Surrey County Council Pension Fund

Review of current AVC provider

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Contents

1 Executive Summary

Introduction

We have been asked by Paul Baker, Pension Manager, at Surrey County Council ("the Council") to carry out a review of the Council's existing AVC provider for the Surrey Pension Fund ("the Fund"). The Fund currently utilises Prudential in order to provide an AVC facility to scheme members. This is 'desk' based review arranged via the Croydon Framework and provides our views on the effectiveness of the current AVC arrangements for the Fund, together with our thoughts on any changes the current provider could reasonably make to ensure the best quality of AVC provision to scheme members. We have summarised our thoughts against the following criteria;

- Provider profile
- Administration support and capability
- Communications support
- Investment choice and performance
- Charges.

Results

Analysis of our research indicates that Prudential are the most committed AVC provider in the local government market place. As well as its commitment to public sector schemes (LGPS, NHS, Civil Service and Teachers) it is also one of the few providers with a plausible with- profits offering.

Prudential has, however, recently introduced early exit charges to its LGPS AVC arrangement for all new contributors on or after 19 August 2012. These charges will be applicable against the fund value where an individual withdraws their AVC funds within 5 years of commencing AVC contributions. These charges are set out below:-

Year of withdrawal	year 1	year 2	year 3	year 4	year 5	year 6
% charge	15%	10%	8%	6%	5%	0%

Prudential offers good marketing of its AVC products to members and is specific to the LGPS Pension Fund. They are able to provide financial advice (at a small additional charge), although we find that the majority of members are happy with information, rather than advice.

We believe there is sufficient spread of AVC fund investment choices available to LGPS scheme members via Prudential. In our view, the extensive choice available by the Fund may actually serve to confuse members; we would recommend a more restricted range of AVC investment funds (to enable better understanding but which also provide adequate choice).

High level recommendations are made as part of this review, but if the Fund wishes to look into this in more detail we would be happy to assist in any AVC fund rationalisation exercise.

If the Fund sought to extend its AVC providers then Standard Life is the only viable option within the current marketplace. While there are potential advantages from Prudential's commitment to the marketplace serious

consideration would need to be given to the exit charges they now levy on early withdrawal of AVC funds as this be a deterrent for members close to retirement.

Recommendations

We recommend the Fund retain Prudential as its AVC provider.

> If, however, the Fund wishes to extend its AVC providers the only current viable alternative in the marketplace is Standard Life. Were the Fund to seek to appoint Standard Life as an alternative provider of AVCs, we assume that the Fund would undertake a formal tender exercise in order to do so. Were Standard Life ultimately successful we would further recommend that the Fund retains Prudential as an alternative provider (at least in the short term)

If support is needed for these exercises Hymans Robertson would be happy to assist the Fund.

2 Current AVC arrangements

Background

Local Government Pension Scheme ('LGPS') administering authorities in England & Wales are required by the terms of the Local Government Pension Scheme (Administration) Regulations 2008, as amended, ("the Administration Regulations") to make available a facility to which LGPS members of their pension fund can make additional voluntary contributions ('AVCs') to enhance their pension entitlement.

The Fund currently has Prudential as its sole AVC provider.

There are 601 Fund members who have AVC accounts. The take up of AVCs could be considered as low at around 2% of active members of the Fund.

Our knowledge of Prudential shows that:

- it has developed bespoke literature in relation to the LGPS and specific to the Fund;
- support is provided to members and contributors.
- It is proactive in promoting the AVC option to potential new members and existing AVC contributors.

The support from Prudential together with scheme and Fund specific approach does, in our opinion, increase the likelihood of AVCs being seen by contributors and potential contributors as an important vehicle for pension investment.

Current market AVC providers

There is a limited range of AVC providers; Standard Life, Scottish Widows, Legal and General, Aegon, Friends Provident, and Prudential.

Standard Life and Scottish Widows both have an LGPS presence but we do not see a specific commitment at present to grow their market share by providing innovative and supportive services; Prudential show much greater commitment than the others in the LGPS and wider public sector AVC marketplace.

3 Criteria for assessment

In carrying out our reviews of Prudential's provider capability we have considered a number of areas which we believe to be of key importance; provider profile, administration services, investment options communication capabilities and level of charges.

Each of these areas is broken down into more detail below:

Provider profile

Covering:

- Brand awareness
- Commitment to market
- LGPS profile
- Corporate social responsibility
- Long term stability

Administration capability

Covering:

- Quality and ownership of systems
- Administration team resource
- Level of support to members
- Level of support to the Fund
- Collection, investment and reconciliation of contributions
- Service standards and management reporting
- Relationship management,
- Internal controls / quality management
- Business continuity
- Innovation

Communication

Covering:

- Quality of communication materials, including website
- Quality / clarity of communication materials for prospective AVC contributors
- Degree to which communications are bespoke for LGPS / the Fund
- Level of initial and ongoing communication support

Investment options

Covering:

- Fund range
- Ability to restrict / expand member fund choice
- Fund switching process

Charges

Covering:

- Annual management charge
- What's included?
- What is extra and how much?

