

SURREY COUNTY COUNCIL

SURREY PENSION FUND BOARD

DATE: 19 SEPTEMBER 2014

LEAD OFFICER: SHEILA LITTLE, DIRECTOR OF FINANCE

SUBJECT: MANAGER ISSUES AND INVESTMENT PERFORMANCE



7

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 making a £7m commitment each year for 2014/15, 2015/16 and 2016/17 to the Capital Dynamics LGPS Collective Private Equity Vehicle.
3. give consideration to making a USD 20m commitment to the Goldman Sachs Private Equity Managers (PEM) Fund.

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 30 June 2014 and 27 August 2014 are shown in Annex 1.
Standard Life	Global Focused Strategies	Members agreed to allocate £60m to Standard Life's Global Focused Strategies Fund at the Board meeting on 15 May 2014. This was achieved on 12 June 2014 with a transfer from equities run by Legal and General Investment Management to the Standard Life GFS Fund. An adjustment has been made to the Statement of Investment Principles (SIP) as a result.
Mirabaud	Client meeting	Update included in minutes of external fund manager meetings held on 17 September 2014.
Newton	Client meeting	Update included in minutes of external fund manager meetings held on 17 September 2014.
Western	Client meeting	Update included in minutes of external fund manager meetings held on 17 September 2014.
CBRE	Client meeting	Update included in minutes of external fund manager meetings held on 17 September 2014.
Capital Dynamics	Private Equity opportunity	Members are invited to consider the Capital Dynamics LGPS Collective Private Equity Vehicle opportunity set out in (9) below.
Goldman Sachs	Private Equity opportunity	Members are invited to consider the Goldman Sachs Private Equity Managers (PEM) Fund opportunity set out in (9) below.

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
10/04/2014	Private Individual	n/a	Information relating to tobacco investment held by the Fund.	A spreadsheet containing the market value of directly held tobacco company assets over the previous 4 years, including both fixed income and equity investments
20/06/2014	Company	Pitchbook	Information pertaining to private equity investments made by the Fund	A spreadsheet with a breakdown of private equity investments held by the Fund.

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

The schedule of meetings for 2014 is as follows:

- 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 30 June 2014, stock lending earned a net income for the Fund of £105,519, with an average value on loan equal to £120.6m

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. This notice was published on 3 September 2014. 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.

7) **Private Equity**

A review of the private equity portfolio was presented to the Board at the meeting of 15 May 2014. Latest information was taken from the global custodian position reports and, where possible, information provided from the private equity managers themselves. Officers have since taken the opportunity to review the data and update where necessary. A revised valuation as at 31 March 2014 is shown at Annex 2.

8) **Internally Managed Cash**

The internally managed cash balance of the Pension Fund was £0.8m as at 30 June 2014.

9) Private Equity Opportunities

Capital Dynamics LGPS Collective Private Equity Vehicle 2014/2015

Capital Dynamics, one of the Fund's existing private equity managers, has developed its first Collective Private Equity Vehicle specifically designed for LGPS funds (LGPS CPEV) in response to the ongoing campaign to reduce management fees via collaboration. The sterling denominated pooled vehicle provides a means for LGPS funds to gain access to an optimally balanced portfolio of private equity strategies.

The global portfolio includes primary (65% minimum), secondary (up to 30%) and co-investment (5%) strategies. The primary investments are weighted 40% US, 40% Europe and 20% Asia/Emerging Markets. The secondary and co-investment proportion of the portfolio will be geographically opportunistic, but will have global diversification. The portfolio has been designed to minimise risk whilst preserving attractive target returns of between 12% and 15% net/net IRR (1.5x to 1.8x multiple of cost).

The fund raising period for each closed end Fund will span the fiscal year, i.e. from 1 April to 31 March. The investment period will be two years from the first close of each Fund. The reduced fund raising and investment periods, plus the secondary element of the fund will ensure that cash is returned to investors more efficiently, significantly mitigating the J-Curve effect.

The fee is 10bps for 80% of the Vehicle, i.e. 8bps per annum. 20% of the Vehicle will be invested directly into Capital Dynamics' secondary and co-investment funds with no additional layer of fees. Moreover, LGPS investors who commit to three annual programmes in advance will qualify for a management fee reduction of 50%, i.e., 4bps per annum. The performance fee of 7.5%, is payable after all capital invested has been returned to investors in cash plus a compounded 8% hurdle.

Surrey has previously invested in Capital Dynamics US Solar Fund and Capital Dynamics Clean Energy and Infrastructure Fund.

