

**Surrey
Pension
Fund**
Summary
Document



SURREY

**2014
/ 15**

Contents

Overview

3-14

Investment Arrangements
and Performance

15-36

Governance and
Administration

37-42

Asset and Liabilities

43-55

Overview

Chairman's Introduction

The 7 May 2015 election brought the country a new Government nationally and new members to the Surrey Pension Fund Committee. We welcome our new Deputy Chairman, Councilor Alan Young, and Councilor Hazel Watson, both from Surrey County Council, and Councilor Peter Stanyard from Mole Valley District Council, who is representing the Surrey districts and boroughs. We say goodbye to Councilor Nick Skellett, who has become Vice-Chairman of Surrey County Council, Councilor John Orrick who is joining the Local Pension Board and Councilor Judith Glover who has retired from local government, and thank them for their valuable contributions to the Committee over many years.

Members will recall that the previous Government held a second consultation on further proposed changes to the Local Government Pension Scheme (LGPS) entitled: "Opportunities for Collaboration, Cost Savings and Efficiencies". There have been extensive responses to this consultation, but there has been no announcement of any specific further changes to the LGPS apart from what was announced in the Chancellor's summer Budget on 8 July 2015 (page 78, par. 2.19):

"Local Government Pension Scheme pooled investments: the government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments."



Denise Le Gal is
Chairman of the Surrey
Pension Fund Board

The message is clear: we need to pool our investment assets with other LGPS administering authorities. In terms of scale, the indications are that LGPS assets will be pooled into five or six large vehicles of £30-40bn each but individual funds, like Surrey, will retain local accountability and responsibility for setting their own investment strategies and asset allocation. This level of scale should reduce costs overall for the LGPS, including the costs associated with manager selection and turnover.

Officers are currently examining various options as a matter of urgency and will report back to the committee in September 2015. We are committed to choosing a solution that will best serve the long-term interests of Surrey's LGPS membership, and ensure good value for money for our employer organisations.

One good example of where we have already made excellent progress on collaboration is our joint working on pensions administration with East Sussex County Council, which continues to expand. I am pleased to report that Westminster City Council is now fully on board and the London Boroughs of Hammersmith & Fulham

and Kensington & Chelsea have also appointed us and are coming on board during this summer. This example of large scale collaboration is bound to expand as other local authorities have also expressed an interest. Costs are very important, but need to be considered on a risk-adjusted basis and against the achievement of long-term investment returns.

I am delighted to announce that the Fund has been shortlisted for an award for the best risk management project at the LAPF Investment Awards on 3 September 2015. In part, we were nominated for having established a framework for de-risking the portfolio when interest rates and inflation rise in the future, and for when the portfolio achieves a higher funding level. The Fund was also nominated and shortlisted for LGPS Fund of the Year 2014 and Fund Manager of the Year 2014 at last November's LGC Investment Awards, and Fund Manager of the Year 2015 at the Institutional Investor UK and Ireland Awards in June 2015.

The Fund continues to perform in the upper quartile amongst its peers. For the five years to 31 March 2015,

Costs are very important, but need to be considered on a risk-adjusted basis and against the achievement of long-term investment returns.

the Fund returned an annualised 9.2% overall, surpassing the five-year annualised benchmark target of 8.7%.

The Committee continues to place great emphasis on the development of its member skills and knowledge. All members have completed a comprehensive needs and training assessment, allowing us to tailor our training to individual Committee member needs, in addition to the Committee's regular training sessions. The Committee also recently completed an annual self-assessment of how the Committee is governed, what works well, and what can be added and improved.

The Council's constitution was changed in March 2013 and what was previously the Investment Advisor's Group became the Surrey Pension Fund Board. Earlier this year, the Council adopted a separate Local Pension Board with a guidance, advisory and scrutiny remit. To avoid confusion about the roles of the two boards, the Council has agreed to rename the Surrey Pension Fund Board to the Surrey Pension Fund Committee.

Looking ahead, the Fund will be facing some big changes, including large scale asset pooling as already mentioned. Other areas that we will be consulted upon through the Department for Communities and Local Government (DCLG) will include further work on liability management and separation.

With the ever-changing profiles of our employers, the Committee will be considering asset unitisation of the fund to support a more focused employer funding and investment strategy. And further work on our investment strategy will include a mandate on infrastructure that will be added to the liability driven investment and multi asset credit portfolios that were implemented in 2015.

Finally, good governance and strong performance do not happen by accident. I would like to thank our excellent investment and pension administration teams, who work hard and tirelessly to deliver a seamless service to our employers and our members. I would also like to thank members of the Committee for their commitment and dedication to the Fund, always exercising their best judgment in making often very complex decisions on investment strategy and liability management. Along with our advisors, investment managers and service providers, I am confident the Surrey Pension Fund team is delivering and will continue to deliver prudential fund management fit for the future.

Denise Le Gal
Chairman, Surrey Pension Fund Board

I am confident the Surrey Pension Fund team is delivering and will continue to deliver prudential fund management fit for the future.



The Board continues to place great emphasis on the development of member skills and knowledge. Regular training forms part of all Board meetings and Members attend external seminars and other training sessions.

Purpose of the Pension Fund

The Local Government Pension Scheme (LGPS) is a nationwide pension scheme for those working in local authorities or for other organisations that have chose to participate in it. All employees of local government in Surrey have guaranteed access to the LGPS unless they are eligible to join another public pension scheme, including Firefighters, Teachers or NHS schemes. Employees of other organisations, that provide a public service, may be granted membership if they are covered by an admission or resolution agreement.

The Surrey Pension Fund is a defined benefit occupational pension scheme which means that the amount of pension due to each individual member is determined by the characteristics and duration of their membership of the scheme, not by investment returns made on their and employer contributions.

In contrast to other UK public sector defined benefit pension schemes, the LGPS is a funded scheme. This means that pensions for retired Surrey Pension Fund employees are paid from a separate pool of assets managed solely for this purpose. The assets are built up from all employer and employee pension contributions and are invested to help meet the overall cost of providing pensions.

Surrey County Council is the administering authority for the Surrey Pension Fund and is responsible for the administration of all aspects of the management of the fund including administer pension benefits, provide appropriate communications with scheme members and participating employers, coordinate the investment of fund assets, uphold financial controls and maintain accurate accounting records for all fund transactions.



Surrey County Council has delegated the duties of the administering authority to The Surrey Pension Fund Board (renamed as Pension Fund Committee from 22 May 2015) established from 21 May 2013. The membership the Committee is comprised of

- Six Members of the County Council;
- One representative from employee members of the Fund (this can not include a Surrey County Council member of staff as membership of Council committees is restricted by section 104 Local Government Act 1972
- Two representatives from Districts and Boroughs of the Fund;
- One representative from all other employers in the Fund

Committee Membership

Chairman
Councillor Denise Le Gal

Vice Chairman
Councillor Nick Skellett (Councillor Alan Young, from 1 April 2015)

County Council Members
Councillor William Barker
Councillor Tim Evans
Councillor John Orrick (Councillor Hazel Watson, from 1 April 2015)
Councillor Stuart Selleck

Employer Representatives
Tony Elias, Tandridge Council
Judith Glover, Epsom and Ewell (Councillor Peter Stanyard, from 1 April 2015)
Ian Perkin, Office of the Surrey Police & Crime Commissioner

Employee Representative
Phillip Walker

Other Representatives

Officers
Sheila Little, Director of Finance (Section 151 Officer)
Phil Triggs, Strategic Manager Pension Fund & Treasury

