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SURREY
COUNTY COUNCIL

Making Surrey a better place

Surrey Pension Fund

Annual Report 2006

Contents

Introduction

This annual report sets out key information about how the Fund is managed for the benefit of all employing bodies, contributors and beneficiaries.

Review of Fund Performance

During 2005-2006 the average local authority fund generated a return of 24.8%, reflecting exceptional returns in worldwide stock markets. The Surrey Fund returned 25.2%, which means that for the fifth year out of six the Surrey Fund performance was above average. The performance relative to the local authority benchmark can be attributed to asset allocation – the Surrey Fund has a higher weighting in equities than the average local authority fund. In particular the Fund has benefited from its position in emerging markets where index returns for the year were in excess of 60%. Paul Meredith explains the market background in some depth on page 13.

It is still too soon to say whether the individual manager appointments have been successful since we take a longer-term view of investments. However, an above average total fund investment return is extremely pleasing. Some managers have underperformed relative to their individual performance targets, but in periods of extreme market conditions this is inevitable.

Fund Management Structure

2005-2006 was quiet in comparison with the previous two financial years when we saw a review of the Fund's strategy and implementation of a new fund management structure. That said, periods of consolidation and reflection are often more important, and more challenging, than major changes. We are currently reviewing the Fund's asset allocation strategy, which could mean a change in the proportion of the Fund's assets allocated to particular asset classes. We last carried out an asset-liability modelling study in 2000 – and the results of the study drove the subsequent restructuring of the Fund. We do not expect to have to make such radical changes again, although we expect that there may be some marginal changes. For example, and in common with most Funds, we may see an increase in the Fund's weighting to overseas equities and property. We will also have to consider whether there is a need to consider further investment in alternative asset classes. These issues are on the agenda for 2006-2007.

The Year Ahead

Looking forward we have a number of major challenges. We continue to have a large number of managers to work with and monitor. We are also currently reviewing the Fund's asset allocation to ensure that it is still appropriate. Finally, the 2007 actuarial valuation is looming large on the horizon.

Philip Walker
Head of Finance
October 2006

Members and Advisers

Administering Authority	Surrey County Council County Hall Kingston upon Thames Surrey, KT1 2EA
Administrator	Head of Finance (from April 2006) Executive Director, Resources (to April 2006)
Investment Advisers	
County Council Members	David Harmer Peter Langham Val Tinney (from October 2006) Tony Rooth (to October 2006) Chris Slyfield
Representatives of Employing Bodies	Cllr Nick Harrison, Reigate & Banstead BC Cllr Paul Tuley, Runnymede BC (from July 2006) Cllr Roger Whittaker, Elmbridge BC (to July 2006)
Employee Representative	Don Josey
Professional Investment Advisers	Bob Mundie, Watson Wyatt (from Sep 05) Debbie Clarke, Watson Wyatt (to Aug 05) Paul Meredith, Independent
Head of Finance (from April 2006)	Philip Walker
Executive Director, Resources (to April 2006)	Michael Taylor
Fund Managers	Citigroup Asset Management ING Real Estate JP Morgan Asset Management Legal and General Investment Management Majedie Asset Management Marathon Asset Management Mirabaud Investment Management Ltd Schroder Investment Management Ltd SG Asset Management TCW Investment Management Company UBS Global Asset Management Western Asset Management

Five Year Profile

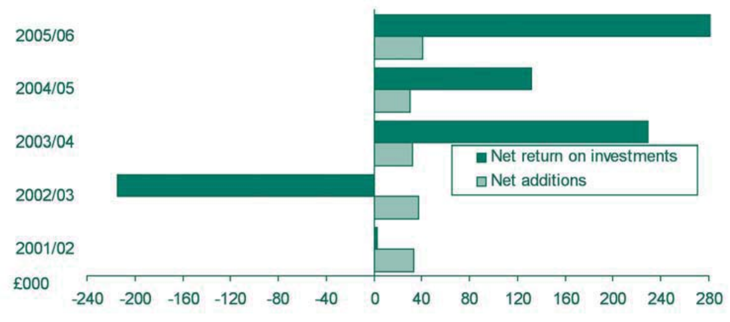
Global Custodian	Northern Trust
Development Capital Advisers	Goldman Sachs & Co HG Capital ISIS Capital Blackrock (formerly Merrill Lynch) Standard Life
Fund Actuary	Ronald S. Bowie, Senior Partner, Hymans Robertson
AVC Provider	Prudential Assurance Company Equitable Life Assurance Society
Auditors	Audit Commission

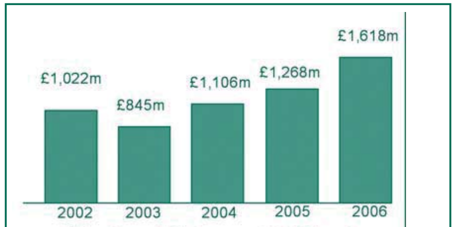
Financial Summary

	2001/02 £000	2002/03 £000	2003/04 £000	2004/05 £000	2005/06 £000
Contributions	96,704	105,242	102,357	107,106	122,046
Less benefits and expenses paid	63,634	67,770	70,701	77,272	81,393
Net additions	33,070	37,472	31,656	29,834	40,653
Net investment income **	25,321	25,576	39,682	24,516	27,900
Change in Market Value	-25,270	-240,153	189,320	107,797	281,492
Net return on investments	51	-214,577	229,002	132,313	309,392
Net increase in Fund	33,121	-177,105	260,658	162,147	350,045
Fund Balance at 31 March (Market Value)	1,022,002	844,897	1,105,555	1,267,702	1,617,747

Note **Net of expenses

Annual increase/(decrease) to the Fund

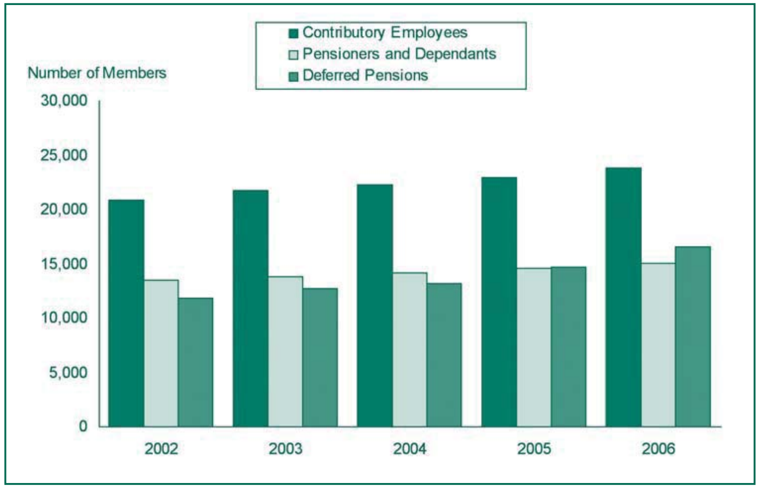




The Fund Balance at 31 March

Membership Summary

	2001/02	2002/03	2003/04	2004/05	2005/06
Contributory Employees					
Scheduled Bodies	19,382	20,187	20,743	21,184	22,122
Admitted Bodies	1,518	1,593	1,612	1,796	1,719
	20,900	21,780	22,355	22,980	23,841
Pensioners and Dependants					
Scheduled Bodies	12,812	13,112	13,426	13,736	14,109
Admitted Bodies	651	712	770	839	906
	13,463	13,824	14,196	14,575	15,015
Deferred Pensions					
Scheduled Bodies	11,073	11,879	12,209	13,674	15,431
Admitted Bodies	843	907	945	1,037	1,189
	11,916	12,786	13,154	14,711	16,620
Total Membership	46,279	48,390	49,705	52,266	55,476



Regulatory Background

Pensions Regulations

The Local Government Pension Scheme Regulations 1997 are made under the 1972 Superannuation Act and require the County Council to maintain a Pension Fund for certain of its own employees together with the majority of employees of Probation Committees, the District Councils within the County area and eligible employees within the Surrey Police Authority and former County Educational Establishments. The same regulations empower the County Council to admit certain other bodies to the Fund and a list of such bodies within the Fund is shown on page 34. The regulations also allow for the admission of private sector contractors providing outsourced services. The Fund does not cover teachers and firefighters for whom separate statutory regulations exist.

The Fund is financed by contributions from employees and employers, together with income earned from investments. The surplus of contributions and investment income over benefits currently being paid is invested.

The core benefits payable under the 1997 Regulations are mandatory. In addition the regulations have become more flexible to give members and employers the maximum freedom of choice in determining their benefits package.

Employees' contributions are now standardised at the rate of 6% of pensionable pay although there is a protected rate of 5% for certain existing employees who were previously classed as manual workers.

Employers' contribution rates are set following each Actuarial Valuation. A valuation of the Fund's financial position must be made every three years when the Actuary certifies the employers' rates payable until the results of the next valuation are known.

Under the Regulations employer contributions are determined in two parts.

- A common rate based on the existing and prospective liabilities of the Fund having regard to the circumstances common to all the participating employers and to the desirability of maintaining as nearly constant a rate as possible and
- Individual adjustments arising from circumstances peculiar to an individual employer.

Pensions paid to retired employees, and benefits with a deferred payment date, are subject to mandatory increases under pensions increase legislation. The cost of inflation-proofing benefits is funded through the employers' contribution rate.

Employers' Contributions in 2005/2006

The results of the actuarial valuation undertaken at 31 March 2004 applied for the three years commencing 1 April 2005 as detailed below.

- The common contribution rate payable by each participating body in order to maintain funding for future service at 100% of liabilities is 193% of pensionable employees' contributions and
- An individual adjustment to the common rate which is expressed as a percentage of pensionable employees' contributions together with a cash amount for most Scheduled Bodies.

The basis and assumptions used will be found in the Actuary's disclosure statement on page 19. The contributions payable by scheme employers in 2005/2006 are shown on pages 31 – 34.

Future Contribution Rates

The contribution rates applying in the three-year period commencing 1 April 2005 were determined by the Actuary on completion of his triennial review of the Fund as at 31 March 2004. He assessed the Fund's current and future liabilities and determined that it was necessary to increase the rate of employers' common contribution from 160% to 193% of pensionable employees' contributions. He also determined the additional annual sums to be paid by most employers to ensure a return to 100% solvency over the average future working lifetime of the members (20 years).

Annual Review

Amendments to the Local Government Pension Scheme Regulations 1997

The main amendments to the scheme in 2005/2006 were as follows:

The 85-year rule

- It was reported in last year's annual report that the government had issued regulations that removed the right to retire under the 85-year rule. The 85-year rule enabled scheme members to receive an unreduced pension if they retired voluntarily from age 50 if their age, when added to their pensionable service, equalled or exceeded 85 (employer's consent was required if the scheme member wished to retire before age 60). The Government subsequently revoked these regulations as a result of protests from trade unions.

Following consultation with employers and trade unions, the Government issued further regulations confirming that the 85-year rule would be removed from the scheme in respect of pension benefits that accrue from 1 October 2006. However, there will be some level of protection for those who were active members of the scheme at 30 September 2006, as follows:

- The removal of the 85-year rule will only apply to benefits accrued from 1 April 2008, rather than 1 October 2006

The government believes that this protection can be justified because it will provide continuity and security for existing scheme members between the removal of the 85-year rule on 1 October 2006 and the start of the new LGPS scheme on 1 April 2008

- Scheme members who will be 60 or over and would have satisfied the 85-year rule by 31 March 2016 will have pension benefits that accrue in respect of their pensionable service to 31 March 2016 protected.

The government believes that this protection can be justified because it provides protection to scheme members closest to retirement who do not have time to make alternative arrangements to offset the reduction that would otherwise have been applied to their benefits.

