

**SURREY COUNTY COUNCIL****PENSION FUND COMMITTEE****DATE:** 10 MARCH 2022**LEAD OFFICER:** ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL**SUBJECT:** INVESTMENT MANAGER ISSUES AND PERFORMANCE AND ASSET/LIABILITIES UPDATE**SUMMARY OF ISSUE:****Strategic objectives****Investment****Funding**

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 an update on investment performance and the values of assets and liabilities.

**RECOMMENDATIONS:**

It is recommended that the Pension Fund Committee:

- a) Notes the main findings of the report in relation to the Fund's valuation and funding level, performance returns, asset allocation and performance fees

**REASON FOR RECOMMENDATIONS:**

In order to judge the performance of the Fund's investment managers against the Fund's target returns, and whether it is meeting its Strategic Investment objective in line with its Business Plan.

**DETAILS:****Freedom of Information Requests**

1. The table below summarises the Freedom of Information request responses provided by the Fund during the last quarter.

<b>Date</b>	<b>Organisation</b>	<b>Request</b>	<b>Response</b>
12/10/2021	PEI Media	Private Equity records	Information provided
19/10/2021	Preqin	Private Equity records	Information provided

19/10/2021	Bloomberg	Private Equity records	Information provided
20/10/2021	Ion Group	Private Equity records	Information provided

## Stock Lending

2. A temporary lending of securities, which are held against collateral. On payment, the “borrower” returns the security along with an agreed fee margin, and the “lender” returns the collateral held for the period of the loan.
3. Securities are borrowed by Investment Banks, Prime brokers, Local brokers, Investment funds, Prop traders and other intermediaries. Each borrower must be able to demonstrate their credit worthiness. Northern Trust, the Fund’s custodian has long term experience in this area of activity and provides security lending to over 450 clients. Annexe 3 provides further information on Northern Trust securities lending programme.

### Risks

- a) As with any lending there is a risk of borrower default which may result in the loss of the asset. Northern Trust’s proposal however includes a borrower default indemnification backed by Northern Trust’s strong balance sheet. This would protect the Fund from loss in the event of borrower default.
- b) Although lenders with enhanced indemnity are contractually protected for any shortfall, the following controls assist in ensuring that the following operating risks are adequately managed.

<b>Risk</b>	<b>Mitigating Factors</b>
Borrower default combined with insufficient collateral to buy-in replacement securities & compensate for accrued entitlements	<ul style="list-style-type: none"> <li>•Rigorous credit committee review for approval</li> <li>•Daily marking of loans/collateral</li> <li>•Risk analysis tools (MSCI Barra) to measure and calibrate exposure</li> <li>•Borrower default and close-out simulation exercise carried out at least once every 2 years</li> <li>•In house transition manager</li> </ul>
<u>Trade Settlement</u> Client sells loaned security and borrower fails to return in time to settle the trade	<ul style="list-style-type: none"> <li>•Robust automated reallocations</li> <li>•Trade settlement protection/ Contractual Settlement</li> <li>•Buffer management process</li> </ul>
<u>Cash Reinvestment</u> Cash collateral investment becomes impaired or decreases in value	<ul style="list-style-type: none"> <li>•Multiple risk committee reviews and robust oversight of cash pools and investments</li> <li>•Dedicated team of Fixed Income Research analysts reviewing securities</li> <li>•Daily automated monitoring of portfolio guidelines and compliance</li> </ul>
<u>Interest Rate</u>	<ul style="list-style-type: none"> <li>•Close daily communication between lending and cash management teams</li> </ul>

Loan rebate rate exceeds earnings on cash collateral investments	<ul style="list-style-type: none"> <li>•Shared risk between Northern Trust and client</li> <li>•Weekly “gap analysis” and periodic stress testing of portfolio</li> </ul>
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- In the quarter to 31 December 2021, stock lending earned a net income for the Fund of £1,507.

### Internally Managed Cash

- The internally managed cash balance of the Fund was £4.87m as at 31 December 2021.

### Transitions

- The Fund transitioned assets from Diversified Growth Funds, which included Aviva, Ruffer and Baillie Gifford to Border to Coast Listed Alternatives Fund. The transition was completed in early February 2022.

