

# **AVON PENSION FUND COMMITTEE ANNUAL REPORT TO COUNCIL (April 2018 - March 2019)**

## **1 INTRODUCTION**

This is the annual report to Council detailing the work carried out by the Avon Pension Fund Committee for the period from 1 April 2018 to 31 March 2019.

The Council has delegated responsibility for the Fund to the Avon Pension Fund Committee (the “Committee”) which is the formal decision-making body for the Fund. The Committee’s role is strategic in nature, setting policy framework and monitoring implementation and compliance within that framework.

Due to the wide scope of the Committee’s remit it is supported by the Investment Panel (the “Panel”) which considers the investment strategy and investment performance in greater depth. The Committee has delegated authority to the Panel for specific investment decisions.

The Pensions Committee and administering authority are scrutinised by the Local Pension Board ensuring that the governance surrounding the scheme remains robust and fit for purpose.

The scheme is heavily regulated and overseen by the Pensions Regulator. Other bodies and agencies undertake key roles, particularly the LGPS Advisory Board, the Ministry for Housing Communities and Local Government, and CIPFA, which sets the accounting standards.

Brunel Pension Partnership Ltd, the company established by the Brunel pool to implement the Fund’s investment strategy is regulated by the Financial Conduct Authority.

The Avon Pension Fund is a statutory scheme regulated by the Local Government Pension Scheme Regulations 2014 (as amended) and the Local Government Pension Scheme Regulations (Management and Investment of Funds) Regulations 2016 (as amended).

Bath & North East Somerset Council (“the Council”) administers the Fund on behalf of approximately:

- 420 employing bodies
- 111,000 members

The value of the Fund as at 31 March 2019 was £4.8 billion.

In 2018/19 the Fund:

- received £154m in pension contributions
- paid out £182m in pension payments and transfers.

## 2 COMMITTEE MEMBERSHIP

The Committee structure is as follows:

Voting members (12)	5 elected members from B&NES (subject to the rules of political proportionality of the Council) 3 independent trustees 1 elected member nominated from each of the other 3 West of England unitary councils 1 nominated from the Higher and Further education bodies 1 nominated from Academy bodies 1 nominated by the trades unions
Non-voting members (4)	1 nominated from the Parish Councils Up to 3 nominated from different Trades Unions

The Committee meets quarterly. Attendance at the meetings was 85% for the voting members and 50% for the non-voting members.

During the year the Committee undertook a review of its governance structure due to changes in its employer composition. The revised arrangements were agreed by Committee in March 2019 following consultation with employers and the Local Pension Board.

The agreed changes are the addition of an academy member to ensure this growing employer group is represented and a further independent member to strengthen the independence and specialist knowledge of the governance structure.

### Investment Panel

The Panel consists of up to six voting members from the Committee and meets at least quarterly ahead of Committee meetings.

The Panel met formally four times during the year, with attendance at 83%, and met with selected managers at dedicated workshops where managers presented on their performance and outlook for their portfolio.

## 3 TRAINING

The Fund provides training to committee members to ensure they possess an appropriate level of knowledge, skill and understanding to discharge their fiduciary duties.

The Fund has in place a training framework which is based on CIPFA's (Chartered Institute of Public Finance and Accounting) Knowledge and Skills Framework for LGPS funds.

Committee training is delivered in a variety of formats such as detailed Committee and Panel reports and workshops where the topic is explored in greater detail. Four workshops were delivered over the year covering Legal Framework, Risk Management, Interim Valuation and Brunel Portfolios

In addition, members attended a number of seminars and conferences which broaden their understanding of investments and topics of relevance to the LGPS.

