Pricing and Cost Allocation Policy Review

11 January 2022

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Exec Summary, it's time to review the pricing policy

The current Pricing Policy is scheduled for review by 31 October 2021. Its **purpose remains unchanged**, i.e., "the Policy is fundamental to ensuring that there is a formal agreement across all clients and Brunel on how costs will be priced and charged equitably."

The evolution of the business over the period from the last iteration of the policy (November 2018) and the successful transition of assets to date, make this a suitable time to review the mechanics of the pricing policy to ensure it remains suitable going forward.

Pricing Policy Evolution

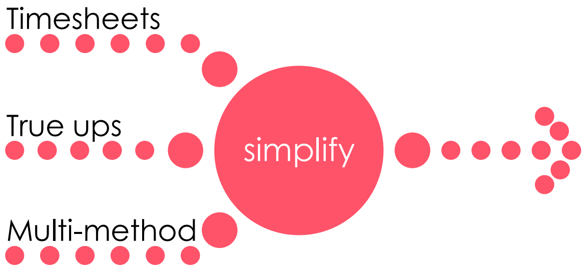
- Jul 17 – simple 1/10th split or AUM in PM or LM
- Sep 18 – split launch & monitor costs; adds complexity
- Spring 22 – simplify; fixed allocation share and variable basis by asset type

The current policy was designed to manage complexity, to charge clients whilst assets transitioned, and would not be considered if the business were starting today with current levels of AUM.

This document sets out a suggested approach and revision to the current Pricing Policy with a replacement "Pricing and Cost Allocation Policy" for a further three year period. Client Group are asked to review, provide comment and agree a proposed approach going forward. Any change to the policy is subject to a unanimous Special Reserved Matter (SRM) and following agreement with Client Group the proposal will be taken to the Brunel Oversight Board for consideration.

Pricing and Cost Allocation Policy - drivers for change

It is now appropriate to refine the model to be fit for purpose in the next phase of the business development, i.e., an increasing focus on the management of the investments, as opposed to launching funds, and ensuring the provision of optimum services for our clients and shareholders.



The current policy is a time consuming and complex process to administer and is subject to onerous resource tracking and allocation processes. A simplification of approach would free up limited resource and permit a more straightforward allocation of costs.

The next iteration of the Pricing Policy ("Pricing and Cost Allocation Policy") has been developed with established investment management pricing practice in mind and aims to increase transparency and ensure ongoing fairness across all clients.

The pricing of individual elective services will enable external market comparison to ensure competitiveness and value for money.

Section 1

Proposed changes to the methodology of Client cost allocations

Pricing and Cost Allocation Policy – key points

- Stakeholders **retain control** of setting budgets in £m
- The process for budget setting is **unchanged**

The only change is the allocation methodology at a Client level, which will provide the following outcomes:

- Clearer linkage between the value of assets managed and invoices
- Clearer comparison to market
- Minimal Client invoicing swings (vs today)
- Simplify operations and increase transparency
- Fit for purpose in next phase of maturity

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Pricing and Cost Allocation Policy - how we do this…

Total Costs

- No change to budget approach.
- Overall cost budget plus mark-up retained

Elective Services

Separate rate card for Elective Services

Allocation basis

Shared fixed element

- Proportion of total budgeted costs allocated evenly
- 45% of total costs allocated evenly each year

AUM bps

- Rate card approach
- Basis points charge tiered by asset type
- Active equities/debt, Passive equities/debt and Private Markets
- AUM at 31st March plus commitments each year

Specific activity costs

- Costs specifically attributed to a Client e.g., from State Street or Colmore.

