

AVON PENSION FUND

SERVICE PLAN

2023 - 2026

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1 MANAGEMENT SUMMARY

The Ukraine conflict and other global challenges have adversely impacted the Fund in 2022. Markets have experienced elevated volatility, with UK government bonds for example declining in value by c.30%.

Even though the Fund's portfolio declined by 11% during 2022 to £5,231m, we enter 2023 in a robust financial position with c.97% funding, as rising interest rates and hence a higher Fund discount rate reduced the present value of future liabilities. The triennial actuarial review has not required a material change in employer contributions.

The Fund has diversified into renewable infrastructure and Paris-aligned equities and is making excellent progress towards its climate change targets. The fund is reviewing its investment strategy and will implement changes during 2023-24.

Operationally the Fund has had more mixed success during 2022-23. Service performance in aggregate is below required levels, with only 5 of 19 service measures completed within target timescales. This is a result of high staff vacancy rates of c.13%, churn of leavers and joiners, regulatory change, and slow progress in digitising administration. To address these challenges, we are driving three core actions:

- *Backlogs*: we are working to reduce backlogs with an immediate focus on outstanding 'leaver' cases, ensuring that those services most critical for members are prioritised.
- *Performance insight*: we are seeking to maximise the range and quality of MI from the Altair system, to more accurately measure members' service experience and assess key bottlenecks in work flow.
- *Project portfolio*: we are framing a portfolio of change projects into a 3-year plan with aligned resource requirements. Data and digitisation run through the plan which seeks to achieve three core objectives for the Fund:
 - Meet regulatory requirements
 - Raise operating efficiency to increase our capacity
 - Improve members' service experience.

On the regulatory front, we expect to focus on three key initiatives during 2023-24:

- The McCloud judgement and Exit Cap require further work and we are still waiting for the final rules to implement solutions.
- Pensions Dashboard is gathering momentum, even though the deadline date is under review. Current work focus is on data cleansing to ensure exchanges of accurate data.
- We also expect to complete work during 2023-24 on enabling the fund to comply with final rules in respect of the Minimum Pensions Guarantee (MPG).

In terms of technology resilience, further work is being undertaken with B&NES' Financial Systems team on Cyber security as the threat levels across the public sector increase.

2 BACKGROUND

Administration

Since Covid, the Fund has adopted a hybrid model of office and home working. Staff returned to Keynsham Civic Centre in September 2022 in space which accommodates 60% of APF employees, with a mandate that all full-time staff be in the office at least 2 days per week.

The Fund is experiencing a high staff vacancy rate of c.13%. This is causing capacity strains which lead into issues with member service levels and delays in planned developments, e.g. digital transformation. While there has been material improvement in service levels during 2022, with a significant rise in total cases processed, performance in aggregate is below required levels, with only 5 of 19 service measures completed within target timescales.

The Fund sought external support in 2022-23 to help with statutory projects, e.g. delivering the Annual Allowance and Pension Saving Statements, and project management for the McCloud Remedy. Support in these areas will remain ongoing in 2023-24.

The Fund has appointed Legal & General as its AVC provider and successfully transferred members from Aviva and Utmost Life. We still expect to transfer administration of the Avon Fire & Rescue pension scheme to an alternative supplier before 31 March 2024.

Ongoing challenges of rising employer numbers and regulatory change complexity are likely to continue, with impacts on workload. Operating circumstances have been challenging over the past three years during which many improvement projects have not met delivery times.

Investments & Funding

Significant work has been undertaken to complete the 2022 triennial valuation and prepare for the strategic investment review, both of which complete in March 2023. These major strategic projects have been undertaken at a time of significant economic change with higher bond yields and inflation having a material financial impact.

Despite rising inflation which has raised future pension payments, the funding position has improved to 97% on the back of higher interest rates. The Fund is benefiting from some materially positive drivers:

- Higher bond yields have enabled some employers nearing exit to switch to the Low Risk Funding Strategy, which is reducing the Fund's aggregate risk profile.
- Higher inflation and interest rates have enabled the Fund to lock in inflation and interest rate hedging at attractive levels, thus raising the proportion of better matched liabilities.

During the year we worked with Blackrock to refine our liquidity management strategy, with tighter alignment to net zero commitments. As a responsible investor the Fund disclosed its climate related activities through Task Force on Climate-Related Financial Disclosures and the FRC's Stewardship Code. In addition, we are engaging stakeholders around how, as an investor, we promote positive change and demonstrate leadership in responsible investment.

Addressing the Climate Emergency

The Fund's strategy to reduce carbon emissions encompasses all aspects of its activities. Being administered by B&NES Council, the Fund is committed to achieving the Council's goal of being net zero by 2030 in respect of its own operations. It will achieve this by digitising service for members and employers (with manual options for those not electronically enabled). In addition, use of technology to enable remote working and online learning lowers carbon emissions by reducing travel.

Responsible investing is embedded in the investment process, starting with investment objectives and climate goals. These objectives are kept under regular review as development of government policies and technology enables milestones to be brought forward over the next 5-10 years.

