BRUNEL
Pension Partnership

# Brunel Pension Partnership

## Spring 2018 Report to MHCLG

*Forging better futures*

**Authorised and regulated by the Financial Conduct Authority No. 790168**

# Pooling update report to MHCLG

The Local Government Pension Scheme (LGPS) Investment Regulations (2016) required LGPS funds to pool their investments to make the LGPS more cost effective.

Eight pools have been established. All pools are required to provide 6 monthly updates to the Ministry of Housing, Communities and Local Government (MHCLG) for their review.

The Spring Report is for the period to 13 April 2018, submission date 4 May 2018.

**Brunel Pension Partnership is one of the pools. This is our Spring 2018 Report on our progress against the four criterion for pooling responding to the questions and in the format set by MHCLG.**

# The Criterion, a summary

**Scale - £25bn**
Brunel £29.4bn as at 31 December 2017

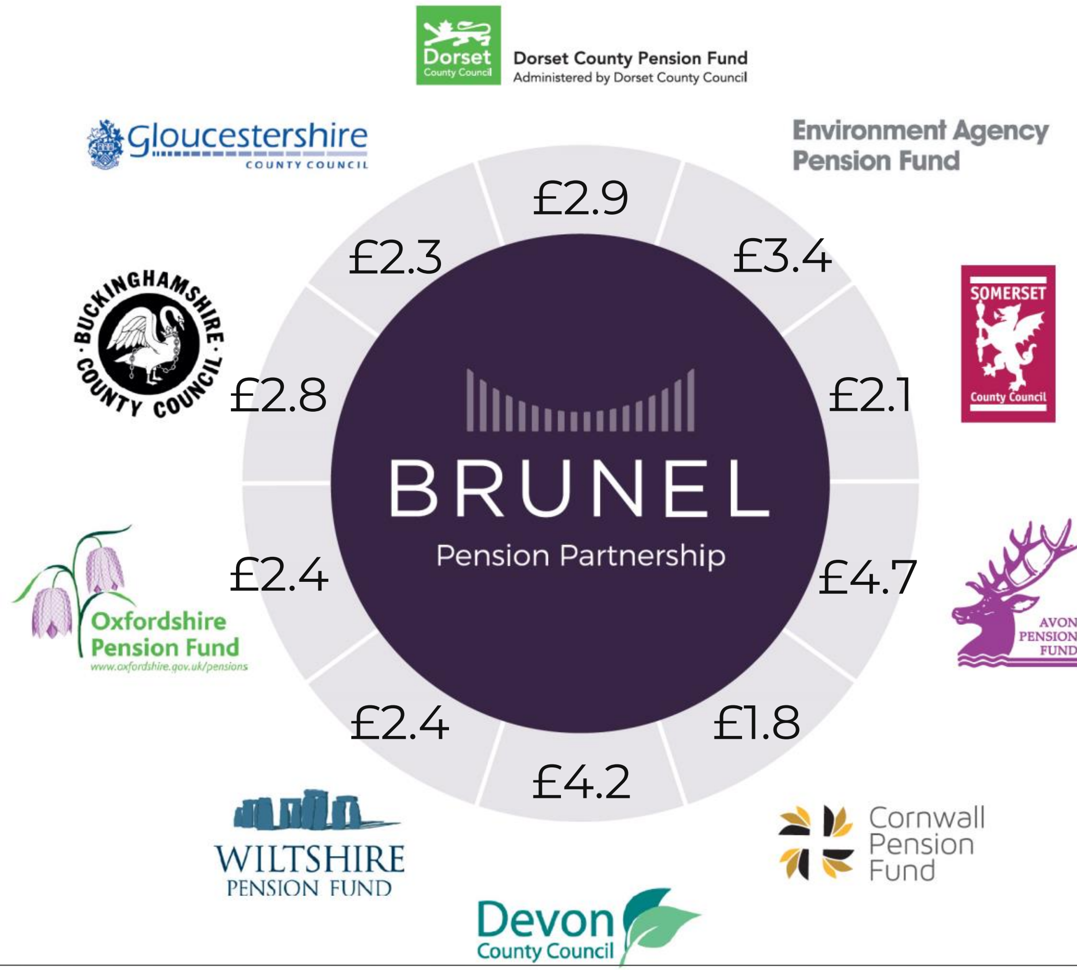
**Governance**
Brunel is approved as a MiFID full scope Investment Firm. Authorised and regulated by the Financial Conduct Authority No. 790168

**Cost Savings - Reduce fees, maintain performance**
Brunel Business Case £550m savings, payback FY2023

**Infrastructure - Increased capability & capacity**
Brunel is developing its proposition to have the capability and capacity to provide capacity for 10% infrastructure allocations, Brunel now has a dedicated Private Markets Team of 5 investment professionals, working on 5 asset classes including Infrastructure.