We consider each of these areas in more detail in the following sections of this report.

4 Provider assessment against the criteria

Provider Profile

The provider profile is an important differentiator between providers. Brand awareness will contribute towards improving take up of the AVC scheme and we would give this equal weight with provider's commitment to market. Ongoing investment in the AVC facility by the provider is another important consideration. An LGPS profile of the provider and the match of the provider's client base to the Fund's membership are desirable but may be of less importance to the Fund. The provider's corporate social responsibility policy may also be a concern to the Fund.

Brand awareness: Prudential is able to demonstrate very strong brand awareness and the leading provider in the LGPS marketplace.

Commitment to market: Prudential demonstrates a good commitment to the AVC market when compared with other providers.

LGPS profile: The profile of Prudential in the LGPS marketplace is very good. They are amongst only a handful of providers who remain committed to providing a viable AVC product to LGPS funds. We believe their direct member communications help to achieve this.

Corporate social responsibility: All providers, including Prudential, have a corporate social responsibility policy.

Long term stability: Long term stability is difficult to assess in the current financial climate and we have relied on Standard and Poors ratings which positions Prudential as one of the stronger providers.

Results

Overall our analysis suggests that Prudential maintain a good profile within the LGPS arena, with an ongoing commitment to promote its AVC product to LGPS funds.

5 Administration

Administration

Good quality administration is important to ensure the smooth operation of the AVC and the correct payment of members' benefits. In our research we consider various aspects of the administration service and all providers we have information on appear to achieve good standards in this area. We place particular emphasis on the level of support offered to the Fund and to members by the provider and it is in this area that we find many providers fall short.

Quality and ownership of systems: All providers are able to demonstrate good investment in, and support for, systems along with good functionality, so we do not see systems as a clear differentiator in this area.

Administration team resource: All providers have good teams in place to administer the AVC facility. Only a small number have invested in setting up teams with any LGPS or generic public sector specialism. Our investigations suggest Prudential does offer specific expertise to its LGPS AVC clients.

Level of support to members: All providers provide help lines and good online functionality, however Prudential also offer dedicated LGPS and general public sector support.

Level of support to the Fund: The degree of support that can be offered by the provider is as an important factor. All of the providers are able to offer an account manager during implementation and on an ongoing basis to provide a contact point for the Fund. Few though, are able to provide ongoing support through LGPS specific user groups, newsletters and publications, which could remove this burden from the Council. Prudential does provide this level of support.

Collection, investment and reconciliation of contributions: We consider all providers to demonstrate adequate procedures are in place.

Service standards and management reporting: The various providers all have similar service standards and turnaround times, all of which we consider to be reasonable. While an important issue, we do not consider this category to be a key differentiator, given the relating similarities across all providers.

Relationship management, including complaints handling: While all providers offer a relationship manager we have found that only Prudential have a specific public sector account manager, which sets them apart from the other AVC providers.

Internal controls / quality management: All providers will have procedures are in place for checking accuracy of work. Again we do not see this as a key differentiator between providers.

Business continuity: All providers have business continuity plans in place.

Innovation: Prudential is able to demonstrate recent innovations in customer service, including increased use of technology and the ability for contributors to access more information via the internet. While Standard Life offer limited facilities via the internet, we would like to see them develop this side of their service more for the LGPS clients.

Results

Overall in this section our analysis suggested that Prudential offer a good level of service and support, and continue to provide specific Fund literature and support to contributors.

6 Communications

Communications

Good communication is key to raising awareness and understanding of AVCs amongst the membership of the Fund, particularly as take up has been so low in the past. Prudential has developed bespoke literature in relation to the LGPS and the Surrey Pension Fund.

Quality of communication materials, including website: Most of the AVC providers demonstrate good quality communication materials, Prudential offers the additional facility of a 'fund' portal via their website.

Quality / clarity of communication materials for prospective AVC contributors: The quality of communication material offered by Prudential and Standard Life is considered to be of good quality and compares well with other providers.

Degree to which communications are bespoke for LGPS / the Fund: We believe that bespoke communication material is by far the most effective method of encouraging people to consider investment options such as AVCs. Prudential does provide LGPS specific material and fund specific material. We find other providers are generally willing to provide further bespoke communications following discussions with the client, although there may be an additional fee for doing so.

