

Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND COMMITTEE	
MEETING DATE:	9 December 2016	AGENDA ITEM NUMBER
TITLE:	LGPS Pooling of Investments – Review of Full Business Case	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report:		
Appendix 1 – Full Business Case for Avon Pension Fund		
Exempt Appendices 2 – 6 Detailed sections of Full Business Case		
Appendix 7 - Summary BPP Risk Register		
Exempt Appendix 8 – Detailed BPP Risk Register		
Exempt Appendix 9 – Financial model (circulated separately to papers)		

## **1 THE ISSUE**

- 1.1 The Local Governments Pension Fund (Management and Investment of Funds) Regulations 2016 (the Regulations) effective 1 November 2016 require LGPS funds to pool their investment assets.
- 1.2 To meet this requirement the Avon Pension Fund is participating in Brunel Pension Partnership (BPP).
- 1.3 The Full Business Case (FBC) for BPP has now been finalised. It has been reviewed by the Chief Finance and Legal Officer Group and ratified by the Shadow Oversight Board.
- 1.4 The summary of the FBC can be found in Appendix 1. The detailed sections of the FBC can be found in Exempt Appendices 2-6. In addition the Summary and detailed risk register is included as appendices. The Financial model will be circulated separately to the papers.
- 1.5 Committee are asked to consider the FBC in respect of the Avon Pension Fund in order to recommend it to Council.

## **2 RECOMMENDATION**

**That the Avon Pension Fund Committee recommends the following to Council:**

- 2.1 **In its capacity as the Administering Authority for the Avon Pension Fund, and having received and reviewed the Full Business Case relating to the proposed Brunel Pension Partnership, the Council hereby resolves to enter into investment pooling with respect to the Avon Pension Fund.**

**Such resolution is made on and subject to the following terms and conditions:**

- 1) That the Brunel Pension Partnership investment pool is developed, funded and implemented substantially in accordance with provisions in the Full Business Case and more particularly that:
  - A FCA regulated company to be named Brunel Pension Partnership Limited be established and operated substantially in accordance with provisions in the Full Business Case as to its ownership, structure, governance and services capability;
  - A new supervisory body be established comprising the Council and all other Administering Authority participants in the Brunel Pension Partnership to act to ensure effective oversight of the Council's investment and participation in the Brunel Pension Partnership.
- 2) The Avon Pension Fund Committee be authorised and granted delegated powers to undertake such tasks as it thinks appropriate to progress implementation of investment pooling, and to take such decisions and do all other things deemed necessary in order to promote the interests of the Council with respect to pooling, which without limitation shall include participation in the development of Terms of Reference and the role of the supervisory board and agreeing and authorising financial expenditure or investment that may be required consequential upon the Council's participation in the Brunel Pension Partnership.
- 3) That the Chief Finance Officer, Chief Legal Officer and Head of Business Finance and Pensions be authorised and granted delegated powers to undertake such tasks as it thinks appropriate to progress implementation of investment pooling, and to take such decisions and do all other things deemed necessary in order to support the Avon Pension Fund Committee with respect to pooling, which without limitation shall include agreeing and authorising documentation and contracts, and informing and advising the Committee on the continued viability and suitability of investment pooling in light of any developments, financial or otherwise, in the period up to the establishment of the Brunel Pension Partnership.
- 4) That subject to the above, all such matters be carried out with the aim of achieving a target date for investment pooling of 1 April 2018, and otherwise subject to such intermediate steps and timescales as may be considered appropriate and necessary by the Avon Pension Fund Committee.

### **3 FINANCIAL IMPLICATIONS**

- 3.1 There is provision in the 2016-17 budget for the work to complete the FBC. Spending is in line with the budget. To date the full cost to APF has been £120k, in line with budgeted costs.
- 3.2 Included in the FBC are the development costs to establish the company, working capital and regulatory capital up to April 2018. APF share of these costs is £330k (including working and regulatory capital for Brunel company of £200k).
- 3.3 The Regulations state that all costs are to be met from the pension fund assets.

