Register (attached as **Annex 3** to the Minutes). He highlighted a new entry at number 18 ‘Failure to hold personal data securely’. This had been added following a recent Audit report of Pensions Administration which suggested this be treated as a separate risk.

2

Actions/further information to be provided:
None.

Resolved:
That the report was **NOTED**.

75/15 DATE OF NEXT MEETING [Item 10]

The date of the next meetings was NOTED and the Chairman reminded members of the committee of the AGM on 21 November 2016.

Meeting ended at: 11.35 am

____

Chairman

SURREY PENSION FUND BOARD

FRIDAY 13 NOVEMBER 2015

ITEM 4 QUESTIONS AND PETITIONS

PUBLIC QUESTIONS

(1) MR STEVE MCDONALD TO ASK:

Would the committee please confirm the current level of Surrey Pension Funds directly or indirectly made in Oil, Coal and Gas - commonly known as fossil fuels?

Reply:

The market value of directly held investments within oil, gas and coal sectors as determined by the S&P Global Industry Classification Standard as at the 30 September was £99.4m.

This page is intentionally left blank

Notes from Meetings with Fund Managers: 9 November 2015

Hosted by Baillie Gifford

Manager	Attending
Marathon	Graeme Neuff Simon Todd
Franklin Templeton	Chris Orr Stuart Lingard
UBS	Digby Armstrong Steve Magill Guy Walker
Baillie Gifford	Anthony Dickson David McIntyre

2

Marathon

Performance	Return	Benchmark	Relative
	%	%	%
Quarter	-3.2	-6.0	2.8
1 year	3.5	-0.1	3.6
3 years*	12.3	9.3	3.0
5 years*	9.8	7.3	2.5
10 years*	9.4	6.1	3.3
Since inception*	10.8	7.5	3.3

**Annualised*

1. Met with Graeme Neuff and Simon Todd.

2. Some reservations expressed about the emerging market ‘speed bumps’ and the interpretations that can be generated.

3. Marathon’s long standing scepticism about China was helpful as investor concerns about the pace of slowdown took hold over the summer. Also, the China infrastructure boom funded by long term debt.

4. The portfolio has a large overweight to safe consumer staples and is very underweight in mining, energy, construction and industrials. This benefitted both security selection and market allocation, with low exposure to emerging markets.

5. Valuation swings have been prominent, so there are increasing opportunities in emerging markets, albeit selectively. An example is the Chinese snacks business Want Want that has fallen from a Price Earnings ratio of 30x to around 17x.

6. Marathon thinks it is still too early to make a decisive move into industrials. Valuations, while lower, are not in ‘revulsion’ territory and there is scope for further disappointment on China. Once a low point is reached, there is an opportunity for a bounce back. Chinese subsidiaries of western consumer businesses are reporting flat or subject to falling demand, which is not consistent with the consensus view that economic growth is still around 6%. Despite this negative stance, Marathon thinks there are still good businesses in China.

7. Marathon is concerned about US companies using debt to finance share buy backs. Capex in US is low at around 6% of sales and debt levels are high. While corporate cash balances are high, this is largely focused on a small number of large companies, for example, Apple and Coca Cola.

8. Marathon managers are wary of companies with high debt because they are vulnerable to any loss of confidence in central bankers. Having said this, the consumer staples holdings are now much more expensive – Reckitts is an example on 26x PE with margins of 24%. Marathon is concerned about the US and UK delay in increasing interest rates and the market uncertainty that is generated being damaging to expectations. The adage that low interest rates beget low interest rates with too much debt built on that low permanence was mentioned. A consumer melt down on event the slightest increase is considered a possibility.

9. Discussions took place on VW (cars purchased with PPI payouts and consumers now on the verge of more compensation). VW is a stock that is in the European sleeve but not in the global sleeve of the portfolio. While the share price has fallen a long way, Simon is not sure that it is possible to assess the potential scale of liabilities – he believes fines in such high profile cases are levied according to ability to pay rather than damage done, so there is further downside possible in the share price. VW also has a significant exposure to Chinese markets, representing a double whammy in their current fortunes.

10. A couple of housekeeping issues were also discussed, including fee aggregation, the timing of the move to a more tax efficient fund structure and the possibility of using P-notes in India, given the holding limits for the pooled fund. Graeme was asked to provide more details about the counterparty risk aspects of P-notes and to what extent we could address the India issue within the pooled fund constraints.

Advisor view: another very strong period of performance supported by clear and insightful investment thinking. Marathon remains a core investment capability.

2

Franklin Templeton

Performance	Return	Benchmark	Relative
	%	%	%
Quarter	-6.9	0.5	-7.4
1 year	-8.8	-3.6	-5.2
Since inception*	-1.8	-1	-0.8
Capability:			
*3 years**	*1.5*	*-1.5*	*3.0*
*5 years**	*4.2*	*1*	*3.2*

*Annualised

1. Met with Chris Orr and Stuart Lingard.

2. Franklin Templeton has suffered large outflows from its retail products and there has also been some loss of investment professionals. The team confirmed that the institutional client base for the Global Macro fund has seen minimal net outflows in 2015 to the end of September 2015 (10 new clients and 14 losses with net outflow of less than $20m) and that the asset base is close to $100bn. There have been no changes in the investment team in 2014 or 2015.

3. Performance was very poor in the quarter to end September 2015, but has improved since then, with a return of 3.9% in October (versus a benchmark of 0.4%) and further gains in the first few days in November. The since inception performance for Surrey to end October 2015 would be about 0.5% per annum, ahead of the benchmark.

4. The portfolio is positioned for rising US interest rates and is to be very different from the benchmark, with a negative correlation to US Treasuries and large exposures to EM bonds. These were both significant detractors in the latest quarter to September 2015.

5. Credit views were positive (+0.8%), but offset by country (-2.7%) and especially by currency (-5.6%). Within emerging markets, the biggest hits were from currencies exposed to China (South Korea, Malaysia) or oil (Mexico, Brazil). The main positives were a short position in Australian dollars (a hedge on China) and the refinancing of Ukrainian bonds. The Ukrainian holdings are now trading above cost despite the haircut on refinancing.

6. Franklin's core views remain the same – that US interest rates will rise in December 2015 as wage pressures increase and the strength of the US economy and the US consumer continue apace; China will experience a soft landing (with consumer/service sectors offsetting weak industrial sectors) and world economic growth will be about 3% pa. FT regards the Chinese devaluation as having made sense and a sensible move, despite the poor communications and poor implementation. The Chinese stock correction was marked but should be taken in the context of previous growth.

7. On this basis, they believe US Treasuries are highly overvalued. FT regards the Federal Reserve as remaining very aware of global events. Could EM economies could be a disaster area when the US raises its rates? Possibly, but places like Mexico will continue to supply export markets. They regard it as being hard to argue against the future strength of the US dollar.

2

8. The Franklin portfolio has virtually no duration (0.1 years) and a very short profile to maturity (average 2.8 years). This is regarded as a defensive stance. They hold very little in US or Euro bonds and no Japanese government bonds. The currency positions are also hugely short in terms of Euro (-48%) and Yen (-30%), with long positions in Mexico (+19%) and the Korean Won (+18%). Ukraine debt is still holding a profitable position.

9. With regard to Brazil, reforms will worsen the recession in the short term, but things look favourable over the long term.

Advisor view: FT takes huge views relative to the index so relative returns will often be very different each quarter or year. While the latest quarter is clearly disappointing, it is still too early to judge the manager properly. The encouraging aspects are that they are sticking to their views and that the team is stable. Nonetheless, we should remember that this fund will not behave like any of our other bond mandates. It would suffer hugely if a collapse in China prompted a global deflation crisis, but should deliver good returns if the world economy continues to muddle through. As a result it is a diversifying growth asset not a defensive matching asset.

2

UBS

Performance	Return	Benchmark	Relative
	%	%	%
Quarter	-8.4	-5.7	-2.7
1 year	-4.8	-2.3	-2.5
3 years*	**9.7**	**7.2**	**2.5**
5 years*	8.2	6.7	1.5
Since inception*	6.7	5.5	1.2

**Annualised*

1. Met with Digby Armstrong, Steve Magill and Guy Walker.

2. The retirement of Richard West and the new arrival of Guy Walker have not resulted in any changes to the client base for the UK Value product. Indeed, it has been upgraded to 'buy' by Mercer, although there is little demand for new UK equity mandates. The UBS team regard Guy as having made a good start since Richard's departure.

3. Different value indices all show substantial headwinds for the style since early 2014, with a large fall over the summer. Value indices are overweight in mining, oil and banks, so they were heavily hit by weaker commodity prices and concerns about China. The portfolio was also affected by the mining section downturn.

4. The performance shortfall of 2.7% in the quarter is large, but not unprecedented for this product. Roughly half of the shortfall came from strong performance from stocks not held, such as SAB Miller that was the subject of a takeover bid. Active risk is regarded as having risen over the year with a medium risk stance now being taken.

5. Historically, M&A activity tends to benefit the value style, but this is not the case at present because most M&A is in 'safe' sectors that are already expensive.

6. Valuation remains the key focus for stock selection. The Value Team does not interact with the wider analyst team at UBS.

7. During the quarter the fund added to mining stocks, which now trade at a low price relative to tangible assets or sustainable return on capital. The fund introduced Glencore during the quarter as its price fell from 250p to a low of 70p. The average purchase price was 114p with many small purchases undertaken during the quarter. The market perception of risk and low price has allowed aggressive buying to take place. Industrial stocks contributed significantly over the quarter and consumer stocks detracted from performance.

8. The advisor asked about stocks where the team had changed its view. An example is Standard Chartered where the initial expectation for a management turnaround was undermined by deteriorating trading conditions in Asia. The position was sold at a loss when the fund bought HSBC. The team is currently debating whether or not to switch back into Standard Chartered following a substantial share price fall. There is a compelling case to return but a clear out at the bank and further price fall could still happen.

9. The team took positions in Serco Group with a new management team in place. The shares were lowly valued with the company looking good with prospects for major improvement.

2

10. The portfolio will remain overweight with oil/gas, industrials and financials. The portfolio still has a very strong value bias and the team are very happy with the new working arrangements.

Advisor view: Value is a cyclical style that has a good long-term track record but with a lot of bumps along the way. When investors change from being relaxed to being worried, as they have this year, it is usual for value stocks to suffer. As those fears recede, value stocks should tend to do well.

2

Western Asset Management

1. Met with Anthony Dickson and David McIntyre.

Performance	**Return**	**Benchmark**	**Relative**
	%	%	%
Quarter	-2.1	0.1	-2.2
1 year	1.6	0.5	1.1
3 years*	**4.5**	**0.5**	**4.0**
Since inception*	5.8	0.5	5.3

Annualised

2. Following Mike Brooks's departure, the Diversified Growth team has added a new analyst (Scott Lothian) and Felix Amoako has been appointed a Fund Manager.

3. Performance is regarding as having fallen away over the last quarter.

4. The long term capital market assumptions have been reduced to reflect lower expected 'normal' interest rates at 2.25% nominal over the next 10 years. This, in turn, reflects lower structural productivity growth, demographic headwinds in developed economies and the high starting debt burden. The implication is that equities will probably trend to 6% per annum rather than 8% per annum.

5. The last 12 months have been disappointing, with emerging market exposure undermining positive contributions from currency, absolute return and property. EM markets are weak as the market reassessed future growth prospects under the threat of increased US interest rates. However, EM markets are still favoured in the long term, given the advantages of demographic profile and the potential growth from infrastructure improvements. Also, whilst the level of EM debt is lower, growth prospects are higher than developed markets.

6. However, some emerging economies will fail despite having the right ingredients, largely because the political structures are inefficient. Brazil is an example. Mexico, by contrast, is progressing well, although it has been hit just as hard in the recent sell off. In part, this is due to liquidity factors. Mexico has a more liquid bond market, so it tends to suffer when investors want to reduce EM exposure across the board. Mexico's structural reforms provide a clear sense that things are starting to get better.

7. While positive on EM generally, BG are wary of China. The transition of such a large economy from industrial to consumer/services driven seems implausible without a financial crisis along the way, but the economic/investment data is too opaque to be sure what is actually happening. While such an outcome would be damaging, they would expect some offsets through short positions in Australian and NZ dollars. They would also expect the trend following absolute return funds to perform well.

8. Recent valuation swings make listed equities and high yield more attractive relative to senior secured assets. Similarly, the reduced expectations for cash returns make real assets with low nominal returns (property and infrastructure) more interesting.

9. Insurance linked continues to be wound down, with the exposure likely to fall from 4% to below 2% early next year following renewals. Capital flows into this market have forced renewal rates too low. In particular, they highlighted US retail demand, with one firm apparently now accounting for over 10% of the ILS market and needing to bid aggressively for every new issue to satisfy fund flows.

10. The new Diversified Growth fund is still in the pipeline, but will launch soon. It is designed for the DC market, so has a lower fee charge and makes less use of external or illiquid capabilities.

11. The advisor asked if there were any regrets in the quarter. With hindsight, BG would have chosen to hedge EM currencies. The portfolio suffered for this.

12. With regard to the worst future scenarios, deflation and a China collapse remain high on the possible damage radar. If such a collapse took place, high rated sovereign gilts would be a safe haven to turn to. Currently, Brazilian bonds are very cheap but BG are unsure if they might go cheaper still.

Advisor view: it has been a difficult year for Diversified Growth funds generally and Baillie Gifford has performed broadly in line with others. The fund continues to provide exposure to a range of interesting asset classes and an attractive mix of consistent, risk adjusted returns in the long term.

This page is intentionally left blank

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) Liability driven investment strategy implementation designed to hedge against future risk approved by Pension Fund Board on 13 February 2015. Future trigger points for leverage will provide liability protection against interest rate risk with the full protection framework in place. Once leverage commences, this will reduce the net score arising from mitigating actions.	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 within a liability driven investment portfolio to mitigate risk. 4) Liability driven investment strategy implementation designed to hedge against future risk approved by Pension Fund Board on 13 February 2015. Future trigger points for leverage will provide liability protection against inflation risk with the full protection framework in place. Once leverage commences, this will reduce the net score arising from mitigating actions.	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 and postcode 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) 2015/16 Investment strategy review is current. 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. Overall investment benchmark and out-performance target is fund specific.	3	30
Operational	5	5	Rise in ill health retirements impact employer organisations	1	4	1	6	4	24	TREAT- 1) Possibility of insuring against the cost and impact previously considered and deferred.	4	24
Investment	6	6	Investment Managers fail to achieve performance targets over the longer term: a shortfall of 0.1% on the investment target will result in an annual impact of £2.6m	4	4	4	12	3	36	TREAT- 1) The Investment Management Agreements clearly state SCC's expectations in terms of performance targets. 2) Investment manager performance is reviewed on a quarterly basis. 3) The Pension Fund Board should be positioned to move quickly if it is felt that targets will not be met. 4) Having LGIM as a rebalancing/transition manager facilitates quick changes. 5) The Fund's investment management structure is highly diversified, which lessens the impact of manager risk compared with less diversified structures.	2	24
Financial	7	7	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	8	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
Investment	9	9	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 compared with historical data.	2	20
Funding	10	10	Structural changes in an employer's membership or an employer fully/partially closing the scheme. Employer bodies transferring out of the pension fund or employer bodies closing to new membership. An employer ceases to exist with insufficient funding or adequacy of bond	3	4	3	10	3	30	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) Periodic reviews of the covenant strength of employers are undertaken and indemnity applied where appropriate.	2	20
Funding	11	11	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 appropriate with stabilisation and phasing in processes.	2	18
Governance	12	12	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
Investment	13	13	Volatility caused by uncertainty with regard to the possible withdrawal of the UK from the European Union	3	3	2	8	3	24	TREAT- 1) Officers to consult and engage with advisors. 2) Possibility of looking at move from UK to global benchmarks on UK Equities and UK Property. 3) Possibility of further hedging of currency movements against Sterling.	2	16
Operational	14	14	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	15	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	16	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	17	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
Operational	18	New Entry	Failure to hold personal data securely	1	1	4	6	3	18	TREAT- 1) Data encryption technology is in place, which allow secure the sending of data to external service providers. 2) Phasing out of holding records via paper files. 3) Pensions Admin records are locked daily in a secure safe. 4) SCC IT data security policy adhered to.	2	12
Funding	19	18	Impact of government policy on the employer workforce	3	2	1	6	3	18	TREAT- 1) Hymans Robertson use prudent assumptions on future of workforce. Employers to flag up potential for major bulk transfers. The potential for a significant reduction in the workforce as a result of the pressures that the public sector is under may have an additional impact on the Fund. 2) Need to make worst case assumptions about diminishing workforce when carrying out the actuarial valuation.	2	12
Governance	20	19	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	21	20	Change in membership of Pension Fund Committee leads to dilution of member knowledge and understanding	4	1	1	6	4	24	TREAT- 1) Succession planning process to be implemented. 2) Ongoing training of Pension Fund Board members. 3) Pension Fund Board new member induction programme. 4) Training to be based on the requirements of CIPFA Knowledge and Skills Framework and the results of the test undertaken in 2012. New Board members to take the test.	2	12
Operational	22	21	Inaccurate information in public domain leads to damage to reputation and loss of confidence	1	1	4	6	3	18	TOLERATE- 1) Ensure that all requests for information (Freedom of Information, Member & Public questions at Council, etc) are managed appropriately and that Part 2 items remain so. 2) Maintain constructive relationships with employing bodies to ensure that news is well managed.	2	12
Operational	23	22	Financial failure of third party supplier results in service impairment and financial loss	2	2	2	6	3	18	TOLERATE-1) Performance of third parties (other than fund managers) monitored. 2) Review of Northern Trust took place in January 2009, ahead of decision on whether to retain (Jan 2009) - a fee reduction was secured in 2011). 3) Actuarial and investment consultancies are provided by two different providers.	2	12
Operational	24	23	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	25	24	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
Governance	26	25	Failure to comply with recommendations from the local pension board, resulting in the matter being escalated to the scheme advisory board and/or the pensions regulator	1	1	4	6	1	6	TOLERATE -1) Ensure that an cooperative, effective and transparent dialogue exists between the pension committee and local pension board	1	6
Financial	27	26	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	28	27	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	29	28	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

2

This page is intentionally left blank

SURREY
COUNTY COUNCIL

Surrey Pension Fund Board
12 February 2016

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).