Level of initial and ongoing communication support: Communication is important both to raise awareness and understanding of the AVC facility at the outset and throughout the lifetime of the contract when new members join the Fund, or when existing members may wish to increase their retirement savings. Generally all providers demonstrate good or excellent communications support.

Results

Our analysis suggested that Prudential have a very good approach to communication and AVC literature.

7 Investment performance

Current Arrangement

The Scheme currently offers a range of funds through a bundled arrangement (i.e. including administration services) with Prudential

Fund name	Asset Class	Manager	Active/Passive	Charges %
Prudential UK Equity	UK Equity	M&G[1]	Active	0.75
Prudential UK Equity Passive	UK Equity	M&G	Passive	0.65
Prudential Socially Responsible	Ethically screened UK equities	M&G	Active	0.75
Prudential International Equity	Overseas Equity	M&G	Active	0.75
Prudential Global Equity	70% UK Equity, 30% Overseas Equity	M&G	Active	0.75
Prudential Discretionary	Global Equity, Bonds, Property and Cash	M&G	Active	0.75
Prudential Property	UK Commercial Property	M&G	Active	0.75
Prudential With Profits	Multi-Asset	M&G	Active	1.00
Prudential Fixed Interest	Gilts and UK corporate bonds (and Overseas government bonds)	M&G	Active	0.75
Prudential Index-Linked	UK Index-Linked Gilts	M&G	Active	0.75
Prudential Retirement Protection	Long dated UK Gilts	M&G	Passive	0.65
Prudential Cash	Deposits and Treasury bills	M&G	Active	0.75
Prudential Deposit	Deposits and Treasury bills (With Profits)	M&G	Active	-

[1] Prudential's wholly owned asset management business

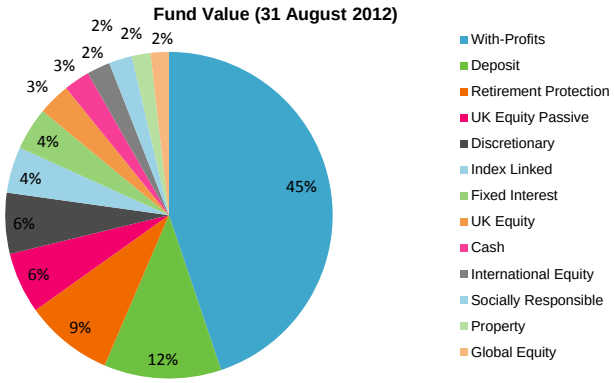
The "default" fund (i.e. the fund into which members will be placed if they do not make an active decision on their investments) is currently the With Profits Fund and there are three "lifestyle" options available for members. A lifestyle strategy offers members an 'off the shelf' strategy that invests their contributions in a mix of growth assets in the early years (while they are a long way from retirement) and then progressively switches their fund into lower risk, more stable assets nearer retirement. The current lifestyle strategies all use the passive UK equity fund in the growth phase and gradually switch into the Retirement Protection Fund prior to a member's retirement over 6, 8 or 10 years (ending up 100% invested in the Pre-Retirement fund).

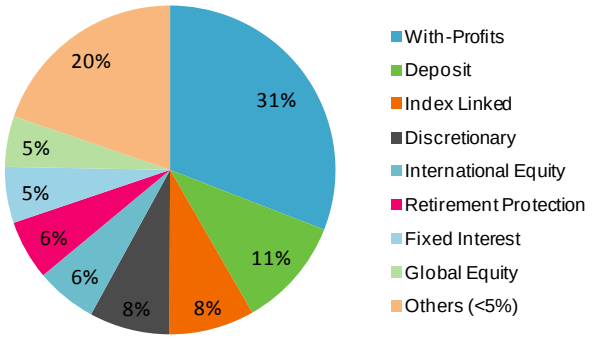
Membership

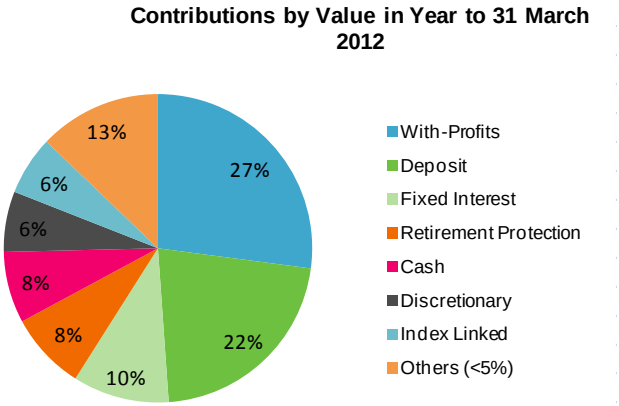
As at 31 August 2012, there were a total of 601 active members. Of the self select (non lifestyle) there were 583 fund choices made into the above funds (shown below). Annual contributions totalled £1.138m (year to 31 March 2012) and total fund value was £6.701m as at 31 August 2012 (We have shown contributions to 31 March 2012 (as 31 August 2012 data was not available) being indicative of annual contributions). We note that contributions in the year to 31 March 2012 are relatively high compared to fund values. Across all the funds offered, there were 583 self select contributions (some members may invest in more than one fund). Only 29 members have chosen a lifestyle option.

