Brunel Pension Partnership

Autumn 2018 Report to MHCLG

Forging better futures

October 2018

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 six monthly updates to the Ministry of Housing, Communities and Local Government (MHCLG) for their review.

The Autumn Report is for the period to 30 September 2018. Submission date 15 October 2018.

Brunel Pension Partnership is one of the pools. This is our Autumn 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 £28.833bn as at 31 March 2018

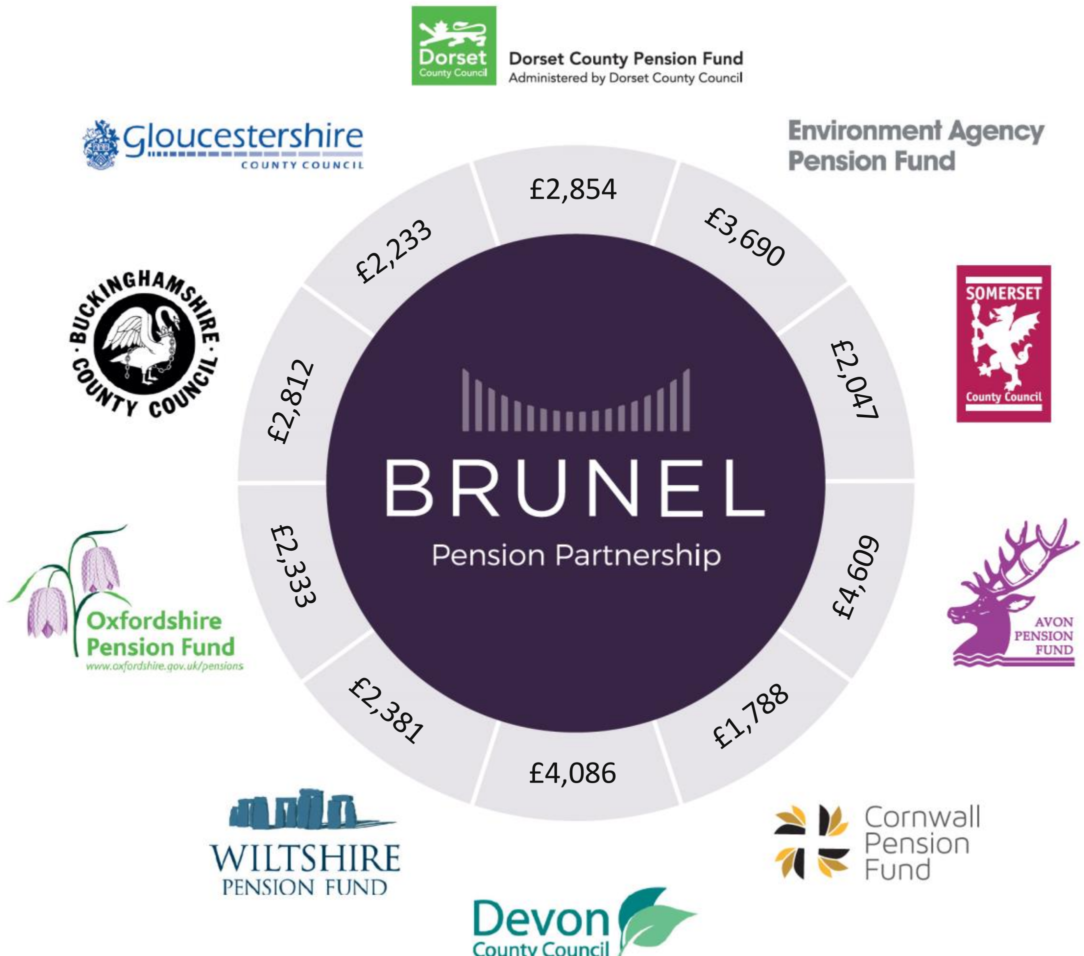
Governance
Brunel is approved as a MiFID full scope Investment Firm. Authorised and regulated by the Financial Conduct Authority No. 790168

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 March £28.833bn



Criterion A: Scale

<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.

£28.833bn as at 31 March 2018.

Currently £1.783bn 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.

Criterion A: Scale

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Diagram 1 part 1 shows the timetable for transitioning assets

Core Portfolio	Portfolio construction date	Portfolio launch date	Asset transition date	Current Asset Value
Passive Equities	January 18	June 18	July 18	£4.8bn
Smart-Beta	January 18	June 18	July 18	£1.2bn
UK Equities	March 18	October 18	November 18	Circa £1.6bn
Low Volatility Equities	March 18	October 18	November 18	Circa £0.3bn
Emerging Market Equities	November 18	July 19	September 19	Circa £1.4bn
High Alpha Developed Equities	January 19	October 19	November 19	Circa £2.2bn
LDI	December 18	July 19	August 19	Circa £1.4bn
Passive Bonds	December 18	June 19	August 19	Circa £1.1bn
Diversified Growth Funds	March 19	November 19	December 19	Circa £2.1bn
Core Global Equities	May 19	February 20	April 20	Circa £0.8bn
Sustainable Equities	September 19	June 20	July 20	Circa £0.7bn
Smaller Companies Equities	October 19	July 20	August 20	Circa £0.4bn
Multi Asset Credit	December 19	June 20	August 20	Circa £1.2bn
Sterling Corporate Bonds	February 20	August 20	September 20	Circa £2.1bn
Global Bonds	June 20	March 21	April 21	Circa £0.5bn
Hedge Funds	August 20	March 21	April 21	Circa £0.5bn

Criterion A: Scale

Diagram 1 part 2 shows the timetable for transitioning assets.

