SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **15 SEPTEMBER 2017**

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 the transfer of the Franklin Templeton Absolute Return Fund into the recently launched institutional only fund vehicle, Templeton Global Multisector Plus SIF.
3. Approve the USD40m commitment to the Pantheon Infrastructure Fund.

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
All	Possible Rebalancing	The asset allocation is within the Fund's policy control limits. The asset allocations at 30 June 2017 is shown in Annex 1.
Various	Client meetings	Minutes from external fund manager meetings held on 30 August 2017 are included 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.

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Date of Response	Organisation	Request	Response
18/04/2017	Bloomberg	Information concerning the private equity investments of the pension fund	An investment summary of active private equity partnerships as at end of Q4 2016/17
14/06/2017	Independent	Information concerning investments in tobacco companies	Summary of investments in Tobacco companies over last 5 years
28/06/2017	Pitchbook	Information concerning the private equity investments of the pension fund	An investment summary of active private equity partnerships as at end of Q4 2016/17

3) Future Pension Fund Committee Meetings/Pension Fund AGM

The schedule of meetings for 2016 and 2017 is as follows:

- 10 November 2017: Committee meeting hosted at County Hall
- 17 November 2017: Pension Fund AGM hosted at County Hall
- 9 February 2017: Committee meeting hosted at County Hall
- 8 June 2017: Committee meeting hosted at County Hall
- 14 September 2017: Committee meeting hosted at County Hall
- 16 November 2017: Committee meeting hosted at County Hall
- 23 November 2017: Pension Fund AGM hosted at County Hall

4) Investment Strategy Review

At its meeting on 10 February 2017, the Pension Fund Committee resolved to request that a specification paper for the strategic review of asset allocation by Mercer be circulated to all Members of the Pension Committee for approval. Delegated authority was given to the Strategic Manager Pension Fund & Treasury to arrange for Mercer to provide strategic review options.

At the meeting on 2 June 2017, members asked for further work to be completed reference the scoping document from Mercer and asked officers to complete this with a view to a strategy review being carried out for the September meeting.

The investment strategy review is the subject of a separate report to the committee for 15 September 2017.

5) Border to Coast Pensions Partnership (BCPP)

See separate update report to the committee for 15 September 2017.

6) Stock Lending

In the quarter to 30 June 2017, stock lending earned a net income for the Fund of £113,945.

7) Internally Managed Cash

The internally managed cash balance of the Fund was £84m as at 30 June 2017. As at 1 September 2017, the cash balance was £90m.

8) Franklin Templeton: Total Return Fund

In the quest for cost reduction, Franklin Templeton are keen to try to reduce fees to a level where the Committee is more comfortable over the longer term. To this end, they have proposed that the scheme transitions into its recently launched institutional only fund vehicle: Templeton Global Multisector Plus SIF (Specialised Investment Fund). The vehicle is a Specialised Investment Fund structure, domiciled in Luxembourg (as the existing fund is) and was launched in July 2016. Franklin Templeton launched the vehicle for institutional investors in order that they would benefit from the better (lower) pricing structure and reduced client flows (that ultimately can dilute returns for investors). The Templeton Global Multisector Plus SIF invests across the entire fixed income spectrum and is the corresponding fund to that which Surrey is invested in now.

To transition to this SIF, Surrey would require to redeem its existing shareholding from the SICAV (société d'investissement à capital variable) (an open-ended investment fund) vehicle and invest in the SIF on the same day, i.e., no out-of-market exposure.

Surrey is currently paying a total fee of 64bps p.a. in the current SICAV fund. The scheme would benefit from a lower fee (53bps) should it switch to the institutional-only SIF. There would be an indirect cost to transition from SICAV to SIF of approximately 18bps, which Franklin Templeton propose to share 50/50 with the scheme by rebating back 9bps of the SIF management fee in the first year. So, should the scheme transfer to the SIF, the TER would be reduced from 64bps currently in SICAV to the following in the SIF:

Proposed:
Year 1: 44bps TER
Thereafter: 53bps TER

Current:
Ongoing: 64bps

Mercer have been consulted and will report on its views at the committee meeting.

9) Liability Driven Investment (LDI) Framework

At its meeting on 13 February 2015, the Committee set the real yield trigger for future LDI leverage 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. Officers will report verbally to the meeting.

10) Environmental Social and Governance (ESG) Issues and Responsible Investing

Progress is outlined below following the minutes of the presentation of the ESG report to the Pension Fund Committee at its meeting on 2 June 2017.