- Scheme members who retire before age 65 and will be 60 and would have satisfied the 85-year rule between 1 April 2016 and 31 March 2020, will have a lower, tapered actuarial adjustment factor applied to their benefits accrued from 1 April 2008.

The government believes this protection can be justified because it serves to overcome the perceived "cliff-edge" application of the regulations. Without the protection it would have resulted in significantly different treatment of members who were 60 and satisfied the 85-year rule at 31 March 2016 (who would suffer no reduction to their benefits) and those who were 60 and satisfied the 85-year rule one day later (who would suffer a full actuarial reduction to their benefits that accrued from 1 April 2008).

New tax rules for pensions

New tax rules affecting all pension schemes were introduced with effect from 6 April 2006. As a consequence the LGPS has been amended as follows.

- Pension benefits will no longer be restricted by service or salary limits. Scheme members will now be able to continue to accrue benefits beyond 40 years' service and will not be subject to an earnings cap. Instead a life time allowance (LTA) has been introduced which limits the total amount of pension savings an individual can have without being liable to a tax charge. The LTA will increase each year and has been set at £1.5 million for the tax year 2006/7. A limit has also been imposed on how much an individual's pension benefits can grow each year without incurring a tax charge. This limit is known as the annual allowance, which will also increase each year and has been set at £215,000 for the tax year 2006/7. Generally the LTA and annual allowance will only affect very high earners.
- The maximum pension contribution a scheme member can pay has been increased from 15% of pensionable pay to 100%. Full tax relief will continue to be applied to pension contributions.
- The maximum tax-free lump sum a scheme member can take has been increased to 25% of the value of their pension benefits. This is a significant increase compared to the previous amount of 3/80ths of final years' pay for each year of service. The scheme will continue to provide the standard 3/80ths lump sum but a member can elect to increase this amount by giving up part of their annual pension at the rate of every £1 of pension providing an additional £12 of lump sum.
- It is now possible for employers, at their discretion, to allow their employees to continue working, but on a reduced hours basis, and receive payment of their pension benefits. The pension benefits that became payable on this basis would be subject to actuarial reduction to allow for early payment. The employer has the discretion to waive the actuarial reduction if it believes there is sufficient justification for doing so. However, the employer would then have to pay the pension fund the cost of paying the benefits without reduction. All scheme

- employers will have to publish a policy on how they intend to operate flexible retirement options for their employees.
- All scheme members are now permitted to remain in the scheme until they are age 75. Previously, it was generally the rule that all employees had to leave the scheme when they reached age 65.

Councillor pensions

The normal pension scheme retirement age for councillors has been reduced from age 70 to age 65 in line with scheme rules applying to employee scheme members. This now means that if a councillor elects to receive retirement benefits from age 65, they will no longer be actuarially reduced to allow for early payment.

Added years

A new limit has been introduced on the purchase of added years from 6 April 2006. The maximum period that can now be purchased is 6 years 243 days.

Civil partnerships

From 5 December 2005, the Civil Partnership Act 2004 allows same-sex partners to register a civil partnership with the registration service. Same-sex partners that enter into a civil partnership will be entitled to a survivor pension from the LGPS if their partner dies while a member of the scheme.

Application of Powers

Throughout the year decisions under the Pension Scheme Regulations were made by officers under powers delegated by the County Council. The decisions taken, which generally related to the application of mandatory entitlements and prescribed calculations, ensured the full discharge of the County Council's statutory obligations under the scheme.

A number of discretionary decisions were made by officers under delegated powers either in line with decisions made by Committee or in line with clear precedents which had emerged from decisions previously taken by Committee.

New Scheme Employers

East Horsley Parish Council joined the scheme on 1 April 2005.

Investment Powers

The principal powers governing investment activity and management are defined in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended) which permit a wide range of investments subject to the following restrictions:

- No more than 15% of the Fund may be invested in securities which are not quoted on a recognised stock exchange.
- No more than 10% of the Fund may be invested in a single holding, and no more than 35% of the Fund may be invested in unit trust schemes managed by any one body and open-ended investment companies managed by any one body.
- No more than 10% of the Fund may be deposited with any one bank.
- Loans from the Fund, including money used by the administering authority or lent to other local authorities, but not including loans to the Government, may not in total exceed 10% of the value of the Fund.

Investment Management

The main regulatory stipulations applying during the year were:

- An administering authority may appoint one or more investment managers to manage and invest fund monies on its behalf.
- When appointing fund managers the administering authority:
  - must be aware that the investment manager is suitably qualified.
  - must be satisfied that there are an adequate number of managers and that the sums to be managed by any one will not be excessive.
  - must take proper advice.
- The investment manager must provide at least once every three months a report setting out his actions.
- The investment manager must have regard to the need for diversification of investments of fund monies and to the suitability of investments which he proposes to make.
- The regulations also impose requirements concerning the terms of appointment and the reviews of the performance of fund managers.

In November 2003 an amendment to the Local Government Pension Scheme Regulations was introduced. This amendment provides Local Authorities with the opportunity to increase their exposure to certain types of investment, but only where:

- proper advice has been obtained.
- the decision has been made with due regard to the general provisions of the regulations.
- the Statement of Investment Principles has been revised and published.

The new headrooms are not mandatory and individual authorities can, if they prefer, maintain existing investment policy.

Surrey has decided to maintain its existing investment policy at this moment in time.

At Surrey the responsibility for the overall direction of the Fund's investment is delegated to the Head of Finance who acts in consultation with the Chairman of the Investment Advisers Group. The Investment Advisers Group comprises

- 4 county council members
- 2 district council members
- 1 representative of the scheme members
- 2 professional investment advisers

The Fund is separated into 3 elements

- passive core
- specialist core
- satellite element

There are 12 external investment managers, who have been appointed to undertake day-to-day decisions on the allocation of investment between types of asset and choices of individual stocks within approved classes. They are required to take a long-term view, balancing risk against return and are remunerated on scales related to the value of funds under management. Quarterly meetings are held with the external managers who explain the reasons for their actions in the previous quarter, and propose a strategy for the coming period.

In addition the Fund has investments in Development Capital funds managed by ISIS Capital, H G Capital, Merrill Lynch, Goldman Sachs and Standard Life with some residue funds in Bridgepoint Capital (formerly funds managed by Gartmore Asset Management).

At 31 March 2006 the market value of assets under management (excluding assets held by Surrey County Council) was £1,589 million; the proportion with each of the managers being:

Investment Manager	Mandate	Proportion of Funds Under Managements
Passive Core		
Legal & General Investment Managers	Multi Asset	21.0%
Specialist Core		
UBS Global Asset Management	UK & Global Equities	16.3%
Societe Generale Asset Management	UK Equities	11.6%
Marathon Asset Management	Global Equities	10.1%
Western Asset Management	Fixed Interest	13.5%
Satellite		
ING Real Estate	Property	5.9%
Mirabaud	UK Equities	4.0%
Majedie	UK Equities	4.1%
TCW	US Equities	2.8%
JP Morgan	Japanese and Pacific Basin Equities	3.2%
Citigroup	Emerging Markets Equities	3.4%
Schroders	European Equities	3.2%

Market Background

(Courtesy of Paul Meredith, independent investment adviser)

Economic and market background

In the last year, developed economies enjoyed a further year of good growth with the higher cost of oil and other raw materials apparently absorbed with only a modest up-tick in inflation and inflationary expectations. Currency, bond and equity markets seemed to have become inured to the growing US trade deficit, viewing it as an inevitable offset to the inability of Asian manufacturing and OPEC to recycle their surpluses. Cheap manufactured imports continued to restrain prices to western consumers. With capital investment remaining subdued company profits rose strongly. The ready availability of cheap finance promoted a steady stream of corporate acquisitions, particularly in European markets where the concept of national champions was further eroded. Indeed in the UK many famous quoted companies became foreign owned subsidiaries including P&O, British Plaster Board, Allied Breweries and Ready Mix Concrete, and since year end they have been joined by British Airports and Associated British Ports. The resulting actual and projected inflow of capital helped to support sterling against the UK trade deficit.

Equity markets rose rapidly back towards levels last seen at the height of the internet bubble in early 2000, though this time the strength was much less narrowly based. In the UK it was led by these "mid cap" takeovers plus the heavily weighted mining and oil sectors and gave a total index return of 28%. Europe [ex UK] performed even more strongly returning 35% and the US returned 23%, of which the local market return was just 13% supplemented by a 10% contribution from the strengthening dollar. The Japanese economy appeared to have finally thrown off the spectre of deflation and its equity market returned 48%. But all were eclipsed by a return of 63% from emerging markets with investors piling in with apparently little regard for risk. Property also had another strong year, returning 21% with further strong demand from institutional investors for diversifying assets with a reasonable income. There was also an unseemly scramble for assets to match the liabilities of corporate pension funds leading to wild gyrations in the prices of the very longest dated UK fixed interest and index-linked bonds. However, overall their market returns were relatively modest with both at 9%.

Outlook

The world economy has benefited enormously from the rapid growth of China, India and many of the other developing nations, who have embraced the potential of free trade particularly in manufacturers. Control of monetary and fiscal policies in the US and Europe has been widely seen as judicious. Despite some natural disasters and political "sabre rattling" there has been no serious disruption to the supply of oil or other raw materials. The enormous US economy has successfully weathered terrorism and the cost of the war in Iraq and the devastation of New Orleans. After three good years it is little surprise that consumers and markets have been displaying apparently unbridled confidence.

Uncertainties get sidelined at such times. Oil from the Middle East is vulnerable to stability in the Arabian Peninsula and the passivity of Iran, which is already exerting its influence in Lebanon without the threat yet of nuclear weapons. The enormous economic stimulus to developed economies from low interest rates and increased government spending in recent years is now winding down: indeed interest rates are already moving a little higher in all major economies to keep the lid on inflation. France and much of the rest of "core Europe" provide regular reminders that even prosperous citizens do not always support free movement of labour and completely free trade. But above all the imbalance created through the US trade deficit is a constant and growing threat: now at 7% of gross domestic product, it is more than half total exports. Resolution requires significantly lower spending by the US consumer, which seems unlikely, even with house prices now flattening out. The only sustainable alternative is a major reduction in the value of the dollar, which could well unsettle financial markets.

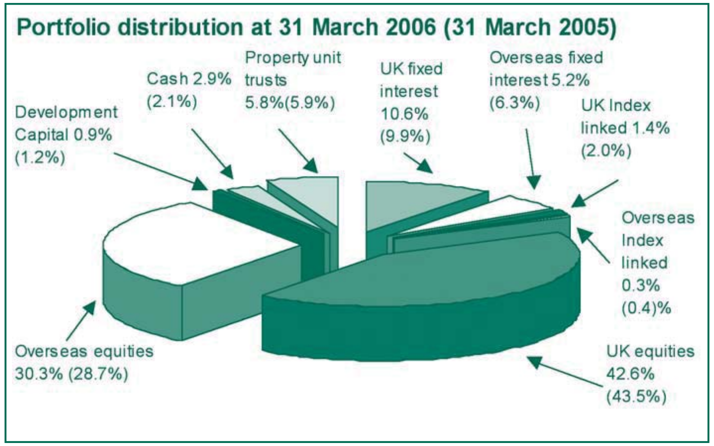
Policies trending inexorably towards free market and free trade have contributed to recent sustained growth, low inflation and strong growth in company profits. The collapse of the "Doha" round of trade negotiations raises the spectre of a reversal of this trend. But in any event further rapid progress in company profits will be difficult in the face of current high prices of oil and other commodities and global competition is increasingly being felt outside mass manufacturing. It is hardly conceivable that future equity returns can match the pace of the last three years and, with property yields and real yields on bonds now historically low, the returns from all asset classes may be decidedly more pedestrian.