Investment Advisors
Steve Turner, Mercer LLC
John Harrison, Independent

Fund Actuary
Barry McKay, Hymans Robertson

Fund Custodian
Northern Trust

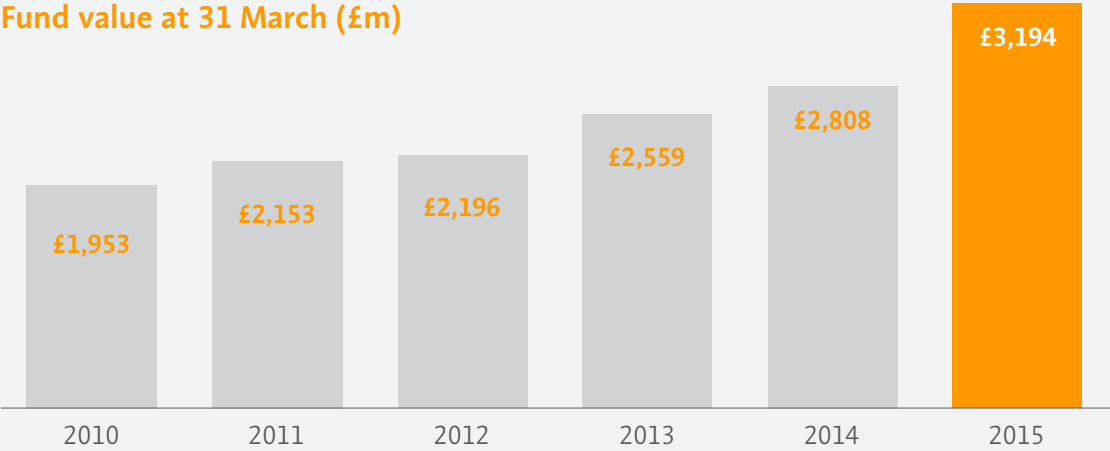
Summary Financials

	2010/11 £000	2011/12 £000	2012/13 £000	2013/14 £000	2014/15 £000
Contributions in	157,703	152,550	173,377	164,366	181,104
Less benefits and expenses paid	-117,439	-147,352	-123,705	-127,406	-130,758
Net additions	40,264	5,198	49,672	36,960	50,346
Net investment income*	32,592	36,737	33,789	36,402	39,504
Change in market value	137,170	1,441	278,985	175,422	299,210
Net return on investments	169,762	38,178	312,774	211,824	338,714
Net increase in Fund	210,026	43,376	362,446	248,784	386,020
Fund value at 31 March	2,152,894	2,196,270	2,558,716	2,807,500	3,193,520

*Net of Investment and governance expenses and tax



Fund value at 31 March (£m)



Summary Membership Details

31 Mar 2014		31 Mar 2015
32,530	Employees in the fund	32,851
21,598	Pensioners	22,481
30,639	Deferred pensioners	33,833
84,767	Total	89,165



Investment Arrangements and Performance



Investment Performance

Market Commentary 2014/15

Economic background

The period since the financial crisis in 2008/09 has been quite exceptional for financial markets. The collapse of the banking system globally led the world economy to the brink of an abyss and necessitated exceptional measures by policymakers. These measures succeeded in averting what might otherwise have been a depression similar to or perhaps even worse than the 1930s. The policy steps taken have proved successful, but we are still working through the aftermath of the crisis.

Perhaps the biggest influence on markets during this period was the adoption of extremely lax monetary policy. We still see this policy in action in interest rates in most developed markets at close to zero and in massive Quantitative Easing (QE) programmes. The combination of high levels of liquidity and low returns on 'safe' assets is a cocktail specifically intended to encourage buying of riskier assets to stimulate growth.

It appears to have worked. The world economy has grown for six consecutive years since emerging from recession in 2009.



That is no mean feat given the headwinds of austerity, debt reduction, Eurozone tensions, the slowdown in China and the related slump in commodity markets. While the economy has managed to push on, in large part thanks to the life support from central banks, the headwinds have taken their toll. The recovery has taken longer to get started and has been far less robust than in a typical economic cycle.

The global economic recovery has continued to gather momentum in the last year, but the pattern is anything but even. Developed economies were hit hardest by the financial crisis, but have rebounded more decisively with 2015 set to be the fastest year of growth since 2010. By contrast,

Commodity prices in particular have been falling as demand from emerging economies has waned and supply has increased.

emerging economies fared much better during the crisis but are now struggling. For them 2015 is set to be the weakest year of growth in seven years.

It is increasingly difficult to view the world purely in terms of developing and emerging economies. There seem instead to be three broad categories.

The first is recovered economies where growth is now sufficiently strong that central banks will soon be able to increase interest rates to more normal levels. The US and the UK are in this category.

The second is economies that are on the mend but that still need significant central bank support to avoid slipping back into recession. This category includes Japan, South Korea and most of the Eurozone.

The third is vulnerable economies that have poor economic momentum, fragile financial systems or other credibility issues. In these economies central bank policy alone may not be enough to restore confidence, so a period of prolonged recession is possible. Greece and China fall into this category, as do Brazil, Russia and some other emerging economies.

Against this background inflation has been more subdued than in a normal economic cycle. Commodity prices in particular have been falling as demand from emerging economies has waned and supply has increased. Oil is the most notable example, with prices roughly halving during the year. This has been an important benefit to oil importing economies, such as Europe and Japan, but an increasing challenge for the oil exporting economies, such as Brazil and Russia.

One notable feature of the last year was volatility in major currencies. Huge increases in the size of the QE programmes in Europe and Japan caused the value of the Euro and the Yen to weaken significantly relative to the US dollar. In principle this should even out the pace of growth in future by making European and Japanese products more competitive relative to those from the US. Sterling was caught in the middle, falling relative to the US dollar, but rising relative to the Euro and the Yen.

Market returns

The returns from financial markets in recent years have been remarkably strong given the uncertain and generally lacklustre economic picture.

Equities delivered good returns in most developed markets. The UK equity market was one of the laggards, with a return of 7%. The UK index has a high proportion of international businesses, with a heavy weighting in oil and mining, both industries that have suffered from falling prices.

For UK funds invested in overseas equities, the best returns were from Japan, with share markets responding positively to a huge increase in QE. The return of 27% was despite a 4% loss from currency movements. US equities returned 25% but in this case half the gain came from a 12% rise in the US dollar. European equities were held back by a 12% fall in the Euro, but still returned 8%. The return from emerging markets was 16%.

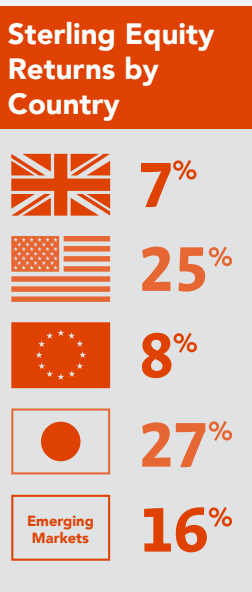
Bonds also performed well. Deflation fears in Europe prompted the European Central Bank (ECB) to increase their QE programme significantly driving yields on European government bonds to unprecedented low levels. This culminated in negative nominal yields on a broad range of bonds. For the first time in history, investors were prepared to buy bonds knowing they would be guaranteed to lose money.

The collapse in bond yields was particularly beneficial for longer dated issues. In UK gilts the return on the All Stocks index was 14%, but the Over 15 year index returned 27%. UK index-linked gilts saw a similar divergence between the All Stocks index return of 19% and the Over 25 year index of an astonishing 35%. In comparison the returns from UK corporate bonds at 13% and overseas government bonds at 8% appear subdued.

The improving economic environment for the UK was also helpful for commercial property. The average local authority pension fund achieved a return of 16%. Other alternatives delivered decent returns, but in comparison to listed equities and bonds they appear modest. The average return was 16% on private equity, 10% on Diversified Growth Funds (DGF) and 9% on hedge funds. The only asset class to perform poorly was commodities with an average return of -9%.