# Brunel Pension Partnership client funds

Assets Under Management – Value as at Dec. 2017 £29.4 bn



# Criterion A: Scale

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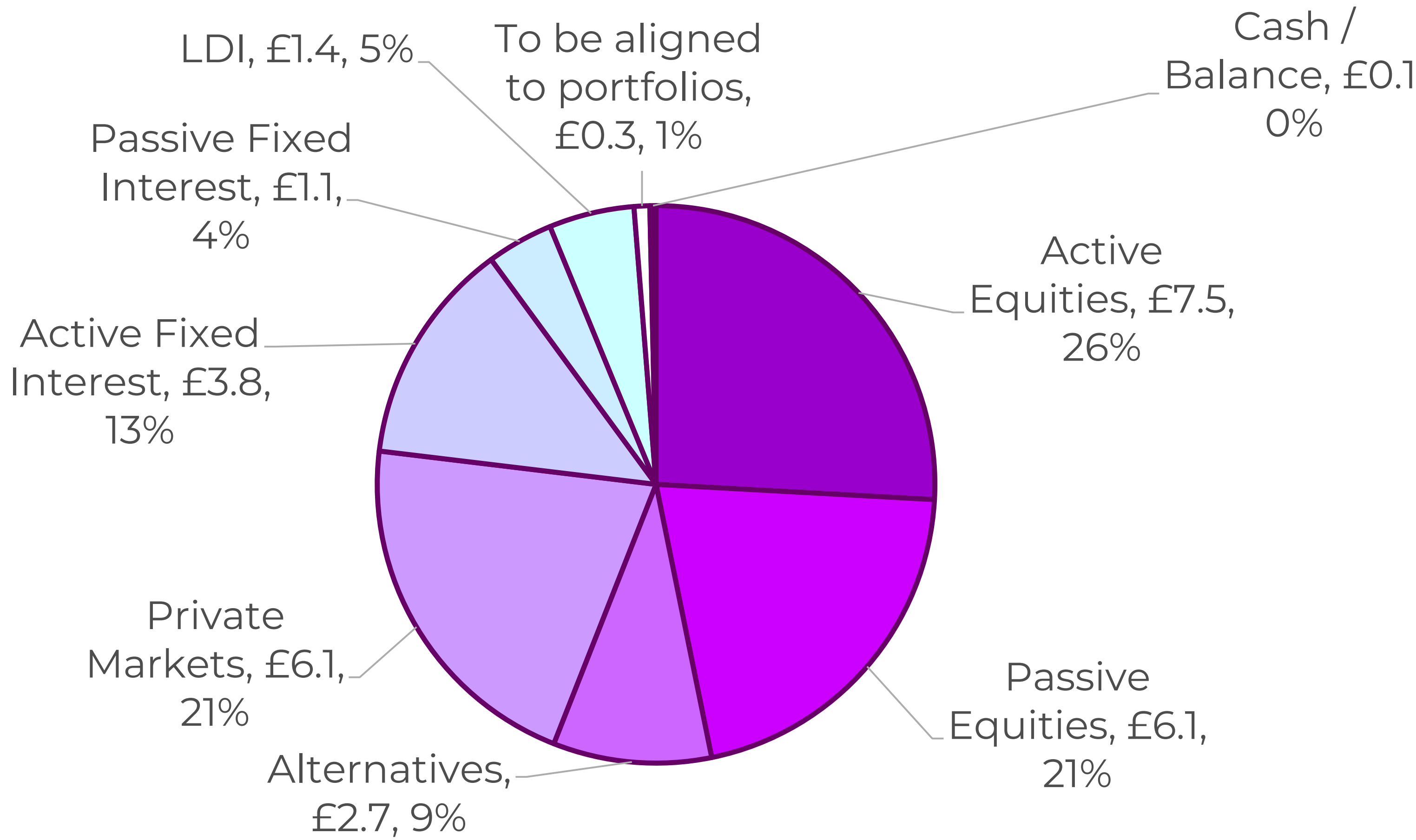
***<u>Scale</u> - please state the estimated total value of assets included in your transition plan for investment through the pool structure, with date of estimate***

