

SURREY COUNTY COUNCIL

SURREY PENSION FUND BOARD

DATE: 22 MAY 2015

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 Surrey Pension Fund Board, as well as manager investment performance.

RECOMMENDATIONS:

It is recommended that the Surrey Pension Fund Board:

1. Note the report.
2. Discuss and make a decision as to the allocation of the £34.5m cash position.
3. Give consideration to multi asset credit as a future strategy for the Fund.
4. Approve the Surrey Pension Fund Board training policy shown as Annex 4.

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 March 2015 and 07 May 2015 are shown in Annex 1. |
| Mirabaud, LGIM and Majedie | 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 as at 8 October 2014 valuation date was placed into LGIM's N – UK Equity Index Passive Fund on 9 October 2014. At the Board meeting on 14 November 2014, members agreed to transfer the allocation in its entirety to Majedie Asset Management. This was completed on 9 February 2015. A transition outcome report is included as a separate item in this agenda. |
| CBRE | Contract/benchmark change | The Surrey Pension Fund Board resolved at the 19 September 2014 meeting to amend the wording in the CBRE contract to allow investment in global property. At the Board meeting on 13 February 2015, it was resolved that part of the CBRE portfolio be diversified by setting a target of 25% to be invested in CBRE's Global Alpha Fund, with the other 75% remaining in UK property and the CBRE benchmark amended to reflect this allocation. Further discussions have taken place with CBRE and these will be reported to the Board in the Fund Manager meetings part of the agenda. |
| Franklin Templeton, UBS, CBRE, Marathon | Client meeting | Update of minutes of external fund manager meetings held on 11 May 2015 shown in 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 |
|------------------|------------------------|--|---|
| 05/02/2015 | Journalist - The Times | Information pertaining to the investment managers employed by the fund and the investment fees paid. | A list of existing investment management firms that manage Surrey Pension Fund assets combined with management fee detail taken from the previous year's financial accounts and a link to the Surrey County Council committee webpage to access the latest board reports. |
| 18/03/2015 | Pitchbook | Private Equity Investment Data | Valuations and returns provided for each fund partnership as at the most recent valuation date. |

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

The schedule of meetings for 2015 and 2016 is as follows:

- 18 September 2015: Board meeting hosted at County Hall.
- 13 November 2015: Board meeting hosted at County Hall.
- 20 November 2015: AGM hosted at County Hall
- 12 February 2016: Board meeting hosted at County Hall.
- 13 May 2016: Board meeting hosted at County Hall.
- 9 September 2016: Board meeting hosted at County Hall.
- 11 November 2016: Board meeting hosted at County Hall.
- 18 November 2016: AGM hosted at County Hall

4) **Stock Lending**

In the quarter to 31 March 2015, stock lending earned a net income for the Fund of £60k with an average value on loan equal to £129.0m

5) **Private Equity**

A separate report is included in the agenda.

6) **Internally Managed Cash**

The internally managed cash balance of the Pension Fund was £28.4m as at 31 March 2015. As at 12 May 2015, the cash balance was £34.5m. Members are invited to discuss the position with a view to making a decision reference its use and distribution.

7) **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 £90m.

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

On 14 April 2015, LGIM confirmed that the Liability Driven Investment policy is now set up on LGIM systems, has received the planned transfer and is being run with a Managed Fund Policy.

Officers have received the Policy Document. LGIM proceeded with the novation on the dealing date of 17th April 2015.

Now that the implementation for the leveraged gilt mandate has been completed, it will be useful for the Board to regularly monitor movements in real yields and, specifically, the trigger that has been agreed. Mercer has produced a simple one page document for this, shown as Annex 3. This will be shown produced at every future Board meeting.

There will be element of ongoing training with this annex, with a regular reminder of the relationship between changes in yields (including the volatility in how these can move up and down) and the impact this has on the value placed on the liabilities.

8) Multi Asset Credit

Included within the agenda is a training session on multi-asset credit from an investment strategy perspective: the case for multi asset credit, expected benefits, potential risks and how to implement. Papers on this training session will be sent out prior to the meeting. The asset class is also the subject of a separate report within the agenda. The training will be provided from 9:30am to 11:00am before the meeting commences at 11:00am.

It is recommended that members give consideration to the asset class as a strategy for the Fund.

