Annex 1

THE AVON PENSION FUND

SERVICE PLAN

2017 - 2020

PREPARED BY:

TONY BARTLETT, LIZ WOODYARD, GEOFF CLEAK and MARTIN PHILLIPS

MARCH 2017

CONTENTS OF SERVICE PLAN

SECTIONS

APPENDICES

AVON PENSION FUND SERVICE PLAN 2017-2020

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!

Key initiatives

Pooling of investment assets

Since agreeing the 2016-19 Service Plan last March significant progress has been made on the pooling of the Fund's investment assets. The Avon Pension Fund is participating in the Brunel Pension Partnership along with nine other likeminded funds.

The government continues to press for all the proposals to pool to be established by 1 April 2018 which we have always viewed as a challenging deadline. As work has progressed to develop the Brunel Pension Partnership (BPP), this reality of this challenge has become evident. Governance arrangements are in place to ensure the project can be developed in terms of having access to resources and funding, that decisions can be taken by those responsible for them, that there is adequate scrutiny and that committee members and stakeholders are kept informed.

As the Full Business Case (FBC) for BPP has now been approved by all the 10 administering authorities, work is now being under taken to establish the company that will implement the investment strategies on behalf of the ten funds. Parallel to this, the funds (or "clients") will start to focus on detailed client requirements, investment portfolios and the plans for transitioning the assets and the operational implications of this.

There are significant upfront costs for this project, arising from the development and establishment of the new company as well as officer resource diverted to the project. In addition, the work involved in transitioning liquid assets and unwinding illiquid assets will take a number of 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. The Committee has agreed the budget as set out in the FBC for the development, operational and regulatory capital costs when the FBC was approved. In addition, extra resource for the investment team was agreed for the period up to 1 April 2018

In addition new governance structures will need to be put in place for the pool and the impacts on the Investment Panel and Committee' s own governance structure and terms will have to be considered appropriately as the pool progresses.

Academies

The flow of schools converting to academy status continues which creates significant 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 the outsourcing of support functions presenting further complications. It is likely that the number of employers within the fund could rise to around 500 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.

Funding and Investment Strategy

The valuation process has now been completed in line with the Funding Strategy Statement which ensured the funding position and deficit management remains robust but took into account the financial pressures on the employers. Using the updated liability profile from the valuation, the investment strategy will be reviewed to 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 have a more effective investment strategy for those liabilities that use a more prudent strategy will be explored.

Administration Strategy

The 2016-19 Service Plan included significant investment in both IT systems and people to meet the increasing demands on the service, especially from the increase in employers within the Fund.

The administration team has now been restructured to better align its focus with its clients, namely members and employers. The team has achieved a lot in terms of data cleansing ahead of the 2016 valuation and processed a number of bulk redundancy exercises. However this has had an impact on the performance of the administration function over the past year. With the organisational restructure implemented the team is currently recruiting to achieve the full resource level which means performance will be addressed over the next year.

The IT Strategy outlined in the 2016-19 Service Plan is being implemented but supplier issues means that some milestones have slipped into this year. As part of the administration restructure, the Funds Systems and Development team has been merged with the Councils Financial Systems Team to build resilience and this is reflected in the treatment of costs in the budget.

With the employer base fragmenting due to outsourcings and academy conversions, and the increasing complexity of the scheme benefits, communications is a key focus for the Fund. In a time of reduced funding, employers need to understand and

manage their pension costs and financial risk. Government initiatives have resulted in members needing to make more decisions about their pensions including HMRC allowances and potential exit caps.

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. The Fund also supports the work of Local Fire Pension Board and is responsible for reporting compliance with TPR to the local board on a regular basis.

2. KEY OBJECTIVES 2017-20

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 turbulent times but has been resource and governance intensive to implement; the emergence of pooling will positively address this but not immediately and is likely to incur one off upfront costs and absorb resources 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 and the monitoring of employer covenant will become more important; 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 2016-19 service plan.

The **Key Objectives** for the Fund during the 2017-20 Service Plan period will be as follows:

Funding Strategy:

1. To establish and implement the policy for ongoing covenant assessment for incorporating into the funding strategy and funding plans.
2. To keep the Funding Strategy Statement under review so that it continues to protects the solvency of the Fund but remains affordable for employers.
3. To investigate options for insuring ill-health retirement costs for smaller employers or employer clusters within the Fund.
4. To continue to mitigate the risks to small employers of funding variations.
5. Improve and develop employer communications to support employers more efficiently.

Investment Strategy:

6. To develop and implement the plans to pool assets including the transition plan.
7. Review strategic allocation to ensure
    - it meets long term objectives post 2016 valuation
    - the pooling arrangements can deliver the strategy over time.
8. To implement any changes to the Investment Strategy in line with the principles set out in the Investment Strategy Statement.
9. Implement the Liability Risk Management Framework as a mechanism for managing liability risk through the investment portfolio.
10. Create a bespoke portfolio to match the cash flows of the liabilities
11. Review the options arising from the Responsible Investing Policy review to ensure the Fund addresses emerging risks and opportunities.
12. Explore opportunities to have a more effective investment strategy for those liabilities that use a more prudent strategy.

