

## **AVON PENSION FUND COMMITTEE ANNUAL REPORT TO COUNCIL (April 2014 - March 2015)**

### **1 BACKGROUND TO THE AVON PENSION FUND**

The Avon Pension Fund is a statutory scheme regulated by the Local Government Pension Scheme Regulations 2014 (as amended) and the Local Government Pension Scheme Regulations (Management and Investment of Funds) Regulations 2009 (as amended). Bath & North East Somerset Council (“the Council”) administers the Fund on behalf of more than 214 employing bodies including the four unitary authorities. The Fund has c. 96,000 members and the value of the Fund as at 31 March 2015 was £3.4 billion. In 2014/15 the Fund received £198 million in pension contributions and paid out £163 million in pension payments.

#### **(a) GOVERNANCE**

The Council has delegated responsibility for the Fund to the Avon Pension Fund Committee (the “Committee”) which is the formal decision-making body for the Fund. The Committee’s role is strategic in nature, setting policy framework and monitoring implementation and compliance within that framework. Due to the wide scope of the Committee’s remit it is supported by the Investment Panel (the “Panel”) which considers the investment strategy and investment performance in greater depth. The Committee has delegated authority to the Panel for specific investment decisions. The Terms of Reference, agreed by the Council, for the Committee and Panel are set out in Appendix A to this report.

#### **Committee Membership**

The Committee structure is as follows:

Voting members (12)	5 elected members from B&NES (subject to the rules of political proportionality of the Council) 2 independent trustees 3 elected members nominated from the other West of England unitary councils 1 nominated from the education bodies 1 nominated by the trades unions
Non-voting members (4)	1 nominated from the Parish Councils Up to 3 nominated from different Trades Unions

The Committee meets quarterly. Attendance at these meetings was 81% for the voting members and 37% for the non-voting members. (Note: one of the non-voting members was on long term leave)

Ad hoc workshops are arranged as necessary reflecting the Committee’s meeting agendas. During the last twelve months one workshop was arranged to discuss the new governance arrangements for the LGPS including pension boards.

#### **Investment Panel**

The Panel consists of up to six voting members from the Committee and meets at least quarterly ahead of Committee meetings.

The Panel met formally five times during the year with attendance at 96%. Each meeting was followed by a workshop where selected investment managers present on their performance and outlook for their portfolio. In addition Panel members attended three selection panels held to appoint new managers for infrastructure, diversified growth fund and hedge funds.

## **2 TRAINING**

The Fund provides training to committee members to ensure they possess an appropriate level of knowledge, skill and understanding to discharge their fiduciary duties. The administering authority must ensure:

- that decisions are taken by persons or organisations with the skills, knowledge advice and resources necessary to make them effectively and monitor implementation; and
- those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

The Fund has in place a training framework which is based on CIPFA's (Chartered Institute of Public Finance and Accounting) Knowledge and Skills Framework for LGPS funds, which identifies six areas of knowledge as follows:

- i. Legal and governance context
- ii. Pensions Auditing and Accounting Standards
- iii. Procurement and Relationship Management
- iv. Investment Performance and Risk Management
- v. Financial Markets and Product Knowledge
- vi. Actuarial Methods, Standards and Practices

Committee training is delivered in a variety of formats, reflecting the strategic importance of the subject matter to the Committee's agenda and the differing level of knowledge and understanding across the Committee. Many of the areas identified by the framework are covered through detailed Committee and Panel reports and workshops where the topic is explored greater in detail.

Committee members will be required to complete the Pensions Regulator's Knowledge and Skills Toolkit within the first year of their appointment to the committee.

In addition, members are encouraged to attend seminars and conferences which broaden their understanding of investments and topics of relevance to the LGPS.

## **3 REVIEW OF THE YEAR**

### **a) INVESTMENTS**

- The Fund's assets increased from £3,325m at 31 March 2014 to £3,829m at 31 March 2015. The Fund generated an investment return of 13.5% during the year, with a return of 11.2% p.a. over the last three years.
- The 2014/15 investment return was driven primarily by the strong returns from equities, bonds and property. Overseas equities (25% of the Fund's assets) were the main driver, whereas UK equities (15% of Fund assets) lagged the overall return. Having delivered negative returns in 2013/14, bonds

rebounded strongly on expectations that bond yields will stay lower for longer. Property assets continue to appreciate as demand for income generating real assets continues to outstrip supply.

- The appointment of a manager to invest in infrastructure and the restructuring of the hedge fund portfolio completed the actions arising from the review investment strategy in March 2013. The Fund terminated one of the Diversified Growth Fund mandates following the loss of key investment personnel and appointed a new manager to manage the assets.

## **b) FUNDING LEVEL**

- As at 31 March 2015 the Actuary has estimated that the funding level has fallen back to 78% from 84% declared a year earlier and the deficit has increased to c. £1,104m from £636m.
- The deterioration in the funding level was due to a fall in gilt yields (which are used to value the liabilities) from 3.5% to 2.3%. This was partially offset by a small fall in inflation but overall there was a fall in *real* gilt yields (which take inflation into account). As the value of the future pension liabilities is calculated using a discount rate based on UK gilt yields and the benefits are indexed to inflation, a decrease in real gilt yields will increase the value of the liabilities.
- During the year the value of the assets rose by more than expected. However, this was insufficient to offset the increase in the liabilities.

## **c) PENSIONS ADMINISTRATION**

### **(i) Budget**

- During the year to 31 March 2015, total administration costs (excluding governance and investment management costs) were £2.16 million a saving of £226,000 (9%) on the budget.
- Total costs including Investment Management, custody and governance costs, were £19 million, in line with the budget. Investment management fees were higher than expected due to the larger than anticipated increase in asset values since the setting of the budget. Governance costs were also slightly higher than expected due to the re-tendering of investment mandates.
- The investment management and custody fees of £16.2 million equates to 0.42% of the Fund's assets.

### **(ii) CIPFA Benchmarking (Benefits Administration)**

- The Fund participates in the annual Pensions Administration CIPFA Benchmarking exercise where its performance and running costs are compared against its peers and against the "average fund".
- In 2013/2014 the Fund's overall costs at £18.27 p.a. per member were less than the average of £20.75. Staffing costs (excluding payroll) were significantly less at £6.97 per member against £8.87. Payroll costs per pensioner member of £1.74 compares favourably against the average of £1.97.

- The Fund invests heavily in communications with communication costs at £1.27 per member compared to the average of £0.87. Although significantly higher, the Committee has prioritised resources to this area as it strongly believes in the importance of providing members with timely, accurate information. This is delivered by specific newsletters to active and pensioner members, a high quality website, provision of member access to their “account” via the website and the facility for scheme employers to send information digitally via secure portal. Savings are being realised through the increased use of electronic delivery for employers ‘ESS’ & ‘i-Connect’ and through the introduction and promotion of the member self-service facility ‘MSS’.

### **(iii) Pensions Administration Strategy**

- The Administration Strategy sets out how the administering authority and scheme employers will work together to provide an improving quality level of service to Fund members.
- Performance of both the Fund and employers is closely monitored by officers and the Committee. The Strategy provides a transparent and robust operating and performance framework which improves accountability and has successfully focussed attention on the need for both parties to invest in and make use of electronic data provision to improve efficiency.

## **4 COMMITTEE BUSINESS TO MARCH 2015**

### **a) Investment Strategy**

During the year a number of strategic decisions were implemented as follows:

- The final restructuring of the investment portfolio was completed during the year with the appointment of an infrastructure manager to manage 5% of the fund’s assets. The Investment Panel also reviewed the hedge fund portfolio and agreed to appoint a single manager to manage the assets on a bespoke basis for the fund. This will enable the fund to structure its investment exposure having considered its other investments and its cash flow requirements.
- The Fund has continued to support the Local Authority Pension Fund Forum (LAPFF) as part of its Responsible Investing Policy, with members and officers attending quarterly meetings. LAPFF act on behalf of local authority funds to promote best practice in governance in investee companies either on its own or in collaboration with other organisations with similar objectives.

### **b) Funding Strategy**

- The next actuarial valuation is due in 2016. The Committee are updated quarterly on the funding position from the 2013 valuation as part of the financial monitoring process.

### **c) Approval of the 3-year Service Plan and Budget 2015/18**

- The Service Plan sets out the Pension Fund’s objectives for the next three years (2015/18). The three year budget supports the objectives and actions arising from the plan.

- The main focus of this plan is to ensure the Fund complies with The Pension Regulator requirements; to develop and implement an IT strategy to achieve a digital step change in service delivery and to mitigate service demand growth; to develop a medium term funding strategy; to explore the options for more effective matching of liabilities; and to support the introduction of Pension Boards
- The later years will focus on consolidation, realising efficiencies and embedding partnership working with stakeholders.
- The budget approved for administration for 2015/16 was £2,378,600. This includes gross savings of £224,000 that have been made through changes in working arrangements and the greater adoption of digital technology. £71,400 of these savings will meet the costs of additional responsibilities, regulations and inflation. A further £147,600 of the savings will be invested in the IT Strategy to generate cost savings in the future.
- The Service Plan includes a three year cash flow forecast reflecting the maturing of the scheme, which is no longer cash flow positive on a monthly basis. Investment income is now required to meet pension payments so closer monitoring of the cash flow position is required for the investment strategy to be effectively managed.

**d) Approval of draft revised Administration Strategy**

The Fund revised its 2011 Administration strategy to include a more detailed ICT Strategy and also to ensure the Governance and administration requirements of the Pension Regulator are properly addressed.

**e) Public Service Pensions Act 2013 and government reform**

- The Public Sector Pensions Act 2013 (PSPA2013) has changed the governance structure of the local LGPS funds. There was a consultation as to how the Act could be applied to the local LGPS funds.
- PSPA2013 gives the Pensions Regulator a role in regulating the public service schemes including the LGPS. The Regulator will require greater disclosure of member training and require all pension board members to attain a satisfactory level of knowledge in order to discharge their duties.
- The Act also established local pension boards for each local LGPS fund. The remit of these boards is to secure the Fund's compliance with regulations and TPR's Codes of Practice as well as assisting the administering authority to ensure effective and efficient governance and administration of the scheme. The Committee reviewed the Terms of Reference for the new Pension Board prior to it being considered by the Council.
- The government consulted further on their proposals for restructuring the local LGPS funds to reduce investment management costs and increase the efficiency of the national scheme. This consultation included a cost-benefit analysis of the potential option the Government's preferred approach to reform which focussed on the use of collective investment vehicles managed by the scheme itself. The government was not supportive of fund mergers at this stage. The government has yet to respond to the consultation but it is expected to be revived following the elections.

- The Committee responded to these consultations and further consultations on the regulations for the new scheme.

#### **f) Treasury Management Policy and Cash Management Policy**

- The Committee approves the Fund's Treasury Management Policy annually. The policy sets out how the Fund's cash is invested to meet its day-to-day requirements. The cash managed under this policy at any time is c. £25 million, which represents less than 1% of the Fund's value.
- The management of this cash is delegated to the Council's Treasury Management Team. However, the Fund's cash is invested separately (via separate bank account) to the Council's and the Fund has a bespoke Treasury Management Policy.
- The policy has been further revised in line with the Council's policy due to the downgrading of the credit ratings of the UK banks, to ensure there is adequate flexibility for the efficient management and investment of the short term cash.

#### **g) Responsible Investing Annual Report**

- The Fund has a Responsible Investing (RI) Policy which supports its investment strategy. As transparency and disclosure are an important element of being a responsible investor the Fund publishes an annual report of its activities.
- The policy sets out how the Fund will incorporate and manage the risks arising from its investment activities that relate to Environmental, Social or Governance factors (ESG). The approach is to identify and manage these risks in a variety of ways: through considering how they can impact the overall risk and return of the Fund; by understanding how the investment managers evaluate the materiality of such risks within their investment decisions; by using its votes as a long term shareholder and to engage with company Boards to influence corporate behaviour
- The 2014 report highlighted the main activities as follows:
  - (i) Embedded ESG criteria into the evaluation and implementation of the new investment strategy for the new Diversified Growth Funds and infrastructure mandates and appointment decisions
  - (ii) Monitored whether our investment managers implemented RI policies or approach in line with their stated policy and the Fund sought to influence where appropriate
  - (iii) The Fund followed through with issues identified last year by asking the investment managers to promote board diversity for the 2014 proxy season and by reviewing managers policy towards resolutions on remuneration following the introduction of the binding vote structure on their voting policy and whether they support the public declaration of investment managers' opinions on how executive pay packages should be structured
  - (iv) Continued to support the Local Authority Pension Fund Forum (LAPFF) recognising that their collaboration and engagement activities are important tools to manage RI risks.

#### **h) Administration**

- In accordance with the Pensions Administration Strategy the Committee monitors the KPI for pensions administration and the scheme employers quarterly.
- Focus in 2014/15 was the continued rollout of electronic receipt and delivery of data with employers. Work with employers in this area has resulted in a significant move towards full electronic data transfer with 60% of scheme employers now submitting member data electronically, representing 81% of overall fund membership.

#### **i) Advisory Contracts**

- In line with Council policy, the actuarial and investment consultancy contracts were re-tendered at the expiry of each contract. The fund tendered through the South West LGPS Advisory Framework Contract, a collaborative initiative to reduce procurement costs. Mercer Investment Consulting replaced JLT as the Fund's investment consultant from 1 April 2015.

#### **j) Workplans**

- Separate workplans are prepared for the Committee and Panel detailing the forthcoming areas of work relating to the investment and funding strategies and to the administration of benefits to give the Committee and officers the opportunity to review the workload and accommodate issues that may arise.

### **5 FUTURE BUSINESS**

The Committee and Panel's focus over the next twelve months will be as follows:

#### **a) Investments**

- Investment Strategy – explore options for more effective management of the liabilities through the investment portfolio, including how liability driven investing could assist in hedging the interest rate and inflation impact on the liabilities.
- Establish the framework for making investments that fall outside the strategic asset allocation. The fund can allocate up to 5% of its assets in “other bond” assets and up to 5% in “other growth” assets. A framework is required to set out the investment parameters and the decision making process.

#### **b) Funding Strategy**

- Explore options for insuring against ill-health retirements.
- Commission an interim valuation to prepare the Committee and employers for the potential outcome of the 2016 valuation.
- Review work undertaken to assess the financial covenants of scheme employers and how this analysis will be used in setting contribution rates in the 2016 valuation.

**c) Benefits Administration**

- Ensure compliance with stringent requirements of The Pensions Regulator (TPR).
- Review and approve the Funds data improvement plan in accordance with TPR Codes of Practice.
- Approve the Funds KPI Benchmarking reports and Fund/Employer performance reports following the implementation of the revised Pensions Administration Strategy.
- Review the AVC Strategy on the number and types of funds to be offered to members to assist them in saving towards retirement.

**d) Governance of the LGPS**

- Engage with and respond to government consultations expected during the year on the governance structure of funds at the local level. It is expected that the focus will be on proposals to change the arrangements for the investment of assets across the LGPS funds nationally to improve investment returns through lower investment costs.
- The PSPA2013 included the use of cost cap mechanisms to control employer costs in the future. The LGPS cost cap mechanism is being developed and should be agreed during the year for it to be implemented alongside the 2016 valuation.
- The Committee will respond to consultations issued by the government or the Scheme Advisory Board on these issues.
- The Committee will focus on the impact that the 2014 Budget freedoms for pension fund members has on the Fund to ensure there is a robust governance process in place to manage the potential risks arising from these changes.

**Avon Pension Fund**

**June 2015**



**Terms of Reference for the Avon Pension Fund Committee and Investment Panel**

**1 Avon Pension Fund Committee**

Bath and North East Somerset Council, in its role as administering authority, has executive responsibility for the Avon Pension Fund. The Council delegates its responsibility for administering the Fund to the Avon Pension Fund Committee which is the formal decision making body for the Fund.

**Function and Duties**

To discharge the responsibilities of Bath and North East Somerset Council in its role as lead authority for the administration of the Avon Pension Fund. These include determination of all Fund specific policies concerning the administration of the Fund, investing of Fund monies and the management of the Fund's solvency level. In addition, the Committee is responsible for all financial and regulatory aspects of the Fund. At all times, the Committee must discharge its responsibility in the best interest of the Avon Pension Fund.

The key duties in discharging this role are:

1. Determining the investment strategy and strategic asset allocation.
2. Determining the pensions administration strategy.
3. Making arrangements for management of the Fund's investments in line with the strategic policy.
4. Monitoring the performance of investments, investment managers, scheme administration, and external advisors.
5. Approving and monitoring compliance of statutory statements and policies required under the Local Government Pension Scheme Regulations.
6. Approving the Pension Fund's Statement of Accounts and annual report.
7. Approving the annual budget for the Pension Board subject to the approval of Pension Board's workplan.
8. Commissioning actuarial valuations in accordance with the provisions of the Local Government Pension Scheme Regulations.
9. Considering requests from organisations wishing to join the Fund as admitted bodies.
10. Making representations to government as appropriate concerning any proposed changes to the Local Government Pension Scheme.

**Delegations**

In discharging its role the Committee can delegate any of the above or implementation thereof to the Sub-Committee (referred to as the Investment Panel) or Officers. The current delegations are set out in Sections 2 & 3 below.

## Membership of the Committee

Voting members (12)	5 elected members from B&NES (subject to the rules of political proportionality of the Council) 2 independent trustees 3 elected members nominated from the other West of England unitary councils 1 nominated from the education bodies 1 nominated by the trades unions
Non-voting members (4)	1 nominated from the Parish Councils Up to 3 nominated from different Trades Unions

The Council will nominate the Chair of the Committee.

### Meetings

Meetings will be held at least quarterly. Meetings will be held in public, though the public may be excluded from individual items of business in accordance with the usual exemption procedures.

### Quorum

The quorum of the Committee shall be 5 voting members, who shall include at least one Member who is not a Bath & North East Somerset Councillor.

### Substitution

Named substitutes to the Committee are allowed.

## 2 Investment Panel

The role of the Avon Pension Fund Committee Investment Panel shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

The Investment Panel will:

1. Review strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee.
2. Review the Statement of Investment Principles and submit to Committee for approval.
3. Report regularly to Committee on the performance of investments and matters of strategic importance

and have delegated authority to:

4. Approve and monitor tactical positions within strategic allocation ranges.
5. Approve investments in emerging opportunities within strategic allocations.
6. Implement investment management arrangements in line with strategic policy, including the setting of mandate parameters and the appointment of managers.
7. Approve amendments to investment mandates within existing return and risk parameters.

8. Monitor investment managers' investment performance and make decision to terminate mandates on performance grounds.
9. Delegate specific decisions to Officers as appropriate.

### **Panel Membership**

The Panel shall comprise a maximum of 6 voting Members of the Avon Pension Fund Committee, of which 3 shall be Bath and North East Somerset Councillors. The membership shall include the Chairman of the Committee and /or the Vice- Chair and 4 other Members (or 5 if the Chair or Vice-Chairperson is not a member of the Panel).

Note: The appointment of Bath and North East Somerset Councillors to the Panel is subject to the rules of political proportionality of the Council.

Members shall be appointed to the Panel for a term of one year.

The Council will nominate the Chair of the Panel.

### **Panel Meetings**

Though called a "Panel", it is an ordinary sub-committee of the Committee. Accordingly, meetings must be held in public, though the public may be excluded from individual items of business in accordance with the usual exemption procedures.

The Panel shall meet at least quarterly ahead of the Committee meeting on dates agreed by Members of the Panel.

### **Panel Quorum**

The quorum of the Panel shall comprise 3 Members, who shall include at least one Member who is not a Bath & North East Somerset Councillor.

### **Panel Substitution**

Substitutes for the Panel must be members of Committee or their named Committee substitute.

### **Panel Minutes**

Minutes of Panel meetings (whether or not approved by the Panel) shall appear as an item on the next agenda of the meeting of the Committee that follows a meeting of the Panel.

### **3 Officer Delegations**

Officers are responsible for:

1. Day to day implementation and monitoring of the investment, administration, funding strategies and related policies.
2. Appointment of specialist advisors to support the Committee in discharging its functions.
3. The Section 151 Officer has authority to dismiss investment managers, advisors and 3<sup>rd</sup> party providers if urgent action is required (does not refer to performance failures but to their inability to fulfil their contractual obligations or a material failing of the company).

4. The Section 151 Officer has authority to suspend policy (in consultation with the Chairs of Committee and Panel) in times of extreme market volatility where protection of capital is paramount
5. Under its wider delegated powers, the Section 151 Officer has delegated authority to effectively manage the liabilities of the Fund including the recovery of debt.
6. Exercising the discretions specified in the Local Government Pension Scheme Regulations in connection with deciding entitlement to pension benefits or the award or distribution thereof.

May 2015