### Cashflow Analysis

- Pensions Funds have a positive cash-flow when their contribution inflows exceed pension benefits paid.
- Contributions are derived from employers and employees. Pension benefits are derived from pensions and lump sum benefits paid to retired members and benefits paid to employees on leaving the Fund.
- Any positive cash-flow is invested in accordance with the Fund’s cash management plan.
- The half-yearly (quarters two-three) cash-flow for the Surrey Pension Fund shows positive cash flow of £9,304,903 as follows:

Quarter	Total contributions received	Total pension benefits paid	Net cash-flow
Two (1 July 2021 – 30 Sept 2021)	£50,002,306	£45,187,399	£4,814,907
Three (1 Oct 2021 – 31 Dec 2021)	£51,344,362	£46,854,366	£4,489,996

- An indication of the current membership trends is shown by movements in membership over quarters two-three (as taken from statistics provided by the pension administration team):

<b>Period</b>	<b>Active members</b>	<b>Deferred members</b>	<b>Pension members</b>	<b>Total members</b>
Quarter Two 2021/22  (1 Jun 2021 – 30 Sept 2021)	39,080	41,615	29,089	109,784
Quarter Three 2021/22  (1 Oct 2021 – 31 Dec 2021)	39,244	41,719	29,371	110,334

## **Financial and Performance Report**

### **Funding Level**

12. The funding level is derived as the ratio of the value of the Fund's assets to the value of its liabilities.

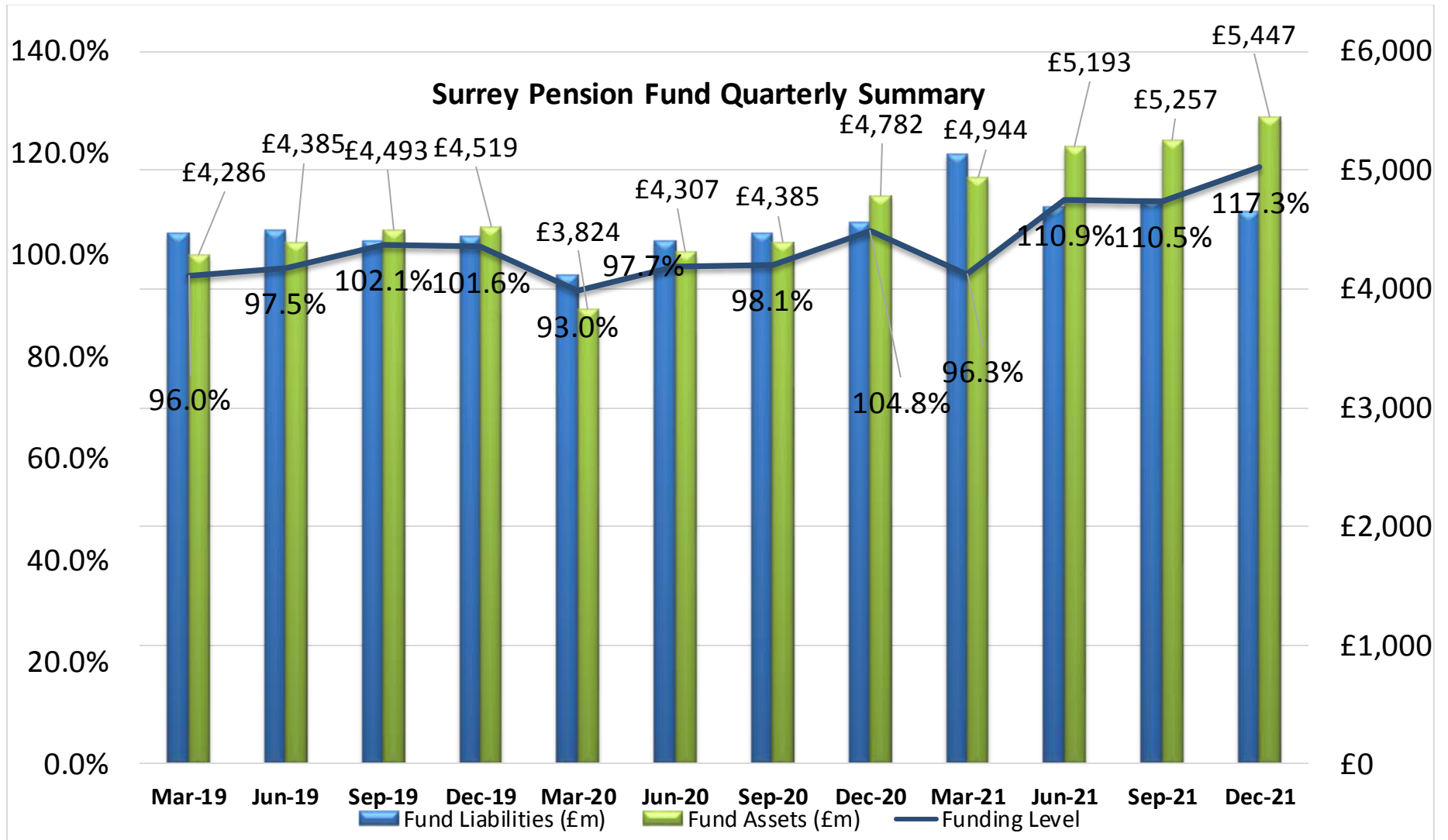
#### **Liabilities**

13. The Fund's liabilities are the future benefit payments due to members in respect of their service accrued in the Fund. Currently, the majority of benefit payments are in respect of pensioner members. However, over time, the benefit payments will transition from being mostly in respect of pensioners to deferred and active members (i.e. the pensioners of the future).