REPORT CONTACT: Democratic Services
020 85419 122

Sources/background papers: None

Surrey Pension Fund Committee – ACTION TRACKING

ACTIONS

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action by when	Action update
A12/15	18 Sept 15	Chancellor's Budget: Update	That officers undertake further investigation into the options set out in the report, with option 7 being the preferred option, and bring a report back in November 2015.	Strategic Manager, Pension Fund & Treasury	November 2015	A letter detailing progress was circulated on 29 October and a report would be brought to committee in February 2016.
A15/15	18 Sept 15	Pension Fund Cost Base: Deep Dive Review	A shortlist of investment consultants would be brought to committee in due course at a special meeting.	Strategic Manager, Pension Fund & Treasury	February 2016	To be arranged in the new year.
A16/15	13 Nov 15	Manager Issues and Investment Performance	Officers to consider how to present the real yield trigger at future meetings of the committee.	Strategic Manager, Pension Fund & Treasury/Regulatory Committee Manager	February 2016	An update to be provided at the meeting on 12 February 2016.
A17/15	13 Nov 15	Manager Issues and Investment Performance	Officers to provide regular private updates to the committee on national asset pooling.	Strategic Manager, Pension Fund & Treasury	February 2016	As above
A18/15	13 Nov 15	Manager Issues and Investment Performance	Director of Finance and Strategic Finance Manager (Pension Fund & Treasury) to bring a report in February 2016 outlining the CPI model, economic model and gilts model and detailing the risk s and opportunities involved.	Director of Finance, Strategic Manager, Pension Fund & Treasury	February 2016	As above.

Surrey Pension Fund Committee – ACTION TRACKING

COMPLETED ACTIONS

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action by when	Action update
A5/15	13 Feb 15	Manager Issues and Investment Performance	The Chairman to hold one to ones with Board members to discuss the assessment results.	Chairman	November 2015	On 13 November the Chairman confirmed that she had held all one to ones with Committee members.
A14/15	18 Sept 15	Manager Issues and Investment Performance	Information provided by CBRE on cash flow to be circulated to the committee.	Strategic Manager, Pension Fund & Treasury	November 2015	This was shared on 13 November 2015.

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **12 FEBRUARY 2016**

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

SUBJECT: **LGPS INVESTMENT REFORM: NATIONAL POOLING**

SUMMARY OF ISSUE:

At the summer Budget 2015, the Chancellor announced the intention to invite administering authorities to bring forward proposals for pooling Local Government Pension Scheme investments, to deliver significantly reduced costs while maintaining overall investment performance.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Committee approve and adopt the attached proposal to government reference the Border to Coast Pensions Partnership, shown in Annex 1 (not included within committee papers, to be issued before the meeting).

2 The Pension Fund Committee approve an initial £50,000 for consultancy and advisory costs.

REASON FOR RECOMMENDATIONS:

A national asset pooling proposal is invited by government by 19 February 2016.

DETAILS:

Background

1 Authorities are being asked to create up to national asset pools, each with at least £25bn of LGPS scheme assets in order to reduce investment costs and enable the authorities to develop more capacity and capability to become leaders in infrastructure investment. Authorities have been asked to consider who they will work with and how best to achieve the benefits of scale.

Chancellor's Intention

2 In the July 2015 Budget, the Chancellor announced the Government's intention to work with LGPS administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. Authorities are invited to submit proposals for pooling which the Government will assess against the criteria. The Chancellor has announced that the pools should take the form of up to six British Wealth Funds, each with

assets of at least £25bn, which are able to invest in infrastructure and drive local growth.

Deadline for response

3 Authorities are asked to submit their initial (brief and broad based) proposals based on four criteria (as set out in paragraphs 5 onwards) to the Government by 19 February 2016. Submissions should include a commitment to pooling and a brief description of their progress towards formalising their arrangements with other authorities. Authorities can choose whether to make individual or joint submissions, or both, at this first stage. Government will then feed back on the suitability of the initial submission.

4 Given the acceptability of the initial submission, the Government has stipulated that it requires refined, costed and complete submissions by 15 July 2016, which fully address the criteria in this document, and provide any further information that would be helpful in evaluating the proposals. At this second stage, the submissions should comprise:

a) for each pool, a joint proposal from participating authorities setting out the pooling arrangement in detail. For example, this may cover the governance structures, decision-making processes and implementation timetable; and
b) for each authority, an individual return detailing the authority's commitment to, and expectations of, the pool(s). This should include their profile of costs and savings, the transition profile for their assets, and the rationale for any assets they intend to hold outside of the pools in the long term.

Government criteria

5 The following criteria set out how administering authorities can deliver against the Government's expectations of pooling assets. It will be for authorities to suggest how their pooling arrangements will be constituted and will operate. In developing proposals, they should have regard to each of the four criteria, which are designed to be read in conjunction with the supporting guidance that follows. The submissions should describe:

A. Asset pools that achieve the benefits of scale

6 The 89 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported. Authorities should explain:

a) The size of their pool(s) once fully operational.
b) In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
c) The type of pool(s) they are participating in, including the legal structure if relevant.
d) How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.

e) The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

B. Strong governance and decision making

7 The proposed governance structure for the pools should:

a) At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
b) At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

8 Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability. Authorities should explain:

a) The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
b) The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
c) Decision making procedures at all stages of investment, and the rationale underpinning this.
d) The shared objectives for the pool(s), and any policies that are to be agreed between participants.
e) The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
f) How any environmental, social and corporate governance policies will be handled by the pool(s).
g) How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
h) How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
i) The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

C. Reduced costs and excellent value for money

9 In addition to the fees paid for investment, there are investment related costs within some asset structures that are difficult to ascertain and so are not reported in pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.

6

10 Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

11 As part of their proposals, authorities should provide:

a) A fully transparent assessment of investment costs and fees as at 31 March 2013.
b) A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
c) A detailed estimate of savings over the next 15 years.
d) A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
e) A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

D. An improved capacity to invest in infrastructure

12 Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class. Authorities should explain:

a) The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
b) How they might develop or acquire the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than an existing fund, or "fund of funds" arrangements.
c) The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

Current pooling options being considered

13 The following pooling options have emerged and currently total more than the six pools that the Government intends to create.

14 **London CIV:** This is already established and has 32 of the 33 London Borough funds signed up to use it. Potential assets to pool total £24bn.

15 **Northern Powerhouse:** This is dominated by the large metropolitan funds including the Greater Manchester, Merseyside and West Yorkshire Pension Funds. This would create a pool of £42bn and would include a large proportion of internal management.

16 **Central:** This is dominated by the West Midlands Pension Fund (with internal management) plus seven other county funds. Part of this group recently completed a joint procurement for passive management. This would create a pool of around £35bn.

17 **Access Group:** Access stands for "A Collective of Central, Eastern and Southern Shires". The group is on target to create a pool of around £25bn.

18 **South West Brunel Group:** These are regionally located and like-minded funds working together in the south west. This would create a pool of around £35bn.

19 **Lancashire/LPFA:** These are two very strong founder members but, to date, no further additional joining funds. The pool size is currently in the range of £10bn.

20. **Wales:** This is currently planning a Collective Investment Vehicle similar to London with assets of around £15bn.

21 **Border to Coast Pensions Partnership:** As discussed at the committee meeting of 13 November 2015, this is a geographically dispersed pool, including Surrey, East Riding and Cumbria, Lincolnshire, Warwickshire, North Yorkshire, South Yorkshire, Tyne and Wear, Durham and Northumberland. The pool size is currently £28bn with two other funds considering joining.

Cost implications

22 The creation of any pool will incur set up costs, along with a requirement for officer time and member support. It is too early to be more precise until the structural decisions about how the pool is created are agreed. It is recommended that the pension fund committee approve an initial £50,000 for consultancy and advisory costs. All costs will be distributed to all partnership funds on an equitable share of costs per fund.

Surrey's Approach

23 As a founding member of the Border to Coast pool, the committee is asked to endorse the decisions to work with the group to achieve the best outcome of pooling for the Surrey Fund. Authorities are invited to submit a proposal (from their pooled group) to Government by 19 February 2016. The Border to Coast proposal will be shown as Annex 1 to this report.

CONSULTATION:

24 The Chairman of the Pension Fund Board has been consulted on the Border to Coast pooling initiative and has offered full support for the proposals and the document to be presented to government.

RISK MANAGEMENT AND IMPLICATIONS:

25 Risk related issues are contained within the report's annex (the proposal to government).

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

26 Financial implications are contained within the cost base of the proposal to government.

DIRECTOR OF FINANCE COMMENTARY

27 Initial financial implications will be set out in Annex 1 and full details will be developed ahead of the detailed proposals required by 15 July 2016.

LEGAL IMPLICATIONS – MONITORING OFFICER

28 Legal implications will be discussed with the report that submits the Fund's final proposal later this year.

EQUALITIES AND DIVERSITY

29 An equality/diversity analysis will not be required as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT:

31 The following next steps are planned:

- Delivery of the Border to Coast initial proposal to Government by 19 February 2016.
- It is expected that Government will let asset pools know of the suitability (or otherwise) of their initial proposals.
- Developments will be discussed at future pension fund committee meetings.
- Delivery of the Border to Coast final proposal to Government by 15 July 2016
- Envisaged delivery of the implemented national pool by mid 2018.

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

Consulted:
Pension Fund Board Chairman

Annexes:
Annex 1: Proposal to government

Sources/background papers:
None

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **12 FEBRUARY 2016**

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

SUBJECT: **LGPS INVESTMENT REGULATIONS: CONSULTATION**

SUMMARY OF ISSUE:

The Government is seeking consultation on planned reforms to the Investment Regulations governing the LGPS in England and Wales.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Committee approve and agree the attached response to government, shown in Annex 2.

REASON FOR RECOMMENDATIONS:

To assist the Department of Communities and Local Government in the drafting of an appropriate set of Investment Regulations.

DETAILS:

Background

1 The Government is seeking consultation on planned reforms to the Investment Regulation governing the LGPS in England and Wales by 19 February 2016.

2 The draft Regulations are shown as Annex 1.

Consultation Process

3 This consultation proposes to revoke and replace the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 with the reformed regulations as described in this paper. There are two main areas of reform:

- A package of reforms that propose to remove some of the existing prescribed means of securing a diversified investment strategy and instead place the onus on authorities to determine the balance of their investments and approach to risk.

- The introduction of safeguards to ensure that the more flexible legislation proposed is used appropriately and that the guidance on pooling assets is adhered to. This includes a suggested power to allow the Secretary of State to intervene in the investment function of an administering authority when necessary.

4 Views are sought on:

- Whether the proposed revisions to the investment regulations will give authorities the flexibility to determine a suitable investment strategy that appropriately takes account of risk.

- Whether the proposals to introduce the power of intervention as a safeguard will enable the Secretary of State to intervene, when appropriate, to ensure that authorities take advantage of the benefits of scale offered by pooling and thus deliver investment strategies that adhere to regulation and guidance.

5 A draft response is attached at Annex 2 and with the deadline set by the Department for 19th February 2016.

CONSULTATION:

6 The Chairman of the Pension Fund Board has been consulted on the draft Regulations and the proposed response and has offered full support.

RISK MANAGEMENT AND IMPLICATIONS:

7 Risk related issues within the parameters of the proposed prudential approach to investment with no regulatory constraints, and the government holding too much power to intervene in local authority investment decisions are contained within the Council's official response in Annex 2.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

8 Financial implications within the parameters of possible cost to a local authority resulting directly from a government intervention are contained within the Council's draft response set out in Annex 2.

DIFRECTOR OF FINANCE COMMENTARY

9 There are no material financial implications contained within the Government's draft Regulations.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

11 The creation of a business plan 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:

- Consultation response to be returned by 19 February 2016.

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

Consulted:
Pension Fund Board Chairman

Annexes:
Annex 1: Draft Regulations
Annex 2: Consultation response

Sources/background papers:
None

This page is intentionally left blank

STATUTORY INSTRUMENTS

2016 No. 0000

PUBLIC SERVICE PENSIONS, ENGLAND AND WALES

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

Made - - - -	*2016*
Laid before Parliament	*2016*
Coming into force - -	*2016*

These Regulations are made in exercise of the powers conferred by sections 1 and 3 of, and Schedule 3 to, the Public Service Pensions Act 2013(**a**).

In accordance with section 21 of that Act, the Secretary of State has consulted such persons and 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, commencement and extent

1.—(1) These Regulations may be cited as the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

(2) These Regulations come into force on 1st April 2016.

(3) These Regulations extend to England and Wales.

Interpretation

2.—(1) In these Regulations—

"the 2000 Act" means the Financial Services and Markets Act 2000(**b**);

"the 2013 Regulations" means the Local Government Pension Scheme Regulations 2013(**c**);

"the Transitional Regulations" means the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014(**d**);

(**a**) 2013 c 25
(**b**) 2000 c 8
(**c**) S.I. 2013/2356
(**d**) S.I. 2014/525

"authority" means an administering authority listed in Part 1 of Schedule 3 to the 2013 Regulations;

"fund money" means money that is or should be in a pension fund maintained by an authority;

"proper advice" means the advice of a person whom the authority reasonably believes to be qualified by their ability in and practical experience of financial matters;

"the Scheme" means the scheme established by the 2013 Regulations.

(2) Any restrictions imposed by these Regulations apply to authorities which have the power within section 1 of the Localism Act 2011(**a**) (local authority's general power of competence) or section 5A(1) of the Fire and Rescue Services Act 2004(**b**) in the exercise of those powers.

(3) Any authority which does not have the powers mentioned in paragraph (2) has, by virtue of these Regulations the power to do anything authorised or required by these Regulations.

Investment

3.—(1) In these Regulations "investment" and related expressions have their normal meaning.

(2) But the following provisions of this regulation specify things which count as investments for these Regulations, although they might not otherwise do so, and exclude things which might otherwise count.

(3) A contract entered into in the course of dealing in financial futures, traded options or derivatives is an investment.

(4) A contract of insurance is an investment if it is a contract of a relevant class, and is entered into with a person within paragraph (5) for whom entering into the contract constitutes the carrying on of a regulated activity within the meaning of section 22 of the 2000 Act(**c**).

(5) The persons within this paragraph are—

(a) a person who has permission under Part 4A of the 2000 Act (permission to carry on regulated activities) to effect or carry out contracts of insurance of a relevant class;

(b) an EEA firm of the kind mentioned in paragraph 5(d) of Schedule 3 to the 2000 Act (EEA passport rights), which has permission under paragraph 15 of that Schedule(**d**) to effect or carry out contracts of insurance of a relevant class; and

(c) a person who does not fall within sub-paragraph (a) or (b) whose head office is in an EEA state other than the United Kingdom, and who is permitted by the law of that state to effect or carry out contracts of insurance of a relevant class.

(6) A contract of insurance is of a relevant class for the purposes of paragraphs (4) and (5) if it is—

(a) a contract of insurance on human life or a contract to pay an annuity on human life where the benefits are wholly or partly to be determined by reference to the value of, or income from, property of any description (whether or not specified in the contract) or by reference to fluctuations in, or an index of, the value of property of any description (whether or not so specified); or

(b) a contract to manage the investments of pension funds, whether or not combined with contracts of insurance covering either conservation of capital or payment of minimum interest.

(7) It is an investment to contribute to a limited partnership in an unquoted securities investment partnership.

(8) For the purposes of this regulation—

"limited partnership" has the meaning given in the Limited Partnerships Act 1907(**a**);

(**a**) 2011 c. 20.
(**b**) 2004 c. 21; section 5A was inserted by section 9(1) of the Localism Act 2011.
(**c**) Section 22 was amended by section 7(1) of the Financial Services act 2012 (c.21).
(**d**) Paragraph 15 was amended by S.I. 2007/126.

"recognised stock exchange" has the same meaning as in section 1005 of the Income Tax Act 2007(**b**);

"traded option" means an option quoted on a recognised stock exchange; and

"unquoted securities investment partnership" means a partnership for investing in securities which are not quoted on a recognised stock exchange when the partnership buys them.

Management of a pension fund

4.—(1) An authority must credit to its pension fund(**c**), in addition to any sum otherwise required to be credited by virtue of the 2013 Regulations or the Transitional Regulations—

(a) the amounts payable by it or payable to it under regulations 15(3), 67 and 68 of the 2013 Regulations (employer's contributions and further payments);

(b) all amounts received under regulation 69(1)(a) of the 2013 Regulations (member contributions);

(c) all income arising from investment of the fund; and

(d) all capital money deriving from such investment.

(2) In the case of an authority which maintains more than one pension fund, as respects sums which relate to specific members, the reference in paragraph (1) to the authority's pension fund is to the fund which is the appropriate fund(**d**) for the member in question in accordance with the 2013 Regulations.