## **4 BACKGROUND**

- 4.1 In the July 2015 budget statement the government announced that the LGPS funds were to put forward proposals to pool their assets in order to reduce investment costs and increase their capacity to invest in infrastructure.
- 4.2 The new Regulations require funds to set out in their Investment Strategy Statement their approach to pooling. In addition, the Regulations provide the Secretary of State with back-stop powers to intervene if they deem the fund has not complied with the Regulations and related guidance.
- 4.3 The Regulations are clear that responsibility for individual fund investment strategy remains with the individual Administering authorities; the FCA regulated company (Brunel company) set up by the pool will be responsible for implementing the asset allocation decisions.
- 4.4 In response to the government agenda BPP was set up to explore the options for pooling. BPP comprises of the following 10 funds: Avon, Buckinghamshire, Cornwall, Devon, Dorset, Environment Agency, Gloucestershire, Oxfordshire, Somerset and Wiltshire with combined assets of c. £23bn at 31 March 2015.
- 4.5 The Committee has received regular updates on progress and reviewed the two proposals submitted by the 10 participating funds to the DCLG; the initial proposal in February 2016 and the outline business case in July 2016.
- 4.6 Since July a detailed FBC has been developed for approval by the administering authorities to establish Brunel company and the new governance arrangements for the pool.

## **5 FULL BUSINESS CASE – ASSURANCE PROCESS**

- 5.1 The officer group has developed the FBC alongside a range of advisors specialising in specific aspects of the project as follows:
  - a) PWC – financial advice and assurance including the financial model
  - b) Osborne Clarke – legal advice and assurance
  - c) Bfinance – advised on investment fee savings and transition costs
  - d) Alpha Financial Markets Consulting – advised on financial market and FCA authorisation aspects
- 5.2 The FBC has been reviewed in detail by the Finance and Legal Assurance Group (FLAG) comprising the chief finance and legal officers of each authority. The role of this group is to ensure the FBC is robust and sustainable. FLAG agreed the final FBC on 8 November 2016.
- 5.3 The FBC was reviewed by the Shadow Oversight Board on 23 November 2016 and they agreed to recommend it to the 10 administering authorities. The SOB however remain concerned about the costs incurred to develop and implement the pooling arrangements and the taxation costs that will arise when transitioning the assets. They will continue to engage with government on these issues on behalf of the funds.
- 5.4 Internal approval process: the Committee is being asked to approve the FBC and make a recommendation to Council to establish Brunel company and associated governance arrangements including delegations. The Council is scheduled to consider the Committee's recommendation at its meeting on 14 February 2016.
- 5.5 Each of the 10 participating authorities in BPP is also in the process of obtaining approval from their Council or Board.

## 6 FULL BUSINESS CASE – KEY ASPECTS

6.1 Appendix 1 contains the FBC for Avon Pension Fund.

6.2 The FBC includes the following sections:

- a) **The strategic case:** focuses on the legal requirements, the regulatory imperative for pooling, and how BPP meets the pooling criteria. This has been updated since the July submission to include revised cost and saving forecasts.
- b) **The financial case:** drawn from the core financial model developed by PWC. It includes the development costs to establish the pool, regulatory capital and operating costs of Brunel company, costs of transitioning the assets, operational savings at each fund and fee savings.

The financial case focuses on 3 key metrics

- (i) The net annual savings once initial structural development and transition costs have been met
- (ii) The breakeven year
- (iii) The cumulative net savings over a 20 year period

A sensitivity analysis of the core model metrics has been undertaken to assess the impact of differing scenarios on the business case. The core case makes no assumptions for improved investment performance and financial opportunities as a result of pooling. These are discussed in the detailed Financial Case.

- c) **The economic case:** examines the rationale and options for the pool, specifically whether to rent or build the operator against 3 groups of issues; accountability, procurement and staffing; and costs. The analysis concluded that the build model had advantages over the rental model, especially with regard to accountability.
- d) **The commercial case:** sets out the proposed structural arrangements of BPP including relevant ownership, governance and contractual matters. The detail of the contractual documents, shareholder agreements, articles of association and Terms of Reference (ToR) are still to be agreed; this will be the focus of work during the next phase of the project.