Governance

The national Scheme Advisory Board's Good Governance review sets out recommendations to improve governance of LGPSs. And statutory guidance necessary for the recommendations to take formal effect is expected to be published shortly.

The Fund reviewed its arrangements vs the Good Governance recommendations and in 2022 implemented a Conflicts of Interest Policy, Representation Policy and Training Policy. The Fund has also adopted the Hymans Learning Academy to supplement knowledge and training for Committee and Board members as well as officers. An additional requirement to have a workforce plan in place will be added to the governance plan for 2023.

The Fund continues to meet its responsibilities under data protection legislation, regularly monitoring and updating as requirements change. Staff training continues on a regular basis for new and existing staff in line with B&NES' policy.

Regulatory Update

Projects for McCloud and the Pensions Dashboard implementation are in place and resourced. For McCloud, data collection is near completion and technical guidance is still awaited from DLUHC on the remedy (benefit calculations). For the Pensions Dashboard, new regulations came into force on 12 December 2022, though the staging date of 30 September 2024 and data readiness by 1 April 2025 are now under review,

Other regulatory updates from relevant bodies are still to be finalised. These include further reforms on public sector exit payments, SCAPE discount rates, and the in-service revaluation date for active CARE members.

We regularly review guidance and bulletins from the LGA. There are regular discussions with APF management to discuss changes to legislation to ensure required changes are made. This includes reviewing and updating systems, processes and member documentation to ensure calculations and documents are technically correct.

There are ongoing 'business as usual' projects which are regulatory, e.g. members' annual benefit statements, statements for the annual allowance. Planning and delivery of these projects is managed by the Quality Assurance Team and ensures all service areas act on their tasks within given timescales to meet regulatory deadlines.

3 KEY OBJECTIVES – 2023-26

Administration Strategy

The resource challenge – with c.13% vacancy rate – is the most urgent issue facing the Fund, as it adversely impacts member service levels and our ability to improve and digitise the Fund. There are no simple solutions and addressing these challenges requires a blend of actions which, in combination, can improve staff retention and raise capacity.

At its heart is a strategic change programme of projects to meet regulatory needs, raise operational efficiency, and improve member experience. To be implemented over 2023-26, this will raise our capacity and enable us to serve members and employers more effectively over time. The plan is being developed and will be shared in detail with the Committee in June 2023. At a high level it is designed to meet a few core objectives:

1. *Regulations:* meet required regulatory commitments
 - We will assess the McCloud judgement and implement required remedies.
 - We will undertake necessary work to ensure the Fund meets regulatory compliance with DWP Pensions Dashboard ahead of the expected compulsion date.
 - We will also 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 liabilities.
 - The Fund will comply with other regulatory changes as required.
2. *People:* drive improvements in resourcing and engagement
 - We will implement a new organisational structure. This includes a digital service team, a Change function leading improvement projects, and a team focused on data management.
 - Pay scales: retention and recruitment is impacted by salary scales currently less than many LGPSs and the private sector. Hence we are reviewing pay scales for the APF with independent advice from Aon. We will recommend a proposal to B&NES Finance and HR leadership during April 2023, to be implemented as soon as practical.
 - APF leadership is also focused on training, development, and communication, to improve staff engagement and strengthen their sense of connection with the APF.
3. *Service* raise efficiency to create capacity and improve member experience
 - We will continue the move towards digital communications for all stakeholders, reflected in a revised communications strategy.
 - We will complete rollout of I-Connect and the receipt of monthly member data returns.
 - The Fund will undertake website upgrades to support improved experience for members and employers.
 - The Fund will manage transfer of the Firefighters' Pension Scheme administration to an alternative provider, in partnership with the Avon Fire Authority.
4. *Insight* raise the quality of MI to inform operational improvements
 - The Fund will maximise the range and quality of MI from the Altair system.
 - This will enable us to more accurately measure members' service experience and assess key bottlenecks in work flow, to drive operational improvements.

Governance

The essence of good governance is a robust process for decision making, with proportional checks and controls. During 2023-26 the Fund will continue to:

- Robustly identify and mitigate material risks.
- Ensure that the Pensions Committee operates effectively in making key decisions, with all members properly trained and briefed on relevant pension matters.
- Enable the Board to continue providing well informed independent scrutiny of the Fund.

We will also undertake the following work and projects:

- The Fund will review and implement additional requirements from the Strategic Advisory Board's Good Governance Review and TPR's Single/General Code of Practice.
- We will re-tender service contracts, including a new 3-year investment consultancy contract which will be agreed in 2023.
- We will review Committee reports and transition them to the Modern Gov library.

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

Local elections in May are likely to result in some changes to composition of the Pensions Committee. There will be a focus on induction training for new members to ensure they have sufficient knowledge and understanding to fulfil their roles. There are also likely to be changes to the Pension Board as a couple of members' terms are due to end in 2023. A process will be initiated to recruit new members.

Funding Strategy

The focus during 2023-26 will be on managing employer admissions and exits as well as annual covenant work. In 2022 a number of smaller bodies exited the Fund or moved to the Lower Risk Funding Strategy to reduce investment risk. Work will continue to ensure scheme exits are viable for smaller employers without affecting solvency of the Fund.

