SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **31 MAY 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

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 Board, as well as manager investment performance.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Board approve the report and, following discussions at the meeting, make the following decisions:

a) asset allocation rebalance
b) fund access cash
c) allocations to private equity

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
CBRE	Redemption	Update included in minutes of external fund manager meetings held on 25 April 2013 (Annex 2). This includes the latest Triton Fund situation.
LGIM	Rebalancing	Discussions have taken place quarter reference the out-performance of Equities during the first quarter of 2013 and the consequential drift away from asset allocation policy. The current consensus is that there is a degree of comfort with regard to the current equity overweight position. There is the view that there could still be some way to go with regard to the recovery of the equity market and cutting back on the Fund's most successful manager (Marathon) could be counterproductive, especially as the Fund is not high in the Local Authority League Table with regard to its funding level and therefore, a small additional element of well placed risk could be desirable. Mention was also made of the recent de-risking process whereby the entire Diversified Growth pooled fund allocation was funded from the Equities category. Members are invited to discuss the question of rebalancing and the various options available. A schedule setting out the asset allocation position at 14 May 2013 is shown in Annex 1.
LGIM	Currency Hedge	LGIM’s Counterparty Credit Sub-Committee (CCSC) monitors and proved foreign exchange counterparties and currently have a minimum credit rating requirement of A1 (Standard & Poor’s) and P1 (Moody’s). The CCSC have reviewed the current situation and taken the decision to reinstate Royal Bank of Scotland (RBS) and Citi which had been downgraded by Moody's to P2 last year. They have also decided to add Bank of America (BoA), also on A1/P2 and Goldman Sachs (GS) which has an A1 rating but does not have a short term rating from Moody's. Surrey’s investment management agreement (IMA) restricts dealing with counterparties whose short term credit rating is below A1 (S&P) or P1 (Moody's). This will result in RBS, Citi and BoA being restricted and this has been agreed by officers. With regard to GS, officers recommend use of this countertparty with its A1 rating (no current Moody’s rating), subject to the Pension Fund Board’s approval.

Hg Capital	Hg Capital 7	Officers submitted the necessary signed paperwork within the necessary deadlines for the new Hg Capital 7 private equity fund. Confirmation of acceptance by Hg Capital has been received by officers.
ISIS	Growth Fund	Officers received the final documentation for the ISIS Growth Fund on 16 May. This will be completed and returned as early as possible.
Marathon		Update included in minutes of external fund manager meetings held on 25 April 2013 (Annex 2).
Newton	Performance Concern	Update included in minutes of external fund manager meetings held on 25 April 2013 (Annex 2).
Western	Transition of UK Gilts to Fixed Income Absolute Return	Update included in minutes of external fund manager meetings held on 25 April 2013 (Annex 2).

2) Freedom of information requests

The table below summarises the FoI requests received by the fund since the last meeting. There is currently high interest from newspaper journalists in the values of holdings in so called 'sin' stocks. In addition to the list below the Council's communications team also received two press enquiries (non FoIs) from the same journalist at the Epsom Guardian about tobacco investments and investments in the defence industry. The requested information was provided.

Date	Requestor	Organisation	Request	Response
Feb -13	Company	Pitchbook	Information on private equity holdings	Provided summary as at 31 Dec 2012
Mar-13	Individual	N/A	Proportion of SSC expenditure spent on pension contributions.	Provided based on figures in SSC accounts for 2011/12

3) Future Pension Fund Board Meetings/Pension Fund AGM

The schedule of meetings for 2013 is as follows:

- 31 May 2013: Board meeting hosted at Standard Life, London offices.
- 30 Aug 2013: Board meeting hosted at County Hall.
- 15 Nov 2013: Board meeting hosted in City
- 22 Nov 2013: Pension Fund Annual Meeting hosted at County Hall.

Report of the Pension Fund & Treasury Manager

Internally Managed Cash

The internally managed cash balances of the Pension Fund are currently around £32m. This is cash managed by SCC as part of the Treasury Management process and is separate from the cash balance held at the Fund's custodian, Northern Trust. The cash is currently split between a NatWest call account paying interest of 0.60% and an RBS money market fund paying 0.40%. The cash balance was going to be used to fund the majority of the additional allocation to Majedie's global fund. That allocation can no longer take place following the departure of key staff to Marathon. The Statement of Investment Principles (SIP) has been updated to reflect this change. Given the fund's policy of no asset allocations dedicated to cash, an allocation of £25m to an existing approved asset category is desirable. The Pension Fund & Treasury Manager will report at the meeting.