Private Markets Portfolio	Portfolio construction date	Portfolio launch date	Asset transition date	Current Commitment / Asset Value
Property	April 18	April 18	Commences January 19	Circa £2.6bn
Infrastructure	April 18	April 18	N/A	£0.4bn
Private Debt	April 18	April 18	N/A	£0.0bn
Private Equity	April 18	April 18	N/A	£0.2bn
Secured Income	April 18	April 18	N/A	£0.5bn

- The above Private Market values, do not include the legacy positions. 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.

Portfolio Overlay Services	Construction date	Service Launch date	Asset Transition Date	Current Asset Value
Currency Hedging	February 19	June 19	N/A	N/A
Equity Protection	September 20	June 21	N/A	N/A
Tactical Asset Allocation	September 20	July 21	June 21	Circa £0.1bn

Criterion A: Scale

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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.

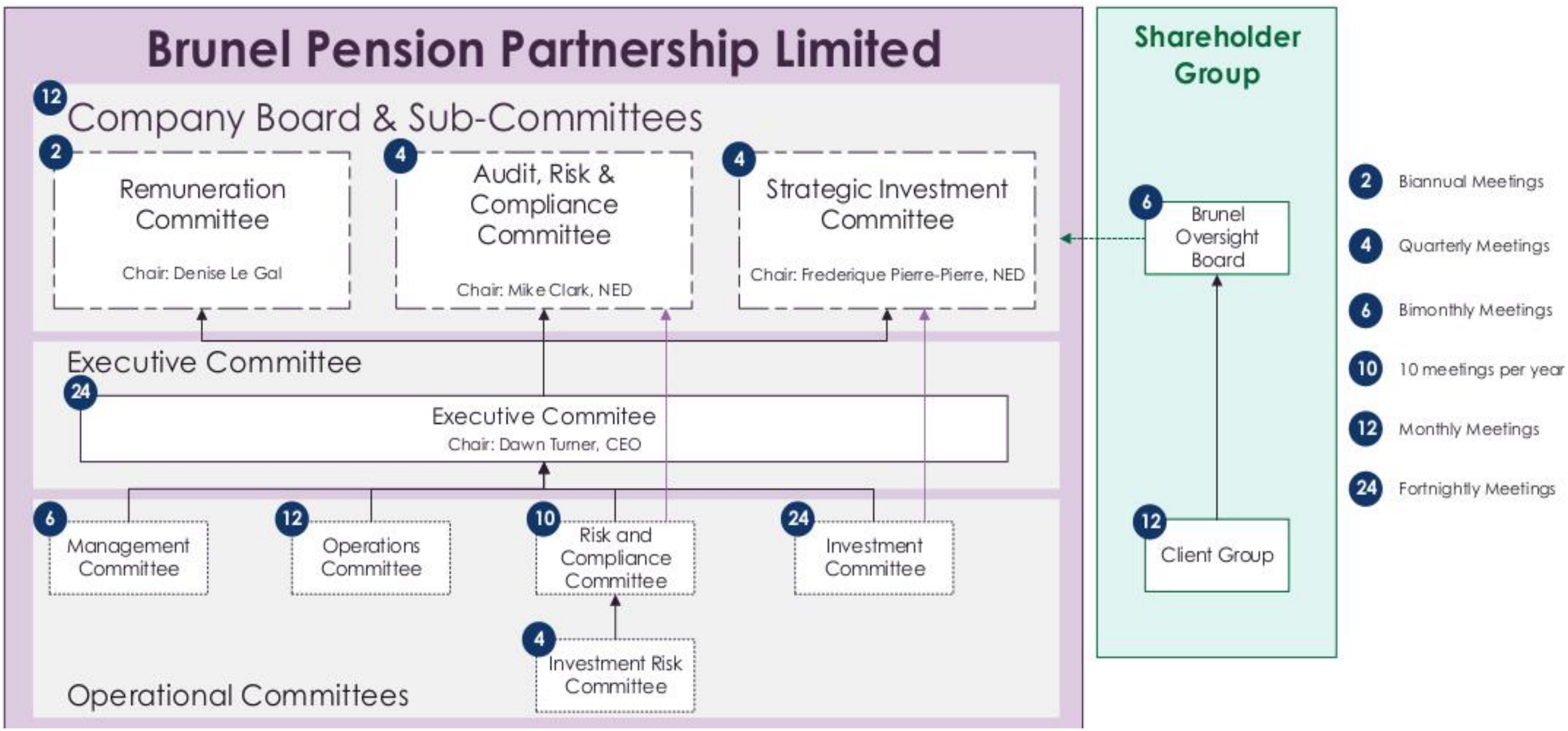
Criterion B: Governance

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

Diagram 2



Criterion B: Governance

All governance arrangements, including terms of reference for ARC and RemCo, are captured in the Shareholders agreement.