Fund	Number of Contributors (Self Select)	Contributions in Year to 31 March 2012 (£)	Fund Value (31 August 2012) (£)
Prudential UK Equity	27	£12,809	£214,689
Prudential UK Equity Passive	18	£44,519	£405,857
Prudential Socially Responsible	22	£23,843	£153,543
Prudential International Equity	35	£30,627	£154,685
Prudential Global Equity	29	£19,655	£120,675
Prudential Discretionary	46	£72,245	£403,851
Prudential Property	27	£14,796	£123,459
Prudential With Profits	180	£308,260	£3,000,720
Prudential Fixed Interest	32	£115,103	£282,693
Prudential Index-Linked	49	£70,330	£305,436
Prudential Retirement Protection	34	£92,733	£583,587
Prudential Cash	21	£85,109	£171,968
Prudential Deposit	63	£248,062	£776,594

Members have made a total of 583 self select fund choices as shown in the charts below:

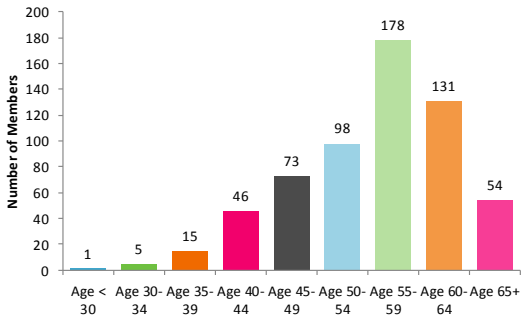


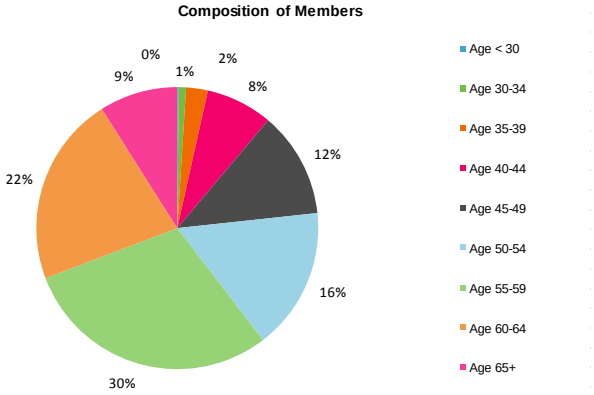




In terms of contributors, value of contributions and fund value, the default With Profits fund is clearly the most popular fund both for existing and ongoing contributions. We would question whether the current fund literature is encouraging members to invest in this fund or whether there are historic reasons behind the choices being made. Underlying these fund choices there are only 29 members who have selected the lifestyle option (a small proportion of total membership). Of these, 24 are over 50 years of age.

The age profile of the active members is shown below. This highlights a mature membership with 77% over 50.





Fund Performance

We show a summary of the Fund performance (gross of fees) in Appendix 1. M&G's active bond and UK and overseas equity performance has been good, with returns exceeding the benchmark over the past one and three years. Longer term performance of the funds has also been ahead of benchmark before fees (although in most cases performance net of fees has been slightly below the benchmark). Overall, we are therefore happy with the performance of the actively managed Prudential funds. The main exception is the Socially Responsible Fund where performance has been consistently behind the benchmark. The Property Fund has underperformed recently mainly due to its underweight position to Central London office properties but its longer term performance has been ahead of benchmark.

With Profits performance is difficult to quantify and this is one of the reasons we would now not normally recommend using a With Profits Fund within an AVC fund range. There is a lack of transparency to these funds, not just in terms of performance but also in connection with the underlying investments and fees. Having said this, we rate the Prudential With Profits Fund highly compared with comparable funds.

AVC Principles

Before considering any potential changes to the current investment options, we have set out below the principles that we consider when designing a suitable AVC range.

AVC objectives

Although sharing many similarities with other pension provision, the objectives of an AVC section can be fundamentally different. For example, cash might be considered an inappropriate choice as the investment strategy of a member's main pension vehicle due to its low growth expectation. However, this is not necessarily the case for AVC investments where needs or expectations of members may differ.