#### **Assets**

14. The Fund's assets are used to pay member benefits accrued to date. It is estimated that, based on the fund returns 4.2% p.a. the Fund's assets will be sufficient to pay all future benefit payments due.
15. The graph below summaries that funding level has reached 117% (96% as at 31 March 2019) and is based on the formal valuation results as at 31 March 2019, updated for market conditions at 31 December 2021. Based on the data that has been provided, the market value of assets is approximately £5,447bn and the value placed on the liabilities is £4,645bn.

*The assumptions used are as follows: A discount rate of 4.2%, Salary inflation of 2.9%, Pension increases of 2.0%*





## 16. Asset Allocation

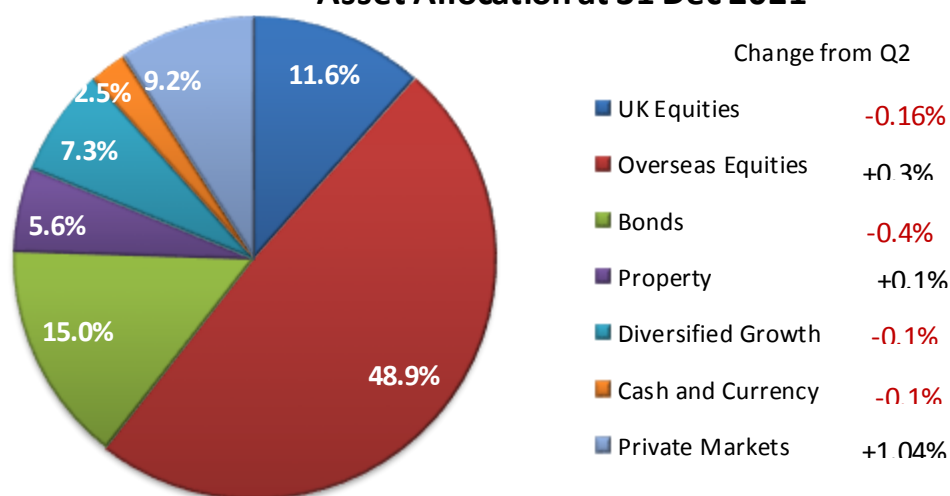
The table and the graph below provide an overview of the asset allocations of the fund for the quarter ending 31 December 2021.

The table below highlights the actual asset allocation against target for each class of asset.

	TOTAL FUND	Actual	Target
	£m	%	%
Bonds			
Multi Asset Credit	613.2	11.26%	9.7%
Conventional Gilts	201.1	3.69%	5.5%
Unconstrained	0.0	0.00%	2.4%
Equities			
UK	632.5	11.61%	17.4%
Global Equities (Overseas)	1,313.5	24.12%	19.0%
Emerging Markets (Overseas)	306.8	5.63%	3.8%
Multi Factor (Overseas)	1,044.7	19.18%	9.8%
Low Carbon (Overseas)	0.0	0.00%	9.8%
Property Unit Trusts	305.2	5.60%	6.2%
Diversified growth	395.3	7.26%	11.4%
Cash*	120.8	2.22%	-
Currency hedge	14.7	0.27%	-
Private Markets	499.0	9.16%	5.0%
<b>TOTAL</b>	<b>5,446.8</b>	<b>100.0%</b>	<b>100.0%</b>

\*The Asset Allocation table includes The Fund's holding of cash, while the Asset Allocation in Annex 1 is the Fund's Strategic Asset Allocation of its Funds under Management based on its most recent Investment Strategy Statement

