Annex 1

THE AVON PENSION FUND

SERVICE PLAN

2016 - 2019

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AVON PENSION FUND SERVICE PLAN 2016-2019

1. BACKGROUND

In the 2015 Service plan, the Pensions Committee agreed a clear direction of travel for the three key Fund Strategies namely Administration, Funding and Investment. This recognised that the Fund would come under greater scrutiny from the Pensions Regulator and the then soon to be created Pensions Board. The plan recognised the difficult economic outlook and continued austerity that would create difficulties for employers with a valuation fast approaching and agreed to continue with the development of the investment strategy to better align liabilities and cash flows whilst recognising that issue of government prescription over investment strategy had not gone away!

Since the election in May 2015 there have been two announcements that will have a significant operational impact on the Fund going forward;

- The requirement that funds pool their assets to create super pools of £25b
- The requirement that all schools will become academies by the end of the current parliament

Pooled Funds

Whilst the Committee have agreed to work with the Southwest Funds to produce a pooling proposal for submission to government by 16th July, the work involved in unwinding assets particularly liquid funds will take many years and it is unlikely that savings will emerge until this work is near completion. Indeed for a number of years the Fund will have two operate on a two tier basis holding pooled and non-pooled assets. Provision has already been agreed by Committee to support this work to the July submission, but undoubtedly there will be more upfront costs as the implementation plan for pooling unfolds.

New governance structures will need to be put in place for the Pools and the impacts on the Investment Panel and Committee' s own governance structure and terms will have to be considered appropriately.

Academies

Whilst there has been a steady flow of schools converting to academy status over the past few years, there are already signs of increasing numbers preparing to convert since the government announced its intention that all schools should become academies. It is anticipated that this could happen as early as the end of 2018. Clearly this creates a lot of work in respect of Fund admissions for fund officers and actuaries alike, but this is an evolving scenario with ongoing school mergers into Multi Academy Trusts and outsourcing of support functions presenting further complications. It is likely that the number of employers within the fund will rise to around 450 over the next two years and the administration therefore needs to be resourced effectively to deal with not only the flows of member information but the ongoing training and compliance matters that continually arise.

Austerity

Public sector organisations have been planning for the impact of ongoing austerity to different degrees, but the impacts on resources are not necessarily fully developed, which is compounded by the direction of travel for schools. What is clear is that it is impacting the Fund in three key areas;

- The need to support employers and their members through the process of downsizing which is set to continue for the next few years
- The need to support ongoing outsourcing and alternative service delivery arrangements through management of the admissions process
- The need to protect the Fund and minimise future financial risk.

Given this direction of travel, the need to ensure the Pensions Regulators compliance requirements are met and to properly manage fund risk, greater attention must be paid to Employer Services not at a cost to member services but in addition to it. During the last valuation the Fund Actuary recognised the increasing costs arising from compliance and fragmentation of the employer base but did not raise the administration contribution rate which has been static for almost a decade. This will have to be seriously considered in 2016 in order to maintain an effective administration and fully compliant service.

It is therefore proposed to restructure the Administration function to create specific member and employer focused services and strengthen the Actuarial service within the Investment Function to enable it to more effectively manage employer risk. The Administration Strategy will also be reviewed to examine further opportunities for direct charging of services.

Staff Retention

Of increasing concern is the Funds inability to retain staff with 15 staff leaving the organisation over the past 18 months. This is the result largely of higher paying competitors and is unlikely to change with continued low levels of public sector pay awards. In order to combat this trend, it is proposed to build upon the successful apprentice scheme and to examine opportunities for role redesign – which is necessary anyway - as part of the structural review.

Valuation and Funding Strategy

Ongoing austerity and low bond yields will present significant challenges in setting the Funding strategy this year and it is unlikely that the Government will use the cost sharing mechanism in 2016 to adjust the balance of liabilities. Maintaining a robust funding position is key to the Funds' deficit management but equally important will be the need to review the asset/liability positon once the Actuary has completed the valuation. This will ensure that the Fund is able to manage the ongoing call on cash as the Fund continues to mature and examine opportunities to enhance the investment strategy. Similarly further examination of opportunities to minimise liability risk will be explored.