The Oversight Board will be comprised of representatives from each of the Administering Authorities. It will have an agreed constitution and ToR; however it will not be a Joint Committee under S102 LGA but an oversight body responsible for monitoring and overseeing Brunel company, acting on behalf of the Administering Authorities.

Brunel company will be wholly owned by the Administering Authorities. Legal advice confirms that the procurement of the services of Brunel company by the Administering Authorities will be exempt from the application of the public contract procurement procedures.

- e) **The management case:** considers the project management still required to:
  - (i) Set up Brunel company through to FCA authorisation;
  - (ii) Establish the governance arrangements of BPP and
  - (iii) Implement client side governance, resource and process changes.

## 7 AVON PENSION FUND FINANCIAL CASE

7.1 The costs and benefits are derived from the financial model. The level savings and breakeven date are determined by the starting point, that is, the current asset allocation and existing fee levels, and the asset transition timetable as this affects how quickly each fund will realise fee savings.

7.2 The core model forecasts the following key metrics for the combined pool and Avon Pension Fund are shown in the table below.

Core Model	Breakeven Year	Total 20 years net gain to FY36		Running annual rate of net savings in FY25	
		£m	Discounted value £m	£m	Basis points of AUM
<b>AVON</b>	<b>FY24</b>	<b>73.3</b>	<b>36.4</b>	<b>3.5</b>	<b>6.8</b>
Combined Pool	FY23	550.1	279.5	27.8	8.9

It should be noted that the savings quoted includes savings from lower fees that have already been negotiated as a result of pooling of c. £200k p.a. from 1 April 2017 (c. £100k in 2016/17).

7.3 The sensitivity analysis provides an indication of how the key metrics could change under various scenarios. The results for Avon Pension Fund are in the following table. The most positive/negative impacts arise if forecast fee savings or asset performance differs from the core model assumptions. The first will be determined by Brunel company's ability to negotiate lower fees; the latter is outside the control of the pool. Different asset transition costs/delay or higher operating costs of Brunel company have a lesser impact.

AVON		Break-even Year	Total 20 years net gain to FY36		Running annual rate of net savings in FY25	
			£m	Discounted value £m	£m	Basis points of AUM
<b>Core Model</b>		<b>FY24</b>	<b>73.3</b>	<b>36.4</b>	<b>3.5</b>	<b>6.8</b>
Variable 1: fee savings	-2 bps pa saving	FY26	46.6	21.3	2.3	4.5
	+2 bps pa saving	FY22	100.2	51.4	4.7	9.1
Variable 2: asset transition costs	+£15m on total transitional costs	FY25	70.6	33.9	3.5	6.8
	-£15m on total transitional costs	FY23	75.9	38.8	3.5	6.8
Variable 3 + £1m pa Brunel company running costs		FY24	70.2	34.1	3.4	6.5
Variable 4: Transition delay		FY25	66.7	32.8	3.4	6.5
Variable 5: asset performance	Equity market crash FY20	FY24	63.9	31.1	3.1	6.7
	-1%pa (3% pa total)	FY24	58.3	28.0	3.1	6.6
	+1% pa (5% pa total)	FY24	91.2	46.3	4.0	7.0

7.4 The S151 Officer and Monitoring Officer support the financial case to pool. The FBC for Avon Pension Fund indicates that there are significant financial benefits in the longer term, derived principally from increased economies of scale, skills and resources that pooling will bring.

7.5 Furthermore the cumulative discounted savings to FY36 of £36.4m should be considered against the funding position. At 31 March 2016 the funding deficit was £597m (discounted at a higher rate than the FBC savings) to be paid over 17 years to FY34. Thus over time the cumulative savings generated from pooling should reduce the cost burden to employers by around £26m (using the discount rate consistent with the actuarial valuation 2016).

## **8 RISK MANAGEMENT**

8.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

## **9 EQUALITIES**

9.1 An equalities impact assessment is not necessary.

## **10 CONSULTATION**

10.1 N/a.

## **11 ISSUES TO CONSIDER IN REACHING THE DECISION**

11.1 Set out in the report.

## **12 ADVICE SOUGHT**

12.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

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<b>Background papers</b>	Supporting Information to BPP
<b>Please contact the report author if you need to access this report in an alternative format</b>	