

**SURREY COUNTY COUNCIL**

**PENSION FUND COMMITTEE**

**DATE: 10 FEBRUARY 2017**

**LEAD OFFICER: SHEILA LITTLE, DIRECTOR OF FINANCE**

**SUBJECT: ASSET POOLING: BORDER TO COAST PENSIONS POOL**



**SUMMARY OF ISSUE:**

The recently published Local Government Pension Scheme (LGPS) asset pooling consultation has set out a vision for each administering authority of the LGPS to commit to a national pool. The Surrey Pension Fund was instrumental in setting up the Border to Coast Pensions Partnership (BCPP) and submitted a proposal to Government on 15 July 2016, proposing a countrywide pooling arrangement and consisting of 12 administering authorities. This report makes the case for Surrey County Council to officially endorse the Border to Coast pool and create a Joint Committee and Shareholder Board for the purpose of delegating authority for the running of the pool to the Joint Committee and the Shareholder Board, and setting out the administrative issues that need to be considered.

**RECOMMENDATIONS:**

It is recommended that the following matters are supported by the Pension Fund Committee and referred to full Council for final determination:

1. Approve the BCPP as its pooling option to provide compliance with the legislation that mandates pooling.
2. Approve the acquisition by the Council, as Administering Authority of the Surrey Pension Fund, of one share in the Border to Coast Pensions Partnership Limited and nominate the Chairman of the Pension Fund Committee (or Vice Chairman in their absence) to attend any meetings of the BCPP Shareholder Board on behalf of the Council;
3. Approve the creation of the BCPP Joint Committee and nominate the Chairman of the Pension Fund Committee (or Vice Chairman in their absence) to attend on behalf of the Council.
4. Delegate authority to the Director of Finance and the Monitoring Officer in consultation with the Chairman of the Pension Fund Committee to update the Council's Constitution to reflect the above approvals and to approve for execution by the Council the final versions of any documents necessary to put these decisions into effect.
5. Approve the revised Pension Fund Committee Terms of Reference functions as set out within the Constitution with the following addition: *"Receive minutes and consider recommendations from and ensure the effective performance of the Joint Committee of the Border to Coast Pensions Pool and any other relevant bodies."*

<b>REASON FOR RECOMMENDATIONS:</b>
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1. To comply with legislation.
2. To conform to best local authority pensions practice.

<b>DETAILS:</b>
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### **Background**

- 1 The Surrey LGPS provides a pension service for 91,500 members across over 200 separate employers. The Fund is financed by employee and employer contributions and holds assets valued at over £3.6bn (current valuation) that fund the current and future liabilities of pension payments for members.
- 2 The Government has mandated that the 89 separate LGPS Funds in England and Wales should combine their assets into a small number of investment pools. The Surrey Pension Fund is proposing to join the Border to Coast Pensions Partnership (BCPP) with 12 other Pension Funds with assets at 31<sup>st</sup> March 2015 totalling £35.9 billion.
- 3 It is proposed that Surrey County Council will take a 1/12<sup>th</sup> ownership in BCPP (Asset Management Company) and have equal shareholder voting rights with the other administering authorities in the pool. It should be noted that the South Yorkshire Passenger Transport Pension Fund will have no shareholding or voting rights in the new company.<sup>1</sup>
- 4 The pooling of Local Government Pension Fund assets will have no impact on the pension entitlement of members of the fund (current employees, previous employees who are yet to draw their pension, or pensioners).

### **Requirement to Pool Assets**

- 3 Following three years of consultation, in October 2015, the then Chancellor of the Exchequer set out the final stages of the plans to legislate that all assets of the 89 Local Government Pension Funds in England and Wales be pooled into a small number of larger asset pools. In response to this, on 15 July 2016, eight separate investment pools submitted proposals to Government with the Surrey Fund being included within the submission for the Border to Coast Pensions Pool (BCCP).
- 4 The BCPP is proposed to be formed of 13 Local Government Pension Funds with combined assets of £35.9 billion (at 31 March 2015) as set out in the table below.

