



BCPP Member Steering Group

Date of Meeting: 20th October 2017

Report Title: Update on development of Target Operating Model and transition plan

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 6th June 2017.
- 1.2 The design phase of the Target Operating Model has been completed and the tenders for the two main service providers have been issued with preferred suppliers expected to be identified by the end of 2017.
- 1.3 The FCA application pack is currently being prepared and is expected to be submitted in November 2017.
- 1.4 The asset allocation template has been finalised and is presented for approval by the Joint Committee.
- 1.5 The draft transition plan has been prepared and will be subject to further review during the transition process.
- 1.6 The process for Administration Authorities opting up from retail status to elective professional status under MiFID II has been simplified.

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 implementation of the operating model and the procurement of suitable service providers for the next period.
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2.2 Members approve the asset allocation template (**Appendix 1**).

2.3 Members note the progress on transition planning (**Appendix 2**) and support the continued development of the transition management arrangements.

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
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
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
Asset allocation template	Design of the asset allocation template detailing the sub-funds to be offered – to be approved by the Joint Committee	Ongoing to plan	Mark Lyon
Sub-fund prospectuses	Drafting of the prospectus for each sub-fund – to be approved by the Joint Committee with regulatory approval by the FCA prior to launch	Plan to commence next period	Mark Lyon
Transition planning	Timetable for transition of assets and selection of appropriate external transition managers	Ongoing to plan	Mark Lyon
Resource planning	Determining the appropriate level of resources to manage the proposed sub-funds – this will link into the People work stream	Ongoing to plan	Mark Lyon

External advisors

3.2 The external advisors for the workstream are:

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

Planning Phase

3.3 The design phase of the Target Operating Model was completed in July 2017. The operating model design determines the overall structure of the entity and how it will operate once established. This includes which activities are performed internally and which are performed through outsourced service providers, and the associated budget and resource implications.

3.4 The design of the operating model was 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.
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- **Technology and Data Model.** This defines the key components of the technology and data requirements.
- **Infrastructure Model.** This includes technology hardware, office locations and physical resources required to support the business.

3.5 The core principle applied throughout the design phase was to adopt market-standard practices rather than build a bespoke operating model on the grounds of relative simplicity and cost.

Implementation Phase

3.6 Following the completion of the design phase tenders have been issued for the following:

- Third Party Administrator (TPA) – this is responsible for a wide range of investment administration services including the safekeeping of assets, the processing of tax reclaims and corporate actions, the pricing of the investment sub-funds, and any dealing in the units of the sub-funds.

BCPP is not following a strict OJEU procurement process due to some of the inherent inflexibilities but it is following a Treaty of Rome compliant procurement process which follows the spirit of OJEU but which permits ongoing dialogue with providers throughout the process.

The timeline for the process is as follows:

- Tender documents were issued at the end of August.
 - Pre-qualification assessment was completed by the Project Team at the end of September.
 - Initial dialogue meetings between the Project Team and the six shortlisted providers were held in early October.
 - Project Team will assess the outline solutions from these providers by the end of October.
 - Further dialogue meetings will take place in early November.
 - Final tenders are required to be submitted by mid-November.
 - The Project Team will assess these final tenders and a preferred provider will be identified by the end of November.
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- Following the standstill period, BCPP and the preferred supplier will negotiate and finalise contract documents from January 2018 with the process expected to take up to 3 months.
- Investment ICT platform – this will provide a wide range of investment services including data, analytics, portfolio management and dealing capabilities.

BCPP is following an open OJEU procurement process with the following timeline:

- Tender documents were issued at the end of September.
- Tenders are required to be submitted by the end of October.
- The Project Team will undertake a pre-qualification assessment and then evaluate the tenders of those providers that pass this assessment resulting in a preferred supplier by early November.
- Following the standstill period, BCPP and the preferred supplier will finalise the contract documents by the end of November.

3.7 The FCA authorisation pack is currently being prepared and is expected to be submitted in November. The details of this have been covered in Item 7.

Asset Allocation template

3.8 Following further discussions within the Officer Operations Group the asset allocation template (**Appendix 1**) has been finalised and is being presented to the Joint Committee for approval.

3.9 It is important to note that the figures in the template reflect the current asset allocation requirements of the pension funds and only serves as a guide to the potential scale of assets in each sub-fund in the future. As a result, some sub-funds may appear sub-scale at present but this does not reflect the potential for an increase in size as asset allocations change over time.

