SURREY
COUNTY COUNCIL

Surrey Local Pension Board
18 January 2018

Summary of the Pension Fund Committee meeting(s), 10 November 2017 and 29 November 2017

Recommendations:

1. The Board is asked to **note** the content of this report.

Detail:

Introduction

2. The Pension Fund Committee met on 10 November 2017 and 29 November. This report provides a summary of these meetings and any resolutions made.

10 November 2017:

Revised funding strategy statement (FSS)

3. The Pension Fund Committee (Committee) were presented with annexes to the FSS. These annexes reflected amendments previously agreed by the Committee:
   - Academy pooling policy: academies in multi-academy trusts are pooled as a category 1B employer by default;
   - Ill-health self-insurance policy: ill-health risk is pooled across all employers in the Fund.

   The Committee approved the two annexes to the FSS

Border to Coast Pension Partnership (BCPP) Corporate Governance Voting Guidelines and Responsible Investment Policy

4. The Surrey Fund has a responsibility to maintain its own Responsible Investment Policy and Share Voting Policy. However, the Committee were presented with the BCPP Corporate Governance Voting Guidelines and Responsible Investment Policy:
    - The BCPP Corporate Governance Voting Guidelines reflect the belief of BCPP that companies operating to higher standards of corporate governance along with environmental and social best practice have greater potential to protect and enhance investment returns. BCPP will engage with companies on environmental, social and governance issues and exercise its voting rights at company shareholder meetings;
    - The BCPP Responsible Investment Policy is based on the belief that environmental, social and governance (ESG) issues can have a material impact on the value of financial assets and on the long term performance of investments, and therefore need to be considered across all asset classes in order to better manage risk and generate sustainable, long-term returns.

The Committee agreed to adopt the BCPP Corporate Governance Voting Guidelines and Responsible Investment Policy

Private Equity Report

5. Based on investment assets of £3,845m as at 31 March 2017, 7.7% of the Fund is committed to private equity investments. The actual level of investment (based on the Fair Value of the remaining investments) is 4.6% of the Fund versus the asset allocation target of 5.0%.

6. In the period 1 April 2016 – 31 March 2017 the private equity portfolio has an internal rate of return of 11.5% (the benchmark for this asset class is the MSCI World Index, which returned gains of 7.2% over the same period).

Manager Issues and Investment Performance

7. The funding level has increased to 97.0% as at 30 September 2017 (82.6% as at 31 March 2016) and is based on the formal 2016 valuation results, updated for market conditions at 30 September 2017 and actual fund returns to that date.

8. The value of the Fund was £3,965.9m at 30 September 2017 compared with £3,890.5m at 30 June 2017. The investment performance for the period was +3.3%.

Administration and Governance Update

9. The Committee considered the following:
    - Key Performance Indicators for the quarter to 30 September 2017;
    - Proposals to receive a focused summary of the administration Performance Report, produced after scrutiny by the Local Pension Board, in future meetings;

- Updates to the monitoring report of the Local Pension Board in respect of the Pensions Administration Audit 2016/17;
- The recommendation of the Local Pension Board for the Pension Fund Committee to establish the Fund's exposure to climate change and carbon risk through the commissioning of a carbon audit of the Fund's portfolios;
- The comments of the Local Pension Board with regard to defining triggers for de-risking as the funding position improves;
- The procurement timetable for the actuarial contract (the new contract is due to be awarded on 14 March 2018.

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

Risk Register(s)

10. The review of the risk register during the preceding quarter has not led to any adjustments to the existing risk ratings or mitigation actions.

Investment Strategy Review

11. At its meeting on 10 February 2017, the Committee resolved to request that a specification paper for the strategic review of asset allocation by Mercer be circulated to the Committee for approval. Delegated authority was given to the Head of Pensions to arrange for Mercer to provide strategic review options.

12. At the meeting on 2 June 2017, the Committee asked for further work to be completed, reference the scoping document from Mercer and asked officers to complete this with a view to a strategy review being carried out for the September meeting.

13. A further report was included concentrating on the following areas:
    - Downside protection with regard to equity risk;
    - Alternative indexation reference passive investing; and
    - Allocating to long-term illiquid asset classes;

14. *Downside protection with regard to equity risk*: equity market values are at record levels, company valuations are above their long term averages, but earnings expectations are relatively weak. In addition, global economic growth remains below trend and there are a number of credit based and geopolitical events that could provide a tipping point to market volatility. Given this scenario, the Committee considered if it is an appropriate time to consider some form of protection for its asset equity values.

15. *Alternative indexation reference passive investing*: traditionally, passively managed portfolios have tracked market capitalisation indices. This can mean that passive portfolios are biased towards past success. They can also be vulnerable to the effects of asset price bubbles. To mitigate this risk it is possible for alternative indices to be constructed which may well have superior return and/or risk characteristics to standard indices.

16. *Allocating to long-term illiquid asset classes*: consideration could be given to making an allocation to long-term illiquid asset classes which would be expected to return an

equity like yield whilst reducing overall volatility relative to the value of the liabilities. One such asset class discussed was Private Debt.

The Committee resolved:

1) *To meet on 29 November 2017 to consider options for downside protection with respect to equity risk.*
2) *To approve the implementation work to be carried out by Mercer with regard to the selection of suitable investment managers for alternative indexation investing.*
3) *To defer an allocation of private debt until the Border to Coast Pension Partnership (BCPP) vehicle is available.*

29 November 2017:

Downside Protection

17. The Committee recognised that the strong performance of equity markets has resulted in a current estimated funding level relative to liabilities of close to 100%. In the last actuarial valuation, as at March 2016, the expected funding level by March 2019 was significantly lower than this. The Committee is concerned to ensure that the recent funding level improvement associated with asset prices is not lost through market volatility between now and the next actuarial review. In order to protect this gain and secure greater stability in employer contribution rates.

18. The protection recommended by Mercer is achieved by introducing a nil-premium put spread collar structure to hedge equity exposure. This approach provides protection against falls in equity markets, with equity upside sold to cover the cost of protection; this is referred to as a “nil premium” approach.

19. Total current equity exposure in the portfolio is broadly categorised as £1.4b in global equities, £950m of which is invested in passive funds and £1b in UK equities. The relative attractiveness of a downside protection to global and UK equities contrasts markedly.

20. The position with regards to global equities is that protection can be positioned at market falls of between 5% and 25% matched against the most appropriate index (MSCI global). This is paid for by ‘selling’ upside exceeding 8%.This position is much less compelling with regards to UK equities, where protection is positioned at market falls of between 10% and 30%, but, the cost is made up by ‘selling’ an upside exceeding only 1% matched against the most appropriate index (FTSE).

The Committee authorised a downside protection strategy through a cost neutral put/call option strategy on the £1.4b of global equities.

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Sources/background papers:

Annexes: