APPENDIX 2

Blackrock - UK equity

The international nature of stock markets means that it is important to understand the underlying portfolio exposure to each currency. Following the fall in sterling this year, companies with overseas revenues and earnings have benefited from these earnings being translated back into sterling. In addition to identifying underlying earnings exposure, it is also necessary to ascertain if an individual company uses currency hedging strategies.

For the Suffolk Pension Fund's UK equity portfolio, there is a good understanding of the geographic earnings exposure for the companies in which there is an investment and the source of earnings will form part of the investment view. For example, holding companies such as Wolseley or RELX, where over 50% of revenues are from the US, when there is a positive view on US economic growth. Both implicit and explicit currency exposure and risk systems allow Blackrock to measure the contribution risk from currency exposure and to stress test the portfolio to help forecast how the portfolio may respond to large currency moves.

Over the longer term Blackrock believes that share prices are driven by company fundamentals, but recognise the potential for shorter term impact from factors such as currency, especially where there is direct currency exposure through holding companies that are listed overseas.

Blackrock - Global bonds

The share class in which the Pension Fund has invested in is always hedged to sterling so that currency exchange rates do not dominate the returns of the investment.

The nature of the different fixed income assets means currency exposure is viewed alongside country exposure for each investment. The aim of Blackrock's risk management is to ensure no single country or currency dominates the fund.

Blackrock typically hedges non-base currency bonds back to the fund's base currency (USD) in order to avoid large currency positions dominating the risk profile of the fund.

Blackrock would not hedge in this way if there is a risk profile to the bond, including the currency element that does not make it favourable to do so or the portfolio manager has an insight into currency markets and wishes to call on the movement.

Newton - Global equities

Newton manages a global equity portfolio, investing in what they regard as being the best combination of companies around the world in local currencies but with Newton's MSCI AC World Index NDR benchmark being quoted in sterling terms. Consequently, the movements in international currencies relative to sterling can play an important part in the absolute and relative return outcomes achieved. This was clearly evidenced in the week following the recent Brexit referendum where Newton's decision not to hedge their overseas currency exposure back to sterling created significant value for the Suffolk Pension Fund. This decision helped to add something in the region of £30m to the value of the portfolio over the final week of June.

Newton have the authority to undertake currency hedging decisions. Decisions to invest in companies are undertaken based on the merits of the individual company as opposed to being taken due to the relative attractiveness of the currency. The need for currency hedging will be assessed subsequently, with any currency hedging undertaken aiming to enhance and to protect the value of their investments on our behalf. They see it as part of their role to take account of such factors in the management of the mandate. They are of the view that they are best placed to undertake this role and responsibility for currency hedging on their mandate is included in the investment management fees that are paid to Newton.

M & G - Global bonds

The Suffolk Pension Fund invests in the M&G Alpha Opportunities Fund (AOF) and has subscribed to the sterling denominated share class. The base currency of the AOF is denominated in euros, so in order to protect investors in the sterling share class from currency fluctuations, a "hedge" is put in place each month to immunise movements in the euro/sterling exchange rate and ensure that investors receive the return of the fund in purely sterling terms. As such, all income and principal amounts are effectively denominated in sterling despite the AOF being a euro-denominated fund. This is known as a "share class hedge".

To hedge the currency risks at a share class and fund level, M&G uses Forward Foreign Exchange contracts, usually for one month at a time. These are used to "fix" the exchange rate at a specific level for a specific amount for a period of one month in advance. Each month, these instruments are renewed to set a stable and known rate for another month in advance. For example, US dollar denominated debt holdings would be hedged back to Euros. If these holdings in US dollars are subsequently added to or removed from the fund during the month, so the amount of the currency hedge is adjusted. This means that the fund does not have unwanted exposure to currency market movements.

Forward Foreign Exchange contracts are collateralised, meaning that cash has to be set aside by the manager if currency movements are particularly volatile. To ensure that these cash holdings are kept to a minimum within the fund (which would otherwise act as a drag on returns given the low/negative deposit rates available), exposures are "netted" wherever possible meaning that gains and losses on hedges are offset against one another. In addition, if there is a hedging currency exposure for the sterling share class, then only the non-sterling assets are hedged, and if hedging for the euro share class, then only the sterling and the US dollar assets are hedged.

Some of the underlying assets in the fund are denominated in currencies other than sterling such as euros and US dollars. These currency exposures are also routinely hedged to remove any currency risks that arise within the fund by fully hedging the currency risks back to the base currency of the fund, which is the euro. This is known as a "fund level hedge".

Legal & General - Passive mandates

The Pension Fund currently has two currency hedging mandates in place with Legal & General; £81m Europe equities index and £26m Japan equities index, they are both hedged to sterling. Legal & General do not currency hedge unless the Fund implicitly sets one up.

There are two currency hedging approaches that they can accommodate:

1. Currency hedged pooled funds

This approach can be used to hedge the holdings with Legal & General. These investments are hedged back to sterling and can be hedged 100% or run side by side i.e. 50% hedged and 50% unhedged to give an overall hedge of 50%. These are hedged using 'over the counter' (OTC) forward contracts with commercial banks.

