

PENSION FUND COMMITTEE – 2 DECEMBER 2016

BRUNEL PENSION PARTERSHIP – APPROVAL OF FULL BUSINESS CASE

Joint Report by Chief Finance Officer and Chief Legal Officer

Introduction

1. Following the Government's announcement in the July 2015 budget statement that they intended to work with Local Government Pension Scheme (LGPS) administering authorities to ensure that they pool investments to significantly reduce costs, considerable work has been undertaken to set up the Brunel Pension Partnership comprising ten LGPS Funds.
2. Regular reports have been brought to this Committee at all stages of the process, with additional engagement events also being held to provide the opportunity for Committee members to provide input to the proposals. As required by Government an initial joint submission from the ten Brunel funds was approved by this Committee in February 2016 and a more detailed response in June 2016 which was submitted to the Government in July 2016.
3. Following the July 2016 submission of what was in effect an outline business case, work has been continuing on developing a full business case for the Brunel Pension Partnership. The full business case (Annex 1 to this report) has now been completed and needs to be approved by each of the ten administering authorities in order that the establishment of the company can be progressed. Each Authority will consider the full business case amended to show their individual financial case, as well as the overall position for the pool.
4. A significant amount of work supports the full business case, and a full list of the supporting documents is included as Annex 2 to this report. Annex 3 sets out a glossary of the key terms used throughout the documents. The business case itself is set out in five sections and each of these is supported by a more detailed case which is included in the confidential annexes 4 – 8. The current risk register is included at Annex 9. If Members wish to access any of the unpublished additional supporting information listed in Annex 2, they are invited to contact the Service Manager (Pensions) who will make it available to them. Annexes 4 – 9 contained commercially sensitive data relating to each of the Funds and the proposed company.
5. **The public should therefore be excluded during consideration of Annexes 4 -9 because their discussion in public would be likely to lead to the disclosure to members of the public present of information in the following category prescribed by Part I of Schedule 12A to the Local Government Act 1972 (as amended):**

3 Information relating to the financial or business affairs of any particular person (including the authority holding that information)

and since it is considered that, in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information, in that disclosure at this time is likely to prejudice the future negotiations to set up the pooling arrangements.

Full Business Case and Cost Model

6. The full business case seeks approval to establish a company called Brunel Pension Partnership Ltd (Brunel Company or BPP Ltd), regulated by the Financial Conduct Authority (FCA). It comprises five sections:
 - The Strategic Case;
 - The Financial Case;
 - The Economic Case;
 - The Commercial Case;
 - The Management Case.
7. The full business case was reviewed by the Finance/Legal Assurance Group (FLAG), comprising the Chief Finance Officers and Monitoring Officers of each of the ten administering authorities during November 2016 and signed off by the shadow Oversight Board, comprising the chairmen of the ten funds on 23rd November 2016. The business case has been put together with significant work by officers of the ten administering authorities, supported by professional expertise provided by PwC (operational and financial support), Osborne Clarke (legal support), Alpha (FCA expertise), JLT (project support) and Bfinance (investment advice).
8. The strategic case focuses on the legal and regulatory requirements as well as the costs and benefits of pooling. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016 No 946) came into force on the 1st November 2016. These regulations provide the legal basis which requires LGPS funds to pool their investments. They also include provision for the Secretary of State to intervene if he does not believe an Authority has complied with the Regulations and the accompanying guidance.
9. The financial case is drawn from a complex financial model that has been developed by the Brunel partnership in conjunction with PwC, which analyses the costs and savings for the partnership as a whole and for each of the individual funds. The model allows scenario testing, changes to individual assumptions and the removal of individual funds from the partnership for sensitivity analysis and stress testing the proposal. The core model analysis shows the breakdown between funds of a total of £550m forecast cumulative net savings over the next 20 years.
10. The economic case examines two potential models for how to set up the Brunel Company, either to rent it from a commercial provider or build it. An

analysis was carried out as part of developing the Outline Business Case to consider the relative merits and limitations of each model, examining them against accountability, procurement and staffing factors, and costs. The analysis showed that the build model had advantages over the rental model, especially on accountability.