### Asset Allocation at 31 Dec 2021



## 17. New asset allocation

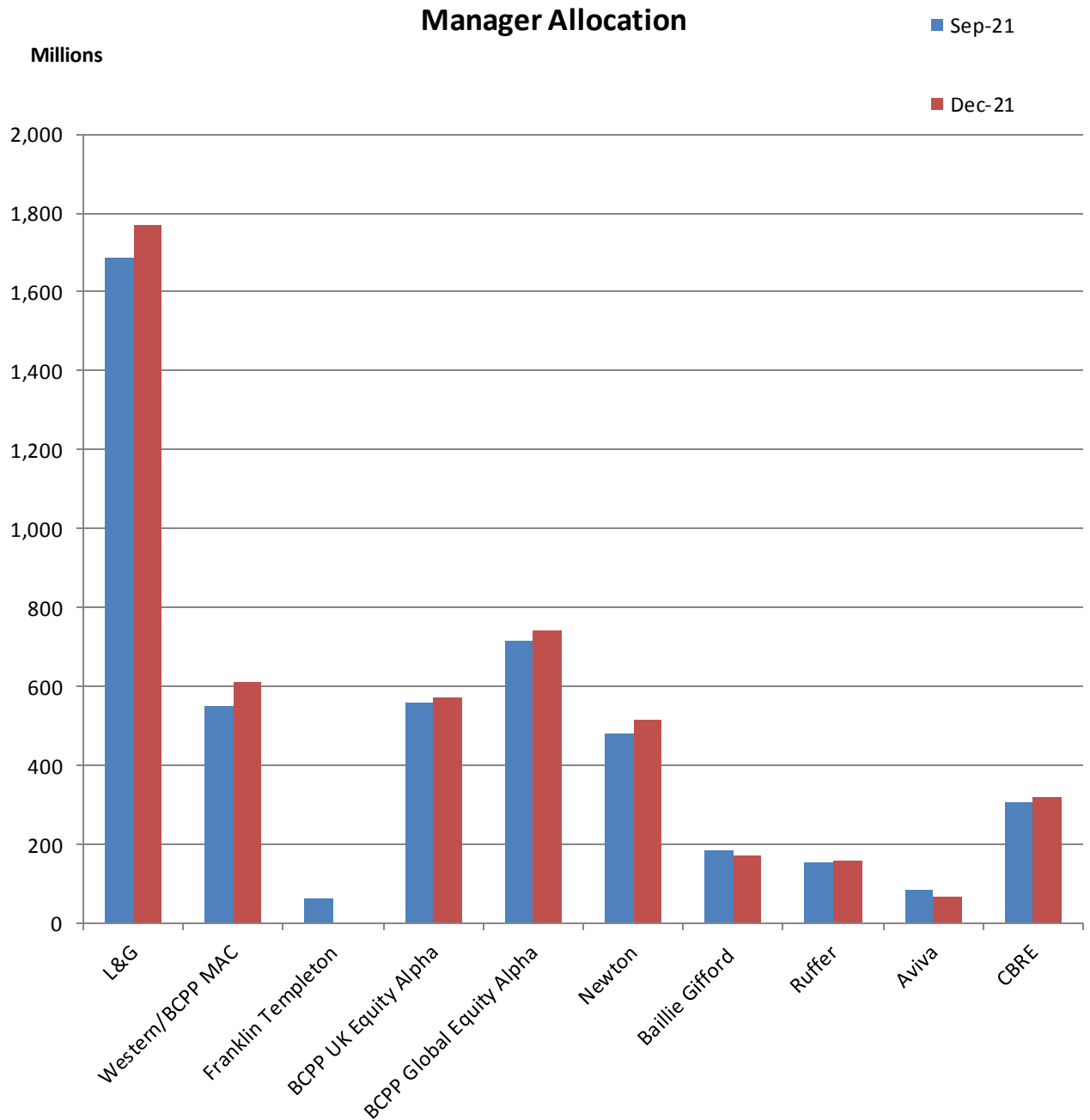
The Fund asset allocation above and manager performance below are as at 31 December 2021, which is prior to the Fund transition to BCPP and do not reflect new asset allocation as agreed by the Pension Fund Committee in December meeting. The new asset allocation in the table below will be reflected in June committee meeting.

