

**SURREY COUNTY COUNCIL**

**PENSION FUND BOARD**

**DATE: 14 NOVEMBER 2014**

**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 Board, as well as manager investment performance.

**RECOMMENDATIONS:**

It is recommended that the Pension Fund Board:

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

**REASON FOR RECOMMENDATIONS:**

In order to achieve best possible performance alongside optimal risk.

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

<b>Manager</b>	<b>Issue</b>	<b>Status/Action Required</b>
L&G	Possible Rebalancing	The asset allocation is within the Fund's policy control limits. The asset allocations at 30 September 2014 and 31 October 2014 are shown in Annex 1.
Standard Life	Global Focused Strategies	Members agreed to allocate £60m to Standard Life's Global Focused Strategies Fund at the Board meeting on 15 May 2014. This was achieved on 12 June 2014 with a transfer from equities run by Legal and General Investment Management to the Standard Life GFS Fund. A report of an initial meeting with Standard Life on 7 November 2014 will be circulated prior to the Board meeting on 14 November 2014.
Mirabaud	UK Equities Portfolio	At its meeting on 19 September 2014, the Board agreed to terminate Mirabaud's contract with immediate effect and temporarily move the 4% allocation from Mirabaud to a UK Equities passive portfolio with Legal & General. Officers immediately contacted Mirabaud to let them know of the Board's decision and make arrangements with both managers for the transfer of the funds. An in specie transfer with a net valuation of £98,437,899 from Mirabaud at 8 October 2014 valuation date was placed into LGIM's N – UK Equity Index Passive Fund on 9 October 2014. Officers wrote to Mirabaud to acknowledge the long association and thank them for their work over the past years. Board members will be invited to discuss the future possible options for this portfolio.
CBRE	Contract change	The Pension Fund Board resolved at the 19 September 2014 meeting to amend the wording in the CBRE contract to allow investment in global property. CBRE are currently working on this change, specifically the benchmark requirements for such a mandate. Officers will report to the 13 February 2015 meeting.
Franklin Templeton	Client meeting	Update included in minutes of external fund manager meetings held on 7 November 2014.
UBS	Client meeting	Update included in minutes of external fund manager meetings held on 7 November 2014.
Marathon	Client meeting	Update included in minutes of external fund manager meetings held on 7 November 2014.

## 2) Freedom of Information Requests

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

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Date	Organisation	Request	Response
09/08/2014	Private Individual	Disclosure of correspondence relating to a complaint made to the fund by the individual about treatment received from an organisation with which the Fund had invested.	Disclosure where appropriate within FOI legislation of correspondence between officers in SCC and with other organisations.
26/08/2014	Inframation Group (Infrastructure Research)	Infrastructure investments held by the pension fund.	Summary of private equity funds, considered as infrastructure based: Capital Dynamics US Solar & Clean Energy and Infrastructure
31/08/2014	SP Capital IQ (Market Research)	Private equity investments held by the pension fund.	Summary portfolios of the private equity portfolio as at 31/12/2013 and 31/03/2014.
15/09/2014	Pitchbook (Private Equity Research)	Private equity investments held by the pension fund.	Summary portfolios of the private equity portfolio as at 31/12/2013 and 31/03/2014.
30/09/2014	Pitchbook (Private Equity Research)	Investment memorandum and due diligence materials for private equity from 1 March 2014 to 27 August 2014.	This request was subject to a partial exemption under section 41 and 43 (1) & (2) for information provided in confidence and commercial sensitivity. The minutes and reports from the May Board Meeting were provided.