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Pricing and Cost Allocation Policy – Proposal and principles

Based on forecast 2021 total costs and AUM (c£11.2m equivalent to 3.3 bps on total Client AUM / 4.6bps on transition AUM) an indicative view of the level of recharge required to achieve a break-even position in each of the following years can be summarised as follows:

Allocated charge basis	Budget year to 31 March 2022/23	Budget year to 31 March 2023/24	Budget year to 31 March 2024/25
Total budgeted cost as a fixed share	45%	45%	45%
Activity – State Street / Colmore	Direct	Direct	Direct
AUM rate – Passive (fixed bps)	0.5 bps	0.5 bps	0.5 bps
AUM rate – Active (flex bps)	1.9bps-2.4 bps	1.8bps-2.3 bps	1.7bps-2.1 bps
AUM rate – Private Markets (flex bps)	4.5 bps	4.27 bps	4 bps

After the fixed share (45%) has been attributed evenly, and the specific activity costs allocated to each Client, the remaining budgeted costs are recovered by the AUM rate card. The rate card is flexed each year to achieve a break-even position. The bps per asset type move proportionately to maintain the relative ratio of charging by asset type (noting we keep passive unchanged).

Indicative levels of recharge are shown in the Appendix, based on current and projected AUM comparing 2021/22 invoicing to projected.

The AUM rate card and indicative Client basis points are outlined further on the next pages.

Pricing and Cost Allocation Policy – Proposal and principles

As Brunel takes on an increasing share of Client assets there is a natural shift from expenditure incurred in launching investment portfolios to increasing costs associated with monitoring, managing and administration of the portfolios on an ongoing basis.

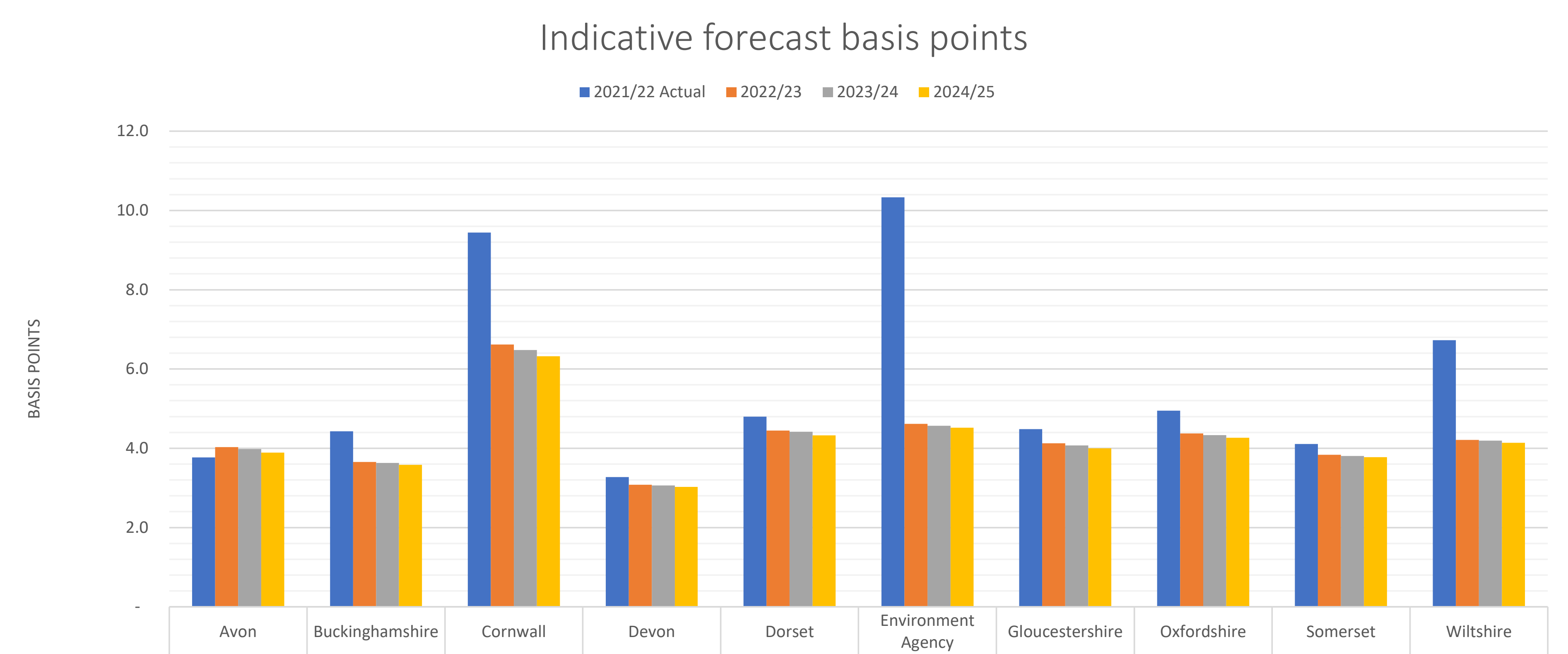
The tiered AUM rate card approach recognises the differential in costs associated with the differing types of asset and include:

- Passive – monitoring the achievement of climate-aligned benchmarks (and other passive products).
- Active – ongoing due diligence, management and consideration of investment delivery against objectives.
- Private Markets – complex investment opportunities with greater level of research, analysis, illiquidity risk and servicing cost.

The rate card is further refined to differentiate between active equities and debt and passive equities and debt.

The indicative rate card has been set to achieve a comparable level of total income for Brunel to cover their total costs. In determining the level of bps to charge, some limited benchmarking is available and is detailed on page 9.

Pricing and Cost Allocation Policy – Indicative forecast bps on Brunel AUM (excl. LDI)



	Avon	Buckinghamshire	Cornwall	Devon	Dorset	Environment Agency	Gloucestershire	Oxfordshire	Somerset	Wiltshire
2021/22 Actual	3.8	4.4	9.4	3.3	4.8	10.3	4.5	4.9	4.1	6.7
2022/23	4.0	3.7	6.6	3.1	4.4	4.6	4.1	4.4	3.8	4.2
2023/24	4.0	3.6	6.5	3.1	4.4	4.6	4.1	4.3	3.8	4.2
2024/25	3.9	3.6	6.3	3.0	4.3	4.5	4.0	4.3	3.8	4.1

Assumptions:

- Draft cost budget 2022/23 £11.4m +3%
- Costs increased by 3% 2023/24 onwards
- Q3/21 Asset allocation with remaining commitments to Q1/22
- Excludes LDI from AUM
- MHCLG forecast AUM growth 2023-25
- No market growth assumed in AUM

Pricing and Cost Allocation Policy – market intelligence

Asset type	Bps	Description
Passive	0.5	London CIV earn 0.5 bps on LGIM and Blackrock passive funds. Ongoing charges (OCF) for typical retail index tracker funds 10-20 bps.
Active	Avg. 2 bps (0.5 – 2.5)	London CIV average income on ACS of c2 bps (0.5 bps on Global Bond fund, 1 bp on MAC fund and 2.5 bps on other ACS funds). Investment Trust OCF typically in range 20-40 bps.
Private Markets	n/a	Overall management fees including the full investment management process in the region of 150-200 bps.

We note in the London CIV annual report (2020-21) that they have reviewed their pricing policy and with EY assisting they have determined that a greater emphasis on variable fees is desirable once they achieve 75% transition (currently 54%).

The London CIV suggested split of 30% fixed to 70% variable is felt to be appropriate, although noting that the variable fees are truly variable and determined entirely by the level of AUM rather than to achieve a certain level of cost recovery.

At Brunel the previous methodology for allocating fixed overhead (c59%) has been revised in line with the move towards a maturing portfolio position and greater allocation of costs to ongoing Investment activity. The budgeted 2022/23 fixed operational costs of Brunel (facilities, telecoms, insurance etc.) with the addition of currently allocated central functions (HR, Finance, IT etc.) is c44%. See Appendix for further details of the fixed allocation.

London Pension Partnership have a base rate of 10bps and which increases in 5bps steps as complexity grows (noting they exclude Passives).