Fund performance

The Surrey County Council Pension Fund once again delivered a return well above inflation, at 12.3% for the year. Inflation as measured by RPI was 0.9%. This continues a longer-term record of achieving returns well above inflation over 3 years (11.8% pa versus 2.2% pa), 5 years (9.2% pa versus 3.1% pa) and 10 years (7.9% pa versus 3.0% pa).



The Fund’s overall return can also be compared with other LGPS schemes. The Fund return was behind the average by 0.9% in 2014/15, but remains ahead by 0.8% pa over 3 years and by 0.5% pa over 5 years. The asset allocation of the Pension Fund is very similar to the average LGPS fund, so the main cause of the difference is the relative performance of the Fund’s actively managed mandates

Investment outlook

The problem for investors as always is trying to work out what happens next. The next few years should see a gradual return to normality, with QE programmes at first scaled back and eventually unwound and interest rates slowly increased to a sustainable long-term level slightly above inflation. However, this process is unlikely to be smooth and policymakers will face challenges along the way. The US Federal Reserve will be watched keenly to see when and how quickly it increases interest rates in the current year.

In the meantime, many assets now appear quite highly rated. The outlook for bonds is particularly uncertain. On a pure valuation basis bonds continue to appear unattractive for long-term investors, with long-dated gilts offering

a nominal yield of 2.5% pa and long-dated index linked gilts offering a real yield of -0.9% pa. Investors may be willing to accept such low yields when the return on cash is set well below

inflation but as monetary policy reverts to normal one would expect investors to demand rather higher returns for investing in long-dated assets. If that were to happen quickly, bond prices would have a long way to fall before yields returned to historic averages.

However, QE is not the only distortion faced by bond markets. In index linked markets is particular a continuing mismatch between high demand from pension funds, insurance companies and other liability constrained investors and low issuance of new index linked securities by the government may mean index linked yields remain low for many years to come. The likely outcome is that bonds will produce a disappointingly low long-term trend return but with rather more volatility than in recent years.

The valuation of developed market equities is also above long-term averages, but much less so than bonds. Steady economic recovery will be required to justify such ratings. The rating of emerging market equities is not as high and expectations are less demanding, but the differentiation between individual markets is becoming more important.

The other major theme in the coming years may be an increase in financial market volatility. The strong returns seen across most asset classes in the aftermath of the financial crisis have been accompanied by much lower than

average volatility. As central banks gradually step back from large-scale market intervention it seems likely that volatility will rise.

In an environment where investors are faced with significant economic and market uncertainty and few assets are cheap, there is likely to be continued interest both in diversification to smooth returns and in income generation to make returns more predictable. Property has benefited again from this trend this year but still offers high yields relative to other asset types and some protection against long-term inflation.

Strategic asset allocation

The Pension Fund has a long-term investment horizon. Following the triennial actuarial review in March 2013 the Fund is expected to have positive cash flow for many years to come. The investment priority therefore remains long-term return generation rather than short-term risk mitigation.

The current investment strategy seeks to achieve this by having a core allocation to equities within a strategically diversified overall portfolio. The target allocation to equities (both quoted and private) at 65% is broadly similar to the average LGPS fund. A further 17% is invested in growth assets offering strategic diversification, with 6% in property and 11% in DGFs. This leaves 18% invested in bonds.

While there were no material changes in strategic asset allocation, there were three changes in the Pension Fund’s manager structure during the year.

The most significant was to adjust the passive bond mandate so that the assets will over time be better aligned to the Pension Fund’s liabilities. The initial steps have been modest in that we have switched the existing fixed interest gilt holdings into long-dated index linked gilts. Real yields on index linked gilts have since fallen and are too low to justify any further moves at this stage, but the new mandate means the Pension Fund will be able to act quickly when any opportunities arise in future.

The Pension Fund also invested in a newly launched DGF managed by Standard Life with a higher performance target than the existing very successful investment in GARS. One of the equity mandates was terminated.

John Harrison
15th August 2014

Information contained in this report is provided for information purposes only. Nothing contained herein should be construed as a recommendation or solicitation to buy or sell any security. Please remember past performance is not necessarily a guide to future returns.



John Harrison
is Independent Advisor
to the Surrey Pension
Fund Board

Long-dated index
linked gilts offering
a real yield of:

-0.9%



Investment Arrangements and Principles

Overall Responsibility

The County Council is the designated statutory body responsible for administering the Surrey Pension Fund on behalf of the constituent Scheduled and Admitted Bodies. The Council is responsible for setting investment policy, appointing suitable persons to implement that policy and carrying out regular reviews and monitoring of investments.

Investment Objectives

The Pension Fund Committee seeks to ensure that the Pension Fund has sufficient assets to be able to meet its long term obligations to pay pensions to the Fund's members, i.e., over the long term to be at or above a 100% funding level. It also has an objective to maintain employer contribution rates as reasonably stable and affordable as possible. In order to meet these objectives, a number of secondary objectives have been agreed:

i) To have a clearly articulated strategy for achieving and maintaining a fully funded position over a suitable long term time horizon; the Committee recognises 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 steady course through changing market environments.

ii) To have a strategic asset allocation that is both well diversified and expected to provide long term investment returns in excess of the anticipated rise in the Fund's liabilities.

iii) To appoint managers that the Committee believes can consistently achieve the performance objectives set and to give each appointed manager a clearly defined benchmark and performance objective against which they can be judged.

iv) To ensure investment risk is monitored regularly both in absolute terms (the risk of losing money) and relative to the Fund's liabilities (the risk of funding shortfalls); the Committee will have regard to best practice in managing risk.

v) To have sufficient liquid resources available to meet the Fund's ongoing obligations.

The Pension Fund Board seeks to ensure that the Pension Fund has sufficient assets to be able to meet its long term obligations to pay pensions to the Fund's members

vi) To achieve an overall Fund return 1% per annum in excess of the overall benchmark over rolling three-year periods.

Investment Style and Management

The Committee has delegated day-to-day management of various parts of the Fund to external fund managers each of which has been given an explicit benchmark and performance objective. The Committee retains responsibility for ensuring the mix of managers and by implication the overall asset allocation is suitable for the long-term objectives defined above.

The Committee has appointed two different types of manager: 'Index Relative' who seek to achieve a return relative to a market index within a specified asset type and 'Absolute Return' who seek to achieve a desired return outcome by moving between different asset types.

Index Relative managers

The managers in this category have been set differing performance targets and will take accordingly differing levels of risk relative to the benchmark index they are given.

Passive mandates seek to replicate the market index as closely as possible and are expected to take very little relative risk. Typically, such portfolios will have the largest number of individual holdings each of which will be close to the index weighting. The expected performance should be within 0.5% of the index return in any year.

Core active mandates seek to achieve a performance between 0.75% per annum and 2% per annum ahead of the relevant market index. Typically, core active mandates have diversified portfolios and take medium levels of relative risk. Most managers will only be appointed to manage a single asset class (for example, global equities, bonds or property).

Concentrated active mandates seek to outperform their relevant index by 3% per annum or more and take larger relative risks by owning a smaller number of individual holdings. The Pension Fund Committee usually confines such mandates to specialist managers in regional equities.

Passive mandates seek to replicate the market index as closely as possible and are expected to take very little relative risk.

Absolute Return managers

The managers in this category are all expected to achieve returns well ahead of cash or inflation in the long-term.

Diversified Growth managers use a very broad range of asset classes and actively vary allocations between asset types depending on investment market conditions. They will also use derivatives from time to time to limit the scope for large falls in value. The expected returns from such mandates will be close to the long term return from equity markets but with much less volatility.

Absolute return managers also seek to achieve good long term returns with dampened down volatility, but typically they are focused on a particular investment area. The desired outcome is similar to Diversified Growth mandates but with possibly greater variability across mandate types and usually with a much smaller amount invested in each capability.

Fees

The level of fees paid to managers varies greatly according to the complexity of the mandate and the geographic area involved. Fees are usually expressed as a proportion of assets under management. There may also be additional performance related fee charges.

