



BCPP Member Steering Group

Date of Meeting: 6th June 2017

Report Title: Development of Target Operating Model and Asset Template Progress

Report Sponsor: Operating Model Sub Group Lead – Mark Lyon

1.0 Executive Summary:

- 1.1 This report provides an update on the work that has been undertaken within the Operating Model Workstream since the last meeting on 24th March 2017.
 - 1.2 All advisors for the workstream are now in place.
 - 1.3 A project scoping day has been held with all the Workstream leads from the BCPP Project Team and all of the advisors to develop the high level project plan. Further meetings have been held with AlphaFMC, the lead advisor on this workstream, to develop the planning phase further.
 - 1.4 The proposed asset allocation template has been revised following feedback from the funds' investment consultants and advisors and further discussions within the Officer Operations Group. A further Officer Operations Group meeting will be held in June with the aim of resolving the outstanding issues on the more complex investment sub-funds so that the template can be incorporated into the design of the Operating Model and structuring of the investment sub-funds. While the full details of each sub-fund prospectus will not be required until late 2017, the sub-fund framework is required to be formulated in outline now to enable a successful tender process for the asset servicing requirements to be conducted.
 - 1.5 There have been positive developments with regards to the implication of MiFID II on administering authorities which should simplify the opt-up process and enable LGPS funds to continue to access the widest range of possible investments.
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2.0 Recommendation:

- 2.1 Members note progress to date and support the outlined plan to progress the work on the Operating Model Workstream including the design and implementation of the operating model and the procurement of suitable service providers for the next period.
- 2.2 Members approve the changes to the asset allocation template and support the plan to progress the work on the asset allocation template (notably the Multi-Asset Credit and Property asset classes) and associated transition planning for the next period with the Officer operations group, advisors and the sub-group.
- 2.3 Members approve that “legacy” investments (i.e. investments where it is not possible or cost effective to transfer into BCPP) will continue to be managed at the individual Fund level. This decision will be reviewed post-full implementation.
- 2.4 Members note the progress and support the continued liaison with the FCA and the Investment Association in order to ensure that the opt-up process for administering authorities is relatively straightforward.

3.0 Background:

- 3.1 The key areas of scope within this Workstream are summarised in the table below:

Core Activity	Description	Status	Lead Officer
Tax and Financial Services tender	Tender for external consultancy services covering the tax and financial considerations relating to the Operating Model and asset structuring	Completed	Mark Lyon/ Jo Ray
Operating and Regulatory Model tender	Tender for external consultancy services covering the selection of the depositary, FCA compliance, and ICT design and implementation	Completed	Mark Lyon/ Jo Ray
Operating Model	FCA approval process, selection of depositary and associated service providers, and design, testing and implementation of ICT (in conjunction with external adviser(s))	Ongoing to plan	Mark Lyon/ Jo Ray
Asset allocation template	Design of the asset allocation template detailing the sub-funds to be offered – to be	Ongoing to plan	Mark Lyon/ Jo Ray

	approved by the Joint Committee		
Sub-fund prospectuses	Drafting of the prospectus for each sub-fund – to be approved by the Joint Committee and reviewed/approved by the FCA	Plan to commence next period	Mark Lyon/ Jo Ray
Transition planning	Timetable for transition of assets and selection of appropriate external transition managers	Plan to commence next period	Mark Lyon/ Jo Ray
Resource planning	Determining the appropriate level of resources to manage the proposed sub-funds – this will link into the People work stream	Plan to commence next period	Mark Lyon/ Jo Ray

External advisors

3.2 All external advisors for the workstream are now in place:

- Legal (Eversheds Sutherland);
- Tax and Financial Services (Deloitte); and
- Operating and Regulatory Model (AlphaFMC)

Planning Phase

3.3 An initial two day project planning meeting was held on the 5th and 6th April 2017 with the BCPP Project Team and the three advisors in order to review the high level project plan for the workstream including ownership of tasks, responsibilities, interdependencies, both within the workstream and to the wider project, and project delivery timescales. AlphaFMC will be the lead advisor with Eversheds and Deloitte contributing where necessary. Further meetings have been held with AlphaFMC to progress the planning phase further.

