MINUTES of the meeting of the **SURREY PENSION FUND COMMITTEE** held at 9.30 am on 10 November 2017 at Ashcombe Suite, County Hall, Kingston upon Thames, Surrey KT1 2DN.

These minutes are subject to confirmation by the Committee at its next meeting.

Elected Members:

* Mr Tim Evans (Chairman)
* Mr Ben Carasco (Vice-Chairman)
  Ms Ayesha Azad
* Mr John Beckett
* Mr David Mansfield
* Mrs Hazel Watson

Ex officio Members:

Mr David Hodge CBE, Leader of the Council
Mr Peter Martin, Chairman of the Council

Co-opted Members:

* Tony Elias, Borough/District Representative
* Margaret Janes, Employers
* District Councillor Peter Stanyard, Borough/District representative
  Philip Walker, Employees

In attendance

52/17 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]

Apologies were received from Ayesha Azad and Philip Walker. There were no substitutions.

The Chairman noted that Phil Triggs would be leaving the Council for a new role in December, and thanked him for his support on behalf of the Committee.

53/17 MINUTES OF THE PREVIOUS MEETING: 15 SEPTEMBER 2017 [Item 2]

The Minutes were approved as an accurate record of the previous meeting.

54/17 DECLARATIONS OF INTEREST [Item 3]

There were none.

55/17 QUESTIONS AND PETITIONS [Item 4]

1. Two questions were received from the public. The response was tabled at the meeting and is attached as an annex to these minutes.

The Chairman noted that Sarah Finch had been unable to attend in person. Vicki Elcoate was invited to ask her supplementary question. She commented that the response felt weak, and asked what specific barriers prevented the Fund from entering the Border to Coast Pension Partnership (BCPP) with a clear statement on disinvestment on fossil fuels.

2. The Chairman commented that the Fund was working with the BCPP around sustainable and responsible investment. It was also highlighted that there was a fiduciary duty to all members of the Fund, and restricting investments could be seen to compromise this. It was noted that climate change was perceived as a risk and that the Fund had a number of active managers who had a position on mitigating that risk.

56/17 ACTION TRACKER [Item 5]

The Committee reviewed the action tracker, there were no further comments.

57/17 FORWARD PLAN [Item 6]

The Committee noted the Forward Plan. There were no further comments.

58/17 EXCLUSION OF THE PUBLIC [Item 16]

Resolved: That under Section 100(A) of the Local Government Act 1972, the public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information under the relevant paragraphs of Part 1 of Schedule 12A of the Act.

PART TWO – IN PRIVATE

59/17 INVESTMENT STRATEGY REVIEW [Item 9]

[The Committee took the agenda in a different order to facilitate discussion]

Declarations of interest:

None

Witnesses:
John Harrison, Advisor
Sheila Little, Strategic Director of Finance
Neil Mason, Senior Pensions Advisor
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
Hemal Popat, Mercer
Steve Turner, Mercer

Key points raised during the discussion:

1. The Committee was briefed on a number of options available with respect to future protection of the Fund portfolio. It was highlighted that the Fund was exposed if there was some form of market correction related to equities. The Committee reviewed the options for downside protection with respect to equity through a form of derivative. It was

also noted that there were options around alternative indexation with respect to passive investments, and an allocation to long-term illiquid assets.

2. The Chairman informed the Committee that these options had been in response to conversations at the Committee meeting on 17 September 2017 about protecting investments. He expressed the view that these options would be a matter of consideration regardless of the current funding level, and were seen as a way of protecting against market correction. It was noted that equity returns had been strong since the 2008 financial crisis, and that the cost of buying protection were at low levels at the present time.

3. It was commented that the Fund had a large allocation to equities and this had seen an increase in value by £75 million over the previous quarter. The Committee was informed that over £1 billion was invested in UK equities without any protection. Mercer estimated that there one in 20 likelihood of those investments losing 30% of their value through market correction.

4. The Committee was also advised that protection would be considered by the actuary when reviewing measures in place to address a deficit position. This would have a positive impact in respect to the triennial valuation and how the funding level was assessed.

5. A range of questions were asked regarding the technicalities of the protection. The Committee was informed that active investment managers would have some forms of protection against poor investment outturns, though not against an overall market drop. It was clarified that downside protection would not be affected by the move into pooled arrangements with the Border to Coast Pension Partnership (BCPP) as equities would be retained with Legal and General. Clarity regarding the arrangements for equities and pooling was cited as one of the reasons that the paper was being brought to the Committee at this stage. It was noted that East Riding had put protection in place and three other funds in BCPP were considering similar arrangements with Mercer.