Administration Strategy:

13. 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.
14. To continue to implement planned IT Strategy designed to achieve a digital step change in service delivery and mitigate service demand growth.
15. To complete a review of the charging basis for Fire Scheme Pension and finalise a revised service offer and SLA.
16. Undertake development of website and Member Self Service solution for Fire Service members as per SLA.
17. To provide ongoing “as required” support to the local LGPS and Fire Service Pension Boards.
18. To complete redesign development of website services and information for employers which is fully integrated with self-service provision.
19. To complete the rollout of Employer self-service and i-Connect to achieve 99% pension data receipt in 2017.
20. 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.
21. To undertake review of pensioner member ‘pots’ to identify potential commutation opportunity in line with Government Budget announcement. Trivial commutations
22. To complete the move towards electronic delivery of Scheme communications to active members.

23. To undertake a review of the Data Improvement Plan to ensure the quality of member data continues to meet the Pension Regulators minimum legal requirements.
24. To meet the increasing demand for additional reporting to external bodies such as the Government Actuary's Department and the Scheme Advisory Board.
25. To meet the need of increasing communication with members in response to the legislative agenda and its consequent changes such as in taxation and exit caps.

Governance:

26. Review governance arrangements following the pooling of assets.
27. To ensure the relationship between the Committee and the Pensions Board operates effectively and in the best interests of the Fund.
28. 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.
29. Ensure effective engagement with Committee on the proposal to pool assets and its implementation.
30. Appoint independent member to Committee when current term expires in May 2017.

3. RESOURCE IMPLICATIONS

In the 2016-19 Service Plan there was provision for extra resources in the Actuarial Team. In respect of investments, pooling will have an impact on the internal investment operations but given that the focus will be on establishment and then transition, the full implications are still uncertain, especially around timings. 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. The Committee will be updated about the new team structure and transitional resources once this is agreed.

The Fund is entering a period of uncertainty regarding the pooling of assets in terms of establishing BPP Ltd. (the FCA regulated company) and this will have an impact on internal resources but as yet the timing is unknown. Therefore, as with the contingency for the operating costs of BPP for 2017/18, there may be a need for extra resources internally to manage the process. This will be brought to Committee once any additional requirements are identified.

4. BUDGET & CASHFLOW FORECAST 2017–20

Budget:

During this Service Plan period the significant costs of establishing the pool and transitioning the assets will be incurred. These costs will be funded from the Fund's

asset portfolio as are the investment expenses and management fees currently. Savings in investment expenses and management fees may begin to materialise by the end of this period to partially offset the costs of the BPP Ltd. but not at a level that will offset the transition costs. The Fund is expected to realise net cumulative savings by 2024-25. For the purpose of this Service Plan the current investment arrangements have been used and BPP Ltd. costs have been included from 2018/19 onwards (in addition to current investment management fees). The budget for 2017/18 as shown in Appendix 4A includes the Fund's share of regulatory capital (estimated to be c. £200k) to be provided as part of the FCA application process during 2017/18 (Brunel Management Fees). The balance is to cover the operating costs of BPP Ltd. prior to the transfer of assets.

The Service Plan includes the investment of savings in to the IT Strategy. The IT Strategy has been revised to reflect the rolling forward of some of the expenditure in response to the systems supplier changing their product offer. The budget shows a reallocation of resources from Salaries to Central Allocated costs reflecting the transfer of the Fund's IT Support Team to the Council's Financial Systems Team in order to provide greater resilience. In the salaries budget this transfer has offset the costs of the pay award and the restructure of the Administration team that was agreed in the previous Service Plan. 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.

The budget level (excluding investment costs) proposed for 2017/18 is £3,421,000 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 £49,000. This increase reflects the additional resources that are being focused on the employer and data control to meet the challenge of the increasing number of employers and importance of maintaining accurate up to date data. The potential savings in the Investment Team and expenses following the introduction of BPP have not been included because the timing of these savings is currently uncertain. Once the timing and scope are confirmed the budget will be updated.

The Investments budget includes increases in Investment management fees that are a consequence of the anticipated growth in asset values. It also includes the cost of performance fees relating to earlier years that will become payable. These are only partially offset by year on year savings that have been achieved following changes in Investment mandates that have led to lower fee rates. Actual expenditure will clearly depend on the level of growth in asset values.

The Pension Fund is required to meet the costs of the Pensions Board that became operational in July 2015. The estimated full year costs of the Board for 2017/18 to 2019/20 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 over the following three years exacerbated the negative annual cash flows. Following the Triennial Valuation in April 2017 employers again have the opportunity to make three years deficit contributions in a single advance payment. This again will create a large cash in-flow and exacerbate the negative cash flow over the next three years. The negative cash flows are managed by using income from the investment portfolio and divestments (of the lump sums already invested) if required.

Full details of the budget between 2017-18 and 2019-20 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 2016 -17 and 2017-18 is given in **Appendix 4B.**