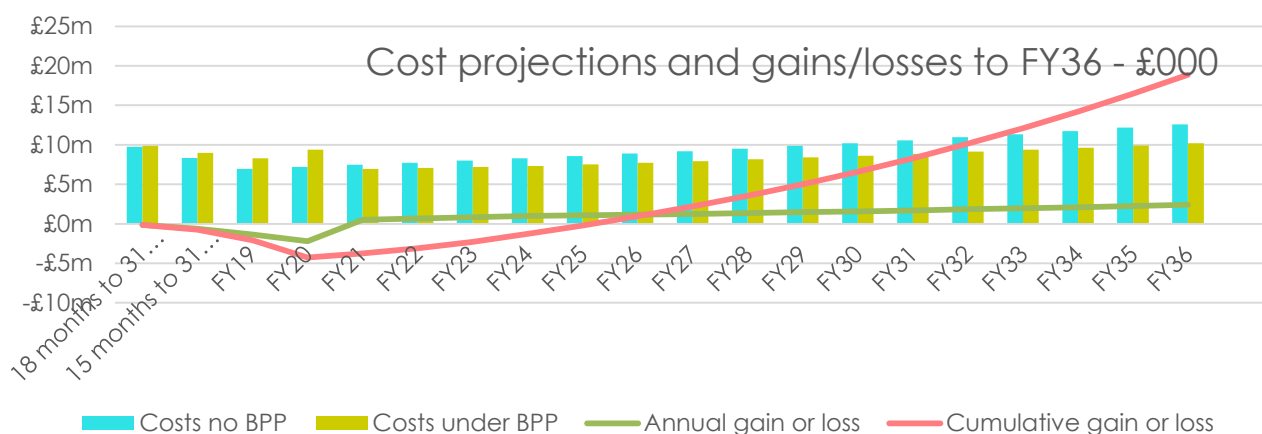
11. The commercial case sets out the structure of the Brunel Pension Partnership as well as the governance and contractual arrangements that will exist. The Brunel Company will be set up as a “Hamburg Waste” type joint working arrangement between public authorities and therefore fall within the exemption in the Public Contracts Regulations 2015 in relation to its appointment by the founding funds to manage the investments of the funds. The 10 founding Administering Authorities will be equal shareholders in the company. The company will be managed by the company board with a chairman, three other non-executive directors, a chief executive officer and three operational directors. The governance arrangements will include an Oversight Board representing each participating fund’s pensions committee.
12. The management case looks at the project management that will be required to set up Brunel Pension Partnership Ltd including recruitment of staff, legal and physical set up, procurement of third party providers including the Administrator/Custodian, definition and set up of the services, and obtaining FCA authorisation. It also covers the work to establish the arrangements for governance of the company by the Administering Authorities (AAs) and to implement the client side governance, organisation and process changes.

Oxfordshire Pension Fund Costs and Benefits

13. The financial case for Brunel has been derived from the financial model put together by PwC. The core model forecasts cumulative savings for the Oxfordshire Fund of £18.9m over the next 20 years, which has a discounted present value of £7.8m. This results in a breakeven point in the 2025/26 financial year, which is within 10 years of this current decision to approve the full business case, and as such is in line with the County Council’s financial strategy for invest to save projects. The savings are summarised in the following table and graph:

Costs and Benefits to the Oxfordshire Pension Fund to 2035/36

Core Model	Breakeven Year	Total Net Gain to FY36		Annual Rate of Net Savings in FY25	
		£m	Discounted Value £m	£m	bps of AUM
Oxfordshire	FY26	18.9	7.8	1.1	4.2
Combined Pool	FY23	550.1	279.5	27.8	8.9



14. The Brunel Pension Partnership costs include estimated costs of transitioning assets. These are being shared by all the Pension Funds pro rata to their allocation to each asset class, to ensure that no individual fund is disadvantaged by, or benefits from fund manager selection that will be made by the company. Other costs include the taxes involved in transitioning assets into the company and the operating costs of the company itself.
15. The actual asset transition costs for the company will not be known until the Fund Managers have been appointed and will depend on the number of funds that need to be transitioned and the market conditions over the period of transition. The transition of assets is expected to begin in April 2018 through to 2020 for the majority of assets, although illiquid alternative assets will need a longer transition timetable. Oxfordshire's allocation to listed private equity is currently unique across the Brunel funds, and any transition will have to be reviewed as the Brunel model is developed.
16. The savings by establishing BPP Ltd will be achieved through reduced direct investment costs, predominantly investment manager fees, expected to be payable by the company once it is operational. In addition there are the savings that the Administering Authorities expect to make as a result of no longer needing to carry out tasks internally because of services provided by the company. In the case of the Oxfordshire Pension Fund, this will be through reduced custodian and performance reporting costs.
17. The financial model allows the sensitivity of the financial case to the above key assumptions to be tested. The greatest sensitivity is in respect of fee savings. However, the partnership would have to fail to achieve 50% of the assumed fee savings before the model suggests that the Oxfordshire Pension Fund would not breakeven.
18. In respect of the transition costs, an increase of 50% would only move the breakeven point from 2025/26 to 2026/27, and reduced net savings over 20 years to £17.1m. Similarly, variations in the costs of operating the Brunel

Company have very little impact on the overall savings figures and the breakeven point.