The Fund's responsibility is therefore to offer an appropriate choice of funds to cater for a wide range of members' objectives whilst ensuring that the arrangements remain relatively straightforward for the members to understand. This will help to ensure that members are not discouraged from contributing due to the need to make complex investment decisions.

The Fund also retains a responsibility for monitoring the appropriateness of the arrangements. Therefore simplicity in the AVC arrangement is desirable as it reduces the overall governance burden, allowing more time to focus on other issues.

In addition, the Fund should also encourage members to take advice to assist their understanding of risk and objectives and how their decisions about pensions and AVCs might be affected by other assets and liabilities they have. Any communication material should also emphasise to members the importance of their investment strategy on their final returns.

Member objectives

Members of the Fund will have different objectives for their AVC investments based on their individual needs. For example:-

1) Some members may want to take a significant amount of investment risk to achieve a high anticipated investment return, giving them a chance of achieving a much better income in retirement. However, these members must appreciate the potential downside in their investments.

2) Some individuals may have a low tolerance to investment risk and may not want to invest in a higher risk investment strategy.

3) Some members may have significant pension provision and assets elsewhere, and this may impact their tolerance for investment risk.

As a result, we need to recognise that one investment strategy cannot fit all these varied members' needs. Therefore we need to make available a range of investment options that can broadly meet these differing needs. In particular, we should consider offering:

1) Appropriate "pre-packaged" solutions which will allow for growing a member's pot throughout their working life and protecting the value as approach retirement and;

2) A range of self select funds that will allow members to make their own investment choices

In order to allow members to formulate their own investment strategy, the Fund needs to offer them access to funds that invest in the key 'building blocks' of any investment strategy: equities, bonds, property and cash. Again, we work by the following principles in designing a self select fund range;

- A narrow range of funds is desirable to help with member understanding and governance.
- Lifestyle and default strategies can be built from these key building blocks.
- We generally prefer to offer members passive funds where possible.

There are a number of reasons why we favour passive funds. These include:-

- They provide access to the market return. The choice between investment markets is the most important factor in building an investment strategy and will have a much greater impact on a member's final pension than the choice of investment manager.
- They are cost effective, with lower annual management charges than active funds.
- They avoid the need to constantly review investment managers, as most (well managed) passive funds will track the underlying benchmark indices very closely and will not need to be replaced due to personnel changes.
- For the same reasons, they require less active governance.

Actively managed funds are not strictly necessary, but add to members' choice of funds.

Review of Funds

The current self select fund range covers a good mix of "traditional" asset classes (equities, bonds and property). However, most of the funds offered currently are actively managed and therefore have a higher annual management charge than comparable passive funds. Whilst we would not suggest the removal of any funds from the current range, we would propose introducing more passive options where this is possible as well as the closure of a number of the funds to new members. Our recommendations are therefore as follows:-

UK Equity

Currently both an active and passive fund are made available to members. We are comfortable with the actively managed Prudential Fund and also the passive fund (although we believe the annual management charge on the passive fund is relatively high and should be reviewed as part of an overall review of fees) We note that the passive fund is M&G's in-house index tracking fund. M&G would not normally be one of our preferred index tracking managers but the fund has tracked its benchmark within a reasonable tolerance. A BlackRock index tracking fund is available in the fund range but at an additional cost (0.1% p.a.). BlackRock are one of our preferred providers but we would not recommend a switch at this time because of the additional annual charge and the cost of moving assets. As a matter of completeness, we generally recommend that a Socially Responsible fund is included in the range to meet member demand for such a fund. This type of fund is already included in the Fund range. Despite the poor performance of the Socially Responsible Fund, we therefore recommend no change to the UK equity funds offered.

Global and Overseas Equity

There are two funds offered in this category, a Global Equity Fund (i.e. World including UK) and an International Equity Fund (i.e. World excluding UK). Both of these are actively managed.

Fund Name	Asset Allocation	Comment
Global Equity Fund	70% UK equity / 30% Overseas Equity	Consensus split of Overseas containing small Emerging Market exposure (actively managed)
International Equity Fund	100% Overseas Equity	Consensus split of Overseas containing small Emerging Market exposure (actively managed)

Ideally, we would prefer to see a passively managed market capitalisation (index) weighted global equity fund (i.e. including UK and Emerging markets). Unfortunately, such a fund is not available on the Prudential range. The closest available fund to this would be the passively managed BlackRock Aquila World ex UK equity Fund.