2. Segregated currency overlays

This approach is a bespoke service that is typically utilised when a decision has been made to manage currency exposure across the scheme. Legal & General receive all the manager valuations for the Fund which they would aggregate with the holdings with Legal & General to calculate the total currency exposure to be hedged. Currency forwards are used to hedge the exposure in accordance with a pre-determined/hedge ratio.

Pyrford - Absolute return

The Pyrford global total return fund has four key drivers of return: (1) Asset Allocation, (2) Bond Duration Management, (3) Stock Selection and (4) Currency Management.

Currencies – just like equities and bonds – can experience periods of over and under-valuation. Pyrford actively manages the currency exposure of the fund by using long-term "purchasing power parity" (PPP) analysis to judge the relative value of different currencies. If they believe that a currency is overvalued by a significant margin (25%) they will reduce exposure in order to counter the risk to capital. They do this by either "hedging" the currency to protect against moves back towards fair value or alternatively sell the underlying assets and repatriate assets back to sterling to reduce exposure. Conversely, if a currency appears undervalued Pyrford will increase exposure.

Recently (July 2016), Pyrford took the decision to reduce unhedged exposure to the USD and sold all US bonds (~10% of the portfolio). This followed a significant fall in sterling (v USD), following the UK's surprise "Brexit" decision, a fall which benefitted the portfolio in terms of performance. Pyrford considered sterling to be undervalued against the US dollar and hence decided to repatriate the US dollar bond exposure.

In line with Pyrford's purchasing power parity analysis, only the Swiss franc exposure within the portfolio remains fully hedged, insulating the portfolio against any fall in the value of that currency.

Winton - Hedge funds

The investment objective of the Fund is to achieve long-term capital appreciation through compound growth. The investment strategy of the Fund is to invest globally long and short, using leverage, in a diversified range of liquid instruments, taking exposure to the four major asset classes of fixed income, equities, currencies and commodities in approximately equal measure by following a systematic investment process that is based on statistical research.

As such, with regards to the currency hedging policy, whilst Winton does employ some hedging between share classes, taking active currency risk is a significant component of the overall programme.

Winton Share Class Hedging

Hedged share classes aim to limit currency risk for shareholders by reducing the effect of exchange rate fluctuations between the fund's base currency and the currency to which shareholders wish to be exposed. For example, a sterling investor wishing to capture the investment performance of the US equity market, but without taking additional risk of movements between the sterling and the US dollar, could invest in a US equity fund's sterling-hedged shares.

It is also worth noting that whilst investing in a hedged share class can shelter returns from a weakening US dollar, investors will miss out on gains should exchange rates move the other way.

Pantheon - Private Equity

Pantheon does not hedge currency, although they continuously look at how they can improve the efficiency of their investment programmes in relation to currency exposure. They don't hedge because they believe it is very difficult to know what to hedge over the life of a fund. An investor will make a dollar or euro commitment and this will transition in to a NAV position and then ultimately cash distributions. Whilst a NAV position may be denominated in the fund currency, the underlying fund positions in Europe and Asia may be in different currencies (e.g. Swedish Krone) and the same applies to the currency exposure of the underlying portfolio companies.

Pantheon Global Secondary Fund V makes use of dollar and euro loan facilities to hedge the currency exposure when entering into deals that need to be funded in these currencies. This takes away the currency risk in the deal and when the cost of borrowing is so low, can help add to the investment returns of the programmes for investors.

Given the length of private equity programmes, the currency effect tends to even itself out over the life of a typical programme. Many investors may decide that they will address what they have identified as their private equity currency exposure from time to time through an overall portfolio overlay approach.

KKR - Infrastructure

KKR has hedges foreign exchange risk associated with its overseas infrastructure investments. The goal of KKR's hedging policy is not to speculate or earn income from hedges but to reduce FX exposure and minimize currency effects on investment performance. The fund is currently hedged back to the US dollar.

KKR's hedging strategy is executed strictly on a fund-by-fund basis, utilising FX forwards with a settlement date estimated to match the expected life of the asset as the primary hedging tool for infrastructure investments (7 Year duration for Infrastructure assets).

KKR typically hedges 50-75% of the FX risk on the first investments in the relevant fund and thereafter assume a portfolio-type approach towards hedging. As new investments are added to the portfolio and the portfolio begins to mature, they usually hedge not only the original cost of the investments but also any incremental value. As investments are exited, the relevant forwards are concurrently settled.

Currencies that have a material cost of hedging (INR, AUD, NOK, CAD, SEK, KRW) are examined on a case-by-case basis to determine the size and scope of the hedging program.

Partners - Infrastructure

Exchange rate risk is a consequence of the global nature of Partners Group's investment activities and may have a significant impact on a portfolio particularly in times of increased volatility in foreign exchange markets.

Additionally, depending on the hedging strategy implemented, hedging cash flows may potentially trigger liquidity risks. To address these risks, Partners Group implements a hedging strategy for a portfolio, which is designed to limit total foreign currency exposure.

The Portfolio and Mandate Solutions team calculates such exposure on a regular basis, using automated tools that are linked to the relevant investment and accounting databases. Once the exposure to the various currencies is verified, the team, in conjunction with the Global Portfolio Strategy Committee, calculates the parameters for the appropriate hedging contracts (e.g. size, maturity, type). Based on this information, Partners Group determines the appropriate hedging strategy for its clients. The firm seeks to execute hedges on a best price basis by negotiating with several counterparties.