1. That the Local Pension Board continue to gather evidence from peers, such as South Yorkshire Pension Authority, the Environment Agency and Avon, with a view to recommending proposals to the Committee for long term ambition in regard to sustainable investment for consideration later in 2017

   Work is underway with regard to the consultation process with evidence gathering from the above funds. The Environment Agency is part of the Brunel pool, chaired by the former Chairman of the Surrey Pension Fund Committee. Evidence from these funds will be presented to the next Pension Fund Committee meeting. An update on peer review will be taken to the next Local Pension Board meeting on 12 October 2017.

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2. That the Fund publishes its Stewardship Statement with the Financial Reporting Council (FRC) as part of the Strategy review.

   Officers are currently reviewing the Fund's Stewardship Statement with a view to and updating and refreshing prior to publication with the FRC.

3. To develop a set of principles on its approach to climate change as part of its Investment Strategy Statement (ISS).

   Work on these principles will flow from the evidence gathering from (1) above, which is still underway.

4. To consider what additional transparency and reporting arrangements could be made in regard to its Responsible Investment activities, including reporting its interaction with the Local Authority Pension Fund Forum (LAPFF), annual Environment, Social and Governance (ESG) ratings and stewardship reports.

   The Pension Fund is a member of the LAPFF although resources are currently tight with regard to any significant attendance at meetings. An officer and chairman are entitled to attend the annual LAPFF conference in December 2017 where a write-up to the committee will be included in a future committee report. The Pension Fund Committee Chairman will be consulted with regard to the quarterly business meetings held by the LAPFF.

5. That UN Principles for Responsible Investment (PRI) be followed but not to be a member.

   The Committee resolved not to undertake membership of the UNPRI, but officer will take a closer look at the principles to assess their viability to best practice in ESG policy within the ISS.

6. To request that Mercer undertake further research into the fiduciary prudence of adopting a target of investment in low carbon assets.

   Work on this project with Mercer will commence post completion of the current investment strategy review.

7. That the Committee support the following expectations with the Border to Coast Pensions Partnership (BCPP) asset pool:

   - That portfolio level monitoring of ESG metrics and carbon foot printing is developed as part of the pooling arrangements.
   - That the pooled fund use its scale and influence to develop a consistent RI approach.
   - That the pooled fund appoint managers with clear ESG policies in place.
   - That the pooled fund retain specialist expertise in respect of responsible investment.
   - That the pooled fund make arrangements to develop a specific low carbon passive investment vehicle.

   The Chairman of the Local Pension Board will be writing to Border to Coast to check that the Committee's and Board's recommendations are in line with work due to be implemented by the Border to Coast with regard to its own ESG and RI policies. The letter and any response will be brought to a future Pension Fund Committee meeting.

8. That the next steps contained in the report be taken forward.

   Officers will update the Pension Fund Committee at its next meeting.

11) Pantheon Global Infrastructure Fund III (PGIF III)

Pantheon is a specialist private markets fund investor with considerable experience investing in private equity primaries, secondaries and co-investments. Pantheon has a long-term global presence, with offices established in London, San Francisco, Hong Kong, New York, Seoul and Bogotá. Pantheon currently has $36.6 billion in assets under management, and has a total of over 400 institutional clients with the firm employing 223 professionals.

The firm currently manages investment programs for 24 LGPS investors combining AUM of over US$4.3 billion. A number of the LGPS fudns have committed to Pantheon over several phases and market cycles, with its longest LGPS relationship dating back to 1990.

Pantheon is currently fundraising for PGIF III, its third dedicated Infrastructure commingled fund. PGIF III will invest in infrastructure secondaries and co-investments, with the aim of generating attractive returns with potential downside protection. The focus on secondaries and co-investments provides portfolio benefits, including the potential for J-curve mitigation, time diversification, yield enhancement and cost-effective access to the asset class.

PGIF III will aim to target attractive risk-adjusted return opportunities across the infrastructure asset class and take advantage of the growing secondary and co-investment market opportunities. Capital will be deployed over a number of vintage years, geographies, industry sectors and managers. Key characteristics of PGIF III's strategy are:

- Focus on developed economies, with the aim to capitalise on investment opportunities arising from infrastructure deficiencies, government policies supporting infrastructure investment and a growing range of mid-market opportunities coming from the private sector.
- Target a combination of Core and Core Plus assets, aiming to generate attractive risk-adjusted returns through yield and capital growth.
- Build exposure across a range of sub-sectors, including mid-stream (renewables and conventional power) transport, communications, water and social infrastructure.
- Primarily target brown field assets, with limited exposure to green field investments and development risks.

PGIF III will aim to pursue a differentiated investment strategy which Pantheon believes offers investors an attractive Infrastructure solution. Important factors supporting this view are:

- Broad diversification across the investment universe: PGIF III will be diversified across a range of sub-sectors, core/core plus assets and regions, with target allocations derived through an assessment of the entire market opportunity. Pantheon aims to partner with a select group of complementary and "best-in-class" Infrastructure GPs.

- Differentiated access routes: Through the secondary market, Pantheon believes that there is a compelling opportunity to gain exposure to quality infrastructure assets, of the same types being fought over so heavily in the primary direct market, but at much more attractive valuations.

- Overall fee load comparable to a direct fund: PGIF III will not incur a double layer of fees in the way a traditional fund-of-funds strategy might.

Since the inception of its infrastructure program in 2009, Pantheon has made 59 infrastructure investments totalling US$1.7 billion in capital commitments (including 25 secondary and 13 co-investment transactions). PGIF I (first fund launched in 2009) is exhibiting a gross IRR of 16.5% and a net IRR of 13.1%, whilst Pantheon's total infrastructure program (inclusive of all investments across commingled funds and segregated accounts) is exhibiting a gross IRR of 17.0% and a net IRR of 14.5%. Pantheon now has $3.2 billion in AUM across Infrastructure commingled and separate account programs.

PGIF III has an annual management fee of 0.85% charged on commitments, attenuating after year 7 to 90% of the amount charged in the previous year. Over a 13-year fund term, this equates to an average annual fee of 73 bps on committed capital. There will be a carried interest charge of 10% after an 8% preferred return. The target fund size is US$1.2 billion. Closes are scheduled for October, November and December 2017.

With regard to other Border to Coast funds, Tyne & Wear and Northumberland both committed to Pantheon Private Equity in 2017. Their combined commitments total £125m. Lincolnshire, East Riding and South Yorkshire are also investors in prior Pantheon PE funds.

Mercer will report on its latest research at the meeting.

It is recommended that the Committee approve a USD40m allocation to PGIF III.

Report of the Strategic Finance Manager

Financial and Performance Report

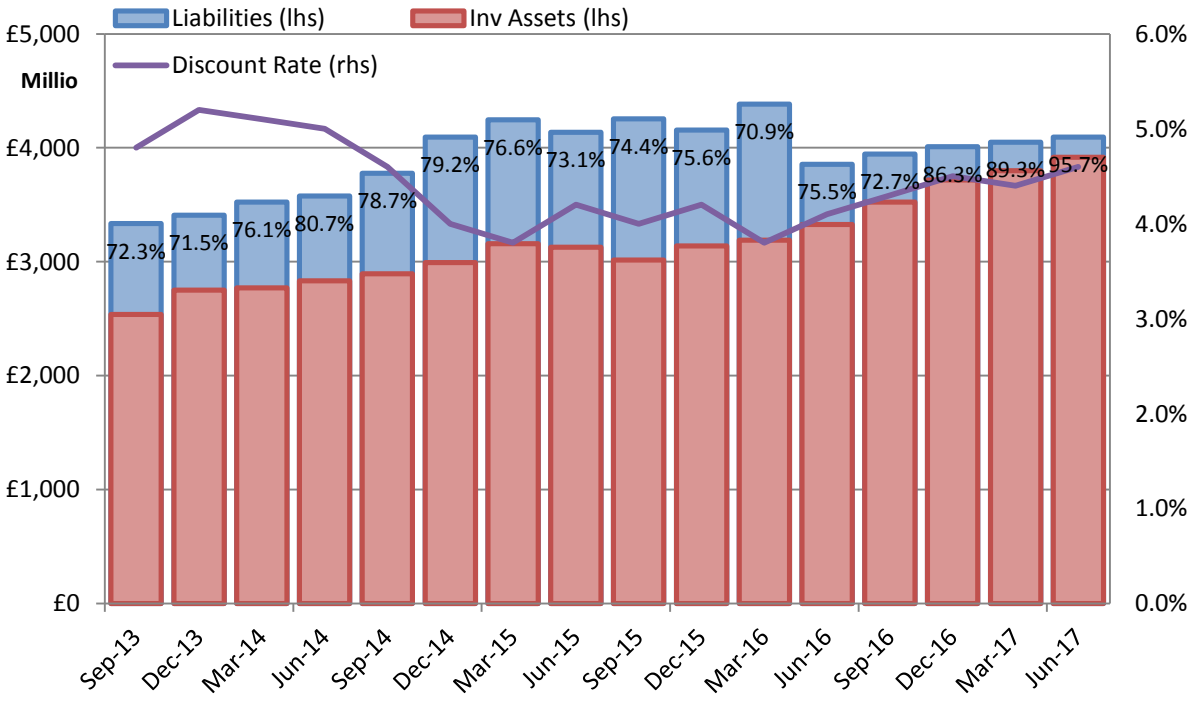
1. Funding Level

The actuary has been consulted and has set out an approximate funding position and the assumptions used for the funding position as at 30 June 2017.