6. The Committee was informed that diversifying away from equity market risk would take a long time to implement, and the protection was beneficial as it could be implemented quickly at a minimum cost to the Fund. The Committee debated the extent to which selling upside would protect against downside, and the extent to which it wanted to protect equity investments through this mechanism. Mercer highlighted that other funds had chosen to buy protection lasting up to 9-12 months after the next valuation, in order to achieve the maximum benefit from having it in place.

7. The Committee explored options relating to the cost of the protection, and was informed that there were a number of arrangements that could be put in place. It was suggested that receiving a premium and paying out a premium of 3% would create a nil overall cost to the Fund, though this would require having to sell more upside in order to fund the protection.

8. The Committee discussed that this was a time-limited tactical investment decision, and that it would not be considered over a long term basis. It was noted that the Committee's role in securing long term security of its investments made equities a good investment, as they frequently out-performed other investments over the longer term.

9. The Chairman invited Committee views. There was some concern that there was insufficient detail in the papers to consider making a decision, and that that the financial risks were not wholly clear. Concern was also raised as to what extent the proposals covered all equities, and what the cost would be in respect to this. At the same time, the Committee had broad support for protecting its equity investments, and indicated it would consider a proposal that would minimise the cost to the Fund with a clear outline of the benefits and risk. It was agreed to consider this at a future extra-ordinary meeting of the committee.

10. The Committee discussed alternative indexation, and it was acknowledged that this frequently out performed a market-based approach. The Committee was informed that the Fund could look to invest with Legal and General, which would use a multi-factor approach. The Fund's Independent Advisor expressed the view that market capitalisation indices were structurally sub-optimal, and that a Market Capitalisation Index had benefits as it took into account the liquidity of markets.

11. The Committee was informed that the budget contained in the papers took account of the cost of transition, and that the fees would reduce as a result of moving to a market indexation approach. It was noted that Legal and General would need to set up a specific vehicle for the Fund. It was noted that the first priority would remain equity protection for the Fund.

12. The Committee discussed the proposals related to private debt. It was noted that private debt was categorised broadly into senior (lower risk, lower return) and junior (higher risk, higher return). The Committee explored the structure of the proposals, and queried whether the proposals exposed the fund to sub-prime debt. It received assurances that the underlying loans were secured against the assets of the companies, and that one default would not significantly affect the value of the investments.

13. The Committee discussed the length of time it would take to make the transition following a decision and it was noted that this would be a number of years. Committee Members felt that the decision could be deferred until the BCPP was operational.

Actions/ further information to be provided:

None.

Resolved:

- That the Committee meet on 29 November 2017 to consider options for downside protection with respect to equity risk.

- That the Committee approve the implementation work to be carried out by Mercer with regard to the selection of suitable investment managers for alternative indexation investing.

- That the Committee defer an allocation of private debt until the Border to Coast Pension Partnership (BCPP) vehicle is available.

60/17 PUBLICITY OF PART 2 ITEMS [Item 17]

61/17 REVISED FUNDING STRATEGY STATEMENT [Item 7]

[The Committee took the agenda in a different order to facilitate discussion]

Declarations of interest:

None

Witnesses:
John Harrison, Advisor
Sheila Little, Strategic Director of Finance
Neil Mason, Senior Pensions Advisor
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
Hemal Popat, Mercer
Steve Turner, Mercer

Key points raised during the discussion:

1. The Committee discussed whether there should be some adjustment to the wording of the funding objective, in view of the positive performance of the fund. There was strong support for this from the Committee in order to better reflect the position of the Fund, both in respect to its liabilities, actuarial assumptions around its investment returns and the volatility of its portfolio.

Actions/ further information to be provided:

None.

Resolved:

- That the Committee adopt the changes to the funding strategy statement.

- That the Committee consult with the actuary and investment consultants to consider how the funding objective can reflect the positive performance of the Fund.

62/17 INVESTMENT STRATEGY STATEMENT [Item 8]

Declarations of interest:

None

Witnesses:

John Harrison, Advisor
Sheila Little, Strategic Director of Finance
Neil Mason, Senior Pensions Advisor
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
Hemal Popat, Mercer
Steve Turner, Mercer

Key points raised during the discussion:

1. Following the discussion of the previous item, the Committee reviewed the wording and agreed a change.

Actions/ further information to be provided:

None.