Covenant assessment is an important tool to identify employers which may face funding issues, so that we can work with them to manage pension costs and minimise financial risks.

The Fund already has captive group-wide insurance for Ill-health retirement given that this can result in significant liabilities. The main new project in 2023 is to explore similar group-wide captive insurance options for Death in Service, at minimal extra cost to employers. Officers will come back to the Committee with a proposal for their approval later in 2023.

Investment Strategy

The focus for 2023 will be implementing changes from the Strategic Investment Review, to be discussed separately for approval in the Committee meeting of 17 March 2023. This includes potential changes in the Fund's risk/return profile and asset allocation.

Three other key investment changes will be tabled for Committee approval later in 2023:

- *Risk management:* we are undertaking an in-depth review of 'liability driven investments' (LDI) and related hedging, with a view to bringing a proposal to Committee no later than September 2023.

- *Climate:* fresh climate goals will be presented to Committee for approval in September 2023, using latest climate analyses. The Fund is a member of the Institutional Investors Group on Climate Change (IIGCC) and our approach to managing climate risk utilises the IIGCC's net zero framework. This approach is supported by Brunel.
- *Local Investment:* officers will bring a proposal for approval to Committee during 2023, setting out how the Fund could invest up to c.3% of its assets in local initiatives. The proposal will include a definition of what 'local' means, and a structure in which the Committee sets objectives and a mandate, executed by an independent asset manager to ensure that potential conflicts are managed and technical investment expertise is embedded in the process. It will reflect the latest DLUHC guidance on Levelling Up.

Communications Strategy

The Avon Pension Fund has several objectives in 2023 from a communications perspective.

- *Regulatory:* the first and most important objective is to support the administration strategy in meeting regulatory commitments, e.g. timely production of the Annual Benefit Statements, publishing documents like the Responsible Investment Report.
- *Stakeholder engagement:* the Fund needs to clearly communicate with key stakeholder groups, e.g. councillors, scheme members, trades unions, etc. on investments and climate change. This will encourage broad feedback and input to influence the Committee's decisions on revised climate targets in September 2023. We also need to communicate with employers and members on how Pension Dashboards and the McCloud remedy will impact them.
- *Digital adoption:* a critical objective is to maximise members' adoption of 'my pension online' which will support improved service levels and higher operational capacity. Required work includes more pro-active member communication, streamlined member onboarding with 'activation keys' for online set up, and new websites with fresh content and functionality. The Fund is also changing its brand logo for simpler digital deployment.

4 BUDGET & CASHFLOW FORECAST 2023-26

The budget includes Administration and Investments. The 2023-24 £24.9m total is £2.7m (10%) below the £27.6m budget of 2022-23.

£ millions	2022-23	2023-24	Change
Administration	5.9	7.0	+ 1.1
Investments & Governance	21.7	17.9	- 3.8
Total	27.6	24.9	- 2.7

Administration Costs

The administration budget of £7.0m for 2023-24 is £1.1m higher than 2022-23. The difference comprises 5 core categories of change:

- £0.3m: new posts required to improve service, control and meet regulatory obligations, e.g. Head of Pensions, Web Development Manager, McCloud Pensions Officer.
- £0.2m: expected 4% pay rise in 2023-24, flat rate pay awards, and other costs.

- £0.4m: contingency for salary reviews required to address the c.13% vacancy rate,
- £0.1m: website developments and higher Altair costs for membership above 150,000.
- £0.1m: support for McCloud remedy and technical & compliance.

Investment & Governance Costs

2023-24 investment fees of £17.9m are £3.8m (18%) lower than the £21.7m of 2022-23. The difference comprises 3 core categories of change:

- £1.4m: asset values are lower than in the 2022-23 budget.
- £1.5m: changes in allocations between portfolios and lower portfolio fees
- £0.9m: raising the proportion of passive equities from 39% to 50%

Investment costs above include fees from Brunel which manage £4.5 billion (85%) of Avon assets¹. Estimated fees for 2023-24 assume current mandates are retained though actual fees will depend on asset values and performance. Avon's estimated share of Brunel costs is c.13% or £1.6m pa (3 bps). The 6% increase over current year budget is largely driven by inflation and higher pension costs.

The Governance component increases in 2023-24 driven by wider use of online training, Good Governance projects, and more employer-specific changes requiring external advice.

The Fund is required to meet costs of the Pensions Board. Estimated full year costs for 2023-24 to 2025-26 have been included in the 3-year budget.

Cashflow

As Fund membership matures, monitoring cash flow trends becomes increasingly critical. The Fund is now passing through an inflection point from being cash flow positive (more cash from contributions than paid in benefits) to cash flow negative. Cash flow is monitored monthly and reported quarterly to Committee.

Owing to advance future service payments from major employers in April 2023 and some employers paying 3 years' deficit in advance, the Fund will enjoy high cash in-flows at the start of the financial year, followed by greater negative monthly cash flows mitigated by using investment income and divestments.

Full details of the budget between 2023-24 and 2025-26 together with a cash flow forecast for the payment of benefits and the receipt of contributions are in Appendix 3.

¹ 31 December 2022