

**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE: 15 MAY 2014**

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

**SUBJECT: MANAGER ISSUES AND INVESTMENT PERFORMANCE**



**SUMMARY OF ISSUE:**

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

**RECOMMENDATIONS:**

It is recommended that the Pension Fund Board:

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

**REASON FOR RECOMMENDATIONS:**

In order to achieve best possible performance alongside optimal risk.

**DETAILS:****1) Manager Issues during the Quarter**

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

## 2) Freedom of Information Requests

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

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

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

The schedule of meetings for 2014 is as follows:

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

## 4) Stock Lending

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

## 5) Share Voting

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

## 6) Ill Health Insurance

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

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

## **Report of the Pension Fund & Treasury Manager**

### **Internally Managed Cash**

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

### **Private Equity Opportunities**

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

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

### **Actuarial Update**

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

### **Governance Strategies and Policies**

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

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

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

## **Fund Manager Meetings on 22 April 2014**

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

## Report of the Pension Fund & Treasury Manager

### Financial and Performance Report

#### 1. Market Value

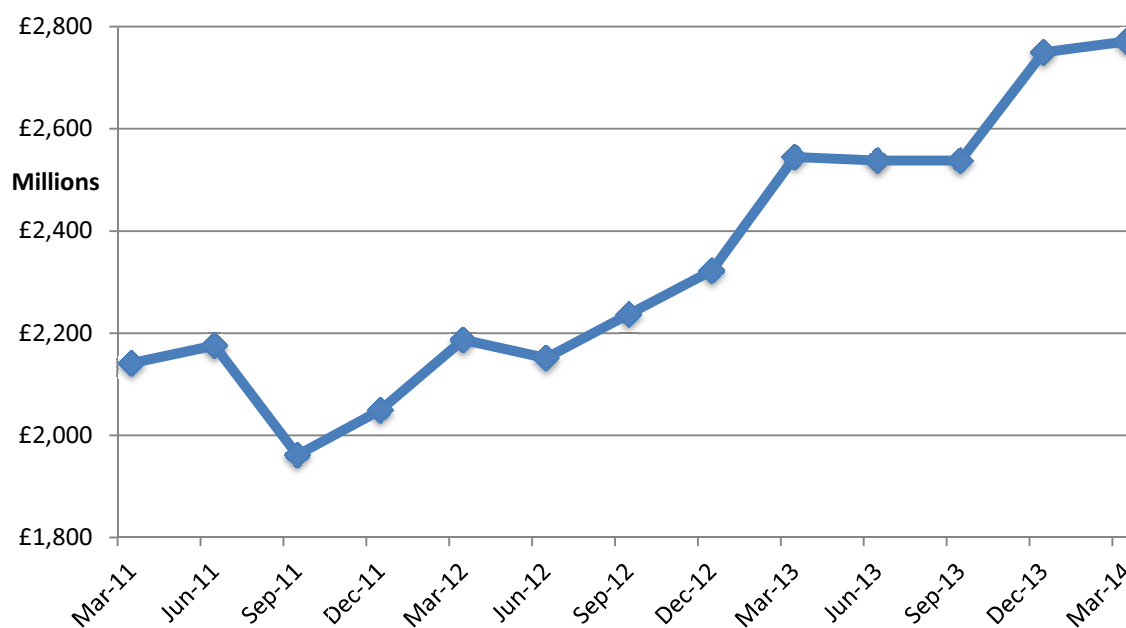
The value of the Fund was £2,771.1m at 31 March 2014 compared with £2,749.5m at 31 December 2013. Investment performance for the period was +1.0%.

The increase is attributed as follows:

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

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

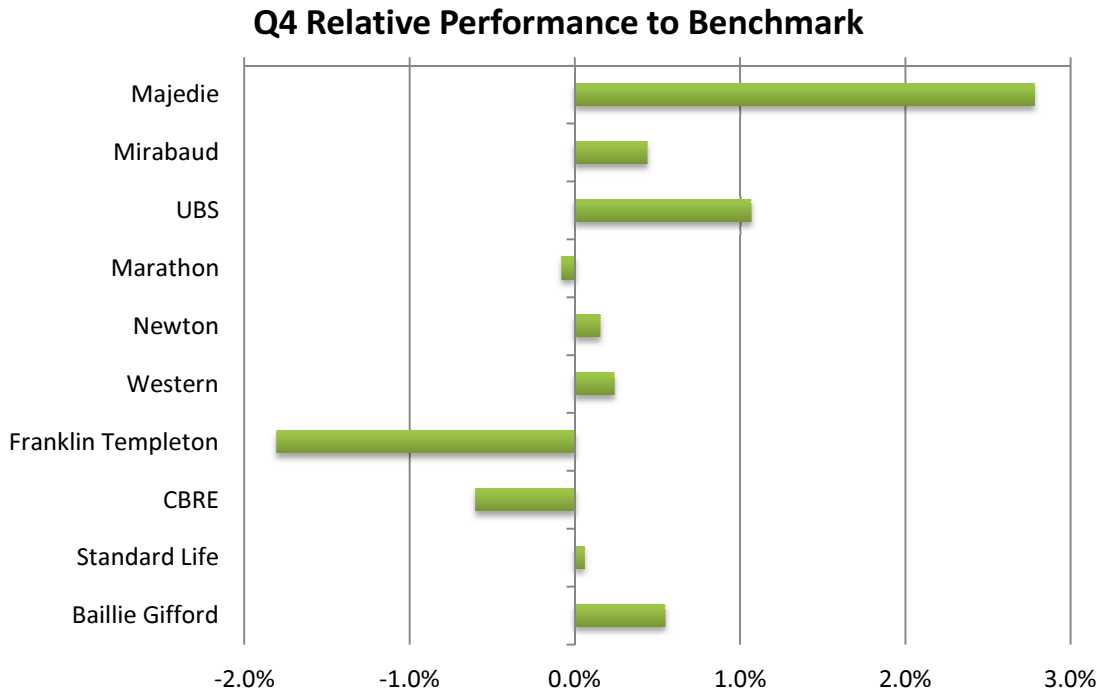
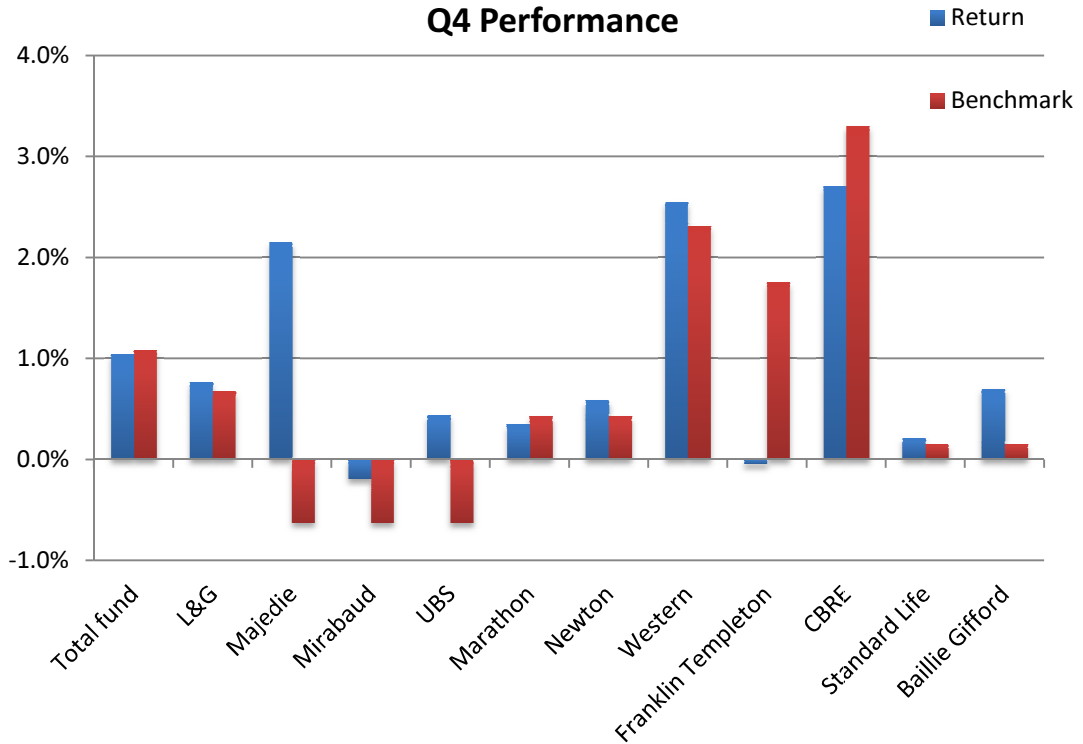
#### Total Fund Value - 31 March 14