Goldman Sachs Private Equity: Vintage Fund VI

Goldman Sachs Asset Management has informed the Fund of its next private equity secondary fund, named as The Vintage VI Fund. The Vintage VI Fund has closed on $3.4bn in commitments to date and expects to hold a final close on 15 June 2013. The fund is opportunistic in its nature, acquiring interests in private equity funds and companies from sellers who are looking to achieve liquidity for their positions. The Fund is expected to be predominantly focused on mid market buyouts across all industries. The geographic focus is also opportunistic, although historically the funds have allocated more to North America which is also expected to be the case for The Vintage VI Fund. The Fund will seek to outperform public equities and historically has achieved between 573 and 1016bps of outperformance for the prior five Vintage funds compared with the MSCI S World Index when historical cash flows are compared. The investment team (Alternative Investments and Manager Selection group) which is responsible for this Fund has over 270 people across ten offices globally. The investment committee for the Fund comprises 12 Managing Directors who have an average over 16 years of investment experience.

It is recommended that the Surrey Pension Fund make a USD 20m commitment to the Vintage VI fund.

BlackRock Private Equity: DivPep V Fund

BlackRock Private Equity Partners ("PEP") has informed the Fund of its next private equity fund. The DivPEP V Fund has closed on $170 million in total commitments as of 4 January 2013 and has another $230 million scheduled to close in May this year.

DivPEP V's investment strategy mirrors the strategy that PEP has successfully employed in four prior commingled programmes and four customised separate accounts: it is designed to provide exposure to private equity investments while attempting to mitigate risk by constructing a diversified portfolio of private equity funds and direct co-investments. The DivPEP programmes are opportunistic and designed to seek capital appreciation through diversification, asset selection, and experience, and construct a diversified portfolio of primary funds, direct co-investments and secondaries.

PEP takes an opportunistic approach to sector and geographic diversification. DivPEP V will be invested about 50-70% in the United States, 20 - 50% in Europe and up to 20% in the rest of the world. DivPEP V will seek to outperform the equity markets in line with its mature predecessors' performance, which, as of September 2012, have outperformed the S&P 500 by 710 to 720 bps and MSCI World by 460 to 760 bps.

BlackRock has over 460 portfolios managers and 245 research analysts that PEP can tap into as part of its due diligence process. Global staff includes approximately 1,550 investment professionals across asset classes and regions worldwide. BlackRock's Private Equity Partners' Managing Directors average 20 years of private equity and related experience.

It is recommended that the Surrey Pension Fund make a USD 20m commitment to the DivPEP V Fund.

Investment Regulations: Increase of limit on Investment in Partnerships

Schedule 1 to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 stipulated a maximum 15% with regard to asset allocation in partnerships. This has now been revised to 30% with the main intention of enabling LGPS schemes to allocate substantial amounts to infrastructure funds. Infrastructure will be the subject of a future report to the Pension Fund Board.

Actuarial Update

The process of data transfer to the Fund's actuary for the triennial actuarial valuation as at 31 March 2013 has now started. Officers are in regular contact with the actuary. The Pension Fund and Treasury Manager has also been in regular contact with the Surrey Treasurer's Association to keep them appraised of progress. The Pension Fund and Treasury Manager will report at the Pension Board meeting.

Fund Manager Meetings on 25 April 2013

Notes of the fund manager meetings are shown as Annex 2.

