

Avon Pension Fund Committee Annual Report to Council (April 2019 - March 2020)



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 2019 to 31 March 2020.

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

Brunel Pension Partnership Ltd (Brunel), 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:

- 445 employing bodies
- 121,000 members

The value of the Fund as at 31 March 2020 was £4.5 billion.

In 2019/20 the Fund:

- received £161m in pension contributions
- paid out £194m in pension payments and transfers.

Full details can be found in the Fund’s annual report (<https://www.avonpensionfund.org.uk/finance-and-investments>)

2 COMMITTEE MEMBERSHIP

The Committee structure is as follows:

Voting members (14)	<p>5 elected members from B&NES (subject to the rules of political proportionality of the Council)</p> <p>3 independent members</p> <p>1 elected member nominated from each of the other 3 West of England unitary councils</p> <p>1 nominated from the Higher and Further Education bodies</p> <p>1 nominated from Academy bodies</p> <p>1 nominated by the Trade Unions</p>
Non-voting members (3)	<p>1 nominated from the Parish Councils</p> <p>2 nominated from different Trade Unions</p>

The Committee meets quarterly. Attendance at the meetings was 84% for the voting members and 55% for the non-voting members.

During the year the Committee welcomed the additional independent member and Academy representative who were appointed as a result of the review of its governance structure in 2019.

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 three times during the year, with attendance at 82%.

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.

Along with the Local Pension Board the Committee took part in the first ever LGPS National Knowledge Assessment carried out by Hymans Robertson. The overall results look very positive and they will be used to develop future training requirements

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. Over the year a workshop covering the Valuation & Funding Strategy took place as well as an Investments workshop specifically for Investment Panel and new committee members. Further Induction training was also carried out for new members and a series of four workshops to review the Investment Strategy were delivered during 4Q19/1Q20.

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

4 COMMITTEE ACTIVITIES & REVIEW OF THE YEAR

The year was dominated by the impact of the Coronavirus pandemic in the last quarter as the virus took hold globally, nations responded with restrictions to contain the spread and investment markets took fright as an extremely sharp economic slowdown materialised. As the year ended

the Fund was establishing new remote working arrangements to ensure it could still deliver its service to members and employers alike, monitoring cashflow and reviewing proposed changes to the investment strategy to ensure it was still appropriate given the uncertain outlook.

a) Investment Strategy Review

During 2019 the Committee undertook a number of workshops to review the strategy and consider, amongst other things, the impact of climate change on potential investment returns and the Fund's maturing cash flow profile. The outcome was a number of asset allocation changes and the setting of specific climate change objectives.

Evidence-based modelling was used to establish long-term objectives and targets relating to climate change and determine appropriate allocations to alternative energy and carbon solutions. Specifically, the Fund committed to;

- Implement a <2°C aligned portfolio by committing to net zero emissions by 2050 or earlier. This will be achieved by working with Brunel using the results of the industry wide project being undertaken to assess what each 2°C asset portfolio will look like. Expect to review the findings in line with the global stocktake timeline in 2022/23.
- Reducing the carbon intensity of the equity portfolio over time with the aim of being 30% less carbon intensive than the benchmark by 2022.
- Invest sustainably so that we support a 'just transition' to the low carbon economy with the aim of investing at least 30% of the assets in sustainable and low carbon investments by 2025.
- Use the Fund's power as a shareholder to encourage change. Financial markets and companies urgently need to adapt their activities to support the transition to a low carbon economy. Collaboration as part of Brunel makes our influence more powerful as they manage a £30bn pool of assets. In addition, the Fund will independently support investor led initiatives such as ClimateAction100+ and Institutional Investors Group on Climate Change to increase pressure on companies and governments to align with the Paris goals. If engagement does not work ahead of the Paris Stocktake in 2023, we will consider selective divestment from laggard companies.

In April 2020 an assessment of the impact of the COVID-19 pandemic on these asset allocation changes concluded that they remained appropriate given the Fund's long-term investment approach. However, measures were put in place to mitigate the risk of any short-term cash flow implications by phasing the commitments made to Secure Income, Renewable Infrastructure and Private Debt over a two-year period.

The LGPS regulations require funds to publish a revised Investment Strategy Statement (ISS) following significant changes to the strategy. 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 revised ISS was published in September 2020 following reflecting the revised strategy.

b) Investment performance & Pooling of Assets

- During the year the value of the Fund's assets decreased by £352 million to £4,467 million at 31 March 2020. The investment return of -6.4% was the first negative return since 2016. The return over the last three years was 1.0% per annum which is below what is required in the funding plan. Positive investment returns for the first nine months of the year were eliminated

by year end due to the impact of COVID-19 on investment markets globally. The Fund has since made a significant recovery in the first quarter 2020/21 as confidence across markets was bolstered by significant international government intervention.

