

**SURREY COUNTY COUNCIL****PENSION FUND COMMITTEE****DATE: 9 JULY 2021****LEAD OFFICER: ANNA D'ALESSANDRO, DIRECTOR OF CORPORATE FINANCE****SUBJECT: INVESTMENT CORE BELIEFS AND THE UNITED NATION'S SUSTAINABLE DEVELOPMENT GOALS****SUMMARY OF ISSUE:**

Strategic objectives	
Investment	Governance

This paper provides details of the progress made in developing the Surrey Pension Fund's (the Fund's) investment strategy, consistent with the environmental, social and governance (ESG) commitment in its Mission Statement and with actions agreed in the Pension Fund Committee meetings of 11 December 2020 and 12 March 2021.

**RECOMMENDATIONS:**

It is recommended that the Pension Fund Committee:

1. Approve for the Committee to receive further background to proposals in this report, through a dedicated information session and to convene an additional Pension Fund Committee meeting to allow for the Committee to approve next steps once they have received this information.
2. Note the proposed revised Investment Strategy Statement (shown as Annexe 1), subject to further consideration in accordance with recommendation 1.
3. Note the proposed structure for a standalone Responsible Investment Policy (shown as Annexe 2) and authorise officers to work with Minerva to bring a recommended policy to the Committee for consideration at its next meeting, subject to further consideration in accordance with recommendation 1.
4. Note the proposal for the internal transition of RAFI multi-factor and low carbon indexed equity assets with Legal and General Investment Management (LGIM) to the Future World Fund, with reference to the report from the investment consultant, Mercer (shown as Annexe 3), subject to further consideration in accordance with recommendation 1.

**REASON FOR RECOMMENDATIONS:**

To keep the Pension Fund Committee apprised of the progress made in reviewing the Fund's investment strategy with a view to ensuring that it is in line with its Mission Statement and the emphasis on ESG considerations.

## BACKGROUND:

1. At its meeting of 7 June 2019, the Pension Fund Committee approved the following mission statement:

*“The Surrey Pension Fund will deliver a first-class service through strong partnerships with scheme members, employers, the Border to Coast Pool and the wider LGPS community. Environmental, Social and Governance factors are fundamental to our approach which is underpinned by risk management, informed decision making, the use of technology and the highest standards of corporate governance”.*

2. Further to this, at its meeting of 20 December 2019, the Pension Fund Committee approved for a Committee sub-group to be convened to develop the Fund’s responsible investment approach, consistent with the ESG commitment in its Mission Statement.
3. As a result of the findings of this Committee sub-group, the Fund had chosen to use the United Nations Sustainable Development Goals (SDGs) as a reference for Responsible Investment, as it represents a framework of universally agreed goals in which all countries within the United Nations should aim to achieve by 2030.
4. The Fund appointed Minerva Analytics to examine the existing Investment Portfolio holdings of Surrey Pension Fund and their relationship (positive/negative) to the SDGs, and identify the risks and opportunities associated with the analysis.
5. The Fund received a report from Minerva Analytics in its meeting of 11 December 2020. In response to this report and the Committee approved the following:
  - a) Having considered all aspects of incorporating ESG considerations into the investment approach, and in acknowledgement that there is no universally agreed approach in this area, agrees that the use of SDGs provides a forward thinking and comprehensive approach in referencing the transition to sustainability within the Fund’s investment strategy.
  - b) The Minerva Report provides sufficient assurance to enable a decision to move to the next stage of more detailed preparation and implementation.
  - c) A request for further action from officers and, where appropriate, advisors, to cover the following areas:
    - i) Draft relevant changes to the Investment strategy.
    - ii) Develop SDG into an engagement framework for companies as well as Investment Manager activity.
    - iii) Work to incorporate SDG metrics in selecting, monitoring and evaluating investment managers.
    - iv) Work with Border to Coast on developing SDG approach to Pooled assets.