3.4 The operating model design determines the overall structure of the entity and how it operate once established including which activities are performed internally and which are performed through outsourced service providers. The design of the operating model has been split into six sections:

- **Business Strategy and Design Principles.** These are the overriding principles that will guide the design and implementation of the business model.

- **Business and Entity Model.** This includes the corporate entity, the level and type of interaction between the entity and the funds, the products and services that the business will provide e.g. types of investment, the legal structure of investments and how they will be recorded, and the regulatory requirements.
- **Governance and Organisation Model.** This defines the governance model and terms of reference of the key committees that will manage and control the business; defines the key functions, management and reporting lines for the business; defines the key roles and responsibilities in the senior management team; and outlines the policy documents that will be required e.g. regulatory policy requirements and risk framework.
- **Functional Model.** This defines the key roles and responsibilities of each function within the business model including internal and outsourced functions; the capabilities required to deliver the business model including personnel, process and procedures, technology, and controls and reporting; and the entity's approach to outsourcing.
- **Technology and Data Model.** This defines the key components of the technology and data requirements required.
- **Infrastructure Model.** This includes technology hardware, office locations and physical resources required to support the business.

3.5 The core principle being applied throughout the design and build of the target operating model, (which will be used to inform the asset servicing tender due to be published at the end June) is that a standardised approach and therefore service offering to the future Partner Funds (i.e. clients of BCPP Ltd) will be applied. This approach is predominantly to ensure that BCPP Ltd can operate on the lowest cost base going forward but also to ensure it can maximise the benefits of scale where applicable.

3.6 Standardised ICT build and future operating processes drive efficiencies and maximise potential influence when applied at scale, but they can only be implemented effectively when the partners have similar beliefs and requirements.

3.7 Currently there are two main areas where design decisions fall within this context e.g. that as the owner of the shares BCPP Ltd the company will undertake stock lending across appropriate investments held and that shareholder voting will be undertaken by BCPP Ltd across all assets to a single policy, to be agreed in advance of trading and thereafter reviewed and approved annually by the Joint Committee.

- 3.8 Stock lending permissions will form part of each sub-fund prospectus for which the individual Funds will have input into their design, and will sign up to when they agree to transfer assets.
- 3.9 With shareholder voting - the aim here is to implement the agreed principles as submitted in the July proposal of maximising influence through collaborate voting at scale, while delivering efficiencies by limiting the use of the need for all Funds to have advisory service providers but while also retaining Fund discretion in exception circumstances *“There may be occasion when an individual fund wishes to exercise its right to vote contrary to an agreed policy, and where possible a mechanism will be put in place to facilitate this.”* use a collaborate voting policy and thereby maximise the benefits and influence that can be exercised through voting shareholdings at scale. This is similar to the approach adopted by all Partner Funds through their membership of LAPFF, which BCPP Ltd will continue to work alongside.
- 3.10 To ensure BCPP operates in accordance with the wishes of the Partner Funds in this area the BCPP Ltd voting policy will be agreed in advance of trading and reviewed annually by the Joint Committee. Due to the significance of this piece of work Jane Firth from SYPF is to join the project team to ensure both the BCPP Ltd collaborate RI / Shareholder Voting policy takes into account the views of all the Partner Funds and that the subsequent design and procurement of the asset servicing piece reflects those requirements.
- 3.11 There may be exceptional circumstances where a Partner Fund may wish to have its proportionate holding of shares voted outside the terms of the collaboratively agreed policy. To accommodate these exceptional circumstances rather than build an unnecessarily bureaucratic and expensive asset servicing solutions it is intended that a manual process will be offered by BCPP Ltd to the Partner Funds. To ensure this process can operate reasonable notice of the Partner Funds requirement will be needed to enable the BCPP through its custodian to split the vote as required. The administrative costs of this will be charged directly to the Partner Fund requiring it.
- 3.12 The focus to date has been on populating the above sections with information that is already available through work undertaken to date from various sources and determining additional information requirements.
- 3.13 The Project Team and AlphaFMC are holding weekly meetings or conference calls to progress the design phase. It is intended that this phase will be completed by the end of June 2017, and the project is broadly in line with the expected timescale.
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- 3.14 The implementation phase will then commence which will include tendering for the key service providers, such as the depositary and the specialist ICT software, and the FCA authorisation application.
- 3.15 A key decision required to be made now is that “legacy” investments (i.e. investments where it is not possible or cost effective to transfer into BCPP) will continue to be managed at the individual Fund level. The option for BCPP to manage these assets on behalf of the underlying funds in an advisory capacity was considered. However, advice from AlphaFMC and Eversheds is that the FCA would consider managing investments on behalf of external clients at the same time as setting up an ACS and other collective investment vehicles as a relatively high risk business model and would not be favourably supported by the FCA in any application process.