19. In addition to the financial model's core estimate of savings that BPP Ltd can achieve, the financial case also outlines the opportunity for additional benefits from improved performance. This would result from improved diversification between managers and better risk management that could be achieved from investing in greater scale. In addition, there is a further opportunity to make savings should the company undertake internal management of some active equity investments. This would reduce external manager fees and could therefore further increase the savings. There will also be increased opportunities for co-investments in property, infrastructure and private equity.
20. There are also a number of non-financial benefits resulting from the proposal. These include significantly improved resilience, improvements in reporting and benchmarking, improved resources for risk analysis including all economic, social and governance risks, and improved knowledge sharing.

Conclusion

21. Government policy, now brought into effect by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, requires the Oxfordshire Pension Fund to pool its assets. In the light of this, the Fund has already committed to participating in the Brunel Pension Partnership through the decisions made at previous meetings of this Committee. This Committee and the Council now need to approve the full business case to set up the Brunel Company in order that the pooling proposals can progress to the implementation phase.
22. Although investment pooling is being driven by the central government agenda, the financial modelling that has been undertaken demonstrates that there are net savings opportunities for the Oxfordshire Pension Fund in entering into the Brunel Pension Partnership. The detailed business case sets out the structures and governance arrangements that will be put in place, which will ensure that the company provides value for money to the Oxfordshire Fund.
23. The Committee is therefore asked to recommend the resolution to set up the Brunel Pension Partnership Ltd to Council. Further reports will be brought to this Committee as the project progresses. For avoidance of doubt, approval of the resolution includes approval of the budget provision for the development costs, including those already incurred of £267,000 for professional advice etc and £200,000 for working and regulatory capital.

RECOMMENDATION

24. The Committee is **RECOMMENDED** to **RECOMMEND** the following resolution to the Council:

In its capacity as the Administering Authority for the Oxfordshire County Council Pension Fund, and having received and reviewed this report and the Business Case attached to it, the Council **HEREBY RESOLVES** to enter into investment pooling with respect to the Oxfordshire County Council Pension Fund.

Such Resolution is made on and subject to the following terms and conditions:

- **THAT** the Brunel Pension Partnership investment pool be developed, funded and implemented substantially in accordance with the terms and provisions described in the said Business Case, and more particularly that:
 - a FCA regulated company to be named Brunel Pension Partnership Limited be established, and that the company be operated with all necessary and appropriate arrangements as to its ownership, structure, governance and services capability.
 - a new supervisory body comprising representatives of the Council and all other participants in the Brunel Pension Partnership be established to ensure oversight of the Council's investment and participation in the Brunel Pension Partnership.
- **THAT** the Pensions Committee be authorised and granted delegated powers to undertake such tasks as it thinks appropriate to progress implementation of investment pooling, and to take such decisions and do all other things deemed necessary in order to promote the interests of the Council with respect to pooling, which without limitation shall include agreeing and authorising any documentation, contracts, terms of reference, financial expenditure or investment that may be required consequential upon the Council's participation in the Brunel Pension Partnership.
- **THAT** the Chief Finance Officer and Chief Legal Officer be similarly authorised and granted delegated powers to undertake such tasks as they think appropriate to progress implementation of investment pooling, and to take such decisions and do all things deemed necessary in order to support the Pensions Committee and to promote the interests of the Council with respect to pooling, which without limitation shall include informing and advising the Pensions Committee on the continued viability and suitability of investment pooling in light of any developments, financial or otherwise, in the period up to the establishment of the Brunel Pension Partnership.
- **THAT** subject to the above, all such matters be carried out with the aim of achieving a target date for investment pooling of 1 April 2018, and otherwise subject to such intermediate steps and timescales as may be considered appropriate and necessary by the Pensions Committee.

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