Fund Name	Asset Allocation	Comment
BlackRock Aquila World ex UK	100% Overseas Equity	"Market Cap" Weighted excluding UK and Emerging Markets (passive)

The current Global Equity Fund has a benchmark of 70% UK equity / 30% World ex UK equity. The UK is a small part of the world market (c8% of global market capitalisation). It increasingly bears less and less resemblance to the UK economy (as companies on the UK market become increasingly dominated by those with large overseas earnings). It is also very concentrated, with 20% of the market represented by 3 companies (HSBC, BP and Shell). As members already have access to both active and passive UK equity funds, we would prefer to see a global equity fund with a much higher degree of overseas equity.

Additionally, the Global Equity Fund's overseas equity exposure is weighted according to the overseas equity distribution of the BNY Mellon CAPS Balanced Pooled Fund Survey – effectively a "consensus" rather than an index

weighting. It is also worth bearing in mind that the Global Equity Fund currently has only a 4% exposure to Emerging Markets (compared to 11% of the World Index). Whilst the current International Fund is also based on the CAPS weighting, it does not have a UK equity exposure and is therefore more suitable for members seeking overseas equity exposure.

Given our comments above, we would suggest that the Global Equity Fund is closed to new investors. If a "market cap" global fund (including UK and Emerging Markets) was available we would recommend that. Failing that, we would recommend adding the passive BlackRock Aquila World ex UK fund to be added to the fund range.

Ideally, we would also like to see existing members transferred to the existing International Equity Fund (or the passive alternative if this is introduced) but we appreciate that this would create the need for a transition of assets which may not be desirable at this stage.

With the addition of a passively managed International Equity Fund (i.e. World ex UK), this could be used in conjunction with the passively managed UK Equity Fund (currently available) allowing members to tailor their own passive "global equity" portfolio (i.e. allocating across the UK and "World ex UK" funds). The passive international equity fund available in the Prudential range is (as mentioned above) the BlackRock Aquila World ex UK Fund. Unfortunately this fund does not include Emerging Markets. Therefore, in addition to adding the new passive fund, we would recommend retaining the existing active International Fund so that members could use this and a UK Equity Fund to gain exposure to all markets including Emerging Markets.

The resulting global and overseas equity options can be summarised as follows:-

Fund(s)	Active / Passive	Exposure
Prudential International Equity Fund (existing fund)	Active	Overseas Equity including Emerging Markets
Prudential UK Equity Fund & Prudential International Equity Fund (both existing funds)	Active	Combination to give UK, World ex UK and Emerging Markets
BlackRock Aquila World ex UK (new fund)	Passive	Overseas Equity ex Emerging Markets
BlackRock Aquila World ex UK (new) and Prudential UK Equity Passive Fund (existing fund)	Passive	Combination to give UK and World ex UK (but excluding Emerging Markets)

Bonds

We support the continued inclusion of the Fixed Interest Bond Fund in the fund range with the caveat that we would prefer a passive fund. The annual management fee, at 0.75%, is relatively high for a bond fund and again should be reviewed as part of a wider review of fees.

The Fixed Interest fund contains government and corporate bonds together with some exposure to overseas bonds. We rate M&G highly in bond management particularly in credit mandates.

We support the availability of the Prudential Retirement Protection Fund as it is a passive fund and it is useful for any members wishing to target annuity purchase with their AVC savings on retirement.

Index-linked bond fund

Some members may want to protect the real value of their investments, perhaps because they aim to purchase an inflation linked annuity at retirement. Therefore we support the continued inclusion of an index-linked bond fund in the self select range. This fund is actively managed by M&G whom we rate highly as bond managers, although again we would generally prefer passive management for index linked investment. The annual management fee, at 0.75%, is relatively high for a bond fund and again should be reviewed as part of a wider review of fees.

Property fund

Property as an asset class offers good diversification away from the traditional asset classes and is appropriate for most members to consider as part of a long term investment strategy. We are comfortable with the M&G Property fund as part of the core fund range. M&G are one of the largest institutional managers of property in the UK and we believe that M&G is a 'safe pair of hands' for property mandates. Whilst it could be argued that the safety of internal assets results in less of a commercial edge, we would support the continued inclusion of this fund in the self select range. We would expect the Property Fund to perform in line with benchmark over the long-run.

With Profits Fund

In general, we do not now recommend including a With Profits Fund in an AVC fund range. This is due to lack of transparency over the performance of the underlying investments (given the annual and terminal bonus structure) and the sizeable penalties which can be incurred if the policy is surrendered early (which could be an issue if a member decides to retire earlier than originally planned). Performance comparisons across different providers are also problematic. For this reason, we would recommend closing this fund to new investors and removing it as the default fund. However, for existing investors, we would propose retaining the With Profits option as an ongoing fund. The fund is invested across a very well diversified portfolio and at 31 March 2012, had assets of £62bn. The size of the fund enables it to be invested across a very well diversified portfolio of investments and ensures that it remains a high priority fund for Prudential.