Asset Allocation template

- 3.16 The asset allocation template has been amended to reflect the issues that were raised by the Funds’ investment consultants and advisors meetings and further discussions within the Officer Operations Group. The changes that have been made relate to the following areas:
- **Multi-Asset Credit (MAC).** A second sub-fund has been added in order to offer a sub-fund that will consist of external MAC funds as well as an internally managed sub-fund which would invest in a diversified range of credit investments.
 - **Property.** The sub-fund for UK property has been sub-divided into Direct and Indirect sub-funds. The rationale for this is that there is currently c. £1.5bn of direct property holdings across four funds. Although these could be treated as legacy investments and remain with the underlying funds there are potential economies of scale to be gained if they are transferred, particularly as, depending on the legal structure of the sub-fund, stamp duty (currently 5%) would not be payable on any properties transferred as initial “fund ceding assets”. Ceding assets are subject to tax rules on initial holding periods etc. but these conditions are not considered onerous or contrary to what BCPP would want to do from an investment perspective.
- 3.17 Some issues remain with the proposed sub-funds for MAC and Property. As a result, a further Officer Operations Group meeting is planned for 20th June 2017 to resolve these outstanding issues. It is important that the template is finalised relatively quickly as it feeds into the design of the Operating Model, associated sub-fund structuring and forms a major driver in the information required to run the asset servicing procurement. For example, in order to benefit from the stamp duty exemption for direct property the investments would have to be held within the Authorised Contractual Scheme (ACS). If the current direct investments were not transferred into BCPP other legal structures are considered to be more
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suitable but the benefits of investing in direct property at scale would potentially be lost.

- 3.18 Once the asset allocation template has been finalised further work can be performed on transition planning.
- 3.19 The asset allocation template, shown at Appendix 1, has been updated to reflect asset values as at 31st March 2017. The combined value of assets of the funds within BCPP has increased from £35.9bn (at 31st March 2015) to £43.3bn.

Update on MiFID II

- 3.20 The LGPS MiFID II working group has been liaising with the FCA, LGA, and Investment Association (IA) regarding the criteria for local authorities to opt-up from retail client status to elective professional status.
- 3.21 Points to note since the last update are:

- The FCA board meeting on 25th May 2017 will consider a new policy statement with regards to MiFID II. This is expected to include a fourth criterion in the quantitative test which will be satisfied if the entity is an administering authority of an LGPS fund. As investors have to satisfy two of the four criteria, an administering authority only needs to meet the minimum size criteria (minimum assets of £15m) to pass the quantitative test. It has previously been felt that a large proportion of administering authorities may not be able to meet either of the other two criteria (number of transactions per quarter and financial experience).

It is also expected that the FCA will clarify that the qualitative test will continue to reference the individual but will make clear that this can include legal entities as well as natural persons and that the collective decision making structure of the client can be taken into account.

- The IA is in the process of drafting a template questionnaire which will then be shared with the LGPS and the LGA for comments. This is to ensure that administering authorities only have to provide a standard suite of documents to each investment manager rather than having to tailor it for each manager. The initial template is expected to be issued by the end of May 2017 with a final version targeted by the end of June 2017. Once the final questionnaire has been approved the IA are happy for this to be shared with investment managers who are not currently members of the IA.
 - Discussions with asset managers leading on this work with the IA have indicated that this will require an assessment of the investment capabilities of the “decision makers” even where they are a collective e.g. a Committee. While this will make opting up easier than initially
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anticipated there will still be a process and information requirement from the Administering Authorities. Asset managers representing the IA on this indicated that to make an assessment they may still require evidence of the experience and capacity of the individuals of the collective, possibly supported by training policies, professional advice, etc. of those party to the collective decision making process.