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

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

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

### 4) **Stock Lending**

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

### 5) **Share Voting**

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

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

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

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

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

**7) Ill Health Insurance**

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

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

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

**8) Private Equity**

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

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

**9) Internally Managed Cash**

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

**10) Liability Driven Investment Framework**

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

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

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

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

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

#### **11) Mirabaud Portfolio: UK Equities**

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

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

**12) Newton Portfolio: Global Equities**

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

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

**13) Governance Strategies and Policies**

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

**14) Members' Knowledge Assessment**

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

**15) Fund Manager Meetings of 7 November 2014**

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

## Report of the Strategic Finance Manager

### Financial and Performance Report

#### 1. Funding Level

Table 1

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

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

#### 2. Market Value

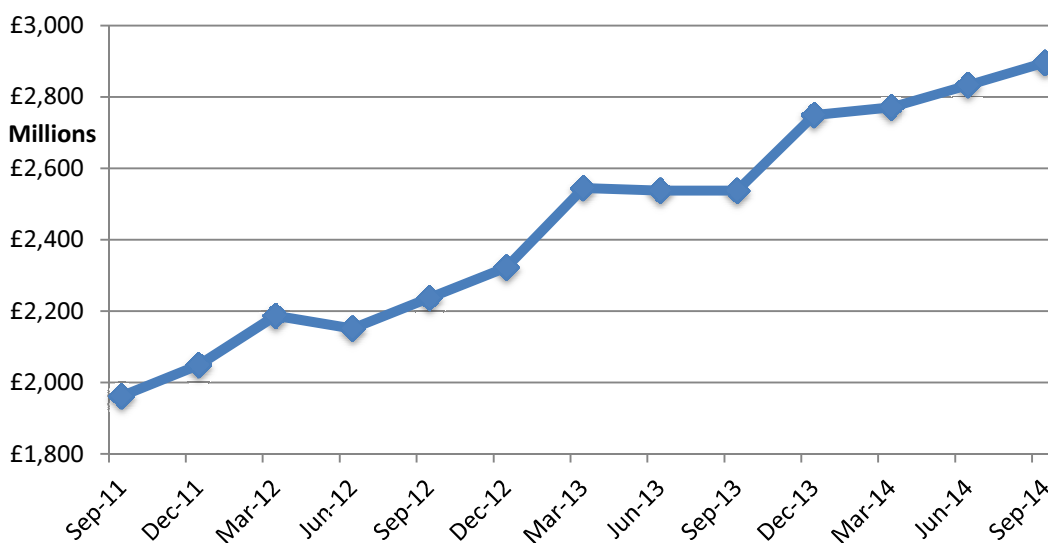
The value of the Fund was £2,893.8m at 30 September 2014 compared with £2,833.0m at 30 June 2014. Investment performance for the period was +1.4%.

The increase is attributed as follows:

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



### Total Fund Value

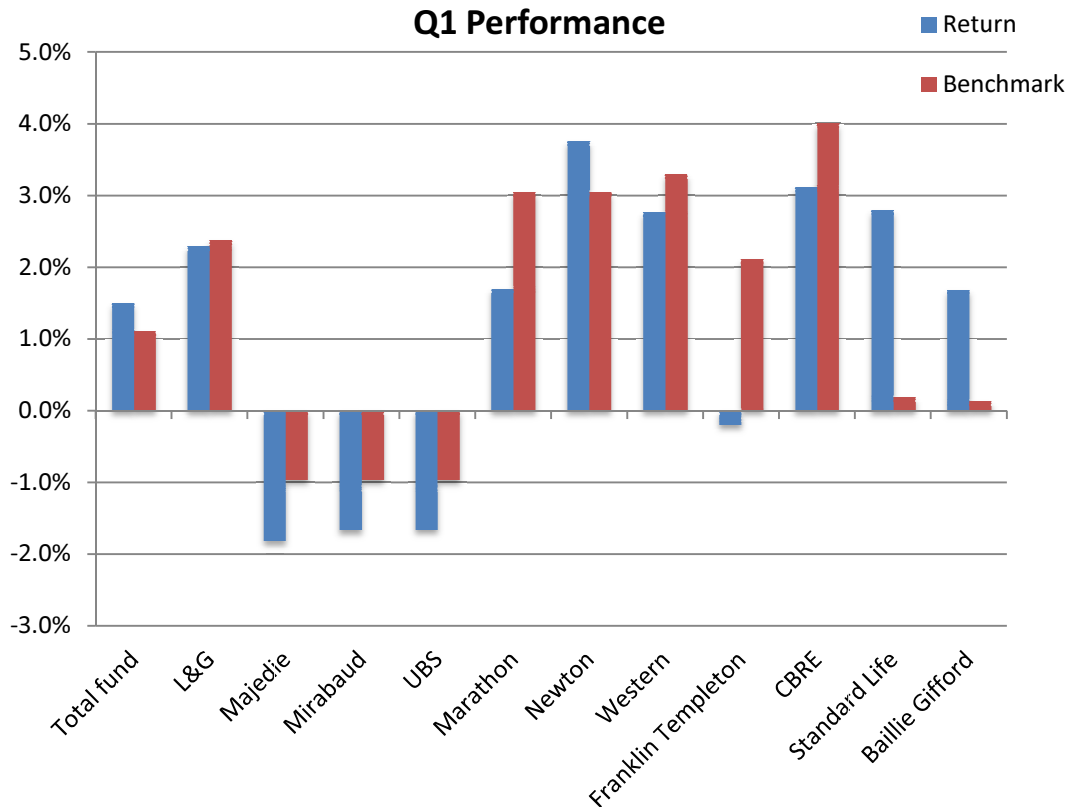


### 3. Fund Performance

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

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

#### Q1 Performance



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

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

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

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

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

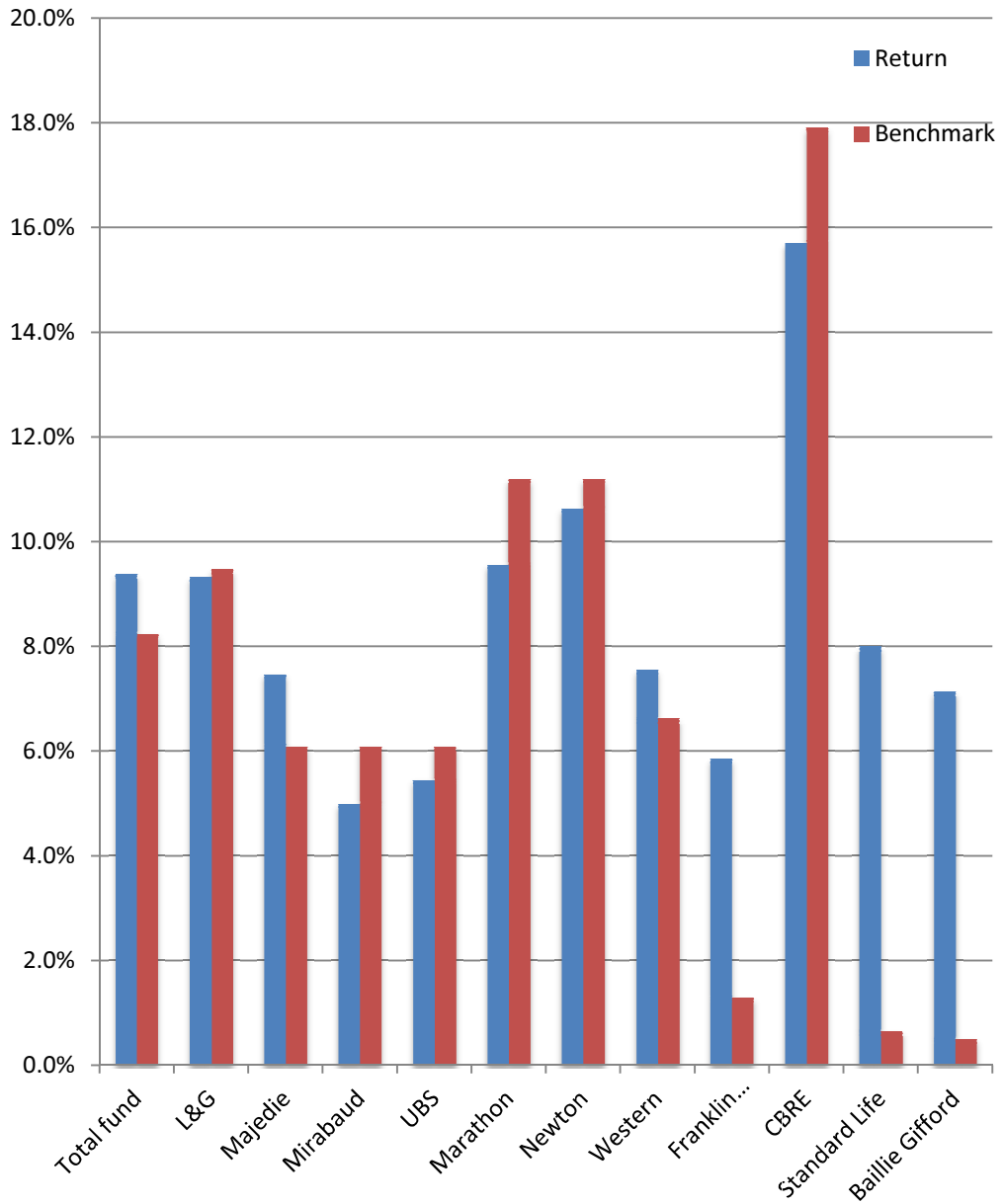
*Franklin Templeton is measured against a US Dollar denominated benchmark which is then converted back to Sterling. This can cause a disparity between performance and benchmark given large currency movements.*