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<sup>1</sup> South Yorkshire LGPS Pension Fund will manage and represent the interests of South Yorkshire Passenger Transport Pension Fund within the pool. SYPTPF will not have any voting rights or other control mechanisms available to them

Table 1. Local Government Pension Funds within the Border to Coast Pensions Pool

<b>BCPP Partners:</b>	<b>Fund Value at 31 March 2015 (£bn)</b>
Bedfordshire Pension Fund	1.7
Cumbria Pension Fund	2.0
Durham Pension Fund	2.3
East Riding Pension Fund	3.7
Lincolnshire Pension Fund	1.8
North Yorkshire Pension Fund	2.4
Northumberland Pension Fund	1.1
South Yorkshire Pension Fund	6.3
South Yorkshire Passenger Transport Pension Fund	0.2
Surrey Pension Fund	3.2
Teesside Pension Fund	3.2
Tyne and Wear Pension Fund	6.4
Warwickshire Pension Fund	1.7
<b>BCPP TOTAL</b>	<b>35.9</b>

- 5 The legislation (LGPS Investment Regulations 2016) that mandates pooling came into effect on 1 November 2016. Following this, on 12 December 2016, Government gave its support to the governance structures and operating principles as proposed in the 15 July 2016 submission for the creation of the BCPP.
- 6 BCPP is now poised to advance with these proposals and create a separate regulated asset management company, appoint staff (including TUPE transfer where appropriate) and develop the corporate and governance structures that will enable the pooling of the partners' assets by the deadline date of 1 April 2018.
- 7 Whilst fund assets will be transitioned into BCPP, the Surrey Fund, through delegated responsibilities to the Pension Fund Committee, will retain sovereign responsibility for setting the investment strategy and asset allocation of the pension fund.

#### **Creation of the BCCP Company**

- 8 From 1 April 2018, BCPP will be responsible for managing investments in line with the investment strategy and asset allocation as instructed by each of the Pension Fund Committees.
- 9 BCPP's objectives are to:
  - reduce investment costs by taking the opportunities of economies of scale;
  - improve professionalism and personnel resilience through engagement of a larger team at the pool level than is present in individual administering authority funds;

- provide opportunities for Funds to access the benefits of using its partners' internal investment teams;
  - provide opportunities for funds to access more complex asset classes;
  - improve risk control and performance monitoring by investing through regulatory structures.
- 10 In developing the BCPP proposal in response to the Government's pooling requirements, separate legal and cost/benefit studies were commissioned and both advisors concluded that the most appropriate model, given the constituent makeup of the partner Funds of BCPP, was for a wholly owned and controlled company, operating a fully regulated structure under the Financial Conduct Authority (FCA).
- 11 Where the above conditions are fulfilled, a contracting authority may directly award a contract to the company without needing to put it out to competitive tender.

#### **Ownership of the Company by a Shareholder Group**

- 12 Subject to approval from the respective 12 administering authorities' full Councils, the company would be owned by the 12 local authorities within the investment pool, with each local authority having equal shares and voting rights.
- 13 The role of the administering authorities as shareholders will be to provide oversight and control of the operation of the Company and will include the:
- Appointment and removal of Directors, including non-executive directors of BCPP;
  - Approval of the Annual Business plan;
  - Approval of budgets, fee models and the overall cost base and cost apportionment;
  - Approval of the remuneration policy;
  - Approval of capital requirements;
  - Approval of significant transactions, e.g., mergers and acquisitions;
  - Approval of any new entrants to BCPP and the terms of entry;
  - Determination of exit terms, including notice period and exit treatment;
  - Approval of Conflict of Interest policy;
  - Review of risk register;
  - Appointment of Auditor;

- 14 It is recommended that the Chairman of the Pension Fund Committee (or Vice Chair in their absence) has the delegated authority to vote on behalf of the Council's shareholding at BCPP (Asset Management Company) shareholder meetings.
- 15 The exercise of these rights will be governed by the constitution of the company and private company law. This means that different priorities from simple to majority to unanimity can be attached to different types of decision. Meetings will be held in private.
- 16 The proposed Articles of Association of the Company are shown as Annex 1. The proposed Shareholder Agreement is shown in Annex 2.

### **Management of the Company**

- 17 BCPP (Asset Management Company) will be required to operate under local authority Regulations, the Financial Services Act (FCA compliance) and the Corporate Governance Code.
- 18 Border to Coast Pensions Pool Limited is a private company limited by shares. The company has been formed to act as an alternative investment fund manager to run and operate one or more collective investment vehicles, including an Authorised Contractual Scheme (ACS), to allow the administering authorities to pool their respective investments. In due course, the company will become authorised by the FCA. Unlike the company, the ACS itself is not a separate legal entity but is a contractual arrangement.
- 19 The company will be run by a Board of Directors which will comprise of a non-executive chair and two other non-executive directors, and up to three executive directors. Directors are appointed (and can be removed) by the authorities as shareholders.
- 20 The company will have twelve shareholders who are the administering authorities for the funds: Bedford Borough Council (Bedfordshire Pension Fund), Cumbria County Council, Durham County Council, East Riding of Yorkshire Council, Lincolnshire County Council, Middlesbrough Borough Council (Teesside Pension Fund), Northumberland County Council, North Yorkshire County Council, South Tyneside Council, South Yorkshire Pensions Authority, (acting on behalf of itself and the Sheffield City Region Combined Authority), Surrey County Council and Warwickshire County Council.