## 2. Fund Performance

### Summary of Quarterly Results

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



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

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

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

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

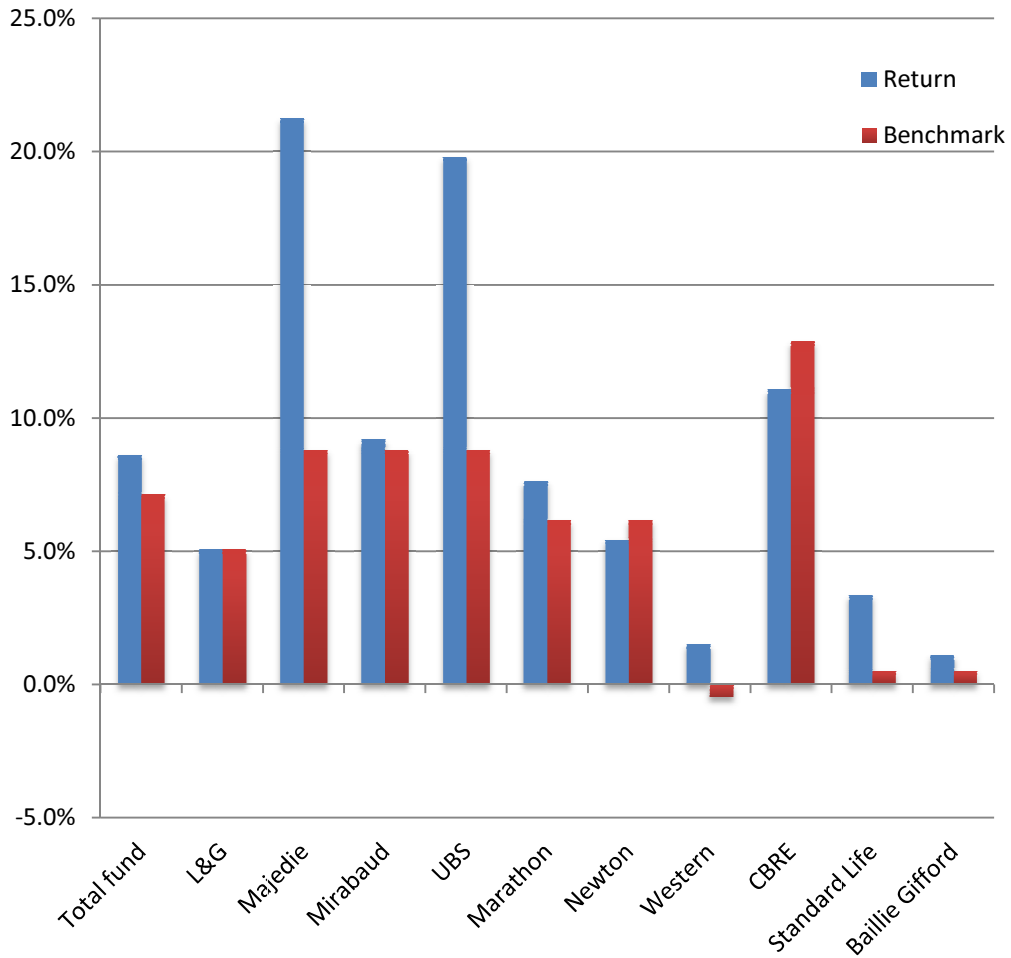
*Franklin Templeton is measured against a US Dollar denominated benchmark which is then converted back to Sterling. This can cause a disparity between performance and benchmark.*