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

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

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

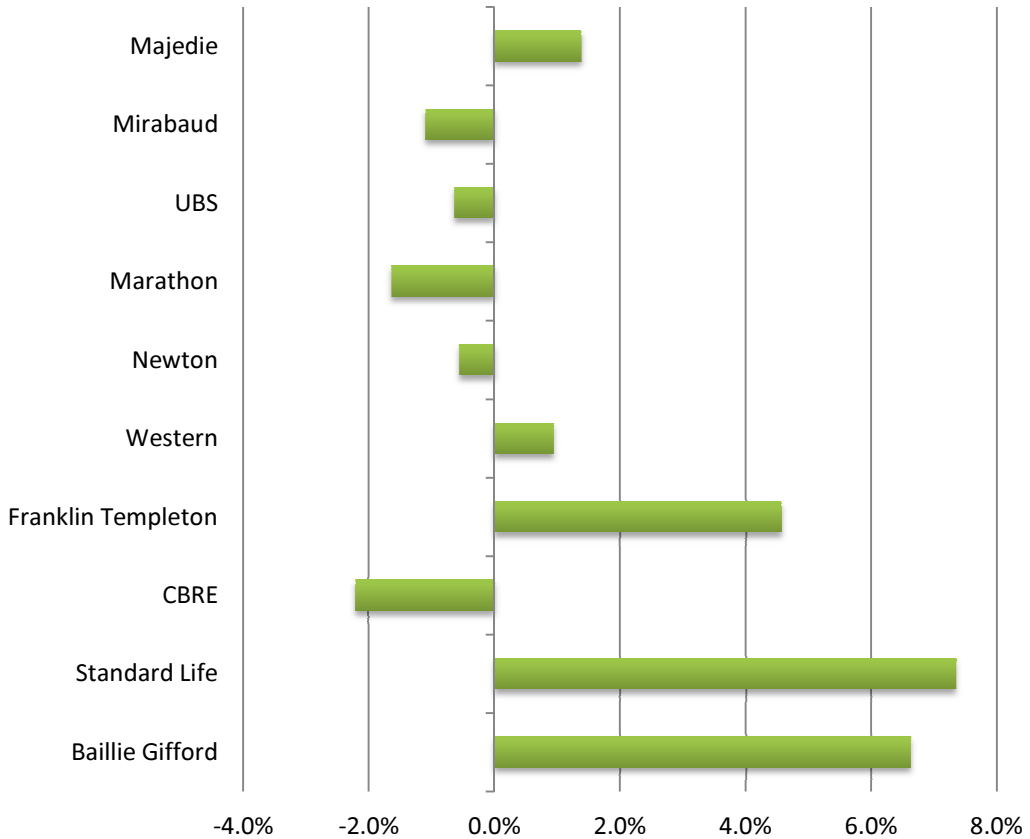
### Rolling Full Year Performance



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

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

### Full Year Relative Performance to Benchmark



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