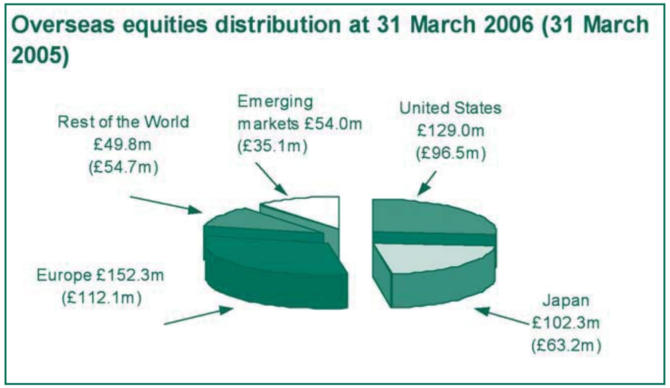
Strategic Asset Allocation

Over the long term equity returns should broadly track company earnings and economic growth and with dividends added to total return to exceed them by a small margin. Under most conceivable scenarios this should eventually provide a better return than bonds. However, a balance must be struck, with enough in equities to produce these higher returns which help to minimise employer contributions in the long term, offset by enough in bonds and property to provide diversification and hence to help to moderate potential short term upward fluctuations in those contributions. This is a complex risk judgement reviewed formally after every triennial actuarial valuation with a strategic asset allocation study. From the current study by Hymans Robertson the key decision will be whether the strategic weighting of 75% in equities remains appropriate. Other issues to be addressed will be reducing emphasis on the increasingly concentrated and unrepresentative UK stockmarket and the wider use by pension funds of alternative investment vehicles.

Portfolio Distribution

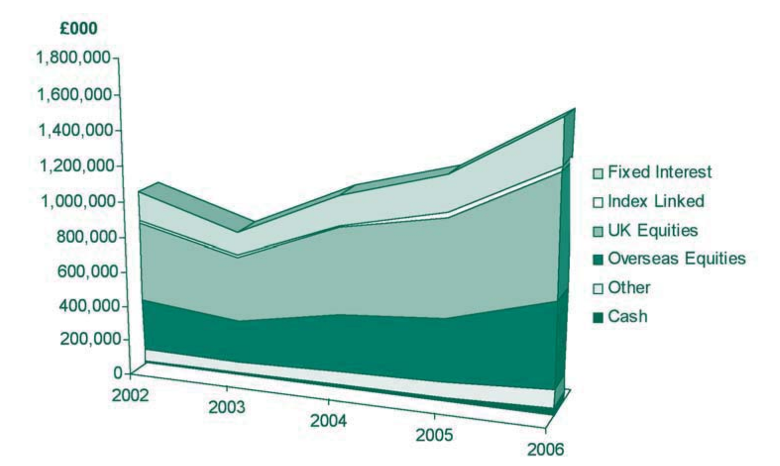
The distribution of the portfolio at 31 March 2006 is shown below. The larger chart shows distribution over the entire structure of the portfolio, whereas the smaller chart provides more detailed analysis of the overseas equity sector.





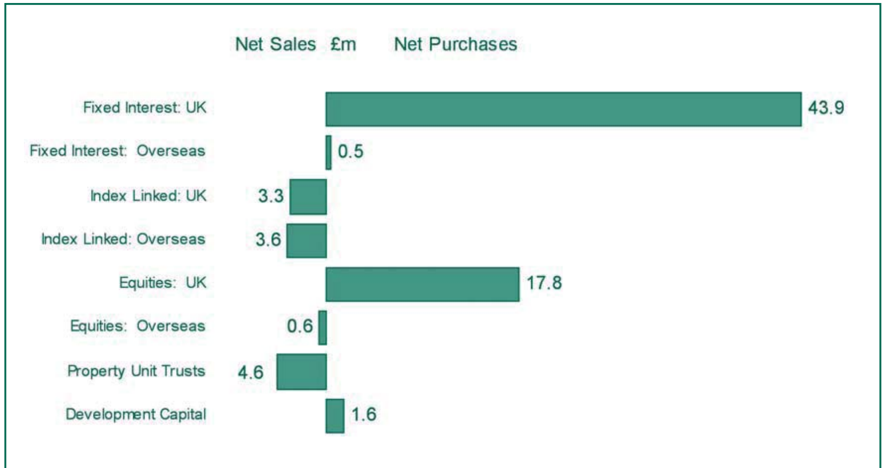
Investment Distribution

The chart below shows how the Fund has been invested over the last five years.



Investment Activity

The net investment activity during the year ended 31 March 2006 is reflected in the chart below.

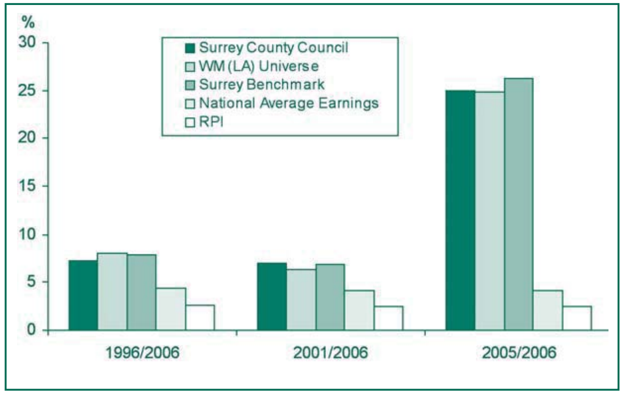


Investment Performance

The Fund participates in two investment performance measurement services which assess the rate of return achieved by the Fund and provide comparisons with the performance achieved by the other pension funds. One of these services, covering local authority pension funds, is provided by the Society of County Treasurers and the Chartered Institute of Public Finance and Accountancy through the WM Company. The other service is provided by Surrey's global custodian Northern Trust. Surrey also has a customised benchmark for performance measurement.

Performance is continually reviewed at regular intervals as per the Statement of Investment Principles on page47.

The graph below shows how the Fund is performing over the short and long term periods in comparison to national average earnings and the retail price index as well as the WM Universe and the Surrey Benchmark.



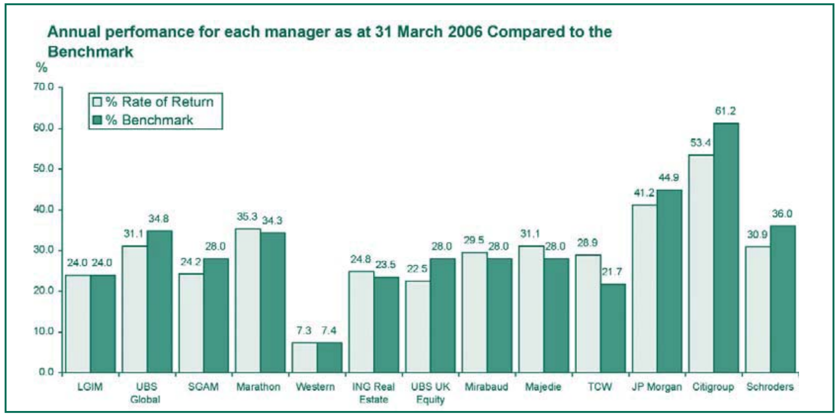
All the rates of return quoted take into account investment income as well as realised and unrealised capital profits or losses in the period. Annual returns over each of the last five years, and the five and ten year are as follows:

Financial Years	SCC (measured by Northern Trust) %	WM Local Authority Universe %	Surrey Benchmark %
2005-2006	24.9	24.8	26.3
2004-2005	11.6	11.7	11.5
2003-2004	25.5	23.9	23.3
2002-2003	-20.4	-20.1	-20.5
2001-2002	0.3	-1.0	-1.3
2001-2006 (5 year average)	7.0	6.4	6.8
1996-2006 (10 year average)	7.2	8.1	7.9

The Surrey benchmark figure for 5 and 10 year periods reflects both the new core satellite approach and old balanced structure

Annual Returns for Fund Managers

The annual investment returns for each fund manager and asset class as at 31 March 2006 are displayed below .



Pension Fund Performance measured by asset class for the year ended 31 March 2006		
	Portfolio	Index
UK Equities	26.3	28.0
Overseas Equities	36.4	37.5
North America	26.0	24.3
Europe	35.8	36.0
Japan	45.7	48.3
Pacific Basin	35.3	37.6
Emerging Markets	53.4	61.2
UK Fixed Interest		
Gilts	7.9	7.4
Non-Gilts	7.7	7.8
Overseas Bonds	8.1	3.7
Index Linked	11.0	8.4
Property	25.3	23.5
Total Fund	24.9	26.3

Report of the Actuary

Disclosure Statement On Actuarial Position

Report of the Actuary for the Year Ended 31 March 2006

As required by Regulation 77 of the Local Government Pension Scheme Regulations 1997, the last actuarial valuation of Surrey Pension Fund's assets and liabilities was carried out as at 31 March 2004.

Security of Prospective Rights

In my opinion, the resources of the Fund are likely in the normal course of events to meet the liabilities of the Fund as required by the Regulations. In giving this opinion, I have assumed that the following amounts will be paid to the Fund:

- Contributions by the members in accordance with the Local Government Pension Scheme Regulations 1997 at the rate of 6% of pensionable pay for all members except manual staff who joined before 1 April 1998 who contribute at the rate of 5% of pensionable pay;
- Contributions, for the three years commencing 1 April 2005, by the employers as specified in our Rates and Adjustments certificate dated 22 March 2005.

Summary of Methods and Assumptions Used

Full details of the method and assumptions are described in our valuation report dated March 2005 and the Rates and Adjustments certificate contained therein.

Copies of these documents are available on request from the Finance Department of Surrey County Council.

My opinion on the security of the prospective rights is based on:

- the projected unit valuation method where there is an expectation that new employees will be allowed to join an employer; or
- the attained age valuation method for employers who were closed to new entrants.

These methods assess the cost of benefits accruing to existing members during:

- the year following the valuation; or
- the remaining working lifetime, respectively

allowing for future salary increases. The resulting contribution rate is adjusted to allow for any difference in the value of accrued liabilities and the assessed value of assets.

Valuation of Assets

A "market related" valuation method has been used. However, in the previous valuation, a "smoothed" approach was taken for deriving the financial assumptions and assessing the value of assets. At the 2004 valuation, such a smoothing methodology was not used to devise the financial assumption – spot yields were used instead. Nor was any smoothing used in assessing the asset values.

Valuation assumptions

The key financial assumptions adopted at the 2004 valuation are set out in the table below:

Financial Assumptions	March 2004 Unsmoothed	
	% p.a.Nominal	% p.a. Real
Discount Rate	6.3%	3.4%
Pay Increases	4.4%	1.5%
Price Inflation/Pension Increases	2.9%	-

The 2004 valuation revealed that the Fund's assets, which at 31 March 2004 were valued at £1,107 million, were sufficient to meet approximately 68% of the liabilities accrued up to that date.

Individual employer's contributions have been set in accordance with the Fund's Funding Strategy Statement. The deficit for each individual employer is being spread over a period up to a maximum of 20 years. Any increases in contribution rates from 31 March 2005 are being phased in over a period of up to 3 years.

Forthcoming actuarial valuation

The next valuation of the Fund will be carried out as at 31 March 2007 and the results known later that year. This valuation will allow for the experience of the fund since 31 March 2004 and up-to-date financial assumptions at that time.