#### **4 COMMITTEE ACTIVITIES & REVIEW OF THE YEAR**

##### **a) Investments & Pooling of Assets**

- During the year the value of the Fund's assets increased by £211 million to £4,819 million at 31 March 2019. The investment return was 5.2% with a return over the last three years of 8.9% per annum which exceeds the return required in the funding plan. This return is after all fees paid to managers and transaction costs are taken into account
- Awareness of climate change and the implications for pension funds in terms of the risk to asset values as the world transitions to a low carbon economy increased markedly during the year. The committee received a number of statements from members and campaigners requesting that the Fund divests from fossil fuel companies. The Committee has committed to reviewing its policy to remain invested when it reviews its strategic policy later this year. The Fund has acknowledged the risk climate change poses to the asset portfolio since 2016 and has been implementing strategies to reduce the impact; this will develop further as the Fund continues to explore the range of solutions and opportunities within its investable universe.
- During the year further progress was made to align our portfolio with a low carbon economy by committing £115m to renewable and sustainable infrastructure funds, some of which had been invested by the end of the year. We expect the rest to be invested during 2019/20. This builds on the investment in passively managed Low Carbon Global Equities fund made in 2017/18.
- Within the wider scope of Responsible Investing which covers all our Stewardship activities (voting and engagement with companies), Avon was acknowledged as a leader in the LGPS community for its RI policy development in Unison's 2018 report entitled "Responsible Investment in the LGPS"
- With no major changes to the investment strategy the main focus was the transfer of assets to Brunel Pension Partnership Ltd (Brunel). Under the pooling arrangements, Brunel will implement the Fund's strategic asset allocation by offering a range of portfolios to which the Fund can allocate; responsibility for strategic asset allocation remains with the Committee.
- Five committee members attended the Stakeholder Engagement day arranged for Brunel Pension Partnership to update members on the progress made in developing the investment services Brunel will provide to its clients (ten LGPS funds, one of which is Avon).
- The Committee receive an update report on Brunel Pension Partnership at each committee meeting. Governance arrangements are in place for

monitoring service delivery, the transition of assets and the ongoing costs & savings. The Committee is represented by its Chairperson on the Brunel Oversight Board; the Board is supported by officers from each of the funds.

- The passively managed Low Carbon Global Equities and one of the UK Equity mandates transitioned to Brunel's portfolios during the year. In addition, our new allocations to Secured Income and Infrastructure assets are being invested via Brunel's portfolios.
- In 2018/19 fee savings were achieved on the assets that transferred to Brunel. The costs associated with setting up Brunel and transitioning the assets mean the Fund has incurred net costs of £2.6 million; however this is lower than the costs anticipated in the Business Case that was approved by Council in 2017. The Fund is not expected to show a net saving until financial year 2024 which is consistent with the Business Case.

#### **b) Investment Strategy Statement**

The LGPS regulations require funds to publish a revised Investment Strategy Statement (ISS) if there are significant changes. The ISS sets out the Fund's core beliefs that underpin the investment strategy, the process for ensuring the suitability of investments and the key risks the Fund is exposed to, and how these risks are managed.

The Fund updated its ISS and was approved by Committee in December 2018, to reflect the changes in the investment strategy implemented during the year, and development of Brunel's activities and services.

#### **c) Risk Management Strategy**

Following the successful implementation of the liability risk management and equity protection strategies last year, the Committee focussed on refining the way these strategies are implemented. This involved a review of the trigger-based framework attached to the liability risk management strategy as well as a review of the equity protection strategy, collateral requirements placed on the Fund and the appropriateness of the financial instruments used to implement these strategies in the context of a changing regulatory environment. The Committee agreed to maintain the current trigger framework.

#### **d) Responsible Investing Policy (RI)**

The Committee sought to manage Responsible Investment and Environmental, Social and Corporate Governance (ESG) risks during the year as follows:

- For the second year the Fund measured its carbon and environmental footprint so that it understands its exposure to the risks arising from climate change and other environmental factors. This analysis will be used when considering the financial impact of climate change on the asset portfolio in the upcoming investment review. The analysis of the equity holdings concluded that Fund exposure was more carbon efficient than its benchmark, outperforming by 28.5% versus 20.5% last year. This improvement was mainly due to switching

some of the assets into a passively managed Low Carbon Global equity fund during 2017/18. In addition the actively managed portfolios also invested in less carbon intensive sectors and picked less carbon intensive stocks than the broader market.