3.10 The changes to the template since the last meeting relate to the Multi-Asset Credit (MAC) sub-funds and are as follows:

- There were originally two Multi-Asset Credit sub-funds – an internally managed sub-fund (which would consist of a diversified range of credit investments in pooled investments, co-investments, and direct investments) and an externally managed sub-fund (which would consist of externally managed MAC funds).
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- The externally managed sub-fund has been retained but the internally managed sub-fund has been split into the following:
 - Private Debt (low risk) – this would invest in private debt investments in the senior (lowest risk) part of the capital structure.
 - Private Debt (higher risk) – this would invest in private debt investments that would be subordinated to the senior debt in the capital structure (e.g. second lien, mezzanine etc.).
 - Multi-asset Credit (low risk) – this would invest in a wide range of private and public debt investments in the senior (lowest risk) part of the capital structure.
 - Multi-asset Credit (higher risk) – this would invest in a wide range of private and public debt investments that would be subordinated to the senior debt in the capital structure.
- This split has been done to accommodate the requirements of those funds that specifically want exposure to private debt investments whilst still offering the flexibility of investing in public debt investments, when appropriate, for those funds that wish to retain that exposure.
- This inevitably leads to some overlap between the sub-funds. This should not result in a significant loss of economies of scale as BCPP can continue to invest in those investments that overlap at scale and allocate the investment across the suitable sub-funds in line with a suitable deal allocation policy. However, it will increase costs overall due to the costs of the additional sub-funds.

Transition Planning

- 3.11 Following the finalisation of the asset allocation template initial work has been performed on transition planning including a draft transition plan (**Appendix 2**).
- 3.12 Due to capacity constraints at the TPA, and within BCPP Limited itself, and the relatively high risks and costs associated with asset transitions it has been decided to use a phased approach to transition assets over a period of 2 – 3 years. An overview of the phases are as follows:
- **First phase (Jul – Sep 2018)** – internal UK equity (3) and UK fixed income (3) sub-funds (c. £5.5bn of assets). This transition is expected to be relatively straightforward as it relates to 3 markets within the UK (UK equities, UK Government, and UK Corporate) and the assets will be transferred in-specie.
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At the same time, the first non-ACS structure for illiquid assets will be launched. This is expected to be a limited partnership structure and will focus on Private Equity. Compared to liquid assets, these are more straightforward as there are no assets transitioning into the sub-fund and it does not require significant input from the TPA.

- **Second phase (Sep – Dec 2018)** – external UK equity (3) sub-funds (c. £2.1bn of assets). Although the original intention was to transfer all of the internally managed assets before transitioning externally managed assets it is now considered appropriate to alternate. This is because the externally managed authorities will be paying an element of BCPP Limited's operating costs from the outset and, therefore, it is equitable that they should receive the benefit of fee savings from economies of scale to counter these costs. This phasing also provides more time to ensure that the internally managed sub-funds are operating effectively.

At the same time, non-ACS structures for UK Indirect Property and Infrastructure will be launched. The Infrastructure sub-fund will follow the same process as the Private Equity sub-fund launched in the first phase. The UK Indirect Property sub-fund may include the transition of investments currently held by all authorities (not just the internally managed authorities). The assets that will be transitioned will depend on the cost and ability to transfer legal title and whether they are permitted by the sub-fund prospectus.

- **Third phase (Jan – Mar 2019)** – internal North American and European equities, and internal Overseas Bonds (c. £2.7bn of assets).

At the same time, the non-ACS structures for Multi-Asset Credit will be launched.

- **Fourth phase (Apr – Jun 2019)** – this phase will focus on the externally managed Global Equities (3) sub-funds (c. £5.6bn of assets). This is expected to be the most complex transition due to the number of external managers currently used, the wide range of markets covered, and the number of administering authorities who will transition assets into these sub-funds. It is also where most of the cost savings from liquid assets will be generated.

At the same time, the non-ACS structures for Private Debt will be launched.

- **Fifth phase (Jul – Sep 2019)** – this phase will focus on the internally managed Japanese, Asia Pacific, and Emerging Markets equities (c. £1.9bn of assets) at which point the transition of internally managed liquid assets will be complete.
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At the same time, the non-ACS structure for Global Property and external Multi-Asset Credit will be launched.

- **Sixth phase (Oct – Dec 2019)** – this phase will focus on the externally managed Fixed Income (3) and Diversified Growth Funds (c. £3.9bn of assets).

At the same time, the non-ACS structure for Other Alternatives will be launched.

- **Seventh phase (Jan – Mar 2020)** – this phase will focus on the externally managed Regional Equity (5) sub-funds (c. £1.7bn of assets). Although BCPP is proposing to launch five sub-funds at the same time it is expected that this will be informed by previous sub-fund launches. If at this point, following an evaluation, the risks of launching five sub-funds are considered too high the sub-fund launches will be split into two phases.

