Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE

Minutes of the Meeting held

Friday, 24th March, 2017, 2.00 pm

Bath and North East Somerset Councillors: David Veale (Chair), Christopher Pearce (Vice-Chair), Cherry Beath and Lisa O'Brien

Co-opted Voting Members: Councillor Steve Pearce (Bristol City Council), Councillor Mary Blatchford (North Somerset Council), Councillor Mike Drew (South Gloucestershire Council), William Liew (HFE Employers), Ann Berresford (Independent Member), Shirley Marsh (Independent Member) and Wendy Weston (Trade Unions)

Co-opted Non-voting Members: Richard Orton (Trade Unions), Cheryl Kirby (Parish and Town Councils) and Steve Paines (Trade Unions)

Advisors: Tony Earnshaw (Independent Advisor), Steve Turner (Mercer) and Paul Middleman (Mercer)

Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Liz Woodyard (Investments Manager), Matt Betts (Assistant Investments Manager), Geoff Cleak (Pensions Manager) and Martin Phillips (Finance & Systems Manager (Pensions))

67 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer advised the meeting of the procedure.

68 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Cllr Shaun Stephenson-McGall.

69 DECLARATIONS OF INTEREST

Ann Berresford declared an interest in respect of agenda item 9 (LGPS Pooling of Assets) as she had applied to become a non-executive director of the Brunel Company. She said that she would withdraw from the meeting when this item was discussed.

William Liew declared that he was about to join the board of a multi-academy trust which included academies which were members of the Avon Pension Fund. His appointment would not take effect for a couple of weeks, but he was making the declaration now, in case any issues relating to academies arose.

70 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

71 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

72 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

73 MINUTES: 9TH DECEMBER 2016

The public and exempt minutes of 9th December 2016 were approved as a correct record and signed by the Chair.

74 AUDIT PLAN 2016/17

The Finance and Systems Manager (Pensions) presented the report. He asked Members to note that the closing of the accounts for 2016/17 had been brought forward by one month to 31 May from 30 June as a dry run for 2017/18, when the earlier closing date becomes mandatory. The draft accounts would be presented to the June meeting of the Committee, the audit would be completed by the end of July and the final accounts would be presented to the Corporate Audit Committee on 12 September and to this Committee at the September meeting. The Committee was invited to note the audit plan prepared by Grant Thornton, which explained their approach to the audit. He introduced Julie Masci and Megan Gibson from Grant Thornton.

Ms Masci and Ms Gibson commented on the audit plan.

A Member noted that benefits based on final salaries were being replaced by benefits based on average salary and asked whether the audit would examine whether employers were making the correct contributions. Ms Masci said that specific testing on contribution payments was carried out a sample of employers. The onus was on employers to pay correct contributions, but the auditor had a responsibility to report to the Fund if there was evidence that employers were calculating contributions incorrectly. The auditor also carried out high-level checks on employer systems to make sure that they were appropriate.

A Member referred to the section in the audit plan dealing with the role of Internal Audit (agenda page 33) and said that he could not recall having seen any report from them. The Head of Business, Finance and Pensions responded that the last report on the Fund by Internal Audit had reviewed its performance against the Pensions Regulator’s requirements. The Fund was found to be fully compliant. This report had been presented to the Pension Board, which had raised some issues in relation to the Fund’s employers. He had spoken to the Head of Audit and it had been agreed that in view of the number of employers now in the Fund and the increased churn of membership there should be a more regular review of the transactional aspects of the Fund, not on a risk-based approach, but focussing on the testing of valuations and calculations. Reports from these reviews would be brought to the Committee.

The Head of Business, Finance and Pensions noted that in contrast to previous years this year's final accounts would be presented to the Corporate Audit Committee before being presented to this Committee. Lessons would be learnt from this year's dry run as to whether controls needed to be adjusted to take account of the earlier date. He thought that this year's audit report might be longer than in previous years, but this would help to identify improvements for when the earlier closing date became mandatory. Ms Masci said that experience from other authorities who had already brought their accounts forward had shown that there was an increased need for management to make judgements about entries in the accounts because final information was not available before closure. It was possible that more errors would be noted by the auditors because more information would be available at the time of audit that was available at closure. An increase in identified errors would not necessarily indicate a decline in accounting performance by the Council.