- £29.4bn as at 31 December 2017. Currently £1bn of the total assets represent the legacy illiquid investments, into Private Equity, Private Debt and Infrastructure that are held by the Funds.
- The management of these legacy assets will be undertaken in partnership between Brunel and the Funds. Once the term of these legacy positions has been realised, the proceeds will be invested through the pool structure to portfolios, depending upon the strategic asset allocation set by the Funds.
- The only assets held outside of the pool would be strategic and operational cash.

# Criterion A: Scale

- Diagram 1 shows the indicative allocation to high level portfolio groups



# Criterion A: Scale

- Diagram 2 shows the timetable for transitioning assets.

| Portfolio | Portfolio under construction | Portfolio launch date | Asset transition date |
|---|---|---|---|
| Passive Equities (including low carbon) | **Yes** | **May 2018** | **May/June 2018** |
| Passive Bonds | **Yes** | TBC with clients | TBC with clients |
| Smart-Beta | **Yes** | June 2018 | June/July 2018 |
| UK Equities | **Yes** | October 2018 | November 2018 |
| Low Volatility Equities | **Yes** | October 2018 | November 2018 |
| High Alpha Developed Equities | **Yes** | January 2019 | February 2019 |
| Emerging Market Equities | **Yes** | January 2019 | February 2019 |
| Core Global Equities | **Yes** | March 2019 | April 2019 |
| Sustainable Equities | **Yes** | March 2019 | April 2019 |
| Smaller Companies Equities | **Yes** | March 2019 | April 2019 |
| Sterling Corporate Bonds | **No** | between April 2019 & April 2020 | between April 2019 & April 2020 |

# Criterion A: Scale

- Diagram 2 continued.

| Portfolio | Portfolio under construction | Portfolio launch date | Asset transition date |
|---|---|---|---|
| Global Bonds | **No** | **between April 2019 & April 2020** | **between April 2019 & April 2020** |
| Multi Asset Credit | **No** | between April 2019 & April 2020 | between April 2019 & April 2020 |
| Diversified Growth Funds | **No** | between April 2019 & April 2020 | between April 2019 & April 2020 |
| Hedge Funds | **No** | between April 2019 & April 2020 | between April 2019 & April 2020 |
| LDI | **Yes** | November 2018 | December 2019 |
| Property | **Yes** | April 2018 on advisory basis. | Commencing Oct/Nov 2018 |
| Infrastructure | **Yes** | April 2018 on advisory basis | N/A |
| Private Debt | **Yes** | April 2018 on advisory basis | N/A |
| Private Equity | **Yes** | April 2018 on advisory basis | N/A |
| Secured Income | **Yes** | April 2018 on advisory basis | N/A |
| | | | |

# Criterion A: Scale

***Reporting – please explain how you will publicly and transparently report progress against your transition timetable***

- All information will be available to view via our website www.brunelpensionpartnership.org
- Announcements of activities will be formally made through this medium as well as engagement events which we hold on a regular basis. In addition, all information will be included in reports back to MHCLG, which will also be made available on our website.

# Criterion B: Governance

## *Progress with governance arrangements - please provide an updated high-level project plan for the implementation of governance arrangements*

- Brunel's governance arrangements are all in place. Diagram 2 provides a high-level view.
  - The Brunel Board has 4 non-executives and 4 executives.
  - The clients' Oversight Board has a representative from each of the pension committees, and is generally the Chair of their Pension Committee. There are also two pension fund member representatives as observer members of the Oversight Board.
  - The client group has officer representation from each of the pension funds.
  - The role of shareholder varies between the clients and includes for example both pension committee chairs and Section 151 officers.