It is designed to provide long term capital growth though it has a lower risk/return profile than the pure equity funds (and ‘balanced’ funds) offered elsewhere in the fund range. To the extent that performance comparisons are possible, the long term returns of the fund have compared well against peer group funds. Approximately 50-60% of the fund’s assets are invested in equities, property and other alternative assets, with the remaining 40-50% invested in bonds and cash.

Lifestyle

We believe that the default investment strategy going forward for the Scheme should be a lifestyle (or lifecycle) strategy. This will invest members’ assets in return seeking assets while they are a long way from retirement and de-risk them to assets with lower volatility as they approach retirement.

Traditional lifestyle strategies de-risk members to 75% in bonds and 25% in cash at retirement. This is with a view to them buying an annuity with the 75% and taking their maximum allowable tax free cash lump sum with the remainder. However, given the nature of the membership of the Scheme, we believe that the majority of members will use their AVC investments to fund towards their tax free cash lump sum at retirement. Therefore, we believe that a strategy that de-risks members to 100% cash at retirement is more appropriate.

There are currently three lifestyle strategies available to members. All of these use the actively managed UK equity fund in the "growth" phase and de-risk members to bonds and cash over either 6, 8 or 10 years. We would propose two changes;-

1) During the growth phase we would prefer a more diversified portfolio. This could either be a global equity fund or preferably a multi asset fund;

2) We would propose that the lifestyle strategy de-risks members to 100% in cash.

There are a number of options which could be used to provide more diversification and we would be happy to explore these further with you.

Discretionary Fund

We would not generally promote the use of a Discretionary (or Consensus) Fund in a core range. We believe that there are better ways of achieving a diversified portfolio (either through a building block approach of core funds or perhaps through a Diversified Growth Fund which can access a wider range of alternative assets but with higher charges). We would propose closing the Discretionary Fund to new members (but retaining it for existing members).

Cash and Deposit Funds

We support the use of a Cash Fund in the range. However, the annual management charge on the Cash Fund is 0.75%. With UK base rates at 0.5%, this fund will be producing a negative net return for members (the gross of fees return over the year to 30 June 2012 was 0.5%).This issue should be addressed as a matter of urgency.

The Deposit Fund which provides a "cash like" return is also available within the range. However, this is backed by assets in the With Profits Fund and, as highlighted above, we dislike the lack of transparency associated with With Profits in general. With a Cash Fund already available to members, we see no need to offer this additional fund and would propose the closure of this fund to new members, In the short term, we would highlight that the annual management charge of 0.75% on this fund also means that it will be producing a negative net return for members in the present interest rate environment. Again, this issue should be addressed with urgency.

Summary of Recommendations

Fund Choices

Below we have set out the self select fund range we would propose going forward. As you will see, and for the reasons highlighted above, we have recommended the closure of a number of the funds to new members. We have, however, recommended the funds are retained for existing members as the majority of members are over 50 and therefore relatively close to retirement. We believe that it would be inefficient for these members to incur transaction costs at this stage of their careers.

We also recommend a change to the default fund and would suggest that this could be a new lifestyle arrangement.

Fund name	Asset Class	Manager	Active/Passive	Charges %	Open/Closed
Prudential UK Equity	UK Equity	M&G[1]	Active	0.75	Open
Prudential UK Equity Passive	UK Equity	M&G	Passive	0.65	Open
Prudential Socially Responsible	Ethically screened UK equities	M&G	Active	0.75	Open
Prudential International Equity	Overseas Equity	M&G	Active	0.75	Open
Prudential Global Equity	70% UK Equity, 30% Overseas Equity	M&G	Active	0.75	Closed
BlackRock Aquila World ex UK (NEW)	Overseas Equity (ex Emerging Markets)	BlackRock	Passive	0.75	Open (new
Prudential Discretionary	Global Equity, Bonds, Property and Cash	M&G	Active	0.75	Closed
Prudential Property	UK Commercial Property	M&G	Active	0.75	Open
Prudential With Profits	Multi-Asset	M&G	Active	1.00	Closed
Prudential Fixed Interest	Gilts and UK corporate bonds (and	M&G	Active	0.75	Open
Prudential Index-Linked	UK Index-Linked Gilts	M&G	Active	0.75	Open
Prudential Retirement Protection	Long dated UK Gilts	M&G	Passive	0.65	Open
Prudential Cash	Deposits and Treasury bills	M&G	Active	0.75	Open
Prudential Deposit	Deposits and Treasury bills (With Profits)	M&G	Active	-	Closed

[1] Prudential's wholly owned asset management business

Other issues – review of fees

Given the issues we have highlighted above regarding fees, we would suggest a review of the annual management charges being made on the funds offered to members as a matter of urgency. We would be happy to support you in such a review.