A Member suggested that if officers felt that the accounting processes for the Fund needed further improvement, they might consider convening a sub-group of Members to advise on this.

RESOLVED to note the Audit Plan for the accounts for the year ended 31 March 2017.

75 LGPS POOLING OF ASSETS - OUTCOME AND EMPLOYER UPDATE

Ann Berresford withdrew from the meeting in accordance with her declaration of interest.

The Investment Manager presented the report. She asked Members to note that the Committee's Terms of Reference would need to be amended to add the function of nominating a representative to the Oversight Board when this passed from shadow to substantive status. The proposed new Terms of Reference were attached as Appendix 1 to the report; they would need to be approved by Council in May.

A Member asked about the contingency of £500,000 to manage significant variances in individual items in the 2017/18 budget (para 7.1 of the report). He said this was a very high proportion of the £750,000 of the project budget for 2017/18 and wondered whether this indicated that the original cost estimates for the project had been wrong. The Investment Manager said that the total budget for the 15-month project was £1.4m. FLAG had agreed the contingency so that it would not be necessary to go back to the Committees if there were cost overruns. The money could only be drawn on if this was agreed by S151 officers. The Head of Business, Finance and Pensions added that the contingency had been agreed after it was found that the cost of recruitment process for the Chair of the Brunel Company would be well over budget. Another issue was that the FCA accreditation process had imposed a heavier workload than anticipated. A reserve had been set up to facilitate the process without the need to make repeated requests to Committee or Council for additional funds. These were one-off costs to ensure that the company could begin operations on 1st April 2018.

The Member nominated by Higher and Further Education bodies said that it was not correct to state that he was nominated by "the education bodies" (Terms of

Reference, top of agenda page 48). A Member pointed out that the term "'West of England" (ibid.) was now ambiguous, because the Mayoral Combined Authority does not include North Somerset.

The Chair invited the Committee to go into exempt session before discussion of Exempt Appendix 2.

The Committee **RESOLVED** that it was satisfied that the public interest would be better served by not disclosing relevant information, and that therefore the public should be excluded from the meeting for the duration of the discussion of Exempt Appendix 2 to this item in accordance with the provisions of section 100(A)(4) of the Local Government Act 1972, because of the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act as amended.

Having returned to open session the Committee **RESOLVED**

1. to approve the amended Terms of Reference for the Committee to be recommended to Council for approval at Council meeting in May 2017;

2. to note that the Committee will have to formally nominate its representative to the Brunel Partnership Oversight Board once the Board moves from shadow to formal status;

3. to note the progress with establishing the Brunel Pension Partnership Limited company.

76 2016 ACTUARIAL VALUATION OUTCOME AND EMPLOYER UPDATE

The Investment Manager presented the report.

She said that the Actuary would complete the valuation report, subject to further data which might emerge from the valuation, by 31st March 2017. Section 5 of the report summarised the outcome of the valuation and gave details of actions to be taken to mitigate employer risk. A report on the financial covenants of the employers would be presented to the committee annually starting from 2017/18. Exempt Appendix 2 gave an update on the Funds management of the risk associated with Community Admission Bodies.

In reply to a question from a Member she said that until 2006 Community Admission Bodies were admitted to the Fund without guarantees. Since that date the Fund has been able to require the outsourcing employer to provide a guarantee and its policy has required a guarantee. The provision of a guarantee in respect of all Admission Bodies was made mandatory by the 2013 Regulations.

The Fund's Actuary, Paul Middleman, and officers replied to questions from Members.

Q: Has longevity plateaued?
A: The rate of improvement is tailing off. It is yet to be seen whether it will reverse. References to longevity in the valuation relate to members of the Fund, who are rather different from the general population. There is some falling back, but the improvement rate of the longevity of males is still catching up with that of females.