Report of the Pension Fund & Treasury Manager

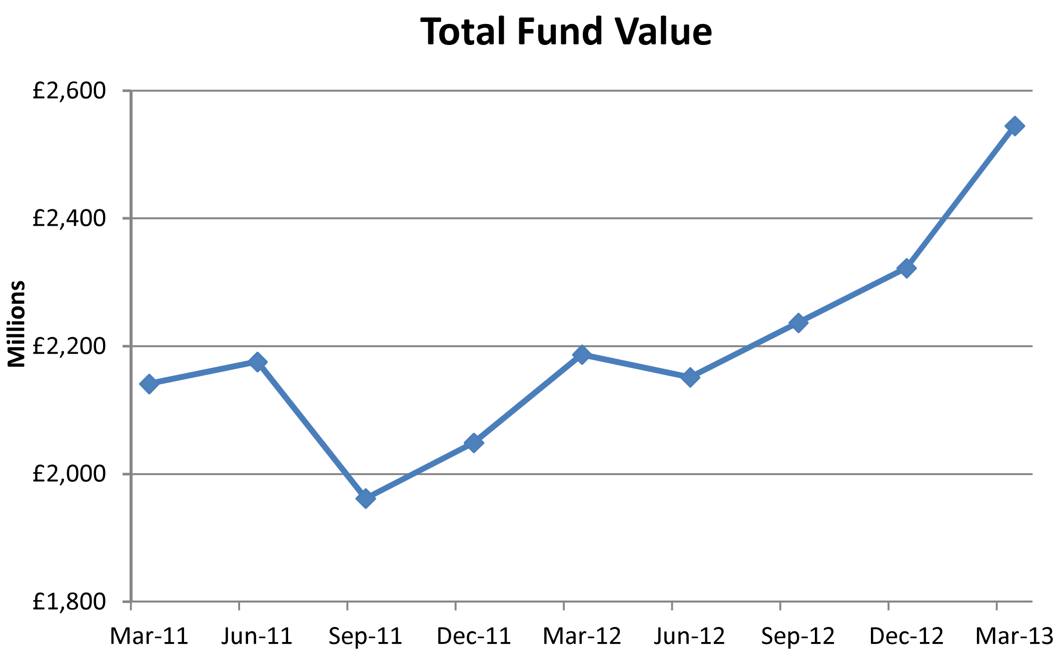
Financial and Performance Report

1. Market Value

The value of the fund was £2,545.0m at 31 March 2013 compared with £2,322.4m at 31 December 2012. Investment performance was 8.9% for the quarter against the customised (hedged) benchmark return of 7.0%

The increase is attributed as follows:

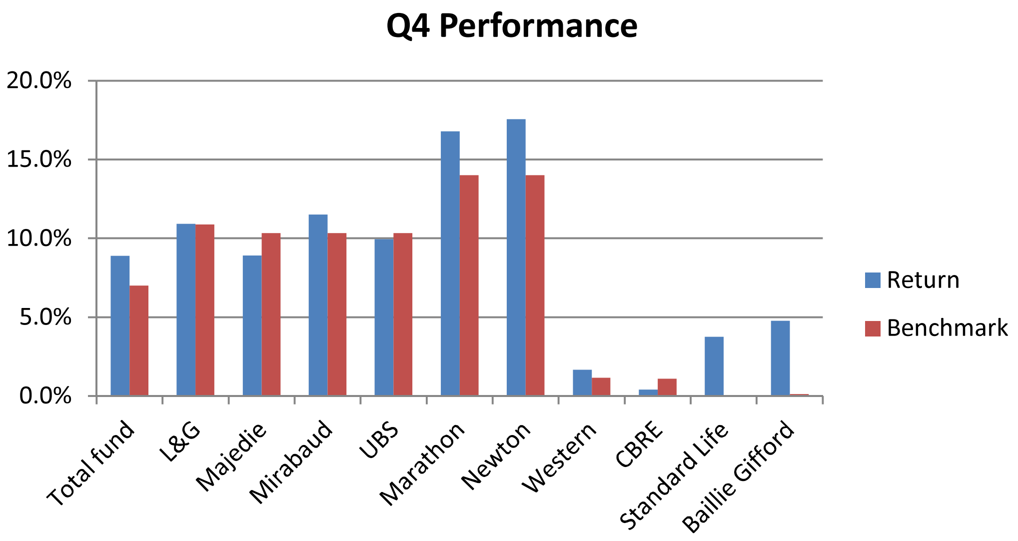
	£m
MARKET VALUE AT 31/12/2012	**2,322.4**
Contributions less benefits and net transfer values	12.6
Investment income received	8.8
Investment expenses paid	-2.2
Market Movements	203.3
Market Value at 31/03/2013	**2,545.0**
Estimated Market Value at 14/05/2013	**2,629.3**