It is recommended that the Surrey Pension Fund give consideration to making a total £21m commitment to the Capital Dynamics LGPS Collective Private Equity Vehicle, optimising the fee discount offered over three annual programmes by investing £7m per vehicle.

Goldman Sachs Private Equity Managers (PEM) Fund

The Goldman Sachs Private Equity Managers (GSAM) "PEM" 2014 is the fourth in a series of annual funds called the PEM Program that is managed by Goldman Sachs Asset Management's AIMS private equity team. This is the same team that manages Surrey Pension Fund's existing commitments to GSAM's Private Equity Partners ("PEP") and Vintage Funds.

The PEM 2014's primary focus will be on constructing a portfolio of six to eight private equity commitments with diverse strategies, which may include middle-market buyout, large buyout, distressed, growth equity, credit, venture capital and industry focused strategies. On an opportunistic basis, the PEM 2014 may also acquire interests in private equity funds from investors seeking liquidity prior to the termination of those vehicles (i.e. secondary investments).

The investment objective for PEM 2014 is to realise long-term compounded returns in excess of those available through conventional investments in the public equity markets. For commitments of USD 20m and more into PEM 2014, the average annual management fee on committed capital is 47bps (assuming a 12-year fund life), without any performance fee charged by GSAM.

Goldmans expects the PEM to outperform equity markets by three to five percent (net of all fees) over the long term.

It is recommended that the Surrey Pension Fund give consideration to making a USD 20m commitment to the Goldman Sachs Private Equity Managers Fund.

10) Governance Strategies and Policies

All outstanding papers have now been drafted and presented to the Board.

The share voting framework and share voting policy are due for revision and revised papers will be presented to the Board on 14 November 2014, following publication of the changes to the UK Corporate Governance Code due to be published at the start of October 2014.

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
12. Private Equity Reporting Framework
13. Responsible Investment and Stewardship Policy
14. Risk Register Reporting Framework
15. Share Voting Reporting Framework
16. Statement of Investment Principles
17. Stewardship Code
18. Stock Lending Policy

11) Results of the Governance Self-Assessment Survey

The results of the Governance Self-Assessment completed by members of the Board were tabled at the 15 May 2014 Board meeting.

There were six important issues taken from the self-assessment process. Each is laid out below with action points to be undertaken by the Strategic Finance Manager.

1) The Board does not have enough time to be truly effective and that meetings do not allow sufficient focus on the 'big picture' strategic issues.

Where appropriate and where there is sufficient material on the agenda, board meetings will continue for the whole day (typically 9:30am to 3:30am). Strategic issues and an hour's member training scheduled for each meeting will take overall priority. If an agenda is considered to be too time consuming, the investment manager meetings will take place on a separate day and these manager meetings will be open to Board members to attend. Minutes from those meetings will be taken directly to the next Board meeting for consideration. Investment manager meetings (both within Board meetings and held externally) will be subject to a pre-meeting briefing in order to decide what questions should be asked of the managers.

2) There is value in having additional training and informal discussions between formal Board meetings in order to develop a general consensus on where the market is headed and an understanding of what other Pension Fund Boards are doing.

A full range of quality training days will be offered to Board members as and when the opportunities are communicated to the Strategic Finance Manager. Typically, such opportunities are afforded to all LGPS funds with a resultant attendance of LGPS trustees from across the UK. Discussions between fund members at those meetings as to varying strategies being considered and implemented are encouraged.

3) There is value in holding pre-meetings with advisors and consultants in order to ensure that members are supported with the right questions when meeting fund managers.

Pre-meetings will be held ahead of all future meetings where investment managers are attending for presentation.

4) There is no value to be gained from increasing the number of formal Board meetings.

The standard quarterly meeting format will remain.

5) There is no value in setting up smaller sub-committees.

There are no plans to set up sub-committees.

6) The Fund's Administration function is not adequately monitored.

The internal audit report of the Administration function was presented to the Board on 15 May 2014. Detailed performance on administration key performance indicators (KPIs) are presented at every Board meeting.

12) **National Changes to the LGPS: Collaboration**

At the last Board meeting on 15 May 2014, the Strategic Finance Manager introduced a report with regard to possible future collaboration with the South East 7 counties. An officer meeting subsequently took place on 28 May 2014 to work on proposals. The outcome of the meeting produced the following to be worked on for the next meeting.

Response to 9 July 2014 CIV/Passive Consultation: authorities to share responses in the run up to the deadline. Achieved.