9) Governance Strategies and Policies

A report is included in the Board agenda reference the Governance Compliance Statement, which was last considered at the Board meeting of 31 May 2013. There are two strands to this document which can be combined. The Fund currently has a governance policy and a governance compliance statement. It makes sense to make the policy part of the overall compliance statement. Work has been done on this linked to a study published by the Pensions Regulator Code of Practice. A separate agenda item covers this.

10) Marathon Asset Management: Emerging Markets

At the Board meeting of 13 February 2015, the Board was invited to consider the Marathon Emerging Markets Fund. This is offered by Marathon, specifically for clients that cannot access the emerging markets directly, or are not in a position to cope with the level of bureaucracy imposed by particular countries, being far easier to invest via this pooled fund than to open and manage the various accounts on behalf of the Surrey Fund itself.

However, due diligence carried out since the meeting has revealed that the current size of the Fund is not considered sufficient when stood alongside the amount that the Surrey Fund would be investing. Board members are advised to delay a decision until the pooled fund is of sufficient scale for the Surrey Fund to consider.

11) Members' Training

A Surrey Pension Fund Board training policy is shown as Annex 4 for member consideration and approval.

The results of member training assessments were tabled at the 13 February 2015 meeting. The six main areas of desired future training for 2015/16 as highlighted by the results are as follows:

1. Stock lending
2. Role of the global custodian
3. Currency/foreign exchange management
4. Infrastructure
5. LGPS Regulatory background
6. Admissions/Termination Policy

The Strategic Finance Manager (Pension Fund and Treasury) will arrange as early as possible.

Following changes to the membership of the Board, the Chairman will arrange one to one meetings with individual Board members to discuss their training needs.

12) Fund Manager Meetings of 11 May 2015

Notes of the fund manager meetings of 11 May 2015 are shown in Annex 2.

Report of the Strategic Finance Manager

Financial and Performance Report

1. Funding Level

| Past Service Position | 31 March 2015 £m |
|--------------------------|---------------------|
| Past Service Liabilities | 4,245 |
| Market Value of Assets | 3,158 |
| Deficit | (1,087) |
| Funding Level | 74.4% |

The funding level at the latest formal valuation at 31 March 2013 was 72.3%. As at 31 March 2015 the funding level stood at 74.4%, an increase on the latest formal valuation and an increase versus the last quarter of 73.1%.

The following tables show the movement in the Fund deficit.

| Valuation Period to date Reconciliation | £m |
|--|---------------|
| Deficit at 31 March 2013 | -980 |
| Interest on deficit | -101 |
| Excess return on assets | 292 |
| Change in actuarial assumptions | -381 |
| Contributions less benefits accruing | 83 |
| Deficit at 31 March 2015 | -1,087 |

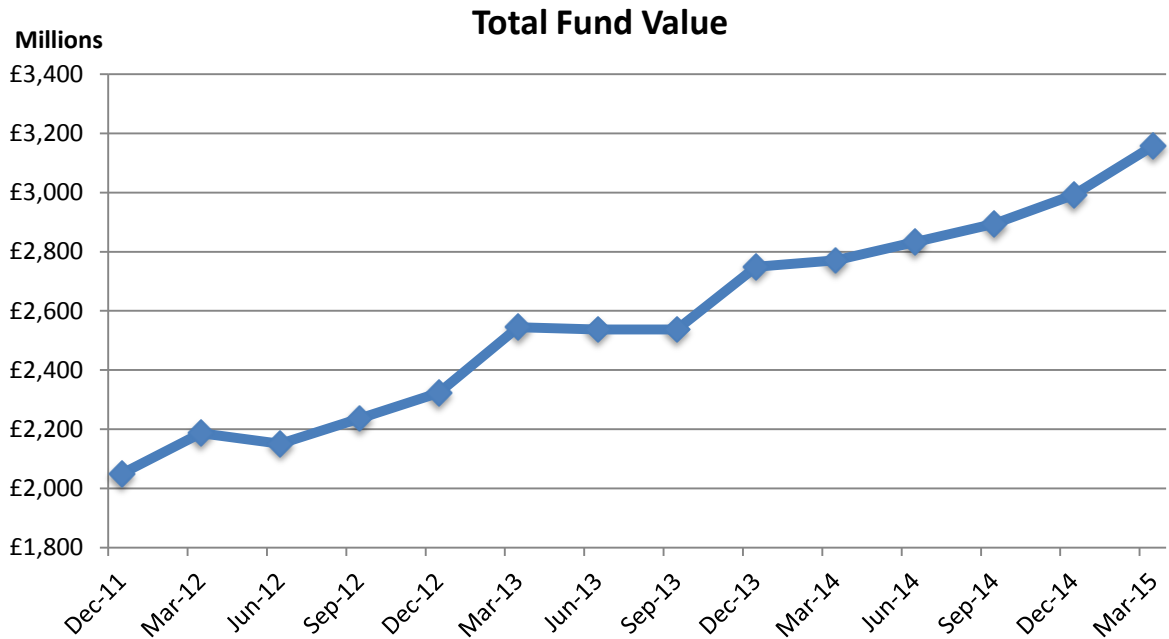
| Quarterly Reconciliation | £m |
|--------------------------------------|---------------|
| Deficit at 31 December 2014 | -1,103 |
| Interest on deficit | -13 |
| Excess return on assets | 126 |
| Change in actuarial assumptions | -110 |
| Contributions less benefits accruing | 13 |
| Deficit at 31 March 2015 | -1,087 |