- Holding managers to account and querying Responsible Investment / Environmental, Social and Governance factors by challenging managers on topics including climate change, pay equality and cyber and data protection.
- Participating in the Local Authority Pension Fund Forum (LAPFF) whose collaboration and engagement activities assist in managing a range of Responsible Investment risks. Officers and Committee members attended three LAPFF meetings during the year.
- Policy development in collaboration with Brunel including dedicated Stewardship and Voting policies which provide the investment managers appointed by Brunel with clear voting guidelines on major themes such as sustainability, human capital, corporate conduct and governance.
- Working with Brunel and key stakeholders to enhance ESG reporting, to help quantify the impact of engagement. Over the year key themes and successes have included engagement with 21 companies held within Brunel portfolios, covering a range of 50 ESG issues. Environmental topics featured in 32% of engagements, 63% of which related directly to climate change. Social topics featured in 18% of engagements, where diversity and human rights featured prominently. Of the 40% Governance related engagements, the majority revolved around executive remuneration.

#### **e) Funding Strategy**

- The funding level at 31 March 2019 is estimated to be unchanged at 96%. The improvement in the funding position since the 2016 actuarial valuation has been driven by the strong asset return of c. 29% over the three years.
- A Committee workshop was held to discuss the interim valuation which was undertaken this year to enable the Fund and employers to plan for the new contribution rates that will be implemented from 1 April 2020, following the 2019 valuation.
- The Government has recently lost a legal case regarding the changes to the public sector pension schemes in 2014/15 which have been deemed to be age discriminatory. At this stage it is not known how the LGPS will be rectified as it means the overall cost of the scheme will be higher than assumed. The estimated increase of this ruling on the Fund's liabilities (without remedy) is £40 million.

## f) Pensions Administration

### (i) Budget

- During the year to 31 March 2019, total administration costs (excluding advisory and investment management costs) were £2.7 million, 7% below budget.
- Annual investment management fees paid in the year were below budget at £20.5 million (excludes performance fees charged via pooled investments). There were fee savings arising from the transition of assets to Brunel portfolios and changes in the investment structure. LGPS funds disclose all direct costs in their financial statement; they are now required to disclose full costs in their annual report, including those incurred indirectly when investing via funds. For 2018/19 the investment management costs on this basis were £26.4m which includes performance fees and transaction costs were £5.9m which in total was 0.7% of assets.
- Governance costs were 12% higher than budgeted at £0.8 million. The main reason was higher than anticipated costs for the interim valuation, which included additional support from the Actuary to improve the quality of member data in preparation for the 2019 valuation. In addition, the increase in employing bodies has resulted in increased levels of employer specific actuarial work

### (ii) Chartered Institute of Public Finance & Accountancy (CIPFA) Benchmarking (Benefits Administration)

The fund is committed to achieving and enhancing value for money and to make the administration of the scheme as efficient and cost effective as possible.

The CIPFA benchmarking data from 2017/18 highlights the Fund's comparative performance in key cost areas, as shown below (note that these are for 2017/18 so will differ from 2018/19 figures quoted elsewhere in this report). All demonstrate the Fund's positive cost performance when compared with national averages.

	<b>Avon Pension Fund</b>	<b>National average</b>
Net cost per member	£17.69	£21.85
Net staff cost per member	£8.06	£9.03
Members per FTE	4,575	3,957
Costs per staff member	£7.86	£9.91

	<b>Total costs (£)</b>	<b>£ per member</b>	<b>National average</b>
Administration costs	1,830,000	£15.75	£20.08
Oversight & Governance costs	1,436,000	£12.36	£8.67
Investment management costs	23,375,000	£198.84	£216.55
<b>Total costs</b>	<b>26,375,000</b>	<b>£226.95</b>	<b>£227.33</b>

### **(iii) Pensions Administration Strategy**

- The Administration Strategy sets out how the administering authority and scheme employers will work together to provide an improving quality level of service to Fund members.
- The strategy ensures the Fund can continue to deliver a high quality pension service at a time when the operating environment is becoming more complex. The employer base has fragmented, especially with the creation of academies and the increase in the number of third party HR and payroll providers.
- The strategy has been updated and approved by Committee in March 2019. The main objectives are:
  - Full electronic receipt of data from all employers
  - Digital delivery of all communications to members
  - Introduction of chargeable services for employers
- The strategy to deliver digital communications to members together with the electronic receipt of data across the employer portfolio aligns with Council strategy to reduce carbon emissions.

