Annex 1

THE AVON PENSION FUND

SERVICE PLAN

2019 - 2022

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AVON PENSION FUND SERVICE PLAN
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1 BACKGROUND

In 2017 the Fund set out its key objectives for the period to 2019/20 and this Service Plan continues that direction of travel recognising the continued challenging environment within which the service operates. This plan therefore updates the progress on those objectives and the further emerging challenges which need to be taken account of in the new programme period

Governance

The Fund is still in transition as it adapts to the changes in its investment arrangements and the complexity that arises from ongoing fragmentation of its employer base.

The transition of the assets and the need to implement the investment strategy through the pool will create issues that will require engagement by the Fund at both committee and officer levels. Although the review of the Fund's governance arrangements takes this into account, this needs to be kept under review as the new arrangements are still evolving, including the engagement process between Brunel, the Oversight Board and the Fund, and further changes may be required to ensure the Fund's requirements are addressed, its interests are protected and the governance arrangements are operationally effective.

The Pensions Board has been in existence for almost four years and is now fully engaged in its scrutiny role and in securing compliance and assisting the Administering Authority in delivering effective governance. Looking ahead, The Board will undertake to support the Committee and Officers in the implementation of the Administration Strategy.

Pooling of Investment Assets

Having established the FCA investment management company, Brunel, to manage the pool's assets, the focus through to 2021/22 is on the transition of the client assets to Brunel. A full range of portfolios have been agreed with assets starting to transition to a number of Brunel portfolios. In parallel with the transition of the listed assets, Brunel has established private market portfolios to invest new money commitments from its clients.

Although much time and resources has been spent establishing the pool and Brunel, significant resources are still required to work with Brunel and the wider pool to ensure the transition plan keeps on track, client strategies (and changes to them) are accommodated within the portfolio structure and that client monitoring is robust to give assurance to the Brunel Oversight Board, and local committees, that Brunel is delivering value for money to its clients.

Investment Strategy

Following a period of returns above expectations, 2018/19 saw the return of volatility to markets; the diverse strategy and focus on risk protected the Fund from significant declines in some assets.

The Strategic Asset Allocation will be reviewed following the 2019 actuarial valuation to ensure the Fund continues to fund its pension liabilities efficiently and provide value to its employers in terms of stable and affordable contributions. Any changes to the asset allocation arising from this review will be implemented through Brunel portfolios or, if a portfolio is not available, as an elective service by Brunel or by the Fund directly.

There were no changes to the strategy over the year; the strategic allocations to Secured Income (Long Lease Property) and Renewable Energy have finally been committed through Brunel portfolios and should be fully invested by mid-2020.

Funding Strategy

Significant work has been undertaken to de-risk the employer position within the Fund through the Funding Strategy. In addition the captive ill-health insurance scheme and the liability hedging strategy already implemented, a strategy to match the liabilities of employers that have exited the Fund is being developed, with implementation planned for early 2Q19. This will de-risk a further £130m of liabilities within the Fund. The options of developing bespoke funds for select groups reflecting their deficit, risk assessment and financial positions will be explored further and the option of moving towards a fully unitised approach will also be explored in time. This will be an important consideration by the Fund given the nature and diversity of employers within the Fund and will be considered on affordability and practical operational criteria.

In addition progress has been made on the covenant assessment work ahead of the 2019 valuation, after which monitoring will be ongoing. This will be an important element of the emerging funding plans at the employer level, especially given the difficult funding environment many of the employers face, both currently and for the foreseeable future.

Administration Strategy

The rapid growth of employers within the APF continues to represent a significant challenge to the Fund. A number of key projects are in train to support objectives and mitigate compliance risk. However, further exploration and development of joined up technical capabilities are required to further maximise service delivery. The Fund has revised its Administration Strategy to continue progress toward a seamless automated pension service, additionally a new employer SLA will include a chargeable service option.

2 KEY OBJECTIVES – 2019/20 to 2020/21

Funding Strategy:

1. Implement the policy for ongoing covenant assessment for incorporating into the Funding Strategy and funding plans.
2. To agree a Funding Strategy for the 2019 valuation to protect the solvency of the Fund and ensure contributions remain affordable for employers.
3. To explore further options for bespoke portfolios to manage the funding and liability position of specific employer risk groups

Investment Strategy:

4. To monitor the transition of assets to the new Brunel Portfolios.
5. To review the strategic asset allocation to ensure the Fund can achieve the returns required in the Funding Strategy and that all risk are effectively managed.
6. To revise the Investment Strategy Statement reflecting strategy developments and changes due to Brunel operations.
7. Monitor and develop the Risk Management Framework further as a mechanism for managing liability risk through the investment portfolio and mitigating investment risk.

Administration Strategy:

8. To implement new SLA arrangements to all employers including chargeable service option.
9. To continue implementation of the planned IT Strategy designed to achieve a digital step change in service delivery and mitigate service demand growth.
10. To introduce a training & development programme across all pension stakeholders
11. To complete the rollout of I-Connect and implement joint monthly contribution and data delivery module.
12. To complete the GMP data reconciliation exercise as required by HMRC to ensure the fund is not at risk of erroneous pension liability.
13. To undertake review of pensioner member ‘pots’ to identify potential commutation opportunity in line with Government Budget announcement on trivial commutations
14. To complete the move towards electronic delivery of Scheme communications to active members.

Governance:

15. Keep governance arrangements under review to ensure effective monitoring of Brunel and the transition of the assets.
16. To ensure the Committee and the Pensions Board is fully trained and briefed on current strategies and operations and in position to scrutinise and make decisions effectively.

A report on progress towards objectives from 2018 – 2021 is given in Appendix 2. Key objectives for 2019-2021 are set out In Appendix 3.