2. Market Value

The value of the Fund was £3,157.5m at 31 March 2015 compared with £2,991.7m at 31 December 2014. Investment performance for the period was +5.2%.

The increase is attributed as follows:

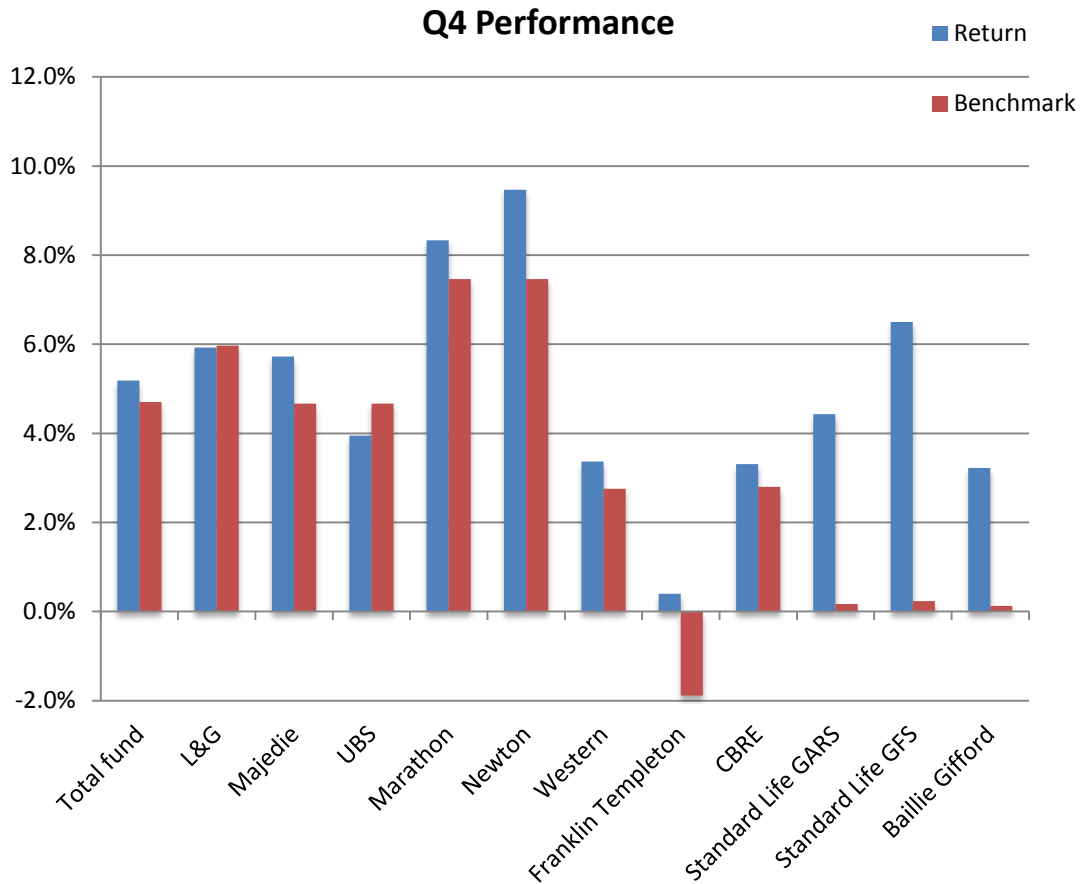
| | £m |
|---|----------------|
| Market Value at 31/12/2014 | 2,991.7 |
| Contributions less benefits and net transfer values | 18.3 |
| Investment income received | 13.1 |
| Investment expenses paid | -3.0 |
| Market movements | 137.4 |
| Market Value at 31/03/2015 | 3,157.5 |
| Market Value at 07/05/2015 | 3,155.0 |



