



OFFICER REPORT TO COUNCIL

SURREY PENSION FUND LOCAL GOVERNMENT PENSION SCHEME ASSET POOLING

KEY ISSUE/DECISION:

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 (BCCP) 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.

BACKGROUND:

Introduction

- 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 March 2015 totaling £35.9 billion.
- 3 It is proposed that Surrey County Council will take a 1/12th 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.¹

¹ 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

- 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

- 5 Following three years of consultation, in October 2015, the former 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).
- 6 The BCCP 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.

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

BCCP Partners:	Fund Value at 31 March 2015 (£bn)
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
BCCP TOTAL	35.9

- 7 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 BCCP. The Minister's confirmation letter is attached at Annex 1.
- 8 BCCP 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.

- 9 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. A summary of the BCPP Pool Governance prepared by law firm Eversheds is attached at Annex 2.
- 10 The Pension Fund Committee at its meeting on 10 February 2017 received and endorsed an earlier draft of this report for presentation to full council. Committee members discussed at that meeting as to why Surrey was not entering a local regional pool, with officers explaining that the Fund had engaged with similarly governed, like-minded funds within the Border to Coast Pool. The Government's vision and ambition with regard to the future direction of the LGPS investment process had been set out very clearly and the Border to Coast project has fully grasped the pooling concept.

Creation of the BCCP Company

- 11 It is anticipated that 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 participant Pension Funds.
- 12 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.
- 13 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 Teckal² company, operating a fully regulated structure under the Financial Conduct Authority (FCA). 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.

Shareholder Board and Shareholder Agreement

² Teckal company: where the local authorities control all of the shares in the company and exercise effective control over its affairs, the same as the relationship between an authority and one of its internal directorates

- 14 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. 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.
- 15 The Shareholder Agreement (shown as Annex 3) identifies shareholder reserved matters which can only be decided with the approval of either all of the shareholders (unanimous reserved matters) or a majority of nine of the 12 shareholders (shareholder majority reserved matters). This means that different priorities from simple to majority to unanimity can be attached to different types of decision. The reserved matters are listed in Schedule 1 of the Shareholder Agreement and include:
- 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.
- 16 Other key provisions of the Shareholders Agreement are:
- the Agreement will be governed by a number of shared objectives that are described in Schedule 2 of the Shareholder Agreement. These include that the Administering Authorities will pool their assets through BCPP Ltd to meet the Administering Authorities' pooling obligations;
 - any Administering Authority may withdraw on giving not less than 12 months' notice to expire on 31 March in any year. On withdrawal, the exiting shareholder must pay outstanding sums owed to the company;
 - on withdrawal (i.e., full withdrawal from the Pool and not withdrawal of part funds under management), the company will buy back the shares

of an exiting shareholder (subject to having the necessary capital) and the remaining shareholders will be required to adjust the regulatory capital caused by the withdrawal;

- profits of BCPP Ltd lawfully available for distribution (after prudent consideration of the amounts required to be retained by the company) will first be used to reduce the Operating Fee and then will be available for distribution to the shareholders unless the shareholders agree otherwise – further details are currently being worked on.
- shareholders will use best endeavours to resolve disputes between themselves. If not resolved, they will be escalated with provision, ultimately, for binding arbitration;
- if a shareholder is in material breach of the Shareholders Agreement and the breach is not remedied, the shareholder in breach is required to sell its A share back to the company and the B shares will be bought by the company (subject to having the necessary capital)
- the Shareholders Agreement may be terminated if all shareholders agree in writing, the company is wound up, such number of shareholders withdraw that the remaining shareholders inform BCPP Ltd that they are unable or unwilling to maintain the company's regulatory capital requirements, or the Board determine that the business of BCPP Ltd can no longer be carried on lawfully;
- the company will provide information to the shareholders including quarterly financial and performance reports, annual accounts and an annual report of progress against the Strategic Plan.

17 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 Board meetings.

Articles of Association

18 The exercise of shareholder rights will be governed by the constitution of the company and private company law. In addition to the Shareholder Agreement, the other main document governing the constitution of BCPP Limited will be the Articles of Association (shown as Annex 4). It is proposed that the Board of Directors will comprise of three Executive Directors and three Non-Executive Directors, one of which will be the Chairman. Each of these directors are required to be noted on the Financial Conduct Authority (FCA) application with some required to be designated with approved person status.

19 Subject to approval from the respective Administering Authorities, BCPP

Limited will be owned by the 12 local authorities as Administering Authorities within the investment pool. Each authority will have one Class A voting share with equal voting rights. It should be noted that South Yorkshire Passenger Transport Pension Fund will have no shareholding or voting rights in the new company. Currently operational control is delegated to South Yorkshire Pension Fund. In additional Class B shares will form the regulatory capital of the company. No shareholder may transfer its shares (Class A or Class B) to any other person, except back to the company as part of a redemption of shares (for example, on a withdrawal from the company by that shareholder).

- 20 The statutory duties and responsibilities of a shareholder mean that each partner fund has protection as it will have limited liability (subject to regulatory capital requirements). The shareholder representative will be exercising the Council's rights in accordance with instructions rather than have any delegated authority. Appropriate support will be provided to ensure any matters of process, governance or conflict are appropriately addressed.