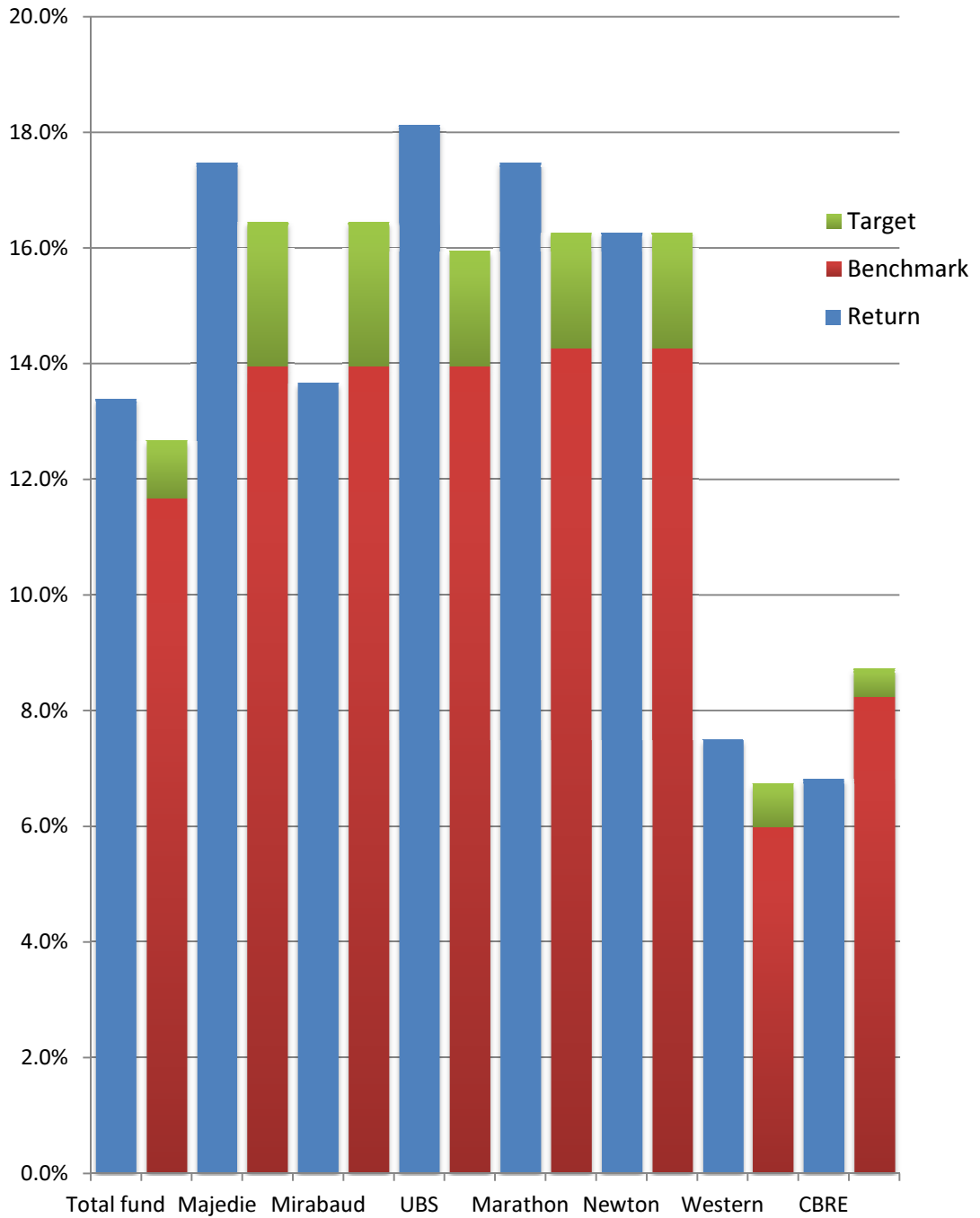
Manager	Performance %	Benchmark %	Relative %
Total fund	9.4	8.2	1.2
L&G	9.3	9.5	-0.2
Majedie	7.5	6.1	1.4
Mirabaud	5.0	6.1	-1.1
UBS	5.4	6.1	-0.7
Marathon	9.6	11.2	-1.6
Newton	10.6	11.2	-0.6
Western	7.6	6.6	1.0
Franklin Templeton	5.9	1.3	4.6
CBRE	15.7	17.9	-2.2
Standard Life	8.0	0.6	7.4
Baillie Gifford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