Prepared by:

Bryan Chalmers FFA
For and on behalf of Hymans Robertson LLP
19 June 2006

Statement of Responsibilities and Certification of Accounts

The Responsibilities of the County Council

The County Council is required:

- to make arrangements for the proper administration of the financial affairs of the Fund and to secure that one of its officers has the responsibility for the administration of those affairs. In this Authority, that officer is the Head of Finance.
- to manage the Fund's affairs to secure economic, efficient and effective use of resources and safeguard its assets; and
- to approve the statement of accounts.

The Responsibilities of the Head of Finance

The Head of Finance, is responsible for the preparation of the Fund's statement of accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in Great Britain ("the Code of Practice").

In preparing this statement of accounts, the Head of Finance has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with the Code of Practice;

The Head of Finance has also:

- kept proper accounting records which were up to date;
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

Opinion of the Auditors

Independent Auditors' Report to Surrey County Council on the Pension Fund Annual Report

I have examined the financial statements included in the Pension Fund Annual Report set out on pages 23 to 29.
This report is made solely to Surrey County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 54 of the Statement of Responsibilities of Auditors and of Audited Bodies, prepared by the Audit Commission.

Respective responsibilities of Chief Financial Officer and auditors

As described on page 21 the Chief Financial Officer is responsible for preparing the Annual Report in accordance with the Statement of Recommended Practice "Financial Reports of Pension Schemes 2002". My responsibility is to report to you my opinion on the consistency of the financial statements within the Annual Report with Surrey County Council's statutory financial statements. I also read the other information contained in the Annual Report and consider the implications for my report if I become aware of any misstatements or material inconsistencies with the statutory financial statements. Our audit report is made solely to Surrey County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 54 of the Statement of Responsibilities of Auditors and of Audited Bodies, prepared by the Audit Commission.

Basis of opinion

I conducted my work in accordance with paragraphs 15 to 18 of Bulletin 1999/6 'The auditor's statement on the summary financial statement' issued by the Auditing Practices Board for use in the United Kingdom.

Opinion

In my opinion the financial statements set out on pages 23 to 29 of the Annual Report are consistent with the statutory financial statements of Surrey County Council for the year ended 31 March 2006 on which I have issued an unqualified opinion.

Nick Ward

Signature:

Date:

Name: Nick Ward

Address:
Audit Commission
1st Floor
MLS Business Centre
Crossweys
28-30 High Street
Guildford
Surrey
GU1 3EL.

Accounting Policies

Accounting Standards
The accounts have been prepared to meet the requirements of the Local Government Pension Scheme Regulations 1997 and in accordance with the Statement of Recommended Practice, "Financial Reports of Pension Schemes".

Actuarial Position

The accounts summarise the transactions of the Scheme and deal with the net assets. They do not take account of liabilities to pay pensions and other benefits in the future. They should therefore be read in conjunction with the actuarial position on page 19 which takes such liabilities into account.

Contributions, Benefits and Transfer Values

- Contributions and benefits are included on an accruals basis.
- Transfer values are accounted for on a cash basis apart from bulk transfers which are accrued at year end. No allowance is made for further outstanding transfer values because of uncertainty arising from the options available to transferred staff.

Investments are included in the accounts at market value. The basis of determining market values is described below:

- All UK securities traded within SETS (Stock Exchange Electronic Trading Service) are valued using last SETS traded price. All other UK securities are valued on the basis of middle market prices at close of business on the last trading day of the financial year.
- Unlisted securities are valued having due regard to latest dealings, professional valuation, asset values and other appropriate financial information.
- Overseas securities are valued on overseas stock exchange quotations at close of business on the last day of the financial year.
- Property and other Unit Trusts are valued at the Unit Trust managers' valuations.
- The sterling values of overseas securities have been assessed on the currency exchange rates ruling on the last trading day of the financial year.

Investment Income

Interest and dividends due but not received on holdings quoted ex-dividend at 31 March 2006 have been accrued and included as investment income.

Taxation

- Investments

The Fund is exempt from UK Income Tax on interest received and from Capital Gains Tax on the proceeds of investments sold. Income from overseas investments suffers a withholding tax in the country of origin, unless exemption is permitted as in the United States and Australia. Tax deducted in some European countries is recovered.

- VAT

All VAT paid is recoverable, and is accounted for through the County Fund.

Administrative Expenses

- Pensions administrative expenses reflect the costs incurred in the payment of pensions and other benefits, actuarial advice, dealing with transfer values and the maintenance of member records. Employer related costs are excluded.
- Investment management expenses include fees to the investment managers, the custodian, the actuary for investment related services and the performance measurement services together with the County Council costs incurred on administration and monitoring of investment related issues.

Fund Account for the Year ended 31 March 2006

	Note	2006 £000	2005 £000
Contributions and Benefits			
Contributions receivable	1	103,281	90,324
Transfers in		18,765	16,782
		122,046	107,106
Benefits payable	2	68,143	62,830
Leavers	3	12,075	13,422
Administrative expenses		1,175	1,020
		81,393	77,272
Net additions from dealings with members		40,653	29,834
Returns on Investments			
Investment income	5	32,029	27,982
Change in market value of investments		281,492	107,797
Investment management expenses	4	(4,129)	(3,466)
Net returns on investments		309,392	132,313
Net increase (decrease) in the Fund during the year		350,045	162,147
Net Assets of the Fund At 1 April		1,267,702	1,105,555
At 31 March		1,617,747	1,267,702

Statement of Net Assets as at 31 March 2006

	Note	2006 £000	2005 £000
Investment Assets	14		
Fixed Interest Securities		254,859	204,259
Index Linked Securities		28,088	30,202
Equities		1,173,042	908,867
Property Unit Trusts		92,833	74,210
Development Capital		13,784	15,339
Cash		45,941	26,304
		1,608,547	1,259,181
Net Current Assets	6	9,200	8,521
Net Assets of the Fund at 31 March		1,617,747	1,267,702

I certify that the Statement of Accounts presents fairly the financial position of the Pension Fund at 31 March 2006 and the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after that date.

Philip Walker
Head of Finance
October 2006

1 Contributions Receivable	2005/2006 £000	2004/2005 £000
Employees' basic		
Administering Authority	12,701	11,903
Scheduled Bodies	9,393	8,880
Admitted Bodies	2,162	2,148
Employees' additional		
Administering Authority	154	112
Scheduled Bodies	111	95
Admitted Bodies	36	37
Employers' basic		
Administering Authority	41,693	36,237
Scheduled Bodies	27,381	23,813
Admitted Bodies	6,104	5,031
Employers' additional		
Administering Authority	1,992	135
Scheduled Bodies	817	1,661
Admitted Bodies	737	272
	103,281	90,324

2 Benefits Payable	2005/2006 £000	2004/2005 £000
Retired employees pensions		
Administering Authority	24,581	23,184
Other Scheduled and Admitted Bodies	26,165	24,767
Lump sums		
Administering Authority	5,709	3,301
Other Scheduled and Admitted Bodies	4,221	4,656
Death grants		
Administering Authority	752	811
Other Scheduled and Admitted Bodies	663	337
Widows' pensions		
Administering Authority	2,511	2,403
Other Scheduled and Admitted Bodies	3,260	3,181
Children's pensions		
Administering Authority	150	75
Other Scheduled and Admitted Bodies	57	50
Total*	68,069	62,765

*Please note the total does not include interest on late payment of benefits £73,316

3 Leavers	2005/2006 £000	2004/2005 £000
Transfers	11,895	12,928
Refunds of contributions	153	352
State scheme premiums	27	142
	12,075	13,422
4 Investment Management	3,907	3,056
Investment management and custodial fees	68	271
Actuarial, performance measurement and legal fees	154	139
Internal administration and accounting	4,129	3,466
5 Investment Income		
Fixed Interest	5,161	6,033
UK	2,820	2,927
Overseas		
Index Linked	251	323
UK	241	207
Overseas		
Equities	16,191	13,006
UK	2,878	2,721
Overseas	2,898	1,800
Property Unit Trusts		37
Development Capital	1,559	907
Cash	30	21
Underwriting Commission	32,029	27,982
6 Current Assets and Liabilities		
Debtors	7,156	6,412
Investment income	3,046	3,130
Contributions	0	3
Inland Revenue	361	411
Benefits (including transfer values)	10,563	9,956
Creditors		0
Contributions	230	0
Benefits (including transfer values)	33	387
Inland Revenue	1,100	1,048
Investment expenses	1,363	1,435

7 **Unlisted Securities**
The value of unlisted securities in the Fund at 31 March 2006 is £13,784,214 (31 March 2005 is £15,339,047).

8 **Outstanding Commitments**
At 31 March 2006 the Fund held part paid investments on which the liability for future calls amounted to £47,508,704. The Fund had no sub-underwriting commitments as at 31 March 2006.

9 **Forward Currency Contracts**
At 31 March 2006 the Fund had 9 forward currency contracts in place with a net unrealised loss of £784,152.

10 **Additional Voluntary Contribution (AVC's)**
AVC's are paid to Prudential Life Assurance with a small number still being paid to Equitable Life. AVC's are not included in the accounts of the Pension Fund.

11 **Book Cost**
The book cost of all investments at 31 March 2006 is £1,264,062,909 (£1,164,259,298 at 31 March 2005).

12 **Custody**
Custody arrangements for securities and cash balances are provided by Surrey's Global Custodian, The Northern Trust Company. Custodian arrangements for the managers responsible for development capital are as follows:

ISIS Capital	RBS Trust Bank
Goldman Sachs	Investors Bank & Trust Company
HG Capital	Bank of New York
Merrill Lynch	Mellon Bank

13 **Related Party Transactions**
Employer pension contributions paid by Surrey County Council and Probation in 2005/2006 were £43,964,988 (£39,634,213 in 2004/2005).

Employers normal contributions	£24.5m
Annual monetary amount	£17.2m
Early retirement liabilities	£2.3m

Net amounts owed by Surrey County Council to the Fund as at 31 March 2006 were £18,825,877, (£7,117,913 as at 31 March 2005). Employer normal contributions include a prepayment of £217,000.

14 Investments	Value at 1 April 05 £000	Purchases at Cost £000	Sale Proceeds £000	Market Movements £000	Value at 31 March 06 £000
Fixed Interest Securities	204,259	123,319	78,967	18,150	266,761
Index Linked Securities	30,202	11,813	18,644	(7,186)	16,185
Equities	908,867	202,768	185,598	247,006	1,173,043
Property Unit Trusts	74,210	19,655	24,216	23,184	92,833
Development Capital	15,339	6,743	5,138	(3,160)	13,784
Cash					
Cash Instruments	-	-	-	-	
Deposits	26,304	16,139		3,498	45,941
	1,259,181	380,437	312,563	281,492	1,608,547

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

		31 March 2006 £000	31 March 2005 £000
14.1	**Fixed Interest Securities**		
	UK public sector & quoted	112,776	86,340
	UK unit trusts	57,265	38,551
	Overseas public sector & quoted	62,590	60,122
	Overseas unit trusts	22,228	19,246
		254,859	204,259
14.2	**Index Linked Securities**		
	UK public sector & quoted	11,182	12,224
	UK unit trusts	11,902	10,032
	Overseas public sector	5,004	7,946
		28,088	30,202
14.3	**Equities**		
	UK quoted	481,244	389,102
	UK unit trusts	204,494	158,162
	Overseas quoted	217,840	160,527
	Overseas unit trusts	269,464	201,076
		1,173,042	908,867
14.4	**UK Property Unit Trusts**	92,833	74,210
14.5	**Development Capital**		
	UK unquoted	3,429	7,549
	UK unit trusts	10,355	7,790
		13,784	15,339
14.6	**Cash**		
	Sterling deposits	51,051	24,822
	Amounts owed to brokers	(4,326)	(608)
	Foreign currency	-	1,766
	Forward Contracts	(784)	324
		45,941	26,304
	Total Investments	1,608,547	1,259,181

15 **Post Balance Sheet Events**
There have been no material post balance sheet events.

