

# **AVON PENSION FUND COMMITTEE ANNUAL REPORT TO COUNCIL (April 2017 - March 2018)**

## **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 2016 (as amended). Bath & North East Somerset Council (“the Council”) administers the Fund on behalf of approximately 365 employing bodies including the four unitary authorities (as at 31 March 2018), of which c. 195 are academies. The Fund has approximately 110,000 members and the value of the Fund as at 31 March 2018 was £4.6 billion. In 2017/18 the Fund received £225m in pension contributions and paid out £171m in pension payments and transfers.

The Local Government Pension Scheme is going through a period of rapid and challenging change. The pressure on administrators has increased exponentially with the accelerated growth in scheme employers and membership. Benefit calculations have to be made separately to reflect different periods of service accrual and a further layer of complexity has been introduced with the advent of the career average revalued earnings structure requiring all member data to be captured accurately on an annual basis.

## **2 GOVERNANCE ARRANGEMENTS**

The scheme is heavily regulated and now overseen by the Pensions Regulator. Other bodies and agencies undertake key roles, particularly the LGPS Advisory Board, the Ministry for Housing Communities and Local Government, and CIPFA, which sets the accounting standards. Brunel Pension Partnership Ltd, the company established by the Brunel pool to implement the Fund’s investment strategy is regulated by the Financial Conduct Authority.

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, to be agreed by the Council, for the Committee and Panel are set out in Appendix A to this report.

The Pensions Committee and administering authority are scrutinised by the Local Pension Board ensuring that the governance surrounding the scheme remains robust and fit for purpose.

## 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 1 elected member nominated from each of the other 3 West of England unitary councils 1 nominated from the Higher and Further 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. In 2017-18 one extra committee meeting was held to approve changes to the Investment Strategy. Attendance at these meetings was 70% for the voting members and 40% for the non-voting members.

Ad hoc workshops are arranged as necessary reflecting the Committee's meeting agendas. During the last twelve months one workshop was held to review the Investment Strategy and evaluate the impact of the proposed changes identified by the Fund's Investment Consultant ahead of the extra committee meeting.

### 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 four times during the year, with attendance at 79%, and met with selected managers at dedicated workshops where managers presented on their performance and outlook for their portfolio. In addition they attended a workshop to review in detail the Risk Management Strategy which was implemented during 2017-18.

## 3 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. Much of the training is delivered through detailed Committee and Panel reports and workshops where the topic is explored greater in detail.

In addition, members attended a number of seminars and conferences which broaden their understanding of investments and topics of relevance to the LGPS.

### **4 REVIEW OF THE YEAR**

#### **a) Investments**

- The Fund's assets increased by £251m to £4,608m at 31 March 2018. The Fund generated an investment return of 4.7% during the year, with a return of 6.3% p.a. over the last three years.
- The investment return was lower than in recent years as the rally in equity markets stalled around the year end. Bond markets were affected by the expectation that interest rates in the US and UK are on an upward trend. Property and infrastructure assets which account for 17% of the fund generated the strongest returns during the year. The appreciation of sterling meant that the impact of hedging the foreign currency exposure within the portfolio added to the overall return in 2017/18; excluding the foreign currency hedge the returns were 3.0% over one year.
- During the year the Fund reviewed its investment strategy to reflect the improved funding level, changes in the outlook for markets and to incorporate the outcome of the review of the Responsible Investing Policy in 2016. In addition the Risk Management Strategy, largely developed in 2016/17, to manage the volatility in the funding position was implemented.

#### **b) Pooling of Assets**

- Since 2015 when the government announced that the assets of the LGPS funds should be pooled to reduce costs and increase the capacity across the LGPS to invest in infrastructure, the Fund has been participating in the Brunel Pension Partnership, a collaboration of 10 LGPS funds.
- Significant progress has been made during 2017/18 with the final milestone, for the company set up by the pool, Brunel Pension Partnership Ltd (Brunel), to obtain FCA authority to operate, being achieved on time in March 2018. This means that from 1 April 2018 this company can provide services to the ten funds or clients in the pool. The 10 funds in the pool are shareholders, each owning 1/10<sup>th</sup> of the company.
- Under these new arrangements, the Avon Pension Fund will retain responsibility for setting its investment strategy (or asset allocation), as well as the funding and administration strategies. Brunel is responsible for ensuring each fund can implement its own strategy via a suite of portfolios that it will offer all its clients. Brunel will create, structure and monitor the performance of each portfolio and report on back on each portfolio to its clients. This means that much of the operational risks will be managed by Brunel rather than the funds and across the pool there will be access to a larger, knowledgeable team of investment specialists.