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

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

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

Rolling Three Year Performance

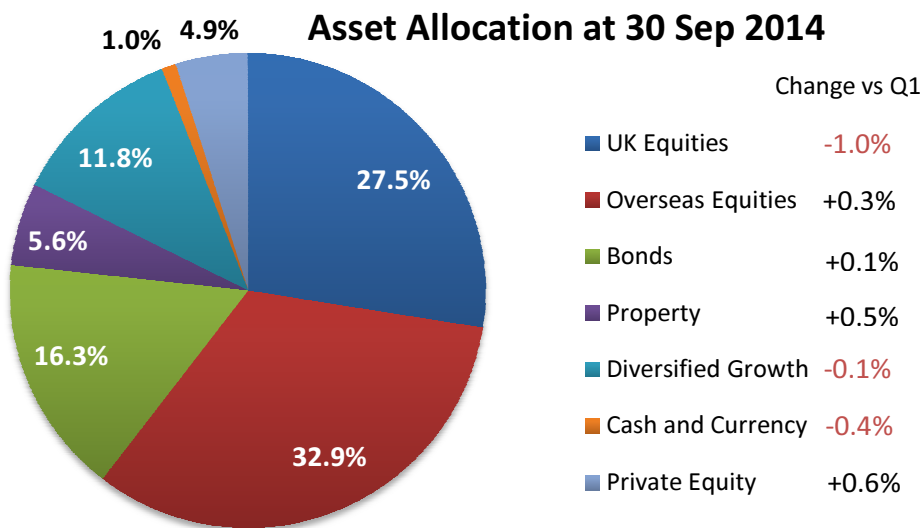


The below table shows the annualised performance by manager for the previous three years.

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

#### 4. Asset Allocation

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



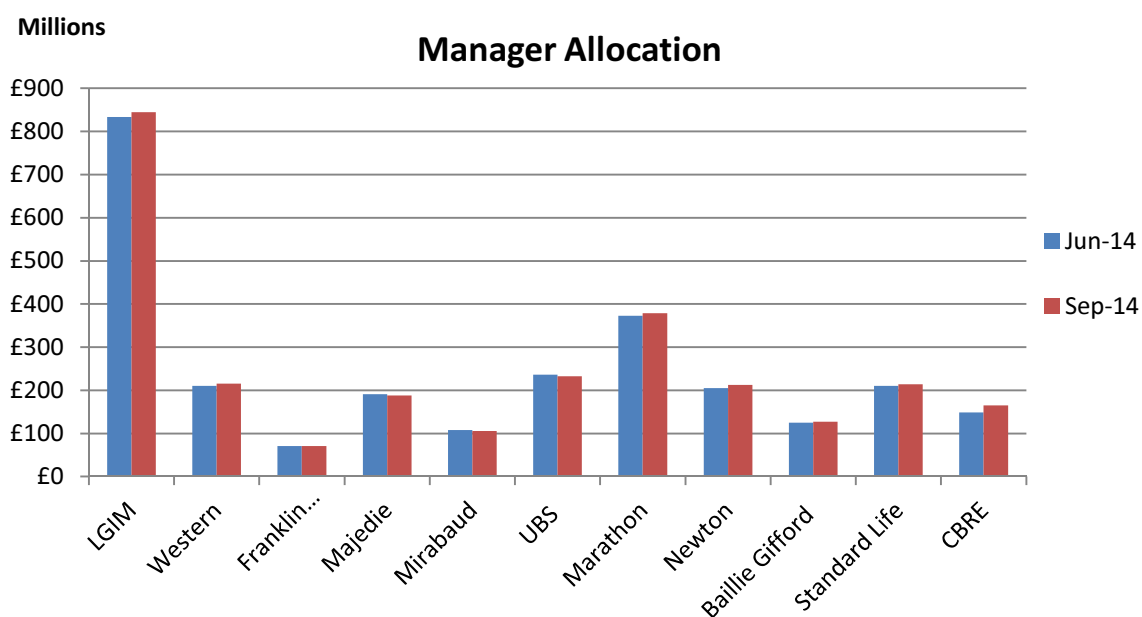
The table below compares the actual asset allocation as at 30 September 2014 against target asset weightings.

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

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## 5. Manager Allocation

The graph below shows the current manager allocation.



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

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



## 6. Fees

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

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

\*Estimated

**CONSULTATION:**

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

**RISK MANAGEMENT AND IMPLICATIONS:**

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

**FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

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

**DIRECTOR OF FINANCE COMMENTARY**

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

**LEGAL IMPLICATIONS – MONITORING OFFICER**

11 There are no legal implications or legislative requirements.

**EQUALITIES AND DIVERSITY**

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

**OTHER IMPLICATIONS**

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

**WHAT HAPPENS NEXT**

14 The following next steps are planned:

- Implementation of the various recommendation approvals.

**Contact Officer:**

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

**Consulted:**

Pension Fund Board Chairman

**Annexes:**

1. Asset Allocation Policy and Actual as at 30 September 2014 and 31 October 2014
2. Private Equity Cash Flow Analysis
3. Private equity analysis
4. UK Equity Manager options
5. Global Equity Manager options

**Sources/background papers:**

None



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