Asset class	Allocation %	Advisory ranges %	Role(s) within the strategy
<b>Listed Equities</b>	<b>54.8</b>	<b>51.8 – 57.8</b>	Generate returns in excess of inflation, through exposure to the shares of domestic and overseas companies.
UK	12.0		
Global Market Cap	13.0		
Global Regional	10.0		
Emerging Markets	3.8		
Global Sustainable	16.0		
<b>Alternatives</b>	<b>27.6</b>	<b>22.6-32.6</b>	Generate returns in excess of inflation, through exposure to illiquid assets that are not publicly traded, whilst providing some diversification away from listed equities and bonds.
Private Equity	5.0	2.0-8.0	
Infrastructure	6.0	3.0-9.0	
Private Debt	6.0	2.0-8.0	
Miscellaneous Alternatives	3.0	0.0-6.0	
Property	7.6	4.6–10.6	
<b>Multi Asset Credit</b>	<b>12.1</b>	<b>9.1-15.1</b>	Offer diversified exposure to global credit markets to capture both income and capital appreciation of underlying bonds.
<b>Fixed Interest Gilts</b>	<b>5.5</b>	<b>2.5-8.5</b>	
Fixed Interest Gilts	5.5		Low risk income stream
<b>Total</b>	<b>100.0</b>		



## 18. Manager Allocation

The graph below shows the manager allocation for the quarters ending 31 December 2021 and 30 September 2021.



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## Fund Manager Benchmarks

Fund	Portfolio	Benchmark Index	Performance Target relative to Benchmark
Surrey Pension Fund	Total Portfolio	Weighted across the fund	+1.0%

Manager	Portfolio	Benchmark Index	Performance Target relative to Benchmark
BCPP	UK Equities Alpha	FTSE All Share	+2.0%
Majedie	UK Equities – Long Only UK Equities – Directional Long/Short	FTSE All Share  FTSE All Share	+2.5%
BCPP	Global Equities Alpha	MSCI ACWI	+2.0%
Newton	Global Equities	MSCI AC World	+2.0%
Various*	Private Equity	MSCI World Index	+5.0%
CBRE	Property	IPD UK All Balanced Funds	+0.5%
Baillie Gifford	Diversified Growth	UK Base Rate	+3.5%
Ruffer	Diversified Growth	UK Base Rate	+3.0%
Aviva	Diversified Growth	UK Base Rate	+5.0%
Western	Multi Asset Credit	Total return Fund (6% return has been used as a comparator/ benchmark against its performance)	+5% to +7% (+6% per annum used for reporting purposes)
Franklin Templeton	Unconstrained Global Fixed Income	Barclays Multiverse Index	+4% to +7% (+5.5% used for reporting purposes)
LGIM	Multi-Asset Equities and Bonds  RAFI Multi-Factor  Low Carbon Index  CN - AAA-AA-A Bonds – All Stocks Index  Index-Linked Gilts	MSCI World  MSCI World Low Carbon Target Index  Markit iBoxx GBP Non Gilts ex BBB All stock  Portfolio of single stock funds structured by reference to Fund liabilities	To track the performance of the respective indices within a lower level of tracking deviation (gross of fees) over rolling 3-year periods
Internal	Cash	LIBID 7-day rate	LIBID 7 day rate

