

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.

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

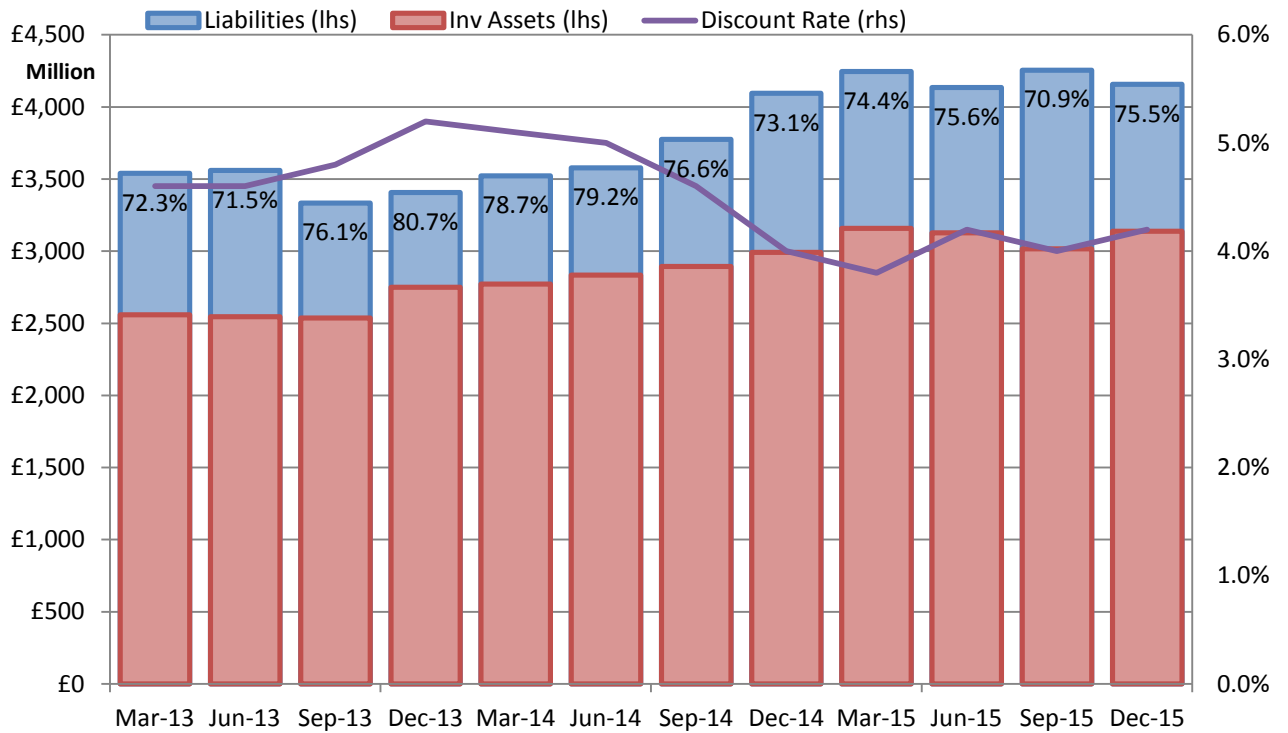
Past Service Position	31 December 2015 £m
Past Service Liabilities	-4,157
Market Value of Assets	3,138
Deficit	-1,019
Funding Level	75.5%

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%.

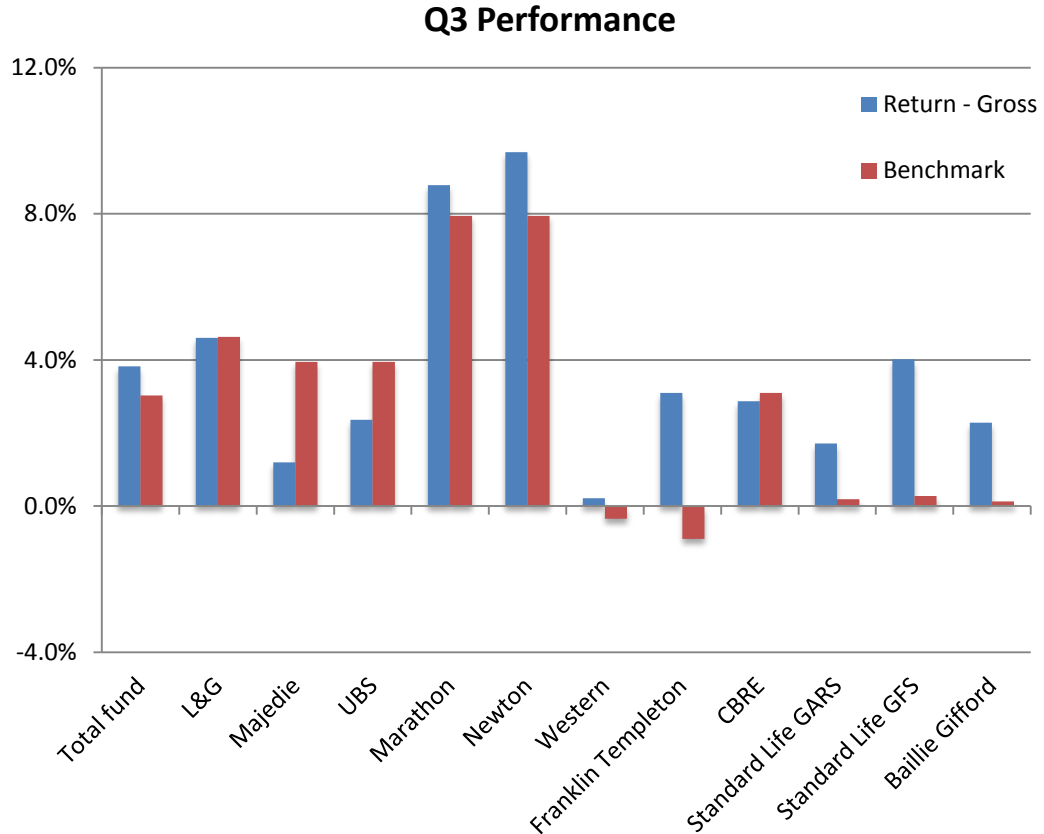
The change in market value is attributed as follows:

	£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.

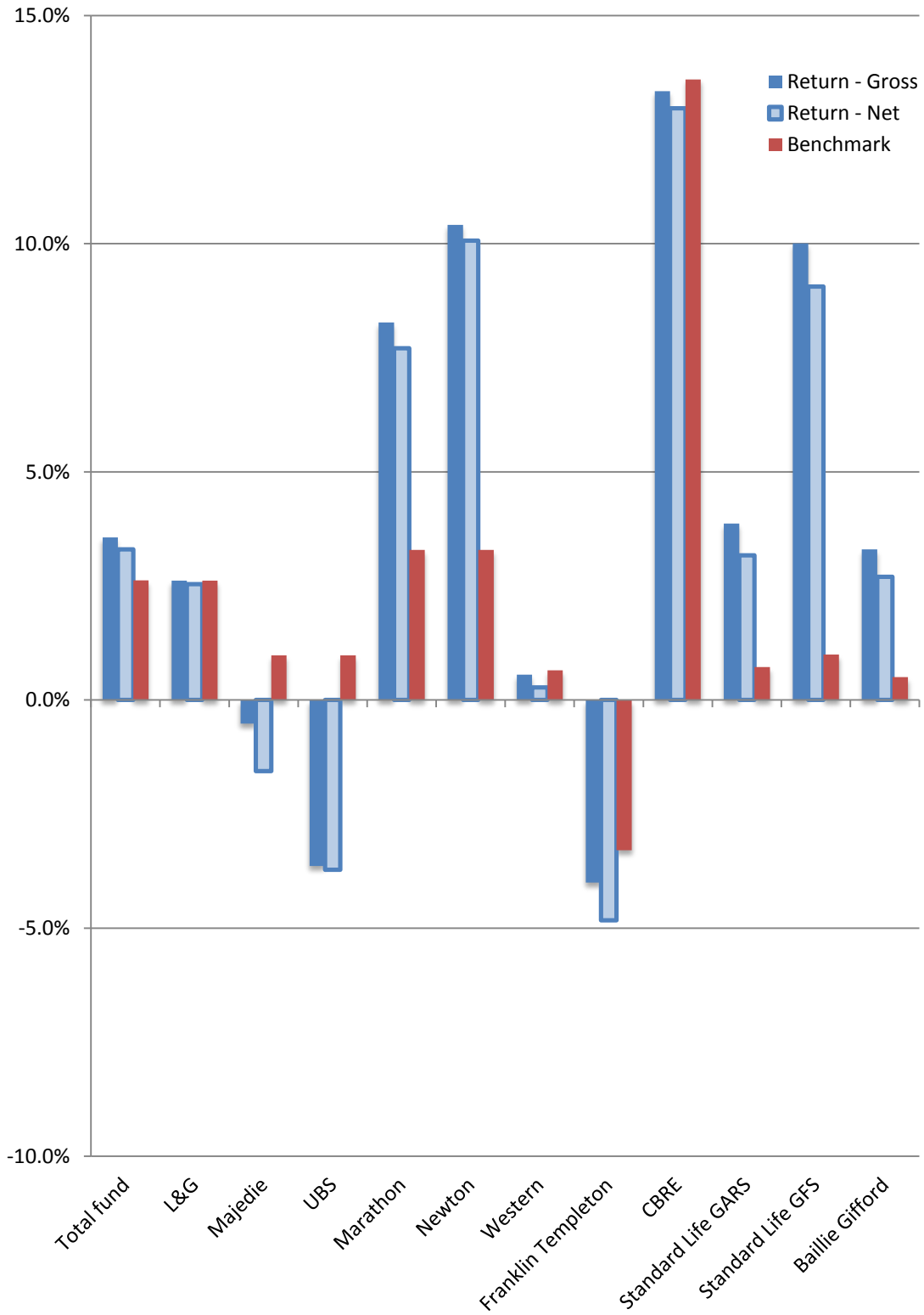
Manager	Performance %	Benchmark %	Relative %
Total fund	3.8	3.0	0.8
L&G	4.6	4.6	0.0
Majedie	1.2	4.0	-2.8
UBS	2.4	4.0	-1.6
Marathon	8.8	7.9	0.9
Newton	9.7	7.9	1.8
Western	0.2	-0.4	0.6
Franklin Templeton	3.1	-0.9	4.0
CBRE	2.9	3.1	-0.2
Standard Life GARS	1.7	0.2	1.5
Standard Life GFS	4.0	0.3	3.7
Baillie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