Resolved:

That the first paragraph of the objectives of the Investment Strategy Statement is altered as follows –

> The Committee seeks to ensure that the Fund has sufficient assets to be able to meet its long term statutory obligations to pay pensions to the Fund's members~~, i.e. over the long term to be at or above a 100% funding level.~~

63/17 MANAGER ISSUES AND INVESTMENT PERFORMANCE UPDATE [Item 13]

Declarations of interest:

None

Witnesses:
John Harrison, Advisor
Sheila Little, Strategic Director of Finance
Neil Mason, Senior Pensions Advisor
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
Hemal Popat, Mercer
Steve Turner, Mercer

Key points raised during the discussion:

1. The Committee discussed the options proposed relating to Marathon Asset Management. It was noted that the option to combine in a single pooled fund account was the officer recommendation, and the Committee discussed the different benefits of each arrangement. It was noted that option two would enable investments in India and Chile, both markets that were unavailable under the present arrangement. The Committee commented continuing a performance fee did not represent a substantial incentive to Marathon.

2. The Committee noted the market value of the Fund's investments had increased. Members queried whether there were concerns about the performance of Avivia. It was explained that Avivia offered a particular type of diversified growth fund, and the Committee had chosen three diversified growth fund that operated differently in order to diversify its risk exposure. The Chairman commented that it was not a major concern as the overall position for the three funds was positive.

3. The Committee was informed that the Chairman and officers had attended a joint committee meeting of the Border to Coast Pension Parnership (BCPP) funds on 20 October 2017. The BCPP chief executive officially started in November, and a new non-executive chairman, Chris Hitchen, had been appointed. The Committee noted that Fiona Miller had also been appointed as Chief Operating Officer on the current project group.

4. The Committee was informed that BCPP had been offered a loan of £4 million starting capital from South Yorkshire Pensions Authority. An update regarding this would be brought to the Committee meeting in February 2018.

5. Officers commented that all other aspects of setting up the BCPP were on track, including the Financial Conduct Authority application. A preferred option for the BCPP headquarters had been identified in Leeds city centre and the initial priority would be moving staff managing portfolios internally within funds into the BCPP pool. It was also highlighted that the section 151 officers for each administering authority met regularly to discuss progress and any areas of common interest.

Actions/ further information to be provided:

None.

Resolved:

- That the Committee note the report
- That the transfer of existing Marathon segregated and pooled accounts to a single pooled fund account is approved, and that an existing asset based fee is applied across the aggregated assets.

64/17 PRIVATE EQUITY REVIEW [Item 12]

Declarations of interest:

None

Witnesses:
John Harrison, Advisor
Sheila Little, Strategic Director of Finance
Neil Mason, Senior Pensions Advisor
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
Hemal Popat, Mercer
Steve Turner, Mercer

Key points raised during the discussion:

1. The Committee reviewed private equity performance, and it was noted that this remained above the target. The Committee was informed that the report did not include Darwin Property Management, as these investments had been recorded in the Fund accounts as property investment following advice from the Fund's external auditor Grant Thornton.

Actions/ further information to be provided:

None.

Resolved:

That the Committee note the current position on the Fund's Private Equity investment performance.

That the Fund continue to commit to drawdowns of the existing private equity schemes, and consider new opportunities for approval as and when these arise.

65/17 BORDER TO COAST RESPONSIBLE INVESTMENT AND VOTING GUIDELINES [Item 10]

Declarations of interest:

None

Witnesses:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Key points raised during the discussion:

1. The Committee noted that the Border to Coast Pension Partnership had produced new guidelines related to responsible investments. Officers commented that there was no significant change from the Fund's current responsible investment policy and guidelines. The BCPP committee had approved the document, which was a consolidation of the different Fund investment policies.

Actions/ further information to be provided:

None.

Resolved:

That the Committee approve the BCPP Corporate Governance Voting Guidelines and the BCPP Responsible Investment Policy.

66/17 CORPORATE GOVERNANCE SHARE VOTING [Item 11]

[Tim Evans left the meeting at 12.29pm. Ben Carasco continued as Chairman.]

Declarations of interest:

None

Witnesses:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Key points raised during the discussion:

1. The Committee reviewed the Corporate Governance share voting in quarter 2 2017/18. There were no further comments.

Actions/ further information to be provided:

None.

Resolved:

That the Committee note the report.

That the Committee approve the latest versions of the Responsible Investment and Stewardship Policy and Voting Template.

67/17 ADMINISTRATION ISSUES AND UPDATE [Item 14]

Declarations of interest:

None

Witnesses:
Jason Bailey, Pensions Lead Manager, Business Operations
John Harrison, Advisor
Sheila Little, Strategic Director of Finance
Neil Mason, Senior Pensions Advisor
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
Hemal Popat, Mercer
Steve Turner, Mercer

Key points raised during the discussion:

1. The Committee noted that the new performance matrix, which had been agreed at the last meeting, would commence from quarter 3 2017/18 and reported to the next meeting of the Committee. Officers had proposed changes to the reporting cycle that would see the Local Pension Board scrutinising administration performance prior to a highlight report to the Committee.