Pricing and Cost Allocation Policy – market intelligence

The overall level of income that Brunel generates (c4.6 bps in 2021 on forecast costs and transition AUM) can be viewed in the context of the following:

- Brunel's cost plus agreement has been reviewed for compliance with HMRC Tax Transfer Pricing principles. Our tax advisers reported that a suitable margin for an organisation like Brunel is in the range 2-6 bps.
- The reported outsourcing of the British Airways scheme to Blackrock earlier this year, with AUM of £21.5bn, is estimated to be based on a flat fee of 5 bps, plus possibly add-on fees for services such as ESG reporting (estimated by Bart Heenk, partner and UK country head at Avida International).
- International investment manager research by NMG Consulting found the lowest cost European investment manager they spoke with had an expense ratio of 9 bps (managing c$50bn with 60 staff).

Pricing and Cost Allocation Policy - further details of the mechanics

The following high level principles would apply in determining the recharge of costs:

- Budget 2022/23 annual costs plus agreed contingency signed off by SRM as the basis for the initial calculation.
- Rate card bps would be agreed each year based on new budgeted costs plus agreed contingency.
- Elective Services to be determined separately.

- The first invoice period (April – June 2022) would be calculated in late April/May (after the approval of the budget) and would be based on the AUM as at 31 March 2022 plus commitments for the remainder of 2022.
- An annual true-up of recharges would take place in late April/May each year to reflect the actual costs for the preceding 12 month period ended 31 March, subject to an excess of the agreed variance to budget (e.g. +/- 5% actual spend vs budget) requiring an additional charge/rebate.
- Commitments – no changes made to AUM for assets that do not transfer as planned.
- Commitments – material additional asset transition not included in plan (>£100m) will be included on a pro-rata time apportioned basis in the AUM in the annual true-up.

Pricing and Cost Allocation Policy - alternatives

The following alternative methods have been considered in preparing this proposal:

Alternative basis	Comment
Stay as per current policy	Missed opportunity to simplify approach, save resource and future proof and achieve other benefits outlined
Simple 1/10th share of all costs	Too simplistic; inequitable split of costs without reference to AUM or understanding of drivers
All costs allocated in proportion to total Brunel AUM	Unfair cost burden for those clients with greater level of AUM, particularly when not all assets are transitioned
Blended Brunel bps (4.1) on total client AUM	Doesn't allow a good enough linkage between cost and charges e.g., a client all in passive has same charge as those all in private markets (if same AUM total).
Fixed + Variable in proportion to AUM	No differentiation in level of cost to support and manage by asset type

CONCLUSION

It is felt that the proposed basis provides the fairest and most reasonable basis moving forward.

Section 2

Proposed changes to the pricing of services, the contingency added as a cost+

Contingency – Pricing Policy

Key messages:

- The partnership has discretion on contingency levels, but they are an SRM (item 6*)
- Reducing the contingency, amongst other things, could be an effective way to manage the total cost increase
- Brunel are aiming to discuss this topic at BOB in January

* The pricing policy was schedule 7 of the services agreement, which is controlled by SRM6 "The amendment or variation of the Services Agreement…"

Overall Budget Increase

The Budget proposal considers the reduction on the level of contingency from 5% to 3%.
This maintains overall budget increase to Clients of ~5% year on year.

	2021/22 £'000	2022/23 £'000	Change
Budget Plan	10,650	11,433	7.4 %
5% Uplift for Contingency	533		
3% Uplift for Contingency		343	
Client Invoiced	**11,183**	**11,776**	**5.3%**

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Appendix

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Indicative impact – MHCLG forecast AUM with current asset allocation

	Actual Invoices 2021/22 £	Average 2021 AUM bps	Budget Charge 2022/23 £	Blended bps	Budget Charge 2023/24 £	Blended bps	Budget Charge 2024/25 £	Blended bps
Avon	1,240,532	3.8	1,440,043	4.0	1,531,218	4.0	1,603,673	3.9
Buckinghamshire	1,210,019	4.4	1,286,462	3.7	1,335,377	3.6	1,373,719	3.6
Cornwall	1,088,450	9.4	953,633	6.6	979,542	6.5	1,000,097	6.3
Devon	1,448,350	3.3	1,556,857	3.1	1,601,022	3.1	1,631,899	3.0
Dorset	945,808	4.8	1,010,587	4.4	1,051,199	4.4	1,174,797	4.3
Environment Agency	1,053,426	10.3	1,150,972	4.6	1,139,699	4.6	1,126,389	4.5
Gloucestershire	1,106,414	4.5	1,245,464	4.1	1,240,520	4.1	1,236,667	4.0
Oxfordshire	1,083,280	4.9	1,113,231	4.4	1,152,358	4.3	1,183,538	4.3
Somerset	907,631	4.1	997,573	3.8	996,047	3.8	991,447	3.8
Wiltshire	1,098,855	6.7	1,021,176	4.2	1,102,298	4.2	1,170,933	4.1
TOTAL	**11,182,766**	**4.6**	**11,776,000**	**4.1**	**12,129,280**	**4.0**	**12,493,159**	**4.0**