Fees for passive mandates tend to be very low, particularly in developed markets where information is readily available. Fees are higher for mandates that require greater manager skill.

Typically a concentrated active mandate will have a higher fee rate than a core active manager and a small absolute return mandate will have a higher fee rate than a larger diversified growth mandate.



Current Manager Structure

The table below shows the asset allocation and manager structure of the Fund as at the end of March 2015.

	Category	Allocation Policy %	Fund %	Control Range% +/-
Equities			63.0	+/-3.0
UK			29.0	
Legal and General	Passive	10.0		
Majedie	Concentrated Active	11.0		
UBS	Core Active	8.0		
Overseas			34.0	
Legal and General	Passive	14.0		
Marathon	Concentrated Active	12.0		
Newton	Core Active	8.0		
Property			6.5	+/-3.0
CBRE	Core Active	6.5		
Alternatives			12.0	+/-3.0
Standard Life	Diversified growth	8.0		
Baillie Gifford	Diversified growth	4.0		
Bonds			18.5	+/-3.0
Fixed interest gilts			2.75	
Western	Core Active	2.75		
Index linked gilts			5.8	
Legal and General	Passive	5.8		
Corporate bonds			7.4	
Legal and General	Passive	1.9		
Western	Core Active	5.5		
Total Return			2.55	
Franklin Templeton	Unconstrained	2.55		
Total			100.0	



The Fund also has a commitment to invest up to 5% of the fund in private equity. This allocation is achieved by investing both in fund of funds and direct funds, managed by a number of private equity specialists. The investments are funded through cash flow. The Pension Fund Committee reviews the private equity strategy on an annual basis and makes commitments in order to achieve the target commitment level of 5% of the Fund.

Fees paid to managers vary due to the levels of risk taken and the geographic areas in which the manager is invested. Fees are generally expressed as a proportion of assets under management. Performance fees are in place for a number of the Fund’s managers. The following table shows the Fund’s private equity investments as at 31 March 2015.

Name	Inception	Commitment
UK Sterling Funds		
£/€/ \$m		
HG Capital MUST 3	2001	2.0
HG Capital MUST 4	2002	3.0
HG Capital 5	2006	10.0
HG Capital 6	2009	10.0
HG Capital 7	2013	15.0
ISIS II	1999-2002	12.0
ISIS III	2003	14.0
ISIS IV	2007	15.0
ISIS Growth Fund	2013	10.0
Darwin Property Fund	2013	20.0
Euro Fund of Funds		
Standard Life ESP II	2004	10.0
Standard Life ESP 2006	2006	15.0
Standard Life ESP 2008	2008	15.0
Standard Life ESF	2011	17.5
US Dollar Fund of Funds		
Blackrock Div PEP I	2001	5.0
Blackrock Div PEP II	2003	5.0
Blackrock Div EP III	2005	17.5
GSAM PEP 2000	2000	10.0
GSAM PEP 2004	2004	10.0
GSAM PEP 2005	2006	17.0
GSAM PEP X	2008	18.0
GSAM PEP XI	2011	18.0
GSAM Vintage Fund VI	2013	20.0
Standard Life SOF	2013	20.0
Standard Life SOF II	2014	20.0
US Dollar Fund of Funds		
Capital Dynamics US Solar Fund	2011	25.0
Capital Dynamics Energy/Infra	2013	25.0

Targets and Benchmarks

Manager	Portfolio	Benchmark Index	Performance Target
UBS	UK Equities	FTSE All Share	+2.0% p.a. (gross of fees) over rolling 3-year periods
Mirabaud	UK Equities	FTSE All Share	+2.5% p.a. (gross of fees) over rolling 3-year periods
Marathon	Global Equities	MSCI AC World	+2.0% p.a. (gross of fees) over rolling 3-year periods
Majedie	UK Equities – Long Only UK Equities – Directional Long/Short	FTSE All Share FTSE All Share	+2.5% p.a. (gross of fees) over rolling 3-year periods Absolute return focused, but aims to out-perform the FTSE All Share Index by an unspecified amount over the long term
Newton	Global Equities	MSCI AC World	+2.0% p.a. (gross of fees) over rolling 3-year periods
Western	Fixed Income	70.0%: Markit i Boxx £ Non-Gilts ex-BBB All Stocks 30.0%: FTSE A UK Gilts – All Stocks	+0.75% p.a. (gross of fees) over rolling 3-year periods
Franklin Templeton	Unconstrained Global Fixed Income	Barclays Multiverse Index	4% to 7% p.a. (gross of fees) over rolling 3-year periods
LGIM	Multi-Asset Equities and Bonds N - UK Equity Index RX - World (ex UK) Dev Equity Index HN – World Emerging Markets Equity Index AA - All Stocks Gilts Index CN - AAA-AA-A Bonds - All Stocks Index Y - All Stocks Index-Linked Gilts	FTSE All Share FTSE AW – Dev'd World (ex UK) FTSW AW – All Emerging FTSE A UK Gilts All Stocks Markit iBoxx GBP Non Gilts ex BBB All stock FTSE A Index-Linked All Stocks	To track the performance of the respective indices within a lower level of tracking deviation (gross of fees) over rolling 3-year periods

Manager	Portfolio	Benchmark Index	Performance Target
CBRE	Property	IPD UK All Balanced Funds	+0.5% p.a. (gross of fees) over rolling 3-year periods
Baillie Gifford	Diversified Growth	UK Base Rate	+3.5% p.a. (net of fees) over rolling 5-year periods
Standard Life	Diversified Growth	6 month LIBOR	+5.0% p.a. (gross of fees) over rolling 5-year periods
Internal	Private Equity	MSCI World Index	+5% p.a. (net of fees) over the life of the contract
Internal	Cash	LIBID 7-day rate	LIBID 7 day rate

The overriding aim is to run the Pension Fund in accordance within the relevant legislation and subject to the following performance target: “to outperform the Surrey benchmark by 1% per annum over rolling 3-year periods, with a maximum underperformance of -2% in any one year.”



Monitoring and Review

The target funding level is set triennially, consequent upon the actuarial review. The statutory requirement is to move towards 100% funding over a period of time, agreed with the Fund Actuary as the average expected future working lifetime of the scheme membership (20 years).

Investment strategy will be reviewed annually, with a major review taking place no later than every five years. The SIP will also be reviewed annually. A review of investment management arrangements is carried out at least every three years.

Investment management performance is reviewed annually upon receipt of the third party performance information. The individual manager’s current activity and transactions are presented quarterly in discussion with the Pension Fund Committee.

An Annual Meeting is held in November each year and is open to all Fund employers and members of the Surrey LGPS.

Stewardship and Responsible Investment

The Council wishes to have an active influence on issues of environmental, social or governance (ESG) concern with companies in which the Pension Fund is a shareholder. It will seek to codify its approach with Fund Managers and will use the services of specialist agencies as necessary to identify issues of concern. The Council requires the Fund Managers to take into account the implications of substantial “extra-financial” considerations, e.g., ESG or reputational issues that could bring a particular investment decision into the public arena.

Whilst the Fund has no specific policy on investing or divesting in stock with regard to ESG issues, in comparing potential investment decisions, and where differences in predicted returns are deemed immaterial, external fund managers could deploy ESG considerations in deciding upon selection.

The Pension Fund also holds expectations of its fund managers to hold companies to account on the highest standards of behaviour and reputational risk management which may damage long term performance, and for those issues to be part of their stock selection criteria.

The Fund wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles. Share voting is undertaken in-house, after consultation with fund managers, and consultation with the Pension Fund Committee on potentially contentious issues. A quarterly report will be posted to the Fund website.

The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), a membership group of LGPS funds that campaigns on corporate governance issues, thus demonstrating a commitment to sustainable investment and the promotion of high standards of corporate governance and responsibility.

