

THE AVON PENSION FUND

SERVICE PLAN

2021 - 2024

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AVON PENSION FUND SERVICE PLAN

2021-24

1 BACKGROUND

This service plan is written against the backdrop of the continuing Coronavirus pandemic and the ongoing battle to prevent its spread across nations and across the globe. Whilst the emergence of several vaccines brings refreshed optimism that the fight against the virus will eventually be won, this will weigh heavily against the human and economic cost that nations have been left to deal with. How governments respond in the bid to stimulate flagging economies amidst calls for greater ethical and social balance and political commitment for a greener future, will have a significant impact on the financial position of the Fund, whilst it is already recognised that “normality” when it returns, will be different and effect ongoing operations and services.

Whilst the Fund has managed to maintain services, enabling almost all activity to be undertaken remotely and online during the past year, several developments have struggled to gain traction, a product of the operational environment. The service has adopted a “make do” or “needs must” approach to both communications and operations which now requires a more robust solution, to enable sustained digital operation. The existing Administration Strategy reflects an evolutionary approach to digital enablement with a number of long term projects ongoing; the dramatic change in circumstances is now challenging this approach and rather demanding a revolutionary step change in digital services and functionality; whilst it is expected that the market offer will continue to be developed in this area, the specialist nature of pensions means there is still likely to be a gap between requirements and available products which could be expensive to bridge.

Running alongside the growing digital challenge is an equally demanding management challenge. “Wellbeing” currently takes top billing on the agenda but the supporting cast of training and development, performance management, communications, security, relationship management and cultural development are becoming co-starring roles and need considerable attention as the service moves into the brave new world. How the service intends to respond to these challenges will be the subject of a revised Administration Strategy in the second half of the year, but there will be a number of key investments to kick start some of this work as Strategy development takes place.

The impact on financial markets of the Covid outbreak in March 2020 was staggering, but equally remarkable was the response of international governments to prop up their economies, creating large amounts of public debt in the meantime. For the Fund, it caused a pause and reappraisal of some of the investment strategy decisions to ensure that strategic direction was still appropriate. Since that time, the Fund has strengthened its equity risk management approach; but the economic outlook remains uncertain and a lot will depend on how governments seek to rebalance their debt positions and for the UK the impact this has on employers will have a direct impact on the Funding Strategy.

Having moved from one period of austerity with the likelihood of facing another, the only strategic dependable now seems to be ongoing uncertainty. The challenge to the public sector purse, uncertain economic outlook and the need to maintain an affordable pension scheme for employers now raises a question for the Fund which may not be unexpected –

“do we need to take more risk?” Appetite for risk is a key component of the Fund’s investment strategy and it has endeavoured to minimise risk in an effort to stabilise employer contributions. This strategy has been successful, stabilising contributions and closing the funding gap over successive valuations, but with the next valuation only 12 months away, the Fund’s appetite for risk will be seriously challenged unless government intervention provides a stay of execution.

The Covid pandemic has increased risk across all the Fund’s strategies and the focus of 2021 will therefore be to work towards mitigating measures. In the case of the administration a more fundamental review of Strategy is required focusing on technology, staff and operational development.

Administration

The most obvious outcome of moving to a solo homeworking environment is that all communication, engagement and operation now has to be timetabled and planned. With limited visibility there is increased pressure on the management team to ensure all operations are effectively maintained. Whilst longer term it is expected that digital tools will develop to support this, at present there is a reliance on increased management effort to sustain this position. As stated earlier a number of developments have been paused as a result but the need to now fully embrace digital operational capability provides a further logistical and management resource drain. Ensuring there remains sufficient management focus in key areas is now a major challenge for the administration and it is recommended that the management team is strengthened in quite specific areas to accommodate this. In addition, the creation of a core projects unit which could be flexed as major projects such as McCloud emerge, will mitigate the current risk of continually diluting operational resource.