Compliance

The Fund will continue to support the work of the Pensions Board and it is anticipated that both the Pensions Regulator and Scheme Advisory Board will increase their scrutiny of LGPS activities focusing on specific areas, with any resourcing or service impacts reported as they arise.

2. KEY OBJECTIVES 2016-19

The Fund's three core strategies, Investment, Funding and Administration are designed to maximise the efficiency and sustainability of the Fund and the success of these is critical. In particular diversification of investments has been a key strength in recent turbulent times but has been resource and governance intensive; the emergence of Pooled funds will impact on this position but not immediately and is likely to incur one off upfront costs initially. The Funding Strategy has been developed to ensure there is flexibility to manage affordability but will be severely challenged going forward in the continued period of austerity; the Administration Strategy has set a direction of travel which is perfectly aligned to the developing operating environment and has to some extent reflected the increasing governance requirements, however it is the growing demands of employers which now have to be addressed. **Appendix 2** sets out progress made against the key objectives in the 2015-18 service plan.

The **Key Objectives** for the Fund during the 2016-19 Service Plan period will be as follows:

Administration Strategy:

1. To continue to implement the agreed published Administration Strategy to ensure the requirements of the Pensions Regulator are properly addressed in respect of both the Fund and Employers responsibilities in accordance with TPR code of practice.
2. To continue to implement planned IT Strategy designed to achieve a digital step change in service delivery and mitigate service demand growth.
3. To undertake a review of the charging basis for Fire Scheme Pension. Current charge does not reflect complexity of Fire Schemes administration or volume of work and resource involved in supporting the service. Develop revised service offer and SLA.
4. To provide ongoing "as required" support to the local LGPS and Fire Service Pension Boards.

5. To complete redesign development of website services and information for employers which is fully integrated with self-service provision.
6. To complete the rollout of Employer self-service and i-Connect to achieve 99% pension data receipt in 2016.
7. To continue GMP data reconciliation exercise as required by DWP to ensure the fund is not at risk of pension overpayment or erroneous pension liability.
8. To undertake review of pensioner member ‘pots’ to identify potential commutation opportunity in line with Government Budget announcement. Trivial commutations
9. To complete the move towards electronic delivery of Scheme communications to active members.
10. To continue to improve the quality of member data held to meet The Pension Regulator’s minimum legal requirements as agreed within the Data Improvement Plan.
11. To complete the review support service arrangements to ensure the fund receives value for money services
12. To put in place the necessary structural changes to support the evolving operating arrangements and the growing need of employers within the fund

Funding Strategy:

13. To complete covenant assessment analysis for incorporating into the funding strategy and funding plans.
14. To set the Funding Strategy Statement that protects the solvency of the Fund but is affordable for employers.
15. To investigate options for insuring ill-health retirement costs for smaller employers or employer clusters within the Fund.
16. To continue to mitigate the risks to small employers of funding variations.

Investment Strategy:

17. To develop and agree the pooling of assets proposal for DCLG and implementation of the transition plan.
18. Review strategic allocation to ensure
    - it meets long term objectives post 2016 valuation
    - the pooling arrangements can deliver the strategy over time.
19. To implement any changes to the Investment Strategy in line with the principles set out in the Statement of Investment Principles.
20. To examine the risks and benefits of Liability Driven Investment as a mechanism for reducing future liabilities.
21. Review the Responsible Investing Policy to ensure it addresses emerging risks and opportunities.
22. Agree the new Investment Strategy Statement in line with new regulations.

Governance:

23. Review governance arrangements following the pooling of assets and creation of Pensions Board.
24. To ensure the relationship between the Committee and the Pensions Board operates effectively and in the best interests of the Fund.

25. To ensure the new committee and the Pensions Board is fully briefed on current strategies and operations and in position to scrutinise and make decisions effectively.
26. Ensure effective engagement with Committee on the proposal to pool assets and its implementation.
27. Appoint independent member to Committee when current term expires in May 2017.