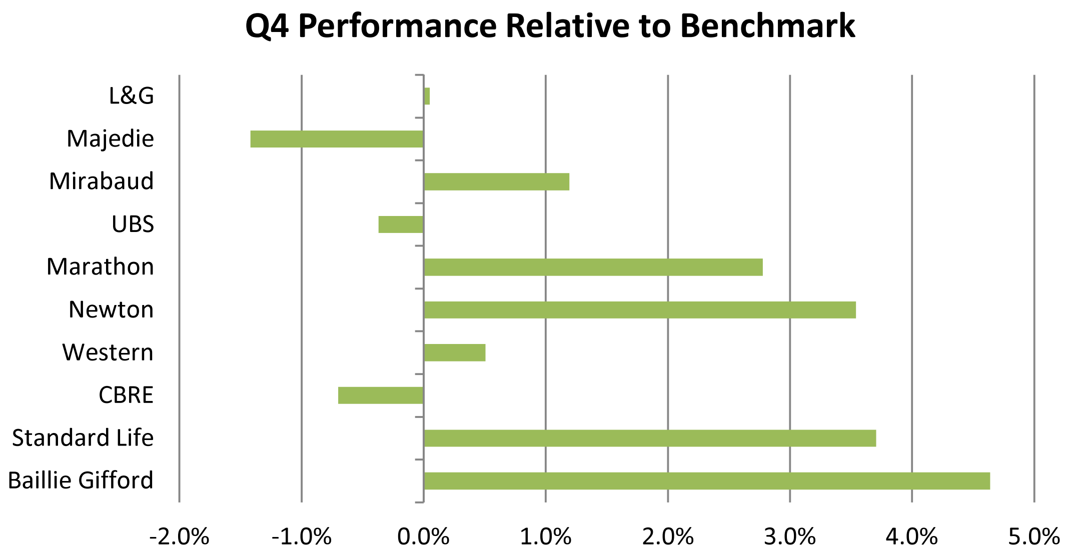
2. Fund Performance

Summary of quarterly results

Overall, the total fund return of 8.9%, was greater than the customised (hedged) benchmark return of 7.0% (+1.9%) during Q4.

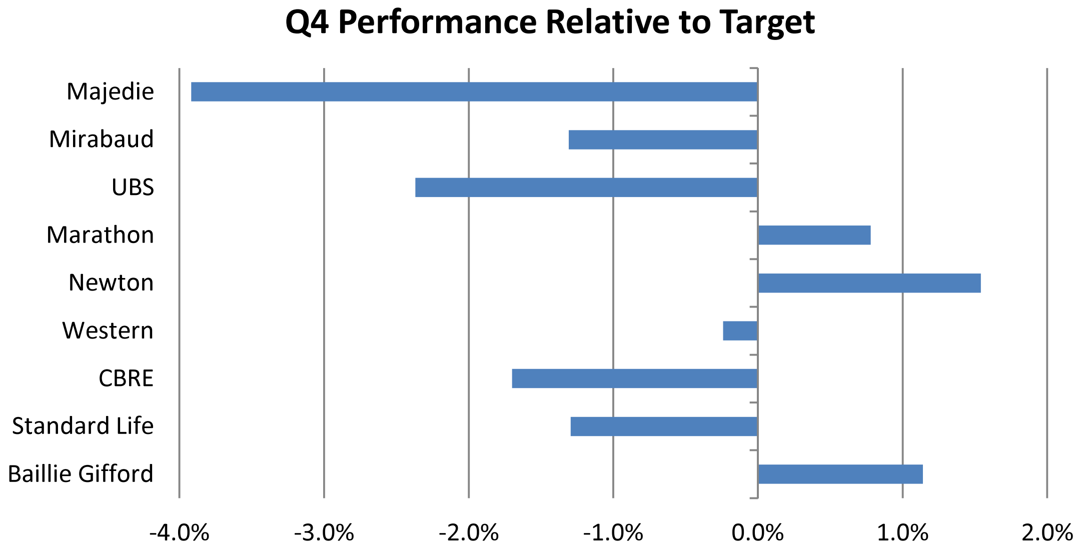


The equity market performed strongly during Q4, especially overseas equity, with the Fund's two global equity portfolios providing an absolute return of +16.8% (Marathon) and +17.6% (Newton).