Society of County Treasurers LGPS Actuarial Survey: West Sussex to ascertain progress as it will be a helpful map as to where commonality exists.

DCLG Governance Consultation: authorities to share responses. Achieved.

Pension Fund Annual Report: new CIPFA guidance recently published. Authorities to share interpretations and ideas.

Current Activity: infrastructure and leveraged gilts (Surrey), transition manager and balanced growth (WSCC).

Potential Collaboration: Foreign exchange and transactions. WSCC to lead on this.

Committee meetings: Surrey Board on 19 September 2014 (all SE7 officers invited). WSCC Governance Working Group on 16 July 2014 (Phil Triggs attended).

Contractual settlement and income collection: WSCC conducting a study.

13 **Fund Manager Meetings of 17 September 2014**

Notes of the fund manager meetings of 17 September 2014 will be tabled at the Board meeting on 19 September.

Report of the Strategic Finance Manager

Financial and Performance Report

1. Funding Level

Table 1

Past Service Position	30 June 2014 £m
Past Service Liabilities	3,577
Market Value of Assets*	2,853
Deficit	(724)
Funding Level	79.8%

* This is an estimate of the fund market value prior to quarter end.

The funding level at the latest formal valuation at 31 March 2013 was 72.3%. As at 30 June 2014 the funding level has increased to 79.8%, a significant improvement. This is largely as a result of strong investment manager performance and an increase in gilt yields, resulting in a higher discount rate (5.0%), which places a lower value on the Fund's liabilities.

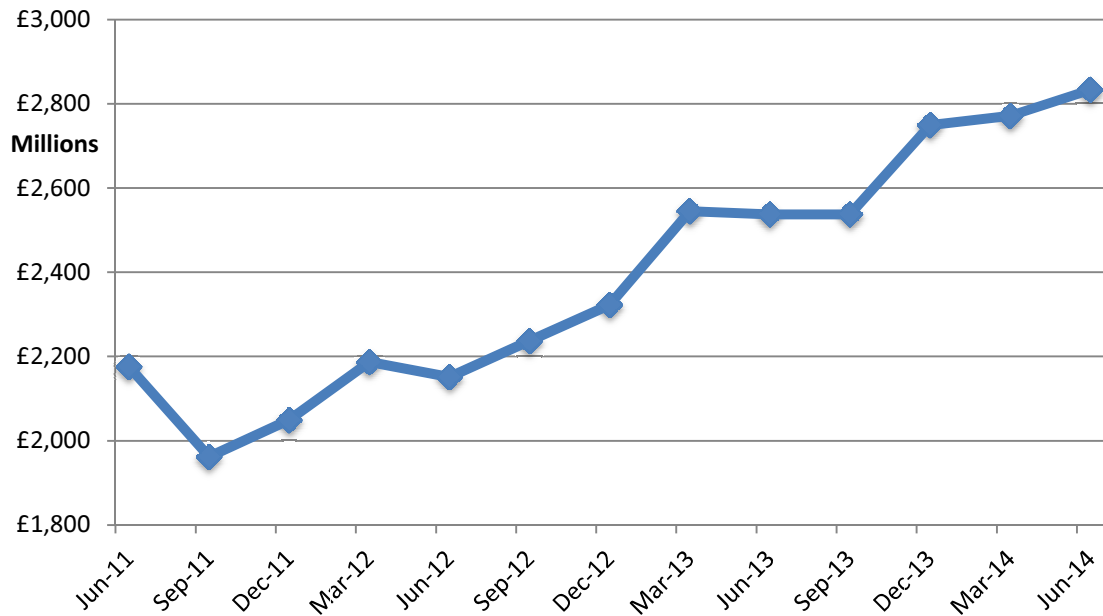
2. Market Value

The value of the Fund was £2,833.0m at 30 June 2014 compared with £2,771.1m at 31 March 2014. Investment performance for the period was +2.2%.