Risk Warnings

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested.

Past performance is not necessarily a guide to future performance.

Appendix – Fund Performance to 30 June 2012

Fund	Year %	3 Years % p.a.	5 Years % p.a.
UK Equity	-1.5	14.5	1.8
Benchmark	-3.1	13.8	0.4
Relative	*+1.7*	*+0.6*	*+1.4*
UK Equity (Passive)	-3.2	13.8	0.6
Benchmark	-3.1	13.8	0.4
Relative[1]	*-0.1*	*0.0*	*+0.2*
Global Equity	-3.2	13.9	1.9
Benchmark	-4.6	13.1	0.9
Relative	*+1.5*	*+0.7*	*+1.0*
International Equity	-7.5	11.5	2.2
Benchmark	-8.0	11.2	2.0
Relative	*+0.5*	*+0.3*	*+0.2*
Fixed Interest	16.8	10.4	9.8
Benchmark	15.9	8.4	8.9
Relative	*+0.8*	*+1.8*	*+0.8*
Index-Linked	19.3	14.5	11.2
Benchmark	16.9	11.6	10.1
Relative	*+2.0*	*+2.6*	*+1.0*
Retirement Protection	27.8	12.4	10.9
Benchmark	27.9	12.4	10.8
Relative[1]	*-0.1*	*0.0*	*+0.1*
Discretionary	-2.1	12.2	3.0
Benchmark	-3.5	11.7	2.4
Relative	*+1.5*	*+0.4*	*+0.6*
Property	3.1	8.7	-3.1
Benchmark	4.0	10.1	-3.9
Relative	*-0.9*	*-1.3*	*+0.8*
Socially Responsible	-3.4	12.1	-5.0
Benchmark	-1.8	14.1	-2.3
Relative	*-1.6*	*-1.8*	*-2.8*
Cash	0.5	2.3	2.1
Benchmark	0.5	0.5	1.9
Relative	*0.0*	*+1.8*	*+0.2*

Deposit	0.5	0.5	1.9
Benchmark	0.5	0.5	1.9
Relative	*0.0*	*0.0*	*0.0*

[1] Passive funds (index-tracking)

8 Charges

Charges

We believe charges are an important element of the providers AVC offering. We consider price over each provider assuming that passive funds are selected either from BGI, Legal & General or State Street (being the high quality passive managers offered across all providers).

Results

Overall in this section our analysis suggested that Prudential has much lower charges than the other providers (0.65% -0.85% for internal funds and 0.75% for BGI's passive funds). Standard Life, as with the majority of other providers, have a standard charge of 1% (for external passive funds).

Annual management charge: Prudential offer the lowest charges and score the best overall in our analysis.

Additional charge for external funds: There is little to differentiate between providers for the additional charge they levy for external funds.

9 AVC Provider Conclusion

Our view is that Prudential provide an overall good product, which has very good support for LGPS clients. Overall we believe Prudential are the market leader in the LGPS having maintained their market dominance by providing an improving bespoke communication team as well as an efficient administration team. If Standard Life is considered as an alternative or additional provider, we would like to see them raise their standards by emulating many of the innovations put in place by Prudential.

10 Restrictions and limitations

This report is addressed to our client, Surrey County Council ("the Council"), the administering authority for the Surrey Pension Fund ("the Fund"), and is solely for the purpose of considering the appropriateness of the existing AVC provider for the Fund. It has not been prepared for use for any other purpose and should not be so used. In particular, we have not considered whether any other provider might be better able to provide an AVC for the Fund and neither have we made any such recommendations. This report should not be released or otherwise disclosed to any third party except with our prior written consent, in which case it should be released in its entirety. We accept no liability to any other party unless we have especially accepted such liability in writing. Where this is permitted, the report may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

In this report we have not conducted a full market review but restricted our comments to summarising the results of previous reviews in which we have considered the effectiveness of Prudential and others as AVC providers in the LGPS marketplace.

Hymans Robertson LLP has relied on managers and other external sources of information in compiling the report. Whilst every effort has been made to ensure the accuracy of the data and views expressed we cannot be held liable for any loss from its use.

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance

The information below has been compiled by Hymans Robertson LLP and is based upon our understanding of legislation and events as at December 2012. The subject of this report may involve legal issues. It should be noted that Hymans Robertson LLP does not provide legal services and, therefore, it is recommended that you seek legal advice on any such matter.

Rona E. Train.

Rona Train
Senior Investment Consultant
For and on behalf of Hymans Robertson LLP

Dave Simson
Benefit Consultant

11 December 2012