Relative to benchmark, Standard Life and Bailie Gifford reported the strongest quarterly figures with results surpassing the benchmark by +3.7% and +4.6% respectively. Newton and Marathon also managed to secure strong outperformance figures to the benchmark of +3.5% and +2.8%.

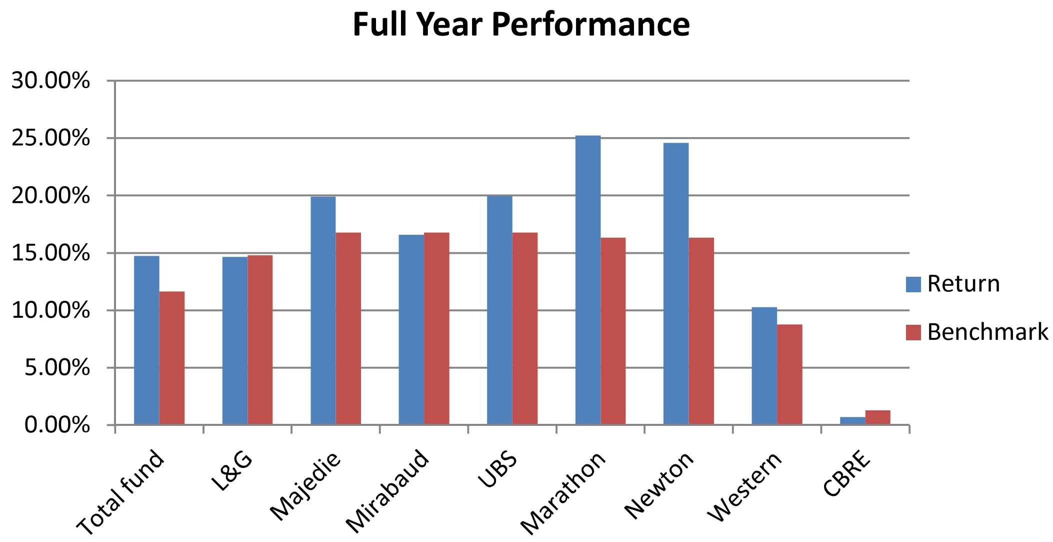
Majedie was the worst performing manager during Q4 in relative terms with a total return of +8.9%, a variance of -1.4% to the benchmark. CBRE and UBS also failed to meet the benchmark with relative performances of -0.7% and -0.4% respectively.



Each actively managed portfolio has an outperformance target over and above the benchmark. Standard Life and Baillie Gifford have comparatively high outperformance targets based upon a less demanding benchmark figure. Only Newton, Bailie Gifford and Marathon achieved their Q4 target.

Summary of Full Year Results

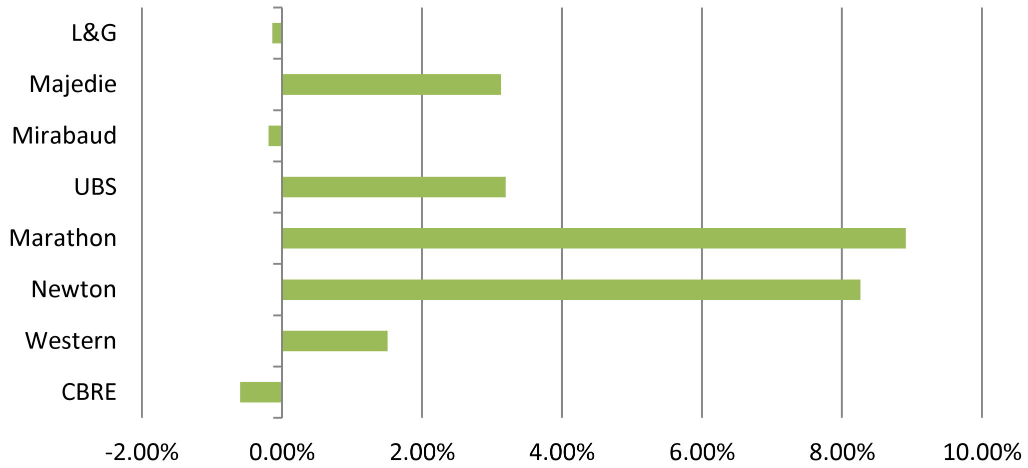
Over the past year, the total Fund returned 14.7% outperforming the benchmark by +3.1%.