The funding level has increased to 95.7% as at 30 June 2017 (82.6% as at 31 March 2016) and is based on the formal 2016 valuation results, updated for market conditions at 30 June 2017 and actual fund returns to that date.

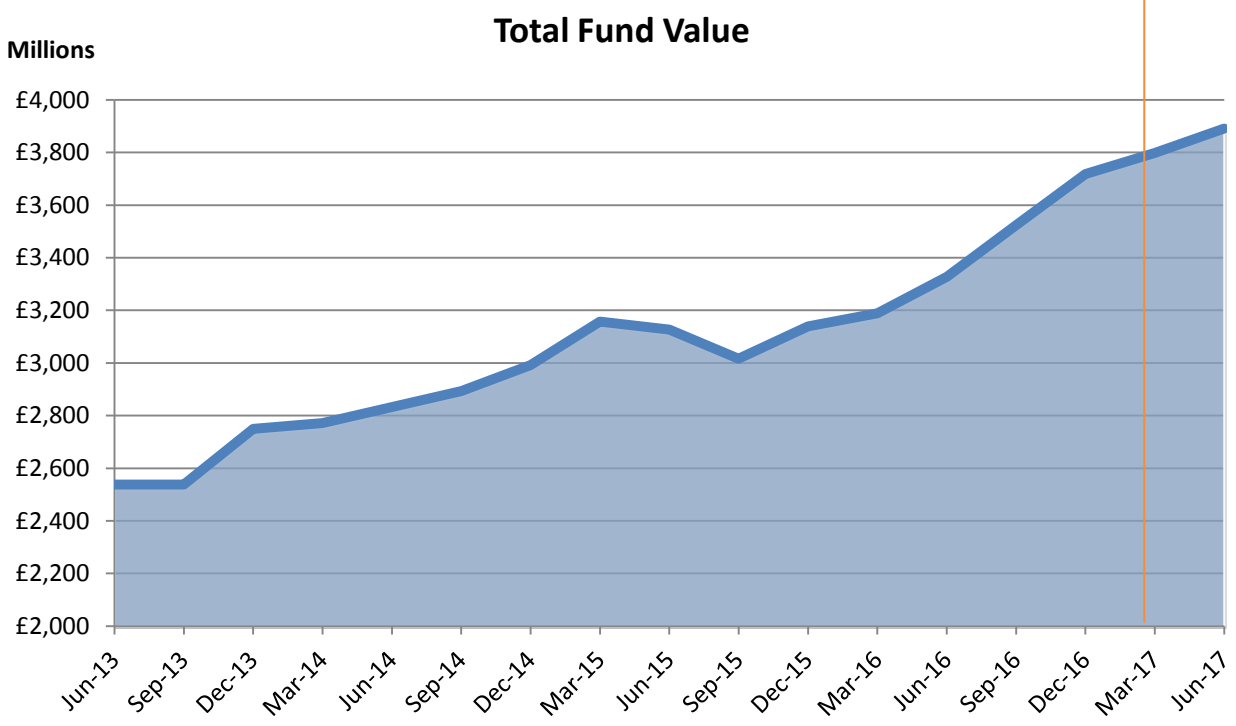
These are as follows:

- A discount rate of 4.6%
- Pension payments increases of 2.4%
- Salary CPI inflation of 2.7%
- Actual fund returns for the period 1 April 2017 to 30 June 2017 of 1.1%