3. Fund Performance

Summary of Quarterly Results (gross of investment fees)

Overall, the total fund returned +5.2% in Q4 2014/15, in comparison with the Fund's customised benchmark of +4.7%.



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

Equity markets had another strong quarter with both global equity managers Newton and Marathon surpassing the overseas benchmark return of +7.5%, with Newton reporting close to double digit quarterly returns of +9.5%. UK equity returns were in relative terms slightly muted with benchmark performance of +4.7%, Majedie outperformed the UK benchmark by +1.0% with UBS reporting underperformance of -0.8%.

The Standard Life GFS diversified growth fund reported a sizable quarterly return of +6.5%

The table below shows manager performance for 2014/15 Q4 (gross of investment manager fees) against manager specific benchmarks using Northern Trust data.

| Manager | Performance % | Benchmark % | Relative % |
|--------------------|----------------------|--------------------|-------------------|
| Total fund | 5.2 | 4.7 | 0.5 |
| L&G | 5.9 | 6.0 | -0.1 |
| Majedie | 5.7 | 4.7 | 1.0 |
| UBS | 3.9 | 4.7 | -0.8 |
| Marathon | 8.3 | 7.5 | 0.8 |
| Newton | 9.5 | 7.5 | 2.0 |
| Western | 3.4 | 2.8 | 0.6 |
| Franklin Templeton | 0.4 | -1.9 | 2.3 |
| CBRE | 3.3 | 2.8 | 0.5 |
| Standard Life GARS | 4.4 | 0.2 | 4.2 |
| Standard Life GFS | 6.5 | 0.2 | 6.3 |
| Baillie Gifford | 3.2 | 0.1 | 3.1 |

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

Franklin Templeton Benchmark

The Surrey Pension Fund is invested in a sterling-hedged share class of the Templeton Total Return Fund. This fund is managed as a US dollar portfolio on an unconstrained basis so, over time, we will assess performance in absolute terms. However, from a practical perspective, the best indication of the opportunity set available to the manager is the Barclays Multiverse Index in US dollars. This is the benchmark used in the table above.

In the past, Franklin Templeton have shown performance of the sterling-hedged share class, the US dollar share class and the unhedged sterling share class, using a range of benchmarks. This has been confusing on occasions, particularly as it included share classes that the Surrey Pension Fund is not invested in.

In future, the main performance page in their quarterly reports will show performance of the sterling hedged share class only (both gross and net of fees) relative to the US dollar index only. This is the most appropriate comparator. Additional performance information will be contained in an Appendix which will include comparative data for the US dollar share class, the unhedged sterling share class, the UK All Stocks Gilt index and the sterling/US dollar exchange rate. These are produced below in the table below.