- d) Agrees that officers provide the following updates for the next meeting:
  - a) Presentation of an implementation plan.
  - b) Propose the method by which progress on implementation is incorporated as part of all future investment strategy reviews.
  - c) Propose the timeline for the assessment and ongoing viability and effectiveness of this approach.

<b>DETAILS:</b>
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### Implementation plan

- 6. The implementation plan is the roadmap to develop the Fund's investment strategy, consistent with the ESG commitment in its Mission Statement. It consists of the following:
  - a) Work with the Investment Consultant and Independent Advisor and present initial amendments to the Fund's Investment Strategy Statement.
  - b) Work to incorporate SDG metrics in selecting, monitoring and evaluating investment managers.
  - c) Develop SDGs into an engagement framework for companies as well as Investment Manager activity, concentrating on the Fund's principal providers of investment products, Legal and General Investment Managers (LGIM) and Border to Coast.

#### Work with Investment Consultant and present initial amendments to the Fund's Investment Strategy Statement

- 7. Officers have now completed their work with the Investment Consultant and Independent Advisor to revise the Fund's Investment Strategy Statement. The revised version, with tracked changes is shown as Annexe 1.
- 8. A summary of the proposed changes to the Investment Strategy Statement is as follows:
  - a) Revisions to the asset allocation to more accurately reflect the revisions to the investment strategy as approved by the Pension Fund Committee on 12 September 2019, 12 June 2020, 11 September 2020 and 12 March 2021 (pages 3, 6-7);
  - b) Revisions to the indexed (passive) portfolio to reflect the proposed termination of the RAFI multi-factor and Low-carbon indexed funds and transition in to the LGIM future world index fund (page 6 (this proposal is detailed later in this report));
  - c) Amendments in anticipation of the development of a standalone Responsible Investment Policy for the Fund (pages 9-13 and 20-35 (this proposal is detailed later in this report));
  - d) Cosmetic changes to provide make the investment strategy clearer and remove the need for frequent future amendments.

#### Work to incorporate SDG metrics in selecting, monitoring and evaluating investment managers

- 9. The Fund opted to use the World Benchmarking Alliance (WBA) SDG2000 to assess its starting position in understanding which companies have the

potential to shift the dial in delivering the SDGs, if they were managed with the highest levels of corporate governance. The Benchmark was used to provide a starting position as opposed to being used for assessing periodic progress.