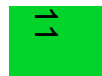
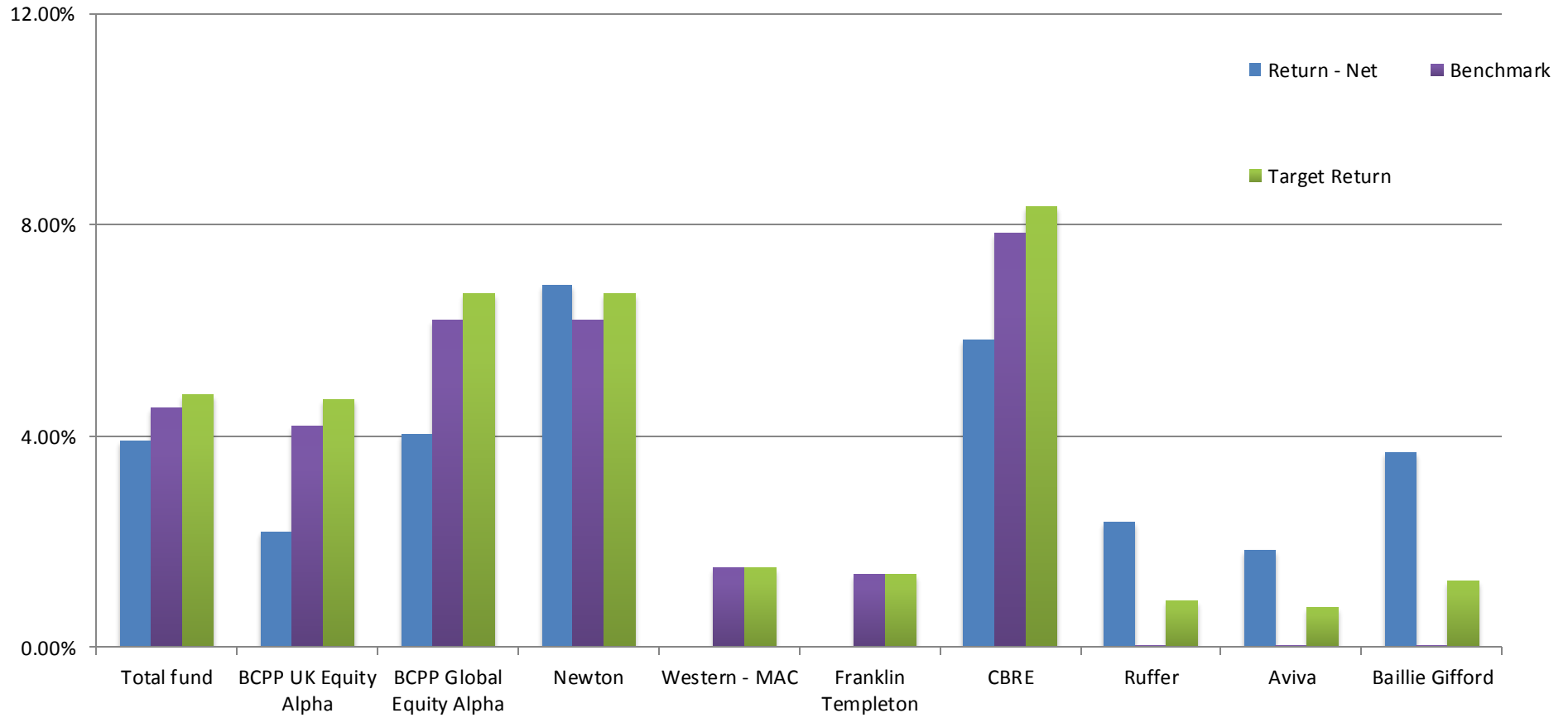
## 19. Fund Performance - Summary of Quarterly Results

Overall, the Fund returned 3.92% in Q3 2021/22, in comparison with the Fund's customised benchmark of 4.53% and the target return of 4.78%. The table below shows manager performance for Q3 2021/22 (net of investment manager fees) against manager specific benchmarks using Northern Trust data.

Manager	Net of Fees Performance	Benchmark Index	Benchmark Performance	Target Return
Total fund	3.92%	Customised	4.53%	4.78%
BCPP UK Equity Alpha	2.18%	FTSE All Share	4.20%	4.70%
BCPP Global Equity Alpha	4.03%	MSCI ACWI Index	6.20%	6.70%
Newton	6.85%	MSCI AC World	6.20%	6.70%
Western – MAC		Total Return Fund (Using +1.5% target return as comparator)	1.50%	1.50%
Franklin Templeton		Barclays Multiverse Index	1.38%	1.38%
CBRE	5.81%	IPD UK All Balanced Funds	7.85%	8.35%
Ruffer	2.38%	UK Base Rate	0.02%	0.88%
Aviva	1.84%	UK Base Rate	0.02%	0.76%
Baillie Gifford	3.70%	UK Base Rate	0.02%	1.26%