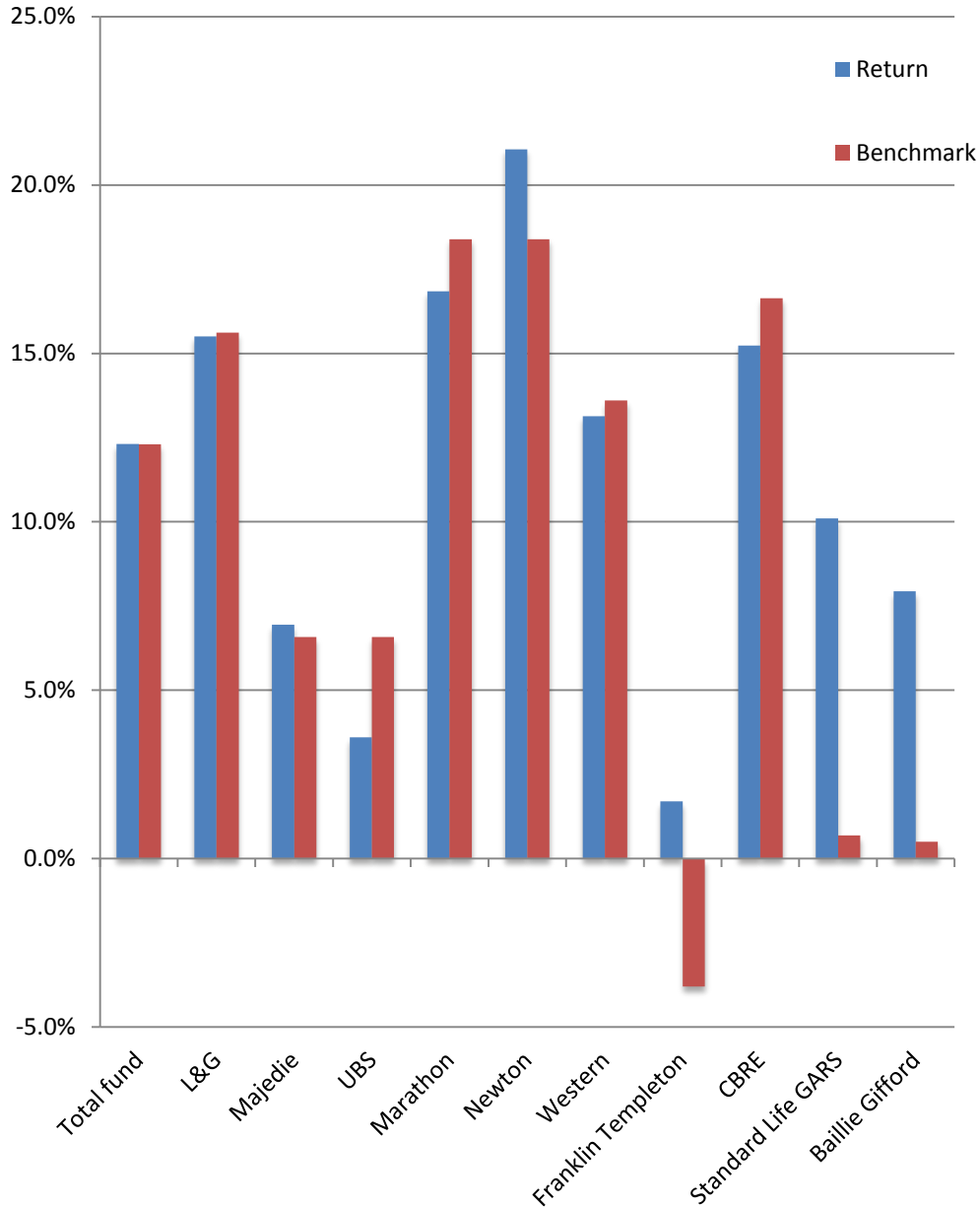
Franklin Templeton Performance

| | Quarterly % | 12 Months % | 2 Years % |
|-------------------------------|------------------------|------------------------|----------------------|
| Sterling Hedged Performance | 0.4 | 1.7 | 1.9 |
| Benchmark Index USD | -1.9 | -3.8 | -0.8 |
| Sterling Unhedged Performance | 5.3 | 13.8 | 3.3 |
| Benchmark Index GBP | 3.1 | 8.1 | 0.3 |
| UK Gilts Index | 2.2 | 13.9 | 5.4 |
| Currency GBP vs USD | 5.1 | 12.4 | 1.2 |

Summary of Full Year Results (gross of investment fees)

During the course of the previous 12 months to 31 March 2015, the Fund returned +12.3% overall against the customised benchmark of +12.3%.

Rolling Full Year Performance



Overseas equity provided the largest absolute investment return over the preceding 12 month period with Newton reporting a substantial +21.1% return surpassing the 18.4% benchmark.

