Focused on the future

Paige Perrin sits down with Avon Pension Fund head of fund, Nick Dixon, to discuss the fund's priorities, how it is using its surplus, and progress towards its climate targets

Please provide an overview of the Avon Pension Fund.

We serve about 150,000 members across the Bath/Bristol region. We serve four counties, which are Bath and Northeast Somerset, Bristol City, North Somerset and South Gloucestershire, along with the West of England Combined Authority and, like any other fund, a smattering of schools, universities and other local employers. We have got about £6.5 billion in assets and are about 110 per cent funded, so we're in a good financial position. We are also really passionate about local investing across the southwest and about having a sustainable strategy vis-à-vis climate change.

Earlier this year, the fund joined the Local Pensions Partnership Investments (LPPI) pool as part of the government's Local Government Pension Scheme (LGPS) pooling agenda. How has this transition impacted the day-to-day running of the scheme, and what have been the main benefits and challenges so far?

It has not affected the day-to-day running. We had assets across several funds with Brunel. We pressed a button on 31 March, and those assets left Brunel and arrived at LPPI. So, at the moment, we have the same funds, asset allocation, etc., and to that extent, it hasn't affected us hugely.

However, some changes are coming through, and we are managing them very closely with LPPI. One of them is that LPPI are becoming our investment adviser – instead of Mercer – as well as our asset manager. And we've already started conducting an investment review with them, which will conclude over the next six to nine months.

And then, aligning with that, LPPI is going to reorganise the underlying funds because they have three existing LGPS funds and six new ones coming in.

For the time being, these six have remained with funds inherited from Brunel. But we're going to have to bring those different funds together into an optimised mix for the whole nine, and that'll happen over the next 12 to 18 months. That will be a significant exercise of churning through the portfolios and changing them.

The LGPS continues to face significant regulatory and policy changes. How has the Avon Pension Fund adapted to reforms such as the Fit for the Future while ensuring strong governance and member outcomes?

We've joined LPPI; that's the first thing. With governance, we were already complying with the good governance guide. We already have three independents on our committee, and we are going to appoint an independent person as we're obliged to do, from our existing independent expertise.

We don't regard that as a bad or good thing; it's merely a regulation we will comply with, but it won't make any practical difference to how we manage the fund.

We also have our independent board and will comply with an independent governance review. But given that we already have independent audit reviews and risk assessments, we don't think that will make much of a difference or add much value.

Can you outline the fund's investment approach and, given the wider debate around defence sector

investments, explain the decision to remain invested in this sector?

The overarching investment approach I want to maximise is the return risk trade-off, so financial returns reach inflation plus 3 per cent to 4 per cent. And if I can do that, then I can reduce employer contributions over time.

My primary aim is to reduce local employers' financial inputs into the pension scheme, so they've got more money for local services.

That is my absolute priority because it helps local governments at the margin have a bit more capacity to do what they really want to.

The second thing is that we need a portfolio that is sustainable vis-à-vis climate change, and therefore, we have a net-zero 2045 target for the fund and invest in companies with a transition pathway towards net zero.

That does not mean they are low-carbon intensive today. It means that they have a transition pathway.

If I take one example, cement is highly carbon intensive. That does not mean we do not invest in cement, because if cement manufacturers have a pathway to move away from coal and gas towards electric power, which is a renewable source, that's a really good pathway.

We'll solve climate change by supporting companies that develop pathways. I can look green and clever by only investing in stuff that's already green, but I will have no impact on the planet. This is not about looking good; it's about doing good and encouraging positive action.

On defence, the decision was driven by two things. One is that if we divest, it should have no material financial detriment to the fund.

Then the second test would be, what do the members think? And we did a survey, and 42 per cent voted for divestment, and there simply wasn't an overwhelming majority to make that decision. And hence we decided to remain invested.

The fund has already met some of its 2030 climate targets ahead of schedule. What key decisions and initiatives have contributed to this progress?

It's investing in sustainable funds, which invest in companies with a downward carbon pathway. We also came out of emerging markets, which tend to be more carbon intensive.

Plus, we've made active investments in renewables, particularly solar, wind and batteries, which have a very beneficial carbon impact.

It is those three things together that have the biggest impact. The carbon intensity of assets in general is coming down; even if you invest passively, your carbon intensity will reduce.

Given that the fund is in surplus, how is that being considered within the funding strategy, and have you had any conversations about what to do with it?

In our latest valuation, we decided to reduce *[employer]* contributions. They have come down from an average of about 21 per cent to 16.5/17 per cent of employees' salaries. There has been a material reduction in overall contributions.

Since then, the surplus appears to have risen further, and we will make decisions at the next valuation in 2028.

But in the meantime, we are not changing our investment strategy. We are roughly 40 per cent in equities and 20 to 30 per cent in other growth assets. And we will remain with that strategy, but may tweak it a little bit with LPPI.

More broadly, we want the return on our investments to increase more quickly than liabilities and offer scope for further reductions in employer contributions.

We have already reduced employer contributions, and if the surplus sustains going forward, we want to plough that into further reductions in employer payments.

Looking ahead, what are your plans for the future?

We're going increasingly digital. We have just launched a new digital platform. We want members to do more for themselves, not so it reduces our costs, but because this would mean they can do it faster, when they want to and on their own terms.

The fund wants to improve member service by making it more digital, cognisant that we have to remain multi-channel.

We have got multiple types of members, and we also have to offer people letters and phone calls and do it in a really joined-up way. That's very important.

We also want an investment strategy that enables those contributions to keep coming down. We also want to increase our investments in the region, the Avon area and the wider Southwest.

Additionally, we want to play a big part in providing growth capital for small firms and local renewables, in a way that does not compromise the overall fund and financial returns.

We have decided to allocate 5 per cent of our fund to regional capital, so that's £300 million, and we've already allocated about £120 million of that.

These investments include solar farms across the southwest, some small businesses through Foresight, and investments in affordable housing, with some announcements imminent.

There's a lot of stuff we're delivering that's going to have a real impact. As well as going more digital, we want to make our processes more efficient by redesigning them.

The more efficient we are, the lower the contributions from the councils and other local employers because the less it costs to manage the fund, the less money you need to put into it and more is available for education, transport, social care, etc.

Written by Paige Perrin