### **Shareholder Representatives**

- 21 Shareholder meetings will be convened in order to deal with the shareholder rights of the twelve administering authorities as individual shareholders in Border to Coast Pensions Pool Limited. This is distinct from the company's Board of Directors and also from the BCPP Joint Committee (see below).
- 22 Each authority as shareholder exercises one vote. Certain major decisions, for example, changes to articles of association, rights in shares, buy-back of shares, etc, which would have an effect on the shareholders' rights, are usually required, through the Companies Act 2006, to be approved by the shareholders at a general meeting called by the directors of the company.

- 23 The Shareholders Agreement records the terms of the authorities' relationship with each other as shareholders and regulates certain aspects of the affairs and their dealings with Border to Coast Pensions Pool Limited. The Agreement provides the framework for the authorities to act in a collaborative and coordinated way. In addition, the Shareholders Agreement specifies the voting levels for various shareholder decisions.
- 24 Meetings of the shareholders are subject to the requirements of the company's Articles of Association of the Operator, the terms of the Shareholders Agreement and general company law. They are therefore subject to different rules to a BCPP Joint Committee meeting, for example, in relation to areas such as access to information and voting rules, and for this reason shareholder meetings need to be kept separate from Joint Committee meetings.
- 25 Each authority will need to appoint a person to attend the shareholder meetings on its behalf and to cast its vote or state its view. Such a person is representing the authority and acting on instructions from the authority. It does not therefore matter legally whether that person is an officer or a member since no delegated powers are being exercised. The representative, if an elected member, may be the same individual that represents the authority on the BCPP Joint Committee.

#### **Joint Committee**

- 26 The BCPP Joint Committee established under the Local Government Act 1972 will be the forum for discussing common investor/customer issues relating to Border to Coast Pensions Pool Limited and the ACS. Each administering authority will be an individual investor in the ACS and any other pooled vehicles managed by Border to Coast Pensions Pool Limited and therefore each authority will have investor rights. These investor rights are embedded in key documents and cover matters including the right to withdraw from the pooled vehicle, investor reporting, and investor voting rights.
- 27 The Joint Committee will act in the best interests of the individual funds acting as investors. It is expected that they will exercise scrutiny over the investment performance of the Company and its sub funds. It will also retain an advisory role over the functioning of the company. Its meetings will be governed by local government law and privacy determined accordingly. Voting will be by simple majority.
- 28 Each authority will be represented on the BCPP Joint Committee by one of its elected members. In accordance with local government law principles, members cannot be mandated how to vote and therefore must use their own judgement when considering Joint Committee business. However, the views of the member's authority will be a factor in any decision.
- 29 The proposed Inter Authority Agreement, which includes the Terms of Reference for the BCPP Joint Committee, is shown as Annex 3.

- 30 To reflect the creation of the Joint Committee, it is recommended that the Pension Fund Committee Terms of Reference functions as set out within the Constitution be amended such that the following section is added: *“Receive minutes and consider recommendations from and ensure the effective performance of the Joint Committee of the Border to Coast Pensions Pool and any other relevant bodies.”*
- 31 Following the government’s approval on 12 December 2016 to proceed with creation and implementation of the BCPP, each of the 12 Local Authorities within the pool are reviewing their respective governance arrangements. Following this, further work is required to set up BCPP (Asset Management Company) and ensure its FCA registration. This will include finalising contract terms between BCPP and the respective administering authorities.
- 32 It is recommended that finalisation of these contract terms is delegated to the Council’s Section 151 Officer and Monitoring Officer, in agreement with the Chairman of the Pension Fund Committee.

### **Financial and Value for Money Implications**

- 33 The Surrey Pension Fund has assets with a value of over £3.6bn as at 30 November 2016. Government has mandated the pooling of Local Authority Pension Funds and it is proposed that the Surrey Pension Fund join the Border to Coast Pensions Partnership.
- 34 The pooling of assets is scheduled to commence from 1 April 2018. However, some assets will take longer to transfer to ensure that this is managed in a timely and cost efficient manner. To transfer the assets to the pool, the current arrangements with fund managers will have to be terminated by the Pension Fund Committee.
- 35 It is forecast that by 2030, as a result of the pooling of assets, reduced costs across the fund of between £2.1m and £4.2m per annum will be generated for the benefit of the Surrey Pension Fund.
- 36 The Local Government Pension Scheme is a defined benefits scheme. This means that the pension payable to a member of the scheme is based on the total service of the member up to 31 March 2014 and final salary at date of leaving and then, from 1 April 2014, the career average revalued earnings whilst in the scheme. Changes to the Pension Fund investment process from the pooling of assets will have no impact on the pension received by existing pensioners, current employees or former employees who are yet to draw their pension.