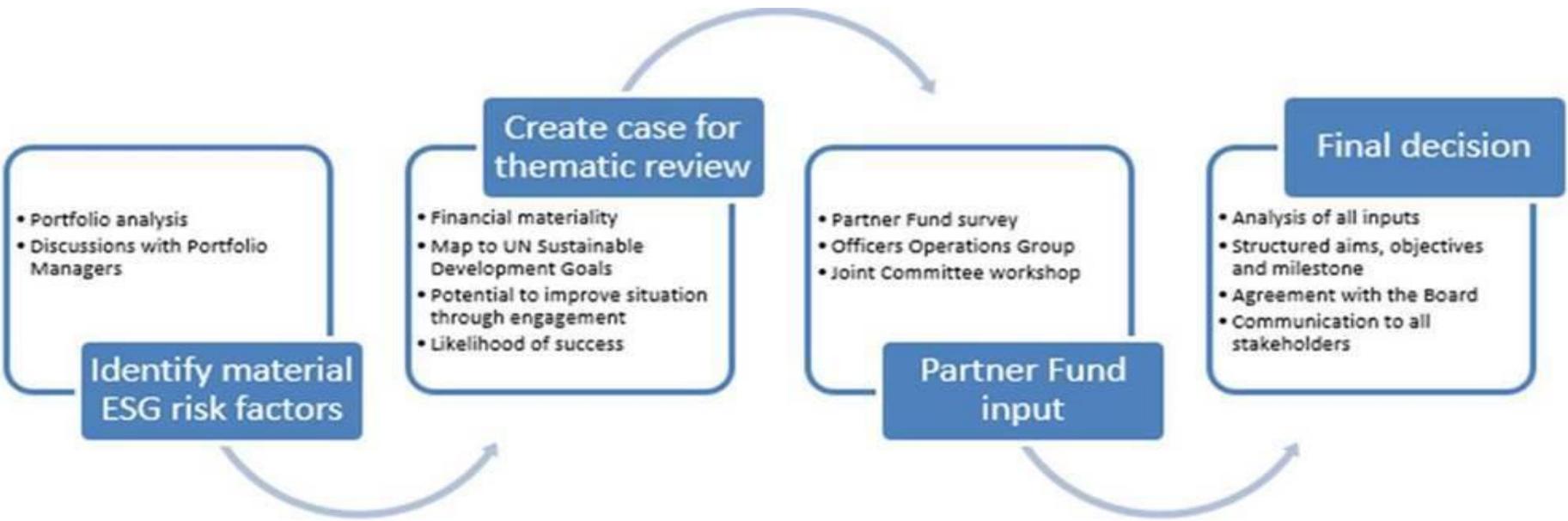
10. In order to provide an overarching framework for the Fund's approach to Responsible Investing, including using SDG metrics in selecting, monitoring and evaluating investment managers, it is proposed that the Fund develops a standalone Responsible Investment Policy.
11. The opportunity exists to establish and promote a comprehensive and up-to-date RI Policy that reflects both current good practice and the Fund's desire to more closely align with the SDGs, whilst working predominantly through third parties such as Border to Coast and Legal & General Investment Management.
12. Officers have worked with Minerva Analytics to produce a 'skeleton format' showing the structure and summarised content, but not the detail, of the following key RI policy pillars (this is shown as Annexe 2):
  - a) Governance: Details of the Fund's approach to the responsible oversight and management of the Fund's investments, and its RI 'beliefs'.
  - b) Investment: Details of the Fund's approach to incorporating ESG/RI factors into the investment process at all levels.
  - c) Implementation: Details of the planned approach to implementing the Fund's RI objectives.
  - d) Stewardship: Details of Surrey's approach to voting at company meetings and engaging with investee companies, with a particular focus on working through Border to Coast.
  - e) Monitoring and Reporting: Details of Surrey's approach to assessing ongoing effectiveness and communicating findings.

Develop SDGs into an engagement framework for companies as well as Investment Manager activity, concentrating on the Fund's principal providers of investment products, Legal and General Investment Managers (LGIM) and Border to Coast

13. As part of its pooling commitment, the Fund has embarked on transitioning all of its actively managed listed and legacy unlisted assets to Border to Coast. In the future all assets will be managed by Border to Coast, with only indexed assets excluded from this commitment. The Fund's current provider of indexed assets is LGIM, therefore, the work to develop SDGs into an engagement framework for companies will concentrate on LGIM and Border to Coast.
14. The Fund has considered LGIM's engagement approach through their Future World Framework. This provides both a robust and measurable framework for assessing the effectiveness of their engagement with companies. The Future World Framework engages on key sustainability themes, which are considered essential elements of the 'Future World' and which the Fund feels closely aligns with the SDGs, including but not limited to:
  - a) Climate Change Energy (SDG 7: Affordable and Clean Energy, SDG 13: Climate Action).
  - b) Biodiversity (SDG 14: Life below Water, SDG 15: Life on Land).
  - c) Waste (SDG 12: Responsible Consumption and Production).

