SURREY
COUNTY COUNCIL

The Surrey Local Pension Board
25 July 2018

Summary of the Pension Fund Committee meeting of 8 June 2018

Recommendations:

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

Detail:

Introduction

2. The Pension Fund Committee met on 8 June 2018. This report provides a summary of this meeting and any resolutions made.

Local Pension Board report

3. The Pension Fund Committee (Committee) received the report from the Local Pension Board (Board) including the following recommendations (shown as Annex 1):
    - Risk registers:
        - The following fund risks should be changed from 'treat' to 'tolerate' as the Board felt that noting constructive can be done to mitigate them: Risk 1 (price inflation higher than expected), Risk 2 (pensioners living longer), Risk 3 (pay increases greater than anticipated) and Risk 5 (increased risk to global financial stability).
        - That officers add GDPR related risks to the register.

The Committee approved all the recommendations

4. The Vice-Chairman of the Board explained that the Board had noted that the administration performance had improved in the last quarter.

5. The Vice-Chairman of the Board noted with concern the administration and monitoring of members in danger of breaching the annual or lifetime allowances and

stressed that the Board would be working to address this in future. Officers noted that this was becoming a national issue and that, while it was the individual's responsibility to resolve, that appropriate information should be provided to help resolve the issue.

6. The Vice-Chairman of the Board noted that the Board would be working with officers on 50/50 schemes to work on how to better publicise these schemes to members of the fund as an option.

7. Members questioned whether the Board had identified whether there were any substantial gaps in the CIPFA benchmarking report. Officers noted that this report undertook administrative benchmarking and that few other funds participated in this, limiting the level of results.

8. Officers explained that there were recommended changes to the risk register which were highlighted in the Board report, which would be implemented by the service.

9. The Committee did not identify any compliance of particular cases, projects or processes that the Board should be asked to undertake.

Business plan 2017/18 outturn report

The Committee noted the report (shown as Annex 2) and provided their congratulations to the pension fund team for their achievements and progress on the Business Plan objectives.

Carbon footprint exposure

10. The Surrey Local Pensions Board conducted a review of Environmental, Social and Governance (ESG) compliance in spring 2017 which was then reported to the Surrey Pension Fund Committee on 10 November 2017.The Pension Fund Committee then approved the recommendation to establish the fund's current carbon asset exposure, with the initial analysis being carried out by Trucost on the Fund's passive and active equities.

11. The table below summarises the carbon asset exposure of each Equity manager in comparison to their Benchmarks.

Equity Manager	Value of Holdings (£m) as at 28 February 2018	Total CO2 Footprint per £m holding (tCO2e/£m revenue)	Benchmark CO2 Footprint per £m holding (tCO2e/£m revenue)	Variance	Benchmark used
LGIM Passive - UK Equity	351.89	361.66	358.17	+0.98%	FTSE UK All Share
LGIM Passive - World Developed	485.13	390.90	394.02	-0.79%	FTSE Developed

LGIM Passive World Emerging Market	54.09	832.70	854.41	-2.54%	FTSE Emerging Markets
Marathon Global Equity	491.86	313.03	420.54	-25.57%	MSCI ACWI
Newton Global Equity	320.8	173.54	420.54	-58.73%	MSCI ACWI
Majedie UK Equity	321.27	286.45	358.17	-20.02%	FTSE UK All Share
UBS UK Equity	306.06	276.04	358.17	-22.93%	FTSE UK All Share

12. The deciding factor which contributes to how a portfolio's carbon exposure exceeds its benchmark is whether it is heavily invested in carbon intensive markets (the more intensive being the Utilities, Energy or Materials market). The other factor would be if a portfolio is invested in the most carbon intensive companies within a market.