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%.

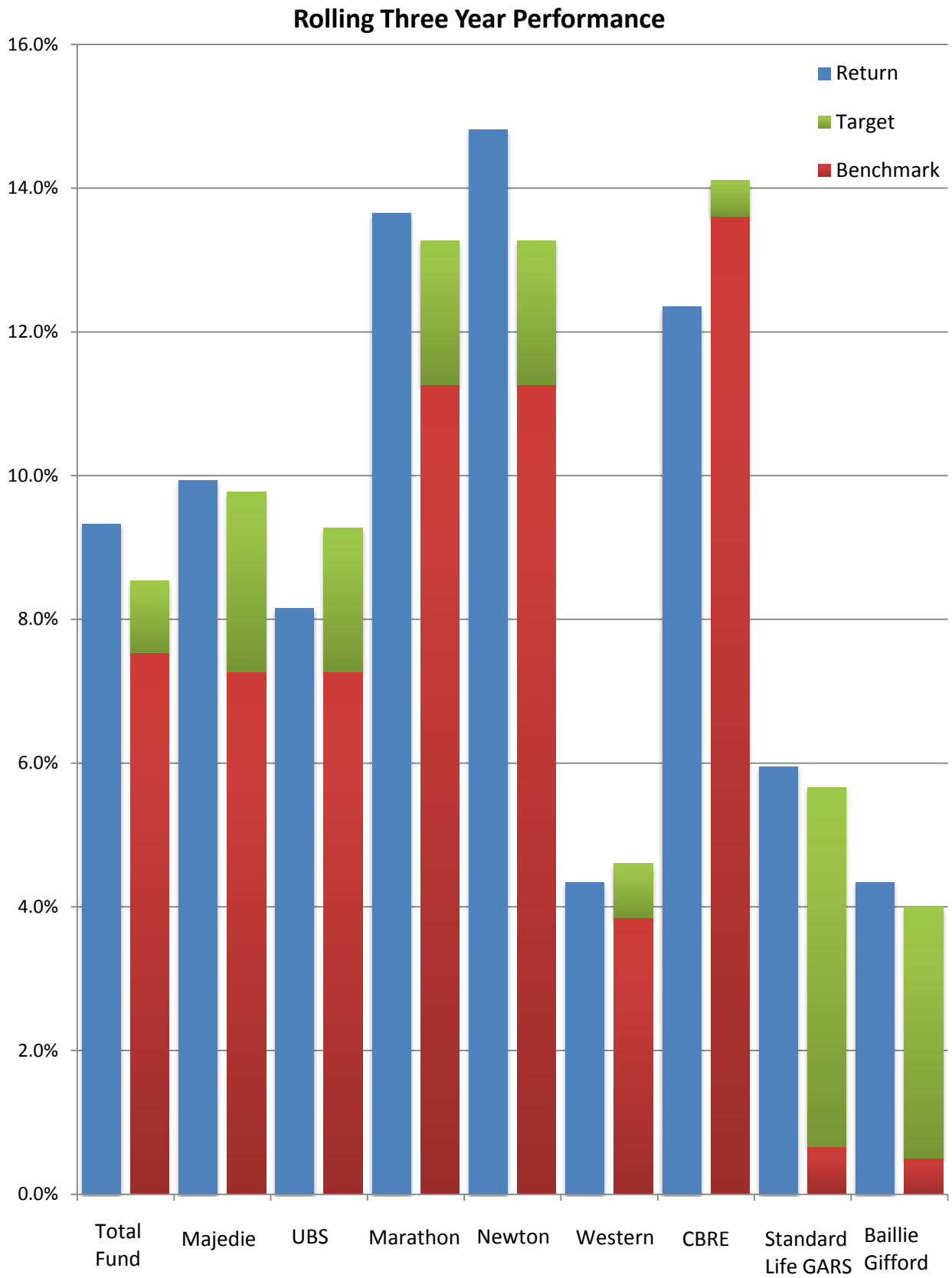
Rolling Full Year Performance



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



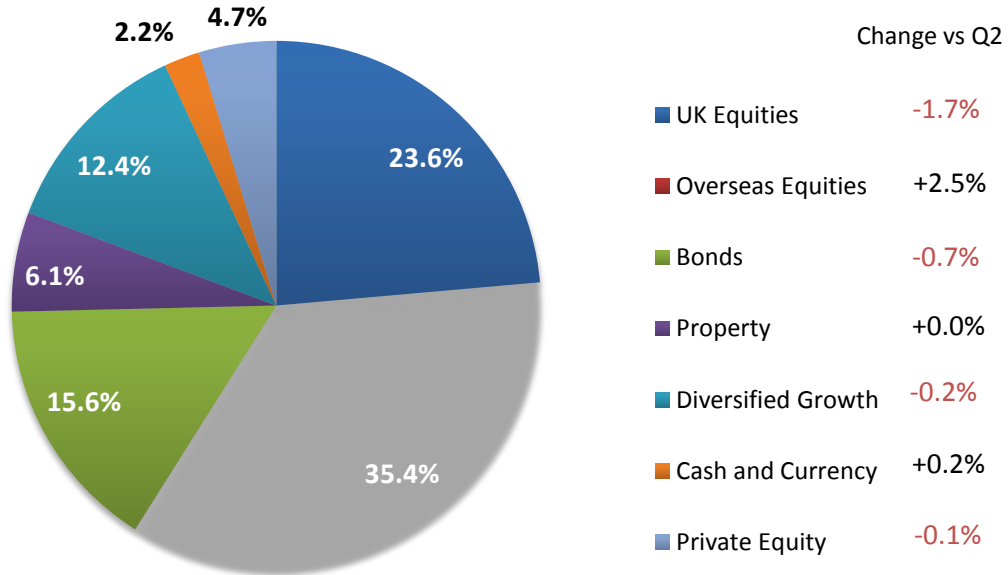
The below table shows the annualised performance by manager for the previous three years.

