

AVON PENSION FUND COMMITTEE ANNUAL REPORT TO COUNCIL (April 2015 - March 2016)

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 230 employing bodies including the four unitary authorities (of which c. 120 are academies). The Fund has approximately 106,000 members and the value of the Fund as at 31 March 2016 was £3.7 billion. In 2015/16 the Fund received £144m in pension contributions and paid out £163m in pension payments and transfers.

(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 91% 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 four workshops were arranged covering:

- Introduction to the pension fund
- Benefits administration training including TPR requirements

- Actuarial valuations and the 2015 Interim Valuation
- Liability Driven investing and the Funding Strategy Statement

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 three times during the year with attendance at 83%. In addition two workshops were held; one for the managers to present to the panel on their performance and outlook for their portfolio and a training session on investment strategy.

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. Much of the training is delivered through detailed Committee and Panel reports and workshops where the topic is explored greater in detail. As there were a number of new members following the 2015 local elections, a number of induction sessions were held.

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 decreased from £3,840m at 31 March 2015 to £3,742m at 31 March 2016. The Fund generated an investment return of -2.1% during the year, with a return of 5.8% p.a. over the last three years.
- The 2015/16 investment return was driven primarily by the fall in equity markets which account for 50% of the fund's assets and the impact of hedging the foreign currency exposure within the portfolio during a period when sterling

depreciated. Excluding the currency hedge the returns were -0.2% over the year and 6.1% p.a. over the last three years. Bonds overall generated a positive return albeit more subdued than in the previous year. Property delivered a positive return as did hedge funds and diversified growth funds to a lesser extent.

b) POOLING OF ASSETS

- In 2015 the government announced that the LGPS funds should pool their assets to reduce investment management costs and increase the capacity across the LGPS to invest in infrastructure.
- Funds were asked to put forward their proposals by February 2015. The fund is participating in a pool of 10 funds mainly from the south west to develop this proposal (known as Brunel Pension Partnership).
- The initial proposal in February was approved by government with a more detailed proposal submitted in July detailing the operational structure of the pool. The government has yet to provide feedback on this stage.
- The full business case for the pool overall and each individual fund is now being developed for approval later in 2016. The new arrangements are to be in place by April 2018. A Shadow Oversight Board comprising the Chair of each LGPS fund is overseeing the process.

c) FUNDING LEVEL

- As at 31 March 2016 the Actuary has estimated that the funding level was 83% from 78% a year earlier and the deficit has decreased to c. 750m from £1,104m. The improvement reflects the change in the discount rate partially offset by the negative return on assets.
- The value of the future pension liabilities is calculated using a discount rate. Historically this has been based on UK gilt yields. However, with gilt yields at very low levels there is a risk that a discount rate based on gilt yields will build too much prudence in to the actuarial valuation meaning employer contribution rates will be overstated.
- Therefore the valuation struck at 31 March 2016 will be calculated with reference to inflation (CPI) as the pension benefits are linked to inflation. The discount rate will reflect the real investment return expected on the investment portfolio.

d) PENSIONS ADMINISTRATION

(i) Budget

- During the year to 31 March 2016, total administration costs (excluding governance and investment management costs) were £2.13m a saving of £253,000 (10%) on the budget.
- Total costs including Investment Management, custody and governance costs, were £19.7m, £1.9m below budget. Investment management fees were lower than expected due to the lower than anticipated increase in asset values since the setting of the budget and lower fee rates on some mandates.

- The investment management and custody fees of £17.1m equates to 0.46% 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 2014/2015 the Fund's overall costs at £16.55 p.a. per member were less than the average of £19.17. Staffing costs (excluding payroll) were significantly less at £6.73 per member against £7.83. Payroll costs per pensioner member of £0.82 compares favourably against the average of £1.85.
- The Fund invests heavily in communications with communication costs at £2.21 per member compared to the average of £0.78. 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 further development 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 ACTIVITY TO MARCH 2016

a) Investment Strategy

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

- A review of the currency hedging strategy during the year concluded that the strategic decision to hedge foreign currency exposure to protect the value of the assets in sterling terms should be maintained. However, implementation was altered from an active to passive approach to ensure more effective hedging of the currency risk
- In addition the committee has begun to explore ways in which the investment portfolio can be used to manage the liability risks more effectively. The current investment strategy only provides limited protection against changes in the value of the liabilities. The Committee is considering how this level of protection could be increased and any decision will be made in 2016/17. As an initial step

the allocation to UK government bonds is now invested entirely in index linked gilts that closely match the fund's inflation linked cashflows.