SCENARIO	2022/23	2023/24	2024/25
Fixed %	45%	45%	45%
Passive Equities - bps	0.50	0.50	0.50
Passive Debt - bps	0.50	0.50	0.50
Active Equities - bps	2.40	2.28	2.14
Active Debt - bps	1.92	1.82	1.71
Private Markets - bps	4.50	4.27	4.00

Assumptions:

- Draft cost budget 2022/23 £11.4m +3%
- Indicative rate card to achieve break-even
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Noting the passive is a fixed bps rate of 0.5, but all other rates flex proportionately eg PM is always 1.875x more than Active Equites, which in turn are always 1.25x more than Active Debt.

Indicative impact – old Pricing Policy on budget 2022/23 costs

The following is an indicative view of the old Pricing Policy being applied to the 2022/23 proposed budgeted costs, in the absence of a full re-work of the AUM and resource data for 2022/23.

The basis for the calculation under the old policy is a high level estimate based on the AUM from the Q1/2022 invoicing together with the current resource allocations which are applied to the budgeted costs for 2022/23.

	Old Policy Budget 2022/23 £	**Proposed Charge 2022/23 £**	**Difference Old vs New 2022/23 £**	**Change 2022/23 %**
Avon	1,309,062	1,440,043	- 130,981	-10.0%
Buckinghamshire	1,252,796	1,286,462	- 33,666	-2.7%
Cornwall	1,177,467	953,633	223,834	19.0%
Devon	1,516,964	1,556,857	- 39,894	-2.6%
Dorset	1,004,064	1,010,587	- 6,523	-0.6%
Environment Agency	1,065,597	1,150,972	- 85,375	-8.0%
Gloucestershire	1,164,364	1,245,464	- 81,100	-7.0%
Oxfordshire	1,146,412	1,113,232	33,180	2.9%
Somerset	972,081	997,573	- 25,491	-2.6%
Wiltshire	1,167,192	1,021,176	146,016	12.5%
TOTAL	**11,776,000**	**11,776,000**	**0**	**0.0%**

Fixed share of costs – proposed allocation

The proposed allocation of the budgeted costs for 2022/23 of £11,433k (pre mark-up) are as follows:

Draft budget 2022/23	£'000
Investments – AUM related and activity costs	6,378
Proposed allocated share of costs	5,055
Total budgeted costs	11,433

Proposed allocated share of costs	£'000	
Total allocated share of costs - current Pricing Policy methodology	6,776	c59% of total costs
Insurance costs	(439)	Costs related to AUM
Investments – incl. consultancy / memberships and subs / legal fees / CTI reporting	(377)	Included in overhead in Launch phase as no alternative to allocate – now suitable for AUM
Investments – tools and monitoring	(456)	Costs related to investments e.g. FactSet and Data views
People – Core & RI team	(230)	Allocated to portfolios to date where direct cost is known. Full allocation to investments going forward
People – reallocation of potential inflation to allocated teams and travel costs in Listed and Private Markets	(219)	No direct data to analyse travel costs by portfolio in current pricing policy
Total proposed allocated costs	**5,055**	**c44% of total costs**

Next Steps

It is anticipated that the Pricing Policy review will proceed as follows:

- Client Group review January 11 2022
- Board approval January 20 2022
- Brunel Oversight Board review January 27 2022
- Special Reserved Matter issued February 1 2022 (deadline March 1 2022)