- d) Water (SDG 6: Clean Water and Sanitation).
  - e) Human Rights (SDG 10: Reduced Inequalities).
  - f) General Population (SDG 11: Responsible Cities and Communities).
15. Of the current portfolio 23.4% is committed to indexed equity assets with LGIM. The current split of indexed assets with LGIM is as follows:
- a) 42% Global multi-factor (RAFI).
  - b) 42% Low carbon.
  - c) 16% Emerging markets.
16. Officers have worked with the investment consultant, Mercer and the independent advisor to consider the appropriateness of the LGIM's Future World Framework as an alternative.
17. In their report, included as Annexe 3, Mercer have highlighted three key considerations when comparing the current and target portfolio:
- a) Cost considerations.
  - b) ESG considerations and specifically UN SDG alignment.
  - c) Impact on carbon footprint.
  - d) Impact on expected return.
18. *Cost considerations:* a total expense ratio (TER) of less than 5bps per annum from the target portfolio is a reduction of c35% (producing approximate annual savings of c£300k). The transition costs of c£600k are therefore offset in approximately two years.
19. *ESG considerations and specifically UN SDG alignment:* the target portfolio provides exposure to a broader range of ESG factors which are most closely aligned to the UN SDGs it also provides an engagement framework with consequences.
20. *Impact on carbon footprint:* 40% reduction in emission intensity and 65% reduction in carbon reserves intensity.
21. *Impact on expected return:* no negative impact on return from moving to the target portfolio.
22. The Fund has also held discussions with Border to Coast on implementation considerations of the Pool's engagement approach.
23. As part of Border to Coast's Responsible Investment 3 Year Strategic Plan, Border to Coast will select engagement themes for the Annual Responsible Investment Policy Review based on three key principles going forward:
- a) That progress in these areas would be expected to have a material financial impact on our investment portfolios in the long-term.
  - b) That the voice of Partner Funds should be a part of the decision.
  - c) That ambitious but achievable milestones can be set through which we can measure progress over the period.





Implementation Plan High Level Timeline																					
Month	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22				
Elements of implementation plan	Work with the Investment Consultant and present initial amendments to the Fund's Investment Strategy Statement						▶					◆	11/06								
	Develop SDGs in to an engagement framework for companies as well as Investment Manager activity									▶								◆	10/09		
	Work to incorporate SDG metrics in selecting, monitoring and evaluating investment managers											▶							◆	10/12	
	Work with Border to Coast on developing SDG approach to Pooled assets											▶							◆	10/12	

**The method by which progress on implementation is incorporated as part of all future investment strategy reviews/ the timeline for the assessment and ongoing viability and effectiveness of this approach**

- 24. As both the SDGs and Impact measurements are very much in their early stages, it may be too early to set a timescale on assessing the appropriateness (or lack of) in using the SDGs as an Investment Framework from the Fund's perspective. However, as this is a subject of considerable interest to our stakeholders, it is proposed the Committee review developments and the progress of the Implementation Plan on an ongoing basis, reported formally through Pension Fund Committee meetings.
- 25. The Fund expects metrics to only improve in their robustness and usability over the coming years as more Asset Managers meet the demand of Asset Owners in seeking sustainable investment products.
- 26. The Fund will continue to assess the effectiveness and practicality of the metrics on a periodic basis, when new measurements are available. This can be assessed triennially in line with its Investment Strategy Reviews and Triennial Valuation timescales.

### **CONSULTATION:**

27. The Chairman of the Pension Fund Committee has been consulted on this report.

### **RISK MANAGEMENT AND IMPLICATIONS:**

28. The consideration of risk related issues, including investment, governance and reputational risk, are an integral part of this project and will be considered as part of the project development.

### **FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

29. There are no financial and value for money implications contained in this report.

### **DIRECTOR OF CORPORATE FINANCE COMMENTARY**

30. The Director of Corporate Finance is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

### **LEGAL IMPLICATIONS – MONITORING OFFICER**

31. There are no legal implications or legislative requirements.

### **EQUALITIES AND DIVERSITY**

32. There are no equality or diversity issues.

### **OTHER IMPLICATIONS**

33. There are no potential implications for council priorities and policy areas.

### **WHAT HAPPENS NEXT**

34. The following next steps are planned:

- a) An information session to be convened to provide the Committee with further background to the proposals in this report.
- b) An additional Pension Fund Committee to be convened to allow the Committee to approve next steps once they have received this information.

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#### **Contact Officer:**

Neil Mason, Strategic Finance Manager (Pensions),

#### **Consulted:**

Pension Fund Committee Chairman

**Annexes:**

1. Revised Investment Strategy Statement (with tracked changes)..
2. Proposed RI policy framework.
3. Mercer report

**Sources/background papers:**

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