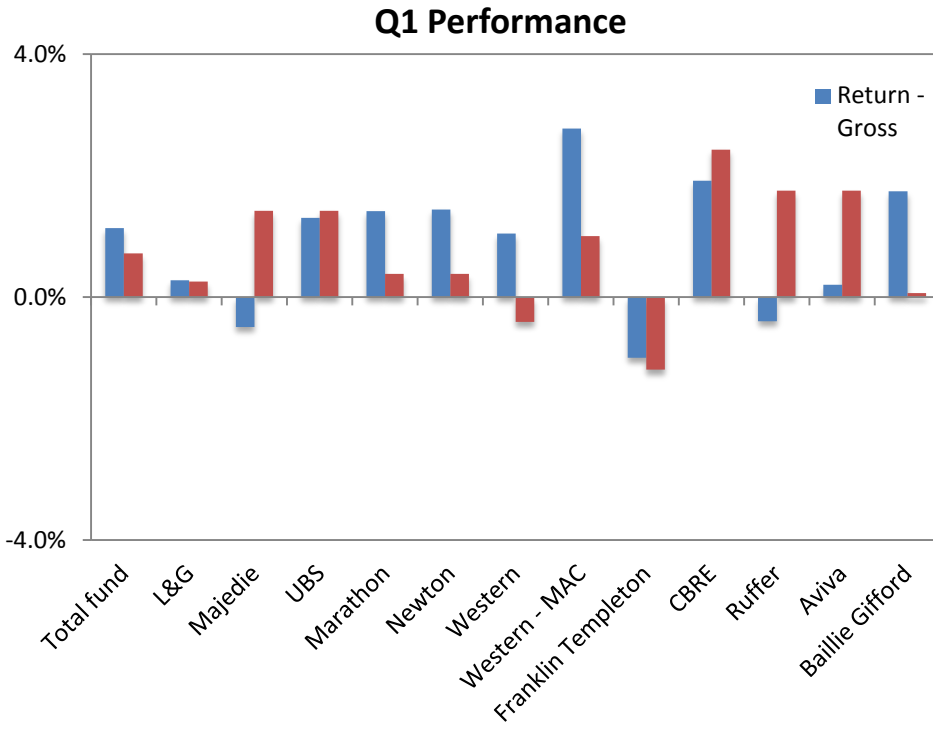
Market Value

The value of the Fund was £3,890.5m at 30 June 2017 compared with £3,798.9m at 31 March 2017. The investment performance for the period was +3.3%.



3. Fund Performance - Summary of Quarterly Results (gross of investment fees)

Overall, the Fund returned +1.1% in Q1 2017/18, in comparison with the Fund's customised benchmark of +3.5%.



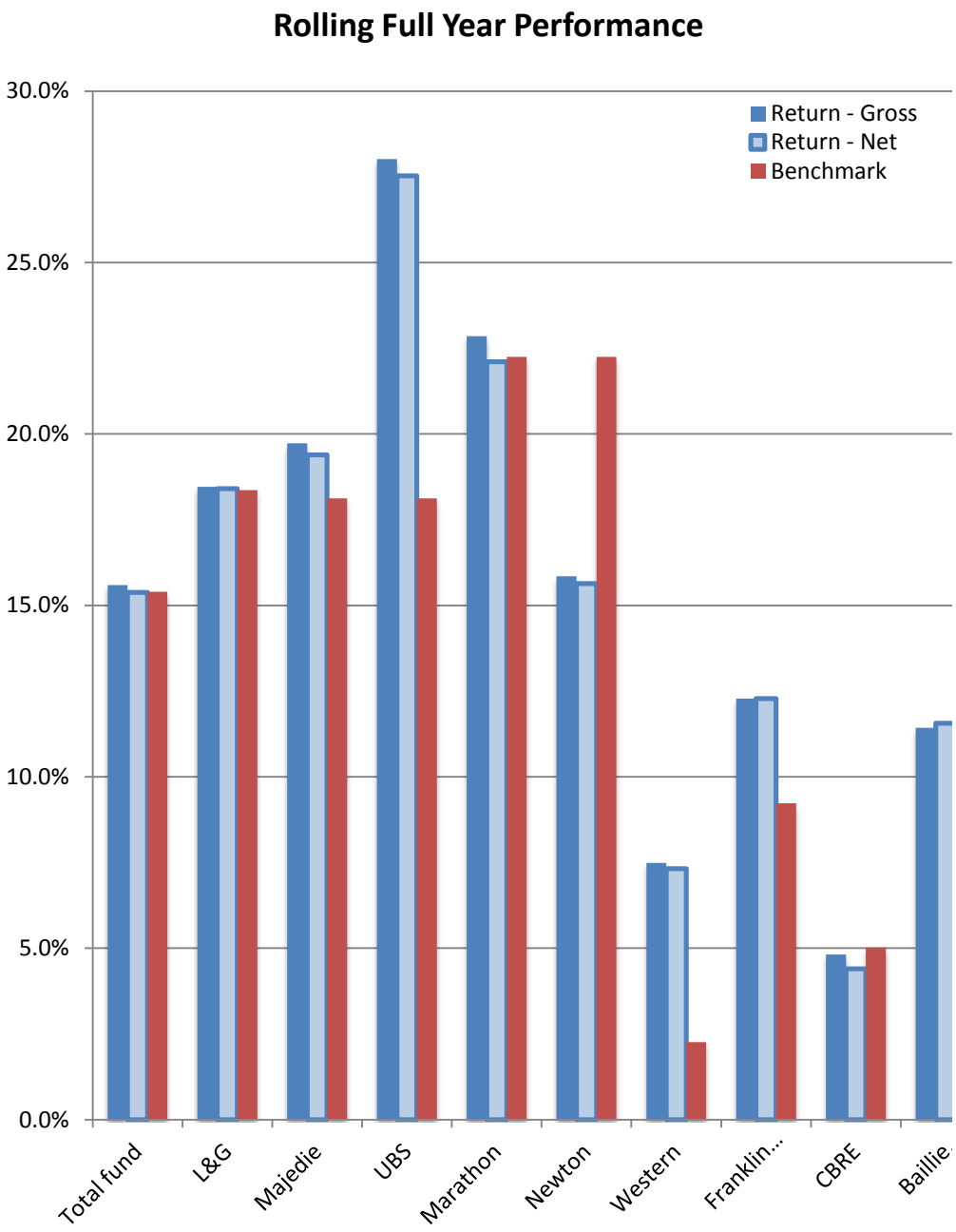
Baillie Gifford diversified growth funds is an absolute return fund with a benchmark based upon short term cash holdings.

