SOUTH YORKSHIRE PENSIONS AUTHORITY

INVESTMENT BOARD

8 MARCH 2018

PRESENT: Councillor S Ellis (Chair)
Councillors: S Cox, A Sangar and I Saunders

Officers: F Bourne (Administration Officer), J Firth (Principal Investment Manager), G Graham (Fund Director), M McCarthy (Deputy Clerk), G Richards (Senior Democratic Services Officer), I Rooth (Head of Financial Services, BMBC) and S Smith (Head of Investments)

Trade Union Members: N Doolan-Hamer (Unison)

Investment Advisors: N MacKinnon and L Robb

Royal London: L Bramwell and J Platt

Apologies for absence were received from: Councillor K Harpham, Councillor J Mounsey, Councillor R Wraith, T Gardener, D Patterson, G Warwick and N Copley

1 APOLOGIES

Apologies were noted as above.

2 ANNOUNCEMENTS.

M McCarthy welcomed Fund Director George Graham to the meeting.

The Board were informed that the Authority was required to appoint a Head of Paid Service in accordance with Section 4 of the Local Government and Housing Act 1989; the Authority's Constitution designated this role to the post of Fund Director. A report would be submitted to the Authority meeting on 15 March 2018.

3 URGENT ITEMS.

None.

4 ITEMS TO BE CONSIDERED IN THE ABSENCE OF THE PUBLIC AND PRESS.

None.

5 DECLARATIONS OF INTEREST.

None.

6 MINUTES OF THE MEETING OF THE BOARD HELD ON 14 DECEMBER 2017

RESOLVED: That the minutes of the meeting held on 14 December 2017 be agreed and signed by the Chair as a true record.

7 WORK PROGRAMME

The Board considered its Work Programme.

M McCarthy informed the Board that the Work Programme would be populated further when the 2018/19 cycle of meetings was approved by the Authority.

With regard to the regular Pooling Update item, L Robb suggested that it would be helpful to focus on different aspects of the pooling process individually.

G Graham agreed and suggested a Workshop session either before or after a Board meeting to consider the best format for this.

RESLOVED: That the Work Programme be noted.

8 PRESENTATION BY ROYAL LONDON

Lucy Bramwell and Jonathan Platt from Royal London Asset Management gave a presentation on the Authority's Buy And Maintain portfolio of sterling denominated corporate bonds.

Members were reminded that the objective was to build a portfolio of sterling credit bonds with an overall interest rate duration target of between 8 and 10 years at the completion of the investment.

Since the last meeting in March 2017 there had been an inflow of £45m and the current value of the portfolio was £390.2m.

The Board noted the portfolio's performance, characteristics and diversification; there was over 270 holdings across 209 issuers with a greater focus on security than the benchmark. There had been one issuer downgraded to sub-investment grade since inception.

In conclusion, the Board were informed that:

- 2017 had witnessed the strongest period of global GDP growth since the financial crisis.
- Government bond markets remained overly-pessimistic about global growth prospects, Royal London expected global bond yields to trend gradually higher.
- In the US, it was anticipated there would be three small policy rate rises from the Fed in 2018.
- In the UK, growth had remained sluggish as a result of continued uncertainty around Brexit.
- It was expected that the Bank of England would raise rates twice in 2018.
- Royal London remained positive on credit bonds relative to government bonds and expected sterling credit to outperform gilts over the next three years.

- Portfolio positioning reflected the defensive nature of secured bonds combined with attractive diversification.

The Chair thanked Lucy Bramwell and Jonathan Platt for an informative presentation.

9 LOCAL AUTHORITY PENSION FUND FORUM: JANUARY 2018 BUSINESS MEETING

A report was considered which informed the Board that the minutes of the LAPFF October 2017 business meeting had been issued and gave an update on the January 2018 business meeting.

Members noted that a tribute to Councillor Kieran Quinn, the LAPFF Chair, was presented at the meeting following the sad news of his death on Christmas day.

The meeting also included items on:

- Verbal updates on pooling, the work of the Scheme Advisory Board and the All Party Parliamentary Group.

- A report was presented on membership fees for 2018/19 onwards. An annual flat rate would be introduced, removing the discounted three year option, and a new category of membership relating to the pools would be created.

The quarterly engagement report for October to December included comments on holdings-based engagement and could be accessed via the LAPFF website. Key issues covered in the report included:

  - LAPFF engagement on environmental and carbon risk.

  - Reflecting the growing concern surrounding cybersecurity, a number of meetings had been held with companies questioning them on their governance and risk management processes.

RESOLVED – That the report be noted.

10 BRITISH VENTURE CAPITAL ASSOCIATION

A report was submitted to seek approval to renew membership of the British Venture Capital Association on the Limited Partner tariff.

Members were reminded that the British Venture Capital Association was a lobbying group and professional body representing private equity and venture capital asset managers and investors. It produced proprietary research, provided technical updates on legal, regulatory and taxation issues and published best practice papers and performance statistics.