The new operating environment also requires a new infrastructure to support it and whilst the service has adapted, the change is far from complete. The establishment of a Transformation function would give the issue real focus and impetus and incorporate the recently created training function, communications and importantly lead on all digital transformation. Whilst this function is being established, a projects officer will be appointed to kick start some of this work particularly digital service specification, digital office working including staff engagement and governance arrangements, more detail of the planned transformation workstreams and timetable being contained in Appendix 3. A high-level admin structure chart to support the transformation process and maintain business operational needs is shown as Appendix 4. It is anticipated that the net cost of this structural change will be £116k with some of the costs being met by existing budgets.

Investments & Funding

The investment team has been strengthened in the past year and it is not proposed to make any further changes albeit the situation will need to be kept under review. The Brunel transition work should complete by the end of 2021 leaving the Fund with some legacy assets to manage down over time. The focus will turn to Paris aligned portfolios with significant regulation and policy development expected in this area to be navigated by the Fund and the Brunel Partnership. In addition, the Fund will increase its transparency around its strategy by reporting in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations for example. The economic impact of the pandemic will no doubt

be apparent for some time and the interim valuation in 2021 will provide a benchmark to consider any further changes to the investment strategy; in particular the fund will need to consider the level of investment risk necessary to maintain funding objectives.

The employer portfolio continues to evolve and there is a need to increase covenant assessment work to reflect the increase in employer risk. In addition, scheme employers are more actively monitoring and managing their pension liabilities which in turn leads to greater engagement and workload for the team. Therefore, it is prudent to review the current resources in the actuarial team, in particular to ensure there is adequate resource for policy development and employer engagement.

Addressing the Climate Emergency

The Fund's strategy to reduce its carbon emissions and exposure encompasses all aspects of its activities. As part of B&NES Council it is committed to achieving the Council's goal of enabling the Bath and North East Somerset area to be carbon neutral by 2030. In respect of its operations it will achieve this by fully digitalising its service delivery to members and employers, accepting that it will have to provide non digitalised service to those that are not electronically enabled in the meantime. In addition, use of technology to enable remote working and online learning and seminars will reduce the carbon emissions from commuting to work and travel to conferences and seminars.

Alongside side the operational strategy the investments strategy embeds responsible investing throughout the investment process starting with setting the investment objectives. A set of climate change objectives have been agreed and the implementation of the investment strategy will be consistent with achieving these goals. These goals will be kept under review as the development of UK and international government policies, advances in technology and creation of investment solutions should mean the milestones can be brought forward over the next 5-10 years.

As a responsible investor the Fund will improve and increase its disclosure on its climate related and broader stewardship activities by reporting in line with the Task Force on Climate-Related Financial Disclosures and the Financial Reporting Council's Stewardship Code in 2021/22. In addition, we will be increasing our interaction with members and employers about our activities and how, as an investor, we are promoting change and demonstrating leadership in the field of responsible investment.

Governance

The Scheme Advisory Board (SAB) launched the Good Governance Review back in 2018 and appointed Hymans Robertson to examine the effectiveness of current LGPS governance models and to consider alternatives or enhancements. The aim of the project is to further improve the high standards of governance and administration of the scheme on a consistent and measured basis across all 87 LGPS Funds, that will better match the standards expected by the Pensions Regulator.

On 15 February 2021, SAB published Good Governance: Phase 3 Report which was produced by the Hymans Robertson project team. The Phase 3 report provides further details on some of the recommendations which will now be submitted to the Local Government minister for consideration. A timeline for implementation is then expected.

The Fund previously measured itself against the recommendations and has an action plan for implementation of the additional measures once all the details are confirmed. The additional requirements include:

- Introduction of an LGPS senior officer responsible for the delivery of LGPS activity for a fund.
- Enhanced governance compliance statement
- Conflicts of interest policy specific to the LGPS.
- Representation: policy on how scheme members and non-administering authority employers are represented on its committees.
- Skills and training: pension committee members and section 151 officers, to have the appropriate level of knowledge and understanding to carry out their duties efficiently.
- Service delivery: compulsory administration strategy.
- KPIs: defined service standards and governance in place to monitor those standards.
- Business planning process: resource and budget allocated to administer the LGPS each year.
- Biennial independent governance review

Work will be planned in to meet the requirements once the scheme regulations and statutory guidance are in place.