(3) Interest under regulation 71 of the 2013 Regulations (interest on late payments by Scheme employers) must be credited to the pension fund to which the overdue payment is due.

(4) An authority must pay any benefits to which any person is entitled by virtue of the 2013 Regulations or the Transitional Regulations from its pension fund.

(5) Any costs, charges and expenses incurred administering a pension fund may be paid from it except for charges prescribed by regulations made under sections 23, 24 or 41 of the Welfare Reform and Pensions Act 1999(**e**) (charges in relation to pension sharing costs)(**f**).

Restriction on power to borrow

5.—(1) Except as provided in this regulation, an authority must not borrow money where the borrowing is liable to be repaid out of its pension fund.

(2) Subject to paragraph (3), an authority may borrow by way of temporary loan or overdraft which is liable to be repaid out of its pension fund, any sums which it may require for the purpose of—

(a) paying benefits due under the Scheme; or

(b) to meet investment commitments arising from the implementation of a decision by it to change the balance between different types of investment.

(3) An authority may only borrow money under paragraph (2) if, at the time of the borrowing, the authority reasonably believes that the sum borrowed and interest charged in respect of that sum can be repaid out of its pension fund within 90 days of the borrowing.

(**a**) 1907 c. 24.
(**b**) 2007 c.3, section 1005 was substituted by the Finance Act 2007 (c. 11) and amended by the Taxation (International and Other Provisions) Act 2010 (c.8).
(**c**) An administering authority is required to maintain a pension fund by regulation 53(1) of, and paragraph 1 of Schedule 3 to the 2013 Regulations.
(**d**) See regulation 53(2) of and Part 2 of Schedule 3 to the 2013 Regulations for provisions relating to an administering authority becoming the "appropriate administering authority" in relation to a person.
(**e**) 1999 c. 30.
(**f**) See S.I. 2000/1047 and S.I. 2000/1049.

Separate bank account

6.—(1) An authority must hold in a separate account kept by it with a deposit-taker all fund money.

(2) "Deposit-taker" for the purposes of paragraph (1) means—

(a) a person who has permission under Part 4A(**a**) of the 2000 Act (permission to carry on regulated activities) to carry on the activities specified by article 5 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (accepting deposits)(**b**);

(b) an EEA firm of the kind mentioned in paragraph 5(b)(**c**) of Schedule 3 to the 2000 Act (EEA passport rights) which has permission under paragraph 15 of that Schedule(**d**) to accept deposits;

(c) the Bank of England or the central bank of an EEA state other than the United Kingdom; or

(d) the National Savings Bank.

(3) An authority must secure that the deposit-taker may not exercise a right of set-off in relation to the account referred to in paragraph (1) in respect of any other account held by the authority or any party connected to the authority.

Investment strategy statement

7.—(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State.

(2) The authority's investment strategy must include—

(a) a requirement to invest fund money in a wide variety of investments;

(b) the authority's assessment of the suitability of particular investments and types of investments;

(c) the authority's approach to risk, including the ways in which risks are to be measured and managed;

(d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;

(e) the authority's policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and

(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

(3) The authority's investment strategy must set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment.

(4) The authority's investment strategy may not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007(**e**).

(5) The authority must consult such persons as it considers appropriate as to the contents of its investment strategy.

(a) Part 4A was inserted by section 11 of the Financial Services Act 2012 (c. 21).
(b) S.I. 2001/544; article 5 was amended by S.I. 2002/682.
(c) Sub-paragraph (b) of paragraph (5) was substituted by S.I. 2006/3211 and then further substituted by S.I. 2013/3115.
(d) Paragraph 15 has been amended by S.I. 2003/2066, S.I. 2007/3253, 2012/1906 and 2013/1881.
(e) 2007 c. 28, section 212 was amended by the Police Reform and Social Responsibility Act 2011 (c. 13) and there are prospective amendments made by the Local Audit and Accountability Act 2014 (c. 2).

(6) The authority must publish a statement of its investment strategy formulated under paragraph (1) and the first such statement must be published no later than 1st October 2016.

(7) The authority must review and if necessary revise its investment strategy from time to time, and at least every 3 years, and publish a statement of any revisions.

(8) The authority must invest, in accordance with its investment strategy, any fund money that is not needed immediately to make payments from the fund.

Directions by the Secretary of State

8.—(1) This regulation applies in relation to an authority's investment functions under these Regulations and the 2013 Regulations if the Secretary of State is satisfied that the authority is failing to have regard to guidance issued under regulation 7(1) (investment strategy statement).

(2) Where this regulation applies in relation to an authority the Secretary of State may issue a direction requiring all or any of the following—

- (a) that the authority make such changes to its investment strategy under regulation 7 as the Secretary of State considers appropriate, within a period of time specified in the direction;
- (b) that the authority invest such assets or descriptions of assets as are specified in the direction in such manner as is specified in the direction;
- (c) that the investment functions of the authority under these Regulations and under the 2013 Regulations be exercised by the Secretary of State or a person nominated by the Secretary of State for a period specified in the direction or for so long as the Secretary of State considers appropriate;
- (d) that the authority comply with any instructions of the Secretary of State or the Secretary of State's nominee in relation to the exercise of its investment functions under these Regulations and the 2013 Regulations and provide such assistance as the Secretary of State or the Secretary of State's nominee may require for the purpose of exercising those functions.

(3) Before making a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must consult the authority concerned.

(4) In reaching a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must have regard to such evidence of the manner in which the authority is discharging or proposes to discharge its investment functions as is reasonably available including—

- (a) any report from an actuary appointed under section 13(4) of the Public Service Pensions Act 2013 (employer contributions in funded schemes) or by the authority under section 62 of the 2013 Regulations (actuarial valuations of pension funds);
- (b) any report from the local pension board appointed by the authority or from the Local Government Pension Scheme Advisory Board(a);
- (c) any representations made by the authority in response to the consultation under paragraph (3);
- (d) any other evidence available that the Secretary of State regards as relevant to whether the authority has been complying with these regulations or acting in accordance with guidance issued under regulation 7(1) (investment strategy statement).

(5) If the Secretary of State is of the opinion that additional information is required to enable a decision to be taken whether to issue a direction under this regulation, or as to what any direction should contain, the Secretary of State may carry out such inquiries as the Secretary of State considers appropriate to obtain that information.

(6) An authority must co-operate with any request from the Secretary of State intended to facilitate the obtaining of information under paragraph (5).

(a) The Local Government Pension Scheme Advisory Board is established under regulation 110 of the 2013 Regulations (which was inserted by S.I. 2015/57).

Investment managers

9.—(1) Instead of managing and investing fund money itself, an authority may appoint one or more investment managers to manage and invest fund money, or any part of such money, on its behalf.

(2) The authority must reasonably believe that the investment manager's ability in and practical experience of financial matters make that investment manager suitably qualified to make investment decisions for it.

(3) The authority must take proper advice in relation to the appointment and the terms on which the appointment is made.

Investments under section 11(1) of the Trustee Investments Act 1961

10. An authority to which section 11 of the Trustee Investments Act 1961(**a**) applies may invest, without any restriction as to quantity, in any investment made in accordance with a scheme under section 11(1) of that Act (which enables the Treasury to approve schemes for local authorities to invest in collectively).

Consequential amendments

11.—(1) The 2013 Regulations are amended as follows.

(2) For regulation 57(1)(a) (pension fund annual report) substitute—

> "(i) the current version of the investment strategy under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016;".

(3) For regulation 58(4)(b) (funding strategy statement) substitute—

> "(b) the statement of the administering authority's investment strategy published under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.".

(4) For regulation 69(2)(b) (payment by Scheme employers to administering authorities) substitute—

> "(b) paragraph (1)(c) does not apply where the cost of the administration of the fund is paid out of the fund under regulation 4(5) (management of a pension fund) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.".

Revocations and transitional provision

12.—(1) Subject to paragraph (2), the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009(**b**) and the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013(**c**) are revoked.

(2) Regulations 11 (investment policy and investment of pension fund money), 12 (statement of investment principles), 14 (restrictions on investments), 15 (requirements for increased limits) of and Schedule 1 (table of limits on investments) to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 continue to have effect in relation to an authority until the date when that authority publishes its investment strategy statement under regulation 7(1) (investment strategy statement).

(3) For the period starting on 1st April 2016 and ending on whichever is the earlier of the date the authority publishes its investment strategy statement under regulation 7 (investment strategy

---

(**a**) 1961 c. 62; section 11(1) was amended by the London Government Act 1963 (c. 4) and the Local Government Act 1985 (c. 51).
(**b**) S.I. 2009/3093.
(**c**) S.I. 2013/410.

statement), or 30th September 2016, Regulation 7 applies to an authority only to the extent necessary to enable that authority to formulate and publish its investment strategy statement.

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)

This page is intentionally left blank

Annex 2

Response to LGPS Investment Regulations Consultation

Summary

1 Surrey welcomes the move from the arbitrary and prescriptive asset limits in the previous LGPS investment regulations, and the move towards prudential regulation. This will enable LGPS funds to effectively manage individual fund investment risk, thus meeting the specific needs of the scheme LGPS beneficiaries. Specific mention of the ultimate objective of the LGPS investment process to meet the ultimate needs of the LGPS beneficiaries would be a useful inclusion as this seems to have been overlooked. Additionally, the design and alignment of the investment strategy alongside the funding strategy would also be a useful mention.

2 The Government should also consider extending the knowledge and understanding requirements (currently falling only on Local Pension Boards) to the Scheme Manager/Pension Fund Committee. A prudent person requirement ultimately only works if those making investment strategy decisions have the knowledge, capacity and capability to achieve this.

3 Surrey has some concern about the broad powers being taken for the government to direct funds' investment processes. Such an encompassing power could ultimately be used by government to direct funds into specific asset classes with limited attention paid to the impact on the future payment of members' pensions. Moreover, a range of criteria or trigger points for government intervention should be considered.

Proposal 1: Deregulating and adopting a local approach to investment

Q1: Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?

The proposed deregulation is appropriate, particularly the removal of the prescriptive Schedule 1 of the Regulations, which no longer has any relevance.

The review of the Investment Strategy Statement should be consistent with the review of the Funding Strategy Statement, such that it can reflect the implications of the latest actuarial valuation and funding levels as they are monitored on a regular basis between valuation cycles.

Q2: Are there any specific issues that should be reinstated? Please explain why.

The proposed regulations appear to remove the requirement to state the extent to which a Fund complies with the Myners' Principles (Regulation 12(3)). The Myners' Principles are seen as best practice in investment management and it is appropriate that LGPS Funds continue to explicitly state the extent of their compliance with the principles. Inclusion of the principles and the "comply or explain" approach stated within the SIP is seen as the best way to achieve this.

Q3: Is six months the appropriate period for the transitional arrangements to remain in place?

The proposed timeframe for the transitional arrangements to remain in place would appear to be somewhat short. Surrey is concerned about the timescale for implementation which feels rushed, given the work commitment on the national asset pooling activity and the deadline for the proposal of 15 July 2015.

Q4: Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?

In addition to maintaining risk management, derivatives can also be used for a number of reasons including efficient portfolio management purposes, e.g., in a transition process, obtaining immediate exposure to an equity market before completing the construction of an equity portfolio, or for pure return-seeking purposes.

The intention of the proposed changes to the existing LGPS regulations is for government to no longer be entirely prescriptive in terms of the types of investments available for Funds. Therefore, it would be more appropriate to permit the use of derivatives within an investment strategy and rely on the requirement for Funds to take an entirely prudential approach in ensuring the suitability of investments, appropriate diversification, and overall approach to managing risk.

Proposal 2: Introducing a safeguard (Secretary of State power to intervene)

Q5: Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?

The proposed power of intervention provides the Secretary of State with wide ranging powers to intervene in the operation of an individual LGPS fund, and this causes Surrey a degree of concern.

The Secretary of State would have to ensure consistency of application across different funds. For example, if a certain piece of evidence, e.g., performance data suggested that there should be an intervention at one particular fund, then this evidence should also be considered to determine whether an intervention is required at another fund. Failure to do this could lead to inconsistent, or even discriminatory, treatment across LGPS funds. It is recommended that a series of criteria/trigger points for intervention should be used as a framework for considering intervention.

Q6: Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?

In the event that the Secretary of State is considering an intervention and gathering evidence, it is essential that this process should remain confidential in order to avoid adversely affecting the reputation of the administering authority before the intervention has been confirmed.

In addition to authorities being able to present evidence in support of their existing governance arrangements, they should also have full access to any evidence that the Secretary of State is using to determine whether an intervention is appropriate, prior to an intervention being determined. The authorities should have an appropriate length of time to consider this evidence with the opportunity to rebut the evidence or to introduce supplementary evidence to support a counter-argument to the evidence provided by the Secretary of State.

No timescales are laid down in the draft regulations and therefore it is not possible to comment as to whether authorities will have sufficient time to present evidence. However, it should be reiterated that the regulations should ensure that authorities have sufficient time to consider the evidence presented by the Secretary of State, as well as to present its own evidence.

Q7: Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?

It would appear that the Secretary of State has a lot of flexibility to determine the extent of the intervention. Whilst it is appreciated that it is the intention that the power to intervene is deliberately broad so that it can be applied in a wide range of circumstances, there is an argument that the power is too dominant and this will increase the risk of a legal challenge from an authority subject to an intervention.

The Secretary of State should consider developing a comprehensive guidance document. Such a document would need to be far more extensive than the small number of examples given in the consultation document. The document can make clear that it is not an exhaustive list, but would give some comfort to authorities that interventions will only be considered when there is a specific and fundamental issue that needs to be resolved.

There are potential issues with the proposed interventions, which may result in the authority being required to implement a completely different investment strategy or for its investment function to be assumed by the Secretary of State or another body. If it can be demonstrated that this has resulted in an adverse impact compared with an authority’s existing investment arrangements, then it could be argued that the authority should not be responsible for the costs of this.

The consultation document states that all costs of the intervention, which presumably includes an adverse impact on the value of the pension fund, will be met by the pension fund’s assets. If the Secretary of State’s intervention has an overall adverse impact on a pension fund’s assets, then the department should be responsible for this, and not the pension fund.

Q8: Do the proposals meet the objective of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?

The proposed changes to the LGPS Investment Regulations are welcome and will provide LGPS funds with the flexibility to implement their chosen investment strategies and will facilitate meeting the requirement to pool assets.

It is also appreciated that the Secretary of State requires a means to prevent an adverse impact from the proposed deregulation, and to ensure that all funds participate in the requirement to pool assets.

7

However, the circumstances under which this power of intervention would be used need to be further refined to ensure that it is only being used when an authority materially departs from best practice, guidance or regulation and cannot justify this action.

In addition, the proposed power to intervene appears to relate only to the investment function of an individual administering authority. The Secretary of State should clarify that this is the case and that the power of intervention would not be extended to the operation of the national asset pools.

SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **12 FEBRUARY 2016**

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

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 Committee, as well as manager investment performance.

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1. Note the report.
2. Approve a $25m USD commitment to Standard Life Capital Partners Secondary Opportunities Fund III.

REASON FOR RECOMMENDATIONS:

In order to achieve best possible performance alongside optimal risk.

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 31 December 2015 and 29 January 2016 are shown in Annex 1.
Western	Multi Asset Credit	Implementation and transition process completed on 21 December 2015 (mentioned in paragraph 8 below).
Various	Client meetings	A verbal update from external fund manager meetings held on 2 February 2016 will accompany this item. Minutes from the meetings are shown as Annex 2.

2) Freedom of Information Requests

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

Date of Response	**Organisation**	**Request**	**Response**
03 November 2015	Preqin	Private equity investment information	Summary of private equity partnerships
11 December 2015	Pitchbook	Private equity investment information	Summary of private equity partnerships
12 December 2015	Scheme member	Arms and fossil fuel investments held by the Fund.	Full list of all investments held by the Fund categorised according to S&P general industry classifications where available.

8

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

The schedule of meetings for 2016 is as follows:

- 12 February 2016: Committee meeting hosted at County Hall.
- 25 February 2016: Committee meeting hosted at County Hall.
- 13 May 2016: Committee meeting hosted at County Hall.
- 9 September 2016: Committee meeting hosted at County Hall.
- 11 November 2016: Committee meeting hosted at County Hall.
- 18 November 2016: AGM hosted at County Hall

4) **Local Pension Board**

The next meeting of the Local Pension Board is scheduled for the 9 March 2016.

5) **Stock Lending**

In the quarter to 31 December 2015, stock lending earned a net income for the Fund of £88k with a value on loan equal to £74.4m.

6) **Internally Managed Cash**

The internally managed cash balance of the Fund was £44m as at 31 December 2015. As at 28 January 2016, the cash balance was £53m.

7) **Liability Driven Investment (LDI) Framework**

At its meeting on 13 February 2015, the Committee agreed to set the real yield trigger for future LDI leverage to 0.27% and this was incorporated into the mandate documentation with Legal & General (LGIM).

Now that the implementation for the leveraged gilt mandate has been completed, the Committee will regularly monitor movements in real yields and, specifically, the trigger point that has been agreed.

8) Western Implementation Multi Asset Credit

At its meeting on 23 July 2015, the Pension Fund Board appointed Western Asset Management to run a Multi Asset Credit portfolio with funds from the LGIM investment grade bonds and the Western UK gilts. The establishment of regulatory approval for the pooled fund was subsequently achieved and the transfer of assets from LGIM and Western's fixed income portfolio was completed on 21 December 2015.