Appendix 1

The Fund's Largest Shareholdings

	Market Value at 31/03/2006 £m
Top 10 United Kingdom Equities	
BP PLC	44.0
GlaxoSmithKline	28.8
Vodafone Group	26.8
Royal Bank of Scotland	23.9
HSBC	23.4
Royal Dutch Shell	22.0
Barclays	17.2
HBOS	15.2
Prudential	10.9
BT Group	9.6
	221.8
Top 10 Overseas Equities	
Jardine Matheson	4.0
Schlumberger Ltd	2.6
Costco Whsl Corp	2.5
Noble Corporation	2.2
Transocean	2.1
Halliburton	2.1
JP Morgan Chase and Co	1.9
Sumitomo Mitsui	1.9
Ecolab	1.8
Mitsubishi UFJ	1.8
	22.9
Top 5 Unit Trusts	
Legal & General UK Equity	
UBS Asset Life Global Optimal	176.8
Citigroup Emerging Markets	69.5
Schroder Retail European	54.0
Legal & General All Stocks Gilt	51.8
	32.4
	384.5
	629.2

These holdings make up 39.1% of the total value of the portfolio.

Appendix 2

Employing Bodies and Contribution Rates payable in 2005/2006

Scheduled Bodies	% of payroll	% of Members' contributions	Annual monetary amount £
Administering Authority			
Surrey County Council	11.6	193	16,720,000
Borough and District Councils			
Elmbridge Borough Council	11.7	195	493,000
Epsom & Ewell Borough Council	12.5	208	584,000
Guildford Borough Council	11.3	188	1,632,000
Mole Valley District Council	12.1	201	388,000
Reigate & Banstead Borough Council	12.0	200	794,000
Runnymede Borough Council	12.5	208	-
Spelthorne Borough Council	12.3	205	-
Surrey Heath Borough Council	12.8	213	-
Tandridge District Council	12.6	210	962,000
Waverley Borough Council	13.0	216	964,000
Woking Borough Council	11.6	193	1,470,000
Parish and Town Councils			
Ash Parish Council	14.6	243	20,723
Bramley Parish Council	14.6	243	476
Bisley Parish Council	14.6	243	-
Claygate Parish Council	12.0	200	41
Cranleigh Parish Council	14.6	243	10,277
East Horsley Parish Council	13.9	231	
Farnham Town Council	14.6	243	9661
Frensham Parish Council	12.0	200	145
Godalming Town Council	14.6	243	8,870
Godstone Parish Council	12.9	215	-
Haslemere Town Council	12.0	200	38
Horley Town Council	14.6	243	7,786
Ripley Parish Council	14.6	243	819
Send Parish Council	14.6	243	723
Shere Parish Council	14.6	243	1,749
Tongham Parish Council	14.6	243	161
Warlingham Parish Council	12.9	215	-
West End Parish Council	12.0	200	36
Windlesham Parish Council	14.6	243	3,095
Witley Parish Council	14.6	243	1,952
Worplesdon Parish Council	12.0	200	247

Scheduled Bodies	% of payroll	% of Members' contributions	Annual monetary amount £
Other Authorities			
The Surrey Police Authority	10.1	168	931,000
Statutory Committees			
Surrey Probation Committee	11.1	185	254,000
Surrey Valuation Tribunal	7.9	132	-
Further Education Establishments			
Brooklands College	17.0	283	-
East Surrey College	17.1	285	-
Esher College	14.1	235	-
Farnham College	14.1	235	-
Godalming College	14.1	235	-
Guildford College	16.5	275	-
NESCOT	17.0	283	-
Reigate College	14.1	235	-
Spelthorne College	14.1	235	-
Strode's College	14.1	235	-
The University College for Creative Arts	14.8	247	-
Woking College	14.1	235	-
Former Grant Maintained Schools			
The Beacon School	21.4	356	-
Binscombe Junior School	21.4	356	-
Blenheim High School	21.4	356	-
Burpham Primary School	21.4	356	-
Burstow Primary School	21.4	356	-
Bushy Hill Junior School	21.4	356	-
Cleves Junior School	21.4	356	-
Collingwood College	21.4	356	-
De Stafford College	21.4	356	-
Epsom & Ewell High School	21.4	356	-
Fullbrook School	21.4	356	-
Glyn School	21.4	356	-
Godstone Village School	21.4	356	-
Gordon's School	21.4	356	-
The Guildford County School	21.4	356	-

Scheduled Bodies	% of payroll	% of Members' contributions	Annual monetary amount £
Hawkedale School	21.4	356	-
Heathside School	21.4	356	-
Hinchley Wood School	21.4	356	-
Holy Trinity School, Guildford	21.4	356	-
Jubilee High School	21.4	356	-
Kings College	21.4	356	-
Kings International School	21.4	356	-
The Manor School	21.4	356	-
Northmead School	21.4	356	-
Park Mead Primary	21.4	356	-
Pewley Down School	21.4	356	-
Rosebery School	21.4	356	-
St John The Baptist School	21.4	356	-
St Paul's Catholic College	21.4	356	-
Salesian School	21.4	356	-
Sayes Court School	21.4	356	-
Send C of E First School	21.4	356	-
The Stoneleigh School	21.4	356	-
Tadworth Primary School	21.4	356	-
Thamesmead School	21.4	356	-
Wallace Fields Junior School	21.4	356	-
Whyteleafe School	21.4	356	-
The Winston Churchill School	21.4	356	-
Woodlea Primary School	21.4	356	-
Woodville School	21.4	356	-
Yattendon Junior School	21.4	356	-
Joint Boards or Joint Committees			
Epsom & Walton Downs Conservators	14.6	243	16,846
Merton & Sutton Joint Cemetery Board	14.6	243	15,517
Nonsuch Park Joint Management Committee	14.6	243	17,974

Appendix 3

Admitted Bodies	% of payroll	% of Members' contributions
With Contributing Employees		
A2 Housing Group	35.6	593
Carillion	15.5	258
Elmbridge Housing Trust	14.3	238
G Burley & Sons	11.8	197
Hanover Housing Association	16.4	273
John Stanley Jeffries Swimming Pool Trust	23.0	383
Moor House School	15.8	263
Commission for Social Care Inspection	17.3	288
Peerless Housing Group	23.4	390
Peper Harow Foundation (Thornby Hall)	53.4	890
Princess Alice Hospice	23.0	383
Reigate Grammar School	23.0	383
Raven Housing Trust	15.6	260
Ringway Highway Services Ltd	16.6	277
Rosebery Housing Association	23.0	383
Royal Grammar School, Guildford	23.0	383
SERCO	9.9	165
Sir William Perkins's School	23.0	383
Surrey Alcohol and Drug Advisory Service	11.6	193
Surrey Community Development Trust	12.2	203
Surrey Voluntary Association for Visual Impairment	23.0	383
Surrey Wildlife Trust	13.7	228
University of Surrey	17.9	298
VT Four S	11.6	193
Waverley Community Transport	11.4	190
Woking Community Transport	23.0	383

Without Contributing Employees

Banstead Common Conservators
East Surrey Water Company
Godalming Joint Burial Committee
Haslemere SC/Shottermill
Lingfield HPL School
Meath Homes
Mid Southern Water
North Surrey Water Company
Nut Prob HM (Rainer)
Peper Harow School
Royal Philanthropic SC
South East Regional Arts
SE Employers Assn
Shalford Parish Council
Southlands College
Spelthorne Housing Assn
Surrey Police committee
The Royal School, Hindhead
WESCAD
West Surrey Waterboard
Woking Meals Service

Appendix 4

Funding Strategy Statement

Introduction:

Purpose of the Fund Strategy Statement

1 The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 came into effect on 1 April 2004. The Regulations provide the statutory framework within which LGPS administering authorities were required to prepare a Funding Strategy Statement (FSS) by 31 March 2005.

2 The purpose of the funding strategy is:

- to establish a clear and transparent fund-specific strategy, which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory requirement to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities

3 The intention is for this strategy to be both cohesive and comprehensive for the fund as a whole, recognising that there will be conflicting objectives that need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the FSS, it must remain a single strategy for the administering authority to implement and maintain.

4 As administering authority of the Surrey LGPS, Surrey CC addressed the key requirement of consulting with all relevant interested parties involved with the pension fund – for example, local authority employers; admitted bodies; scheduled/resolution bodies – before preparing and publishing the pension fund funding strategy.

5 This FSS should be read in conjunction with the County Council's report on the outcome of the 2004 actuarial valuation.

Background to the Surrey Pension Fund

6 The total value of the Pension Fund, as at 31 March 2005, was £1.3bn and in 2004/2005 employer contributions into the pension fund amounted to £67m.

7 There are over 100 employers involved in the Surrey Pension Fund. The largest employers, in terms of the number of active members and monetary contributions to the Pension Fund, are Surrey County Council, the Borough and District Councils, Surrey Police Authority and the University of Surrey.

8 The level of contributions into the fund to be paid by each employer is determined by the triennial actuarial valuation. The 2004 actuarial valuation determined the level of contributions to be paid by employers during the period 1 April 2005 to 31 March 2008. The draft results of the valuation were received at the beginning of December 2004, allowing employers to incorporate any changes in contribution rates into the budget setting process for 2005/2006.

The aims and purpose of the Pension Fund

9 The aims of the Fund are to:

- enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies
- manage employers' liabilities effectively
- ensure that sufficient resources are available to meet all liabilities as they fall due
- maximise the returns from investments within reasonable risk parameters.

10 The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and

expenses, as defined in the Local Government Pension Scheme Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (As Amended).

Responsibilities of key parties

11 Surrey County Council, as administering authority, will:
- collect employee and employer contributions
- invest surplus monies in accordance with the relevant regulations
- ensure that cash is available to meet liabilities as and when they fall due
- manage the actuarial valuation process in consultation with Hymans Robertson, the Fund actuary
- prepare and maintain a Funding Strategy Statement (FSS) and a Statement of Investment Principles (SIP), both after proper consultation with interested parties, and
- monitor all aspects of the Fund's performance and funding and amend the FSS/SIP as appropriate

12 Individual employers in the Fund will:
- deduct contributions from employees' pay correctly
- pay all contributions, including their own as determined by Hymans Robertson, promptly by the due date
- exercise discretions within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain, and
- notify Surrey County Council promptly of all changes to membership,
- or as may be proposed, which affect future funding.

13 Hymans Robertson, the fund actuary, will:
- prepare actuarial valuations, including the setting of employers'contribution rates after agreeing assumptions with the administering authority and having regard to the FSS, and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

Solvency issues and target funding levels

14 Surrey County Council, as administering authority, prudentially seeks to achieve full funding.

Background

15 For many years up to 1989, legislation required that the Fund was adequate to meet all liabilities, i.e. was 100% solvent. In 1989 the regulations in force specified that the target level of funding need only be 75% of future liabilities, thereby leading to a reduction in costs that was intended to offset the impact of the new community charge system.

16 A further complexity arose in 1990 following the 1989 review. Prior to that year the employers' contribution had been set in two parts.

i A rate was set to provide for the basic benefits of the Scheme through the Fund

ii A further rate was set to meet the cost of pensions increases and other non-statutory benefits on a "pay as you go" basis. Pensions increases are the annual uprating of pensions in payment for cost of living.

17 Following the implementation of new regulations from 1 April 1990, the cost of inflation proofing both pensions payments and deferred benefits was incorporated within the overall fund and met through a single employers' contribution rate. This change resulted in a reduction in the solvency level and also to an overall reduction in employers' contributions.

