SURREY PENSION FUND ("THE FUND")

INVESTMENT STRATEGY REVIEW PROPOSAL & SCOPE

Background

- The funding level and deficit has materially improved since the valuation in 2013 due to a combination of reasons, the main ones being: asset returns being above expectations, positive membership experience and the change in actuarial discount rate / basis. In particular, and in addition to the impact on deficit, the change in the latter is significant and means that the requirements of the Fund from a return generation and risk management perspective are now arguably different from when a gilts-plus approach to setting the discount rate was used. We would propose holding a "training section" on this, as part of the review.

- The biggest risk the Fund has within the asset portfolio is to equities, which we estimate accounts for around 75% of the volatility of returns.

- Most major equity markets are at, or near, all-time highs, and there are signs that some equity markets (e.g. the US) are looking expensive.

- Given the open, long-term nature of the Fund, we continue to believe that equities will likely be Fund's largest asset holding for the foreseeable future, but it would be sensible to consider scaling back the size of the risk exposure to equities, given the above. This would also be consistent with the Fund's investment objectives, in particular, in relation to "maintaining" a (significantly improved) funding position:

  "To have a clearly articulated strategy for *achieving and maintaining a fully funded position* over a suitable long term time horizon. The Committee recognizes that funding levels can be volatile from year to year depending as they do both on investment market levels and on estimates of liability values, so the long-term strategy needs to be capable of steering a robust course through changing market environments".

Short Term Focus Points

- In particular, we would propose looking at how the Fund could potentially moderate the equity exposure, move to a more stable funding position, but also maintain a reasonably high expected return, within the existing range of asset classes and managers used. Based our initial view, this would likely involve a combination of Multi-Asset Credit and Diversified Growth Funds. We believe that there would be significant benefits in doing this in terms of: speed of implementation, minimising transition costs and taking into consideration the wider issue of pooling with Border to Coast. In this vein, we would also propose discussing the potential use of an equity protection strategy.

- We would also look to make recommendations on additional potential enhancements that we believe could be made to the existing investment arrangements.

Medium Term Focus Points

- Based on previous discussions with the Committee, we have highlighted Long Lease Property (attractive in terms of providing returns through secure, long-term, inflation linked cashflows) and Private Debt (attractive in terms of making greater use of the Fund's ability to invest in illiquid assets and generate more diversified returns) as asset classes that could be strategically attractive. However, these assets are illiquid and it would take time to get fully invested (e.g., c. 6 to 12 months for Long Lease Property and 2 to 3 years plus for Private Debt).

- As such, pooling with Border to Coast will be an important issue to consider with regards to making longer term strategy changes. At this stage, we would not propose considering Infrastructure (unless requested otherwise) on the assumption that the Fund would probably prefer to see what Border to Coast will be offering in this asset class.

We would look to evidence how any proposed strategy changes are expected to add value in terms of return enhancement or risk reduction, once all practical elements such as transition and implementation costs have been accounted for.

Timescales

We would expect to be able to deliver the review within 4 weeks of agreement to proceed, providing ample time to consider before the next Committee meeting on 2nd June 2017.

Proposed Fees

The proposed fee for the review would be £15,000 (ex VAT). Liaison with Hymans and potential discussions with Officers and the Independent Advisor would be charged for in addition on time cost basis. Advice and assistance with any implementation work would be subject to separate fees.

Steve Turner
Partner