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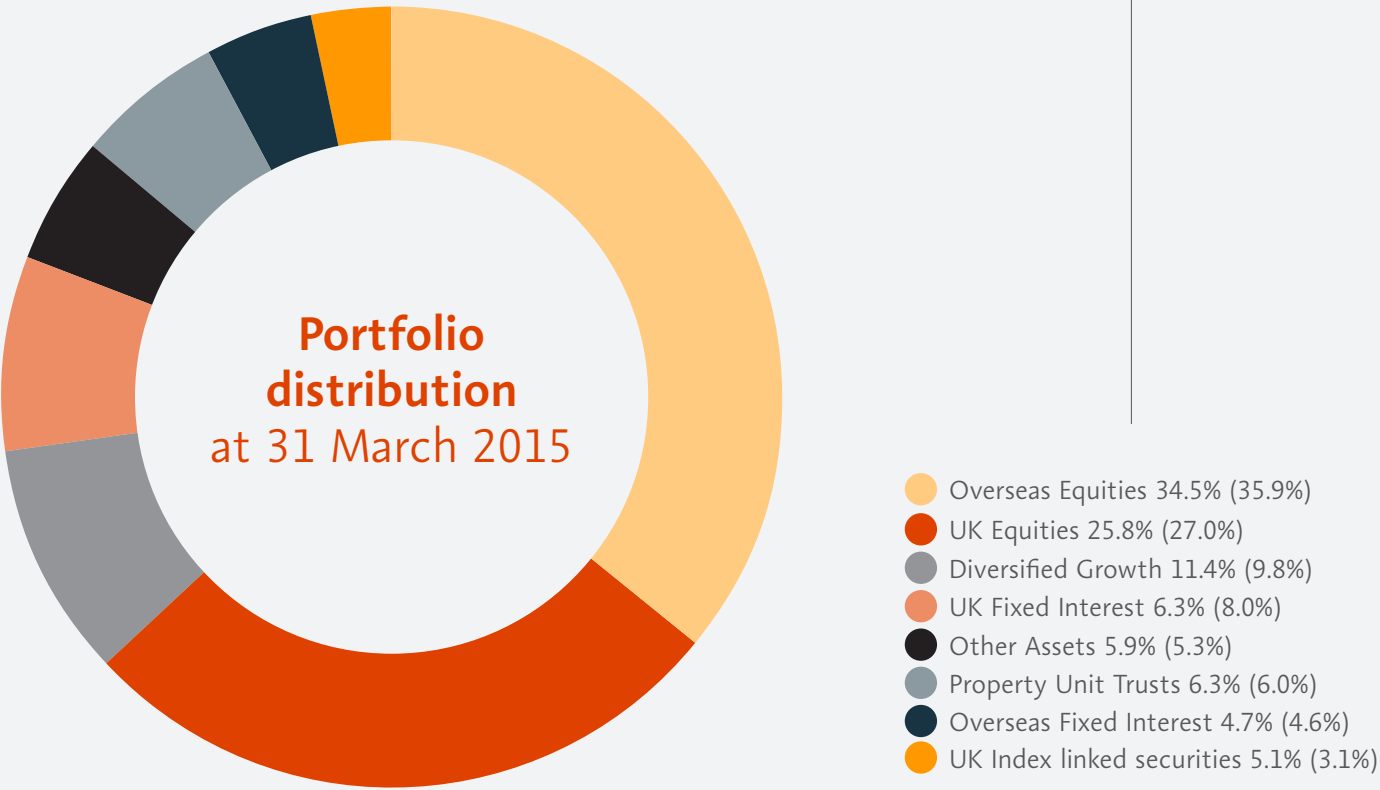
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Custody

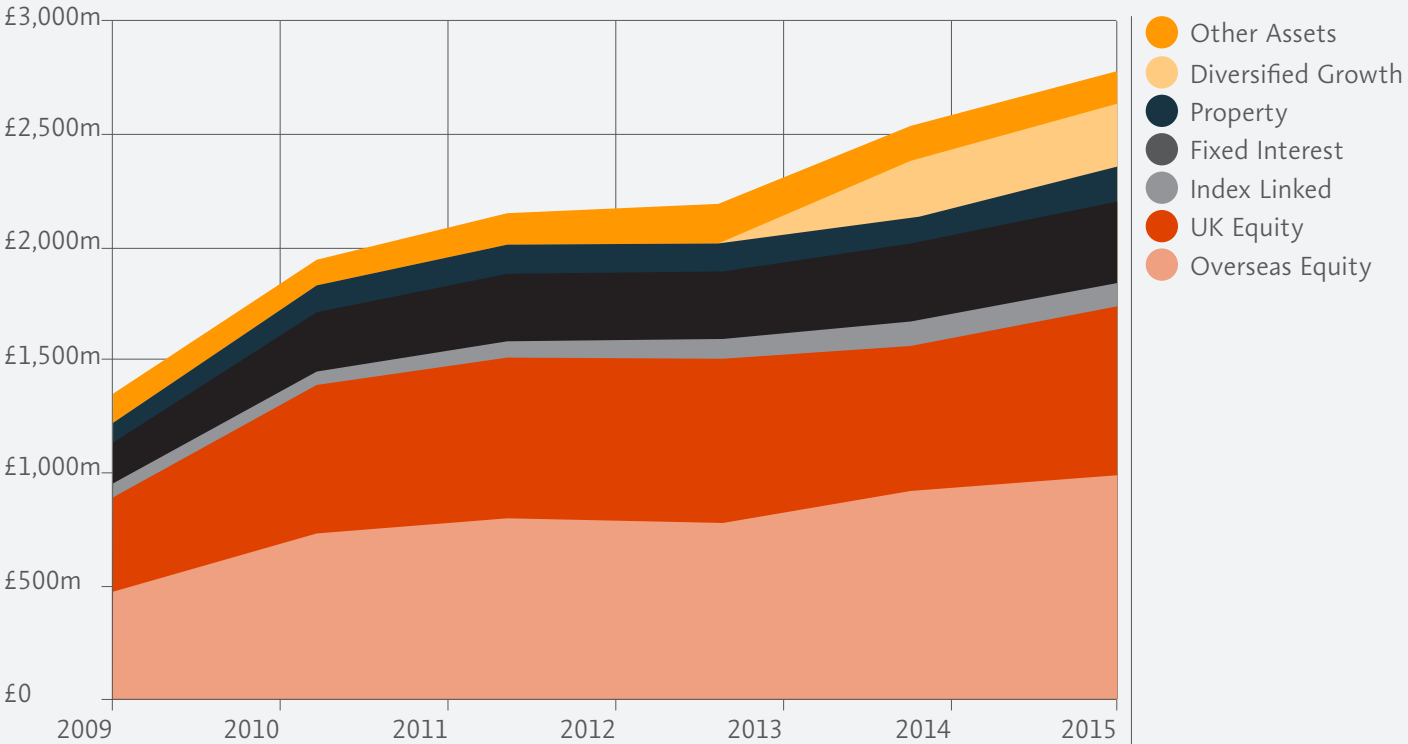
Managers are required to hold cash and stocks in an account managed by Northern Trust, the Fund’s independent global custodian, or by agreement otherwise as appropriate. The Pension Fund aims to hold only a minimum working cash balance. A separate bank account is in place to hold any excess funds held by the administering authority for the purpose of day-to-day cash management of the pension fund.

Portfolio Distribution

The distribution of the Fund investments into different asset classes within the portfolio at 31 March 2015 is shown in the below chart, with the prior year allocation shown in brackets.