Q: Can you explain how the three factors identified in the table of changes to the Future Service Rate (FSA) (agenda page 58) operate?
A: Change in membership profile can be because of gender, but the dominant factor is age. The older the member, the more expensive it is to provide benefits to them. Our assumption is that on average the membership will be older, so there will be an increase in the cost of providing benefits. Change in financial and demographic assumptions is a combination of two elements. The financial element comprises mainly the discount rate, the outlook for future returns based on market conditions and the term of future service liabilities. The discount rate for future service has been reduced, resulting in an increase of 1.2% of pay per annum for the FSR. The demographic assumption was that on average scheme members might live a month less. The third factor was the 50/50 scheme introduced in 2014. An allowance for this scheme was put into the 2013 valuation for the FSR of the Unitary Authorities, but of course at that time there was no experience of who would take it up. This allowance has been removed from the 2016 valuation, resulting in a further 0.5% increase in the FSR.

Q: If after Brexit in 2019 there is a hit to the economy, quite a few employers will struggle in to achieve their recovery periods and may approach the Fund for an extension. Is this not something we should be thinking about now?
A: The intention is to get the average recovery period down to 15 years because the scheme is an open one. We will have to wait and see if there is any adverse impact to Brexit. An important factor is the level of debt. We do not want to take a very high debt on future investments that is triggered post Brexit and then also extend the recovery period. The balance is a difficult one to strike, and it is hard to identify specific actions that we should take.

Q: I am concerned about how increases in employer contributions are phased in. Once raised, they are not going to come down. Are the phased increases really necessary in view of the improved funding position?
A: Employer contributions have been raised by the minimum, just 0.5%. We always consider affordability very carefully. Even though the funding level has improved, cash flow has to be maintained.

Q: There is discussion about people being required to work in their 70s, so employers will have to continue to pay pensions contributions on their behalf. At the same time if they are working, they will not be receiving their pensions. Have any calculations been done about the net effect of this?
A: We do an analysis of when people are retiring and work out the average, so the fact that people are working longer is included in the calculations. If people work past state pension age, on a cost basis they get their benefits in hand and that is taken into account. A more important factor is that the longer people work, the more likely they are to take ill-health retirement, and that is factored in as well.

RESOLVED:

1. To note the outcome of the 2016 actuarial valuation exercise.

2. To note the actions taken to monitor and mitigate employer risk.

77 REVIEW OPTIONS FOR ILL HEALTH INSURANCE FOR SMALLER EMPLOYING BODIES

The Investment Manager presented the report.

She explained that the costs of ill health retirement could be substantial for smaller employers. During the consultations on the 2016 Funding Strategy Statement smaller employers had been interested in options for mitigating this risk. Two options were explored in a document prepared by Mercer attached as Exempt Appendix 1 and the characteristics of these were summarised in section 5 of the report. The recommendation was to implement an internal captive ill health insurance arrangement.

A Member noted the statement in paragraph 1.3 of the covering report that an ill health pension strain is currently met by an ill health allowance in each employer's future service contribution rate and asked whether the establishment of an ill health insurance scheme would allow contribution rates to be lowered. If not, it would seem that employers would be paying twice over. Mr Middleman replied that employer contribution rates would not necessarily decrease if an insurance scheme was set up, but employers would not be paying twice. The advantage to the employer if there were an insurance scheme would be that they would not bear the whole cost of ill health pension strain, because it would be spread across the whole Fund. Premiums would not be reduced unless it considered that the insurance arrangements were funded sufficiently, or if the occurrence of ill health was lower than expected. Employers would not have reduced contribution costs, but would get better protection. That is, essentially, what is meant by self-financing.

A Member said that it was important that the true cost of ill health retirement was identified. Mr Middleman agreed, and said ill health would continue to be monitored on an individual employer basis. There should be strong governance from the outset to ensure this.

In reply to a question from a Member, the Investment Manager said that the captive fund would be kept within the investment portfolio as an investment pot. It would therefore have no impact on the Investment Strategy.

RESOLVED to approve the recommendation to implement an internal captive ill health insurance arrangement with effect from 1 April 2017 (when the new rates from the 2016 internal valuation commence).