18 Regulations issued by the Department of the Environment in 1992 specified a return to the former target funding level of 100%. The consequence of the Regulation is that, since April 1993, those employers with an excess of liabilities over assets ("past service deficiency") have been paying additional contributions into the Fund in order to return to 100% solvency over the remaining working lifetime of the members of the Fund (an average of 13 years).

19 The last actuarial valuation, as at 31 March 2001, determined that the fund was 75% funded, i.e. that the assets of the fund were sufficient to cover 75% of its liabilities. The reasons behind this funding level include those issues mentioned above, together with a change in the tax treatment of pension funds in 1997, which removed the ability for funds to claim credits on tax paid on dividends. This government policy change reduced the funding level of the Surrey Fund by around 8%.

20 The overall funding level remained broadly unchanged over the three year inter-valuation period (1998 – 2001), mainly because poor investment performance relative to the 1998 valuation assumptions offset the contributions being made toward the deficiency.

The 2004 Actuarial Valuation

21 During summer 2004 Surrey County Council had preliminary discussions with Hymans Robertson, to establish ways of responding to the likely outcome of the 2004 actuarial valuation. Early indications were that the whole fund funding level would reduce, leading to an increase in lump sum payments into the Fund. However, ongoing contribution rates were expected to be relatively stable, given the recent changes in the regulations governing the application of the LGPS.

22 A number of ways of mitigating the impact of these results on employers were identified including:
- Increasing the length of time over which fund deficits will be recovered
- Applying different spread period for different employers to reflect the funding level of each individual employer
- Applying different spread periods for different employers to reflect the funding status of each individual employer (i.e. whether or not the employer has tax raising powers)
- Changing the financial assumptions used within the valuation
- Changing the investment assumptions used within the valuation
- Changing the approach for 'closed' employers, i.e. those employers that are no longer accepting new members.
- Grouping certain employers to recognise common characteristics, e.g. size of membership

23 The purpose of this FSS is to have full transparency regarding the options available to employers.

24 As administering authority, Surrey County Council recommends as consistent an approach as is possible. However, it is acknowledged that some employers have unique features that should be recognised when setting the assumptions to be used in the actuarial valuation.

25 Ultimately, it remains Surrey CC's intention to have as stable a long-term employer contribution rate as is possible.

The 2004 valuation results

26 The following table summarises the main results of the 2004 valuation:

	2001 Valuation	2004 Valuation
Active Members		
Number of active members	20,510	22,100
Total Annual Pensionable Pay	£290.5m	£434.4m
Average Pensionable Pay	£14,164	£19,656
Deferred Pensions		
Number of Deferred Pensioners	10,079	14,656
Total annual value of deferred pensions payable in future	£15.0m	£20.9m
Pensioners and Widow(er)s		
Number of pensioners	13,111	14,293
Total annual pensions payable	£48.3m	£53.3m
Average pension in payment	£3,684	£3,729
Value of Liabilities	£1,317.0m	£1,623.0m
Market Value of the Fund	£988.9m	£1,105.6m
Solvency Level of the Fund	75.0%	68.0%

27 As expected, the solvency level of the Fund reduced to 68%. Consequently employer contribution rates had to increase.

28 The employer's contribution rate consists of two elements:

i The ongoing rate, when following the 2001 actuarial valuation was 160% of employees' contributions, which provides the year-by-year accrual of benefits for current employees

ii A lump sum in respect of past service liabilities, currently £26.1m in 2004/2005 and estimated to increase by inflation.

29 Following discussions with the Fund actuary, the following measures were adopted to mitigate the impact of the increase in contribution rates:

Ongoing Rate

30 Allowance for the proposed abolition of the 'rule of 85'. This measure reduced future service contribution rates by 1.6%.

31 Allowance for the Fund's investment strategy and expected future returns on investments. The Fund's current asset allocation strategy was derived following an asset-liability modelling (ALM) study of the Fund in the summer 2000. This resulted in a decision to invest 75% of the Fund in equities and 25% in fixed interest stocks and property. This new benchmark was implemented in November 2000.

32 Having analysed historic results and future projections of equity returns the Fund Actuary and the administering authority recommend that credit should be taken for the additional return that the Fund should generate due to being more heavily invested in equities. To ensure prudence it was assumed that this return will be 2% p.a. more than that which may be achieved if the fund was invested solely in government bonds. This measure reduced future service contribution rates by 7.3% of payroll.

Lump Sum Rate

33 The second element of the contributions made by employing authorities is the contribution paid to liquidate the deficit on the pension fund. The 2004 valuation found that the overall fund deficit increased from £328m to £516m. Historically the deficit has been recovered over the remaining working lifetime of active employees in the Fund. At the 2001 valuation this was determined to be 13 years. If the deficit continued to be spread over 13 years then the average annual employer contribution to liquidate the deficit would amount to 16.6% of payroll (giving a total employer contribution rate of 28.2% of payroll.)

34 However, given the abolition of the 'rule of 85' it was not unreasonable to increase the period over which the Fund deficit is recovered. The actuary assessed that the average age of employees in the Fund is 44.4 years. Therefore each employee has a remaining working lifetime of around 20 years.

35 The Fund Actuary and the administering authority therefore recommended recovering the deficit over 20 years, resulting in an average past service adjustment of 8.9% of payroll (a reduction of 7.7% of payroll), to be expressed in monetary terms for the purpose of effective budgeting. Again lump sums paid by individual employers will vary depending on the size of the employer's share of the pension fund deficit. The total recommended average employer contribution rate (expressed as a percentage of payroll) therefore comprises:

a.	Future service funding rate	11.6%
b.	Past service adjustment	8.9%
c.	TOTAL	20.5%

"Stepping" of Increases in Contributions

36 In 1995 it was agreed that, in order for the Fund to return to 100% solvency, the employers could make stepped increases in contributions to fund past service liabilities. The steps were to be made over a 6-year period after which the annual contributions would be fixed at the final stepped rate determined by the actuary. There are a handful of employers that, despite the increase in the deficit recovery period and due to circumstances specific to each employer, saw a disproportionately large increase in lump sum payments to be made in 2005/2006 compared to the previous financial year. These employers were advised that it may be possible to adopt the 1995 stepping approach.

37 Those employers with less onerous increases in lump sum contributions were offered the opportunity to step their increase over the 3-year inter-valuation

period. The administering authority, however, advised that any employer that chose to step the increases in contributions must be aware that they would be making smaller inroads into the overall deficit, which will be reflected in the 2007 actuarial valuation.

Consultation

38 The larger employers in the Fund were fully consulted on the approaches taken to mitigate the impact of the 2004 actuarial valuation. This consultation includes written communication and attendance at meetings of the Surrey Treasurers' Association.

39 The Borough and District Councils agreed individual approaches to spreading the impact of the increase in the relevant share of the pension fund deficit. Some employers chose to step the increase in lump sum payments, while others opted to implement the full rate in 2005/2006.

40 These employers have also agreed the blanket approach of taking into account the abolition of the rule of 85 and the adoption of a 2% Equity Risk Premium.

Links to the Fund's Investment Policy set out in the Statement of Investment Principles

41 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.

42 The Fund's Statement of Investment Principles is a formal statement of how the County Council carries out these responsibilities.

43 The Investment Advisers Group, having regard to funding levels, cash needs and risk tolerance, determines the overall Fund asset mix. The last asset-liability modelling (ALM) study took place in 2000 and the resultant customised benchmark was implemented in November 2000. The 2006 ALM study and Fund structure review will conclude early in 2007.

The Identification of risks and counter-measures

44 The County Council recognises that there are certain risks that may impact on this FSS. These risks and measures to be taken to counter these risks include:

Financial risks	Counter Measures
Investment markets fail to perform in line with expectations	Do not over-estimate the equity risk premium adopted for the actuarial valuation
Market yields move at variance with assumptions	Apply sensitivity analysis to determine, in advance, the likely financial impact of a 1% deviance from expectations
Investment managers fail to achieve performance targets over the longer term	The Investment Management Agreement (between SCC and the fund manager) clearly states the Customer's expectations in terms of performance targets. Investment manager performance is reviewed on a quarterly basis. The Investment Advisers Group is positioned to move quickly if it is felt that targets will not be met.
Asset reallocations in volatile markets may lock in past losses	The Fund's passive (index-tracking) manager rebalances the fund's asset allocation on a monthly basis.
Pay and price inflation is significantly more or less than anticipated	Apply sensitivity analysis to determine, in advance, the likely financial impact of a 0.5% deviance from expectations
The effect of a possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies	Apply different deficit recovery periods to reflect the financial standing of employers
Demographic risks	
The longevity horizon continues to expand	Hymans Robertson is using long-term longevity projections (30 years) in the 2004 actuarial valuation
Deteriorating pattern of early retirements	The cost of early retirements is recovered from employers as and when they occur
The impact of government policy (e.gThe Gershon review) on the employer workforce	Hymans Robertson will make prudent assumptions about the future local government workforce, under the guidance of the administering authority.

Regulatory risks	
Changes to LGPS regulations	Hymans Robertson will take into account the impact of the Local Government Pension Scheme (Amendment) Regulations 2004 in the actuarial valuation.
Changes to national pensions requirements and/or Inland Revenue rules	Kept under continual review.
Governance	
Administering authority unaware of structural changes in an employer's membership	Employers are required to inform Surrey CC of any significant changes in membership numbers on a timely basis. Surrey CC monitors employer contributions on a monthly basis and queries any obvious variations. Employers are required to produce a year-end report on membership numbers. The County Council carries out in depth movement analysis on an annual basis.
Administering authority not advised of an employer closing to new entrants	This is only relevant to employers with an admission agreement (scheduled and resolution bodies cannot close the scheme to new entrants). It is a requirement of the admission agreement that Surrey CC is informed if the employer closes to new members
An employer ceasing to exist with insufficient funding or adequacy of a bond	Admitted body contribution rates are set at a level that is intended to reflect 100% funding. The terms of a bond provide for regular review of the adequacy of a bond.

Consultation and Publication

45 The larger employers in the Surrey Pension Fund were fully consulted on the approaches taken to mitigate the impact of the 2004 actuarial valuation. The major employers were also asked to approve the first draft of the FSS. This statement will be reviewed as part of the 2007 actuarial valuation process.

Myners Investment Principles-Compliance Statement

Statutory Instrument 2002 No. 1852 requires that Surrey County Council, administering authority of the Surrey Pension Fund, publish details of the extent to which the Fund complies with the ten principles identified as indicators of best practice in the Myners Review of Institutional Investment. The following summarises these principles and explains how Surrey County Council has complied with the principles. Further information is available in the Statement of Investment Principles.

Principle 1
Effective Decision-making

Decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advise they take.

Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities. Trustees should also be paid, unless there are specific reasons to the contrary.
It is good practice for trustee boards to have an investment sub-committee to provide the appropriate focus.
Trustees should assess whether they have the right set of skills, both individually and collectively, and the right structures and processes to carry out their role effectively. They should draw up a forward-looking business plan.

Full compliance – a rolling programme of training is in place for the Investment Advisers Group. The group is supported by the Head of Finance, the Pension Fund and Treasury Manager.

Principle 2
Clear Objectives

Trustees should set out an overall investment objective for the fund that:

- Represents their best judgement of what is necessary to meet the fund's liabilities given their understanding of the contributions likely to be received from employer(s) and employees; and
- Takes account of their attitude to risk, specifically their willingness to accept underperformance due to market conditions.

Objectives for the overall fund should not be expressed in terms which have no relationship to the fund's liabilities, such as performance relative to other pension funds, or to a market index.

Full compliance – the Fund's overall objectives are defined in a Funding Strategy Statement and are directly linked to the findings of the triennial actuarial valuation. The investment objectives are clearly stated in the Statement of Investment Principles and will next be reviewed as part of the 2006 Asset Liability Modelling study (ALM).