# Criterion B: Governance

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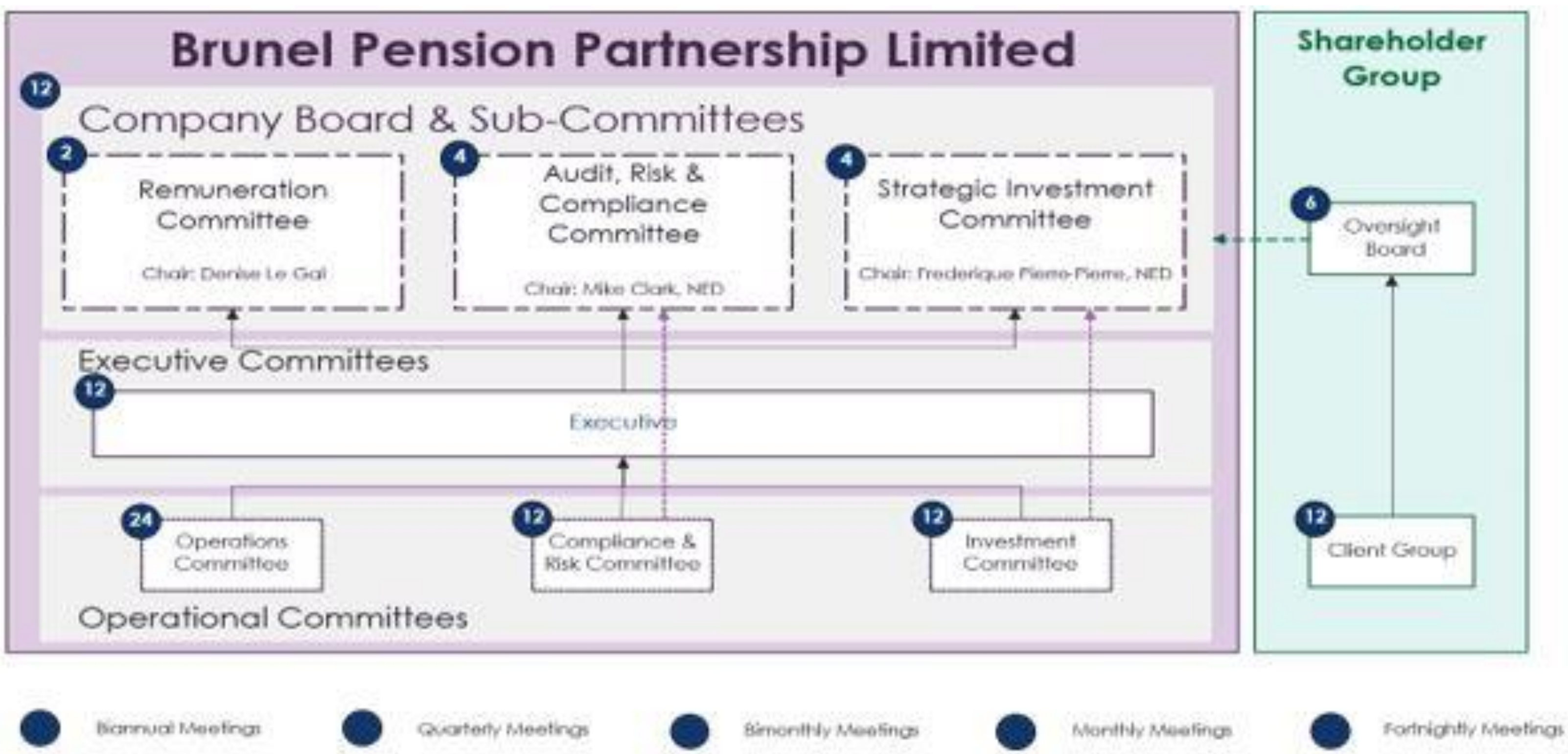
Diagram 3



# Criterion B: Governance

***Additional key appointments since the autumn report:***

- David Anthony – Head of Finance & Corporate Services
- Richard Fanshawe – Head of Private Markets
- Keith Jones – General Counsel

- Under the Brunel approved business plan for 2018/19 staffing complement of 32 was agreed and all these positions have now been recruited to.