The increase is attributed as follows:

	£m
Market Value at 31/03/2014	2,771.1
Contributions less benefits and net transfer values	2.4
Investment income received	15.4
Investment expenses paid	-2.3
Market movements	46.4
Market Value at 30/06/2014	2,833.0
Market Value at 27/08/2014 (estimated)	2,856.6

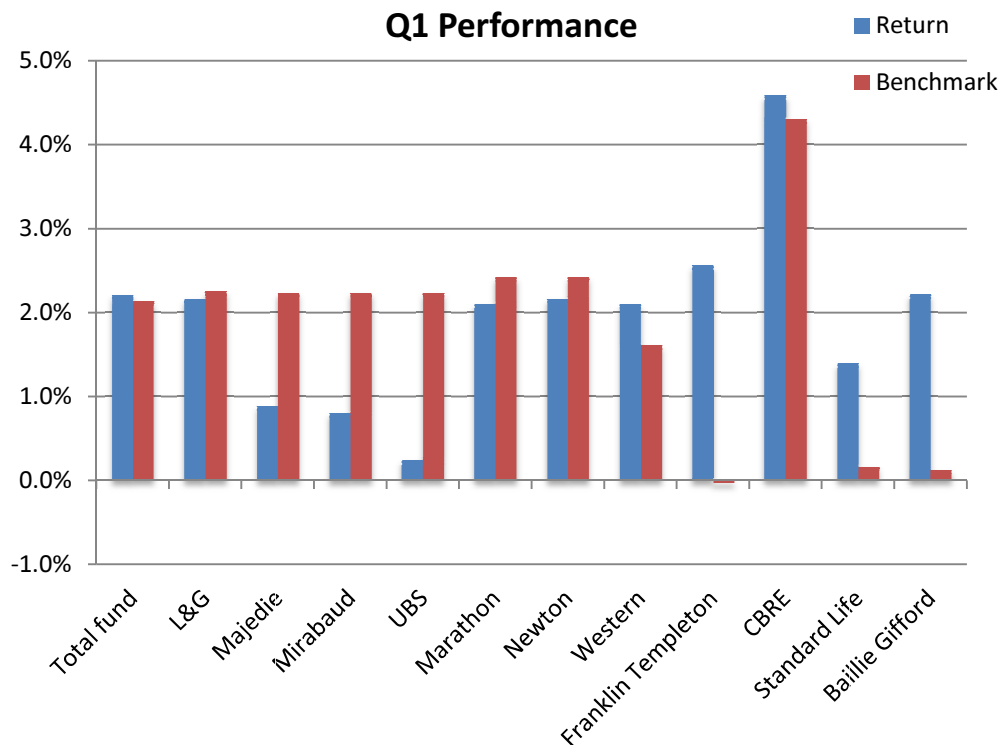
Total Fund Value



3. Fund Performance

Summary of Quarterly Results

Overall, the total fund returned +2.2% in Q1 2014/15 just above the SCC customised benchmark of 2.1%.



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

Property provided the largest absolute return for the fund during the previous quarter with a performance of +4.6% with a +0.3% outperformance against the benchmark. Broadly other asset classes reported fairly even investment performance over the quarter. In relative terms, all three active UK equity managers underperformed the benchmark return of 2.2%

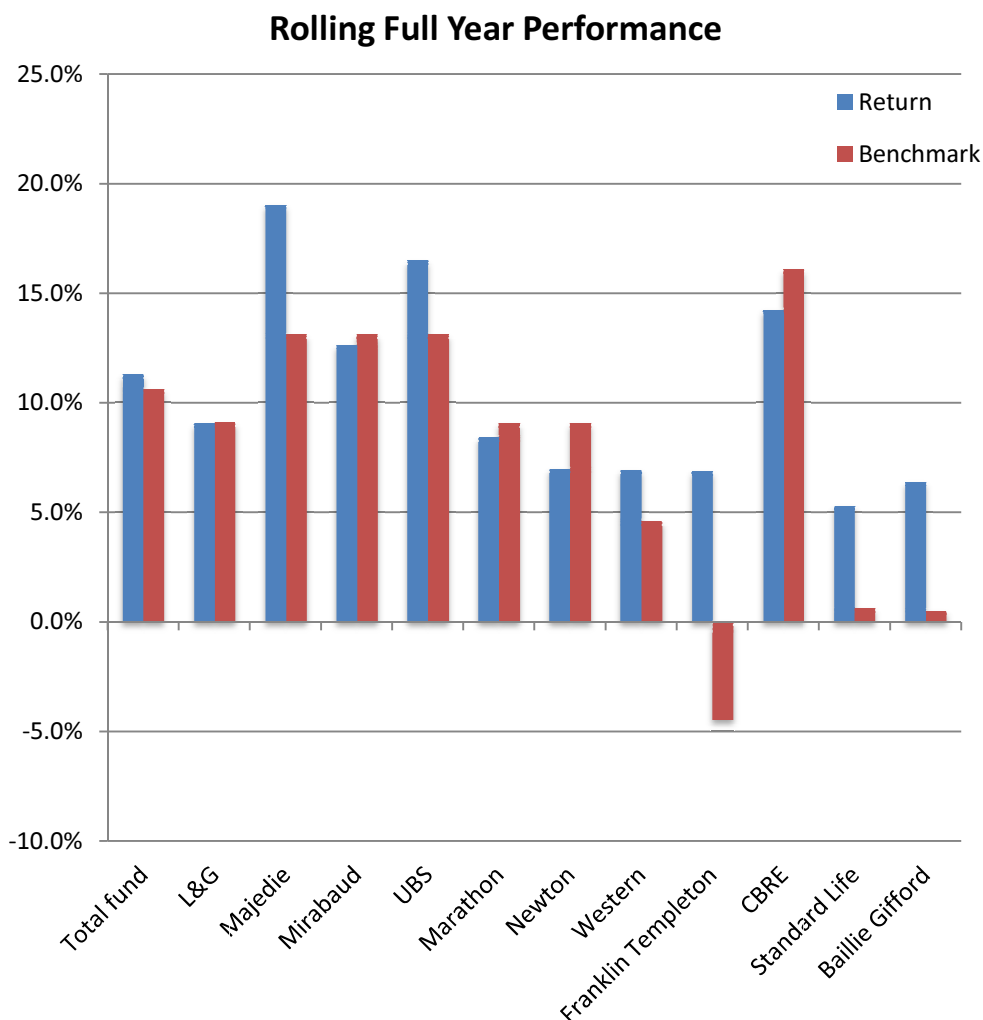
The table below shows manager performance for 2014/15 Q4 against manager specific benchmarks using custodian data.