Management of the Company

- 21 BCPP (Asset Management Company) will be required to operate under local authority Regulations, the Financial Services Act (FCA compliance) and the Corporate Governance Code. 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 (AIFM) to run and operate one or more collective investment vehicles (CIV), 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.
- 22 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 three executive directors. Directors are appointed (and can be removed) by the authorities as members of the Shareholder Board.
- 23 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.

Joint Committee

- 24 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 BCPP 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.

- 25 The focus of the Joint Committee will be on ‘investor’ issues of the Partner Funds (as distinct from shareholder issues). Investor rights relate to the investment in BCPP Ltd as governed by legal documents for each investment e.g. constitutive deed, application form, key investor information, prospectus and FCA handbook of rules and guidance. Investor rights cover such matters as the right to withdraw from the investments, investor reporting (including frequency and content) and investor voting rights.
- 26 The Joint Committee will formally be established by all of the Partner Funds signing the Inter Authority Agreement, shown as Annex 5. This Agreement sets out the role, Terms of Reference and Constitution of the Joint Committee. It also establishes an Officer Operations Group drawn from officers of administering authorities of the Pool to support the working of the Joint Committee with technical advice, as well as a secretariat to provide administrative support.
- 27 The Inter Authority Agreement also provides for one of the partner funds to act as host authority. In particular, the Authority that acts as host authority will be responsible for entering into contracts on behalf of the Joint Committee. This is necessary because the Joint Committee has no separate legal identity. In recognition of the fact that the host authority will take on liabilities and risk on behalf of all the partner funds, the Inter Authority Agreement contains indemnity clauses so that this liability and risk is shared. There is no expectation that the Joint Committee will enter into contracts to any significant extent but it may, for example, need to commission specialist advice on occasions.
- 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 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.”*

Completion of Contracts and Governance Documentation

- 30 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. 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

- 31 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.
- 32 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.
- 33 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.
- 34 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

- 35 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

- 36 There are various risks to be considered which are outlined below:
- 37 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.
- 38 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.
- 39 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.

- 40 Delay or rejection of FCA authorisation application: BCPP will be using experienced specialist advisors to advise on the entire FCA application process.
- 41 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.
- 42 Company premises and ICT not established in timelines: The project plans contain detailed provisions to deliver the required infrastructure within the required timeframe.
- 43 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.
- 44 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

- 45 The Pension Fund Committee has given its support to the recommendations contained in this report.

Section 151 Officer Commentary

- 46 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

- 47 As a non-executive function, the power to make decisions affecting the governance arrangements of the Surrey Pension Fund rests with full council.
- 48 The work to develop the BCPP pooling proposal has been supported by two sets of external lawyers. Eversheds has been appointed to advise the to-be-constituted company BCPP Ltd and to support with its set up. Squire Patton Boggs has been appointed to advise the 13 funds on the contractual and governance arrangements being put in place.
- 49 In their advice to the funds, Squire Patton Boggs conclude:

“Based on the draft documentation which we have seen, we are satisfied that the proposal to participate in the BCPP Pool and to subscribe for shares in BCPP Limited is in compliance with the statutory obligations which fall upon

the Authorities, and there are no obstacles to the structure which has been proposed.”

- 50 The full advice from Squire Patton Boggs, including their assessment of the Council’s powers to enter into the proposed arrangements, is attached to this report at Annex 6.
- 51 Various amendments to the Council’s constitution will be required to reflect the extended supervisory remit of the Pension Fund Committee, the creation of the BCPP Ltd’s Shareholder Board and the BCPP Joint Committee.
- 52 Full council should note that while withdrawal from the BCPP is possible, subject to any significant change in Government policy, if it did so the Surrey Pension Fund would be required to find an alternative pool in which to participate. The costs associated with any unilateral withdrawal could also be prohibitive.

Summary

- 53 The Surrey Pension Fund is mandated to participate in the national pooling of LGPS assets. This requirement will commence from 1 April 2018.
- 54 The Surrey Pension Fund considers the Border to Coast Pensions Pool represents the most optimum opportunity to achieve this objective.
- 55 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 Pension Fund’s views.
- 56 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).

RECOMMENDATIONS:

It is recommended that Council:

1. Approve 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 Class A share in 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."

REASONS FOR RECOMMENDATIONS:

1. To comply with legislation.
2. To conform with best local authority pensions practice.

WHAT HAPPENS NEXT:

1. Implementation of the recommendation with a deadline of 1 April 2018 for the new framework to be in place and the newly formed Joint Committee in place by 1 April 2017.
2. Progress monitoring will take place and, if necessary, matters will be discussed at future Pension Fund Committee meetings.
3. The draft documents will be finalised and entered into by the 13 administering authorities, enabling the creation of BCPP Ltd and progress with its FCA registration.

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Annexes:

Annex 1: Ministerial Letter
Annex 2: Eversheds' BCCP Pool Governance Summary
Annex 3: Articles of Association to be adopted by BCPP Ltd
Annex 4: Shareholder Agreement
Annex 5: Inter Authority Agreement, which includes the Terms of Reference for the BCPP Joint Committee
Annex 6: Squire Patton Boggs legal advice

Sources/background papers:

Border to Coast Pensions Partnership Submission to Government (dated 15 July 2016)

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