The Fund was committed to the private equity asset class and currently had some £370m of value invested and a further £250m committed in undrawn investments.

Members were informed that Limited Partner membership remained at £250 per annum rather than the normal rate of £515 per annum; the present membership would run out on 31 March 2018. Given the move towards pooling new private equity investment, a review would be carried out prior to the next renewal to determine whether continuation of the subscription was justified.

RESOLVED – That the Board agree that the Authority renew its membership of the British Venture Capital Association as a Limited Partner member.

11 EQUITY PROTECTION STRATEGY UPDATE

Members were informed that the Investment Manager Agreement had been signed and the instruction letter issued; collateral would be transferred during the week and the manager would begin to execute the options the following week.

G Graham informed the Board that there was currently a little more upside available than previously reported, this was 15% rather than 12%.

In answer to a question from Cllr Sangar, G Graham remarked that it was difficult to say if the Fund had lost value since the decision was made on equity protection but it was still funded at 100%+.

The Board and the Advisors congratulated the Investment Team on their performance for the Fund to be in its current position.

RESOLVED – That the update be noted.

12 UK VOTING GUIDELINES

A report was submitted to seek Members' approval to the proposed change to the current voting guidelines.

Members were informed that the Authority's voting guidelines were reviewed annually and were considered in conjunction the Authority's corporate governance advisor, PIRC. In 2017 the decision was taken to make no revisions.

Officers had reviewed the current UK voting guidelines with PIRC and consequently suggested that a minor amendment be made.

Members were reminded that officers review individual resolutions at company meetings and that the voting guidelines were overridden if necessary.

The suggested amendment was:-

SECTION ONE

LISTED COMPANIES (EXCLUDING INVESTMENT TRUSTS)

20) Articles of Association

Vote against proposals:-

Insert 2. – To amend Articles to allow virtual only meetings.

The Board discussed the merits, or otherwise of virtual meetings. Some Members felt that virtual meetings gave less opportunity for proper engagement with companies and that they removed the ability for shareholders and stakeholders to lobby in an open forum, while other Members felt that virtual meetings would allow some people to participate who would otherwise have not been able to.

It was noted that if the Board agreed to the proposed change to the voting guidelines this did not prevent the Authority voting against allowing virtual only meetings.

RESOLVED: That the Board agree to the proposed change to the voting guidelines as detailed above.

13 RESPONSIBLE INVESTMENT: ENGAGEMENT UPDATE

A report was submitted to advise Members of the Fund's responsible investment engagement activities.

The Board was reminded that the Authority was fully committed to responsible investment and good stewardship of its investments; the Authority regarded its voting rights as an asset and used them carefully. The internal investment managers of the Fund hold meetings with investee companies throughout the year at which ESG issues are discussed.

The Authority would engage directly on specific issues but would collaborate with other investors to maximise influence. The majority of engagement over the last year had been directed via the Local Authority Pension Fund Forum (LAPFF); the Forum's activities were detailed in the report and was carried out under the following categories.

- Governance Risk.
- Social Risk; and
- Environmental Risk.

The latter was a large part of the engagement work.

The Board noted that during 2017, the Fund voted at 931 meetings in the UK, Europe and North America. The Fund abstained on 545 resolutions, voted against 4370 resolutions and supported all resolutions at 96 meetings.

Cllr Saunders commented that he was not in favour of abstentions.

J Firth replied that the Fund voted in conjunction with how PIRC interpreted the Authority's guidelines; the Fund would normally abstain if it was engaging with a company on specific issues.

G Graham suggested that the matter could be looked at when next reviewing the voting guidelines.

The Board noted that J Firth had attended the AGM's of Tesco and BHP Billiton representing both the Fund and LAPFF.

During the year the Authority had become a signatory to the Workforce Disclosure Initiative which was a new project focusing on human capital management reporting by companies and had signed on to the Climate Action 100+ initiative which was a five-year programme led by investors to engage with the world's largest corporate greenhouse gas emitters.

RESOLVED – That the report be noted.

14 CARBON AUDIT

The Board considered a report that advised them of the outcome of the carbon audit commissioned last year.

Members were reminded that in September 2015, the Board had made a decision to engage a specialist contractor, Trucost, to measure the carbon footprint of the Funds four main equity portfolios, subsequent carbon audits would then be undertaken on a biennial basis. The decision was made in 2017 to use the same provider for the subsequent footprint for comparative purposes.

Members noted that it was widely acknowledged that carbon footprinting had limitations and weaknesses. Although data was improving as companies provided better climate-related financial disclosures, investors still needed to be aware that data was patchy.

The key findings of the carbon footprint were listed in the report. It was noted that each of the individual equity portfolios (UK, US, European, Other Far East) was more carbon efficient than in 2015.

Trucost had stated that three out of the four portfolios were more carbon efficient than their relative benchmarks with sector allocation for all being positive. Therefore, the Authority's policy of positively tilting its equity portfolios was having the desired effect.

Trucost had recommended the following:

- Engage with companies from the lists of top contributors across the various portfolios requesting ambitious short and long term greenhouse gas reduction targets.