Manager	Performance %	Benchmark %	Relative %
Total fund	2.2	2.1	0.1
L&G	2.2	2.3	-0.1
Majedie	0.9	2.2	-1.3
Mirabaud	0.8	2.2	-1.4
UBS	0.2	2.2	-2.0
Marathon	2.1	2.4	-0.3
Newton	2.2	2.4	-0.2
Western	2.1	1.6	0.5
Franklin Templeton	2.6	0.0	2.6
CBRE	4.6	4.3	0.3
Standard Life	1.4	0.2	1.2
Baillie Gifford	2.2	0.1	2.1

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

Summary of Full Year Results

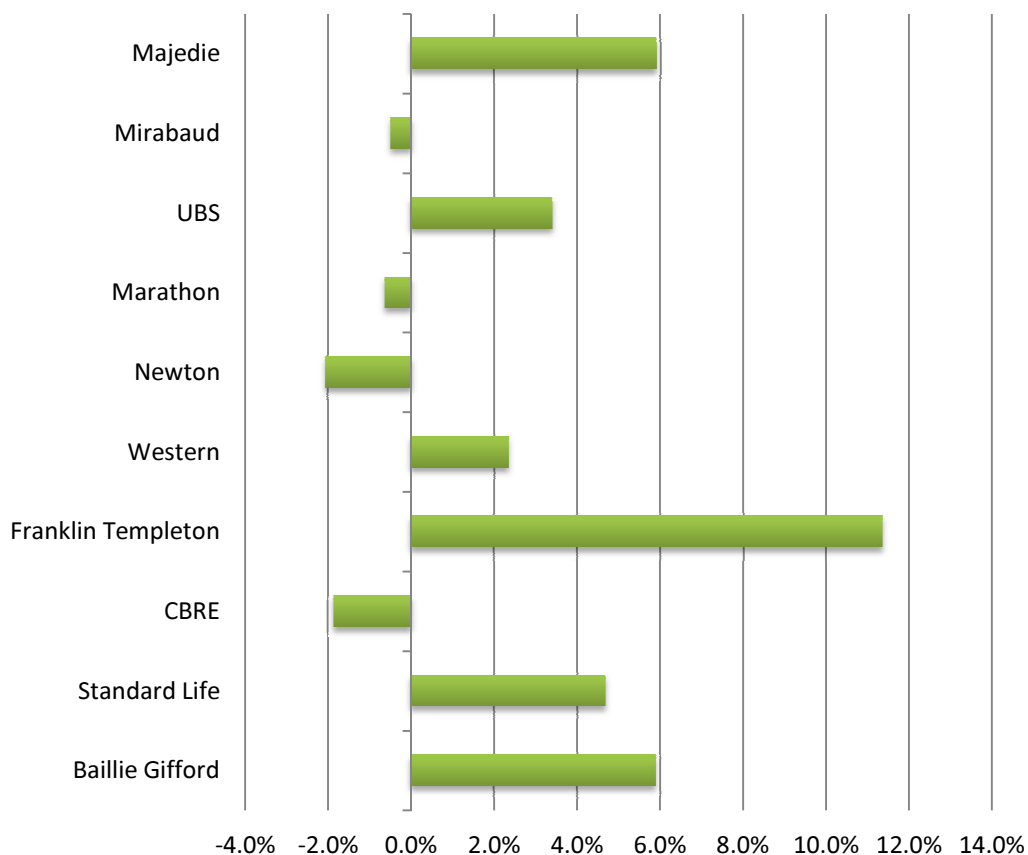
During the course of the previous 12 months to 30 June 2014, the Fund returned +11.3% overall, an outperformance of 0.7% against the customised benchmark of +10.6%.