Global Equities provided the greatest overall return for the fund over the last year with Marathon the best performer with +25.2%, closely followed by Newton with +24.6%. CBRE provided the lowest absolute return as property performed markedly worse than other asset classes.

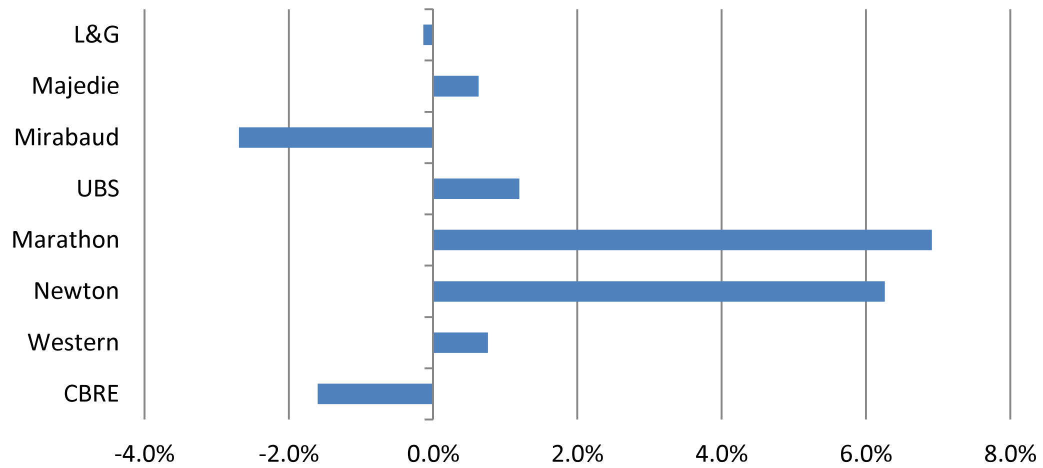
Standard Life and Baillie Gifford have been excluded because their mandates have been in place for less than a year.

Full Year Performance Relative to Benchmark



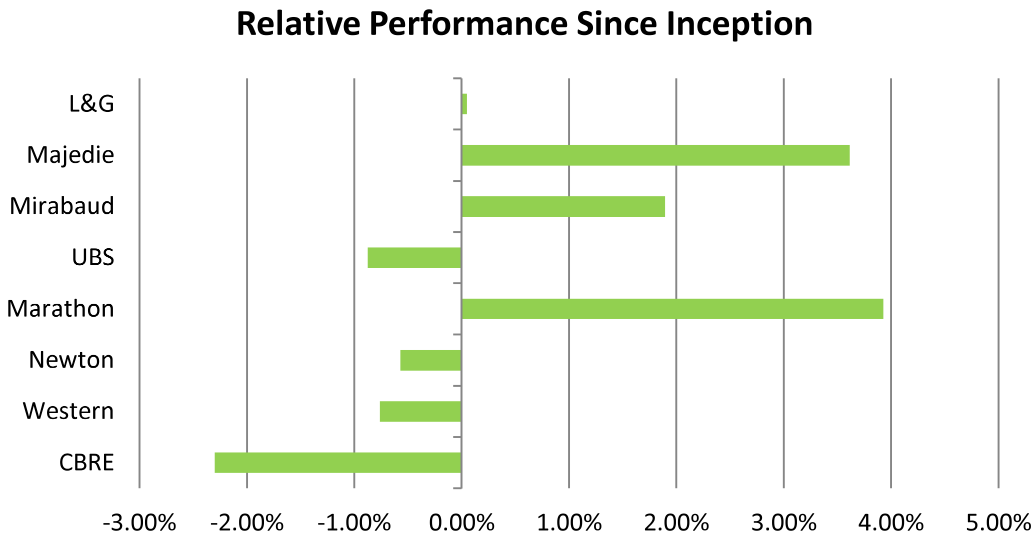
In relative terms, the best performing manager was also Marathon with their return of +8.9% over the benchmark with Newton reporting a similar performance of +8.3%. Both Mirabaud and CBRE failed to surpass the benchmark targets with relative returns of -0.2% and -0.6% respectively.

Full Year Performance Relative to Target



Marathon and Newton have reported full year returns significantly exceeding their outperformance target for the previous year. UBS, Western and Majedie also managed to meet their outperformance targets.

