

<b>Bath &amp; North East Somerset Council</b>		
MEETING:	<b>COUNCIL</b>	
MEETING DATE:	<b>16 February 2017</b>	<b>AGENDA ITEM NUMBER</b>
TITLE:	<b>LGPS Pooling of Investments</b>	
WARD:	ALL	
<b>AN OPEN PUBLIC ITEM</b>		
List of attachments to this report:		
Appendix 1 – Full Business Case for Avon Pension Fund		

## **1 THE ISSUE**

- 1.1 Government policy, now brought into effect by the Local Government Pension Fund (Management and Investment of Funds) Regulations 2016 (the Regulations) effective 1 November 2016, requires the Avon Pension Fund to pool its investment assets.
- 1.2 To meet this requirement the Avon Pension Fund is participating in Brunel Pension Partnership (BPP). The Full Business case (FBC) for BPP has been finalised having been reviewed by each of the Chief Finance and Legal Officers of the 10 funds and ratified by the Shadow Oversight Board (the 10 chairmen of the pensions funds) prior to consideration by each of the administering authorities.
- 1.3 The Avon Pension Fund Committee considered the FBC at its meeting on 9 December 2016 and resolved to recommend it to the Council for approval. This will enable the establishment of the Brunel Company (an FCA regulated company) in order that the pooling proposals can progress to the implementation stage.
- 1.4 The FBC financial model demonstrates that there are net benefits for the Avon Pension Fund in entering into the BPP and establishing the Brunel Company. The detailed business case sets out the structures and governance arrangements that will be put in place, which will ensure the company provides value for money to the fund and that the **administering authorities have appropriate shareholder control over the company.**
- 1.5 **The regulations state that the costs of pooling including the development and ongoing operating and regulatory costs are to be met by the pension fund.** Brunel company will be an asset in the Avon Pension Fund accounts.
- 1.6 Each of the 10 administering authorities within BPP is in the process of approving its FBC. To date all 10 pension committees and eight administering authorities have approved with 2, including B&NES Council, yet to meet.

1.7 The summary of the FBC can be found at Appendix 1. There are a number of background papers that support the FBC. Most are exempt papers and can be obtained on request. The papers include:

- a) Detailed sections of the Full Business Case (exempt)
- b) Summary risk register
- c) Detailed risk register (exempt)
- d) Financial model (exempt)

## **2 RECOMMENDATION**

**Council is recommended to approve the following resolution:**

**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) Delegate to the Leader of the Council the exercising of all Council functions as shareholder of the company, in consultation with the Chief Finance Officer.**
- 3) 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.**
- 4) 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 they think 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.**

- 5) 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 The Regulations state that all costs of pooling (including the development and set up costs) are to be met from the pension fund assets.**
- 3.2 The costs of developing the pool to date have been provided for in the pension fund's 2016-17 budget.
- 3.3 Included in the FBC are the development costs to establish the company, working capital and regulatory capital up to April 2018. The pension fund's share of these costs is £330k (including working and regulatory capital for Brunel company of £200k). These costs will be provided for in the pension fund budget for 2017/18. These costs equate to c. 0.008% of the Fund's 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 their approach to pooling in their Investment Strategy Statement. 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 Financial Conduct Authority (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 Avon Pension Fund 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.
- 5.3 The FBC was reviewed by the Shadow Oversight Board (SOB) on 23 November 2016 when they agreed to recommend it to the 10 administering authorities. The SOB 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.

## 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.

One of the criteria for each pool is ensuring funds can invest in infrastructure. BPP is committed to providing capacity and capability for the 10 funds to invest in infrastructure. Any allocation to infrastructure remains a strategic decision of the fund.

- b) **The financial case:** drawn from the core financial model developed by PWC. The model 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 investment 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 non-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 the advantages and disadvantages of whether to rent or build the operator, examining each against accountability, procurement and staffing factors 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, in equal shares. The company will have its own company board that will need to meet FCA requirements. The non-executive shareholder representative on the company board has yet to be appointed. 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 of 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. The core model forecasts annual savings post transition costs of £3.5m p.a., cumulative savings of £73.3m over the next 20 years, which has a discounted present value of £36.4m. This results in a breakeven point in the FY24.

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 <sup>1</sup> of AUM <sup>2</sup>
<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

Notes: <sup>1</sup> 1 basis point is equal to 1/100<sup>th</sup> of 1%; <sup>2</sup> AUM = Assets under Management

7.3 The costs of transitioning assets into the pool will be shared by all the funds pro rata to their allocation to each asset class to ensure that no individual fund is disadvantaged by or unduly benefits from fund manager selection that will be made by Brunel company.

7.4 The savings will be achieved through reduced direct investment costs, primarily in investment management fees. Far smaller savings are expected from the activities undertaken internally by the Investments Team other than the current tasks that will be undertaken by Brunel company.

7.5 A sensitivity analysis of the financial model provides an indication of how the key metrics could change under various scenarios. The results for Avon Pension Fund are in the following table.

7.6 The greatest sensitivity is in respect of fee savings. If a 30% lower fee saving (equivalent to 2 basis points) is achieved, then the annual and cumulative savings will fall by c. 36% (to £46.6m and £2.3m respectively) and the breakeven point is delayed by 2 years to FY26. Likewise if Brunel company achieves greater fee saving than assumed the savings are greater and accrue more quickly.

7.7 The next most sensitive assumption is the effect of asset returns modelled as an equity market crash during transition or an asset return 1% higher/lower than the 4% annual return assumed in the core model. An equity market crash of 20% would reduce the cumulative savings by c 15%; an asset return of 3% p.a. rather than 4% p.a. would reduce cumulative savings by 20%. However, these impacts are outside the direct control of the pool.

7.8 In respect of transition costs, an increase of c. 50% only moves the breakeven point out by 1 year to FY25 and results in a small reduction (<5%) in cumulative savings over 20 years. Likewise a delay in the transition of assets will result in slightly lower savings. Similarly, variations in the costs of operating Brunel company have very little impact on the overall savings and breakeven point.

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

7.9 In addition to the financial model's core estimate of the net savings that BPP can achieve, the financial case also outlines the opportunity for additional benefits from improved performance. This would result from improved risk management and diversification between managers that will be achievable from investing in

greater scale. In addition there are a number of non-financial benefits as a result of pooling. These include significantly improved resilience in resources, improved resources for risk analytics including environmental, social and governance risks, and greater knowledge sharing.

7.10 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.

## 8 RISK MANAGEMENT

The Brunel Pension Partnership project to establish the Brunel Company has been overseen by the chairs of the administering authorities (Shadow Oversight Board) and scrutinised by statutory Finance and Legal officers. Professional legal and financial advice has been obtained to provide assurance over the proposals and further scrutiny has been undertaken by the DCLG and Treasury. At this point government are content for BPP to move the project forward to implementation which will require obtaining approval from the Financial Conduct Authority. The project maintains a detailed risk register subject to regular review by the Shadow Oversight Board and officers, and progress is regularly scrutinised by the Avon Pension Fund Committee.

The project has maintained a risk register that has been regularly reviewed by the statutory Finance and Legal Officers and the Shadow Oversight Board.

## 9 EQUALITIES

9.1 There is no equalities impact on members of the scheme.

## 10 CONSULTATION

10.1 Extensive consultation with the Avon Pension Fund Committee and Cabinet Member for Resources.

## 11 ADVICE SOUGHT

11.1 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 listed in 7.11 available on request
<b>Please contact the report author if you need to access this report in an alternative format</b>	