Workload

For a number of years the Fund has increased resources to meet the ongoing challenge of employer and regulatory growth and for the time being there is no sign of this abating. The operating circumstances have been challenging over the past twelve months and with the prospect of this continuing, productivity and particularly the management of new developments and projects will remain challenged in respect of delivery times. The service plan priorities have been reviewed and realigned with the current operating constraints in mind to provide a more realistic delivery timescale. The key to success now very much hinges on the necessary developments in technology to enable efficient remote working but with sufficient opportunities to ensure collaborative working can still take place; essential for project delivery strategy and policy development, cultural and social cohesion. The Administration Strategy is under review to ensure that all the issues experienced by the service through this difficult period can be recognised and as far as possible addressed as we continue to operate in an arms-length fashion. The admin strategy will be refocused on areas of communications, training and transformation but the size of the challenge ahead should not be underestimated.

Budget

The budget has been adjusted to reflect a revised structure and the costs of kick starting some of the necessary work in advance of a revised Administration Strategy. At this point the budget is incomplete and will require a further discussion when the Administration Strategy comes back to the Committee in the autumn/winter; by then there should be a clearer indication of digital investment required and over what period in order to make the necessary and/or available changes if this is a direction the committee feel able to support, at which point the net impact on benchmark costs should also be clearer.

2 KEY OBJECTIVES – 2021/22 to 2023/24

Funding Strategy:

1. Undertake an interim valuation during 2021 to identify the issues that may materially affect the 2022 valuation (which will set employer contribution rates with effect from April 2023).
2. Finalise and then implement the Fund's policies within the Funding Strategy Statement that will enable greater flexibility in managing employer risk and scheme exits.
3. Ongoing covenant assessment for incorporating into the Funding Strategy and funding plans.
4. Explore further options for bespoke portfolios to manage the funding and liability position of specific employer risk groups.
5. Ongoing management of smaller employers to ensure pension costs remain affordable for the employer and financially sustainable for the Fund.

Investment Strategy:

6. Monitor the transition of assets to the Brunel Portfolios (expected to complete by end 2021) and performance of Brunel and their portfolios, ensuring Brunel are delivering the Fund's strategic objectives.
7. To meet our climate objectives, review the equity portfolio with the objective of having all the equity assets managed in sustainable or Paris aligned (with low carbon transition) investment strategies.
8. In light of the interim valuation and expectations of future returns, consider whether the current investment strategy meets the funding objectives or whether the level of risk embedded in the strategy is too low.
9. Monitor and develop the Risk Management Framework as required as a mechanism for managing liability risk through the investment portfolio and mitigating investment risk.
10. Support initiatives and undertake activity to demonstrate the Fund's commitment to meeting its climate emergency targets such as reporting in line with the TCFD recommendations in 2021, as a signatory to IIGCC initiatives to influence government policy and regulatory change.
11. Increase communications with our broad array of stakeholders about the investment strategy with a focus on how the strategy is mitigating the financial risk of climate change.
12. Realign the investment advice required post transition of assets to Brunel.
13. Maintain the Investment Strategy Statement reflecting strategy developments and changes due to Brunel operations.

Administration Strategy:

14. To continue the move towards digital delivery of Scheme communications to members.
15. To complete the rollout of I-Connect and the receipt of monthly member data returns.
16. Prioritise the introduction of a staff training and development programme to support the resourcing of operational and digital transformation needs and

- ensure that these meet with and encompass the requirements of appropriate health and wellbeing criteria in accordance with council policy
17. To complete the final phase of the GMP data reconciliation exercise as required by HMRC to ensure the fund is not at risk of erroneous pension liability.
 18. To complete the member address rectification project to identify missing data and implement actions to resolve outcomes.
 19. To monitor outcomes of McCloud judgement and implement actions to manage remedy including actions to support Fire Schemes Immediate Detriment cases.
 20. Undertake gap analysis and specification for digital requirements across all stakeholders.
 21. Develop revised Admin Strategy proposals to include digital transformation and to take to Pensions Committee.