9) Standard Life: Secondary Opportunities Fund (SOF) III

SL Capital Partners (SL Capital), part of the Standard Life Group, is raising SL Capital Secondary Opportunities Fund III (SOF III), which will continue the strategy of the two previous SOF funds (Surrey is invested in both) of focusing opportunistically on secondary interests in less competitive areas of the secondary market, where SL Capital has a specific information advantage or sourcing angle, and which target an internal rate of return (IRR) of 20%.

One of the key areas of focus will be on acquiring positions in private equity fund of funds, regarded as an emerging niche within the broader private equity secondaries market, where assets often sell at significant discounts to net asset value (NAV). SL Capital's last 3 transactions in this area have been at discounts to NAV of 23%, 15% and 18%. All interests targeted by the Fund will be at least 40% funded thereby ensuring good visibility on the underlying portfolio quality.

To date, the positions acquired by previous SOF funds have, on average, been, over 75% funded. The target Fund size is USD 400m, with the underlying assets being predominantly European and North American buyouts.

The fund has a management fee of 75 bps on NAV (no fees on commitments, no fees on undrawn amounts), which is discounted by 20% for cumulative LGPS commitments over $50 million. Surrey will benefit from a further 10% discount by virtue of being an existing investor, bringing the management fees down to 52.5 bps on NAV.

It is recommended that the Surrey Pension Fund make a USD 25m commitment to the SL Capital Secondary Opportunities Fund III.

10) Fund Manager Internal Control Assurance Reports

Fund managers are requested to provide independent verification of their internal control environment on an annual basis. Assurance of a strong internal control environment is vital to the delegation of investment decisions to external managers. This allows the fund to be confident in the knowledge that risks associated with the investment manager are suitably identified, assessed monitored and controlled.

Assurance reports on internal controls are typically produced in accordance with the International Standard on Assurance Engagements 3402 (ISAE 3402), issued by the International Auditing and Assurance Standards Board (IAASB) or the Technical Release AAF 01/06 issued by the Institute of Chartered Accountant of England and Wales (ICAEW). An independent accountancy firm will express an opinion as to the fairness of description and suitability of design and operating effectiveness of the stated internal controls throughout the reporting period.

For governance purposes the most recent internal control report for each investment manager as at the 31 December 2015 has been sent to each Committee member. There were no major concerns upon review of the assurance reports available as at the 31 December.

Investment Manager	Applicable Date for Control Report
Baillie Gifford	Year Ended 30 April 2015
CBRE	Year Ended 30 September 2014
Franklin Templeton	Year Ended 30 September 2015
LGIM	Year Ended 31 December 2014
Majedie	Year Ended 30 September 2015
Marathon	Year Ended 31 December 2014
Newton	Year Ended 30 September 2014
Standard Life	Year Ended 30 September 2015
UBS	Year Ended 31 December 2014
Western	Year Ended 31 March 2015

Report of the Strategic Finance Manager

Financial and Performance Report

1. Funding Level

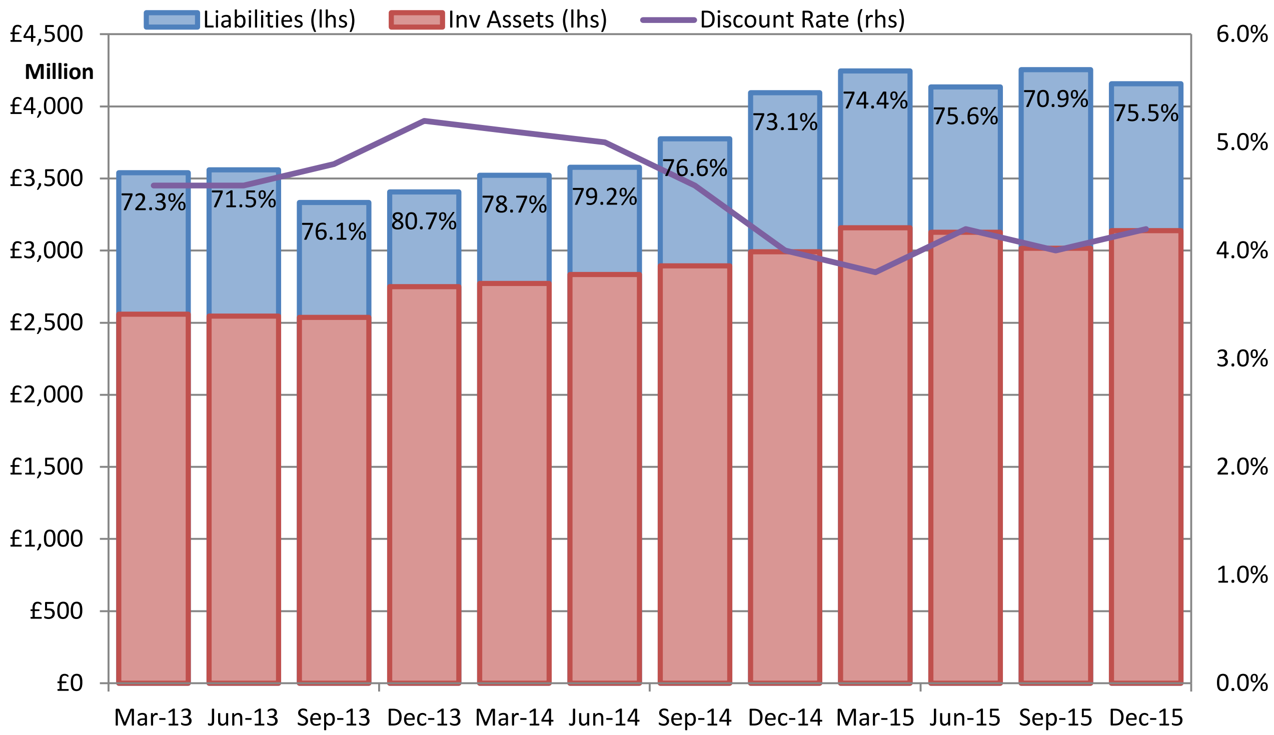
Past Service Position	31 December 2015 £m
Past Service Liabilities	-4,157
Market Value of Assets	3,138
Deficit	-1,019
Funding Level	75.5%

The funding level from the latest formal valuation as at 31 March 2013 was 72.3% and as at the end of December 2015 it was calculated to be 75.5%.

The funding level at 30 September 2015 was 70.9%. The 31 December 2015 level means an increase of 4.6% compared with three months previously. A rebound in equity markets over the quarter combined with a rise in bond yields led to this increase.

Quarterly Reconciliation	£m
Deficit at 30 September 2015	**-1,239**
Interest on deficit	-14
Excess return on assets	80
Change in actuarial assumptions	140
Contributions less benefits accruing	14
Deficit at 31 December 2015	**-1,019**

The period since the 2013 actuarial valuation has seen sizable and volatile movements in the funding level. The graph below sets out the value of liabilities and fund assets and the corresponding funding level along with the relevant discount rate applied for each quarter



Valuation Period to date Reconciliation	**£m**
Deficit at 31 March 2013	**-980**
Interest on deficit	-144
Excess return on assets	152
Change in actuarial assumptions	-171
Contributions less benefits accruing	124
Deficit at 31 December 2015	**-1,019**

2. Market Value

The value of the Fund was £3,138.4 at 31 December 2015 compared with £3,016.0 at 30 September 2015. The investment performance for the period was +3.8%.

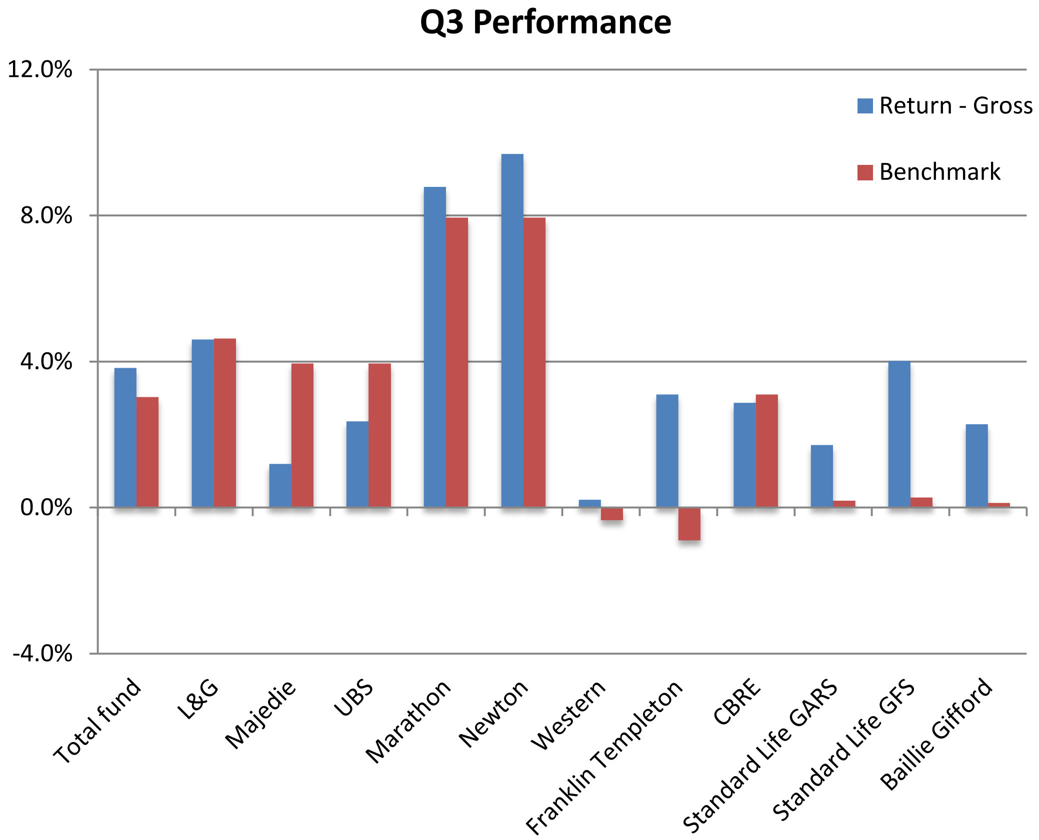
The change in market value is attributed as follows:

	£m
Market Value at 30/09/2015	**3,016.0**
Contributions less benefits and net transfer values	13.3
Investment income received	12.8
Investment expenses incurred	-4.6
Market movements	100.9
Market Value at 31/12/2015	**3,138.4**
Market Value at 29/01/2016	**3,081.8**

3. Fund Performance

Summary of Quarterly Results (gross of investment fees)

Overall, the Fund returned +3.8% in Q3 2015/16, in comparison with the Fund's customised benchmark of +3.0%.



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

Quarter 3 saw the realisation of the much anticipated divergence of central bank policy between the US Federal Reserve versus the European Central Bank and Bank of Japan. The Fed agreed to raise interest rates by 0.25% to 0.5% in December 2015, in spite of persistent low inflation figures and a further decline in the oil price. This was in stark contrast to the decision by the ECB to cut the deposit rate further to -0.3% and the BoJ's continuation of quantitative easing.

This policy backdrop boosted European and Japanese equities over the period, which helped both Newton and Marathon to near double digit investment returns. The UK equity market was slightly subdued in comparison, weighed down by its significant exposure to energy and oil.

The table below shows manager performance for 2015/16 Q3 (gross of investment manager fees) against manager specific benchmarks using Northern Trust data.

Manager	Performance %	Benchmark %	Relative %
Total fund	3.8	3.0	0.8
L&G	4.6	4.6	0.0
Majedie	1.2	4.0	-2.8
UBS	2.4	4.0	-1.6
Marathon	8.8	7.9	0.9
Newton	9.7	7.9	1.8
Western	0.2	-0.4	0.6
Franklin Templeton	3.1	-0.9	4.0
CBRE	2.9	3.1	-0.2
Standard Life GARS	1.7	0.2	1.5
Standard Life GFS	4.0	0.3	3.7
Baillie Gifford	2.3	0.1	2.2

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

8

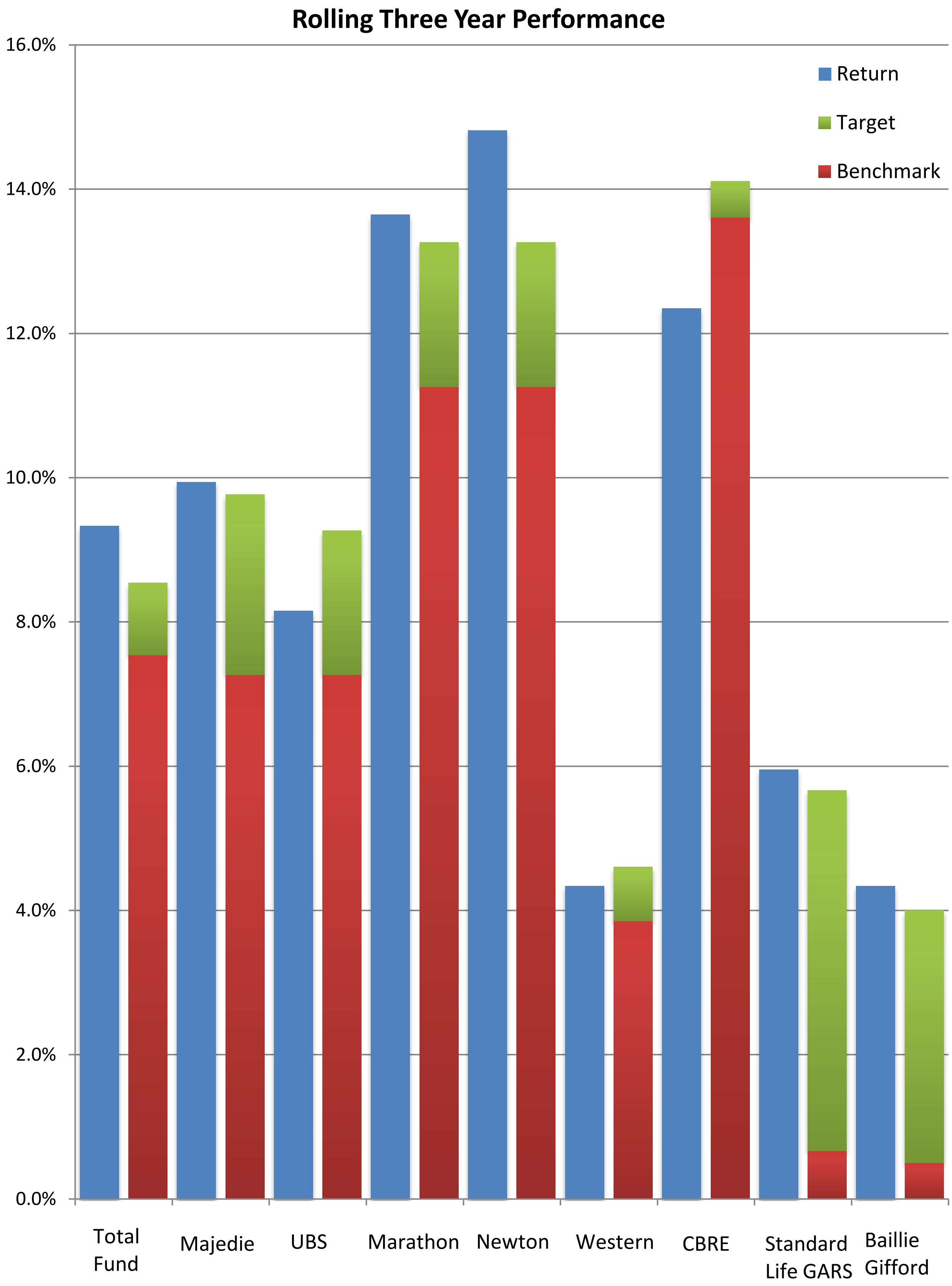
Summary of Full Year Results

During the course of the previous 12 months to 31 December 2015, the Fund returned +3.6% gross of investment fees against the customised benchmark of +2.6%.

Manager	Gross of Fees Performance %	Benchmark %	Relative %	Net of Fees Performance %
Total fund	3.6	2.6	1.0	3.3
L&G	2.6	2.6	0.0	2.5
Majedie	-0.5	1.0	-1.5	-1.6
UBS	-3.6	1.0	-4.6	-3.7
Marathon	8.3	3.3	5.0	7.7
Newton	10.4	3.3	7.1	10.1
Western	0.6	0.6	0.0	0.3
Franklin Templeton	-4.0	-3.3	-0.7	-4.8
CBRE	13.3	13.6	-0.3	13.0
Standard Life GARS	3.9	0.7	3.2	3.2
Standard Life GFS	10.0	1.0	9.0	9.1
Baillie Gifford	3.3	0.5	2.8	2.7

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

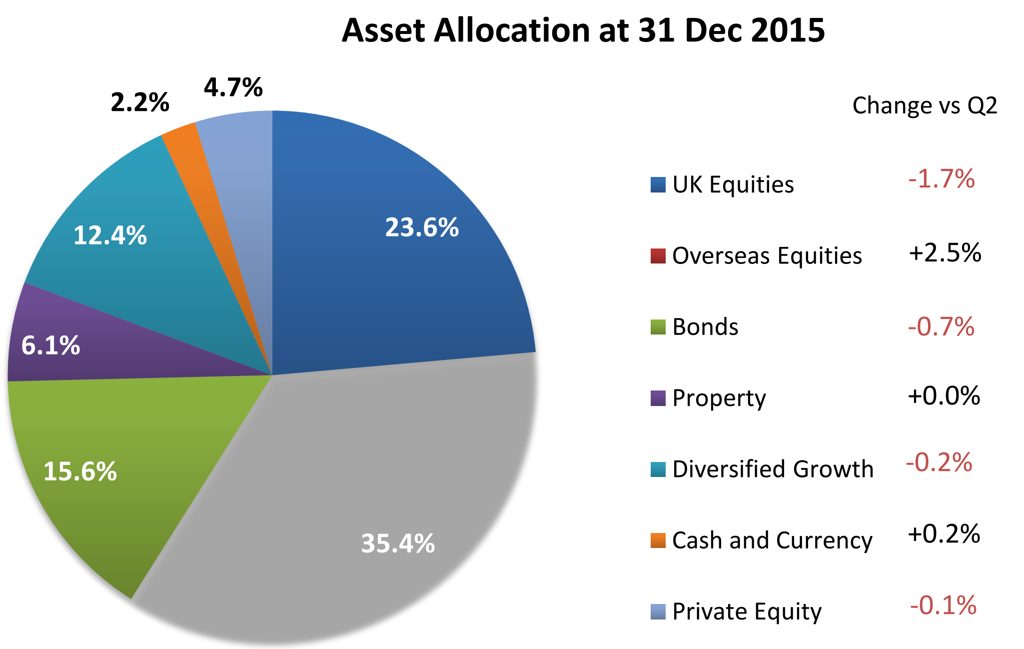


The below table shows the annualised performance by manager for the previous three years.