Domestic equity and property provided the largest return to the fund over the previous quarter with both asset classes securing double digit investment performance. Majedie and UBS recorded absolute returns of +19.0% and +16.5% respectively ahead of the UK equity benchmark of +13.1%.

Franklin Templeton recorded a sizable +11.4% relative performance against the benchmark. The benchmark is an unhedged USD benchmark and when converted to sterling resulted in a underperformance of -4.6%. The benchmark performance in USD terms is +7.7%.

Full Year Relative Performance to Benchmark

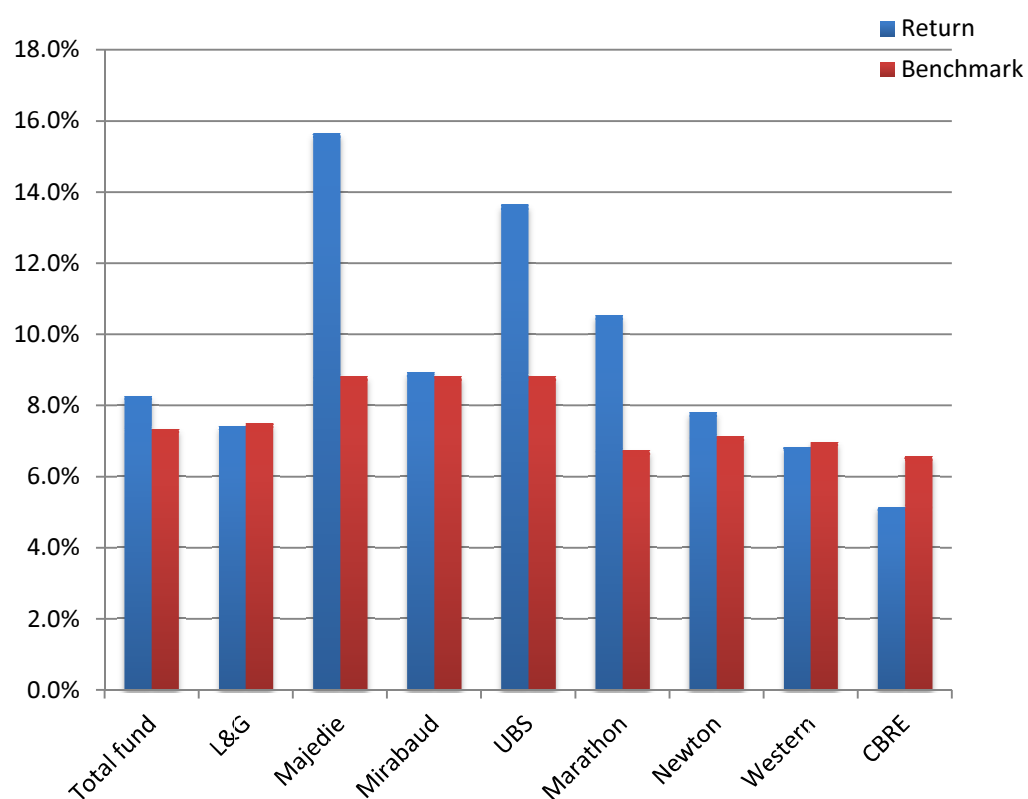


The table below shows manager performance for the year to 30 June 2014 against manager specific benchmarks using custodian data.