Governance:

22. Keep governance arrangements under review to ensure effective monitoring of Brunel and the transition of the assets.
23. Implementation of the Good Governance Review (SAB) requirements.
24. 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.
25. Retender advisory contracts to align contracts with Fund objectives.

A report on objectives, targets & progress towards objectives and those rebased and temporarily put on hold is given in Appendix 2.

3 RESOURCE IMPLICATIONS

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 as well as delivering the investment strategy including Responsible Investing and Risk Management. In addition, internal specialist capability ensures the Fund 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.

Capacity within the Investments Team has now improved with the appointment of a Senior Investments Officer (SIO) in early 2021, with a specific focus on ESG and RI. A second SIO post remains vacant and is already provided for in the budget; further consideration will be given to filling this position once the team has bedded down and all legacy assets have transferred to Brunel (except those that cannot transfer and will be wound down by the Fund). Strategic projects such as the review of the equity assets will be delivered by the Fund's investment advisors.

To address the changing work of the actuarial team, the team's resources will be reviewed during the year to ensure there is adequate support for the Funding and Valuation Manager in developing and implementing policies and funding plans.

In respect of administration at the start of the pandemic a high number of posts remained unfilled. A phased recruitment programme has been in place over the past seven months to complete the establishment albeit with some slippage due to COVID and remote working. Further recruitment to better structure the management team and support transformational

needs of the service will be the introduced as part of the 2021/22 budget and operationally the administration resources will be considered during the year as part of the Administration Strategy review. Appendix 1a details the increase in establishment resource since 2014 highlighting the continuing void between agreed establishment and actual posts filled; set against a background of regulatory change and increased governance and compliance.

The 2021/22 budget allows for additional temporary resource to support the expected workload to manage the McCloud remedy, with the use of external specialist support as part of the ongoing solution to manage elements of specific project work.

4 BUDGET

This Service Plan period includes the costs of managing investment assets through Brunel; savings in investment management fees are materialising as the transition of assets progresses. The Fund is expected to realise net (of transition costs) cumulative savings by 2024-25, with the business case forecasting cumulative savings of £73m by 2036.

The Fund budget (excluding investment fees) proposed for 2021/22 is £ 5.35m.

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.

The budget includes the costs of supporting the Fund's RI strategy to manage the impact of climate change on the asset portfolio. The total budget committed to RI including staff costs, affiliations, advice and communications is around £0.13m p.a.

Within the directly controlled budget for Administration there is a proposed increase in net expenditure over the 2020/21 budget of £0.31m. This includes additional resource to strengthen the management team and to also implement and manage the transformation program. Included within this increase is £0.13m relating to posts added in 20/21 part way through the year.

It also includes continued additional temporary resources to meet expected increased workload resulting from the McCloud remedy. £0.12m is provided in the budget for extra resources and advice to implement the McCloud remedy with provision to increase this up to £0.3m in the 2022/23 budget subject to requirements once legislation has been made. Previous budget provision for consultancy on IT systems has been removed pending the revised admin strategy and digital development requirements. The provision of £20,000 made in the previous budget to provide equipment to support flexible working during the pandemic will continue into 2021/22 and an additional £10,000 has been made to provide office meeting space. The budget also includes the cost of one-off projects to undertake the final phase of the address tracing project and completion of the GMP rectification exercise.