The shareholders agreement also covers relevant policies and procedures, accountability to elected members, external support/scrutiny and contract management function (i.e. reporting)

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

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

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 previous 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 that:

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

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

- (c) there is 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

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.

Key risks worth highlighting for this report are:

Strategy – failure to obtain performance enhancements, lower fees or business case savings.

So far we have delivered to budget and providing costs savings over and above those predicted by the original business case. The regulatory landscape has changed significantly since the last business plan, with the implementation of MiFID II across the asset management industry increasing transparency but alongside this increasing the regulatory burden on firms such as Brunel. In order to get the most from our team, and resources and to adhere to regulatory standard we have now started the process to the shareholders to agree budgets for the next three to five years.

Criterion B: Governance

Client risk – clients may depart, be dissatisfied or cause disruption for Brunel.

We are working hard with clients to facilitate a good understanding of the governance which ensures that all 10 funds in the partnership (clients) act as a pool. This is proving a challenge, advisors are still looking to the individual funds objectives and not yet fully taking pooling into account when advising clients. We will be reviewing our governance and Shareholder Agreement with clients over the next 12 months as part of our strategic client engagement.

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

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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

Plans for delivering savings – please set out your high level plan and timescales for delivering annual savings

Cost and fee savings are estimated through to 2036, as per the Original Business Case. Break even year remains at 2023, as per the Original Business Case.

£m	To date	Estimated future savings/(costs)
Set-up costs	5.2	
Running costs	7.5	140.8
Costs of asset transition	0.9	40.6
Total costs	**13.6**	**181.4**
Investment management cost savings	1.5	820.5
Other savings		49.9
Net savings/(costs)	**-12.1**	**689.0**
Cumulative net savings/(costs)	-12.1	676.9

Criterion D: Infrastructure

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Status – current allocation to infrastructure at participating funds

Current Allocations to Infrastructure now stand at £1,450m, or circa 5% of total assets. £843m is currently invested in infrastructure. £210m is committed but undrawn.

- Brunel has received new money commitments of £398m to Brunel's Infrastructure Portfolio. This money will be committed to new opportunities between now and April 2020 by Brunel's Private Markets Team on behalf of all Client Funds who committed
- Strategic Asset Allocation reviews are commencing as part of the triennial valuation process for March 2019

1 of 2 – Ambition – current ambition of the pool for infrastructure investment with timescale

- Brunel has developed its Pool Infrastructure proposition which was developed in partnership with its 10 Clients and their advisers. Brunel's team has been screening potential investments since February 2018. New investments by the Pool, acting as a whole, are expected before the end of 2018

Criterion D: Infrastructure

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2 of 2 – Ambition – current ambition of the pool for infrastructure investment with timescale

- These investments be made by Brunel on behalf of the Pool, with Clients wishing to allocate to Infrastructure only doing so via the Pool solution from April 2018. This solution was communicated in writing to Clients, detailing the process that would be followed and the targeted portfolio composition. Target returns and risk characteristics were laid out in a Portfolio Specification document
- Brunel's Private Market Team will make commitments to funds of differing strategies and types on behalf of its Clients, acting as a discretionary multi-manager. A Brunel fund is not being formed. The rationale for this was to avoid delay, to aid customisation and tailoring to legacy, to give Brunel's Clients a solution for outstanding unmet allocations to the asset class and to reap the benefits of scale negotiations from Pooling
- Brunel's plan remains to develop expertise within its internal team, to discuss and collaborate on national initiatives and to develop solutions in partnership with third-party managers but only if they fit with its Clients investment criteria, objectives and principles

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 five investment professionals, working on five 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

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. It is intended that this will be with the assistance of an independent Real Assets adviser (once appointed), acting as an extension of the in-house team

1 of 2 – Indicators of progress made to date

– The first two-year cycle of commitments to all private market portfolios have now been gathered from Clients. >£1bn of commitments to three Portfolios have been accepted. These commitments will then be invested by Brunel to suitable opportunities by April 2020

Criterion D: Infrastructure

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2 of 2 – Indicators of progress made to date

- Relevant opportunities have been sourced and screened since February 2018 with >100 manager meetings completed by the team.
- Brunel has more than 9 opportunities across its 3 Portfolios at various stages of due diligence. The team intends to make the first commitment on behalf of its Infrastructure and Private Equity Portfolios before the end of 2018.
- Brunel's Secured Income Portfolio has made one investment on behalf of 3 of its Clients with a second investment close to being finalised. A press release will be issued in due course announcing the appointment of both managers. This followed a 4-month selection process by Brunel's Private Market Team.
- Brunel has carried out a full OJEU procurement process to appoint a mid- and back-office service provider to support its Private Market Portfolios. This will allow Brunel to accurately monitor and track new investments as well as legacy holdings and to conduct detailed fee validation and transparency reporting in keeping with Brunel's commitment to cost transparency.

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