### **Equalities implications**

- 37 The creation of a joint committee will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

### **Risk management implications**

- 38 There are various risks to be considered which are outlined below.

- 39 Funds choosing to withdraw from BCCP: In the event, that funds choose to withdraw from the pool, it is intended that the legal documentation will contain provisions that twelve months' notice will be required and the withdrawing fund will be required to be responsible for all associated costs. The current commitment to BCCP is considered to be strong with regard to all twelve administering authorities.
- 40 Project resource capacity will not be at the required scale: An internal project resource is currently in place with officers and members aligned to the various work streams and external resource tendering is currently being undertaken. The project is being managed by a qualified project manager with monitoring and adherence to deadlines being managed.
- 41 Procurement delays: Early activity is ongoing to procure legal advisory services by a tender process. Specifications for operator and tax/accounting services have been commenced. The internal project team has experienced staff in place.
- 42 Delay or rejection of FCA authorisation application: BCCP will be using experienced specialist advisors to advise on the entire FCA application process.
- 43 Delay in recruitment with key positions not filled: The internal sub-group leads are now filled with existing BCCP officers. Junior roles within the operator can be filled on an interim basis if necessary. A fall-back position would be to recruit locums, but on the understanding that this would increase costs. Recruitment of executive/senior position is one of the initial project tasks.
- 44 Company premises and ICT not established in timelines: The project plans contain detailed provisions to deliver the required infrastructure within the required timeframe.
- 45 Savings are not delivered: Detailed work on the investment structure has been completed to ensure that the project has a clear focus on the achievement of the required savings. Effective monitoring and performance measures are due to be developed as part of the project plan. An effective delivery team and comprehensive programme management are in place.
- 46 Unexpected costs: Project officers are primed to ensure that value for money is achieved from every third party contract. Contingency has been created within the budget for unexpected costs arising from the project implementation.

### **Consultation**

- 47 The Pension Fund Committee Chairman has given her support to the recommendations contained in this report.

### **Section 151 Officer Commentary**

- 48 The Section 151 Officer (Director of Finance) is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the paper's recommendations for the creation of a Joint Committee and Shareholder Board will place the management of the

Surrey Pension Fund's assets in a good position to meet current regulations and ensure robust governance of the investment function of the pension fund.

### **Monitoring Officer Commentary**

- 49 As a non-executive function, the power to make decisions affecting the governance arrangements of the Surrey Pension Fund rests with full council. The Pension Fund Committee is being asked to consider and offer its support to the recommendations to be put to the full council for determination.
- 50 Specialist external legal advisors, Squire Patton Boggs, have been appointed to advise the 13 funds on the contractual and governance arrangements being put in place. It is anticipated that their final advice concerning the legal implications and draft documents will be available prior to the full council meeting.

### **Summary**

- 51 The Surrey Pension Fund is mandated to the national pooling of its assets. It is considered that this will commence from 1 April 2018.
- 52 The Surrey Pension Fund is mandated to formally pool its assets into a national pooling solution and the Border to Coast Pensions Pool represents the most optimum opportunity to achieve this objective.
- 53 In order to create a Joint Committee to manage BCPP, the Council's constitution will need to be amended to ensure that the Council is appropriately represented on the Joint Committee of the BCPP in order to represent the Surrey Fund's views.
- 54 The pooling of Local Government Pension Fund assets will have no impact on the pension entitlement of members of the fund (current employees, previous employees who are yet to draw their pension or pensioners).

### **WHAT HAPPENS NEXT:**

- 55 The following next steps are planned:
- Approval by full council.
  - Progress monitoring will take place and, if necessary, matters will be discussed at future Committee meetings.
  - Implementation of the project with a deadline of 1 April 2018.

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**Contact Officer:**

Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

**Consulted:**

Pension Fund Committee Chairman

**Annexes:**

Annex 1: Articles of Association to be adopted by BCPP Ltd

Annex 2: Shareholder Agreement

Annex 3: Inter Authority Agreement, which includes the Terms of Reference for the BCPP Joint Committee

**Sources/background papers:**

Final submission to Government from BCPP dated 15 July 2016

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