78 BUDGET AND SERVICE PLAN 2017/20

The Head of Business, Finance and Pensions introduced the report. He said that 2016/17 had been an extremely challenging year with an unprecedented level of work, which included the Valuation, developing the Brunel Pension Partnership and setting the Brunel company, introducing a new IT system, and developing the LDI and SRI policies. The implementation of a new structure for Pensions staff was now being completed. The Brunel project and its impact on the operation and governance arrangements of the Fund would be the main priority for 2017. There was work on reporting and performance, and on communications with employers and members. Work would continue on the implementation of the IT strategy. There were also a number of tasks on the investment side, including the review of the strategic allocation.

A Member noted the big increase in members reported in the table on agenda page 95 and said that this was at first sight puzzling, because most employers in the Fund were shedding staff. The Investment Manager replied that there had been an increase in part-time staff.

A Member asked whether it was possible to state the costs of Project Brunel and the Fund’s administration and investment costs more clearly. The Head of Business, Finance and Pensions replied that the restructuring of the Administration Team had been a top priority because of the number of employers now in the Fund. It had now nearly been completed. On the investment side, the impacts of Project Brunel had to be worked through and thought given to the structuring of strategic support to the Committee in the future. As soon as the picture became clearer, the Committee would be updated.

A Member said that data improvement was critical, particularly now that the new career average scheme was operational and that TPR was putting so much emphasis on it; she hoped that progress would be maintained. The Head of Business, Finance and Pensions responded that the Fund did have a training programme for employers. One key difficulty was the turnover of staff dealing with pensions within the employers; employers had to be persuaded to maintain their own training programmes. Some employers were facing resource challenges. The ultimate sanction of reporting employers to TPR was being held in reserve for the time being, but there would be continuing emphasis on communicating to employers the importance of providing correct data.

A Member asked which IT projects would impact this year. The Head of Business, Finance and Pensions replied that the Fund’s software supplier, Heywood, was reviewing the employer self-service package and was building a new product. It was expected that a test package would be available this year. There was also a rebuild of the payroll system, which allowed better task management and workflow facilities. Implementation was planned for the summer. This work has been postponed from the end of last year, because Heywood wanted to subcontract some of the work to other specialist software firms.

In response to questions from a Member, the Investment Manager explained that Governance Costs included the cost of independent investment advice and that the cost of the valuation was included in Compliance Costs. The reason for the fluctuation in the Independent Members’ costs was that the term of appointment for one of the Independent Members would expire this year and so included recruitment costs.

RESOLVED to approve the 3-Year Service Plan and Budget for 2017-20 for the Avon Pension Fund.

79 TREASURY MANAGEMENT POLICY

The Finance and Systems Manager (Pensions) presented the report. He reminded Members that the Treasury Management Policy was reviewed annually. No changes were proposed in 2017/18.

RESOLVED to approve the Treasury Management Policy as set out in Appendix 1 to the report.

80 INVESTMENT STRATEGY STATEMENT

The Assistant Investments Manager presented the report. He reminded Members that the investment Regulations which came into effect in November 2016 required the previous Statement of Investment Principles to be replaced an Investment Strategy Statement. The draft ISS had been circulated to Members of the Local Pension Board, and their comments were set out in the table which he had just provided to Members. This is attached as Appendix 1 to these minutes. The ISS will be formally presented to the Local Pension Board at its next meeting in May.

A Member suggested that the table on page agenda 131 should be reformatted to clarify that the allocations to Developed Market Equities and Emerging Market Equities were included in the 50% overall allocation to Equities.

RESOLVED

1. To approve the new Investment Strategy Statement.
2. To note that the Statement will be revised following the Investment Review to be completed in 2017.
3. To note that in line with Regulations the draft Investment Strategy Statement has been circulated to the Pension Board for comment.

81 REPORT ON INVESTMENT PANEL ACTIVITY

The Assistant Investments Manager presented the report.

RESOLVED:

1. To note the recommendation as summarised in paragraph 4.2(1);
2. To note the Panel noting of the investment manager appointment decision as summarised in paragraph 4.3;
3. To note the minutes of the Investment Panel meeting on 22 February 2017 at Appendix 1 and Exempt Appendix 2.