Manager	Performance %	Benchmark %	Target %	Relative %
Total fund	9.3	7.5	8.5	0.8
Majedie	9.9	7.3	9.8	0.1
UBS	8.2	7.3	9.3	-1.1
Marathon	13.6	11.3	13.3	0.3
Newton	14.8	11.3	13.3	1.5
Western	4.3	3.9	4.6	-0.3
CBRE	12.3	13.6	14.1	-1.8
Standard Life GARS	6.0	0.7	5.7	0.3
Baillie Gifford	4.3	0.5	4.0	0.3

4. Asset Allocation

The graph and table below summarise the asset allocation of the fund as at the 31 December 2015.



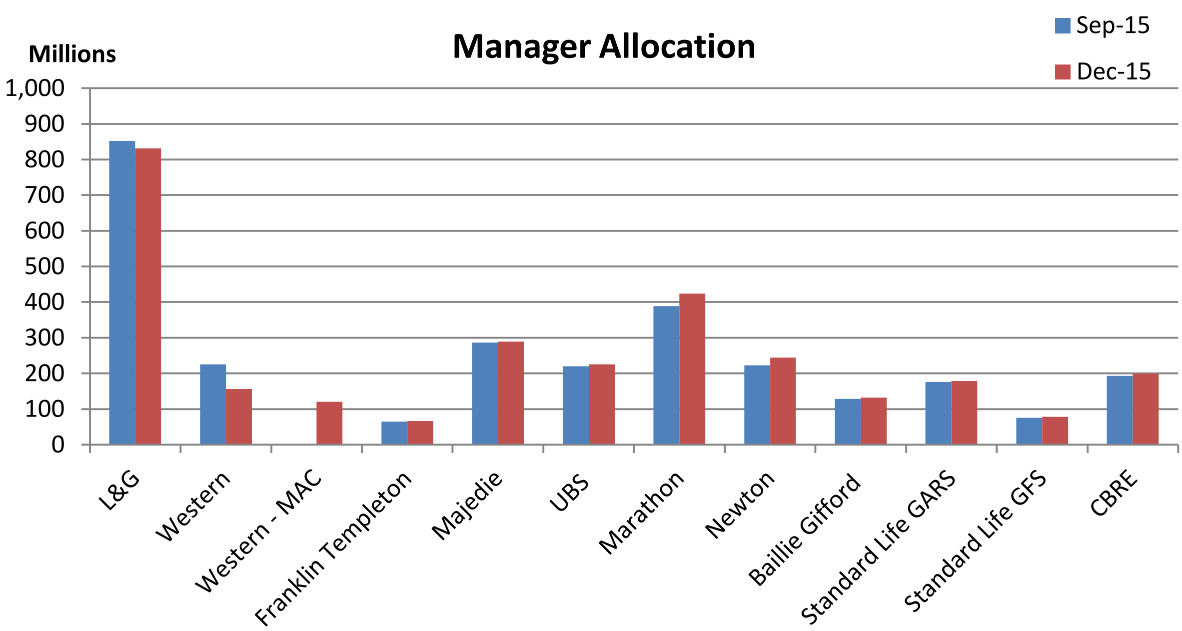
8

The table below compares the actual asset allocation as at 31 December 2015 against target asset weightings.

	TOTAL FUND £m	Actual %	Target %
Bonds			
Multi Asset Credit	120.6	3.8	4.4
Investment Grade Credit	151.3	4.8	5.3
Index Linked Gilts	153.8	4.9	5.5
Unconstrained	66.1	2.1	2.4
Equities			
UK	740.7	23.6	27.5
Overseas	1,109.6	35.4	32.3
Property Unit Trusts	190.6	6.1	6.2
Diversified growth	388.7	12.4	11.4
Cash	86.7	2.8	0.0
Currency hedge	-17.9	-0.6	0.0
Private Equity	148.2	4.7	5.0
TOTAL	**3,138.4**	**100.0**	**100.0**

5. Manager Allocation

The graph below shows the current manager allocation.



6. Fees

The following table shows a breakdown of fees paid during Q3 2015/16

Manager	Market Value 31/12/2015 £m	Manager Fees Q3 £000	Annualised Average Fee
L&G	831.3	130	0.06%
Western	156.4	130	0.33%
Western - MAC	120.6	n/a	
Franklin Templeton*	66.1	120	0.72%
Majedie**	289.3	2,370	3.28%
UBS	224.9	70	0.12%
Marathon	424.1	449	0.42%
Newton	244.6	149	0.24%
Baillie Gifford*	131.7	172	0.52%
Standard Life GARS*	178.7	291	0.65%
Standard Life GFS*	78.4	190	0.96%
CBRE	199.6	105	0.21%
Manager Fees Total		**4,176**	
Tax withheld		142	
Other investment expenses***		245	
Total Investment Expenses		**4,563**	

*Estimated, to exclude transaction fees
** Includes performance element of £2,080k
*** Primarily transaction costs & property fund expenses

CONSULTATION:

7 The Chairman of the Pension Fund Committee 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.

SECTION 151 OFFICER (DIRECTOR OF FINANCE) COMMENTARY

10 The Section 151 Officer (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.

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

Consulted:
Pension Fund Committee Chairman

Annexes:
Annex 1: Asset Allocation Policy and Actual as at 31 Dec 2015 and 29 Jan 2016
Annex 2: Minutes from fund manager meetings held on 2 February 2016

Sources/background papers:
None

Asset Allocation Update

The table shows the actual managed asset allocation as at 31 December 2015 against the target allocation. The allocation for 29 January 2016 is shown overleaf.

	Category	Allocation Policy %	Allocation at 31/12/2015	Variance %
Equities		**63.0**	**63.2**	**+0.2**
UK				
Legal and General	*Passive*	*10.0*	*8.9*	*-1.1*
Majedie	*Concentrated Active*	*11.0*	*9.8*	*-1.2*
UBS	*Core Active*	*8.0*	*7.6*	*-0.4*
Overseas				
Legal and General	*Passive*	*14.0*	*14.2*	*+0.2*
Marathon	*Concentrated Active*	*12.0*	*14.4*	*+2.4*
Newton	*Core Active*	*8.0*	*8.3*	*+0.3*
Property		**6.5**	**6.8**	**+0.3**
CBRE	*Core Active*	*6.5*	*6.8*	*+0.3*
Alternatives		**12.0**	**13.2**	**+1.2**
Standard Life	*Diversified growth*	*8.0*	*8.7*	*+0.7*
Baillie Gifford	*Diversified growth*	*4.0*	*4.5*	*+0.5*
Bonds		**18.5**	**16.8**	**-1.7**
Index linked gilts				
Legal and General	*Core Active*	*5.8*	*5.2*	*-0.6*
Investment grade credit				
Western	*Core Active*	*5.5*	*5.3*	*-0.2*
Total Return				
Franklin Templeton	*Unconstrained*	*2.6*	*2.2*	*-0.4*
Multi Asset Credit				
Western	*Unconstrained*	4.6	4.1	-0.5
Total		**100.0**	**100.0**	

8 **Asset Allocation Update**

The table shows the actual managed asset allocation as at 29 January 2016 against the policy.

	Category	Allocation Policy %	Allocation at 29/01/2016	Variance %
Equities		**63.0**	**62.1**	**-0.9**
UK				
Legal and General	*Passive*	*10.0*	*8.1*	*-1.9*
Majedie	*Concentrated Active*	*11.0*	*9.8*	*-1.2*
UBS	*Core Active*	*8.0*	*7.5*	*-0.5*
Overseas				
Legal and General	*Passive*	*14.0*	*13.5*	*-0.5*
Marathon	*Concentrated Active*	*12.0*	*14.8*	*+2.8*
Newton	*Core Active*	*8.0*	*8.4*	*+0.4*
Property		**6.5**	**7.0**	**+0.5**
CBRE	*Core Active*	*6.5*	*7.0*	*+0.5*
Alternatives		**12.0**	**13.5**	**+1.5**
Standard Life	*Diversified growth*	*8.0*	*8.9*	*+0.9*
Baillie Gifford	*Diversified growth*	*4.0*	*4.6*	*+0.6*
Bonds		**18.5**	**17.4**	**-1.1**
Index linked gilts				
Legal and General	*Core Active*	*5.8*	*5.5*	*-0.3*
Investment grade credit				
Western	*Core Active*	*5.5*	*5.5*	*+0.0*
Total Return				
Franklin Templeton	*Unconstrained*	*2.6*	*2.2*	*-0.4*
Multi Asset Credit				
Western	*Unconstrained*	4.6	4.2	-0.4
Total		**100.0**	**100.0**	

Notes from Meetings with Fund Managers: 2 February 2016

Hosted by Standard Life

Manager	**Attending**
Standard Life	Chris Nichols Nigel Cosgrove
CBRE	Ian Gleeson Alex Bignell DJ Dhanajani
Newton	Paul Markham David Moylett
Western	Andrew Belshaw Marian George

8

Standard Life

1. Met with Chris Nichols and Nigel Cosgrove.

2. Surrey has invested in two DGF mandates with Standard Life: £179m in Global Absolute Return Strategies Fund (GARS) and £78m in Global Focused Strategies Fund (GFS).

3. Both funds are intended to achieve long-term returns significantly above cash with much lower volatility than equities: GARS seeks to beat cash by 5% pa and GFS by 7.5% pa.

4. Success for DGFs is measured as much by their ability to dampen short-term volatility as by the long-term returns they generate. The sharp falls in equity markets in January 2016 therefore provide a test of the effectiveness of the approach.

5. While it is early to make any definitive judgments, GARS and GFS appear to have fared better than most DGFs in January 2016. Global equity market returns are likely to have been worse than -5%. By contrast, GARS will have returned about -2% and GFS will have returned about -1.5%.

6. Although the return was 3.7% in 2015, GARS has achieved its performance target over rolling three and rolling five-year periods (with an annualised return of 6.0% pa). Given the market falls in January 2016, it is likely that the rolling returns to end March 2016, while still positive, will be below the cash +5.0% pa target.

7. GFS was launched two years ago, so has yet to establish a full rolling three-year track record. In 2015 the return was above target at 9.7%.

8. In economic forecasts, they expect modest growth in US and UK economies and a soft landing in China.

9. The key investment views remain cautious on markets, so the scale of directional views (i.e., exposure to equity or bond markets) is well below peak levels.

10. They favour Relative Value positions that are less dependent on market direction. Examples include China consumers versus China manufacturers and US technology versus US small cap.

11. Currency views are usually Relative Value positions. They have been wary of SE Asian currencies relative to USD because of the slowdown in Chinese growth.

12. GARS is approaching £50bn (at end September 2015) with £1bn per month inflow. At some point, the firm will have to consider capacity management measures, but this is more likely to be in fee pricing than closing the fund.

13. Overseas clients pay much more than UK clients (US 1.15% pa, Europe 0.85% pa). There is no suggestion that Standard Life would change the discounted fee level agreed with Surrey, but it is highly unlikely that Standard Life would agree to this being offered to other participants in a collaborative venture.

14. The Multi-Asset Team increased its resources in 2015 from 46 to 60 staff. It has risen further in 2016. None of the key managers has left and additional personnel from Ignis have been integrated.

15. The Ignis team manages a successful global tactical asset allocation (GTAA) overlay for Phoenix. The firm is considering making this available more widely through a new product.

16. **Advisor view: GARS and GFS are both well designed DGF products that are performing well. I have two concerns about GARS in the longer term. The first is that it will eventually grow too big to access attractive opportunities. The second is that competitors will target the key decision makers when building their own DGF teams. There is no evidence that either concern has been relevant in 2015. The continuing strength of the product globally means it will be difficult to achieve fee savings as part of the LGPS collaboration exercise.**

8

CBRE

1. Met with Ian Gleeson, Alex Bignell, DJ Dhanajani.

2. The Surrey mandate is valued at £197m and is close to fully invested.

3. Performance of the UK portfolio has been ahead of target over one, three and five years to end December 2015. The overall fund returned 13.0% in 2015 despite the drag associated with running down the legacy European holdings.

4. Undrawn commitments totalled £7m at end December 2015, with £3m expected to be drawn in Q1 2016. This includes drawdowns of the M&G Debt funds that are, at last, finding opportunities on attractive terms.

5. The key issue for this mandate in 2016 is whether the Committee approves the change in mandate to incorporate a 25% allocation to the Global Alpha Fund.

6. There has been no urgency to do this previously because the UK market has been performing strongly. CBRE expect UK returns to be less robust over the next three years, so there is a stronger case for diversifying outside the UK market.

7. Global Alpha is well diversified across the major developed markets with a small allocation to emerging markets (mostly in Chinese retail).

8. It is likely to take up to nine months to invest new cash allocations in the Global Alpha Fund. If the change of mandate requires reallocation from the existing assets, the drawdown period would be extended by up to a further three months.

9. **Advisor view: Property is a cyclical investment opportunity. The UK has performed well and may lag other real estate markets from here. It is sensible to change the mandate.**

Newton

1. Met with David Moylett and Paul Markham.

2. Surrey has £235m invested in a global equity mandate.

3. Performance in 2015 was very strong. The return of +10.5% was 7.2% ahead of benchmark. Relative performance over the rolling three-year was 3.6% pa ahead of benchmark. It has continued to outperform in January 2016.

4. Newton's defensive bias was helpful in 2015 and continues today. The fund remains underweight in emerging markets and commodities (energy and mining).

5. Market behaviour is a concern, with increasingly narrow leadership, particularly in the US. Only 15 of the top 300 companies outperformed in 2015 with 4 stocks dominating: Facebook, Apple, Netflix and Google (the so-called FANG).

6. Valuation has been less important than earnings trend. There is starting to be valuation discrepancies between similar stocks in the US and Europe (for example, in banks).

7. The long-term trend to greater globalisation is under pressure both from growing protectionism and from geographical differences in the cost of capital.

8. The biggest risk to future relative performance would probably be a sustained improvement in economic growth expectations. The fund is defensively biased and is underweight in cyclical sectors, such as mining.

9. In 2015 the Surrey portfolio performed 0.3% better than the average for the global equity team. It has higher exposure to some winners (Alphabet, Altria, Sugi).

10. Other stocks discussed include Suntory (unlisted parent), CA Technologies (rival in mainframes to Microsoft with strong cashflow and good dividend), Glaxo (vulnerable dividend given patent expiries and tight free cashflow), Sun Art Retail (China supermarkets) and Citigroup (is price/book low enough given exposure to EM and bonds?)

11. **Advisor view: A great year for Newton that has boosted their confidence in applying the thematic approach. The global equity process is more focused following the changes implemented by Jeff Munroe three years ago.**

8

Western Asset Management

1. Met with Paul Shuttleworth and Marion George.

2. Surrey's UK credit mandate is valued at £159m with a further £121m invested in a new multi asset credit (MAC) mandate.

3. John Harrison met the US based manager of the MAC fund, Chris Orndorff, when he was in London in January. Additional comments on this meeting are shown below.

4. Implementation of the new investment in MAC and transition of the UK mandate to 100% UK credit was delayed by changes to the Irish regulatory regime. This delayed approval of the new MAC fund. The mandate changes were implemented on 21 December 2015.

5. Performance of the UK mandate was below benchmark in 2015. The portfolio was more exposed to credit risk and less to gilts. Performance remains ahead of benchmark over the rolling three years, but has not achieved its performance objective.

6. Credit markets have become very pessimistic, with yield spreads widening significantly. Big falls in commodity prices and concerns about growth in China have weighed heavily on sentiment.

7. January 2016 was the worst ever January for credit relative to gilts. Yield spreads have widened further and now stand at the highest level for any period other than in the 2008/9 financial crisis. This suggests investors are discounting a severe recession.

8. Corporate balance sheets have deteriorated, with higher debt issuance, share buy-backs and increased M&A activity. However, spreads are far higher than realised or expected default rates.

9. Western are expecting lacklustre economic growth in UK and US and a soft landing in China. They believe investor risk aversion has gone too far and that credit spreads are attractive.

10. They have specific concerns about the UK economy for two reasons. Firstly, the risk of Brexit adds to investor uncertainty, given a vote to leave would be perceived very badly by markets. Secondly, the UK economy is overly dependent on housing.