Manager	Performance %	Benchmark %	Relative %
Total fund	11.3	10.6	0.7
L&G	9.0	9.1	-0.1
Majedie	19.0	13.1	5.9
Mirabaud	12.6	13.1	-0.5
UBS	16.5	13.1	3.4
Marathon	8.4	9.1	-0.6
Newton	7.0	9.1	-2.1
Western	6.9	4.6	2.3
Franklin Templeton	6.9	-4.5	11.4
CBRE	14.2	16.1	-1.9
Standard Life	5.3	0.6	4.7
Baillie Gifford	6.4	0.5	5.9

Summary of Rolling Three Year Performance

Rolling Three Year Performance

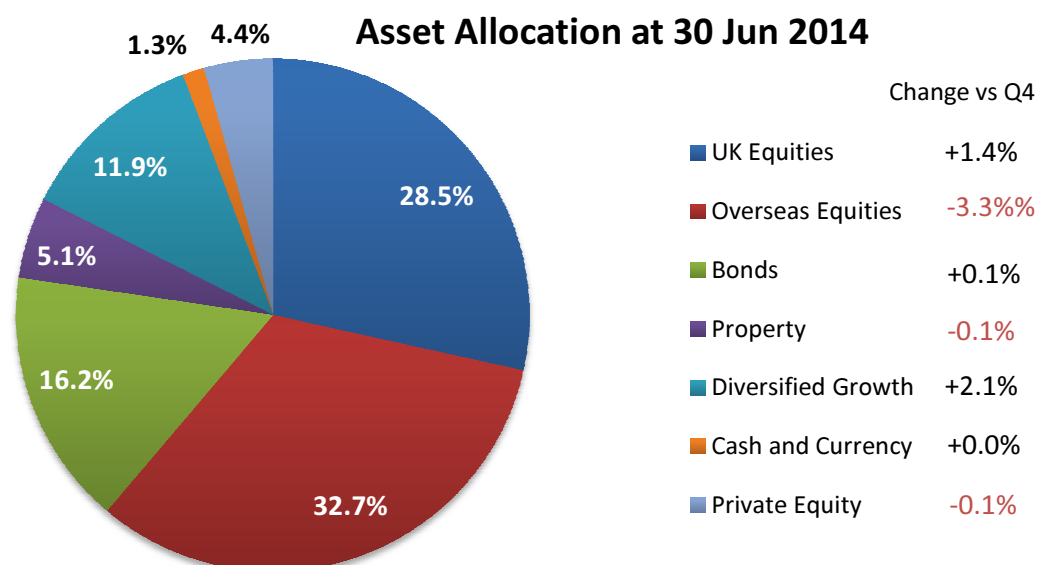


The below table shows the annualised performance by manager for the previous three years

Manager	Performance %	Benchmark %	Relative %
Total fund	8.6	7.6	1.0
L&G	7.5	7.6	-0.1
Majedie	15.0	8.9	6.1
Mirabaud	8.8	8.9	-0.1
UBS	12.8	8.9	3.9
Marathon	10.6	7.3	3.3
Newton	8.5	8.0	0.5
Western	7.0	6.6	0.4
CBRE	6.0	7.4	-1.4

4. 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 sizable movement in equities and diversified growth is a result of the investment into Standard Life GFS Fund, funded by a divestment from passive equities held by L&G.