- The next phase is to transition the current investment mandates from each of the ten funds to the portfolios offered by Brunel. This will start in 2018/19 but will take a number of years given the nature of some of the less liquid legacy assets.
- Eleven committee members attended the Stakeholder Engagement day arranged for Brunel Pension Partnership to update members on progress.
- The Committee receive an update report on Brunel Pension Partnership at each committee meeting. Governance arrangements are in place (at pool level) for monitoring service delivery, the transition of assets and the costs & savings from 1 April 2018.

### **c) Funding Level**

- The funding level at 31 March 2018 is estimated to have risen marginally to 96% (from 95% a year earlier) and the deficit to have narrowed to c. £181m million from £230m a year earlier.
- The next valuation is due in 2019 when the contribution rates for the three years from 1 April 2020.

### **d) Pensions administration**

#### **(i) Budget**

- During the year to 31 March 2018, total administration costs (excluding governance and investment management costs) were £2.4 million, a saving of £0.4m (14%) on the budget.
- Total costs including Investment Management, custody and governance costs, but excluding performance fees that are not yet due for payment, were £26.4 million, £1.6 million above budget. Investment management fees were higher than expected (£1.9m) due to the rise in asset values during the year. Governance and Compliance costs were also higher than expected (£0.09m) due to higher than anticipated expenditure on consultants in relation to the Strategic Review of Investments.
- The investment management and custody fees, excluding Performance Fees, of £19.5 million, equates to 0.42% of the Fund's assets.

#### **(ii) Chartered Institute of Public Finance & Accountancy (CIPFA) Benchmarking (Benefits Administration)**

- The Fund participates in the annual CIPFA Pensions Administration Benchmarking Club. This compares administration costs and performance indicators against other participating LGPS funds and against a group of funds of similar size. The results are used to identify areas for improvement in the Service Plan, to understand the specific service pressures that the Fund faces and to help the Fund operate as efficiently and effectively as possible. In addition it provides an indication of relative operational costs.
- The latest available report for 2016/17 identifies the cost per member for the Fund as £17.55 compared with £15.79 in 2015/16. The increase reflects the approved additional staff resource required to mitigate the challenge of continued growth in Fund employers. However, costs remain significantly less than the cost for the average fund which is £20.14 per member. The Fund's

own performance targets are set out in the SLAs it has in place with employers. In many cases these targets are more challenging than the industry standard. Regular SLA review meetings are held with the larger employers to review each party's performance. The Fund also publishes a Customer Charter on its website. This includes its targets (in working days) for completion of processing of member benefits.

### (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.
- The strategy ensures the Fund can continue to deliver a high quality pension service at a time when the operating environment is becoming more complex: the employer base has fragmented, especially with the creation of academies, furthermore the increase in the number of third party HR and payroll providers (favoured by a number of local education authority (LEA) schools) has added a further layer to the process and provision of data. The table below reflects how the Fund's employer and membership base has changed over the last two years

	31/03/18	31/03/17	+ / -
Number of employers with 5000+ members	2	2	-
Number of employers with between 1000 and 4999 members	5	5	-
Number of employers with between 100 and 999 members	19	16	+3
Number of employers with between 11 and 99 members	209	147	+62
Number of employers with between 0 and 10 members	152	116	+36
Total	387	286	+101

- The Fund revised its Administration Strategy in 2015 to include a more detailed ICT Strategy and also to ensure the governance and administration requirements of the Pension Regulator are properly addressed as they fall to the Fund and employers. The Administration Strategy will be further reviewed in 2018 to ensure it remains focussed on the Funds key objectives and challenges ahead.

