



BCPP Joint Committee

Date of Meeting: 16th January 2018

Report Title: Cost Sharing Principles

Report Sponsor: Ian Bainbridge, Chair Officer Operations Group

1.0 Recommendation

1.1 Members approve the cost sharing principles and the high level approach to transition costs, described in the appended report entitled “Cost Sharing Principles”.

2.0 Background

2.1 The overriding principle set out in the BCPP submissions to Government in February 2016 and July 2016 was that costs should be shared on a fair and equitable basis.

2.2 This needs to take account of the fact that each administering authority has an equal vote on all control and governance matters whilst investment costs are primarily driven by the assets being managed by BCPP and the complexity and nature of each asset class.

2.3 The first point to note is that all set up costs of establishing BCPP are being split between each administering authority on an equal one twelfth basis.

2.4 At the Joint Committee meeting on 6th June 2017 a report was presented on the cost sharing principles to be adopted going forward. At this meeting an approach was proposed whereby:

- All governance related costs of operating a financial services company with the agreed FCA permissions should be split on an equal one twelfth basis. This a continuation of the principle adopted for the set up costs.
 - All other costs and any associated income should be allocated to the individual sub funds in which the assets are held and therefore, netted off the investment return as an expense. There will be full reporting of these costs and expenses.
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- 2.5 It was further noted that transition costs would either be shared between Funds transferring assets into a sub-fund at the initial inception or would be borne in full by a Fund transferring assets alone at a later date.
- 2.6 It was always understood that further work will be required to analyse the range of operational costs to be incurred by the company, and agree a suitable basis for apportioning them to sub-funds in each case. It was also understood that there will be a need for interim arrangements until the company is fully operational, with costs such as rent for the office premises being due from the date of occupancy rather than increase as the company's assets under management increases. In addition, precise arrangements for sharing transition costs would need to be agreed.

3.0 Proposed Cost Sharing Principles Background

- 3.1 To progress these issues a Cost Sharing Principles paper was discussed at the Officer Operations Group meeting on 27th November 2017. This paper was also circulated to the Section 151 Officers in advance of this meeting so their views could be fed through to their Pensions Officers for this meeting.
- 3.2 All twelve funds attended the meeting. This paper set out the context and proposed methodologies for allocating operational costs. It also described a high level approach to transition costs where further work is required.
- 3.3 A consensus was reached by the Officer Operations Group on these methodologies and the high level approach to transition costs, and the amended paper, appended to this report, was further circulated to the Section 151 Officers for comments. No comments have been received.
- 3.4 The Joint Committee is therefore asked to approve the cost sharing principles and the high level approach to transition costs, described in the appended report.
- 3.5 BCPP will use these principles in setting establishing the cost estimates for each administering authority going forward.

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Further Information and Background Documents:

Previous Paper To Joint Committee on 6th June 2017



Cost Sharing Principles

- 1.1 High level cost sharing principles have been reviewed and agreed by the Joint Committee at the meeting on 6th June 2017. At this time it was recognised that further work was needed to refine these principles and determine how costs are allocated. This is a discussion paper to help progress these principles before this is taken back to the Joint Committee for final agreement.
 - 1.2 The first point to note is that all set up costs of establishing BCPP are being split between each administering authority on an equal one twelfth basis.
 - 1.3 The overriding aim going forward is to establish an equitable costs sharing framework which combines the fact that each administering authority has an equal standing (vote) on all control and governance matters with the need to link most of the costs to the overall asset values of each fund and the complexity of the asset classes in which they invest.
 - 1.4 To achieve this it is believed that the following charging mechanisms should be adopted.
 - All governance related costs of operating a financial services company with the agreed FCA permissions should be split on an equal one twelfth basis. This a continuation of the principle adopted for the set up costs. On a steady state on-going basis this will be charged as an up-front annual fee.
 - All other costs and any associated income should be allocated to the individual sub funds in which the assets are held and therefore, netted off the investment return as an expense. There will be full reporting of these costs and expenses.
 - 1.5 These charging mechanisms are considered entirely appropriate once BCPP and all of the sub funds are up and operational. However, it should be recognised that alternative charging methods will need to be considered in the
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period up to getting the sub funds operational to ensure the company remains cash flow positive.