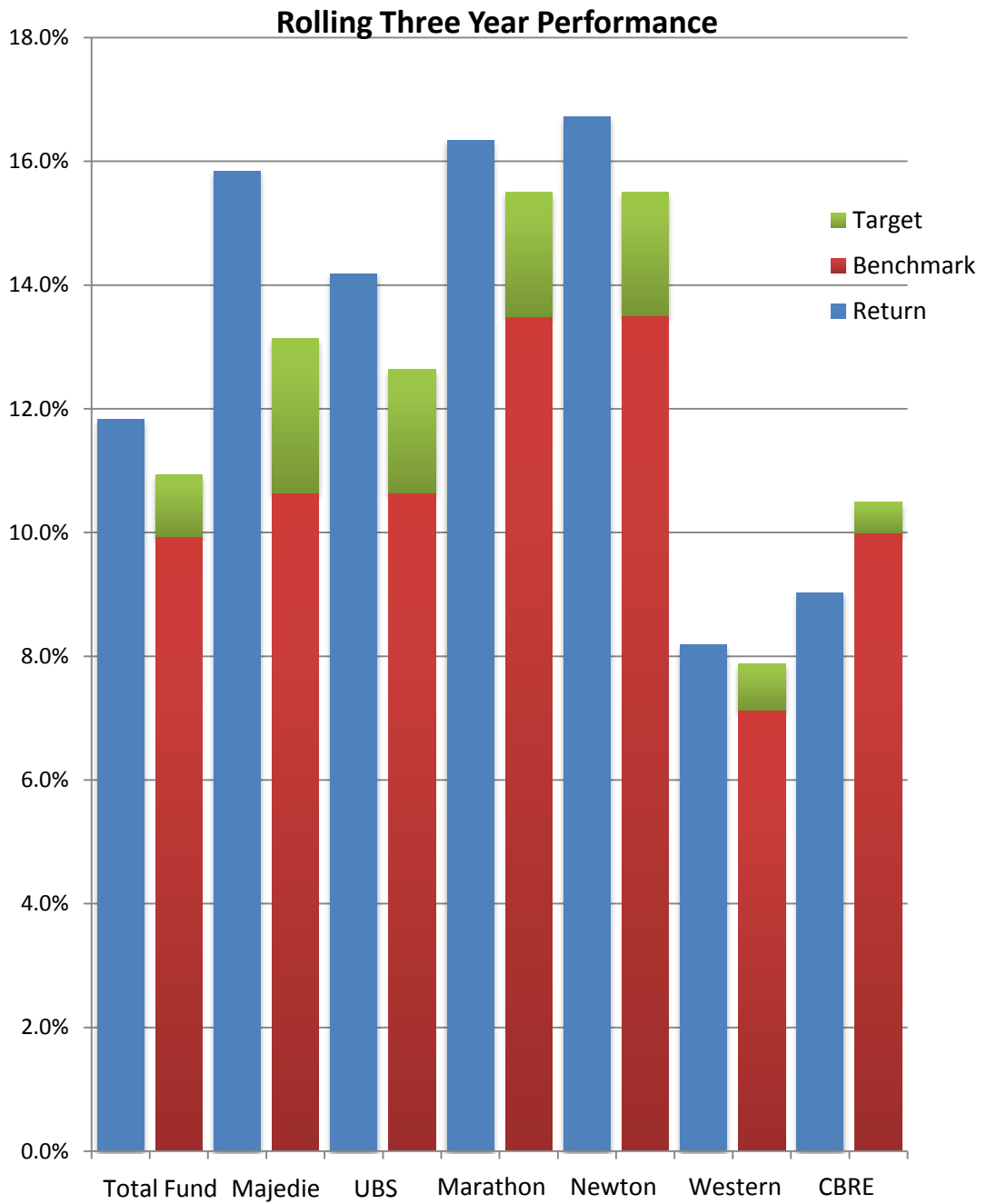
Property also had a strong full year with the fund provided substantial absolute returns for the fund over the preceding 12 months with CBRE reporting +15.2% but below the benchmark of +16.6%. The performance attributable to currency hedging as part of the total fund return for the previous year is -0.4%.