2. Officers commented that the service was restructuring the Pension Service management to improve the focus on service delivery. The Committee was informed that there would cost implications to the Fund, though recent benchmarking had estimated that the Orbis Pension Service was the second lowest in terms of cost. The Chairman of the Local Pension Board commented that the current performance presented a mixed picture and that the Board had

expressed particular concern around the performance related to deaths, retirements and transfers out.

3. The Chairman of the Local Pension Board outlined the work the Board had undertaken to review the environmental, social and governance policies of other local authority funds. It was also highlighted that a breach had been reported to the Pension Regulator following the delay in issuing annual benefits statements. It was estimated to have impacted 2% of active members and the majority of deferred members. The Committee was advised that remedial steps had been taken.

4. The Committee noted the progress report of steps taken since the Pension Administration audit. It was noted that a further progress report would be brought to the Board in January 2018.

Actions/ further information to be provided:

None.

Resolved:

That the Committee note the reports on Key Performance Indicators for the quarter to 30 September 2017.

That the Committee agree to receive a focused summary of the administration Performance Report, produced after scrutiny by the Local Pension Board, in future meetings.

That the Committee notes updates to the monitoring report of the Local Pension Board in respect of the Pensions Administration Audit 2016/17

That the Committee note the comments of the Local Pension Board with regard to defining trigger for de-risking as the funding position improves.

That the Committee note the procurement timetable for the actuarial contract.

68/17 RISK REGISTER 2017-18: PENSION FUND AND ADMINISTRATION [Item 15]

Declarations of interest:

None

Witnesses:

Jason Bailey, Pensions Lead Manager, Business Operations
John Harrison, Advisor
Sheila Little, Strategic Director of Finance
Neil Mason, Senior Pensions Advisor
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)
Hemal Popat, Mercer
Steve Turner, Mercer

Key points raised during the discussion:

1. The Committee reviewed the risk registers, and there were no substantial changes from the previous quarter.

Actions/ further information to be provided:

None.

Resolved:

That the Committee note the risk registers.

69/17 DATE OF NEXT MEETING [Item 18]

The Committee noted that the next meeting would be held on 29 November 2017.

Meeting ended at: 12.48 pm

Chairman

Public questions to Surrey Pension Fund Committee – 10 November 2017

1. I was pleased to read in the report tabled at the last meeting that there is a desire within both the Pensions Board and Committee to take a more active ownership of environmental, social and governance issues. The report highlights three options for doing this: introducing allocations to Low Carbon Indexation, Sustainable Infrastructure and Social Impact Investing. Could the Committee confirm that when they seek to reduce risk as reflected by this aspiration they will prioritise taking funds out of the fossil fuel interests they currently invest in, and move to investments that are better future proofed as they are not based on environmental and social harm?

Submitted by Vicki Elcoate

Response

Surrey Pension Fund is a founder member of the Border to Coast Pensions Partnership (BCPP), a collaboration of twelve Local Government Pensions Schemes (LGPS) that will pool together its funds to form a £42bn national investment pool. BCPP has recently approved its own Responsible Investment policy which, in turn, is due to be considered by the Surrey Pension Fund Committee at its meeting on 10 November 2017.

As part of its policy setting, BCPP will actively consider how climate change, the shifting regulatory environment and potential macro-economic impact will affect its investments. There is acceptance that these issues pose significant investment risks and opportunities with the potential to impact the long-term shareholder value of investments across all asset classes.

BCPP will therefore look to:

- Assess its portfolios in relation to climate change risk where practicable;
- Incorporate climate considerations into the investment decision making process;
- Engage with companies in relation to business sustainability and disclosure of climate risk in line with (Task Force on Climate-related Financial Disclosure (TCFD) recommendations;
- Encourage companies to adapt their business strategy in alignment with a low carbon economy.

In the run-up period (probably a two-year period) to transitioning stocks across to the Border to Coast pool, the Surrey Fund will continue investigating its own strategy with regard to Responsible Investment issues, whilst accepting that such change will have a limited shelf life before the Border to Coast changes are implemented. At its meeting on 10 November 2017, the Pension Fund Committee will consider further the recommendation of the Surrey Local Pension Board to establish the Pension Fund's exposure to climate change and carbon risk through the commissioning of a carbon audit of the Fund's portfolios.