Investment Management fees:

The annual management fees of £18.4m are lower than in last year's budget for 2021/22 of £19.8m despite an increase in asset values between the data points used. During the year further recurring fee reductions were achieved on assets that transitioned to Brunel portfolios. Significant savings of c.£1.6m p.a. were achieved on the Brunel Diversified Returns Funds (DRF) portfolio. Lower fees for the Global Sustainable Equity portfolio save c.£0.2m p.a. and transferring management of the UK Property portfolio to Brunel in 1Q21 will

save c.£0.4 p.a. when the transition completes during 2021/22. To date the cumulative investment fee savings from transitions are c. £3.4m p.a. (when comparing to the fees paid prior to transition).

However, strategic allocation changes will affect the actual savings achieved. For example, switches from lower to higher cost portfolios (e.g. switching from Brunel's UK and Global High Alpha Equity portfolios to the Global Sustainable Equity portfolio) and from lower cost listed asset portfolios to higher cost private market assets puts upward pressure on fees. Compared to previous years, very low performance fees are anticipated to be incurred in 2021/22; this reflects the fall in some property and infrastructure values due to the pandemic which are not expected to recover to pre-pandemic levels this year; therefore performance fees will not accrue until pre-pandemic values are exceeded.

As at 31/12/20, Brunel manage £3.4 billion or 66% of the Fund's assets as follows:

Brunel portfolio	Value at 31/12/20	Date of transition
Passive Low Carbon Equities	£666m	July 2018
UK Equities	£0m	Nov 2018
Emerging Market Equities	£281m	Oct 2019
Global High Alpha Equities	£391m	Nov 2019
Risk Management Strategies	£878m	Oct 2019
Diversified Return Funds	£508m	July 2020
Sustainable Equities	£539m	Sept 2020
Private Market Assets	£182m	n/a

The fees do not include the cost of transitions which is deducted from the asset values. In addition, the budget does not include planned transitions during 2021/22 but assumes legacy mandates are retained.

The actual fees paid in 2021/22 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).

Brunel management costs:

The shareholders are in the process of approving the 3-year budget and Business Plan for Brunel for 2021/22 to 2023/24. The budget ensures there are adequate resources to

- (i) deliver the transition plan within an agreed timeline in order that clients can implement their investment strategy efficiently;
- (ii) support the clients' RI objectives;
- (iii) ensure resilience and capability in the private markets team as the assets under its management increase and
- (iv) develop the reporting to clients as the business moves from the transition phase to business as usual.

The overall costs of Brunel of £10.9m for 2021/22 is c.3% increase year on year. As more assets transition from clients to Brunel, more of the costs are applied to the portfolios on an

AUM basis (rather than on an equal 1/10th basis). Therefore, Avon's share is slightly more than 10% at £1.28m p.a.

Governance Costs:

Ongoing governance costs, primarily actuarial and investment advice are forecast to be higher than last year. The actuarial workload has increased significantly over the last 12 months as the team deals with more employer specific issues and changes to regulations lead to more activity (for example the introduction of exit credits). The main pressure on the 2021/22 budget is the extra activity as a result of the new regulations that permit more flexible funding plans and the interim valuation exercise. Overall, there is a 20% increase in actuarial costs (over 2020/21 revised budget) which this includes a 10% contingency to cover implementation of McCloud, GMP rectification and elements of the pre 2022 valuation work which may fall into the fiscal year.

There is an increase in the budget for Investment Advice, primarily due to the cost of implementing the Dynamic Equity Protection Strategy. This is a one-off cost and the ongoing monitoring and related costs will be lower once the new structure is in place.

Salaries:

There is slight upward pressure on the salaries in the Finance & Investments Team where following unsuccessful recruitment in 2019/20 posts were regraded, enabling vacant posts to be filled last year.

Pensions Board:

The Pension Fund is required to meet the costs of the Pensions Board. The estimated cost of the Board is included in the Fund's 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 future service rate payments, due to be made by the major employers in April 2021, the Fund will have larger cash in-flows at the start of the financial year. The consequent absence of these in the following months will result in greater negative monthly 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 2021-22 and 2023-24 together with a cash flow forecast for the payment of benefits and the receipt of contributions are given in **Appendix 5**.