82 REVIEW OF INVESTMENT PERFORMANCE FOR QUARTER ENDING 31 DECEMBER 2016

The Assistant Investments Manager presented the report and summarised the key points. The funding level had improved by about 1% from 93% (recalibrated since Q3 report) to 94%, mainly because the return from assets had exceeded the increase in liabilities.

Mr Turner commented on the Mercer performance report. He said that unexpected improvement in the funding level had impacted on the options being looked at in the Investment Strategy Review. He would not recommend reducing the current level of currency hedging, given that Sterling was at a five-year low against the Dollar. Currency hedging had lost money, especially since the Brexit vote, but a knee-jerk reaction would not be appropriate. Relative returns of UK equity managers had been disappointing. As part of the Investment Strategy Review, he would recommend a health check on the structure of the equity portfolios. He would also recommend scaling back on equities by a “moderate amount”. Work was under way on a new investment monitoring report, which would move away from a focus on individual manager performance to the monitoring of overall strategy.

RESOLVED:

1. To note the information set out in the report;

2. To note LAPFF Quarterly Engagement Report at Appendix 4.

83 BUDGET AND CASH FLOW MONITORING 2016/17

The Finance and Systems Manager (Pensions) presented the report.

In reply to a question from a Member he said that it was expected that the full year Administration Costs would equal the budgeted cost. The variance currently reported was because of the timing of the report.

RESOLVED to note:

1. The administration and management expenditure incurred for 10 months to 31 January 2017;

2. The Cash Flow Forecast to 31 March 2017.

84 PENSION FUND ADMINISTRATION - BUDGET MONITORING 2016/17, PERFORMANCE INDICATORS FOR QUARTER ENDING 31 DECEMBER 2016 AND RISK REGISTER ACTION PLAN

The Pensions Manager presented the report.

He drew the attention of Members to the information given in section 6.4 about the introduction of new reports following the completion of the Task Workflow Project and the setting of new RAG standards. A high proportion of internal performance was shown as below standard on the current reports. This was a result of reduced staff availability and high workload during the period. Revised work targets and the appointment of additional officers the restructuring of Pensions Administration should lead to improvement against KPIs in future reports.

Workload remained high. Of the 6,067 cases outstanding a third were being held up by the need to wait for Regulations. The Employer Relations Team will be focussing on encouraging employers to submit information earlier and clarifying with them what information is required.

In reply to questions from Members he stated:

- up to now the 50/50 scheme did not appear to be working as intended; it had not reduced the level of opt-outs and was being taken up by some high earners

- the £250 penalty fine, issued to employers who breached the limit for data queries and who had not attended training, had been proposed in the Administration Strategy; the trigger level applied to performance at year end; in 2014/15 117 employers had breached the level, so the latest figure of 31 was a big improvement

[Shirley Marsh left the meeting at this point].

RESOLVED to note:

1. Membership data, Employer Performance and Avon Pension Fund Performance for the 3 months to 31 December 2016.

2. Progress and review of the TPR Data Improvement Plan.

3. Risk Register.

85 UPDATE ON LEGISLATION

The Pensions Manager presented the report.

RESOLVED to note:

1. The current position regarding the developments that could affect the administration of the Fund.

2. The current position regarding HM Treasury Exit Payments Legislation and potential timescales.

3. The response made to HM Treasury on Consultation for GMP Indexation.

86 WORKPLANS

The Investment Manager presented the report.

RESOLVED to note the workplans.

87 COMMITTEE UPDATE - VERBAL

[The Independent Advisor left the meeting.]

The Head of Business, Finance and Pensions addressed the Committee.

He advised that Ann Berresford, Independent Member, would soon complete her second consecutive term as a Member, and would therefore be leaving the Committee. Ann said that she had very much enjoyed her time as a Member. She recalled that when she had joined the funding level had been 70%. It was a pleasure to realise how much the Fund had progressed since then. She hoped that pooling would be a success and contribute to enhanced performance for the Fund. The Committee expressed their thanks to her for her contribution and wished her well for the future.

At the invitation of the Head of Business, Finance and Pensions Members commented on the role of the Independent Advisor.

RESOLVED to note the update.

The meeting ended at 4.50 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services