## Summary of Full Year Results

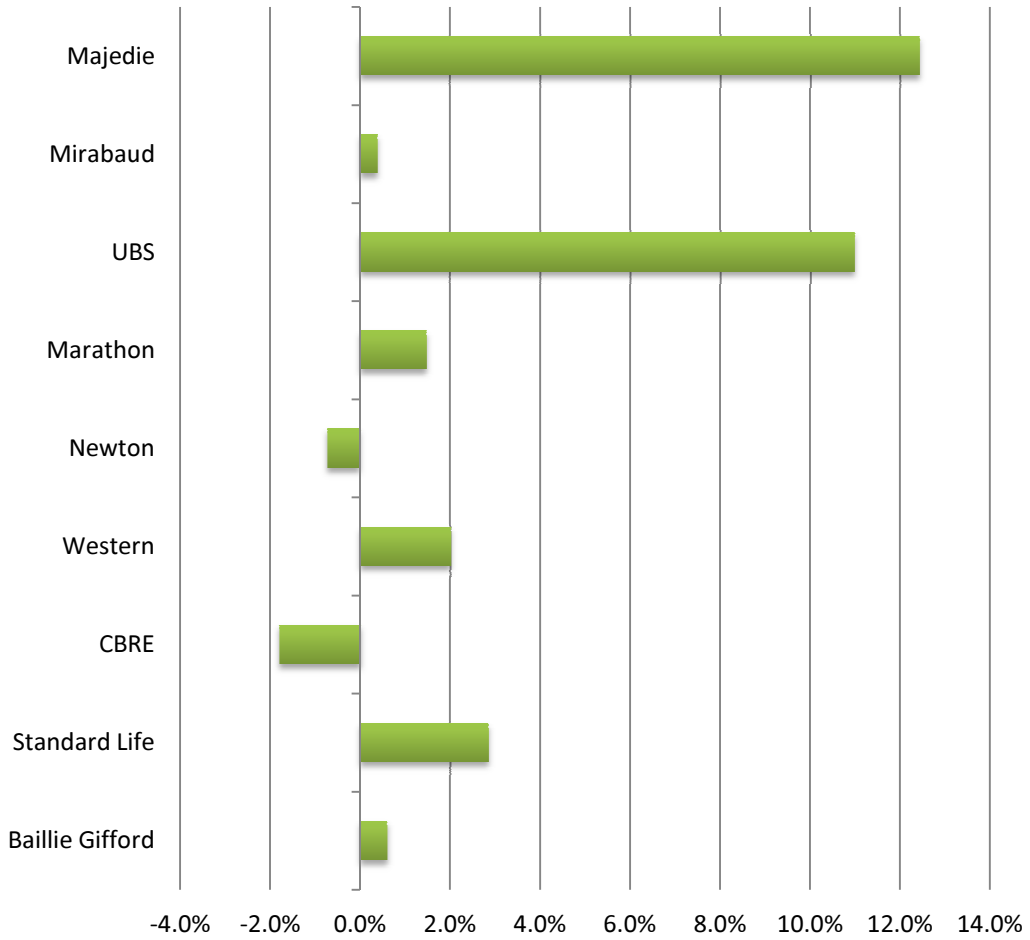
Over the past 12 months to 31 March 2014, the Fund returned +8.6% overall, surpassing the benchmark return of +7.1%.