### Q3 Performance 2021/22

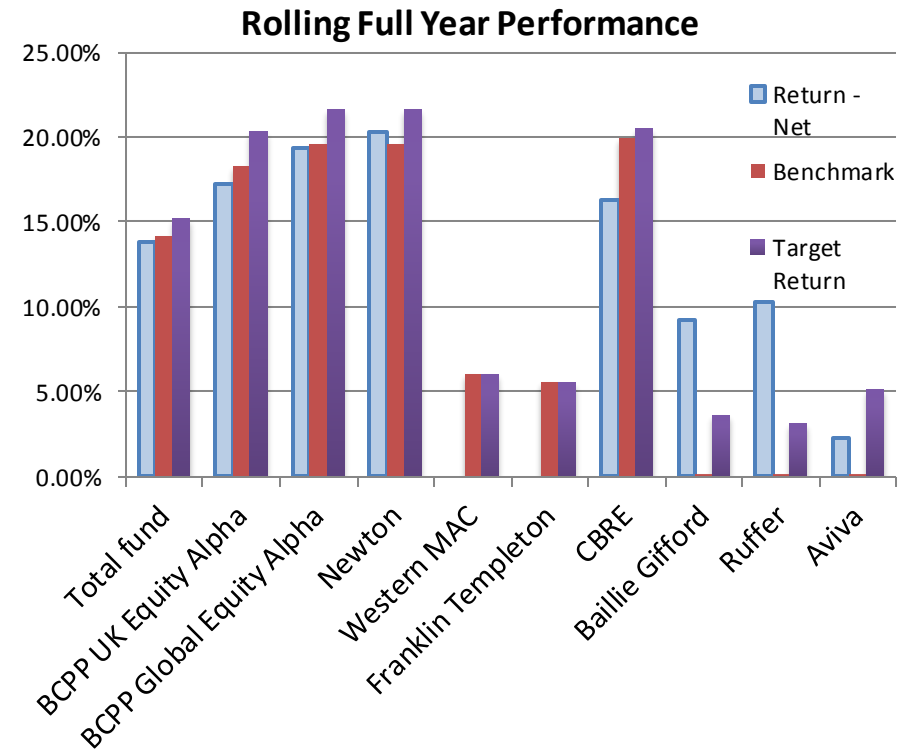


## 20. Summary of Full Year Investment Results

During the course of the previous 12 months to 31 December 2021, the Fund returned 13.84% net of investment fees against the customised Fund benchmark of 14.18% and target return of 15.18%.

Manager	Net of Fees Performance	Benchmark	Target Return
Total fund**	13.84%	14.18%	15.18%
BCPP UK Equity Alpha	17.25%	18.32%	20.32%
BCPP Global Equity Alpha*	19.31%	19.63%	21.63%
Newton	20.25%	19.63%	21.63%
Western MAC		6.00%	6.00%
Franklin Templeton		5.50%	5.50%
CBRE	16.25%	19.99%	20.49%
Baillie Gifford	9.23%	0.10%	3.60%
Ruffer	10.28%	0.10%	3.10%
Aviva	2.21%	0.10%	5.10%

*\*The Total Fund performance should be reviewed in isolation of each individual fund manager, mainly due to former mandates/funds from the last year who are not currently being reported on, which have contributed to the Total Fund return. The actual performance is also driven by actual asset allocation, where an overweight asset class performing strongly can contribute more to the Total Fund return relative to its target.*