- The Fund has so far weathered the crisis well, due to the diverse range of assets within the portfolio and the equity protection strategy which added 0.6% to the overall return. Allocations to diversifying assets such as Diversified Growth Funds and Hedge Funds performed their strategic role by providing some downside protection as equity markets fell. Bond markets, especially credit markets were badly affected as investors feared a rise in defaults. (See paragraph e below for details of the ongoing risk management strategy)
- During the year another three equity mandates transitioned to Brunel totalling £1,511m bringing the assets managed by Brunel on behalf of the Fund to £2,252 million or 50.4% of the Fund's assets.
- Brunel has also appointed a manager to provide Risk Management Solutions to its clients. At least another three mandates are planned to transition by the end of the current financial year. In addition, the allocations to Secured Income, Private Debt and Infrastructure assets are being invested via Brunel's portfolios.
- The Committee receive an update report on Brunel 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.
- Four committee members attended the Stakeholder Engagement day arranged for Brunel 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).

c) Climate Emergency

- In March 2019 Bath & North East Somerset Council declared a climate emergency and awareness of climate change has continued to be high profile. 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 few statements from members and campaigners requesting that the Fund divests from fossil fuel companies.
- The Fund has acknowledged the risk climate change poses to the asset portfolio since 2016 and has been implementing strategies to reduce the financial impact. There was significant focus in the 2019/20 investment review to the strategic impact of climate change on the asset portfolio. Evidence-based modelling was used to establish specific climate change objectives with clear milestones and determine appropriate allocations to alternative energy and carbon solutions.
- Important progress was also made with Brunel publishing its Climate Change Policy in early 2020. This policy is aligned with the Fund's own objectives and will be crucial in enabling the Fund to achieve those objectives over then coming years.

d) Responsible Investing Policy (RI)

Within the wider scope of Responsible Investing which covers all our Stewardship activities (voting and engagement with companies), Avon is acknowledged as a leader in the LGPS community for its RI policy development in Unison's 2018 report entitled "Responsible Investment in the LGPS". This year further content has been added to the website to provide

more clarity to members about the action the Fund is taking across all environmental, social and governance issues.

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

- December 2019 marked the fourth annual review of the carbon exposure of the Fund's equity portfolio. The analysis concluded that the aggregate Fund exposure within equities was more carbon efficient, on a Weighted Average Carbon Intensity (WACI)¹ basis, with a 25% lower carbon exposure than its benchmark which was a 12% year-on-year improvement. The decrease in carbon intensity was driven mainly by the transition of assets into Brunel portfolios, all of which have a lower carbon intensity than their respective benchmarks, indicating that the underlying investment managers generally invest in less carbon intensive sectors and pick less carbon intensive stocks than the broader market.
- The Fund's ability to engage with, and drive change, at the underlying investment manager level was amplified through Brunel, who over the year publicly engaged with investment manager, BlackRock, on their climate change position and worked directly with other managers to optimise the carbon intensity of their respective portfolios.
- Continued participation in industry leading initiatives and coalitions such as Climate Action 100+ and the Local Authority Pension Fund Forum (LAPFF) have contributed to a series of high-profile engagements with major oil & gas companies which have produced significant positive results. The Fund recognises the value of collaboration and engagement as effective tools to manage RI risks and directly address its strategic RI priorities. Officers and Committee members attended three LAPFF business meetings during the year.
- Over the year there was significant engagement with 393 companies held within Brunel portfolios, across a broad range of ESG issues. Environmental topics, on average, featured in 27% of engagements, 66% of which related directly to climate change. Social topics featured in 19% of engagements, where diversity and human rights featured prominently. Of the 37% of Governance related engagements the majority revolved around executive remuneration. Strategy, risk and communications topics such as audit and accounting and cyber security featured in the remaining 17% of engagements over the year.

e) Risk Management Strategy

- The Fund has implemented a number of risk management strategies to de-risk the investment strategy by having a better match to the liabilities and placing less reliance on the riskier assets, such as equities to fund future pension benefits. Ultimately the aim is to protect the funding position and thus provide greater certainty for the funding plan (contribution plans for the employers). The risk management strategies are reviewed annually to ensure they remain appropriate given market conditions.
 - The Liability Driven Investment (LDI) programme that hedges the inflation and interest rate risk posted a negative return over the year as inflation fell materially towards the end of the period, impacted by COVID-19. However, there was a corresponding fall in the present value of the liabilities, thus the strategy delivered as expected.
 - The Equity Protection Strategy (EPS) which protects against large equity market falls, was renewed and extended to cover emerging market exposure as well as developed markets. At year end the strategy provided significant value as equity markets declined.
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f) Funding Strategy