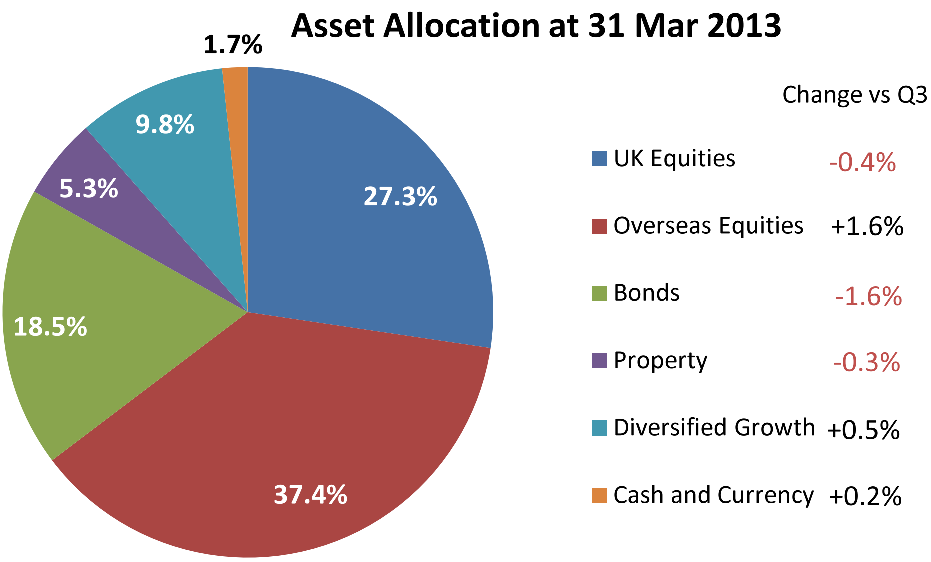
Relative Performance from Inception



Standard Life and Baillie Gifford have been excluded because their mandates have been in place for less than a year.

3. Asset Allocation

The graph and table below summarise the asset allocation of the managed elements of the fund, excluding private equity holdings and internally held cash balances.



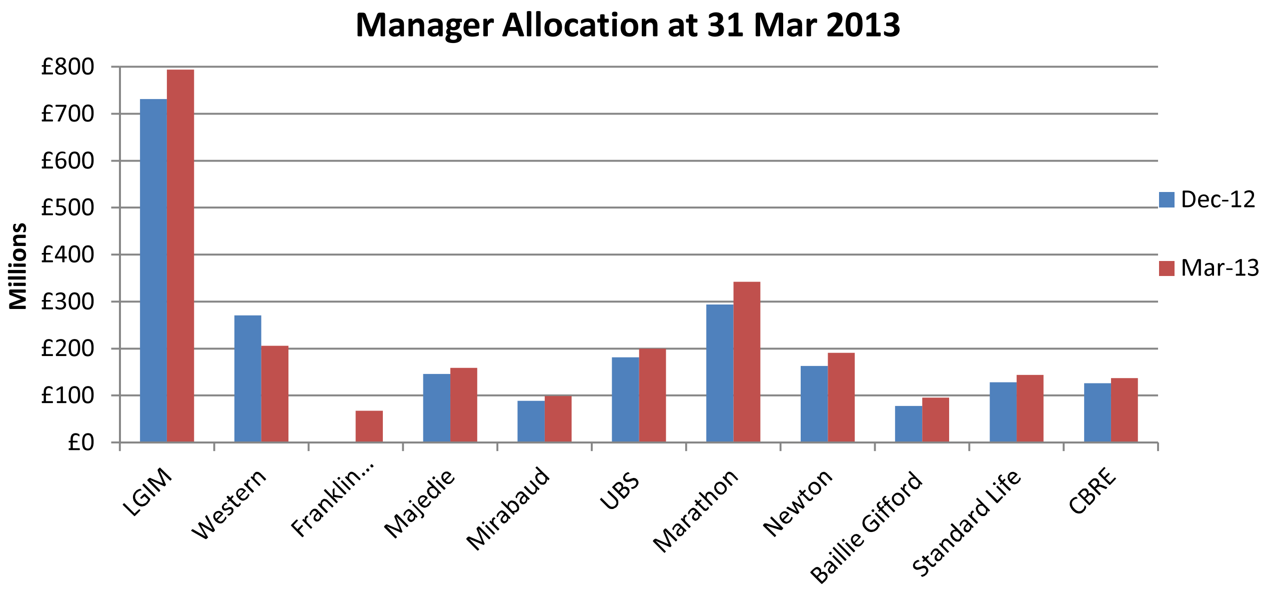
The table below compares the actual asset allocation as at 31 March 2013 against that target asset weightings.