11. The UK credit portfolio has 12% allocated outside the UK. It has a bias away from the higher credit ratings (AAA and AA) in favour of lower credit ratings (BBB and below).

12. **Advisor view: Recent market movements have been difficult for credit managers, given that macroeconomic concerns have dominated security assessment. The changes in the structure of the mandate have also been a slight drag. Western now have a more stable mandate focused on UK credit mandate, so we would not want to see further shortfalls in relative performance from here**.

Western Asset Management: MAC mandate

13. Comment on John Harrison's meeting with Chris Orndorff on 28th January 2016.

14. The investment approach places emphasis on income generation and seeks to avoid persistent biases to individual asset categories. There is no 'neutral' asset allocation and no explicit income target to constrain the process.

15. The three portfolio managers are experienced investors who understand both the benefits and the limitations of risk models.

16. The expected volatility is 5 to 7%, with significant downside protection. The predicted volatility implied by their risk model has been below 5% for most of the period since the fund launch in 2010 and realised volatility has been just over 4%. The managers believe risk models currently understate prospective risk.

17. The portfolio has an income generating core portfolio with relatively low turnover (20% pa). This is supplemented by risk management overlays with higher turnover. Within the risk budget, 40-50bps is allocated to tail risk protection through derivatives.

18. Their biggest fears currently are a China banking crisis or a liquidity squeeze in bond ETFs. Neither is believed to be likely. The duration contribution to risk is higher than previously, but this reflects increased credit quality rather than a view on interest rates – lower quality credits have proportionately less duration risk and proportionately more default risk. They are wary of EM corporates (a value trap) and bank loans (poor liquidity).

19. Overall they perceive the opportunity set for active bond managers to be larger than normal because volatility has been low and is likely to rise.

This page is intentionally left blank

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **12 FEBRUARY 2016**

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

SUBJECT: **PENSION FUND BUSINESS PLAN 2016/17**

SUMMARY OF ISSUE:

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

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Committee adopt the attached Business Plan shown in Annex 1 in respect of the 2016/17 financial year.

REASON FOR RECOMMENDATIONS:

A business plan is required by best practice in order to set relevant targets and monitor progress.

DETAILS:

Background

1 At the Pension Fund Committee meeting of 13 February 2015, the Pension Fund Committee approved a business plan for 2015/16, identifying the key issues affecting the Pension Fund over the medium term and a timetable of activities needed to help achieve the strategic objectives.

2 At the next Committee meeting on 13 May 2016, an outturn report will be presented, detailing the progress and achievements made against the 2015/16 business plan.

Business Plan 2016/17

3 In preparation for the next financial year 2016/17, Annex 1 sets out a draft recommended business plan for 2016/17. The plan lists the investment and pension administration tasks scheduled to be carried out during 2016/17, the target date when these should be achieved, and the responsible officer(s).

CONSULTATION:

4 The Chairman of the Pension Fund Committee has been consulted on the proposed change and has offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

5 A risk related issue is the possibility of not achieving part or all of the business plan. Given the outturn report that is compiled at year end and the measurement of progress against approved objectives, officers are very aware of the need to monitor performance against business plan objectives on a regular basis.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

6 The costs of the proposed actions will be funded from the administrative expenses of the pension fund.

DIRECTOR OF FINANCE COMMENTARY

7 The Director of Finance is satisfied that the business plan focuses on the key strategies and activities that will provide the Pension Fund Committee and officers with a useful framework to aid the setting of objectives, implementation and monitoring of progress.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

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

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT:

11 The following next steps are planned:

- Commencement of the year's work in line with the business plan.
- Progress monitoring will take place and, if necessary, matters will be discussed at future Committee meetings.
- Outturn report of the 2016/17 financial year to be presented at the first meeting of the Pension Fund Committee in 2017/18.

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

Consulted:
Pension Fund Committee Chairman

Annexes:
Annex 1: Business Plan 2016/17

Sources/background papers:
None

This page is intentionally left blank

Surrey Pension Fund
Business Plan and Actions for 2016/17

Administration			
Objective(s) - to ensure scheme is run in accordance with the rules; in accordance with agreed service standards; and compliance with Regulations - to deal with and rectify any errors and complaints in a timely way			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Director of Finance and Pension Fund Committee to receive key performance indicators report on a quarterly basis	Ongoing with reports due at each committee meeting	Phil Triggs/Neil Mason
2	Pension Fund Committee to receive the Pension Fund Annual Report	By 30 September 2016	Phil Triggs
3	Ensure that any complaints against action or inaction by pension staff are dealt with in a timely manner	Ongoing	Jason Bailey/ Neil Mason
4	Review the content of the pension fund website to ensure it is relevant and kept up to date.	Ongoing	Phil Triggs/Jason Bailey/Neil Mason
5	Review the current pension service level agreement between the pension fund and pension services team	30 September 2016	Phil Triggs/Jason Bailey/Neil Mason
6	Review the current pension administration strategy	30 September 2016	Phil Triggs/Jason Bailey/Neil Mason
7	Prepare an employer risk/covenant model in partnership with Hymans	31 March 2017	Phil Triggs/Neil Mason

Communication			
Objective(s) - to convey the security of the Scheme - to ensure members understand and appreciate the value of their benefits			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Production of a newsletter to pensioners in April each year	April 2016	Jason Bailey/Neil Mason
2	Timely production of benefit statements	Active members by 31 Aug 2016 Preserved members by 30 June 2016 Councillors by 31 Aug 2016	Jason Bailey
3	Ensure communication material complies with current legislation and effectively communicates the benefits of the scheme to members and employers. Ensure communication material is amended to comply with the requirements of the new regulations/legislation	Ongoing	Jason Bailey/Neil Mason
4	Communication on a timely basis of material scheme changes to Pension Fund Committee, employer bodies and members	Ongoing	Phil Triggs/ Jason Bailey/Neil Mason
5	Prepare Pension Fund Annual Meeting (November) and receive feedback from employers	30 November 2016	Phil Triggs/ Jason Bailey/Neil Mason
6	Communicate actuarial valuation to all employers	31 March 2017	Phil Triggs/Neil Mason

Actuarial/Funding

Objective(s)

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

Action	Description	Timescale	Primary Responsibility
1	Commence preparation for 2016 actuarial valuation	31 March 2016	Phil Triggs/ Jason Bailey/Neil Mason
2	Implement 2016 actuarial valuation and communicate results to all employers	31 March 2017	Phil Triggs/ Jason Bailey/Neil Mason
3	Receive satisfaction survey feedback from employers (all employer bodies)	31 March 2017	Phil Triggs/Neil Mason
4	Provide employers with IAS19/FRS17 funding statements when requested	Scheduled and admitted bodies: Mar 2016 Colleges: July 2016 Academies: August 2016	Phil Triggs
5	Monitor and reconcile contributions schedule for the County Council and scheme employers	Ongoing	Phil Triggs
6	Member training covering actuarial funding issues	Ongoing	Phil Triggs/Neil Mason

Surrey Pension Fund Committee Members

Objective(s)

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

Action	Description	Timescale	Primary Responsibility
1	Review decision making process to ensure decisions are made effectively	Ongoing with new Pension Fund Committee	Committee Members
2	Review Pension Fund Committee member training requirements and implement training plan as appropriate	Ongoing	Phil Triggs
3	Agree annual plan for Committee member training	13 May 2016	Phil Triggs
4	Ensure that meeting papers are issued at least seven days prior to meeting	Every meeting	Phil Triggs
5	Ensure that governance process remains in line with revised Myners/CIPFA principles to ensure 100% compliance	Ongoing 2016/17	Phil Triggs
6	Ensure that Committee is kept fully up-to-date with the national asset pooling project and proposed amendments to legislation	Ongoing 2016/17	Phil Triggs

Financial & Risk Management			
Objective(s) - To properly record financial transactions to and from the Scheme and produce annual report and accounts within six months of year end - Manage advisers fees against budgets - Assess the risk associated with the management of the Scheme			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Monitor pension fund expenses for next financial year with the target of unit cost in lowest quartile	Ongoing 2016/17	Phil Triggs
2	Produce Annual Statement of Accounts and achieve an unqualified audit	22 May 2016	Phil Triggs
3	Produce Pension Fund Annual Report	30 September 2016	Phil Triggs
4	Ensure ongoing risk assessments of the management of the fund for 2016/17	Ongoing and reported to every committee meeting	Phil Triggs
5	To implement a system of disaster recovery/business continuity in the event of major disaster	Ongoing 2016/17	Phil Triggs/ Jason Bailey/Neil Mason
6	To review the current employer covenant assessment process	Ongoing 2016/17	Phil Triggs/Neil Mason

Investment			
Objective(s) - Periodically review investment strategy and benchmarks - Monitor performance against benchmarks - Meet with investment managers to discuss performance			
Action	**Description**	**Timescale**	**Primary Responsibility**
1	Annual consideration of CIPFA/Myners principles	31 March 2017	Phil Triggs
2	Review of investment manager arrangements	31 March 2017	Phil Triggs
3	Review asset allocation with investment consultant and independent advisor	31 March 2017	Phil Triggs
4	Discuss/meet with all investment managers and report to Pension Fund Committee	Quarterly 2016/17	Phil Triggs
5	Review SIP and Investment Beliefs statement	31 March 2017	Phil Triggs
6	Pension Fund Board to receive quarterly investment monitoring reports	Quarterly 2016/17	Phil Triggs
7	Respond to all national initiatives on pension fund merger/collaboration/mandatory/passive investment and report to the Pension Fund Committee as necessary	Ongoing 2016/17	Phil Triggs
8	Respond to the Government's proposal on national asset pooling and Investment Regulations	19 February 2016 and 15 July 2016	Phil Triggs

Local Pension Board

Objective(s)

- To ensure the Local Pension Board is constituted and functions within the regulations
- To help facilitate the effective operation of the Local Pension Board

Action	Description	Timescale	Primary Responsibility
1	Reasonably comply with any requests from the Local Pension Board with regard to any aspect of the Scheme Manager function	Ongoing 2016/17	Phil Triggs/Neil Mason
2	Give due consideration to recommendations made to the Pension Fund Committee from the Local Pension Board and respond to the Local Pension Board within a reasonable period of time	Ongoing 2016/17	Phil Triggs/Neil Mason
3	Provide Local Pension Board members access to training offered to Pension Fund Committee members	Ongoing 2016/17	Phil Triggs/Neil Mason
4	Invite members of the Local Pension Board to attend Pension Fund Committee meetings	Quarterly 2016/17	Phil Triggs/Neil Mason

SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **12 FEBRUARY 2016**

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 should be monitored on a quarterly basis.

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.

MATERIAL CHANGES FROM THE LAST REPORTING PERIOD (30 JUNE 2015)

1 The review of the risk register during the preceding quarter has led not led to any adjustments to the existing risk ratings or mitigation actions.

2 A new risk pertaining to the government initiative on national asset pooling has been added to the risk register this quarter.

DETAILS:

Background

3 A review of the current risk register for the Pension Fund will give the Pension Fund Committee the opportunity to influence and drive the Pension Fund risk management process during 2015-2016.

Risk Management Process

4 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.

5 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

6 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 Committee and Surrey County Council as the administering authority. Assessment has also been given as to the likelihood of the risk.

7 Each of the three areas of impact identified above is assessed on a scale of one to four, with four implying the highest level of impact. The likelihood of the risk description (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.

8 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.

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

CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

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

DIRECTOR OF FINANCE COMMENTARY

13 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 members and officers with a suitable platform for the monitoring and control of pension fund risks.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

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

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

17 The following next steps are planned:

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

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

Consulted:
Pension Fund Committee Chairman

Annexes:
Annex 1: Pension Fund Risk Register

Sources/background papers:
None

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) Liability driven investment strategy implementation designed to hedge against future risk approved by Pension Fund Board on 13 February 2015. Future trigger points for leverage will provide liability protection against interest rate risk with the full protection framework in place. Once leverage commences, this will reduce the net score arising from mitigating actions.	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 within a liability driven investment portfolio to mitigate risk. 4) Liability driven investment strategy implementation designed to hedge against future risk approved by Pension Fund Board on 13 February 2015. Future trigger points for leverage will provide liability protection against inflation risk with the full protection framework in place. Once leverage commences, this will reduce the net score arising from mitigating actions.	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 and postcode 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) 2015/16 Investment strategy review is current. 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. Overall investment benchmark and out-performance target is fund specific.	3	30
Operational	5	5	Rise in ill health retirements impact employer organisations	1	4	1	6	4	24	TREAT- 1) Investigating the viability of self-insurance across employers within the fund	4	24
Investment	6	6	Investment Managers fail to achieve performance targets over the longer term: a shortfall of 0.1% on the investment target will result in an annual impact of	4	4	4	12	3	36	TREAT- 1) The Investment Management Agreements clearly state SCC's expectations in terms of performance targets. 2) Investment manager performance is reviewed on a quarterly basis. 3) The Pension Fund Board should be positioned to move quickly if it is felt that targets will not be met. 4) Having LGIM as a rebalancing/transition manager facilitates quick changes. 5) The Fund's investment management structure is highly diversified, which lessens the impact of manager risk compared with less diversified structures.	2	24
Financial	7	7	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	8	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
Investment	9	9	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 compared with historical	2	20
Funding	10	10	Structural changes in an employer's membership or an employer fully/partially closing the scheme. Employer bodies transferring out of the pension fund or employer bodies closing to new membership. An employer	3	4	3	10	3	30	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) Periodic reviews of the covenant strength of employers are undertaken and indemnity applied where appropriate.	2	20
Funding	11	11	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	12	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
Investment	13	13	Volatility caused by uncertainty with regard to the possible withdrawal of the UK from the European Union	3	3	2	8	3	24	TREAT- 1) Officers to consult and engage with advisors. 2) Possibility of looking at move from UK to global benchmarks on UK Equities and UK Property. 3) Possibility of further hedging of currency movements against Sterling.	2	16
Operational	14	14	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	15	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	16	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	17	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
Operational	18	18	Failure to hold personal data securely	1	1	4	6	3	18	TREAT- 1) Data encryption technology is in place, which allow secure the sending of data to external service providers. 2) Phasing out of holding records via paper files. 3) Pensions Admin records are locked daily in a secure safe. 4) SCC IT data security policy adhered to.	2	12
Funding	19	19	Impact of government policy on the employer workforce	3	2	1	6	3	18	TREAT- 1) Hymans Robertson use prudent assumptions on future of workforce. Employers to flag up potential for major bulk transfers. The potential for a significant reduction in the workforce as a result of the pressures that the public sector is under may have an additional impact on the Fund. 2) Need to make worst case assumptions about diminishing workforce when carrying out the actuarial valuation.	2	12
Governance	20	20	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	21	21	Change in membership of Pension Fund Committee leads to dilution of member knowledge and understanding	4	1	1	6	4	24	TREAT- 1) Succession planning process to be implemented. 2) Ongoing training of Pension Fund Board members. 3) Pension Fund Board new member induction programme. 4) Training to be based on the requirements of CIPFA Knowledge and Skills Framework and the results of the test undertaken in 2012. New Board members to take the test.	2	12
Operational	22	22	Inaccurate information in public domain leads to damage to reputation and loss of confidence	1	1	4	6	3	18	TOLERATE- 1) Ensure that all requests for information (Freedom of Information, Member & Public questions at Council, etc) are managed appropriately and that Part 2 items remain so. 2) Maintain constructive relationships with employing bodies to ensure that news is well managed.	2	12
Operational	23	23	Financial failure of third party supplier results in service impairment and financial loss	2	2	2	6	3	18	TOLERATE-1) Performance of third parties (other than fund managers) monitored. 2) Review of Northern Trust took place in January 2009, ahead of decision on whether to retain (Jan 2009) - a fee reduction was secured in 2011). 3) Actuarial and investment consultancies are provided by two different providers.	2	12
Operational	24	24	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	25	New	That the Border to Coast Pensions Partnership disbands or the partnership fails to produce a proposal deemed sufficiently ambitious	3	2	4	9	1	9	TOLERATE-1) Partners for the pool were chosen based upon the perceived expertise and like-mindedness of the officers and members involved with the fund to ensure compliance with the pooling requirements. Ensure that ongoing fund and pool proposals are comprehensive and meet government objectives.	1	9
Governance	26	25	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
Governance	27	26	Failure to comply with recommendations from the local pension board, resulting in the matter being escalated to the scheme advisory board and/or the pensions regulator	1	1	4	6	1	6	TOLERATE -1) Ensure that an cooperative, effective and transparent dialogue exists between the pension committee and local pension board	1	6
Financial	28	27	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	29	28	Incorrect, failed or late employee/employer contributions payments received	1	4	1	6	2	12	TOLERATE- 1) Monthly monitoring of pensions contributions against expectation. 2) Reminders sent to employers when they fail to meet payment deadline. 3) Scope to report persistent late payment to OPRA.	1	6
Financial	30	29	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

This page is intentionally left blank

SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **12 FERUARY 2016**

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

SUBJECT: **CORPORATE GOVERNANCE SHARE VOTING**

SUMMARY OF ISSUE:

This report provides a summary of the Fund's share voting process in Q2 and Q3 2015/16 (1 July 2015 to 31 December 2015).

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1 Note the report.

REASON FOR RECOMMENDATIONS:

The Pension Fund Committee must be aware of the voting actions pertaining to the segregated portfolios of shares held within the pension fund.