## 21. Summary of Rolling Three-Year Performance Returns to 31 December 2021

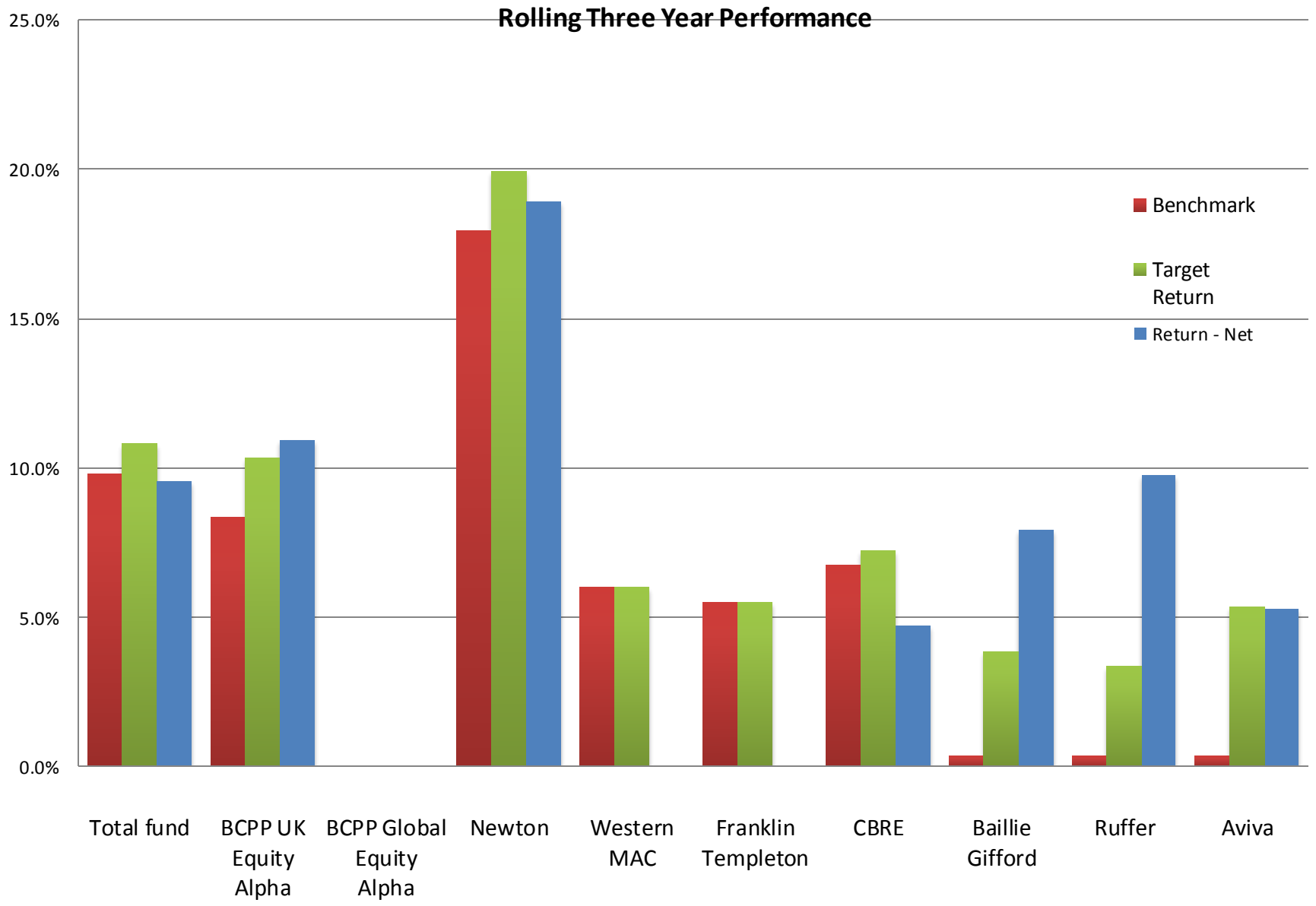
During the course of the previous 3 years to 31 December 2021, the Fund returned 9.54% net of investment fees against the customised fund benchmark of 9.81% and target return of 10.81%.

Manager	Portfolio	Net of Fees Performance	Benchmark	Target Return
Total fund**	Total Portfolio	9.54%	9.81%	10.81%
BCPP	UK Equity Alpha	10.92%	8.34%	29.89%
BCPP	Global Equity Alpha*	19.31%	19.63%	21.63%
Newton	Global Equities	18.92%	17.94%	13.33%
Western	Multi Asset Credit		6.00%	6.00%
Franklin Templeton	Unconstrained Global Fixed Income		5.50%	5.50%
CBRE	Property	4.73%	6.73%	5.16%
Baillie Gifford	Diversified Growth	7.91%	0.35%	3.91%
Ruffer	Diversified Growth	9.74%	0.35%	3.41%
Aviva	Diversified Growth	5.30%	0.35%	5.41%

*\*The performance of these funds is not yet known due to their new inception, so 1 year returns have been reported*

*\*\*The Total Fund performance should be reviewed in isolation of each individual fund manager, mainly due to former mandates/ funds from the last year who are not currently being reported on, which have contributed to the Total Fund return. The actual performance is also driven by actual asset allocation, where an overweight asset class performing strongly can contribute more to the Total Fund return relative to its target.*







## **CONSULTATION:**

22. The Chairman of the Pension Fund Committee has been consulted on this report

## **RISK MANAGEMENT AND IMPLICATIONS:**

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

## **FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

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

## **DIRECTOR CORPORATE FINANCIAL & COMMERCIAL COMMENTARY**

25. The Director Corporate Financial & Commercial is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

## **LEGAL IMPLICATIONS – MONITORING OFFICER**

26. There are no legal implications or legislative requirements.

## **EQUALITIES AND DIVERSITY**

27. 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**

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

## **WHAT HAPPENS NEXT**

29. The following next steps are planned:

- Continue to transition assets onto BCPP and enhance risk adjusted returns

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### **Contact Officer:**

Ayaz Malik, Senior Pensions Finance Specialist

### **Consulted:**

Pension Fund Committee Chairman

### **Annexes:**

Annexe 1: Asset Allocation Policy and Actual as at 31 December 2021

Annexe 2: Manager fee Rates (Part 2)

Annexe 3: Northern Trust Stock Lending

Annexe 4: MJ Hudson Allenbridge – BCPP MAC Review (Part 2)

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