# Criterion B: Governance

***Relationship – please provide an update on the relationship between the fund and the pool company, including who makes what decisions (asset allocation, manager selection, custodian selection, etc)***

What remains with the Funds:

- Strategic Asset Allocation
- Appointment and review of professional providers for their funds' needs (excluding Fund Managers)
- Funding Strategy/oversight of Triennial Actuarial Valuation/Liaison with Fund Employers
- Preparation and maintenance of all local policy documents; ISS, Governance Policy, Fund Business Plan etc
- Administration of Pension benefits
- Governance arrangements for the Fund
- Reviewing performance of all aspects of the Fund
- Monitoring and reviewing performance of Brunel and its portfolios

# Criterion B: Governance

Brunel Pension Partnership

## *What has passed to Brunel*

The pool partnership includes a shareholders agreement and a service agreement which together define how the partnership works, the governance and responsibilities of the pool company and the core and elective services that the pool company will provide, these include the following aspects that used to be the responsibility of the administering authorities and their officers:

- Appointment and on-going monitoring and management of external managers
- Management of Third Party Administrator/Custodian
- Performance reporting to Administering Authorities

# Criterion B: Governance

## *1 of 3 – The key principles of assurance for the benefit of authorities:*

In our 2017 spring and autumn reports we provided an extract from the Commercial Case within the overall Business Case for Brunel Pension Partnership. This provided content on our reporting and performance framework. This position remains the same. The key principles provided below are a part of our reporting and performance framework.

i) Transparency to:

(a) Funds to enable them to make informed strategic investment decisions;

(b) scheme members about the investments made on their behalf;

(c) demonstrate effective stewardship of the assets

# Criterion B: Governance

## *2 of 3 – The key principles of assurance for the benefit of authorities:*

ii) Accountability for:

(a) clear reporting lines from the operating entity delivering the investment management arrangements through to the Funds;

(b) clarity for investment managers of their reporting and disclosure requirements (performance, KPIs);

- (c) full compliance with the scheme and investment regulations;
- (d) performance of both the investment managers and the Brunel company is regularly assessed

iii) Aspire to increased reporting of all risks by:

(a) demonstrating that all investment and operational risks are identified and managed as are those of the service providers, namely Brunel company;

(b) disclosing ESG and stewardship activity

# Criterion B: Governance

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## *3 of 3 – The key principles of assurance for the benefit of authorities*

iv) Efficiency and value for money by:

(a) delivering a standardised suite of reports agreed with by the Funds;

(b) generating data for benchmarking against agreed metrics;

(c) disclosing the costs of the pooling and investment management arrangements in line with the cost/savings model

v) Long-term investment horizon by:

(a) focusing on long-term performance targets

(b) focusing on long-term financial risks.

# Criterion B: Governance

***Risk management/contingency planning on both sides (e.g. how will changes in fund requirements be implemented, how will unsatisfactory performance be tackled) key contract features (where relevant)***

Key risks are monitored and maintained by the Brunel ARC committee and agreed by the Brunel Board. These are shared on an ongoing basis with the Oversight Board, as part of the quarterly reporting.

The shareholders agree a business plan each year with Brunel company which will have been critiqued and reviewed by the Client Group and the Oversight Board. This will include explaining and agreeing deviations from the original business case (both positive and negative) either in the operating model or the financials.

Performance  will be managed in the same manner that you would expect of any outsourced service which includes being given the opportunity to correct and adjust processes right through to the extreme of contract termination of either personnel or organisation. These options and approaches are included in reporting and engagement arrangements within the service agreement and governance and oversight aspects within the shareholders agreement.

# Criterion B: Governance

- ***Transparency***

In October 2017 Brunel formally adopted the Scheme Advisory Board Code of Transparency. One of our investing principles is Openness and Transparency and we are further developing our website in order to communicate better on a wide range of matters. We will continue to publish our annual report and financial statements on our website.

- ***Benchmarking***

Appropriate benchmarking will be undertaken as agreed by Brunel and the Funds and will be in accordance with requirements of FCA and CIPFA.

# Criterion C: Reduced costs and Value For Money

## *Update on costs estimates – current high-level estimates for implementation costs to date, by go live and following go live*

The following implementation costs have been incurred or are forecast to be incurred as per the business plan in the shareholders agreement:

- Stage 1 – August 2015 – February 2016 £0.1m
-
- Stage 2 – March 2016 – July 2016 £0.3m
-
- Stage 3a – August 2016 – December 2016 £0.7m
-
- Stage 3b – January 2017 – July 2017 £1.7m
-
- Stage 3c – August 2017 – March 2018 £2.4m
-
- Stage 4 – from April 2018 will be operational budget rather than implementation costs – first year (as per shareholders financial year of April 2018 to March 2019) are forecast at £6.8m.

