Appendix 6

EXTRACT FROM ANNUAL REPORT
POOLING OF ASSETS – ANALYSIS OF COSTS & SAVINGS

In 2015 **LGPS: Investment Reform Criteria and Guidance** was issued which set out how the government expected LGPS funds to establish their asset pooling arrangements. The objective was to deliver:

- Benefits of scale.
- Strong governance and decision making.
- Reduced costs and excellent value for money, and
- An improved capacity and capability to invest in infrastructure.

This has led to the creation of eight asset pools which have significantly changed the previous approach to managing the Fund's assets. Pools are responsible for implementing each local fund strategy; however, responsibility for determining asset allocation and the investment strategy remains with Avon Pension Fund Committee.

The Avon Pension Fund is one of ten LGPS funds participating in the Brunel Pension Partnership. The other funds ("clients") are Buckinghamshire, Cornwall, Devon, Dorset, Environment Agency, Gloucestershire, Oxfordshire, Somerset and Wiltshire.

The governance arrangements for the pool have been established. The Brunel Oversight Board is comprised of representatives from each of the administering authorities and two member observers with agreed constitution and Terms of Reference. Acting for the administering authorities, it has ultimate responsibility for ensuring that Brunel delivers the services required to achieve investment pooling and deliver each Fund's investment strategy. Brunel Oversight Board is supported by the Client Group, comprised of investment officers drawn from each of the administering authorities. The Client Group is responsible for monitoring Brunel, including the plan for transitioning assets to the portfolios, and provides a forum for discussing technical and practical matters. It is responsible for providing practical support to enable the Brunel Oversight Board to fulfil its monitoring and oversight function.

Along with the other administering authorities, Bath and North East Somerset Council approved the business case for the Brunel asset pool in February 2017, based on estimated potential fee savings of £550 million over a 20 year period (to 2036) across the ten funds, of which Avon Pension Fund's share was £73 million. Initial costs of the project meant the Fund's breakeven was in 2024.

The expected costs and savings for the Fund from the original business case, and submitted to Government as part of pooling, are set out in the following table.

Avon Pension Fund Expected Costs and savings from Pooling:
(as per Business Case Submissions)

	2016-2017 £'000	2017-2018 £'000	2018-2019 £'000	2019-2020 £'000	2020-2021 £'000	2021-2022 £'000	2022-2023 £'000	2023-2024 £'000	2024-2025 £'000	2025 to 2036 £'000	Total £'000
Set up Costs	117	1,148									**1,265**
Ongoing Brunel Costs			674	893	923	953	985	1,017	1,051	14,127	**20,623**
Avon Fund Savings			(259)	(267)	(275)	(283)	(291)	(300)	(309)	(4,077)	**(6,061)**
Transition Costs			2,957	4,067	260	-	-	-	-	-	**7,284**
Fee Savings			(125)	(1,216)	(2,687)	(2,927)	(3,185)	(3,892)	(4,164)	(78,583)	**(96,778)**
Net costs / (savings)	117	1,148	3,248	3,478	(1,779)	(2,257)	(2,491)	(3,175)	(3,422)	(68,533)	**(73,667)**

Following approval of the business case, Brunel Pension Partnership Ltd was established in July 2017, wholly owned by the ten Administering Authorities (in equal shares) that participate in the pool. The company is authorised by the Financial Conduct Authority (FCA). It is responsible for implementing the strategic asset allocation of the participating funds by investing Funds' assets within defined outcome focused investment portfolios. In particular, it researches and selects the external managers or pooled funds needed to meet the investment objective of each portfolio. Once the portfolios are established, Brunel is responsible for allocation between mandates within each portfolio and monitoring the performance of the underlying managers.

Now that the pool is operational, its financial performance will be monitored to ensure that Brunel is delivering on the key objectives of pooling. This includes reporting of the costs associated with the appointment and management of the pool company including set up costs, investment management expenses and the oversight and monitoring of Brunel by the client funds. The set up costs incurred by Avon Pension Fund are set out in the following table.

Set up costs

	Direct £000s	Indirect £000s	Total £000s	Cumulative £000s
Recruitment				18
Legal				133
Consulting, Advisory & Procurement				82
Share Purchase				840
Total Set Up Costs				**1,072**

The set up costs have come in within the budget which was an achievement given the complexity of creating a new company and investment platform.

During the year, £736m of the Fund's assets transitioned to Brunel portfolios and the table below shows the assets currently managed within the pool.