	TOTAL FUND	Actual	Target	Last Quarter	
	£m	%	%	£m	%
Fixed Interest					
UK Government	103.3	4.2	5.2	172.2	7.8
UK Non-Government	178.0	7.3	8.0	178.5	8.1
Overseas	2.2	0.1	0.0	2.3	0.1
Total Return	67.7	2.8	2.8	0.0	0.0
Index Linked	99.4	4.1	4.0	90.3	4.1
Equities					0.0
UK	665.7	27.3	29.0	612.6	27.7
Overseas	909.9	37.4	34.0	791.0	35.8
Property Unit Trusts	129.8	5.3	7.0	123.7	5.6
Diversified growth	239.0	9.8	10.0	205.9	9.3
Cash	46.4	1.9	0.0	27.3	1.2
Currency hedge	-5.9	-0.2	0.0	4.9	0.2
TOTAL	**2,435.4**	**100.0**	**100.0**	**2,208.7**	**100.0**

The value of internally managed cash was £19.2m as at 31 March 2013 and was excluded from this assessment. The above table excludes the Fund’s private equity holdings valued at £90.3m, 3.5% of the fund, with a target allocation of 5%.

4. Manager Allocation

The graph below shows the current manager allocation.



The table below includes the actual and benchmark manager allocation weightings.

		Actual		TARGET	LAST QUARTER	
		£m	%	%	£m	%
LGIM	Multi-asset	794.3	32.6	32.0	731.5	33.1
Western	Bonds	206.0	8.5	8.25	270.9	12.3
Franklin Templeton	Bonds	67.7	2.8	2.75	n/a	n/a
Majedie	UK Equity	158.7	6.5	8.0	145.9	6.6
Mirabaud	UK Equity	98.9	4.1	4.0	88.9	4.0
UBS	UK Equity	199.6	8.2	8.0	181.6	8.2
Marathon	Global Equity	342.0	14.0	12.0	294.0	13.3
Newton	Global Equity	190.8	7.8	8.0	162.7	7.4
Baillie Gifford	Diversified Growth	95.4	3.9	4.0	77.8	3.5
Standard Life	Diversified Growth	143.6	5.9	6.0	128.1	5.8
CBRE	Property	137.3	5.6	7.0	126.5	5.7
	Residual Cash	0.9	0.0	0.0	0.9	0.1
TOTAL		**2,435.4**	**100.0**	**100.0**	**2,208.7**	**100.0**

Benchmark weighting for Majedie includes additional 2% allocation to global equities which will no longer take place. Residual cash is from the termination of JP Morgan's and TCW's mandate.

5. Fees

The following table shows a breakdown of fees due for Q4 2012/13.

Manager	MV 31/03/13 £m	Fee Q4 £	Annualised Average Fee %
LGIM	794.3	188,505	0.09
Western	206.0	106,994	0.21
Franklin Templeton	67.7	82,788	0.49
Majedie	158.7	130,819	0.33
Mirabaud	98.9	138,601	0.56
UBS	199.6	49,714	0.10
Marathon	342.0	318,093	0.37
Newton	190.8	107,913	0.23
Baillie Gifford	95.4	117,808	0.49
Standard Life	143.6	231,737*	0.65
CBRE	137.3	58,080*	0.17
Total		**1,531,052**	**0.25**

*Estimated

CONSULTATION:

6 The Chairman elect of the Pension Fund has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

7 Risk related issues have been discussed and are contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

8 Financial and value for money implications are discussed within the report.

CHIEF FINANCE OFFICER COMMENTARY

9 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

10 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

11 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

12 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

13 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 Board Chairman

Annexes:
1. Asset Allocation Policy and Actual
2. Fund manager meeting notes on 25 April 20123

Sources/background papers:
None

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