The table below shows manager performance for 2017/18 Q1 (gross of investment manager fees) against manager specific benchmarks using Northern Trust data.

Manager	Gross of Fees Performance %	Benchmark %	Gross Performance Relative to Benchmark %
Total fund	1.1%	0.7%	0.4%
L&G	0.3%	0.3%	0.0%
Majedie	-0.5%	1.4%	-1.9%
UBS	1.3%	1.4%	-0.1%
Marathon	1.4%	0.4%	1.0%
Newton	1.4%	0.4%	1.0%
Western	1.1%	-0.4%	1.5%
Western - MAC	2.8%	1.0%	1.8%
Franklin Templeton	-1.0%	-1.2%	0.2%
CBRE	1.9%	2.4%	-0.5%
Ruffer	-0.4%	1.8%	-2.2%
Aviva	0.2%	1.8%	-1.6%
Baillie Gifford	1.7%	0.1%	1.6%

Summary of Full Year Investment Results (Gross and net of fees)

During the course of the previous 12 months to 30 June 2017, the Fund returned +15.4% net of investment fees against the customised fund benchmark of +15.4.

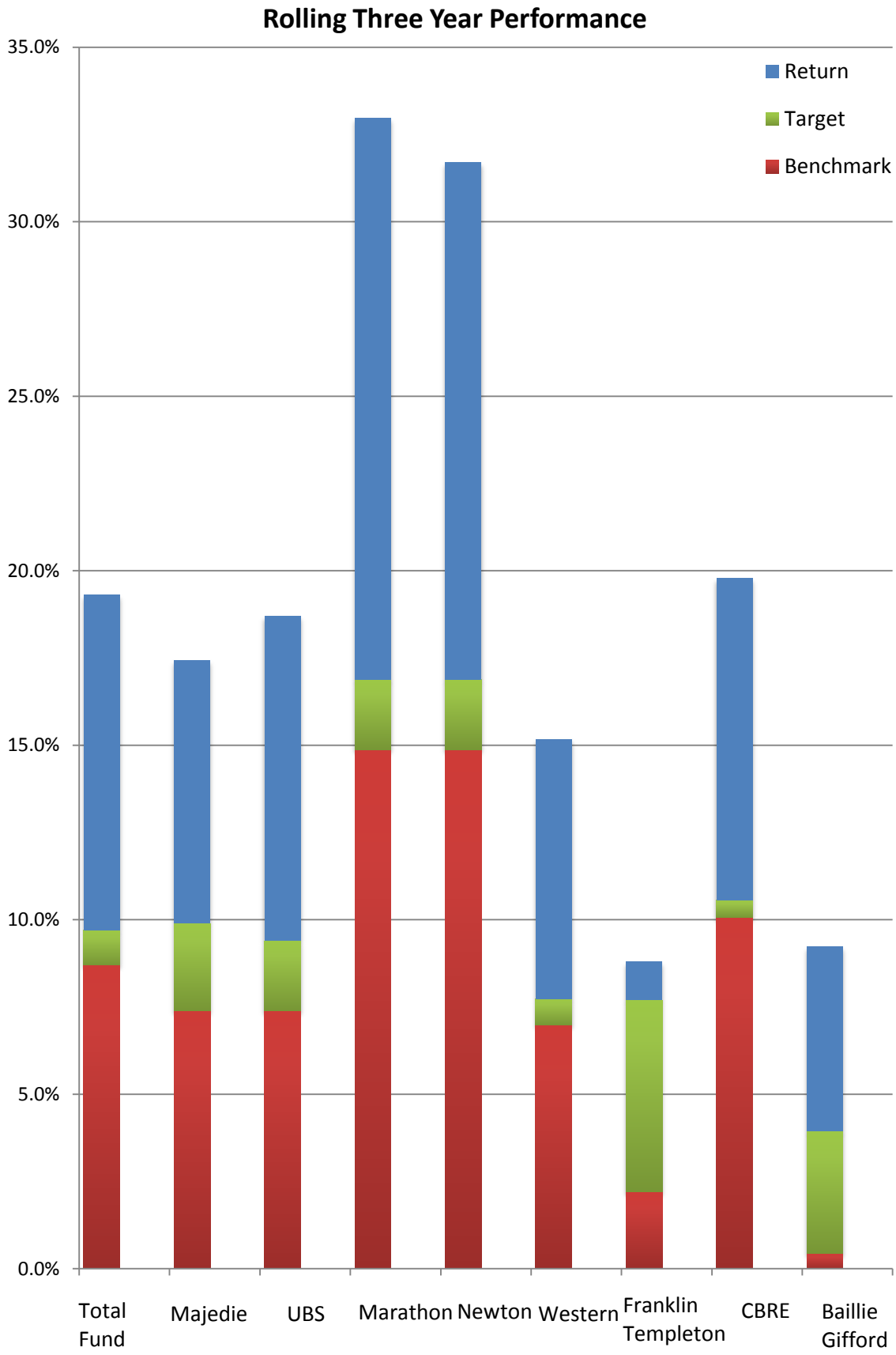