Investment assets by manager from Statement of Accounts

	31 March 2019 £'000	%
Investments managed by Brunel Pension Partnership:		
LGIM Low Carbon Global Equities	**520,926**	**10.8**
Brunel Infrastructure Portfolio	**11,152**	**0.2**
Brunel Secured Income Portfolio	**16,695**	**0.3**
Brunel UK Equity Portfolio	**187,270**	**3.9**
	736,043	**15.3**
Investments managed outside Brunel Pension Partnership	**4,083,710**	**84.7**
TOTAL INVESTMENT ASSETS	**4,819,753**	**100.0**

In 2018/19 transition costs arose from the transition of the Fund's UK Equity and the Low Carbon Passive Equity assets. The transition of the Low Carbon Equity assets was in July 2018 and the UK Equity assets followed in November 2018. The transition costs were below the estimate in the business case for 2018/19 as fewer transitions than anticipated were completed in the year; the original business case assumed c. 50% of the Fund's active equity assets would transition in 2018/19. With an increase in assets transitioning in 2019/20, it is anticipated that transition costs will increase in 2019/20.

Transition Costs

	Direct £000s	Indirect £000s	Total £000s	Cumulative £000s
Transition Fee				
Tax		300	300	300
Other Transition Costs		672	672	672
Total Transition Costs		**972**	**972**	**972**

The analysis below shows the fee savings achieved for the assets that have transitioned to Brunel portfolios against the fees charged to the Fund at the time the business case for pooling was prepared in 2016. It therefore ignores fee reductions that have been negotiated with incumbent managers between the formulation of the business case and the transition to Brunel.

Investment Fee savings from Pooling

	Value in Original Business Case 31 March 2016	Value at 31 March 2019	Price Variance	Quantity Variance	Total Saving / (Cost)
	£'000	£'000	£'000	£'000	£'000
Passive UK Equities	167,800	-	-	49	49
Passive Global Equities	348,900	-	-	101	101
Passive Low Carbon Equities	-	520,925	55	(129)	(74)
Active UK Equities	201,993	187,270	190	39	229
Infrastructure	-	11,152	(13)	(18)	(31)
Secured Income	-	16,695	(7)	(12)	(19)
			226	30	256

The price variance shows the savings / (costs) on the fee rate achieved through pooling. The quantity variance reflects the savings / (costs) due to changes in allocations compared to the business case. Therefore, when comparing the fee savings against the business case the price variance reflects the actual saving in fees.

At the time of the business case in 2016, the Fund was invested in Passive UK and Global Equities; these assets switched into Passive Low Carbon Equities in 2017, prior to pooling. The fees for the Passive Low Carbon equities are higher than those for Passive UK and Global equities, giving rise to a 'cost' from pooling. The fee rates achieved on all the passive portfolios established by Brunel are lower than the fees charged in the business case.

The fee saving for the UK Equity portfolio is due to the lower overall fee rate achieved by Brunel. The fee paid by the Fund prior to pooling consisted of a combined annual management fee and performance fee. The fee rate negotiated by Brunel has no performance element. There is also a saving from transitioning fewer assets than in the business case due to a reduction in the allocation to UK Equities since 2016.

In addition to these transitions, the Fund has made new allocations to Brunel's Renewable Energy Infrastructure and Secured Income portfolios. The Infrastructure portfolio invests in private market pooled vehicles which have a higher cost than the Fund's other infrastructure portfolio. The new allocation to Secured Income is funded from lower cost assets, thus showing an overall increase in costs.

The ongoing fee paid to Brunel in 2018/19 for its core services was £1.05m. This includes custody, performance measurement and reporting costs for Brunel as well as client's side support costs. The estimated cost in the original business case of £0.67m excluded custody and performance measurement costs of £0.15m. The increase in the costs for 2018/19 is due to inflation and additional resources approved by Shareholders required by Brunel over and above those envisaged in the original business case, in order to deliver the service required by the clients. As a result, the ongoing overhead cost of the company is higher than originally estimated.

A summary of the costs and savings to date compared to the original business case is provided in the following table.

Expected versus Actual Costs and Savings to Date

	2017/18				2018/19			
	Budget		Actual		Budget		Actual	
	In Year	Cum. to date	In Year	Cum. to date	In Year	Cum. to date	In Year	Cum. to date
	£000	£000	£000	£000	£000	£000	£000	£000
Set up costs	1,148	1,265	1,072	1,072	-	1,265	-	1,072
Ongoing Brunel Costs	-	-	-	-	674	674	1,053	1,053
Avon Internal Savings	-	-	-	-	(259)	(259)	(215)	(215)
Transition costs	-	-	-	-	2,957	2,957	972	972
Fee savings	-	-	-	-	(125)	(125)	(226)	(226)
Net costs / (savings)	1,148	1,265	1,072	1,072	3,248	4,513	1,584	2,656

The most significant variances from the original business case are summarised as follows:

- Transition costs are lower as fewer transitions completed in 2018/19 than assumed in the Business Case;
- Fee savings are greater than anticipated mainly due to the lower fees of the UK Equity portfolio
- Ongoing costs of Brunel are higher than anticipated

The Fund's internal savings are marginally lower than those envisaged in the original business case. These savings includes the cost of custody and performance measurement (based on 2016/17 costs and now included in on-going Brunel costs), a slight reduction in staff costs and limited savings for investment advice.