The chart below shows the investment breakdown by asset class over the last

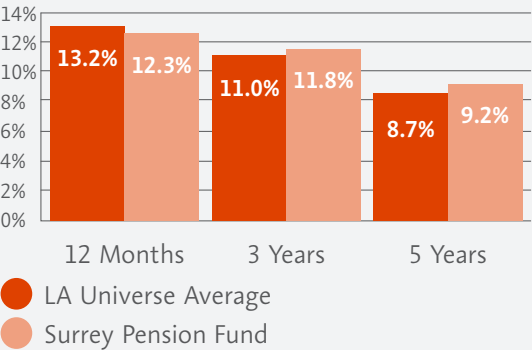


Eleven fund managers undertook the management of investments during 2014/2015 in a mix of passive and active investment. A summary of investment managers and the value of the assets under management is shown on page 22.

The Fund participates in two investment performance measurement services that assess the rate of return achieved by the Fund against a customised investment benchmark and provide comparisons with the performance achieved by other pension funds. Performance against targets and benchmark is reviewed at regular intervals, as stated in the Fund’s Statement of Investment Principles.

The graph below shows how the Fund performed against the average local authority fund, on an annualised basis, for the previous 12 months, 3 and 5 years.

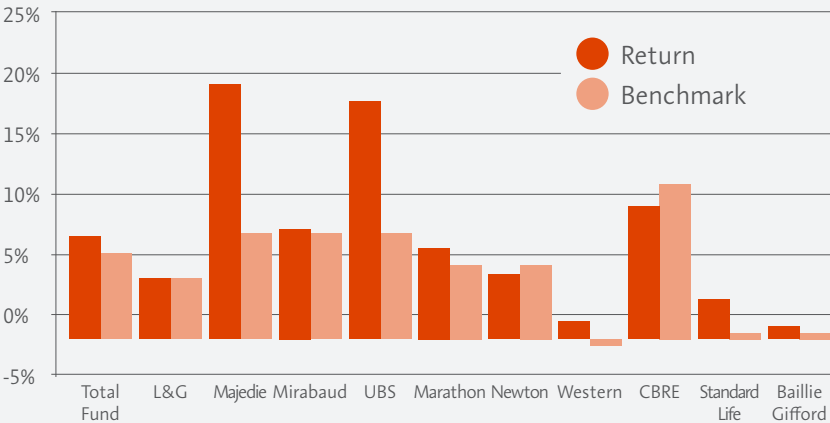
The fund recorded investment performance below the LA Universe for the previous 12 months to 31 March 2015 but outperformance over the longer term 3 and 5 year period, shown in the above table. The outperformance above the benchmark is partly a result of particular asset allocation but the fund has benefited from strong investment returns generated by actively managed portfolios. The annual investment returns as at 31 March 2015 for each fund manager are shown in the below table.



At its meeting on 19 September 2014, the Committee agreed to terminate active UK equity mandate of Mirabaud Asset Management with immediate effect and temporarily move the proceeds of the portfolio from Mirabaud to a passive UK Equities portfolio with Legal and General Investment Management. Following the Committee meeting on 14 November 2014, the allocation was invested entirely within the existing active UK equity mandate with Majedie Asset Management.

The Committee meeting of 19 September 2014 recommended the setting up of a framework for a liability driven investment strategy with the establishment of a index linked gilt portfolio to be run by Legal & General Investment Management, which could be leveraged with the achievement of a trigger point for real yields. This will be funded by the existing passive and index-linked gilts held with Legal & General, amounting to £90m.

(B) Manager performance versus investment benchmark



The table shows the actual managed asset allocation as at 31 March 2015 against the target allocation.

	Category	Allocation Policy %	Allocation at 31/03/2015	Variance %
Equities		63.0	64.7	+1.7
UK				
Legal and General	Passive	10.0	9.2	-0.8
Majedie	Concentrated Active	11.0	10.4	-0.6
UBS	Core Active	8.0	8.1	+0.1
Overseas				
Legal and General	Passive	14.0	14.5	+0.5
Marathon	Concentrated Active	12.0	14.3	+2.3
Newton	Core Active	8.0	8.2	+0.2
Property		6.5	6.0	-0.5
CBRE	Core Active	6.5	6.0	-0.5
Alternatives		12.0	12.1	+0.1
Standard Life	Diversified growth	8.0	7.7	-0.3
Baillie Gifford	Diversified growth	4.0	4.4	+0.4
Bonds		18.5	17.2	-1.3
Fixed interest gilts				
Western	Core Active	2.75	2.3	-0.5
Index linked gilts				
Legal and General	Passive	5.8	5.4	-0.4
Western	Core Active	0.0	0.0	+0.0
Corporate bonds				
Legal and General	Passive	1.9	1.7	-0.2
Western	Core Active	5.5	5.5	-0.0
Total Return				
Franklin Templeton	Unconstrained	2.55	2.3	-0.3
Total		100.0	100.0	

	Market Value at 31/03/2015 £m	Percentage of overall portfolio %
Top 10 United Kingdom Equities		
BP	36.7	1.2%
GlaxoSmithKline	29.4	0.9%
HSBC	27.8	0.9%
Royal Dutch Shell	28.1	0.9%
Vodafone Group	25.8	0.8%
Barclays	23.5	0.7%
Lloyds Banking Group	19.6	0.6%
Marks & Spencer	14.9	0.5%
Tesco	14.4	0.5%
BAE Systems	14.1	0.4%
	234.3	7.4%
Top 10 Overseas Equities		
Toyota Motor Corp	9.6	0.3%
Google	9.4	0.3%
Microsoft Corp	9.3	0.3%
Orange	9.3	0.3%
Nestle	9.3	0.3%
Novartis	8.5	0.3%
Apple	8.4	0.3%
Pfizer	7.7	0.2%
Express Scripts	6.8	0.2%
Telecom Italia	6.7	0.2%
	85.0	2.7%
Top 5 Unit Trusts		
Legal & General World (ex UK) Developed Equity Index	393.9	12.4%
Legal & General UK Equity Index	276.5	8.7%
Standard Life Global Absolute Return Strategies	163.5	5.2%
Baillie Gifford Diversified Growth Fund	132.4	4.2%
Marathon Global Equity Fund	75.5	2.4%
	1041.8	32.9%

Governance and Administration



Governance Arrangements of the Pension Fund

Pension Fund Board (Renamed as Pension Fund Committee May 2015)

Surrey County Council’s functions as administering authority are delegated to the Surrey Pension Fund Committee and relevant officers. The Pension Fund Committee exercises all the powers and duties of the administering authority other than those functions delegated to specific officers of the Council.

The responsibilities of the pension fund Committee is set out below.

- a) To undertake statutory functions on behalf of the Local Government Pension Scheme and ensure compliance with legislation and best practice.
- b) To determine policy for the investment, funding and administration of the pension fund.
- c) To consider issues arising and make decisions to secure efficient and effective performance and service delivery.
- d) To appoint and monitor all relevant external service providers:
 - fund managers;
 - custodian;
 - corporate advisors;

- independent advisors;
- actuaries;
- governance advisors;
- all other professional services associated with the pension fund.

- e) To monitor performance across all aspects of the service.
- f) To ensure that arrangements are in place for consultation with stakeholders as necessary
- g) To consider and approve the annual statement of pension fund accounts.
- h) To consider and approve the Surrey Pension Fund actuarial valuation and employer contributions.

The Director of Finance has overall responsibility for operational management and governance of the fund. This crucially includes making sure that the Committee is in a position to meet the requirements as set out above.

Such responsibilities will include:

- a) ensuring the Surrey Pension Fund Committee governance structure is appropriate and evolves if required;

- b) having a clear idea of and being responsible for the items of business that are taken to the Surrey Pension Fund Committee;
- c) management of the Surrey Pension Fund Committee business;
- d) ensuring the effectiveness of the Committee is measured and improvements made where necessary
- e) ensuring Committee members are properly and effectively trained
- f) ensuring risk assessments are undertaken on a regular basis.

New Local Pension Board

From 1 April 2015 the Surrey Pension Fund Committee will be assisted in its management of the Surrey Pension Fund by a Local Pension Board made up from representatives of members and employers of the scheme.