The table below shows manager performance for the year at 2017/18 Q1 (gross of investment manager fees) against manager specific benchmarks using Northern Trust data.

Manager	Net of Fees Performance %	Benchmark %	Net Performance Relative to Benchmark %	Gross of Fees Performance %
Total fund	15.4%	15.4%	0.0%	15.6%
L&G	18.4%	18.4%	0.0%	18.5%
Majedie	19.4%	18.1%	1.3%	19.7%
UBS	27.5%	18.1%	9.4%	28.0%
Marathon	22.1%	22.2%	-0.1%	22.8%
Newton	15.6%	22.2%	-6.6%	15.9%
Western	7.3%	2.3%	5.1%	7.5%
Franklin Templeton	12.3%	9.2%	3.1%	12.3%
CBRE	4.4%	5.0%	-0.6%	4.8%
Baillie Gifford	11.4%	0.3%	11.3%	11.4%

Both Baillie Gifford is an absolute return fund with a benchmark based upon short term cash holdings.

Summary of Rolling Three Year Performance

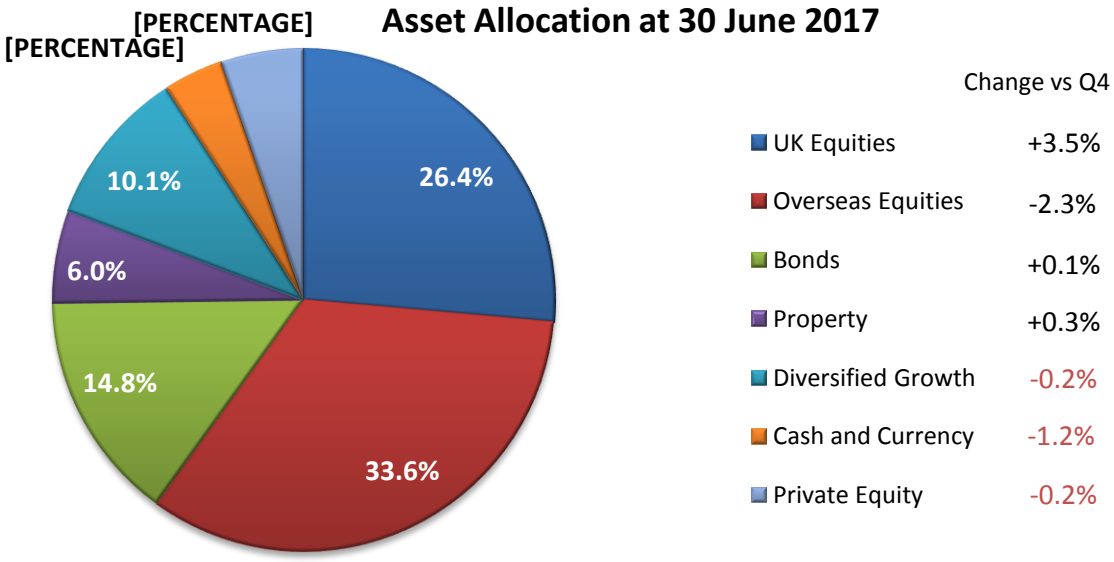


The below table shows the annualised performance by manager for the previous three years.