3. RESOURCE IMPLICATIONS

It will be apparent from the preceding paragraphs that the Fund continues to undergo significant changes to its investment structure, risk management and regulatory compliance operations, a situation which is further fuelled by the growing demands of employers who are still coming to terms with their own pension's responsibilities.

Addressing these issues requires not only increasing resources but some different skills requirements to ensure that the combined operations of employers and the Fund result in compliant and relevant services for Fund members. The Fund will continue to invest in the training and development of its staff and increase its level of professional training undertaken.

However given the level of demand and staff turnover, the Fund now needs to not only increase resources in key areas but needs to prepare for future demand and continuing turnover. In the circumstances structural changes will be undertaken to reorganise the administration into member and Employer focused teams strengthening the later by 3.5 FTE's and in addition extend the pool of apprentices/trainees from 2 to 4 which will be essential to sustain operations. On the investments team there is an increase in resources to deal with the growing actuarial workload relating to scheme admissions and risk management and the proposal is to increase this by 1FTE.. To some extent the building blocks for some of these changes were put in place last year, but since May 2015 the dynamic has completely changed. It is also intended to review some of the higher risk support functions to examine alternative methods of delivery and where possible work in conjunction with other Funds to share and mitigate risk. The full financial impact of these changes will not be apparent until 2017/18.

In respect of investments, the development of Pooled Investment Funds will have impacts on investment operations but given that the focus will be on establishment and then transition, the full implications are unlikely to materialise for some time. That said there is clearly an initial upfront cost to establishing the pool and its operating arrangements and changes over and above what the Committee has already agreed will be notified as they materialise.

4. BUDGET & CASHFLOW FORECAST 2016 – 19

Budget:

The current service plan includes the reinvestment of savings in the IT Strategy to 2017/18 and further savings have been achieved in areas of support services and accommodation, the latter as a result of increasing flexible working arrangements. In the areas of Governance and Compliance and Investment Management, where expenditure cannot be directly controlled the budget reflects the expected volumes of work and fees. Wherever possible the effect of inflation has been absorbed.

Estimated costs of increased staffing requirements to meet current and future demands are £293,000 in 2016/17. This includes one off additional funding that has been agreed to support Project Brunel but has been reduced to reflect the fact that it is unlikely that the recruitment will all be achieved until 2017/18.

The budget level (excluding investment costs) proposed for 2016/17 is £3,633,000 including current expenditure levels, one off costs, new savings and growth.

Within the directly controlled budget for Administration there is a proposed increase in net expenditure of £245,000. This increase includes the resources approved during 2015/16 for the 2016/17 costs of pooling and actuarial support. A further £158,000 is being invested in the IT Strategy funded from the ongoing savings identified in the 2015/16 budget.

The Investments budget reflects savings that have been achieved following changes in Investment mandates that have led to lower fee rates. These are partially offset by the anticipated growth in asset values and the consequent increase in Investment management fees. Actual expenditure will clearly depend on the level of this growth. The higher investments budgets in 2017/18 and 2018/19 result from the cost of performance fees relating to earlier years that will become payable.

The Pension Fund is required to meet the costs of the Pensions Board that became operational in July 2015. The estimated full year costs for 2016/17 to 2018/19 have been added to the overall cost to the Fund for the three year budget. .

Cash flow:

In recognition of the increasing importance of cash flow monitoring the Fund prepares a three year cash flow forecast. In recent years the Fund has changed from being cash flow positive (accumulating cash from contributions at a greater rate than paying out cash in benefits and expenses) to being cash flow negative. This is part of the normal life cycle of a pension fund. The cash flow is currently monitored on a monthly basis and reported quarterly to Committee. As a result of the advance lump sum deficit payments made by the major employers in April 2014 the Fund had large cash in-flows. However the consequent absence of the deficit payments that will continue throughout 2016/17 has exacerbated the negative annual cash flows. The negative cash flows will be managed by using income from the investment portfolio and divestments (of the lump sums already invested) if required.

Full details of the budget between 2016-17 and 2018-19 together with a cash flow forecast for the payment of benefits and the receipt of contributions are given in **Appendix 4A.** A commentary on the budget changes between 2015 -16 and 2016-17 is given in **Appendix 4B.**