With regard to the possible future prioritisation of taking funds out of oil stocks, as part of its investment strategy, there is currently no negative screening of any stocks imposed by the Fund on its external investment managers. Instead, the Fund engages with a wide range of companies (including oil companies) through its association with the Local Authority Pension Fund Forum (LAPFF) in order to influence climate change policy and actions that will improve future impacts on the environment. There are no current plans to change this policy.

2. I am a Surrey Pension Fund member and a Surrey resident concerned about the impacts of climate change. From my correspondence with your former chair, Denise Le Gal, and reading of the report you commissioned from Mercer, I know that the Surrey Pension Fund views climate change as a financially material risk and aims to be an active shareholder in the exercising of its company share voting rights to promote good corporate governance principles. What opportunities do you see for exercising these rights in the coming year, and in particular, what are your specific engagement goals for the oil and gas corporations in which you have holdings?

Submitted by Sarah Finch

Response

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As part of its policy setting, BCPP will actively consider how climate change, the shifting regulatory environment and potential macro-economic impact will affect its investments. There is acceptance that these issues pose significant

investment risks and opportunities with the potential to impact the long-term shareholder value of investments across all asset classes.

BCPP will therefore look to:

- Assess its portfolios in relation to climate change risk where practicable;
- Incorporate climate considerations into the investment decision making process;
- Engage with companies in relation to business sustainability and disclosure of climate risk in line with (Task Force on Climate-related Financial Disclosure (TCFD) recommendations;
- Encourage companies to adapt their business strategy in alignment with a low carbon economy.

At its meeting on 10 November 2017, the Pension Fund Committee will consider the recommendation of the Surrey Local Pension Board to establish the Pension Fund's exposure to climate change and carbon risk through the commissioning of a carbon audit of the Fund's portfolios.

As part of its investment strategy, there is currently no negative screening of any stocks imposed by the Fund on its investment managers. Instead, the Fund engages with a wide range of companies (including oil companies) through its association with the Local Authority Pension Fund Forum (LAPFF) in order to influence climate change policy and actions that will improve future impacts on the environment. There are no current plans to change this policy.

Reference current and future plans for engagement with global oil companies, the Local Authority Pension Fund Forum (LAPFF) issued a number of voting alerts recommending members back shareholder resolutions on climate change disclosure at energy firms. The alerts follow the signing of the Paris Agreement under which countries agreed to limit the global average temperature rise to below 2 degrees Celsius. The objective of the resolutions have been that companies should undertake analysis and produce publically available reports on the impact that a 2 degree scenario is likely to have on their business and shareholder value.

The Surrey Pension Fund voted its Royal Dutch Shell shares on 23 May 2017 with one of the resolutions (Surrey voted For) that requested the Shell Board set and publish targets for reducing greenhouse gas emissions that are aligned with the Paris Climate Agreement. The LAPFF has also signed a joint letter with 200 global investors (representing $15 trillion AUM), urging the G7 to stand by the Paris Agreement and push ahead with its implementation.

During 2017, the LAPFF has had several meetings with oil companies about their strategies for the low carbon transition. As part of collaborative engagement with the Institutional Investors Group on Climate Change (IIGCC) corporate programme, a meeting with senior managers at BP explored the implications of scenario planning for a faster transition and how this related to their core businesses. The LAPFF was also represented at a meeting with the chairman, Carl-Henric Svanberg, where useful discussions were held over a number of topics including low-carbon transition and climate related elements of remuneration policies.

At the BP 2017 AGM, remuneration remained a focus following the defeat of the 2016 remuneration report vote. The LAPFF representative attended and thanked the BP Board for responding to shareholder concern over the perceived disconnect between pay and performance, and welcomed the changes that had been made, particularly the clearer strategic link to rewarding progress towards a low carbon transition. He then pushed for more information on how the board would ensure an appropriate pace for its low carbon transition. The BP Chairman answered in part by indicating that the 20% allocation for strategic targets could be raised to 30%, but cautioned against the use of targets which can have unintended consequences.

The LAPFF attended the Total AGM in Paris and was represented by former Surrey Pension Fund Committee Chairman (Cllr Denise Le Gal). Her questioning revolved around whether Total would be willing to report its oil and gas resources in resource-neutral gigajoules in order to compare better the value of these reserves with the value of renewables for the company. Cllr Le Gal also asked how oil and gas companies could contribute to a meaningful carbon price. Total has offered LAPFF a follow up meeting (still to be arranged) to explore these issues in more detail.

During 2017, LAPFF announced that it is partnering with the 50/50 Climate Project. The new partnership will enhance the LAPFF's actions to promote climate competent boards and enhance collective investor action advocating better climate strategies and decision-making at board level.

Tim Evans
Chairman – Surrey Pension Fund Committee