The Local Pension Board was established in accordance with Section 5 of the Public Service Act 2013 and under Regulation 106 of the Local Government Pension Scheme (LGPS) Regulations 2013 (as amended).

The role of the Local Pension Board is to assist Surrey County Council, as administering authority to:

- (a) to secure compliance with:
 - the scheme regulations;
 - any other legislation relating to the governance and administration of the LGPS Scheme and any connected scheme;
 - any requirements imposed by the Pensions Regulator in relation to the LGPS Scheme.
- (b) to ensure the effective and efficient governance and administration of the LGPS Scheme

The Local Pension Board is made up of 10 members as follows:

- 4x Employer Representatives
- 4x Member Representatives
- 2x Independent Representatives

Risks

Principal Risk	Key Controls
<p>The actuarial valuation of pension fund liabilities is linked to government bond yields, as a proxy for investment income. A fall in bond yields will lead to a decrease in the discount rate applied to future pension payments</p> <p>For example a 0.1% reduction in the discount rate will increase the value of liabilities by 2%.</p>	<p>IAS19 data is received annually and provides an early warning of any potential problems.</p> <p>Early consultation with the actuary will take place with regard to the 2016 valuations.</p> <p>The Fund's ongoing investment strategy review will address liability protection with regard to movements in interest rates.</p>
<p>Inflation is a key determinant of the total pensions owed to members of the scheme, both in terms of pay and price inflation.</p> <p>An increase in CPI inflation by 0.1% will increase the liability valuation by 1.4%</p>	<p>Assumptions made on pay and price inflation (for the purposes of IAS19/FRS17 and actuarial valuations) will be long term assumptions.</p> <p>A portion of the fund's investments are index-linked bonds to mitigate some of this risk.</p> <p>The Fund's ongoing investment strategy review will address liability protection with regard to movements in inflation.</p>
<p>Pensioners living longer than expected will increase the overall financial burden upon the scheme as pensioners will receive a greater amount in pension benefits.</p> <p>Adding one year to life expectancy will increase the rate paid by employers by 0.8%</p>	<p>The Fund actuary Hymans Robertson uses long term longevity projections in the actuarial valuation whilst the Fund's membership of longevity experts Club Vita allows for employer specific mortality rates.</p>
<p>A mismatch of assets and liabilities, an inappropriate long-term asset allocation or investment strategy, mistiming of investment strategy</p>	<p>The Fund's ongoing investment strategy review will address fully the investment current investment strategy and to better align investment strategy with pension liabilities.</p> <p>The Fund is able to draw upon expert investment consultancy from Mercer LLC and from the Fund's Independent Investment Advisor.</p> <p>The Fund monitors the value of Fund liabilities on a quarterly basis.</p>

Principal Risk	Key Controls
<p>A rise in ill health retirements may occur for employer organisations unable to meet the additional financial cost.</p>	<p>The Fund is in the process of implementing a whole fund insurance policy to mitigate the cost of an increase in cost or severity of ill health retirement cases.</p>
<p>Investment managers fail to achieve their respective performance targets over the longer term. This could result in higher employer contribution rates to meet any shortfall. A 0.1% underperformance on the investment target will result in an annual impact of £3.1m</p>	<p>The Investment Management Agreements with each manager clearly state the Fund's expectations in terms of performance targets.</p> <p>Investment manager performance is reviewed on a quarterly basis.</p> <p>The Pension Fund Committee should be positioned to move quickly if it is felt that targets will not be met.</p> <p>Having Legal and General Investment Management as a rebalancing and transition manager facilitates quick and cost effective portfolio restructures when required.</p> <p>The Fund's investment management structure is highly diversified, which lessens the impact of manager risk</p>
<p>A financial loss of investments resulting from fraudulent activity</p>	<p>Policies & procedures are in place to ensure risk of investment loss is minimised.</p> <p>Governance arrangements are in place in respect of the Pension Fund. Fund Managers are required to provide statements verifying their internal control procedures.</p>
<p>The financial failure of an investment manager leads to increase costs and service impairment</p>	<p>The Fund actively manages existing contracts and monitors the stability of investment managers. Assets are held by the Fund custodian so can be reassigned securely and swiftly.</p> <p>The Fund is able to utilise a transition manager to facilitate quick and cost effective portfolio restructures.</p>

Principal Risk	Key Controls
Impact of government policy on the employer workforce	<p>The Fund actuary, Hymans Robertson, use prudent assumptions regarding the future workforce. Employers are requested to flag up potential for major bulk transfers.</p> <p>The potential for a significant reduction in the workforce or major outsourcing as a result of the pressures that the public sector is under may have an additional impact on the Fund</p>
Investment markets fail to perform in line with expectations leading to a deterioration in funding levels and increased contribution requirements from employers	<p>The Fund is invested in a diverse range of asset classes, geographical areas and markets limiting the exposure and reliance on any particular type of investment.</p> <p>The investment strategy and target asset allocation is reviewed on a regular basis to attempt to ensure optimal investment positioning and risk management.</p> <p>The actuarial assumption regarding asset outperformance of 1.6% over gilts is considered a prudent and achievable one over the long term, especially when compared with historical data.</p> <p>The Fund undergoes a simplified valuation every quarter to provide an update on the performance of investment returns related to movements in liabilities.</p>
The 2016 actuarial valuation leads to increases in employer contributions	<p>The Fund will consult and engage with employer organisations as early as possible. The funding strategy statement sets out the approach the fund will take to stabilise contribution rates or phase in any large increases.</p>

Assets and Liabilities

Liabilities and Summary Financials

Liabilities and Funding Levels

The pensions owed to future members of the scheme are estimated fully every three years by the Fund actuary. Whilst the pension benefits for membership of the scheme are set out in the rules of the LGPS, the actual practice of estimating the amount of future pension payments hugely complicated and predicated upon a number of uncertainties. The actuaries estimates of future pay and price inflation as well as longevity assumptions have a significant impact upon the valuation of future pension payments.

The most recent full actuarial valuation carried out under Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008 was as at 31 March 2013. This valuation revealed that the Fund’s assets, which at 31 March 2013 were valued at £2,559 million, were sufficient to meet 72.3% of the liabilities accrued up to that date at £3,539 million. The resulting deficit at the 2013 valuation was £980 million. Individual employers’ contributions for the period 1 April 2014 to 31 March 2017 were set in accordance with the Fund’s funding policy as set out in the Funding

Strategy Statement available on the Surrey Pension Fund website.

Principal Actuarial Assumptions and Method used to value the liabilities

Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

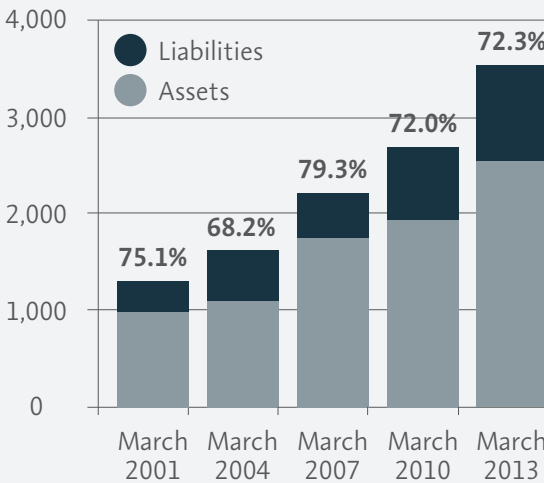
The key financial assumptions adopted for the 2013 valuation were as follows:

31 March 2013		
Financial assumptions	% p.a. Nominal	% p.a. Real
Discount rate	4.6%	2.1%
Pay increases	3.8%	1.3%
Price inflation/ Pension increases	2.5%	-