Principle 3
Focus on asset allocation

Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflects the contribution they can make towards achieving the fund's investment objective. Decision-makers should consider a full range of

investment opportunities, not excluding from consideration any major asset class, including private equity.
Asset allocation should reflect the fund's own characteristics, not the average allocation of other funds.

✓ **Full compliance – a customised benchmark has been in place since 2000 and will be reviewed as part of the 2006 ALM Study. The fund continues to invest in private equity.**

Principle 4
Expert advice
Contracts for actuarial services and investment advice should be opened to separate competition.
The fund should be prepared to pay sufficient fees for each service to attract a broad range of kinds of potential providers.

✓ **Full compliance – the Fund has separate actuarial and professional investment advisers.**

Principle 5
Explicit mandates
Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustees and managers on:

- An objective, benchmark(s) and risk parameters that together with all other mandates are coherent with the fund's aggregate objectives and risk tolerances;
- The manager's approach in attempting to achieve the objective; and
- Clear timescale(s) of measurement and evaluation, such that the mandate will not be terminated before the expiry of the evaluation timescale for underperformance alone.

The mandate and trust deed and rules should not exclude the use of any set of financial instruments, without clear justification in the light of the specific circumstances of the fund.
Trustees, or those to whom they have delegated the task, should have a full understanding of the transaction-related costs they incur, including commissions. They should understand all the options open to them in respect of these costs, and should have an active strategy – whether through direct financial incentives or otherwise – for ensuring that these costs are properly controlled without jeopardising the fund's other objectives.
Trustees should not without good reason permit soft commissions to be paid in respect of their fund's transactions.

✓ **Full compliance – the investment management agreements that were put in place in 2004 (following the appointment of new fund managers) clearly state each manager's objectives and parameters within which they are able to work to meet their objectives. Transaction costs are disclosed by the fund managers in line with industry best practice, and are monitored on a quarterly basis.**

Principle 6
Activism
The mandate and trust deed should incorporate the principle of the US department of Labor Interpretative Bulletin on activism.

Trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure the effectiveness of this strategy.

✓ **Partially compliant – the Statement of Investment Principles sets out the Fund's approach to corporate governance. Fund managers are expected to engage with companies in which they invest on the Fund's behalf and have delegated authority to exercise the Fund's voting rights.**

Principle 7
Appropriate Benchmarks
Trustees should:explicitly consider, in consultation with their investment manager(s), whether the index benchmarks they have selected are appropriate; in particular, whether the construction of the index creates incentives to follow sub-optimal investment strategies;

- if setting limits on divergence from the index, ensure that they reflect the approximations involved in index construction and selection;
- consider explicitly for each asset class invested, whether active or passive management would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned; and
- where they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving the managers the freedom to pursue genuinely active strategies.

✓ **Full compliance – customised benchmark and tolerance ranges for divergence from indices are constantly under review and subject to discussion between the Council, investment advisers and fund managers. Specialist managers have been appointed to maximise returns in each active asset class and outperformance targets reflect the risk/return requirements of both the Fund as a whole and the individual managers.**

Principle 8
Performance Measurement
Trustees should arrange for measurement of the performance of the fund and make formal assessment of their own procedures and decisions as trustees.

They should also arrange for a formal assessment of performance and decision-making delegated to advisers and managers

✓ **Full compliance – each manager's performance is measured regularly against targets which are specified in the contract between SCC and the manager. Northern Trust, the fund's global custodian, produces performance data for each manager and for the fund as a whole. The target outperformance for the fund as a whole is specified within the Statement of Investment Principles. The fund performance is also assessed with reference to the local authority peer group.**

Principle 9
Transparency
A strengthened Statement of Investment Principles should set out:

- who is taking which decisions and why this structure has been selected;
- the fund's investment objective;
- the fund's planned asset allocation strategy, including projected investment returns on each asset class, and how the strategy has been arrived at;
- the mandates given to all advisers and managers; and

the nature of the fee structures in place for all advisers and managers, and why this set of structures has been selected.

✓ Full compliance – the current SIP, read in conjunction with the Funding Strategy Statement, describes the arrangements that were put in place when new managers were appointed in 2004. Further details are included in the Fund's annual report and at the Pension Fund AGM.

Principle 10
Regular Reporting
Trustees should publish their Statement of Investment Principles and the results of their monitoring of advisers and managers.

They should send key information from these annually to members of these funds, including an explanation of why the fund has chosen to depart from any of these principles.

✓ Full compliance – pensions newsletters are sent to fund members and include summarised pension fund accounts. The SIP is published in the annual report, which is sent to employers and available to other stakeholders on request. The County Council's Audit and Governance Committee receives reports on the activities of the Investment Advisers Group. These reports are available on the County Council website.

Statement of Investment Principles

1 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. To content of this Statement reflects the County Council's compliance with the requirements of the Myners Review of Institutional Investment.

Investment policy and associated monitoring and review are delegated to the Head of Finance who exercises the power to invest the Fund's monies in consultation with the Investment Advisers Group, which is made up of:

- four nominated members of the County Council
- two representatives from the District Councils nominated by the SLGA
- a representative of the members of the Fund
- a representative of the Fund's professional investment adviser
- an independent adviser
- the Head of Finance

The Advisers meet quarterly and make a report to the County's Audit & Governance Committee. The Advisers are not trustees (technically the Department for Communities and Local Government is the trustee) but act in a quasi-trustee role.

2 Investment Objectives
The investment objectives are to maximise investment returns over the long term within specified risk tolerances. Investment returns are defined as the overall rates of return (capital growth and income).

3 Investment Style and Management
The investment style is to appoint expert Fund Managers with a clear performance benchmark and place maximum accountability for performance against that benchmark on the Fund Manager.

Historically, three active multi-asset managers managed the fund. This approach had proved effective for the County Fund over the longer term and where results had been less good reviews took place and fund managers replaced if appropriate, as happened in 1998.

In 2003 Watson Wyatt, the specialist investment adviser to the pension fund, advised that the prevailing fund management arrangements were sub-optimal and that a core-satellite structure should be considered. This structure

Type of funds	Level of Risk	Target Return Out-Performance p.a.
Passive (index-tracker)	Low	0 – 0.5%
Active core	Medium	0.75% - 2.0%
Satellite	High	3% – 4%
TOTAL	Medium	

sub-divides investments into three types, each with a different level of risk and target return profile:

The passive core consists of a range of asset classes where the investment objective is to track a relevant index (e.g. FTSE All-Share for UK equities) and produce a return that is as close as possible to the index return.

The active core consists of a range of asset classes where the investment objective is to beat the index by some 0.75% - 2% per annum. Due to the difficulty in finding fund managers that are "best in class" in all types of asset, the active core consists of specialist managers in the key asset classes of UK equities, Global Equities, Bonds and Property. Specialist managers are known for their investment expertise and returns in any one particular asset type, rather than for a bundle of asset types, as is the case with multi-asset or balanced managers.

The satellite structure contains a number of smaller fund managers specializing in specific equity regions with a higher investment target and, by implication, taking a higher level of risk. Following an extensive procurement exercise the Fund moved to a core-satellite structure in 2004. This resulted in substantial changes to the fund management arrangements with a move from 3 multi-asset managers to the following:

	Manager	% of Fund
Passive Core	Legal and General	20.0
Active Core		
UK Equity 1	SG Asset Management	12.5
UK Equity 2	UBS Global Asset Management	13.0
Global Equity 1	Marathon Asset Management	10.0
Global Equity 2	UBS Global Asset Management	4.5
Bonds	Western Asset Management	15.0
Property Fund of Funds	ING Real Estate	5.0
Satellite Managers		
UK Equity 1	Mirabaud	4.0
UK Equity 2	Majedie	4.0
US Equity	TCW	3.0
European Equity	Schroders	3.0
Pacific Basin Inc Japan Equity	JP Morgan Fleming	3.0
Emerging Markets Equity	Citigroup	3.0

The proportion of the fund allocated to each specialist manager was determined with reference to the overall asset allocation specified in the Fund's customised benchmark.

The number of new managers appointed under the new structure reflects the need to diversify by manager and the need to spread risk.

The Fund also has a commitment to invest up to 5% of the fund in private equity or development capital. This allocation is achieved by investing in fund of funds, managed by a number of private equity specialists. The investments are funded through cash flow.

4 Policy on Kinds of Investment

The Investment Advisers Group, having regard to funding levels, cash needs and risk tolerance, determines the overall Fund asset mix. The last asset-liability modelling (ALM) study took place in 2000 and the resultant customised benchmark was implemented in November 2000. The results of the 2006 ALM will be received by the IAG in November 2006.

Acceptable asset classes are

- UK equities
- UK fixed interest
- UK index linked gilts
- UK Property through pooled funds
- Overseas equities, major classes being
  - North America
  - Europe
  - Pacific Rim including Japan
  - Emerging Markets
- Global Bonds
- Overseas index linked stocks
- Unquoted securities via pooled funds
- Emerging market equities via pooled funds, unless specifically authorised
- Direct investment in development capital or development capital funds
- Use of derivatives and other financial instruments is permitted within pre-agreed limits for specific purposes such as asset allocation switches and currency hedging
- Underwriting is permitted provided that the underlying stock is suitable on investment grounds and complies with existing investment criteria
- Stock lending is only permitted subject to specific approval.

There are statutory limits on the proportion of the Fund that can be invested in certain types of investment as determined by the Local Government Pension Scheme (Management and Investment of Funds Regulations) 1998 (as amended from time to time).

5 Investment Performance Targets and Benchmarks

The over-riding aim is to run the Pension Fund in accordance with relevant legislation and the following performance target:

"to outperform the Surrey benchmark performance by 1% per annum over a rolling 3 year period, with a maximum underperformance of -2% in any one year."

The Surrey benchmark, against which the Fund's overall performance is measured, is shown below. The panel considers the Fund's overall actual performance compared to with what it would have been had the assets been invested in the proportions identified in the following table.

Asset Class	Benchmark Allocation %	Permitted tolerance range %	Index
UK Equities	45	40 - 50	FTSE All Share
Overseas Equities			
US/North America	9	5 – 13	FTSE World Index – North America
Europe	9	5 – 13	FTSE World Index – Europe
Japan	6	3 - 9	FTSE World Index – Japan
Pacific Rim	3	0 - 5	FTSE World Index – Asia Pacific
Emerging Markets	3	0 – 5	MSCI Index (Emerging Markets)
UK Fixed Interest Gilts	8	5 – 10	FTSE Actuaries Govt. All-Stock
Sterling non-Government Bonds	8	5 – 10	Merril Lynch All Non-Gilt Index
UK Index-Linked Gilts	1.5	0 - 5	FTSE Actuaries Govt. I-L All-stock
Overseas I-L Gilts	1.5	0 – 5	Lehman Bros. Over 5 yrs TIPS (Hedged)
Overseas Bonds	1	0 – 5	JP Morgan Global (ex UK) Traded Bond Index
Property	5	0 – 10	HSBC All Balanced Funds
Cash	0	0 – 5	LIBID 7 Day Rate

Individual Fund managers have different outperformance targets that reflect the level of risk to be taken by each manager and are summarised in the table below. Individual manager performance is measured with reference to the relevant portion of the benchmark, e.g. the UK equity managers are measured with reference to the FTSE All-Share index, and the relevant individual outperformance target.

Type of funds	Level of Risk	Target Return Out-Performance p.a.
Passive (index-tracker)	Low	0 – 0.5%
Active core	Medium	0.75% - 2.0%
Satellite	High	3% – 4%
TOTAL	Medium	

The performance target for the Development Capital Funds is to outperform returns on quoted UK equities, as measured by the FTSE All Share Index, by 2% p.a..