3 RESOURCE IMPLICATIONS

In 2018/19 a new post was created within the Investment & Finance Team to focus on improving governance and risk management across the whole fund. The post will support the management team to embed a compliance culture, improve best practice and provide more structured training so that the Fund can comply with MiFID II and other regulatory standards.

With the creation of Brunel the resources within the team devoted to investment strategy, policy and operations has diminished, giving rise to resilience and capacity issues. Despite assets transferring to Brunel, significant resources are still required to manage and develop the relationship with Brunel and the client side of the pool. In particular, there is key person risk and inadequate resource to maintain and develop knowledge around strategic investment issues including ESG, where the Fund has specific focus. Internal capability ensures the strategy evolves efficiently to meet the Fund's objectives, there is proper control of implementation, that members are trained and supported, and there is adequate internal challenge of expert advice. Therefore the 2019/20 budget allows for an extra post of Senior Investment Officer to support and deputise for the Assistant Investment Manager.

In respect of administration, an additional part-time post has been included in the budget to support the administration in recruitment, training and development requirements of both Fund officers and scheme employers. Additionally, there is currently inadequate resource to deliver technical training and support across the administration service and therefore the 2019/20 budget allows for an extra post of at Senior Officer to undertake this. Finally, an additional Team Leader post on Member Services team has been created to support the current structure. With the continuous volume of projects being undertaken by managers across the Fund the requirement of a Projects and Processes Manager post has been considered. However, this has been deferred pending the capacity of the new Governance & Risk Advisor role.

4 BUDGET

This Service Plan period includes the costs of managing investment assets through Brunel; however savings in investment expenses and management fees will only begin to materialise as the transition of assets is completed over time. The Fund is expected to realise net (of transition costs) cumulative savings by 2024-25.

The budget (excluding investment costs) proposed for 2019/20 is £4,712,030.

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.

Within the directly controlled budget for Administration there is a proposed increase in net expenditure over the 2018/19 budget of £501,000. This net increase includes additional resources to meet the employer driven demands of schools achieving academy status, the increasing number of outsourcings and the cost of meeting the challenge to maintain accurate up to date data. Provision has been made for IT developments including the option to have the Altair system and Member Self-Service system hosted and the move to a new server. The budget also includes the cost of one off projects to carry out mortality checks and detailed forensic tracing of deferred members. In addition there are provisions for an employer training module, an employer discretions package and a regulatory and guidance tool.

Investment Management fees:

The estimated investment management fees have increased by £4.7m to £28.9m which is more than the assumed 6% increase in asset values. The increase is due to an increase in performance related fees; annual management fees are estimated to be flat year on year at £19.8m. The actual fees paid in 2019/20 will depend on the change in asset values over the year and the performance of the assets subject to the performance fees (performance fees accrue within each year but are only payable when the underlying assets are realised).

The increase in performance fees relate to (i) the infrastructure portfolio following particularly strong asset performance during 2017 and 2018 and (ii) the real estate portfolio where, as the closed ended funds mature into the divestment phase, performance fees increase as asset sales are realised and the annual management fee reduces.

Annual investment management fees paid to managers are estimated to be flat compared to last year. Where asset values have fallen year on year, the annual fees (in monetary terms) based on the asset value show a small saving. However, the Fund's strategy is to increase the allocation to private market assets, sourcing the allocation from listed market assets. Typically the fee rate paid on private market assets is higher (in basis points) than for listed assets, leading to upward pressure on underlying fee rates.

Lastly, the fees are impacted by the transition of assets to portfolios managed by Brunel. The fee rates achieved to date from pooling the UK Equity and Passive Equity assets have been competitive and resulted in a small reduction overall in fee rates. Specifically, the Fund will make savings from the performance related fees that were paid on the legacy UK Equity mandate.

Brunel management costs:

During 2018/19, shareholders approved an increase in Brunel's budget for 2019/20 to ensure there are adequate resources to (i) deliver the transition plan within an agreed timeline in order that clients can implement their investment strategy efficiently and (ii) to support client funds with business as usual activities. In addition, a budget was approved to procure an administrator for the private market assets to be managed by Brunel. The increases were approved by Special Reserve Matters during 2018/19 and the Business Plan for 2019/20 to 2021/22. In the later years of the 3 year Business Plan, the budget stabilises as the costs associated with the transition fall out of the budget.

Governance Costs:

In 2019-20 two significant projects, the 2019 Valuation and Strategic Investment Review will be undertaken and the costs are provided for in the budget. The cost of an additional Independent Member for the Committee and associated appointment costs have also been provided for (subject to changes to the Fund's constitution). Due to the new electoral cycle, it has been assumed there will be a number of new committee members and the training budget has been increased accordingly.

Salaries:

Having identified capacity and resilience risks within the Investments Team, the budget allows for an extra post of Senior Investment Officer to support and deputise for the Assistant Investment Manager. Similarly, to mitigate operational risk and provide support to the administration function the budget allows for extra 3 posts across the Administration Team at Team Leader and Senior Officer level.

Pensions Board:

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 2019/20 to 2021/22 have been added to the overall cost to the Fund for the three year budget.

5 CASH FLOW

As the Fund's profile matures, monitoring future cash flow trends increases in importance. The Fund is transitioning 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. 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 2017 the Fund had large cash in-flows. However the consequent absence of these deficit payments in the following two years results in negative annual cash flows. The negative cash flows are managed by using income from the investment portfolio and divestments as required. Divestments are delegated to Officers as part of their operational duties. Consideration is given to the actual allocation against the strategic allocation as well as the view of investment markets.

Full details of the budget between 2019-20 and 2021-22 together with a cash flow forecast for the payment of benefits and the receipt of contributions are given in **Appendix 4.**