Pension Fund Committee

Investment Pooling Progress Report

Date of Meeting: 20 June 2019

Lead Officer: Aidan Dunn, Executive Director Corporate Development

<u>Executive Summary</u>: At its meeting 7 January 2017, the Pension Fund Committee approved the Full Business Case (FBC) for the establishment of the Brunel Pension Partnership. This report provides an update to the Committee on progress in implementing the FBC. To date, investments valued at approximately £840m have transferred to the pool's management, representing nearly 30% of the Fund's total assets of £3.0bn. South West Audit Partnership (SWAP) have reviewed whether the project is progressing as planned and concluded that the project is on track to deliver the planned benefits, and that asset transitions have been well monitored and scrutinised.
<u>Equalities Impact Assessment</u>: Not applicable.
<u>Budget</u>: Not applicable.
<u>Risk Assessment</u>: Details of the expected risks of implementing the project are included in the report.
<u>Other Implications</u>: None.
<u>Recommendation</u>: That the Committee note the progress in establishing the Brunel Pension Partnership.
<u>Reason for Recommendation</u>: To ensure that the Fund has the appropriate management arrangements in place.
<u>Appendices</u>: Appendix 1: Pension Fund Investments Transfer – SWAP final report Appendix 2: Brunel Oversight Board 31 January 2019 – minutes

Background Papers: Brunel Pension Partnership Full Business Case
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1. Background

1.1 At the additional meeting on 9 January 2017 the Committee resolved that the Brunel Pension Partnership investment pool be developed, funded and implemented in accordance with the Full Business Case (FBC), including the setting up of a Financial Conduct Authority (FCA) regulated company to be named Brunel Pension Partnership Limited (Brunel Ltd). This was then ratified by the County Council on 16 February 2017. The FBC was also approved by the nine other participating administering authorities. This report provides members with update on progress implementing the FBC.

2. Establishment of Brunel Ltd

2.1 Brunel Ltd was formally created on 18 July 2017, with representatives from the administering authorities of each of the ten founding funds signing the shareholders agreement to establish the company. Brunel Ltd received authorisation on 16 March 2018 from the Financial Conduct Authority (FCA) to act as a full scope investment firm, allowing it to provide advisory and discretionary investment management services to Dorset and the nine other client funds.

3. Portfolio Development and Implementation

Listed Equities

3.1 Following a tender process under the LGPS National Framework for Passive Services, Brunel appointed Legal and General Investment Management (LGIM) as the fund manager for passive and Smart Beta equities.

3.2 Dorset's internally managed passive UK equities portfolio successfully transitioned to the Brunel portfolio 11 July 2018 and Dorset's global equities under the management of Allianz successfully transitioned to the Brunel Smart Beta portfolio 18 July 2018.

3.3 Following the conclusion of the Passive and Smart Beta manager selection process, Brunel turned its attention to the seven active equities portfolios, firstly UK Equities and Low Volatility Global Equities, with the other equities portfolios to follow.

3.4 The results of these two initial active equities concluded in September 2018, with transition to the new portfolios in November 2018. These are the first Brunel portfolios managed through the Authorised Contractual Scheme (ACS).

3.5 Dorset has a target allocation to UK core equities of 6.25% (approximately £185m) but no allocation to Low Volatility Global Equities. The Fund's investment with AXA Framlington has now transferred to the Brunel portfolio.

3.6 In total, investments valued at approximately £840m have transferred to the pool's management, representing nearly 30% of the Fund's total assets of £3.0bn.

3.7 In October 2018, Brunel issued their "Manager Search Launch Paper" for their Emerging Markets Equity portfolio. This document sets out the detailed timeline for the establishment of the portfolio, with final transitions not expected until September 2019. Dorset has a target allocation of 3.0% (approximately £90m) to emerging markets equities, and it is anticipated that the Fund's current investment with JP Morgan will transfer to the Brunel portfolio.

3.8 In January 2019, Brunel issued their "Manager Search Launch Paper" for their High Alpha Equity portfolio. This document sets out the detailed timeline for the establishment of the portfolio, with final transitions not expected until November 2019. Dorset has a target allocation of 4.25% (approximately £125m) to global high alpha equities, and it is anticipated that this will be funded by partial disinvestment from the Fund's current investments under the management of Investec and Wellington.

Private Markets

3.9 Work by Brunel establishing private markets' portfolios is progressing concurrently with public markets' activity. Following the meeting of the Committee in June, commitments of 2.0% (approximately £60m) to the Private Equity portfolio and 2.0% to the Secured Income portfolio were agreed.

3.10 Commitments to the private markets' portfolios are expected to be made by Brunel to underlying investments over a two year period ending March 2020, with an opportunity to 'top-up' initial commitments in April 2019. Thereafter, from April 2020, commitments to further two year investment cycles will be sought by Brunel, again with the opportunity to 'top-up' after the first year.

3.11 Private Equity, in particular, has proved challenging for the Fund to reach target allocation. Therefore, officers will need to regularly review and update the required levels of commitments to Brunel, alongside the legacy investments with the Fund's existing managers, HarbourVest and Aberdeen Standard.

3.12 Brunel has made commitments to two Private Equity funds - the Capital Dynamics Global Secondary Fund and the Neuberger Berman Private Equity Impact Fund. Dorset's share of those commitments is £11.5m to the Capital Dynamics Global Secondary Fund and £14.3m to the Neuberger Berman Private Equity Impact Fund, leaving £34.2m uncommitted. To date £2.5m has been drawndown against the Capital Dynamics Fund.