6 Policy on Risk

Fund Managers are required to implement appropriate risk management measures and to operate in such a way that the possibility of undershooting the performance target is kept within acceptable limits. Active monitoring of individual manager and overall portfolio risk is maintained through the use of an independent risk monitoring service.

7 Policy on Balance Between Different Kinds of Investment

The Council has set target asset allocation ranges for each kind of investment within the overall benchmark. Fund Managers are required to report quarterly their current country, sector or asset allocation positions, whichever is relevant, against their strategy, and to seek approval for variations to their strategies.

8 Policy on Realisation of Investments

Fund Managers are required to maintain portfolios that consist of assets that are readily realisable. Any investment within an in-house or pooled fund, which is not readily tradable, requires specific approval.

9 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 Actuary as the average expected future working lifetime of the scheme membership (currently 20 years).

Investment strategy will be reviewed annually, with a major review taking place triennially following the actuarial review. The SIP will also be reviewed annually.

A review of investment management arrangements is carried out every five 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 Investment Advisers Group.

An Annual General Meeting is held and is open to all Fund employers and members.

10 Ethical and Environmental Investment

The Council wishes to have an active influence on issues of environmental or ethical 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 expects the Fund Managers to take note of the possibility that substantial ethical or environmental considerations may be among those bringing a particular investment decision into the "potentially contentious" category referred to in paragraph 11 below.

11 Corporate Governance

The Fund wishes to be an active shareholder and exercise its voting rights to promote and support good corporate governance principles. In practice, Managers are delegated authority to exercise the Fund's voting rights in this respect subject to seeking the Council's specific approval in respect of potentially contentious issues (those which receive significant press or media coverage) and reporting quarterly on action taken.

12 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 holds only a minimum working cash balance.

13 Administration
On behalf of the County Council, the Head of Finance is required to exercise continual monitoring of the managers' investment related actions and administration. This includes

- maintaining the investment ledger and suitable accounting procedures for Fund assets
- preparing and submitting statistics quarterly for performance measurement independent of the managers
- preparing a quarterly report to Investment Advisers Group and the Audit and Governance Committee
- preparing the audited annual report and accounts for employing bodies – in line with statutory deadlines
- publishing a report on the County website that is available to stakeholders
- maintaining an up to date record of cash balances at Surrey to ensure surplus cash is invested promptly or that resources are available to meet the benefit outflow as it arises.

Contacts

Benefits and Contributions
Enquiries should be directed in writing to Pension Services at the following address:

Pensions Unit
Room G59
County Hall
Kingston Upon Thames
Surrey KT1 2EB
Telephone: 020 8541 9289 or 9292
E Mail: pensions@surreycc.gov.uk
Fax: 020 8541 9287

Accounts and Investments
Information regarding the accounts and investments can be obtained from The Pension Fund and Treasury Manager on 020 8541 9894.

Pension Scheme Regulations
1997 Regulations S.I. 1997/1612
Copies may be obtained from:

The Stationery Office Ltd
2nd Floor
St Crispins
Duke Street
Norwich
NR3 1PD
Website:
www.opsi.gov.uk/si/sp1997/19971612.htm

Useful Addresses
Registrar of Pension Schemes
PO Box 1NN
Newcastle upon Tyne
NE99 1NN 019 1225 6316

The Pensions Advisory Service (TPAS)
11 Belgrave Road
London
SW1V 1RB 084 5601 2923

Pensions Ombudsman
11 Belgrave Road
London
SW1V 1RB 020 7834 9144

Employee and Employer Guides
The Department for Community and Local Government has produced guides to the Pension Scheme Regulations. These are available on request from Pension Services.
National Website www.lgps.org.uk

Glossary of Terms

Accruals based accounting
The most commonly used accounting method, which reports income when earned and expenses when incurred, as opposed to cash basis accounting, which reports income when received and expenses when paid.

Active Management
A style of management where the fund manager aims to outperform a benchmark by superior asset allocation, market timing or stock selection (or a combination of these). Compare with passive management.

Actuary
An independent consultant who advises the County Council on the financial position of the Fund. See actuarial valuation.

Actuarial Valuation
This is an assessment done by an actuary, usually every three years. The actuary will work out how much money needs to be put into a pension fund to make sure pensions can be paid in the future.

Additional Voluntary Contribution (AVC)
An option available to individuals to secure additional pensions benefits by making regular payments in addition to the 6% or 5% of basic earnings payable.

Admitted Bodies
Employers whose staff can become members of the Fund by virtue of an admission agreement made between the administering authority and the employer.

Annualised Return
The rate of return for any given period expressed as the equivalent average return per annum.

Asset Allocation
The apportionment of a fund's assets between asset classes and/or world markets. The long-term strategic asset allocation of a fund will reflect the fund's investment objectives. In the short term, the fund manager can aim to add value through tactical asset allocation decisions.

Attribution
Used to explain the differences between a portfolio's return and a benchmark return. Two main factors contribute to this difference: asset allocation strategy and stock selection.

Balanced Management
The fund manager invests in a range of asset classes, as defined by a fund's benchmark.

Benchmark
A yardstick against which the investment policy or performance of a fund manager can be compared. The Surrey Fund's benchmark is customised, meaning that it is tailored to the Fund's liability profile.

Bond
A debt investment with which the investor loans money to an entity (company or government) that borrows the funds for a defined period of time at a specified interest rate.

Book cost
The value of an asset as it appears on a balance sheet, equivalent to how much was paid for the asset (less liabilities due). Book cost often differs substantially from market value.

Broker
An individual or firm that charges a fee or commission for executing buy and sell orders submitted by an investor.

Commission
A service charge assessed by an agent in return for arranging the purchase or sale of a security or real estate. The commission must be fair and reasonable, considering all the relevant factors of the transaction. (Underwriting commission)

Corporate Bond
A debt security issued by a corporation, as opposed to those issued by the government.

Corporate Governance
The system by which companies are run, and the means by which they are responsible to their shareholders, employees and other stakeholders.

Core-satellite
Where the bulk of a fund's assets (core) are invested in a controlled manner to provide stable returns (possibly as a passive fund or lower risk active fund). The remainder of the fund's assets (often called the satellite portfolio) can then be managed in a more aggressive way in search of higher returns.

Creditors
Amounts owed by the pension fund

Custody
Safe-keeping of securities by a financial institution. The custodian keeps a record of the client's investments and may also collect income, process tax reclaims and provide other services such as performance measurement.

Debtors
Amounts owed to the pension fund

Derivative
Used to describe a specialist financial instrument such as options or futures contracts. Financial instruments are agreements to buy or sell something, under terms laid out in a contract.

Development Capital
See private equity.

Diversification
A risk management technique that mixes a wide variety of investments within a portfolio. It is designed to minimize the impact of any one security on overall portfolio performance.

Dividend
Distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. The amount of a dividend is quoted in the amount each share receives or in other words dividends per share.

Dividend Yield
An indication of the income generated by a share, calculated as Annual Dividend per Share/Price per Share.

Emerging Markets
There are about 80 stock markets around the world of which 22 markets are generally considered to be mature. The rest are classified as emerging markets.

Equity
Stock or any other security representing an ownership interest.

Ex-dividend
Purchase of shares without entitlement to current dividends. This entitlement remains with the seller of the shares.

Ex-post
A term that refers to past events or actual returns. Often used in relation to tracking error.

Final Salary Scheme
An employer pension scheme, the benefits of which are linked to length of service and the final salary of the member (also known as defined benefit).

Fixed interest
A loan with an interest rate that will remain at a predetermined rate for the entire term of the loan. See bond.

FTSE All-Share
An arithmetically weighted index of leading UK shares (by market capitalisation) listed on the London Stock Exchange (LSE). The FTSE 100 Index covers only the largest 100 companies.

Funding Level
A comparison of a scheme's assets and liabilities.

Futures Contract
A contract to buy goods at a fixed price and on a particular date in the future. Both the buyer and seller must follow the contract by law.

Gilts
The familiar name given to sterling, marketable securities (or bonds) issued by the British Government.

Hedge
Making an investment to reduce the risk of adverse price movements in an asset. Normally,

a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Index Linked
A bond which pays a coupon that varies according to some underlying index, usually the Consumer Price Index.

LGPS
Local Government Pension Scheme.

LSE
London Stock Exchange

Mandate
The agreement between a client and investment manager laying down how the portfolio is to be managed, including performance targets.

Market Value
A security's last reported sale price (if on an exchange) i.e. the price as determined dynamically by buyers and sellers in an open market. Also called market price.

Option
The name for a contract where somebody pays a sum of money for the right to buy or sell goods at a fixed price by a particular date in the future. However, the goods do not have to be bought or sold.

Passive Management
A style of fund management that aims to construct a portfolio to provide the same return as that of a chosen index. Compare with active management.

Pension Fund
A fund established by an employer to facilitate and organise the investment of employees' retirement funds contributed by the employer and employees. The pension fund is a common asset pool meant to generate stable growth over the long term, and provide pensions for employees when they reach the end of their working years and commence retirement.

Private Equity
When equity capital is made available to companies or investors, but not quoted on a stock market. The funds raised through private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's balance sheet. Also known as development capital.

Property Unit Trusts
Pooled investment vehicles that enable investors to hold a stake in a diversified portfolio of properties.

Resolution Bodies
Scheme employers with the power to decide if an employee or group of employees can join the scheme

Return
Synonymous with profit, be it income received, capital gain or income and capital gain in combination. Usually expressed as a percentage of the nominal value of the asset.

Risk
The likelihood of performance deviating significantly from the average. The wider the spread of investment in an investment sector or across investment sectors, i.e. the greater the diversification, the lower the risk.

Satellite Managers
See core-satellite.

Scheme Employers
Local authorities and other similar bodies whose staff automatically qualify to become members of the pension fund.

Security
An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government, or other organisation, which offers evidence of debt or equity.

Socially Responsible Investment (SRI)
Investments or funds containing stock in companies whose activities are considered ethical.

Specialist Manager
A fund management arrangement whereby a

number of different managers each concentrate on a different asset class. A specialist fund manager is concerned primarily with stock selection within the specialist asset class. Asset allocation decisions are made by the investment committee, their consultant or by a specialist tactical asset allocation manager (or combination of the three).

Stock
A type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings. Also known as shares or equity.

Stock Selection
The process of deciding which stocks to buy within an asset class.

Tracking Error
An unplanned divergence between the price behaviour of an underlying stock or portfolio and the price behaviour of a benchmark. Reflects how closely the make-up of a portfolio matches the make-up of the index that it is tracking.

Transaction Costs
Those costs associated with managing a portfolio, notably brokerage costs and taxes.

Transfer Value
The amount transferred to/from another pension fund should a member change employment. The amount transferred relates to the current value of past contributions.

Transition
To move from one set of investment managers to another.

Underwriting
The process by which investment bankers raise investment capital from investors on behalf of corporations and governments that are issuing securities (both equity and debt).

Unit Trust
A pooled fund in which investors can buy and sell units on an ongoing basis.

Unlisted Security
A security which is not traded on an exchange.

Unquoted Security
A share which is dealt in the market but which is not subject to any listing requirements and is given no official status.

Unrealised Gains/(losses)
The increase/(decrease) at year-end in the market value of investments held by the fund since the date of their purchase.

Yield
The rate of income generated from a stock in the form of dividends, or the effective rate of interest paid on a bond, calculated by the coupon rate divided by the bond's market price. Furthermore, for any investment, yield is the annual rate of return expressed as a percentage.

Surrey County Council
County Hall
Kingston upon Thames
Surrey KT1 2DN

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