REVIEW ON PERFORMANCE MEASUREMENT OF THE PENSION FUND

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Papers with this report	Northern Trust Executive Report WM Local Authority Quarter Reports Private Equity Listing Private Equity report from Adams Street Private Equity report from LGT Valentine Furniss - Q1 Investment Report Scott Jamieson – Q1 Investment Report

SUMMARY

This report reviews the fund management performance for the London Borough of Hillingdon Pension Fund for the quarter to 31 March 2010. The value of the fund as at the 31 March, including Private equity investments, was £563.8m. This reporting period ended prior to the transition of assets commenced.

This report also provides the annual update of the London Borough of Hillingdon Pension Fund's custodian and fund manager control reviews which are recommended under the Statement on Accounting Standards (SAS) 70 and gives an overview of the third party audit opinion of those controls.

RECOMMENDATIONS

1. **That the content of this report be noted and the performance of the Fund Managers be discussed.**

INFORMATION

1. The performance of the whole fund for the quarter to 31 March 2009 showed an underperformance figure of 0.62% with positive returns of 6.35%, compared to the benchmark 6.97%. The one year, three years, five years and since inception figures showed a decline of 0.99%, 0.05%,0.21% and 0.05% respectively.

Performance Attribution

	Q1 2010 %	1 Year %	3 Years %	5 Years %	Since Inception %
Goldman Sachs	0.48	5.86	(0.88)	(0.55)	(0.63)
UBS	(0.51)	1.59	(2.11)	(2.16)	1.16
Alliance Bernstein	(1.30)	(5.37)	(4.80)	-	(3.75)
UBS Property	0.24	(4.25)	(0.19)	-	(0.67)
SSgA	(0.03)	0.13	-	-	0.06
SSgA Temporary	0.10	-	-	-	0.28
SSgA Drawdown	(0.02)	-	-	-	0.17
Total Fund	**(0.62)**	**(1.76)**	**(2.78)**	**(2.16)**	**(0.36)**

2. The underperformance for the quarter was mainly due to asset allocation and the passive currency effect. These factors detracted from performance by 0.28% and 0.65% respectively. In contrast stock selection had a positive impact adding 0.45%. This theme continues in the one year figures with asset allocation and currency detracting and stock selection contributing to performance.

3. Alliance Bernstein returned 6.77% against a benchmark of 8.07% underperforming by 1.30%. Negative impacts on performance came from stock selection, asset allocation and the currency impact. Over the one year time frame, returns from UK equities were the largest driver towards underperformance.

4. GSAM outperformed their benchmark for the fourth consecutive quarter returning 3.84% against their benchmark of 3.36%. Corporate and government selection strategies were the primary drivers for excess returns.

5. UBS delivered a positive performance of 5.91% but underperformed by 0.51% against their benchmark of 6.42%. Stock selection, primarily in industrials had a positive impact whilst the main negative driver came from asset allocation.

6. The property mandate managed by UBS had positive returns of 5.03% compared to their benchmark of 4.80%. The best performance within the portfolio came from two specialist funds; UBS South East Recovery Fund and the Henderson UK Retail Warehouse Fund. Four other funds also outperformed, but in general the outperformance was a reflection of the stock selection undertaken in Q4 2009.

7. The requirement for SSgA as a passive manager is to replicate their performance benchmark. Over the three funds there was underperformance of 0.03% and 0.02% on the main fund and the drawdown fund and outperformance of 0.10% on the temporary fund.

Absolute Returns

	Alliance Bernstein £000	GSAM £000	SSgA (3 funds) £000	UBS £000	UBS Property £000
Opening Balance	106,992	60,803	196,091	100,251	41,256
Appreciation	6,564	2,253	14,487	5,192	1,488
Income Received	643	76	-	701	589
Investment Withdrawal	(468)	(261)	(837)	(434)	(2)
Closing Balance	113,731	62,871	209,741	105,710	43,331
Active Management Contribution	(1,169)	289	(24)	(453)	109

8. The above table provides details on the impact of manager performance on absolute asset values. The outperformance of GSAM and UBS Property had a positive impact on the appreciation of holdings contributing £289k and £109k respectively. In contrast the underperformance of Alliance Bernstein, SSgA and UBS reduced asset appreciation by £1,169k, £24k and £453k.

9. At the end of March 2010, £29.47m (book cost) had been invested in private equity, which equates to 5.23% of the fund against the target investment of 5%. However this level still remains within the limits of the over-commitment strategy of 8%. In terms of cash movements over the quarter, £1,556k was called and £65k distributed by Adams Street whilst LGT called £192k and distributed £253k.

10. The securities lending activity for the quarter resulted in income of £23.2k. Offset against this was £8.1k of expenses leaving a net figure earned of £15.1k. The total net figure earned for 2009/10 totalled £105.9k. The fund is permitted to lend up to 25% of the eligible assets total and as at 31 March 2010 the assets on loan totalled £26m representing approximately 12% of this total.

11. For the quarter ending 31 March 2010, Hillingdon returned 6.35%, outperforming against the WM average by 0.05%. In addition the one year performance figure of 37.90% outperformed average by 2.70%.