- In the 2019 valuation the assets totalled £4,818m and liabilities were 5,102m. 46% of the liabilities related to pensioner benefits, 22% were deferred benefits and 32% related to active members currently contributing and accruing benefits. Consequently, the funding level was 94% which was a significant improvement on the funding level of 86% at the previous valuation in 2016. In monetary terms the deficit fell from £618 million in 2016 to £284m in 2019 with an average deficit recovery period of 13 years.
- A Committee workshop was held in June 2019 to discuss the valuation results and agree the revised Funding Strategy Statement. The main driver of the improvement in the finding level was the strong asset returns, in excess of the valuation assumptions, between 2016 and 2019. However, lower expectations of future returns meant overall there was an increase in the ongoing cost of future accruals, offsetting the lower deficit contributions.
- As at 31 March 2020, the estimated funding level had fallen to 84%. This is due to the fall in investment markets in February and March 2020 as the COVID-19 pandemic took hold. The Fund's risk management strategies, specifically the equity protection strategy, helped mitigate some of the capital losses. Volatility increased dramatically in March causing investors to sell riskier assets as it became apparent that lower GDP growth was inevitable in the short term as more countries introduced restrictions and lockdowns. The medium to longer term implications for economic growth and pace of any recovery are as yet uncertain. Given the impact of COVID-19 on the employing bodies, the Fund will increase its covenant monitoring and work with the Actuary to ensure the funding policies support employers and protect the Fund adequately during this challenging period. The Fund has since made a significant recovery and by the end of June 2020 the funding level was 92%.

g) Pensions Administration

(i) Budget

- During the year to 31 March 2020, total administration costs (excluding advisory and investment management costs) were £3.1 million, 11% below budget, with several staff vacancies occurring during the year being a contributory factor
- Annual investment management fees paid in the year were below budget at £26.9 million.
- Governance costs were just under budget at £1.1 million with £0.41m of the cost relating to the triennial valuation.

(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 2018/19 highlights the Fund's comparative performance in key cost areas, as shown below (note that these are for 2018/19 so will differ from 2019/20 figures quoted elsewhere in this report). All demonstrate the Fund's positive cost performance when compared with national averages.

LGPS Costs

	Avon Pension Fund	National average
Admin cost per member	£18.47	£21.34
Net admin cost per FTE	£55.7k	£71.8k
Members per FTE	2,247	2,848

Management Expenses

	Total costs £'000	£ per member	National average £
Administration costs	1,475	12.51	15.09
Oversight & Governance costs	1,359	11.52	22.34
Investment management costs	19,304	163.67	236.76
Total costs	22,138	187.70	274.19

(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 2014 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 95% was reported in the TPR Scheme Return as at September 2019.
- The Scheme Advisory Board has now provided a list of scheme specific data items. This year the Fund will undertake a review taking these additional checks into account and will 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.

h) 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.

i) 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.

j) 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 2019/20 was £2,698m. The budget for 2019/20 has been increased to £2,935m. The increase will provide additional staffing, technical training and development, IT developments and one off projects.

5 FUTURE activity

The Fund faces a challenging year ahead as the response to the pandemic continues to change working practices for staff, as well as an uncertain future for some employers. Regulatory changes such as the implementation of the McCloud remedy and the introduction of the £95k cap will bring additional challenges to the administration of the Scheme.

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

Funding Strategy:

- Implementing the policy for ongoing covenant assessment for incorporating into the Funding Strategy and funding plans.
- Monitoring the revised Funding Strategy following the 2019 valuation and ensuring policies are updated for regulatory changes.
- Exploring further options for bespoke portfolios to manage the funding and liability position of specific employer risk groups.

Investment Strategy:

- Monitoring the transition of assets to Brunel Portfolios.
- Reviewing the strategic asset allocation, ensuring the Fund is achieving 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. Monitoring 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 potential 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.
- xv. Undertake a project to manage outcomes of the McCloud Judgement – following expected amendments to the statutory underpin designed to remove age discrimination from the LGPS.

Governance:

- xvi. Keeping governance arrangements under review to ensure effective monitoring of Brunel as a service provider, value for money and the transition of the assets.
- xvii. Ensuring the Committee and the Local Pension Board is fully trained and briefed on current strategies and operations, so they can scrutinise and make decisions effectively.

**Avon Pension Fund
August 2020**