### **(iv) The Pension Regulator**

- Since the introduction of the Pension Regulator's (TPR) Code of Practice 2015 and Record Keeping Regulations the Fund has a data improvement plan in place to improve both the quality of the Fund's data as a whole and also working with individual employers to improve their data. A data score of 94% was reported in the TPR Scheme Return as at September 2018. The Committee receive a quarterly monitoring report on progress.
- The Fund is currently awaiting further guidance from SAB in respect of scheme specific data items. Once the list of data is confirmed the Fund will undertake a further review and update its data improvement plan accordingly

### **(v) Risk Register**

- The Fund's Risk Register identifies the governance, operational, funding and investment risks that the Fund is exposed to and, having evaluated the financial and operational impact of the risk on the Fund's objectives, states the actions taken to mitigate and effectively manage the risk.
- The register is reviewed regularly by the management team and is reported quarterly to the Committee.

### **g) Treasury Management Policy and Cash Management Policy**

- The Committee approves the Fund's Treasury Management Policy annually. The policy sets out how the Fund's cash is invested to meet its day-to-day requirements. The cash managed under this policy is 0.5-1% of the Fund's value (up to c. £45m).

- The management of this cash is delegated to the Council's Treasury Management Team. However, the Fund's cash is invested separately from the Council's and the Fund has a bespoke Treasury Management Policy.

#### **h) Work plans**

- Separate workplans are prepared for the Committee and Panel detailing the forthcoming areas of work relating to the investment strategy, funding strategy and the administration of benefits to give the Committee and officers the opportunity to review the workload, plan Committee agendas and workshops and accommodate issues that may arise.

#### **i) Approval of the 3 year Service Plan & Budget**

- The Service Plan sets out the Pension Fund's objectives for the next three years with a three year budget to deliver the plan including work relating to the investment strategy, risk management, compliance and improvements in the administration of the Fund.
- The budget approved for Administration in 2018/19 was £2,940,186. The budget for 2019/20 has been increased to £3,441,335. The increase will provide additional staffing, technical training and development, IT developments and one off projects. Within Governance and Compliance, there is an increase to meet the cost of the 2019 triennial valuation.

### **6 FUTURE ACTIVITY**

The Committee and Panel's focus over the next twelve months will be:

#### **Funding Strategy:**

- i. Implementing the policy for ongoing covenant assessment for incorporating into the Funding Strategy and funding plans.
- ii. Agreeing the Funding Strategy for the 2019 valuation, balancing the need to protect the solvency of the Fund and affordability of contributions for employers.
- iii. Exploring further options for bespoke portfolios to manage the funding and liability position of specific employer risk groups.

#### **Investment Strategy:**

- iv. Monitoring the transition of assets to Brunel Portfolios.
- v. Reviewing the strategic asset allocation, ensuring the Fund can achieve the returns required in the Funding Strategy, that the portfolio is aligned to a low carbon economy and that all risks are effectively managed.
- vi. Revising the Investment Strategy Statement reflecting strategy developments and changes due to Brunel operations as required.
- vii. Monitoring and develop the Risk Management Framework further as a mechanism for managing liability risk through the investment portfolio and mitigating investment risk.



**Administration Strategy:**

- viii. Implementing new SLA arrangements to all employers including chargeable service option.
- ix. Continuing implementation of the planned IT Strategy designed to achieve a digital step change in service delivery and mitigate service demand growth.
- x. Introducing a training & development programme across all pension stakeholders
- xi. Completing the rollout of I-Connect and implement joint monthly contribution and data delivery module.
- xii. Completing the GMP data reconciliation exercise as required by HMRC to ensure the fund is not at risk of erroneous pension liability.
- xiii. Undertaking a review of pensioner member 'pots' to identify potential opportunities in line with the Government announcement on trivial commutations.
- xiv. Completing the move towards electronic delivery of Scheme communications to active members.

**Governance:**

- xv. Keeping governance arrangements under review to ensure effective monitoring of Brunel and the transition of the assets.
- xvi. Ensuring the Committee and the Local Pension Board is fully trained and briefed on current strategies and operations, so they are able to scrutinise and make decisions effectively.

**August 2019**