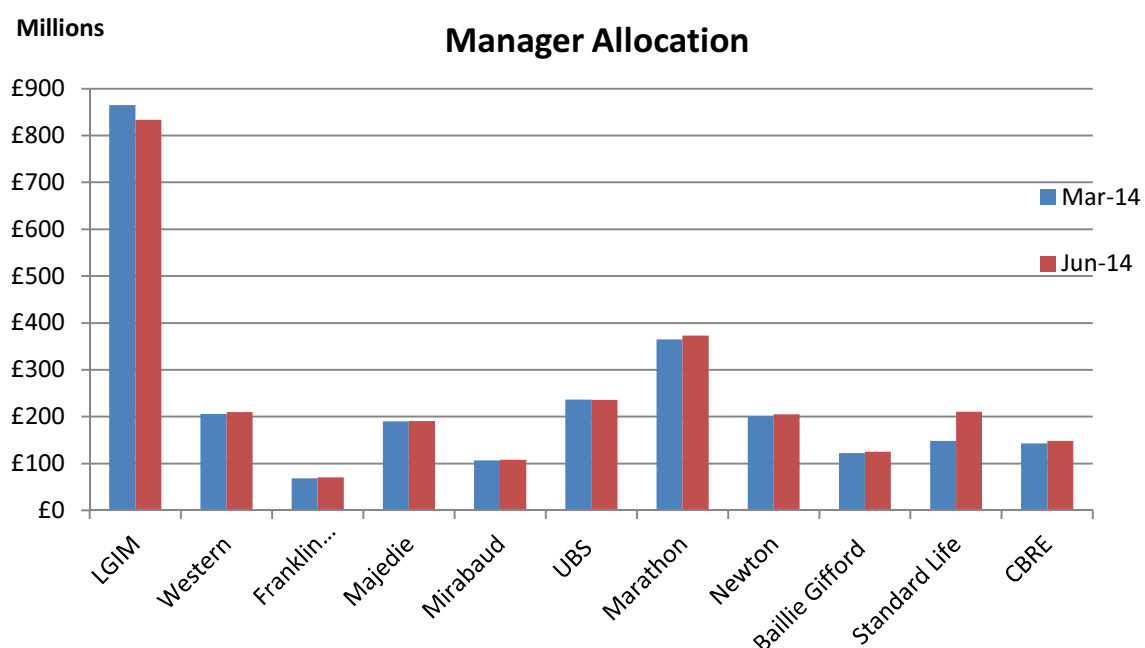


The table below compares the actual asset allocation as at 30 June 2014 against target asset weightings.

	TOTAL FUND	Actual	Target	Last Quarter	
	£m	%	%	£m	%
Fixed Interest					
UK Government	105.2	3.7	4.6	104.6	3.8
UK Non-Government	122.8	4.3	7.1	118.6	4.3
Overseas	61.9	2.2	0.0	60.2	2.2
Total Return	70.6	2.5	2.4	68.8	2.5
Index Linked	98.0	3.5	3.5	94.7	3.4
Equities					
UK	806.5	28.5	27.5	751.2	27.1
Overseas	925.9	32.7	32.3	996.0	35.9
Property Unit Trusts	145.1	5.1	6.2	145.8	5.3
Diversified growth	335.8	11.9	11.4	270.9	9.8
Cash	34.0	1.2	0.0	30.2	1.1
Currency hedge	4.7	0.2	0.0	7.7	0.3
Private Equity	122.5	4.3	5.0	122.5	4.4
TOTAL	2,833.0	100.0	100.0	2,771.1	100.0

5. Manager Allocation

The graph below shows the current manager allocation.



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

Investment Manager	Asset Class	Market Value £m	Actual Allocation %	Target Allocation %
L&G	Multi-Asset	833.7	30.7	31.7
Western	Bonds	210.0	7.8	8.3
Franklin Templeton	Bonds	70.6	2.6	2.6
Majedie	UK Equity	190.9	6.9	7.0
Mirabaud	UK Equity	107.8	4.0	4.0
UBS	UK Equity	235.9	8.7	8.0
Marathon	Global Equity	372.9	13.8	12.0
Newton	Global Equity	205.3	7.6	8.0
Baillie Gifford	Diversified Growth	125.2	4.6	4.0
Standard Life	Diversified Growth	210.5	7.8	8.0
CBRE	Property	148.3	5.5	6.5
	Residual Cash	0.2	0.0	0.0
TOTAL		2,711.3	100.0	100.0

6. Fees

The following table shows a breakdown of fees paid during Q1 2014/15. The annualised fee for Q1 is lower than previous quarters as no performance fees were due this period.

Manager	Market Value 30/06/2014 £m	Manager Fee Paid Q4 £	Annualised Average Fee %
L&G	833.7	206,104	0.10
Western	210.0	120,918	0.23
Franklin Templeton*	70.6	122,693	0.70
Majedie	190.9	183,140	0.38
Mirabaud	107.8	183,667	0.68
UBS	235.9	70,992	0.12
Marathon	372.9	410,437	0.44
Newton	205.3	94,879	0.18
Baillie Gifford*	125.2	197,933	0.63
Standard Life*	210.5	249,378	0.47
CBRE	148.3	77,034	0.21
Total		£1,917,175	0.28

*Estimated

7. CIPFA Benchmarking

Officers have received the results of the CIPFA benchmarking exercise comparing administration costs amongst LGPS funds for 2013/14.

Surrey's administration costs remain in the lowest quartile as per the key performance indicator benchmark requirements.

The cost comparator with similar sized LGPS funds is shown as Annex 3 to the report.

CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

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

DIRECTOR OF FINANCE COMMENTARY

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

LEGAL IMPLICATIONS – MONITORING OFFICER

12 There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

13 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

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

WHAT HAPPENS NEXT

15 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 30 June 2014 and 27 August 2014
2. Table of private equity holdings
3. CIPFA Benchmark Study: LGPS Administration Costs 2013/14

Sources/background papers:

None