M&G UK Companies Financing Fund - update

12. M&G have issued their first draw down notice with funds due from the London Borough of Hillingdon of £922k being settled on the 28 May 2010. M&G believe this first deal offers excellent security together with an attractive price.

13. Since the initial set up of the Fund, due diligence has been carried out on a large number of companies. M&G have met close to fifty companies and are in active dialogue with ten of these at the moment. There has been sufficient progress with five companies as to have termsheets and any of these could result in further lending. Most companies where M&G are no longer in discussion have used banking finance, or occasionally the public bond market, to meet their funding needs. The surprise for M&G has been the willingness of banks to lend in the last twelve months and also their desire to compete with M&G during a difficult period for banking finance. They believe this is solely down to the lending targets imposed on certain banks by the government.

14. M&G also believe it has become more widely understood that the pressure of lending targets for the UK banks has set up a false market. Furthermore, there is a great deal of discussion about the potential problems when the banks are able to act more rationally. This discussion, together with the continued support being receiving from various trade and industry bodies, reassures M&G that the fund remains relevant and will be able to lend further over the next year.

Market Commentary

15. Equity markets started the year well, with the MSCI World posting its strongest first quarter return since 2006. In a reverse of trend developed markets outperformed emerging markets, led by Japan and North America. The robust return for the quarter disguised what was a bumpy ride. The improvement in manufacturing surveys during January helped drive markets forward. This was followed by a period of weakening as concerns regarding Greece's fiscal position mounted. Equity markets then began to recover as members of the European Union indicated their willingness to support Greece and other members should they be unable to re-finance their debts. The equity market rally was furthered by the continuing firming

of economic data throughout March with improvements in both manufacturing and non manufacturing sectors.

16. During late January and early February credit and emerging market spreads widened when the Greek-induced risk aversion swept the markets. They narrowed towards the end of the quarter as support was announced, finishing at a slightly tighter level than at the start of the year. UK gilt returns were subdued as uncertainties surrounding Greece kept sovereign debt firmly in focus.

17. UK commercial property market continued to gain in the first quarter of 2010 with the UK IPD index up 17% from its low in Q2 2009. Forward looking real estate derivatives continue to point towards further gains in 2010.

18. Detailed investment reports have been written by our two Investment Advisors, Valentine Furniss and Scott Hastings, and these are being circulated with this report.

Statement on Accounting Standards - SAS 70 Review

19. The Statement on Accounting Standards (SAS) No. 70 is the authoritative guidance that allows service organisations to disclose their control activities and processes to their customers and their customers' auditors in a uniform reporting format. The issuance of a service auditor's report prepared in accordance with SAS 70 signifies that a service organisation has had its control objectives and control activities examined by an independent accounting and auditing firm. The service auditor's report, which includes the service auditor's opinion, is issued to the service organisation at the conclusion of a SAS 70 examination.

20. The latest versions of the custodian and fund manager Statements of Internal Control were obtained and the audit opinions reviewed. Whilst there is no strict requirement to produce these reports and as such not all managers undertake the SAS 70 review, it is recommended under best practice. The custodian and fund managers based in the UK, namely, Northern Trust, Alliance Bernstein, Goldman Sachs, State Street Global Advisors and UBS all undertook reviews and were able to provide a report and audit opinion.

21. It should be noted that the tests covered a specific period and any conclusions, based on findings, to future periods is subject to the risk that changes made to the system or controls, or the failure to make needed changes to the system or controls, may alter the validity of such conclusions.

22. The private equity managers Adams Street Partners and LGT Capital Partners have considered and reviewed the SAS 70 requirement but to date have not implemented any action.

23. Details of the SAS 70 independent auditor and the period of review for each of the UK based fund managers and custodian are detailed below:

- Alliance Bernstein - PricewaterhouseCoopers 01/10/08 to 30/09/09
- Goldman Sachs - PricewaterhouseCoopers 01/07/08 to 30/09/09
- State Street Global Advisors - PricewaterhouseCoopers 01/07/08 to 30/06/09

- UBS Global Asset Management - Ernst and Young 01/01/09 to 31/12/09
- Northern Trust **-** KPMG 01/10/08 to 30/09/09

24. In each of the above cases the audit opinion showed the described controls were suitably designed to provide reasonable assurance that the specified control objectives would be achieved.

25. Private Equity - Adams Street Partners and LGT Capital Partners have been contracted on a fund of funds basis. As such they are consolidating the accounting of managers to which funds are committed. Both managers have considered the implementation of a SAS 70 review but to date have deemed it unviable. However, all the funds held by the private equity managers have undergone an audit of their financial statements. Although not expressly checking internal controls, an audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. The 2009 accounts are yet to be audited however the audit reports prior to this have provided an unqualified opinion.

FINANCIAL IMPLICATIONS

These are set out in the report

LEGAL IMPLICATIONS

There are no legal implications arising directly from the report

BACKGROUND DOCUMENTS

Custodian and Fund Manager SAS 70 reports