# Criterion C: Reduced costs and Value For Money

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***Update on investment cost savings – best current estimate for investment cost savings to date and in future years, with assumptions***

- Our estimated savings can be summarised as follows:
  - The Financial Model projects an aggregate saving to FY36 of £550m, which has a discounted present value of £280m
  - This allows for the expected net costs in the initial years up to FY20 followed by annual savings, leading to a first year of net savings in FY21, with increasing savings from then onwards, and a breakeven year, when total savings to date exceed costs, of FY23, i.e. the year to 31 March 2023
  - The running annual rate of saving by FY25 is 8.9 bps, representing fee savings in that year of 9.0 bps, less net operational net costs in that year of 1.5 bps plus returns on prior years savings of 1.4 bps.

# Criterion C: Reduced costs and Value For Money

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### *Plans for delivering savings – please set out your high level plan and timescales for delivering the annual savings above*

- Our assets under management have grown and we will be updating our operating costs as part of our formal review of the approved business case which is being undertaken in conjunction with the Funds. These figures were based on a starting position of £23 billion AUM from 2015 and an annual increase of 4% - current valuations are higher than this and the review of the business case in Q2 of 2018 will update and increase these figures to reflect this higher value.

# Criterion D: Infrastructure

## *Status – current allocation to infrastructure at participating funds*

Current Allocations to Infrastructure now stand at £1,429m, or circa 5% of total assets, and are expected to rise further. Approximately £885m of the allocations are currently invested into infrastructure, but this amount will fluctuate as calls and distributions from current investments are made and realised.

## *Ambition – current ambition of the pool for infrastructure investment with timescale*

Brunel is developing its proposition to have the capability and capacity to provide a 10% allocation to infrastructure. Our plan has been to develop expertise within Brunel to support infrastructure investment as well as to participate in any National Initiative. Brunel has recruited a private markets team, led by Richard Fanshawe to focus on private markets with a particular emphasis on infrastructure, with the intention that this team will select and invest directly in funds (rather than take a fund of fund approach), consider suitable partnership opportunities, make appropriate direct investments (most likely as co-investments) and work actively with other Pools on the National Initiative.

# Criterion D: Infrastructure

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***1 of 2 – Progress***
***Pooling has increased capacity and capability to invest in infrastructure, or is expected to, in the following ways:***

- Pooling has transformed Brunel's capacity & capability to invest in Infrastructure. Brunel now has a dedicated Private Markets Team of 5 investment professionals, working on 5 asset classes including Infrastructure. This team brings a wealth of industry and LGPS contacts and experience to complement the existing external manager relationships the 10 Brunel Client funds had prior to Pooling.
- The scale of invested AuM in Infrastructure and dry powder at the Pool's discretion has attracted interest from International Pension Funds and Investment Managers alike. This has led to several approaches regarding the establishment of co-investment platforms with transactions being sourced and managed by experienced, institutional investors yet with fees being transactional and performance related, not on the basis of management fees on committed (but uninvested) capital.

# Criterion D: Infrastructure

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## *2 of 2 – Progress*

- The Brunel Team is also being offered much improved terms to invest earlier and at scale in new direct fund offerings, is insisting on aggregate fee discounts based on total LGPS commitments, not just Pool level commitments and is seeking to collaborate with other Pools on these new opportunities – so maximising due diligence but also potential savings from the coordination of commitments.
- It is becoming increasingly common for investors of Brunel's size to be offered the added benefit of co-investments to bring the blended fee burden down further.
- In addition, multi-GP Co-investment funds are being sought with a view to gaining direct transaction experience and aspiring to invest in individual transactions. This will be with the assistance of Brunel's independent Real Assets adviser (once appointed), acting as an extension of the in-house team.

## *Indicators of progress made to date*

The first cycle of annual commitments to all private market portfolios are currently being gathered from Funds. These commitments will then be invested within a 2-year period. Relevant opportunities are currently being sourced for mandates to be awarded from September 2018.

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