The key demographic assumption was the allowance made for longevity. As a member of Club Vita, the baseline longevity assumptions adopted at this valuation were a bespoke set of VitaCurves that were specifically tailored to fit the membership profile of the Fund The average future life expectancies at age 65 are as follows:

	Male	Female
Current pensioners	22.5 years	24.6 years
Future pensioners	24.5 years	26.9 years

Fund Assets and Liabilities £m



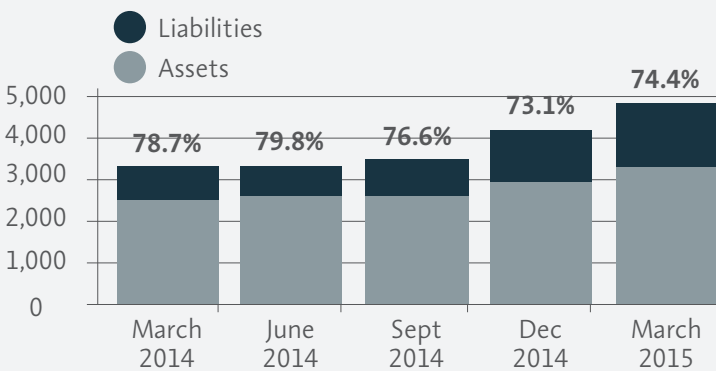
Interim Valuations – Fund experience since March 2013

Since March 2014 the Fund has reviewed the liabilities and funding level of the whole Fund every quarter.

The below graph is the estimated development of the funding position from 31 March 2014 to 31 March 2015. The increase in the funding level from 31 March 2013 to 31 March 2014 was a result of strong investment returns coupled with a more favourable actuarial environment. However, from 30 June 2014 onwards there was a decline in the discount rate causing a decrease in the funding ratio, all this despite substantial investment returns over the period.

The accuracy of this type of funding update calculation is less than a full Fund valuation and will decline over time as the period since the last valuation increases. This funding update does not allow for changes in individual members’ data since the last valuation. It is however a useful estimation of the movement of the Funds liabilities.

Fund Assets and Liabilities £m



Summary of Financial Information

Income and Expenditure

2013/2014		2014/2015
£000		£000
	Contributions and benefits	
149,615	Contributions receivable	173,448
14,751	Transfers in	7,656
164,366		181,104
-119,223	Benefits payable	-126,113
-6,255	Payments to and on account of leavers	-6,195
-13,665	Investment and governance expenses	-15,857
-1,340	Administration expenses	-1,550
-140,483		-149,715
	Return on investments	
49,654	Investment income	56,444
-1,081	Taxes on income	-1,023
176,328	Change in market value of investments	299,210
224,901	Net return on investments	354,631
248,784	Net increase in the fund during the year	386,020
2,558,716	Net assets of the fund At 1 April	2,807,500
2,807,500	At 31 March	3,193,520

Balance Sheet

2013/2014		2014/2015
£000		£000
	Investment assets	
352,134	Fixed interest securities	350,859
94,675	Index linked securities	161,260
1,747,131	Equities	1,908,092
165,824	Property unit trusts	199,410
270,937	Diversified growth	360,061
101,814	Private equity	112,642
	Derivatives	
31	- Futures	0
7,865	- Foreign exchange contracts	3,082
39,212	Cash	77,218
9,676	Other investment balances	9,033
	Investment liabilities	
	Derivatives	
-66	- Futures	-288
-3	- Foreign exchange contracts	-11,501
-7,718	Other investment balances	-2,441
-4,500	Borrowings	0
2,777,012	Net investment assets	3,167,427
14,520	Long-term debtors	12,705
20,761	Current assets	18,949
-4,793	Current liabilities	-5,561
2,807,500	Net assets of the fund at 31 March	3,193,520

Employer Contributions (By Category)

2013/2014		2014/2015
£000		£000
82,504	Employers	93,269
32,937	Employers deficit	43,580
34,174	Members	36,599
149,615		173,448

2013/2014		2014/2015
£000		£000
77,812	Administering authority	83,223
59,663	Scheduled bodies	75,565
12,140	Admitted bodies	14,660
149,615		173,448

Pensions Paid (By Category)

2013/14		2014/15
£000		£000
99,529	Pensions	106,175
17,092	Commutation and lump sum retirement benefits	17,734
2,519	Lump sum death benefits	2,170
83	Interest on late payment of benefits	34
119,223		126,113



Payments to leavers

2013/2014		2014/2015
£000		£000
0	Group transfers to other schemes	0
6,222	Individual transfers to other schemes	5,896
31	Refunds of contributions	227
2	Payments for members joining state schemes	72
6,255		6,195

Current assets

2013/2014		2014/2015
£000		£000
3,364	Contributions - employees	2,816
13,314	Contributions - employer	10,196
4,083	Sundry debtors	5,937
20,761		18,949

2013/2014		2014/2015
£000		£000
1,984	Central government bodies	3,112
16,980	Other local authorities	13,713
1,797	Other entities and individuals	2,124
20,761		18,949

Long term debtors

2013/2014		2014/2015
£000		£000
14,520	Central government bodies	12,705
14,520		12,705

Current liabilities

2013/2014		2014/2015
£000		£000
4,731	Sundry creditors	5,541
62	Benefits payable	20
4,793		5,561

2013/2014		2014/2015
£000		£000
1,225	Central government bodies	1,408
1,550	Other local authorities	1,664
2,018	Other entities and individuals	2,489
4,793		5,561

Fund expenses

2013/2014		2014/2015
£000		£000
1,340	Administrative Expenses	1,550
12,731	Investment management fees	14,908
218	Investment custody fees	226
716	Oversight and governance costs	723
15,005		17,407



Taxes on Income

2013/2014		2014/2015
£000		£000
790	Withholding tax - equities	603
291	Withholding tax - property	420
1,081		1,023

Investment income

2013/2014		2014/2015
£000		£000
	Fixed interest	
5,859	UK	5,905
5,581	Overseas	5,873
2	Index linked	54
	Equities	
18,017	UK	18,781
10,244	Overseas	10,605
6,069	Property unit trusts	7,936
2,103	Diversified growth	2,601
1,554	Private equity	3,793
152	Interest on cash deposits	523
73	Other	373
49,654		56,444

Analysis of Investments

31 Mar 2014	31 Mar 2015	31 Mar 2014
	£000	£000
Fixed interest securities		
UK public sector & quoted	136,448	148,648
UK pooled funds	86,739	51,905
Overseas public sector & quoted	60,175	76,104
Overseas pooled fund	68,772	74,202
	352,134	350,859
Index linked securities Equities		
UK quoted	513,497	540,276
UK pooled funds	237,645	276,454
Overseas quoted	460,880	554,463
Overseas pooled funds	535,109	536,899
	1,747,131	1,908,092
Property unit trusts		
UK property funds	157,900	194,992
Overseas property funds	7,924	4,418
	165,824	199,410
Diversified growth		
UK diversified growth funds	0	0
Overseas diversified growth funds	270,937	360,061
	270,937	360,061

31 Mar 2014	31 Mar 2015	31 Mar 2014
	£000	£000
Cash and equivalents		
Cash deposits	39,212	77,218
Borrowings	-4,500	0
	34,712	77,218
Private equity		
UK limited partnerships	23,431	24,905
Overseas limited partnerships	25,770	13,852
UK fund of funds	0	0
Overseas fund of funds	52,613	73,885
	101,814	112,642
Derivatives		
Futures	-35	-288
FX forward contracts	7,862	-8,419
	7,827	-8,707
Cash deposits	39,212	77,218
Borrowings	-4,500	0
Other investment balances		
Outstanding sales	3,291	2,239
Outstanding purchases	-7,693	-2,408
Tax due on accrued income	-25	-33
Accrued income - dividends and interest	6,385	6,794
	7,827	-8,707
Total investments	2,777,012	3,167,427

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