- **Eighth phase (Apr 2020 – Mar 2021)** – the last phase involves the transfer of UK Direct Property and is expected to be a relatively complex transition. A provisional agreement from the four administering authorities who currently hold direct property has been reached whereby they may be willing to transfer their properties into a Direct Property sub-fund within the ACS. A detailed cost benefit analysis will be performed, both by BCPP Limited and the authorities providing the seeding properties, before any final agreement is made to determine whether it is cost effective to transition the properties. The working assumption is that if currently held properties are transitioned into BCPP Limited it will be into the ACS structure due to the availability of stamp duty seeding relief.

In the event that a transition of existing assets is not considered appropriate a non-ACS sub-fund will be launched in a similar manner to the other Alternatives sub-funds.

- 3.13 It is anticipated that BCPP will appoint a transition manager(s) from the National LGPS frameworks once it is available (expected November 2017). The transition plan can then be developed further with a view to it being approved by April 2018.

Update on MiFID II

- 3.14 Following engagement with the LGPS MiFID II working group:

- The FCA has included a fourth criterion in the quantitative test which is satisfied if the entity is an administering authority of an LGPS fund.
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- The FCA has also clarified that whilst the qualitative test will continue to reference the individual the assessment 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 Investment Association (IA) has adopted a standardised assessment template and associated documents.
- Authorities have started to submit the required documents to the relevant investment managers and advisors in order that they can opt-up to “elective professional” status by the deadline of 3rd January 2018.

3.15 Following the above developments it is anticipated that the opt-up process for the LGPS funds will be less onerous than originally feared.

4.0 Next Steps:

4.1 The preferred suppliers for the TPA and Investment ICT platform will be identified by December 2017.

4.2 The FCA application is expected to be submitted in November 2017.

4.3 Following the approval of the asset allocation template the prospectuses for the sub-funds can be drafted.

4.4 The transition plan will be progressed further and a transition manager(s) will be appointed.

5.0 Conclusion:

5.1 The design phase of the Operating Model has been completed and the tenders for the two main service providers have been issued.

5.2 The FCA application is being progressed.

5.3 The asset allocation template has been finalised and a draft transition plan has been developed.

5.4 The MiFID II opt-up process for local authorities has been simplified.

6.0 Report Author:

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7.0 Further Information and Background Documents:

Appendix 1: BCPP proposed asset allocation template

Appendix 2: BCPP draft transition plan



BCPP Proposed Asset Allocation Template

BORDER TO COAST PENSION PARTNERSHIP		43,310,470	100.0%		
BCPP ASSET ALLOCATION TEMPLATE					
	INTERNAL	ACTIVE	ACTIVE - MODERATE RISK	EXTERNAL	PASSIVE
				ACTIVE - HIGHER RISK	
<u>EQUITIES</u>			One sub-fund offered - risk profile to be determined	Deemed to be held outside of the formal pool due to current legal structure	
UK - FTSE 100	856,616				
UK - FTSE 250	285,539		303,674		62,040
UK - FTSE ALL SHARE	2,650,432		845,800	993,711	2,090,519
EUROPE EX-UK	1,234,625		463,682		186,259
NORTH AMERICA	1,224,626		271,356		249,395
JAPAN	440,462		293,518	One sub-fund offered for each region - risk profile to be determined	124,697
PACIFIC EX-JAPAN	1,034,267		169,372		124,697
EMERGING MARKETS	437,826		492,300		233,611
GLOBAL			3,927,081	1,316,735	1,505,240
GLOBAL - NON-MARKET CAP/FACTOR INVESTING			342,450	One sub-fund offered for factor investing	1,554,470
<u>FIXED INCOME</u>					
UK GOVERNMENT	496,324		461,584	One sub-fund offered for UK Govt bonds	139,865
UK INDEX-LINKED	1,068,120				1,156,665
UK CORPORATE	90,452		1,996,322	355,140	395,299
OVERSEAS GOVERNMENT	258,102				
PRIVATE DEBT - LOW RISK	303,568				
PRIVATE DEBT - MODERATE RISK	367,659				
MULTI-ASSET CREDIT - LOW RISK	249,837				
MULTI-ASSET CREDIT - MODERATE RISK	918,938				
MULTI-ASSET CREDIT			1,076,495		
EMERGING MARKETS					63,136
<u>ALTERNATIVES</u>					
PROPERTY - UK DIRECT	1,452,216				
PROPERTY - UK INDIRECT	2,044,629				
PROPERTY - GLOBAL	692,235				
PRIVATE EQUITY	1,989,750				
INFRASTRUCTURE	1,264,666				
DIVERSIFIED GROWTH FUNDS			1,658,604	One sub-fund offered for DGF's	
OTHER ALTERNATIVES	636,724				
CASH	459,141				
TOTAL	43,310,470				