- 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. In addition an interim valuation was undertaken as at March 2015 to identify the issues that will need to be considered in the 2016 funding strategy and to inform employers of the trend in contribution rates for budgeting purposes.

c) Approval of the 3-year Service Plan and Budget 2016/19

- The Service Plan sets out the Pension Fund's objectives for the next three years (2016/19). The three year budget supports the objectives and actions arising from the plan.
- The main focus of this plan is:
 - (i) To fully engage in the development of pooled funds in the interest of the Avon Pension Fund
 - (ii) to strengthen the resources available to cope with future demand pressures and manage risk and compliance
 - (iii) to continue implementation of the IT strategy to achieve a digital step change in service delivery and to mitigate service demand growth;
 - (iv) to deliver the valuation and revised funding strategy
 - (v) to continue work on Liability Driven Investment and undertake an asset liability review to ensure the Fund manages its cashflows effectively.
 - (vi) to continue 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 in 2016/17 was £2.66m. This includes gross savings of £80,000 that have been made through changes in working arrangements and the greater adoption of digital technology. These savings have partially offset additional costs included to meet the pressures of dealing with the increasing number of employers. The other major additional cost pressure arises from the increase in NI costs.
- 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 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 as they fall to the Fund and Employers.

- 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 key objectives of this Strategy are to ensure that:
- The Fund and Employers are aware of and understand their respective roles and responsibilities under the LGPS Regulations and in the delivery of administrative functions (largely defined in Service Level Agreements)
- The Fund operates in accordance with LGPS regulations and is aligned with The Pension Regulator in demonstrating compliance and scheme governance.
- Communication processes are in place to enable both the Fund and Employers to proactively and responsively engage with each other and other partners.
- Accurate records are maintained for the purpose of calculating pensions entitlements and Employer liabilities, ensuring all information and data is communicated accurately, timely and in a secure and compliant manner
- The Fund and Employers have appropriate skills and that training is in place to deliver a high quality service and effectively contribute to the changing pensions agenda
- Standards are set and monitored for the delivery of specified activities in accordance with Regulations and minimum standards as set out in each Employer's Service Level Agreement
- Administrative services are developed and delivered digitally as outlined in the ICT Strategy, in order to streamline processes and maintain costs at below or average levels
- 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.

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.
- PSPA2013 gives the Pensions Regulator a role in regulating the public service schemes including the LGPS.
- 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. In all, the Fund tested 102,000 membership records through a series of analytical reports and measured the overall level of completeness of data accuracy at 92%. A data improvement plan has been produced to address the issues identified.
- To ensure 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). Additionally, the fund has implemented a Breaches Procedure to enable reporting to be undertaken in situations whereby the failure to comply with TPR is likely to be of material significance or in which a legal duty which is relevant to the administration of the scheme has not been complied with.
- Detailed reports on compliance and the data improvement plan are presented to both Pensions Committee and Local Pensions Board on a quarterly basis for review and approval.

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.

g) Administration

- In accordance with the Pensions Administration Strategy the Committee monitors the KPI for pensions administration and the scheme employers quarterly.
- Focus in 2015/16 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 75% of scheme employers now submitting member data electronically, representing 85% of overall fund membership.

h) 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 ACTIVITY

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

a) Investments

- Investment Strategy – conclude on the options to more effectively manage the liabilities through hedging the interest rate and risks.
- Review the Responsible Investing Policy to ensure all risks are managed and opportunities identified.
- Review the investment strategy following the 2016 valuation with particular focus on meeting updated cash flow requirements.

b) Funding Strategy

- Review the outcome of the 2016 actuarial valuation, the application of the funding strategy on employer funding plans and the work undertaken to assess the financial covenants of scheme employers.
- Explore options for insuring against ill-health retirements.

c) Benefits Administration

- Ensure maintained compliance with stringent requirements of The Pensions Regulator (TPR).
- Review and 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

- Work closely with the Shadow Oversight Board of Brunel Pension Partnership to understand the significance and impact of the pooling proposals on the Avon Pension Fund to make sure due process is followed and the outcome is in the best interests of the fund.
- Consider the impact of pooling on the fund's governance arrangements and put forward recommendations to Council.
- Engage with and respond to government consultations or consultations from the LGPS Scheme Advisory Board. It is expected that the focus will be on the outcome of the 2016 valuation and potential implications of the cost mechanism to control employer costs.
- The Committee will continue to monitor 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

September 2016

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 3rd 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