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.

Asset Allocation at 31 Dec 2015

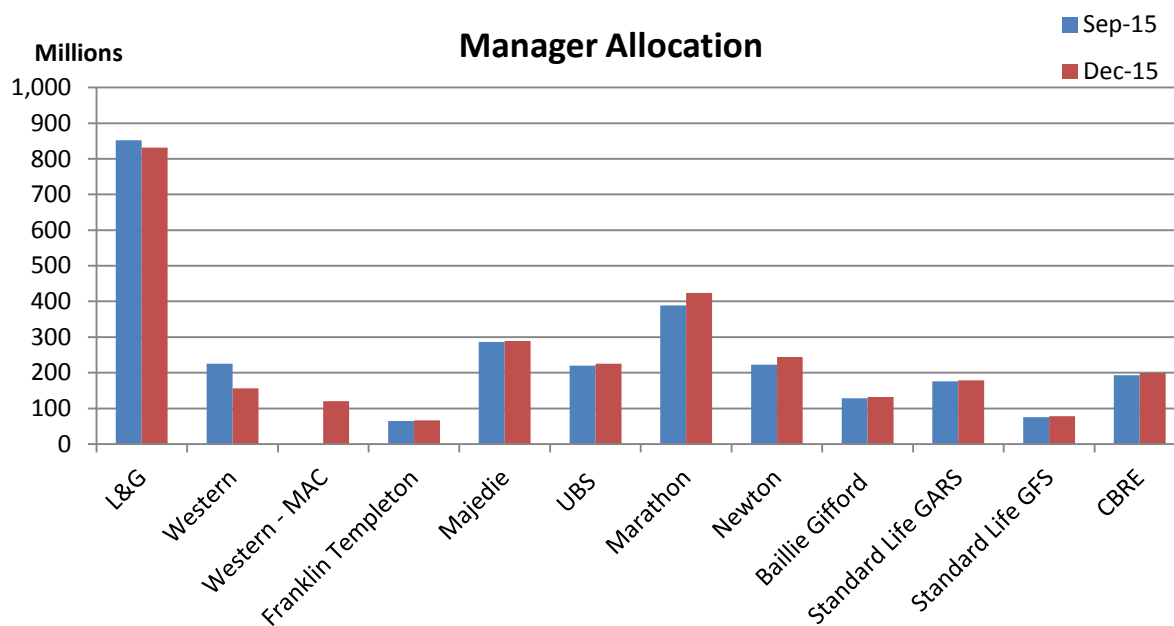


The table below compares the actual asset allocation as at 31 December 2015 against target asset weightings.

	TOTAL FUND	Actual	Target
	£m	%	%
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