Manager	Performance %	Benchmark %	Target Above Benchmark %	Relative to Target %
Total Fund	9.6%	8.7%	9.7%	-0.1%
Majedie	7.5%	7.4%	9.9%	-2.4%
UBS	9.3%	7.4%	9.4%	-0.1%
Marathon	16.1%	14.9%	16.9%	-0.8%
Newton	14.8%	14.9%	16.9%	-2.1%
Western	7.4%	7.0%	7.7%	-0.3%
Franklin Templeton	1.1%	2.2%	7.7%	-6.6%
CBRE	9.2%	10.1%	10.6%	-1.3%
Baillie Gifford	5.3%	0.4%	3.9%	1.4%

4. Asset Allocation

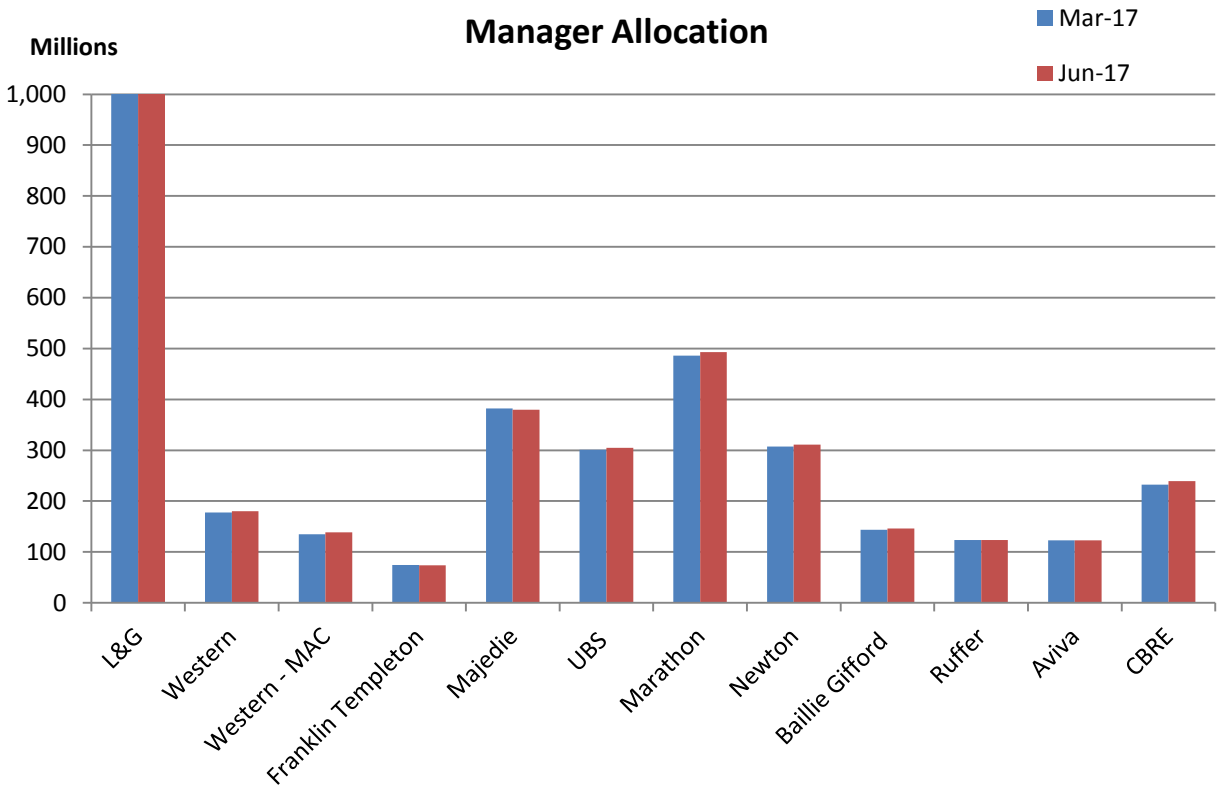
The graph and table below summarise the asset allocation of the fund as at 30 June 2017.The table below compares the actual asset allocation as at 30 June 2017 against target asset weightings.



	TOTAL FUND	Actual	Target
	£m	%	%
Bonds			
Multi Asset Credit	138.7	3.5	4.4
Investment Grade Credit	169.8	4.4	5.3
Index Linked Gilts	194.9	5.0	5.5
Unconstrained	73.5	1.9	2.4
Equities			
UK	1,027.5	26.4	27.5
Overseas	1,305.5	33.5	32.3
Property Unit Trusts	232.3	6.0	6.2
Diversified growth	392.6	10.1	11.4
Cash	152.9	4.0	0.0
Currency hedge	-2.8	-0.1	0.0
Private Equity	205.6	5.3	5.0
TOTAL	**3,890.5**	**100.0**	**100.0**

5. Manager Allocation

The graph below shows the manager allocation as at the 30 June 2017 and 31 March 2017.



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. With regard to investment pooling the S151 officer will continue to work closely with other officers to ensure effective governance and assurance of administering authority responsibilities under any new pooled arrangements.

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 there is no 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 30 June 2017
Annex 2: Minutes from external fund manager meetings held on 30 August 2017 (to be tabled on the day)

Sources/background papers:
None