- It is expected that investment managers will periodically review the information provided by the administering authorities to satisfy the opt-up criteria, probably on an annual basis.

3.22 Following the above developments it is anticipated that the opt-up process for the LGPS funds will be much simpler than originally feared. A verbal update will be provided at the meeting to highlight any further developments.

4.0 Next Steps:

4.1 Further regular meetings will be held with AlphaFMC, and the other advisors where necessary, to progress the design phase of the Operating Model.

4.2 The outstanding issues regarding the asset allocation template will be resolved so that it can feed into the Operating Model design and sub-fund structuring.

4.3 Representatives from BCPP will continue to liaise with the FCA and the Investment Association with regards to the criteria and supporting documentation required to complete the opt-up process in relation to MiFID II.

5.0 Conclusion:

5.1 The design phase of the Operating Model is progressing according to the high level project plan with all milestone activities on track for the agreed overall project implementation date of June 2018.

5.2 Further work is required in order to finalise the asset allocation template which can then be reflected in the design of the Operating Model and associated sub-fund structuring.

5.3 Major risks to the delivery of this workstream at present are:-

- Not reaching agreement on the asset allocation template in a timely manner which could impact the timescales for sub-fund structuring; and
 - Not receiving data or information from underlying funds, at a time when resources are being directed to annual accounts closedown and reporting,
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in order to assist with the tender specifications for outsourced service providers.

- 5.4 An acceptable solution to the MiFID II issue appears to have been found and representatives from BCPP will continue to work with the FCA and the Investment Association to finalise the documentation required to satisfy the opt-up criteria.
- 5.5 Further work will be performed on transition planning and this will link into the further development of the asset allocation template.

6.0 Report Author:

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7.0 Further Information and Background Documents:

Appendix 1: BCPP proposed asset allocation template



BCPP Proposed Asset Allocation Template

FUND NAME					
BORDER TO COAST PENSION PARTNERSHIP		43,310,470	100.0%		
BCPP	INTERNAL		EXTERNAL		
ASSET ALLOCATION TEMPLATE	ACTIVE	ACTIVE - MODERATE RISK	ACTIVE - HIGHER RISK	PASSIVE	
<u>EQUITIES</u>					Deemed to be held outside of the formal pool due to current legal structure
UK - FTSE 100	1,027,939				
UK - FTSE 250	342,646	312,784		62,040	
UK - FTSE ALL SHARE	2,738,663	773,506	1,320,983	2,263,830	
EUROPE EX-UK	1,397,883	475,690		328,862	
NORTH AMERICA	1,621,838	343,718		590,271	
JAPAN	528,344	354,528		168,881	
PACIFIC EX-JAPAN	1,333,019	258,671		198,861	
EMERGING MARKETS	480,127	315,158		362,711	
GLOBAL		2,983,574	1,372,978	1,569,448	
GLOBAL - NON-MARKET CAP/FACTOR INVESTING		1,158,207		1,605,746	
<u>FIXED INCOME</u>					
UK GOVERNMENT	140,201	428,180		131,781	
UK INDEX-LINKED	898,495			1,238,966	
UK CORPORATE	199,712	1,237,968	522,000	377,110	
OVERSEAS GOVERNMENT	148,390			-	
MULTI-ASSET CREDIT	548,592	1,804,931			
EMERGING MARKETS				47,352	
<u>ALTERNATIVES</u>					
PROPERTY - UK DIRECT	1,319,274				
PROPERTY - UK INDIRECT	1,693,204				
PROPERTY - GLOBAL	677,466				
PRIVATE EQUITY	1,534,207				
INFRASTRUCTURE	692,372				
DIVERSIFIED GROWTH FUNDS		1,599,547			
OTHER ALTERNATIVES	603,200				
CASH	1,176,617				
TOTAL	43,310,470				

One sub-fund offered - risk profile to be determined

Deemed to be held outside of the formal pool due to current legal structure

One sub-fund offered for each region - risk profile to be determined

One sub-fund offered for factor investing

One sub-fund offered for UK Govt bonds

Consider two sub-funds - internally managed and externally managed

One sub-fund offered for DGF's