DETAILS:

Background

1 The informed use of shareholder votes, whilst not a legal duty, is a responsibility of shareholders and an implicit fiduciary duty of pension fund trustees and officers to whom they may delegate this function. Such a process requires the adherence to an approved share voting policy and the advice of a consultant skilled in this particular field.

2 The Surrey Pension Fund appointed Manifest in 2013 to provide consultancy advice on share voting and the whole spectrum of company corporate governance. Manifest has assisted in ensuring that the Fund's stewardship policy reflects the most up-to-date standards and officers learn of the latest developments and can reflect these developments in the Fund's share voting policy and the Statement of Investment Principles (SIP).

3 Annex 1 contains a list of terms and abbreviations used in the report. Annex 2 shows the Fund's latest approved responsible investment and stewardship (and share voting) policy.

Meetings Voted: Q2 and Q3 2015/16

4 Table 1: Meetings Voted below shows that 94 meetings were voted in total, comprising 56 AGMs and 38 other meetings.

Table 1: Meetings Voted

Region	Meeting Type						Total
	AGM	EGM	Court	Class	GM	SGM	
UK & Ireland	32	2	3	-	8	-	45
Asia & Oceania – Developed	18	10	-	1	-	-	29
Europe – Developed	5	2	-	-	1	1	9
South & Central America	-	8	-	-	-	-	8
Africa	1	-	-	-	-	-	1
Asia & Oceania – Emerging	-	1	-	-	-	-	1
Europe – Emerging	-	1	-	-	-	-	1
Total	56	24	3	1	9	1	94

Resolutions

5 Table 2: Resolutions Voted shows the total number of resolutions voted by region, broken down by meeting type. This shows the high volume of voting decisions that AGMs bring compared with other meetings. During Q2 and Q3, 991 resolutions were voted, with the bulk of these in the UK and Ireland (664).

Table 2: Resolutions Voted

Region	Meeting Type						Total
	AGM	EGM	Court	Class	GM	SGM	
UK & Ireland	623	-	3	22	16	-	664
Asia & Oceania – Developed	135	1	-	18	-	-	154
Europe – Developed	93	-	-	5	2	2	102
South & Central America	-	-	-	44	-	-	44
Africa	20	-	-	-	-	-	20
Europe – Emerging	-	-	-	4	-	-	4
Japan	-	-	-	2	-	-	2
Asia & Oceania – Developed	-	-	-	1	-	-	1
Total	871	1	3	96	18	2	991

6 The clustering of UK AGMs in July 2015 is explained by the number of companies with 31 March year ends. After December 31st, March 31st is the next most frequently used financial year end date. Because company law requires AGMs to be held within six months of the year end, many companies with March year ends hold their AGMs before the summer break.

Table 3: Resolutions Voted per Month (July to December)

Event	Jul	Aug	Sep	Oct	Nov	Dec	Total
AGM	20	3	7	10	10	6	56
EGM	2	2	3	4	3	10	24
GM	-	1	1	2	1	4	9
SGM	-	-	1	-	-	-	1
Class	-	-	-	-	-	1	1
Court	-	-	-	-	1	2	3
Total	22	6	12	16	15	23	94

Votes Against Management

7 The data in Table 4 (Votes Against Management By Resolution Category) show some important perspective on the type of voting decisions being made. As a part of the research analysis of meetings, each resolution is categorised according to the governance considerations to which they relate. Surrey voted against just over 14% of all resolutions for which votes were cast during Q2 and Q3, which is consistent with the proportion of resolutions opposed in the previous two quarters.

8 A high proportion of the sustainability resolutions were voted against management. Political donation authorities account for all but one of the sustainability resolutions in the second half of 2015. The one exception was a shareholder resolution at the AGM of Australia and New Zealand Banking Group Ltd, where there was a shareholder proposal to request the board of directors produce a report on climate change, which management opposed but Surrey supported.

9 Over a third of the Shareholder Rights resolutions saw votes against management. All but two of these instances where management was opposed were resolutions to approve 14-day notice periods for ordinary general meetings (other than AGMs), with the other two being requests to amend Articles of Association (one of them a shareholder proposal).

10 Surrey opposed management to a great extent on remuneration related resolutions. Of the 32 remuneration resolutions opposed, all but two were resolutions by UK companies seeking shareholder advisory approval on their reports on how pay policy had been implemented during the year. The remaining two resolutions were seeking awards of shares or options to specific directors. All but 3 of the 43 capital related resolutions opposed concerned share issue authority requests, mainly within the UK or Developed Europe.

Table 4: Votes Against Management By Resolution Category

Resolution Category	Total Resolutions	Voted Against Management	% votes against Management
Board	418	18	4.3%
Capital	191	43	22.5%
Audit & Reporting	126	-	-
Remuneration	123	32	26.0%
Shareholder Rights	74	28	37.8%
Corporate Actions	40	-	-
Sustainability	18	15	83.3%
Other	1	1	100.0%
Total	991	137	13.8%

11

Shareholder Proposed Resolutions

11 There were two shareholder proposed resolutions voted on during the period., both at Australia and New Zealand Banking Group Ltd and were related. One was, "'to amend the articles of association in respect of general meetings", and the other was, "to request that the board of directors produce a report on climate change".

12 This former was a motion aimed at changing the company rules so that shareholders could effectively require the company board to publish an opinion or report on a matter when required to do so by shareholders, in preparation for the subsequent motion asking for a report on climate change. It was filed by The Australasian Centre for Corporate Responsibility, who cited the UK, US, Canada and New Zealand as examples of jurisdictions where this was already possible for shareholders. Although the resolution was defeated, the support it received (over 12%, including from Surrey) should not be ignored by the company. Due to its defeat, the climate change report request resolution was withdrawn.

Remuneration

13 Votes on all remuneration resolutions in the second half of 2015 reflected the principles advocated in Surrey's voting policy. The chief concerns were:

- The maximum limit for the amount of potential annual bonus by reference to salary;
- Lack of sufficient alignment between incentive scheme performance measures and key performance indicators used by the company;
- Long-term incentive performance targets were not measured against a peer group or other suitable benchmarks (e.g. RPI, WACC);
- Independence of the remuneration committee;
- Performance conditions for incentive pay not being disclosed.

Table 5: Remuneration

Resolution Category	Total Resolutions	Voted Against Management	% Against Management
Remuneration report	47	27	57.4%
Policy (long term incentives)	24	-	
Amount (Component Individual)	23	2	8.7%
Non-Exec Remuneration	11	3	27.3%
Remuneration Policy	8	-	-
Amount (Total Collective)	5	-	-
Remuneration (Other)	2	-	-
Policy	3	-	-
Total	123	32	26.0%

Monitoring and Review

14 The share voting policy is kept under constant review.

CONSULTATION:

15 The Chairman of the Pension Fund has been consulted on the current position and has offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

17 There are no financial and value for money implications.

DIRECTOR OF FINANCE COMMENTARY

18 The Director of Finance is satisfied that the share voting policy offers an effective framework for the sound share voting of the pension fund, subject to reviews of the policy being presented to the Pension Fund Committee on a regular basis.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

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

OTHER IMPLICATIONS

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

WHAT HAPPENS NEXT

22 The following next steps are planned:

- Share voting policy be kept under review

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

Consulted:
Pension Fund Committee Chairman

Annexes:

Annex 1: List of abbreviations
Annex 2: Latest approved share voting policy

Sources/background papers:
None

AGM

An Annual General Meeting of shareholders, normally required by law.

EGM

An Extraordinary General Meeting of shareholders, where a meeting is required to conduct business of an urgent or extraordinary nature. Such business may require a special quorum or approval level.

GM

A General Meeting of shareholders, often used interchangeably with the term EGM or OGM, depending on the term used by the issuer in question.

OGM

An Ordinary General Meeting of shareholders, which is a meeting at which ordinary business is to be conducted (i.e. business which does not require a special quorum or approval level).

Court

A meeting of shareholders which is convened by a Court as opposed to by management. This is often used in the UK in order to effect a scheme of arrangement during a corporate transaction.

This page is intentionally left blank

Responsible Investment and Stewardship Policy

1 Introduction

1.1 Surrey Pension Fund (the Fund) aims to be an informed and responsible long term shareholder of the companies in which it invests. The Fund has a commitment to encourage responsible corporate behaviour, which is based upon the belief that active oversight and stewardship of companies encourages good long term value and performance. The Fund has a duty to protect and enhance the value of its investments, thereby acting in the best interests of the Fund's beneficiaries.

1.2 The Fund takes seriously its responsibility to ensure that its voting rights are exercised in an informed, constructive and considered manner.

1.3 The fund complies with the Myners Principles of investment management and the UK Stewardship Code, the seven principles of which are shown below at section 5.

1.4 The Fund will review its Responsible Investment and Stewardship Policy annually. The Fund's officers will carry out this review and propose any changes to the Pension Fund Board for consideration.

2 Scope

2.1 The Fund aims to vote its shares in all markets wherever practicable. However, due to the relative size of its holdings, we will focus our attention on the quality of our major asset holdings, i.e., UK, EU, US, Far East and emerging markets assets.

2.2 The Fund supports the 'comply or explain' principles of The United Kingdom Corporate Governance Code (the Code), and will seek to take all relevant disclosures into account when exercising its votes. While the Fund expects companies to take appropriate steps to comply with the Code, we recognise that departure from best practice may be justified in certain circumstances. In these situations, the Fund expects a considered explanation from the company.

2.3 Corporate governance principles and standards vary from market to market, and so the Fund's voting policy allows for some flexibility and discretion with due consideration to local circumstances.

3 General Principles

3.1 In general, the Fund aims to support corporate management in their stewardship role. This document sets out the Fund's high level voting principles and the circumstances where the Fund may override support for company management proposals. In general, where the Fund cannot support management, it will positively abstain or withhold a vote but, in certain cases, reserves the right to vote against company management.

3.2 In ordinary circumstances, the Fund delegates individual corporate engagement activity to its investment managers. The Fund will, however, consider engaging on a collective basis with other investors on issues of mutual interest.

4 Voting Policy

4.1 Audit & Accountability

The audit and financial reporting process affords investors significant protections by ensuring that management has effective internal controls and financial reporting systems.

Auditor independence may be compromised if the same firm has audited the company for a long time, or where the firm earns significant fees from non audit services. In order to help maintain auditor objectivity, we would expect companies to consider submitting the audit function to periodic tender, and to disclose their policy on tendering, including when the audit was last put to tender and when the incumbent audit firm was appointed.

- **Approval of Financial Statements**

Where there is a qualified audit statement; where there is uncertainty about the future viability of the business; where there is a restatement of annual results made in the previous year (apart from where adapting to new regulations); or where there are concerns of fundamental significance, the Fund will consider approval on a case by case basis.

- **Removal of Auditors**

Surrey Pension Fund will normally vote with management on proposals for the removal of auditors, unless the proposal is for alleged financial irregularities. In this instance, the Fund will judge on a case by case basis.

- **Extra Financial Reporting**

Companies should have regard to the environmental and societal risks and impacts of their operations as these can have a material impact on shareholder returns over a variety of time horizons. We believe that it is good management practice to assess and report on material “Extra Financial” risks associated with the governance of environmental and sustainability issues. Where we consider that disclosure on these risks is inadequate, the Fund will withhold its vote on the annual report or a suitable alternative resolution, where available, such as the sustainability report.

4.2 The Board & Committees

- **Nomination & Succession Planning**

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. The board should have plans in place for orderly succession and the policies relating to this should be disclosed in the Company’s annual report.

- **Committee Independence**

Audit, Remuneration and Nomination committees are key components of effective governance for companies. These committees should be composed entirely of independent non-executive directors; the Fund may therefore abstain from a director’s election if they are an executive or non-independent director on the Remuneration Committee.

Committees should be composed of individuals with adequate professional understanding of the matters to be resolved. This is particularly the case for the audit and risk committee. The fund may choose to abstain where there is insufficient evidence of appropriate competencies.

- **Separation of Chairman & Chief Executive Officer (CEO)**

The Fund believes the roles of Chairman and CEO should be separate. There may be individual circumstances where it is necessary to combine the roles for a specified purpose or over a period of time, in which case we will take account of the explanations provided. In all other circumstances, the Fund will abstain on the election of the Chairman.

- **Board Balance and Diversity**

Companies should seek to ensure that their boards are balanced for appropriate skills, competence and experience. Diversity of gender and experience are equally important and we expect to see clear disclosure from companies about their efforts to address gender imbalance and, in particular, how they aim to reach at least 30% female representation.

- **Notice Periods**

Evidence of reward for failure has lead to shareholder concerns over the length of notice periods for directors which have been used in the past to inform severance pay levels. Where the terms of executive pay policy allow overly generous severance pay on early termination of an executive contract, the fund may choose to register concern via an abstention vote.

Director notice periods are significantly important. Where an executive director's notice period exceeds twelve months or where severance pay exceeds an equivalent of twelve months, the Fund may abstain from voting.

- **Removal of Directors**

Where there is a proposal to remove a director, the Fund will vote against it unless the proposal has Board support and it is uncontested by the individual concerned. Where the proposal is contested by the individual concerned, the Fund will consider its position on a case by case basis.

4.3 Executive Remuneration

Executive remuneration should be determined by a formal procedure which is independent of the executives in question. The remuneration committee, in addition to demonstrating independent membership, should have written terms of reference and receive independent advice which is wholly separate from other corporate activities, for example, audit or HR.

There should be comprehensive, transparent and comprehensible disclosure of directors pay and policy. Policy in particular should fully explain the aims and objectives of reward strategies in the context of corporate objectives.

- **Approval of Long Term Incentive Schemes**

The Fund's policy on executive remuneration is that companies should develop equitable reward systems that genuinely incentivise directors to deliver sustainable, long term shareholder value, avoiding reward for results over the short term. The Fund wishes to encourage companies to move away from "one-size-fits-all" performance conditions, and to introduce objective performance conditions related to the company's long-term strategy. Discretionary share options and other long term incentive plans can, subject to appropriate safeguards, be acceptable elements of a director's remuneration.

11

The Fund will vote in favour of executive reward plans when:

- The company has a remuneration structure that encourages participation across the workforce.
- There is a capital commitment on the part of executive participants at the inception of the scheme.
- Where the exercise of options or the vesting of shares for executive participants is based on performance targets which reflect outstanding and sustainable performance and which are insulated from a particular treatment in the accounts or general market factors.
- Where disclosure is adequate to enable the assessment of rewards under the scheme and the cost to the company.
- Where the performance period for any long term scheme is five years or more.
- Where the participants are not eligible for multiple share-based incentives.
- Where the scheme does not have the potential to involve the issuing of shares which will unduly dilute existing holdings or involve a change in control of the company.

The Fund will abstain from supporting an all employee share scheme where non-executives are also permitted to participate.

4.4 Shareholders' Rights and Capital Structures

Surrey will consider resolutions relating to shareholder rights on a case by case basis. The following outlines the principles that we expect our companies to adhere to:

- **Pre-emption right for issues of new capital**

The Fund does not support resolutions that are inconsistent with rules of the Pre-emption Group.

- **"One Share One Vote"**

The Fund does not support issues of shares with restricted or differential voting rights, nor any action which effectively restricts the voting rights of shares held by it.

- **Share Repurchases**

The Fund will normally vote in favour of an authority for share repurchases, provided that it complies with the Listing Rule guidelines (e.g. limit of 15% of issued share capital) and that directors demonstrate that this is the most appropriate use of a company's cash resources. Companies should adopt equitable financial treatment for all shareholders. The Fund therefore supports measures that limit the company's ability to buy back shares from a particular shareholder at higher than market prices.

- **Controlling Shareholder**

Where a controlling shareholder is present on the share register, it is important that minority investors understand fully the nature of the rights held by that shareholder. Minority investors expect a formal relationship agreement to be in place and for this agreement to be fully disclosed to all shareholders.

4.5 Mergers and Acquisitions (M&A)

Support will be given to mergers and acquisitions that enhance shareholder returns in the longer term and encourage companies to disclose fully relevant information and provide for separate resolutions on all issues which require the shareholders to vote, for example, the effect of a merger on the compensation and remuneration packages of the individual Board members.

Due to the investment implications of M&A activity, the fund will liaise with its portfolio managers prior to making a final voting decision in support of takeovers.

Companies should seek shareholder approval on any action which alters the fundamental relationship between shareholders and the Board. This includes anti-takeover measures.

4.6 Article Changes

The Fund does not support proposed changes to Articles of Association and/or constitutional documents that reduce shareholder rights, or do not reflect generally accepted good governance practices.

4.7 Political & Charitable Donations

The fund recognises that some legitimate business related expenditure, such as marketing or sponsorship, may be construed as political under the terms of current legislation in some markets. Where authority for political expenditure fails to distinguish the amounts involved, or the period covered, or the amounts or period are considered excessive, the fund will not support the authority.

In addition the Fund considers that making of donations to political parties is not an appropriate use of shareholders' fund and so will vote against any authority to make such donations.

Charitable donations are acceptable if they are reasonable and further the company's wider corporate social responsibilities. The Fund encourages the issue of a policy statement by companies relating to such donations and full disclosure of the amounts given to the main beneficiaries.

4.8 Shareholder Resolutions

All such proposals will be reviewed on a case by case basis. We will generally support requests for improved corporate disclosure, notably relating to sustainability reporting. In other circumstances the fund will generally vote against shareholder resolutions not supported by management.

4.9 Other Business

Where a resolution proposes moving to an unregulated market or de-listing, the Fund will consider issues on a case by case basis. Schemes of arrangement, significant transactions and bundled resolutions are also considered on a case by case basis.