- Monitor the carbon disclosure of a number of Asian energy and cement companies, encouraging them to disclose carbon emissions data.

- Set targets for reducing coal mining and power exposure, and increase renewable energy exposure.

- Consider investing in alternative asset classes to increase exposure to a lower carbon economy.

- Monitor the top carbon intensive companies in each portfolio to track changes in performance.

Members were informed that the Authority would, where possible, take on board Trucost's recommendations whilst acknowledging the constraints that pooling would bring.

The Authority would encourage Border to Coast Pensions Partnership (BCPP) to reduce carbon exposure across portfolios, to consider reducing exposure to high-carbon intensity companies and expect BCPP to measure and monitor portfolios' exposure to carbon- intensive companies.

Members expressed concern that the products would not be available in BCPP to continue to improve the Fund's carbon footprint.

G Graham would ensure that BCPP were aware of Trucost's recommendations and the Authority's wish to continue in the same vein; R Elwell, CEO of BCPP, was supportive of the Authority's position.

In addition, the Authority's J Firth, was leading on BCPP's Responsible Investment Policy.

RESOLVED – That the report be noted.

15 SYPA CLIMATE CHANGE POLICY

The Board considered a report which reviewed the Climate Change Policy and updated Members on the Authority's actions over the last 12 months.

Members were reminded that a proposed new Climate Change Policy had been submitted to the Investment Board in December 2017. The policy had been aligned with the newly-created LAPFF Climate Change Policy Framework and to reflect pooling.

Members, although content with the structure of the Policy, wanted to retain reference to 'tilting' within the Policy. The current Climate Change Policy was attached for reference along with the proposed new Policy which had been amended to reflect the points made by Members at the meeting of the Investment Board in December 2017.

Members also noted the progress made on implementing the Climate Change policy during the last 12 months.

RESOLVED:

i) That the report be noted.

ii) That the revised Climate Change Policy is approved.

16 POOLING UPDATE

A report was submitted to update the Board on progress towards pooling of the Fund's assets within the Border to Coast pool and to seek members' views on the proposed revisions to BCPP's approach to the transition of listed assets into the various pooled vehicles.

The report listed the progress made with a number of key investment related processes and also seven key pieces of strategic work which needed to be undertaken prior to the scheduled June "go live".

Members noted that there was a significant amount of work to be done which would put considerable pressure on the BCPP team and on the teams within the individual pension funds. As a result of this, thought had been given to how best mitigate the risk around the process for rolling out sub-funds.

As a result of this BCPP were now proposing to reduce the number of sub-funds at launch, the list of which was contained within the report. Members noted that the approach chosen would move internally managed assets into the pool at a faster rate within a simplified series of sub-funds.

Members were informed that the move away from regional overseas equity funds was the most significant aspect of the proposals for South Yorkshire.

Members were informed that the issue was that BCPP were proposing to move away from a position agreed with all Funds of mirroring their initial asset allocation. This would lead to a key debate in the evolution of pooling which was how to define strategic asset allocation which remained unresolved.

Members and advisors (including a paper from T Gardener who could not be at the meeting) discussed a number of concerns and options at length.

After considerable deliberation it was decided to reluctantly accept BCPP's proposals subject to:

i) That BCPP make a written commitment to establish separate North American, European, Asian and Japanese funds by 30 June 2019, or a mutually agreed later date, as set out in the plan already agreed by stakeholders.

ii) That the Asian fund (both within the Global fund and separately) would be run in such a way that investors could invest in Asian emerging markets without having to gain exposure to emerging markets such as Latin America.

iii) It was acknowledged that some adjustments had already been made in terms of the US weighting; the Authority would want to discuss whether this could be increased further.

Members noted that BCPP had already indicated a willingness to move to the S&P 500 as the benchmark for the North American portion of the Global Fund recognising that the inclusion of Canada in the benchmark caused a range of difficulties.

RESOLVED:

i) That the Board note the progress being made towards BCPP becoming operational.

ii) That the Board reluctantly accept BCPP's proposed revisions to the transition process for listed assets, subject to the conditions detailed above.

17 QUARTERLY REPORT TO 31 DECEMBER 2017

The Board considered the Quarterly Report to December 2017.

Members noted that there were several factors affecting markets during the quarter, including:

- Brexit negotiations.
- A rise in interest rates.
- The collapse of coalition talks in Germany; and
- A regional election in Catalonia which failed to resolve the independence issue.

S Smith informed the Board that, for the quarter, the Fund had returned 3.9% against the expected return of 4.1%, with the Fund valuation rising from £7919.0m to £8193.7m. The performance was attributed to:

Bonds - Being underweight bonds added to performance. Asset mix across bonds was also positive.

UK Equities – Stock selection was mixed.

Overseas Equities – Being overweight the asset class added value.

Alternatives - The performance was mixed across the portfolios.

Property – Performance was behind the overall benchmark overall.

RESOLVED – That the report be noted.

CHAIR