13. Some of the contributing factors relating to the Carbon Efficiency of each portfolio are highlighted below

Equity Manager	Contributing Factor to Variance
LGIM Passive - UK Equity	In aggregate, the two sectors that have the greatest positive effect on carbon efficiency are Telecommunication Services and Information Technology, which together contribute 0.0% of the increased carbon efficiency. The two worst performing sectors in the portfolio are Materials and Consumer Discretionary, which contribute to 0.61% of reduced carbon efficiency. The largest Contributors to the Portfolio's Total Carbon Apportionment are Royal Dutch Shell PLC, BP and CRH Plc with a combined carbon apportionment of 45.33% of the portfolio.
LGIM Passive - World Developed	In aggregate, the two sectors that have the greatest positive effect on carbon efficiency are Industrials and Materials, which together contribute 1.11% of the increased carbon efficiency. The two worst performing sectors in the portfolio are Utilities and Energy, which contribute to 1.24% of reduced carbon efficiency. The largest Contributors to the Portfolio's Total Carbon Apportionment are LafargeHolcim Ltd, Exxon Mobil Corp and RWE AG with a combined carbon apportionment of 7.89% of the portfolio.

LGIM Passive World Emerging Market	In aggregate, the two sectors that have the greatest positive effect on carbon efficiency are Utilities and Financials, which together contribute 2.28% of the increased carbon efficiency. The two worst performing sectors in the portfolio are Industrials and Consumer Staples, which contribute to 0.2% of reduced carbon efficiency. The largest Contributors to the Portfolio's Total Carbon Apportionment are Gazprom PJSC, NTPC Ltd and Sasol Ltd with a combined carbon apportionment of 14.36% of the portfolio.
Marathon Global Equity	In aggregate, the two sectors that have the greatest positive effect on carbon efficiency are Utilities and Energy, which together contribute 33.24% of the increased carbon efficiency. The two worst performing sectors in the portfolio are Consumer Staples and Health Care, which contribute to 18.84% of reduced carbon efficiency. The largest Contributors to the Portfolio's Total Carbon Apportionment are Archer-Daniels-Midland Co, Bunge Ltd and Praxair Inc. with a combined carbon apportionment of 43.06% of the portfolio.

14. Members questioned how Trucost calculated the carbon footprint of organisations in which the Fund invests. Trucost representatives explained that emission rates disclosed by companies were used in calculations, but noted that in cases where data were not available, rates were modelled using well established methodology.

15. Members asked whether the carbon footprint of the final product of oil and gas companies was included as part of the footprint. Trucost representatives noted that this was not included but that the use of the end product was included in other company footprints.

16. It was noted that oil, gas and materials companies in which the Surrey Pension Fund invests a significant carbon apportionment in the Fund's investments.

17. Members queried whether the information presented by Trucost regarding carbon footprint impact could be analysed alongside the performance of investments. Officers noted that this comparison would be included as part of future Investment Manager Reports to the Committee to allow analysis and to determine the appropriateness of the investments.

18. Members questioned benchmarks relating to investment in high carbon footprint industries and whether there was a potential for increasing the thresholds for benchmarks to reduce investments in high carbon footprint assets. Advisors noted that the Fund could employ different benchmarks to encourage this that the service could employ.

Equity strategy review

19. Advisors noted that the Committee was required to review the balance between Global and UK equities, the allocation to RAFI and consider investments in low

carbon assets and any potential changes to the balance between active and passive investments.

20. Advisors suggested that the balance between active and passive investments should remain unchanged. It was noted that the weighting between active and passive was similar in Surrey to other comparable LGPS's.

21. Advisors and officers explained that the transfer of assets to the Border to Coast Pensions Partnership (BCPP) made an equity strategy review timely and that it was important for the Fund to consider long term strategy before transfer.

22. It was noted that UK equities were heavily weighted towards oil and gas companies and that stock concentration was significantly higher in UK equities than in global equities. Advisors noted that there was a proposal to reduce UK equities to 20% of the allocation. It was also suggested that the allocation would be actively managed by the BCPP. Advisors noted that there was an agreement that UK equities should be actively managed to maximise returns.

23. Advisors highlighted that MSCI Low Carbon Target Index was the preferred low carbon index.

24. Members noted that the Fund could work to guide the BCPP towards investment in low carbon assets by highlighting the issue as a key priority for the fund.