The table below shows manager performance for the year to 31 March 2015 against manager specific benchmarks using custodian data.

| Manager | Performance % | Benchmark % | Relative % |
|--------------------|----------------------|--------------------|-------------------|
| Total fund | 12.3 | 12.3 | 0.0 |
| L&G | 15.5 | 15.6 | -0.1 |
| Majedie | 6.9 | 6.6 | 0.3 |
| UBS | 3.6 | 6.6 | -3.0 |
| Marathon | 16.8 | 18.4 | -1.6 |
| Newton | 21.1 | 18.4 | 2.7 |
| Western | 13.1 | 13.6 | -0.5 |
| Franklin Templeton | 1.7 | -3.8 | 5.5 |
| CBRE | 15.2 | 16.6 | -1.4 |
| Standard Life GARS | 10.1 | 0.7 | 9.4 |
| Baillie Gifford | 7.9 | 0.5 | 7.4 |

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)

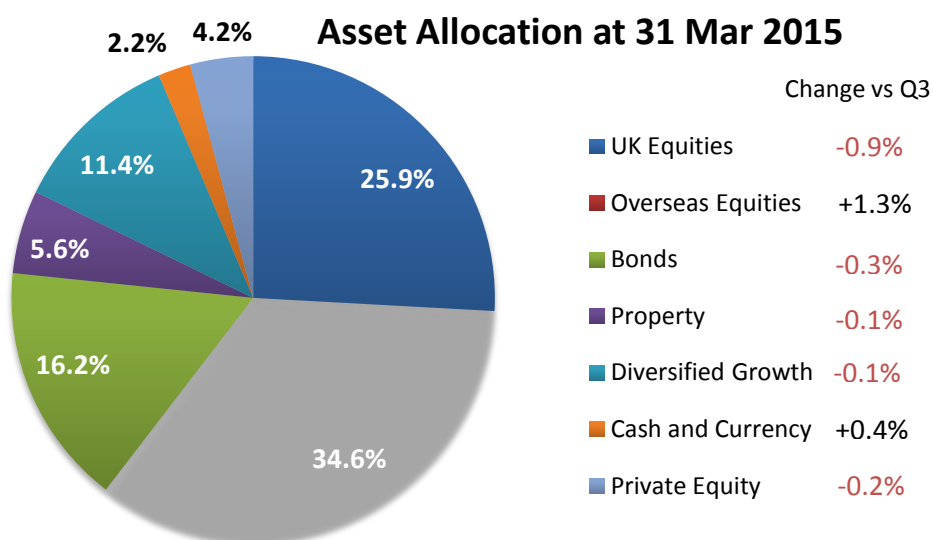


The below table shows the annualised performance by manager for the previous three years.

| Manager | Performance % | Benchmark % | Target % | Relative % |
|------------|---------------|-------------|----------|------------|
| Total fund | 11.8 | 9.9 | 10.9 | 0.9 |
| L&G | 11.6 | 11.7 | 11.7 | -0.1 |
| Majedie | 15.8 | 10.6 | 13.1 | 2.7 |
| UBS | 14.2 | 10.6 | 12.6 | 1.6 |
| Marathon | 16.3 | 13.5 | 15.5 | 0.8 |
| Newton | 16.7 | 13.5 | 15.5 | 1.2 |
| Western | 8.2 | 7.1 | 7.9 | 0.3 |
| CBRE | 9.0 | 10.0 | 10.5 | -1.5 |

4. Asset Allocation

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

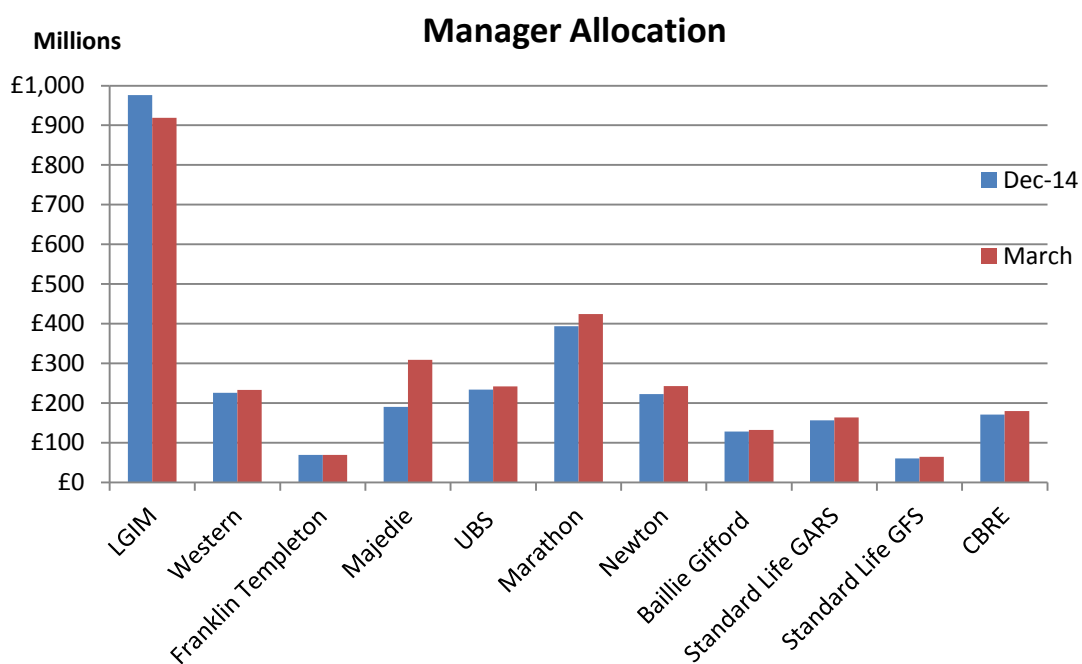


The table below compares the actual asset allocation as at 31 March 2015 against target asset weightings.

| | TOTAL FUND | Actual | Target | Last Quarter | |
|-----------------------------|----------------|--------------|--------------|----------------|--------------|
| | £m | % | % | £m | % |
| Fixed Interest | | | | | |
| UK Government | 66.8 | 2.1 | 2.6 | 67.4 | 2.3 |
| UK Non-Government | 133.5 | 4.2 | 7.1 | 130.7 | 4.4 |
| Overseas | 80.8 | 2.6 | 0.0 | 72.5 | 2.4 |
| Total Return | 69.5 | 2.2 | 2.4 | 69.3 | 2.3 |
| Index Linked | 161.3 | 5.1 | 5.5 | 155.5 | 5.2 |
| Equities | | | | | |
| UK | 816.7 | 25.9 | 27.5 | 800.0 | 26.7 |
| Overseas | 1,091.4 | 34.6 | 32.3 | 995.3 | 33.3 |
| Property Unit Trusts | 176.1 | 5.6 | 6.2 | 170.6 | 5.7 |
| Diversified growth | 360.1 | 11.4 | 11.4 | 345.0 | 11.5 |
| Cash | 76.9 | 2.4 | 0.0 | 55.9 | 1.9 |
| Currency hedge | -8.2 | -0.3 | 0.0 | -2.7 | -0.1 |
| Private Equity | 132.6 | 4.2 | 5.0 | 132.3 | 4.4 |
| TOTAL | 3,157.5 | 100.0 | 100.0 | 2,991.7 | 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 Q4 2014/15

| Manager | Market Value 31/03/2015 £m | Manager Fees Q4 £000 | Annualised Average Fee |
|----------------------------------|----------------------------------|----------------------------|---------------------------|
| L&G | 918.6 | 175 | 0.08% |
| Western | 232.8 | 120 | 0.21% |
| Franklin Templeton* | 69.5 | 111 | 0.64% |
| Majedie | 308.6 | 222 | 0.29% |
| UBS | 242.1 | 136 | 0.23% |
| Marathon | 424.5 | 385 | 0.36% |
| Newton | 242.9 | 142 | 0.23% |
| Baillie Gifford* | 132.4 | 202 | 0.61% |
| Standard Life GARS* | 163.5 | 258 | 0.63% |
| Standard Life GFS* | 64.2 | 152 | 0.95% |
| CBRE | 179.3 | 189 | 0.42% |
| Manager Fees Total | | 2,099 | 0.28% |
| Tax withheld | | 392 | |
| Other investment expenses | | 527 | |
| Total Investment Expenses | | 3,018 | |

*Estimated, to exclude transaction fees

CONSULTATION:

- 7 The Chairman of the Surrey 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:

Surrey Pension Fund Board Chairman

Annexes:

1. Asset Allocation Policy and Actual as at 31 March 2015 and 07 May 2015
2. Minutes from Quarterly Fund Manager Meetings held 11 May 2015
3. Monitoring statement re movements in real yields reference the LDI Strategy

Sources/background papers:

None