Where a resolution is proposed to allow for any other business to be conducted at the meeting without prior shareholder notification, the Fund will not support such resolutions.

5 The Principles of the UK Stewardship Code

In order to conform with the principles of the UK Stewardship Code, institutional investors, such as the Surrey County Council Pension Fund, should:

1. Publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. Have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
3. Monitor their investee companies.
4. Establish clear guidelines on when and how they will escalate their stewardship activities.

5. Be willing to act collectively with other investors where appropriate.
6. Have a clear policy on voting and disclosure of voting activity.
7. Report periodically on their stewardship and voting activities.

The Board will provide an annual report on how the Surrey Pension Fund satisfies its UK Stewardship Code obligations requirements.

SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **12 FEBRUARY 2016**

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

SUBJECT: **KEY PERFORMANCE INDICATORS & ADMINSTRATION UPDATE**

SUMMARY OF ISSUE:

In line with best practice, Pension Fund Committee members will be supplied with Pension Fund key performance indicators (KPIs) on a quarterly basis, covering investment and administration practices. This paper also includes an update on administration issues

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Committee note this report and the KPI statement shown in Annex 1.

REASON FOR RECOMMENDATIONS:

To comply with best practice.

MATERIAL CHANGES FROM THE LAST REPORTING PERIOD (30 SEPT 2015)

1 There is one funding, one investment performance category and nine administration categories that report changes over a three-month period as measured against their target.

2 Three new categories have been added since the previous report. The first provides details of the number of ill health retirement cases during the reporting period, the second provides information regarding the number of internal disputes received during this period and the last provides a break down of membership by active, deferred and pensioner categories.

3 The funding category has shown an improvement as compared with the previous three-month reporting period and the target performance level.

4 Of the nine administration categories, four show a deterioriation as compared against the previous three-month reporting period and five show an improvement. Nine categories failed to meet the performance target and 11 either met or exceeded the performance target in the reporting period.

5 KPI number eight confirms that the administration costs per member remains in the lowest CIPFA benchmark quartile, as measured in the 12 months to 31 March 2015.

DETAILS:

Requirement

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

Key Performance Indicators

7 The current KPIs cover the following areas:

- Funding level;
- Death benefit administration;
- Retirement administration;
- Ill health retirement administration;
- Benefit statements;
- New joiners;
- Transfers in and out;
- Internal dispute cases;
- Material posted on website;
- Employer and member satisfaction;
- Investment performance;
- Data quality;
- Contributions monitoring;
- Audit;
- Overall administration cost;
- Scheme membership;
- Employer membership.

7 To provide the committee with a overview of the number of administration cases completed in the three-month reporting period, this number is now included in the KPI schedule.

8 The KPI schedule to 31 December 2015 is shown as Annex 1.

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

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

CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

13 There are no financial and value for money implications.

SECTION 151 (DIRECTOR OF FINANCE) COMMENTARY

14 The Section 151 (Director of Finance) is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the current KPI model offers an effective framework for the monitoring of the essential pension fund KPIs.

LEGAL IMPLICATIONS – MONITORING OFFICER

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

EQUALITIES AND DIVERSITY

16 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

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

WHAT HAPPENS NEXT

18 The following next steps are planned:

- Continued improvement in the key performance indicators.
- Further refinement and additions of useful data.
- Review of KPIs in accordance with future guidance from the Scheme Advisory Board and Local Pension Board.

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

Consulted:
Pension Fund Committee Chairman.

Annexes:
Annex 1: Schedule of Key Performance Indicators

Sources/background papers:

This page is intentionally left blank

KPI - DETAILED ACTIONS, TIMESCALE AND REPORTING REQUIREMENTS: To 31 December 2015 Annex 1

No	Description	Target	Lead Officer	No of cases	Actual (Score and RAG)	Reporting Period	Previous no of cases	Previous Score	Date Last Reported	Improvement/Deterioration	Comments
1	FUNDING										
	IMPROVE FUNDING LEVEL Funding level to increase from current levels of 72%	100%	PT		75.5%	31/12/15		70.9%	30/09/15	4.60%	
2	PENSION ADMINISTRATION										
	DEATH BENEFITS Notify potential beneficiary of lump sum death in service grant within 5 days	95%	JB	5	100.0%	3 months to 31 Dec 15	4	100.0%	3 months to 30 Sep 15	0.00%	
	Write to dependant and provide relevant claim form within 5 days of notification of death	90%	JB	87	77.0%	3 months to 31 Dec 15	108	75.0%	3 months to 30 Sep 15	2.00%	
	Pay death grant within 5 days of receipt of relevant documentation	90%	JB	29	89.7%	3 months to 31 Dec 15	35	77.0%	3 months to 30 Sep 15	12.66%	
	Issue notification of dependant's pension within 5 days of receipt of relevant claim forms	90%	JB	29	89.7%	3 months to 31 Dec 15	35	77.0%	3 months to 30 Sep 15	12.70%	
	RETIREMENTS Employer decision and options to members within 10 days	90%	JB	167	53.1%	3 months to 31 Dec 15	246	63.0%	3 months to 30 Sep 15	-9.89%	2 Long term sickness absences in Benefits team during period impacted ability to meet targets
	New retirement benefits processed for payment following receipt of election within 10 days	95%	JB	205	89.8%	3 months to 31 Dec 15	293	93.9%	3 months to 30 Sep 15	-4.10%	Team now restructured to focus on improved service delivery
	ILL HEALTH RETIREMENTS Retirement options to members within 10 days	90%	JB	14	100.0%	3 months to 31 Dec 15					New reporting
	New retirement benefits processed for payment following receipt of election within 10 days	95%	JB	13	100.0%	3 months to 31 Dec 15					New reporting
	BENEFIT STATEMENTS ABS issued to 95% of eligible active members by 30th September	95%	JB		Final Tranche Issued Dec 2015/Jan 2016	12 months to 31 Aug 15	7024	1st tranche issued Oct 2015	12 months to 31 Aug 15		
	DBS issued to 85% of eligible deferred members by 30th June	95%	JB		Issued July 2015	12 months to 30 Jun 15		Issued July 2015	12 months to 30 Jun 15		
	NEW JOINERS New starters processed within 20 days	90%	JB	877	86.9%	3 months to 31 Dec 15	691	93.2%	3 months to 30 Sep 15	-6.31%	Temporary staff assisting with processing new joiners
	TRANSFERS IN Non LGPS transfers-in quotations processed within 20 days	90%	JB	100	90.0%	3 months to 31 Dec 15	77	91.0%	3 months to 30 Sep 15	-1.00%	
	Non LGPS transfers-in payments processed within 20 days	90%	JB	59	97.0%	3 months to 31 Dec 15	31	97.0%	3 months to 30 Sep 15	0.00%	
	TRANSFERS OUT Non LGPS transfers-out quotations processed within 20 days	90%	JB	132	93.2%	3 months to 31 Dec 15	126	91.0%	3 months to 30 Sep 15	2.20%	
	Non LGPS transfers out payments processed within 20 days	90%	JB	75	93.3%	3 months to 31 Dec 15	37	92.0%	3 months to 30 Sep 15	1.33%	
	INTERNAL DISPUTE CASES Number of cases referred to the stage 1 IDRP adjudicator	N/A	JB/NM	1	N/A	3 months to 31 Dec 15					New reporting
	MATERIAL POSTED ON WEBSITE Relevant Communications Material will be posted onto website within one week of being signed off	95%	JB/NM		100%	3 months to 31 Dec 15		100%	3 months to 30 Sep 15		
3	CUSTOMER SERVICE										
	EMPLOYER SATISFACTION/SURVEY Overall satisfaction score for employers to be 80%	80%	JB/NM		Annual Survey	At Aug 15		82%	At Aug 15		19/23 respondents rated service good or higher. 4 rated Fair
	MEMBER SATISFACTION/SURVEY Overall satisfaction score for members to be 80%	80%	JB		92%	At Jun 15		89%	At Jun 15	2.67%	April to June 2015 retirements
4	INVESTMENT PERFORMANCE										
	INVESTMENT RETURNS/OVERALL FUND PERFORMANCE Returns to at least match the benchmark	Benchmark	PT		BENCHMARK 3.0%	12 months to 30 Sept 15		BENCHMARK 2.0%	12 months to 30 Sept 15		
					ACTUAL 3.8%	12 months to 30 Sept 15		ACTUAL 2.7%	12 months to 30 Sept 15		
5	DATA										
	DATA QUALITY Common data quality within the Fund should be at least 90% accurate.	90%	JB		Due 31 March 2016	12 months to 31 Mar 15		99%	12 months to 31 Mar 15		
6	CONTRIBUTIONS										
	CONTRIBUTIONS RECEIVED Pension Fund 98% (total value) of contributions to be received by 21st day of the ensuing period.	98%	PT		98%	Dec-15		98%	Sep-15	0.00%	
7	AUDIT										
	CLEAN AUDIT REPORT Receive an unqualified audit opinion from the external auditors	Unqualified	PT/JB / NM			12 months to 31 Mar 15		Achieved	12 months to 31 Mar 15		
	Annual audit returns no significant findings	No significant findings	PT/JB / NM			12 months to 31 Mar 15		Administration Internal Audit opinion "effective"	12 months to 31 Mar 15		
8	COST										
	COST PER MEMBER Administration cost per member to remain in lowest CIPFA benchmarking quartile	< lowest quartile	PT/JB / NM		Lowest Quartile achieved	12 months to 31 Mar 15		Lowest Quartile achieved	12 months to 31 Mar 15		
9	SCHEME MEMBERSHIP										
	SURREY COUNTY COUNCIL Number of SCC members administered by the Pension Service Team	N/A	JB		89,154	As of 31 Dec 15		92,389	As of 30 Sep 15		
	Active members Deferred members Pensioner members	N/A	JB		33,101 32,966 23,087	As of 31 Dec 15					New reporting
	TOTAL Total number of members across all LGPS schemes administered by the Pension Service Team	N/A	JB		204,000	As of 31 Dec 15		No material change	As of 30 Sep 15		This sum includes all current schemes administered by the Pension Services Team.
10	SCHEME EMPLOYERS										
	SURREY EMPLOYERS Number of active employers in the Surrey Pension Fund	N/A	NM		201	As of 31 Dec 15		194	As of 30 Sep 15		

This page is intentionally left blank

SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **12 FEBRUARY 2016**

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

SUBJECT: **REVISED STATEMENT OF INVESTMENT PRINCIPLES**

SUMMARY OF ISSUE:

It is part of good governance that the Pension Fund Committee should review and approve its Statement of Investment Principles (SIP) and Core Belief Statement on a regular basis.

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1 Review and approve the Statement of Investment Principles shown in Annex 1.

2 Review and approve the Core Belief Statement shown in Annex 2.

REASON FOR RECOMMENDATIONS:

The Pension Fund Committee must review and 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.

Revised Statement

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

Core Belief Statement

3 The existing Core Belief Statement is shown as Annex 2.

Monitoring and Review

4 The SIP and Core Belief Statement are kept under constant review and will be submitted for approval to future Committee meetings when any revision is required.

CONSULTATION:

5 The Chairman of the Pension Fund has been consulted and offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

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

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 SIP and Core Belief Statement offer a clear structure, reflecting the current investment strategies and beliefs approved by the Pension Fund Committee.

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:

- Review and approval of the SIP and Core Belief Statement
- Documents to be kept under review

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

Consulted:
Pension Fund Committee Chairman

Annexes:
Annex 1: Revised Statement of Investment Principles
Annex 2: Core Belief Statement

Sources/background papers:
None

This page is intentionally left blank

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**

Responsibility and governance for the Pension Fund, including investment strategy, fund administration, liability management corporate governance is delegated to the Surrey Pension Fund Committee, 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 Committee is advised by a representative of the Fund's professional investment advisor, an independent advisor, the Director of Finance and the Strategic Finance Manager (Pension Fund and Treasury). The Pension Fund Committee meets on a quarterly basis.

Assisting, monitoring and scrutiny are delegated to the Local Pension Board, which is made up of:

- four employer representatives;
- four employee representatives;
- two independent representatives.

The Local Pension Board is advised by the Director of Finance and the Senior Specialist Advisor.

The Local Pension Board meets on a half yearly basis.

2. Investment Objectives

The Pension Fund Committee 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 Committee recognises that funding levels can be volatile from year to year depending as they do both on investment market levels and on estimates of liability values, so the long-term strategy needs to be capable of steering a steady course through changing market environments.

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

iii) To appoint managers that the Committee 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 Committee 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 Committee 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 Committee 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 Committee 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 Committee usually confines such mandates to specialist managers in regional equities.

Absolute Return managers

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

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

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

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 whereas fees are higher for active 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 Asset Allocation And Manager Structure

	Category	Allocation Policy %	Fund %	Review Range% +/-
Equities			**63.0**	**+/-3.0**
UK			29.0	
Legal and General	*Passive*	*10.0*		
Majedie	*Concentrated Active*	*11.0*		
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**
Index linked gilts			5.8	
Legal and General	*Passive*	*5.8*		
Investment Grade Credit			5.5	
Western	*Core Active*	*5.5*		
Total Return			*2.6*	
Franklin Templeton	*Unconstrained*	*2.6*		
Multi Asset Credit			4.6	
Western	*Unconstrained*	4.6		
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 Committee reviews the private equity strategy on an annual basis and makes commitments in order to achieve the target commitment level of 5% of the Fund.

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

Name	Currency	Inception	Commitment
UK Funds			**£/€/$m**
HG Capital MUST 3	£	2001	2.0
HG Capital MUST 4	£	2002	3.0
HG Capital 5	£	2006	10.0
HG Capital 6	£	2009	10.0
HG Capital 7	£	2013	15.0
ISIS II	£	1999-2002	12.0
ISIS III	£	2003	14.0
ISIS IV	£	2007	15.0
ISIS Growth Fund	£	2013	10.0
Darwin Property Fund	£	2013	20.0
Euro Fund of Funds			
Standard Life ESP II	€	2004	10.0
Standard Life ESP 2006	€	2006	15.0
Standard Life ESP 2008	€	2008	15.0
Standard Life ESF	€	2011	17.5
Standard Life SOF 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

The Pension Fund Committee, 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	%	
Multi Asset Credit	4.6	4.4
Investment Grade Credit	5.5	5.3
Index-Linked gilts	5.8	5.5
Unconstrained	2.6	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.

Stock lending is permitted. The Pension Fund Committee 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 UK Equities – Directional Long/Short	FTSE All Share FTSE All Share	+2.5% p.a. (gross of fees) over rolling 3-year periods Absolute return focused, but aims to out-perform the FTSE All Share Index by an unspecified amount over the long term
Newton	Global Equities	MSCI AC World	+2.0% p.a. (gross of fees) over rolling 3-year periods
Western	Investment Grade Credit Multi Asset Credit	100.0%: Merrill Lynch Sterling Non-Gilts Index Total return benchmark	+0.75% p.a. (gross of fees) over rolling 3-year periods +5% to 7% per annum over the market cycle
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 N - UK Equity Index RX - World (ex UK) Dev Equity Index HN – World Emerging Markets Equity Index CN - AAA-AA-A Bonds - All Stocks Index	FTSE All Share FTSE AW – Dev'd World (ex UK) FTSW AW – All Emerging Markit iBoxx GBP Non Gilts ex BBB All stock	To track the performance of the respective indices within a lower level of tracking deviation (gross of fees) over rolling 3-year periods

	Index-Linked Gilts	Portfolio of single stock funds structured 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 70:30 GARS:GFS	6 month LIBOR	+5.75% 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 Committee 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 Committee seeks to spread risks across a range of different sources, believing that diversification limits the impact of any single risk. The Pension Fund Committee 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 Committee:

Mismatch risk: the primary risk upon which the Pension Fund Committee 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 Committee and is reviewed on a regular basis.

Diversification risk: the Pension Fund Committee 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 Committee aims to ensure that the asset allocation policy results in an adequately diversified portfolio.

Concentration risk: the Pension Fund Committee 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 Committee 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 Committee 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 Committee 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 Committee's prior consent.

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

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

Should there be a material change in the Fund's circumstances, the Pension Fund Committee 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 Committee.

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

10 Stewardship and Responsible Investment

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

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

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

The Fund wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles. Share voting is undertaken in-house, after consultation with fund managers, and consultation with the Pension Fund Committee 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 Committee, preparing the audited annual report and financial statements in line with statutory deadlines, and maintain an up to date record of cash balances at Surrey to ensure surplus cash is invested promptly and resources are available to meet the benefit outflow as it arises.

Annex 1

Myners Investment Principles – Compliance Statement

Principle 1: Effective Decision-making

Administering authorities should ensure that:

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

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

✓ **Full compliance**
The Pension Fund Committee and Local Pension Board are supported in their decision making/assisting roles by the Director of Finance, the Strategic Finance Manager (Pension Fund and Treasury) and the Senior Specialist Advisor.

Members of both the Committee and Local Pension 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.

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 Committee on a quarterly basis. Fund managers present to the officers or the Pension Fund Committee 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 Committee, although options other than measuring meeting attendance and the success of the Committee'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.

13

✓ **Full compliance**

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

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

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

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

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 Committee and half yearly reports to the Local Pension 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.

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 present 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.

13

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 A well-balanced portfolio has an appropriate mix of passive and active investments.

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

4.3 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.

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

4.5 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.

4.6 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.

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

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

Document is Restricted

This page is intentionally left blank

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

15

Document is Restricted

This page is intentionally left blank

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

15

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

16

Document is Restricted

This page is intentionally left blank

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

16

Document is Restricted

This page is intentionally left blank