3.13 Brunel has made commitments to two Secured Income funds - the Aberdeen Standard Long Lease Property Fund and the M&G Secured Property Income Fund. Dorset's share of these commitments is £22m to each fund, leaving £16m uncommitted. To date, £2.9m has been drawndown against Dorset's commitment to the Aberdeen Standard Fund, with a call for a further £8m expected shortly.

Liability Driven Investment (LDI)

3.14 Following discussions between Brunel and the three clients who have allocations to LDI (including Dorset) in January 2019, Brunel issued their "Manager Search Launch Paper" for their LDI portfolio. A decision on the preferred provider is expected shortly. Dorset's target allocation to LDI is 14% (approximately £400M) and its incumbent manager is Insight Investments.

Diversified Growth Funds (DGFs)

3.15 In April 2019, a workshop was hosted by Brunel to gain a better understanding of clients' reasons for allocating to DGFs. Dorset's target allocation to DGFs is 8% (approximately £240M) and its incumbent manager is Barings.

Other Portfolios

3.16 Final commitments will be sought by Brunel on a portfolio by portfolio basis, as and when appropriate. The expectation in the FBC is that most of the assets of the ten client funds will in time transfer to Brunel portfolios but, initially at least, some assets will remain outside of the pool for reasons of liquidity and/or value for money. For Dorset such assets are expected to include holdings in property, legacy holdings in private equity and infrastructure, and potentially LDI depending on the Brunel offering.

3.17 Fee savings in a full year from the assets that have transferred to date are estimated at approximately £1.2m, compared to the Fund's share of Brunel's annual running costs of £1.0m in 2019-20. As more assets transition to Brunel's management, fee savings are expected to increase.

3.18 The development and transition plan for all Brunel's portfolios (excluding private markets) is summarised below.

Portfolio	Dorset Allocation	Start Date	Transition Date
Passive UK Equities	12.25%	Jan-18	Jul-18
Passive Smart Beta Equities	8.50%	Jan-18	Jul-18
UK Active Equities	6.25%	Oct-18	Nov-18
Low Volatilty Active Equities	0.00%	Oct-18	Nov-18
Emerging Market Active Equities	3.00%	Oct-18	Sep-19
High Alpha Developed Active Equities	4.25%	Dec-18	Nov-19
Global Core Active Equities	8.50%	May-19	Apr-20
Sustainable Active Equities	0.00%	Sep-19	Aug-20
Smaller Companies Active Equities	2.25%	Oct-19	Aug-20
Liability Driven Investments	14.00%	Dec-18	Aug-19
Diversified Growth Funds	8.00%	Mar-19	Dec-19
Passive Index Linked Gilts	0.00%	Dec-18	Aug-19
Bond Strategy	0.00%	Nov-19	Dec-19
Multi Asset Credit	5.00%	Dec-19	Jul-20
Sterling Corporate Bonds	6.00%	Feb-20	Sep-20
Global Bonds	0.00%	Jun-20	Apr-21
Index Linked Gilts	0.00%	Jun-20	Jun-20
Hedge Funds	0.00%	Aug-20	Mar-21
Equity Protection	0.00%	Sep-20	Jun-21
Tactical Asset Allocation	0.00%	Sep-20	Jul-21

4. Governance

4.1 South West Audit Partnership (SWAP) were commissioned by the Fund Administrator to review whether the project was progressing as it should be. The conclusion of the auditors was that the project is on track to achieve the planned benefits and savings within the timescales of the business case, and that asset transitions are well monitored and scrutinised by Brunel and the clients, including Dorset (see Appendix 1).

4.2 Minutes from the meeting of the Brunel Oversight Board 31st January 2019 are attached as Appendix 2. The oversight board also met on 30th April 2019 but the draft minutes for that meeting have not yet been approved for publication.

5. Key Measures of Success

5.1 Brunel Ltd has identified the following measures by which successful implementation of the project will be judged:

- Delivering within budget,
- Obtaining FCA approval,
- Establishment of first portfolios in 2018,
- Application of the investment principles,
- Control of transition costs,
- Selection of fund managers that indicate investment cost and fee savings with maintained or enhanced performance,

- Compliance and risk management, and
- Feedback from clients and reputation.

6. Key Risks

6.1 Brunel Ltd identified a number of key risks to successful implementation, with the following risks still outstanding:

6.2 **Transition costs:** there is a risk that the transition costs are significantly higher than the level assumed within the business case. Mitigation: implement robust strategic transition management, controls and practical flexibility.

6.3 **Investment cost and fee savings:** there is a risk that the fee savings, whilst maintaining performance, are not achieved. Mitigation: wide research and stimulation of the market, investment team have strong negotiation skills and intelligent consideration of balance between performance and fees.

6.4 **Operational costs and resources:** there is a risk that the required on-going operational costs are significantly higher than the business case and or the people requirements are not met. Mitigation**:** robust remuneration policy and clear communication of the benefits of working for Brunel Ltd, quality procurement procedures and experienced financial management resource within Brunel Ltd. Responsive governance arrangements to enable solutions to key operational issues to be agreed in a timely manner.

6.5 **Assets under management:** there is a risk that clients delay the transition of assets into the pool limiting economies of scales and diminishing the value of the pool structure. Mitigation: clear pooling and investment principles within shareholders and service agreements. Excellent communications from Brunel Ltd to clients.