## 5 COMMITTEE ACTIVITIES TO MARCH 2018

### a) Brunel Pension Partnership

The Committee received quarterly reports informing them of progress in project to pool our assets. In June the legal documentation to establish a company authorised by the FCA to manage the client assets was considered by the Committee ahead of the company formation in July 2017. In December the Committee reviewed the 2018/19 Business Plan and budget put forward by Brunel which was then presented at its AGM in January 2018 for the 10 shareholders to approve.

In March 2018 the Committee approved the mapping of each of the Fund's current mandates to the portfolios offered by Brunel. All the assets will transition to these portfolios; however, given that it is linked to the liabilities of the pension fund, the Risk Management Strategy will remain bespoke to the Avon Pension Fund and not 'pooled'.

## **b) Investment Strategy**

Following the review of the investment strategy the main changes were as follows:

- A reduction in the allocation to equities to lock in gains following strongly rising markets.
- A reduction in the allocation to corporate bonds which will generate capital losses as interest rates rise.
- Allocate to Multi Asset Credit which is less sensitive to rises in global interest rates than corporate bonds.
- Having identified the risk to assets values from climate change in its, review of its Responsible Investing Policy, switched equity assets managed on a passive basis (which mirror the broad market indices) into a passive managed Low Carbon Global Equity fund where the annual carbon emissions are reduced by 76% compared to the equivalent mainstream global index.
- Implemented an Equity Protection Strategy as despite the reduction in the allocation to equities they remain the largest risk to the fund; as a result a strategy has been implemented that will protect the fund if there are significant falls in equity markets.
- Medium term changes are an allocation to Secured Income such as commercial property with long term inflation linked rental income and an allocation to Renewable Energy Infrastructure. Once these are implemented the allocation to equities will be at 37.5% of total assets.

## **c) Investment Strategy Statement**

The LGPS regulations require funds to publish a revised Investment Strategy Statement (ISS) if there are significant changes. The Fund updated its ISS in December 2017 to reflect the changes in the investment strategy implemented during the year.

The ISS sets out the Fund's core beliefs that underpin the investment strategy, the process for ensuring the suitability of investments and the key risks the Fund is exposed to, and how these risks are managed.

## **d) Risk Management Strategy:**

The Fund invests in assets such as fixed interest bonds to provide some matching to the value of the liabilities, in order to reduce the volatility in the funding position. To improve the effectiveness of the "matching" assets" in 2016/17 the Committee agreed a liability risk management framework which should increase the certainty of the Fund's assets achieving the cash flows required to meet the pension payments as they fall due.

In 2017/18 this strategy was implemented through a bespoke investment fund created for the pension fund. The operational risk is managed by the investment manager who locks in the liability values ("hedges") at predetermined market levels. Fund officers advised by the Fund's investment advisor, Mercer, closely monitor the implementation of the strategy and report back to the Investment Panel quarterly. The Panel's focus is ensuring there are enough assets within the investment fund to support the hedged positions and to ensure the fund is locking into attractive market levels.

### **e) Responsible Investing Policy (RI)**

Two key recommendations from the 2016 RI review were agreed as part of the strategic review, namely an allocation to a passively managed Low Carbon Global Equity Fund and to Renewable Infrastructure.

In addition the Fund's carbon footprint was analysed for the first time. At 31 March 2017 the Fund's aggregate exposure within equities was more carbon efficient than its benchmark, outperforming by 20.5% due to both sector and individual stock allocations. This means that the investment managers were investing in less carbon intensive sectors and picking less carbon intensive stocks than the benchmark (note that this was before the switch into Low Carbon equities). In addition overall the Fund was 7.9% less environmentally intensive than its benchmark.

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.

### **f) Funding Strategy**

The improved funding level was a key consideration in the review of the investment strategy. As this was the first year of the new valuation period there was no change to this strategy.

### **g) Approval of the 3-year Service Plan and Budget 2018/21**

The forward looking three year Service Plan 2018/21 sets out the key service objectives and milestones. It also reviews the achievement against the previous year's plan. The main focus of the plan is:

- To work with Brunel Client Group and Brunel to ensure efficient transition of assets and full consideration of investment, financial and governance issues. Ensure Committee and Board kept up to date of progress
- To complete implementation of the IT strategy to achieve a digital step change in service delivery and to mitigate service demand growth.
- To undertake an interim valuation to provide indication for budgeting and to review funding strategy and implications for investment strategy.
- To undertake a review of the Administration strategy to include development of a new chargeable service offer.