25. Members questioned advisors on equity protection and whether the next steps were appropriate. Officers noted that the triggers were in place and advisors suggested that protection be proceeded to stage three. It was stressed that there was a continued strong rationale for equity protection.

Investment Manager Issues and Performance Report

26. The Committee noted the total value of assets at 31 March 2018 as £4,025.6m, meaning the Funding level was 101%.

27. Advisors noted that there were concerns with the performance of Aviva and that the stated objective of 4% performance levels was unlikely to be accomplished. Aviva to be put on watch.

28. The Committee provided authorisation for a power of attorney to act in the repatriation of Taiwanese Dollars (NTD).

29. Members questioned whether the service would review other overseas positions. Officers noted that the Fund team was discussing this issue with the custodian and that an update would be brought back to the Committee when this was concluded.

Cash-flow analysis

30. Members questioned the Quarter 3/4 total contributions and why they had significantly increased. Officers explained that the income management team had performed a reconciliation of contribution balances whereby they allocated cash to appropriate months had not been undertaken in the previous quarters. It was also suggested that an additional reason for the high increase was as a result of some employers paying the deficit contribution at the year-end.

31. Officers noted that they would bring quarterly reviews to the Committee to aid in the review of trends.

Pension Fund Internally Managed Cash Strategy

32. Officers highlighted the report, noting that unutilised cash could be better used by fund managers to yield greater return. It was proposed that the fund set up a collar for future investments of around £20 million. Officers noted that they would seek advice as to where to invest any cash that was outside of the £20 million collar.

The Committee approved all the recommendations

National Pooling Update

33. The Committee approved in principle, the transition of the UK equity portion of the Surrey Pension Fund portfolio to the Border to Coast Pensions Partnership (BCPP) national pool when it has been established, assuming that the "necessary conditions" of governance have been satisfied.

34. The Committee approved the delegation of authority to the Director of Finance (section 151 officer), in consultation with the Chairman of the Pension Fund Committee, to transition the UK equity portion of the Surrey Pension Fund portfolio to the BCPP, assuming that the "necessary conditions" of governance have been satisfied.

1 The "necessary conditions" and BCPP current progress towards meeting them are shown below:

Necessary condition	BCPP progress
Legal documentation:	Significant oversight of drafting of documentation with involvement from Border to Coast team and Board, Eversheds, Deloittes, Northern Trust, OOG and FCA. The ACS prospectus (and governing docs for future non-ACS sub-funds); admission deed / application form; and IMA for those who are taking advantage of advisory services during transition. For July's launch these are already in discussion / have been reviewed; for September these will develop over the next 6 weeks.
Investment proposition due diligence:	Fit with strategic asset allocation requirements and understanding of process, particularly for external manager selection and fund construction)
Plan for sub-fund launch trajectory	Transition timeline paper discussed at OOG meeting of 14 May 2018. See Annex 5

Operational readiness (including Northern Trust)	BCPP will share the paper that is going to the Board on 24th May regarding the "stop/go" decision framework once the Board has signed it off BCPP will share our testing plan (this is expected to be finalised by 18th May) The first ISAE3402 likely to be ready by mid-2019 at the earliest given the need to have a reasonable period of evidence for control testing. The BCPP proposal is to investigate having an interim review (possibly in November / December) – a proposal to be made to Partner Funds with a proposal.
Risk management plans (including contingency planning)	The description of high level risk framework and implementation risk register will be shared post sign-off at the 24th May Board.
Transition plans	This is being discussed in detail at the transition workshops and is a live discussion with the internally managed teams in terms of agreeing process, portfolios and transition methodology. BCPP expect to make available an Inalytics report on transition plan & costs in due course (in the immediate term for July's launch and early August for September's launch). The final agreement on cost sharing is also a key deliverable, which BCPP are working on with Eversheds.
Approach to ongoing oversight	See draft Governance Charter'

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Sources/background papers:

Annexes:

1. Local Pension Board committee report
2. Pension Fund Business Plan 2017/18: Outturn Report

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