### Rolling Full Year Performance



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

### Full Year Relative Performance to Benchmark

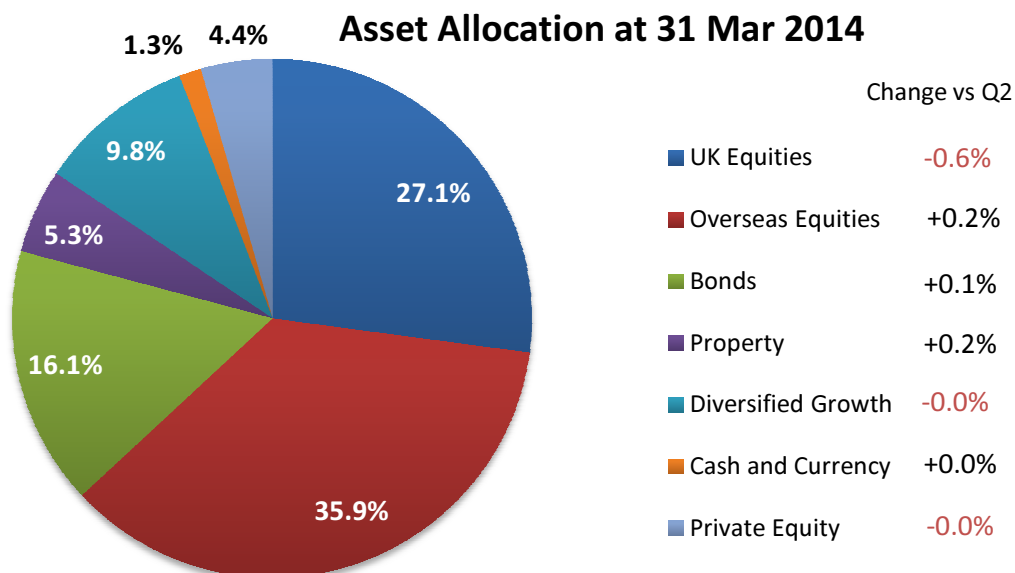


The table below shows manager performance for the year to 31 March 2014 against manager specific benchmarks using custodian data.

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

### 3. Asset Allocation

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

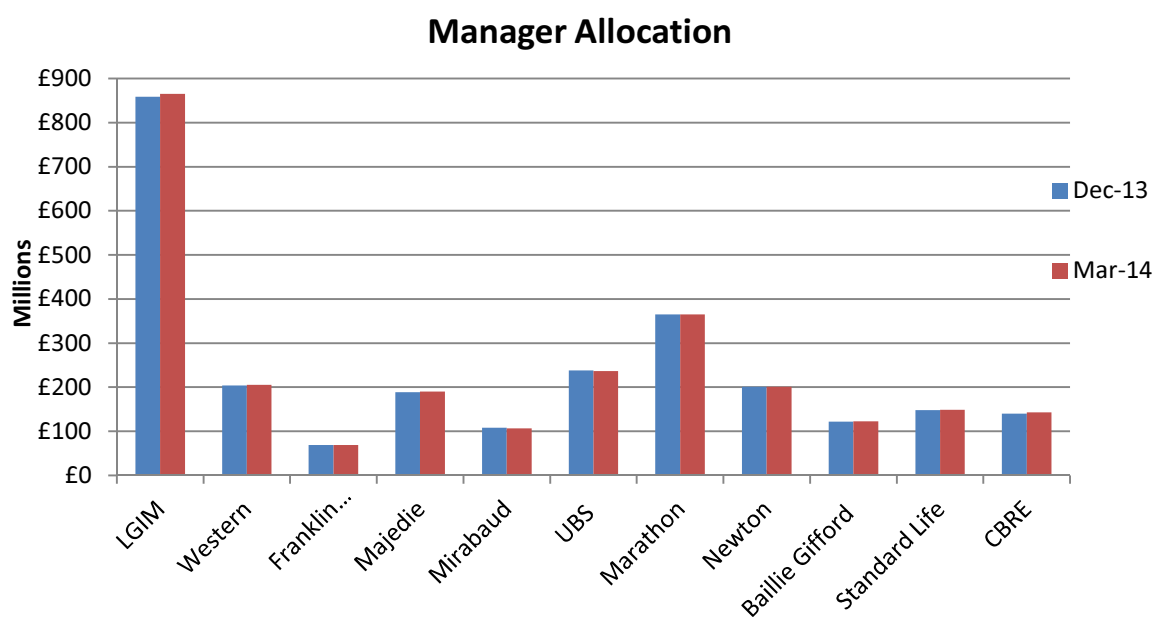


The table below compares the actual asset allocation as at 31 Mar 2014 against target asset weightings.

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

#### 4. Manager Allocation

The graph below shows the current manager allocation.



The table below includes the actual and target manager allocation weightings for those investments managed through the custodian Northern Trust as at 31 March 2014. This excludes the internal cash and private equity portfolio.

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

## 5. Fees

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

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

\*Estimated

\*\* Includes performance fee

**CONSULTATION:**

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

**RISK MANAGEMENT AND IMPLICATIONS:**

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

**FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

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

**CHIEF FINANCE OFFICER COMMENTARY**

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

**LEGAL IMPLICATIONS – MONITORING OFFICER**

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

**EQUALITIES AND DIVERSITY**

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

**OTHER IMPLICATIONS**

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

**WHAT HAPPENS NEXT**

13 The following next steps are planned:

- Implementation of the various recommendation approvals.

**Contact Officer:**

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

**Consulted:**

Pension Fund Board Chairman

**Annexes:**

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

**Sources/background papers:**

None