The budget approved for Administration in 2018/19 is £2.94m.

The budget includes some re-categorisation of expenditure between Administration, Communication and Payroll Communication costs to better reflect their functions. Year on year savings approved in the 2015/16 budget were set aside to fund the IT Strategy. Following a change in the IT systems supplier's product offer this expenditure has previously been delayed. Part of the associated budget has now been transferred to fund the project to roll out the I-Connect solution across all small and medium sized employers. Wherever possible the effect of inflation has been absorbed.

## **h) The Pension Regulator – Code of Practice 14**

- The Pension Regulator's (TPR) Code of Practice 14 and the Public Service Pensions (Record Keeping & Miscellaneous Amendments) Regulations 2014 set out the requirements for public sector pension funds to maintain comprehensive and accurate data on their members and their member's pension contributions.
- The Fund has undertaken a detailed review of its core data and processes and assessed its level of compliance with regulation requirements in respect of:
  - Scheme record keeping
  - Maintaining contributions
  - Providing information to members
- The regulations require 100% completeness of data across a number of core areas. On a quarterly basis the Fund undertakes a series of analytical tests against the total membership to measure the overall level of completeness of data accuracy. Measurements tested against 119,860 records as at 31<sup>st</sup> March 2018 demonstrated an overall data score of 94.48%. A data improvement plan has been developed to address the issues of non-compliance identified. Accordingly, the data improvement plan will be further reviewed and updated in 2018/19 following the Local Pension Boards next annual review of compliance.
- To ensure continued compliance the Fund has also undertaken to review its existing procedures relating to the monitoring of late payment of monthly contributions from employers and its Internal Dispute Resolution Procedure (IDRP).
- Detailed reports on compliance and the data improvement plan are presented to both Pensions Committee and Local Pensions Board on a quarterly basis.

## **i) 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 is 0.5-1% of the Fund's value (£20-45m).
- 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.

## **j) Administration**

- The growth of employers within the APF continues to represent a significant challenge to the Fund despite increases in resource over the past few years.
- Significant numbers of schools are transferring to academy status which, together with outsourcing and continuing public sector cuts, continues to create spikes in workload. This is expected to continue until 2020.

## **k) Work plans**

- 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.

## **6 FUTURE ACTIVITY**

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

### **a) Investments**

- Pooling of assets – monitor the transition of assets. Brunel will manage this process and will have a detailed project plan that it will discuss with the Client Group (officer representatives from the 10 funds). Avon Pension Fund will monitor this via a high level project plan and risk register reflecting to Avon's investment strategy. The transition of assets will begin in 2018/19 but will take at least 2 years to complete.
- The work required managing the current mandates and the transition is significant and the increase in the workload required of officers is considerable.

### **b) Funding Strategy**

- Undertake an interim valuation as at 31 March 2018 to understand the issues and cost pressure ahead of the 2019 valuation.
- Covenant assessment of scheme employers in preparation of the 2019 valuation.

### **c) Benefits Administration**

- Continue to ensure maintained compliance with stringent requirements of The Pensions Regulator (TPR).
- To review the Administration Strategy to ensure the requirements of the TPR are properly addressed, including the option to develop a new chargeable service.
- To complete the roll out of I-Connect digital solution across the whole employer portfolio to achieve 99% electronic pension data receipt.
- To undertake a review of data processes to ensure the requirements of GDPR are met.
- To undertake clearance of outstanding processing backlog to enable 'business as usual' to deliver performance in line with competitive SLA targets and statutory legal deadlines.
- 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**

- Work closely with the Oversight Board of Brunel Pension Partnership to monitor the transfer assets to the company.

- Understand the significance and impact of the pooling proposals on the Avon Pension Fund own internal governance arrangements and put forward recommendations to Council as required.
- Engage with and respond to government consultations or consultations from the LGPS Scheme Advisory Board. It is expected that the focus will be the administration of academies across the LGPS.

**Avon Pension Fund**  
**June 2018**

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

**To be attached after approval by Committee**