1.6 Any costs incurred in establishing the sub funds and before they are operational will be invoiced directly to those administering authorities who ultimately will be investing in these sub funds. It will be necessary for the costs incurred in establishing the sub funds to be invoiced prior to the sub fund being available. It is proposed that an estimate of these costs will be made every six months and an invoice raised and payable upfront . At the end of the six month period a further calculation of the actual costs incurred will be undertaken and either a rebate or additional invoice will be raised.

1.7 Set out below is a table which shows each of the broad cost centres for BCPP and the proposed mechanism for allocating those costs to either, governance and therefore charged on a one twelfth basis or a cost related to investment and charged to a sub fund. In a number of cases the cost allocation methodology and charging mechanism is different in the short term to the long term. The long term is once the sub fund is up and operational, therefore the short term period will differ for each sub fund.

Cost Heading	Short Term	Long Term
NEDs	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
CEO/COO ; company secretary plus exec assstant	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
CIO	Governance cost to be split evenly and invoiced at the start of the year.	Assessment of workload across all sub funds.
CRO and Compliance	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
Investment staff	The CIO will estimate their workload for the upcoming period across all sub funds, based on the agreed business plan. The costs will be charged out to the administering authorities based on the notional assets in the sub fund structure and asset allocation provided by each administering authority.	Assessment of workload across all sub funds.
Implementation Consultancy Support	These are set up costs which will still be being incurred. These costs will be split evenly and invoiced directly to administering authorities.	Not applicable.
ICT & Projects team and Finance	The costs will be charged across all administering authorities based on the	The costs will be charged across all administering authorities based on the

staff	notional assets in the sub fund structure and asset allocation provided by each administering authority.	actual assets in the sub fund structure and asset allocation provided by each administering authority.
Legal staff (ex co secretary)	<p>There will be an estimate of workload for the upcoming period across all sub funds, based on the agreed business plan.</p> <p>The costs will be charged out to the administering authorities based on the notional sub fund structure and asset allocation provided by each administering authority.</p>	Assessment of workload across all sub funds.
Company Secretary	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
Client liaison	The costs will be charged across all administering authorities based on the notional assets in the sub fund structure and asset allocation provided by each administering authority.	The costs will be charged across all administering authorities based on the actual assets in the sub fund structure and asset allocation provided by each administering authority.
Operations	<p>There will be an estimate of their workload for the upcoming period across all sub funds, based on the agreed business plan.</p> <p>The costs will be charged out to the administering authorities based on the notional assets in the sub fund structure and asset allocation provided by each administering authority.</p>	Assessment of workload across all sub funds.
All other staffing costs eg, pensions (FSR and past service deficiency), travel costs, training etc	This will follow the allocation of the direct costs for each staff member.	This will follow the allocation of the direct costs for each staff member.
Insurance	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
Marketing and Recruitment	The costs will be charged across all administering authorities based on the notional assets in the sub fund structure and asset allocation provided by each administering authority.	The costs will be charged across all administering authorities based on the actual assets in the sub fund structure and asset allocation provided by each administering authority.
Premises costs	Allocation per the headcount on the proposed staffing structure.	Headcount in place.
Investment Platform – Trading System	Initial assessment of usage by the sub funds.	Allocated directly to sub funds based on usage.
Corporate platform ; web hosting; etc	The headcount on the proposed staffing structure.	Headcount in place.

Procurement portal	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
Subscriptions	The costs will be charged across all administering authorities based on the notional assets in the sub fund structure and asset allocation provided by each administering authority.	The costs will be charged across all administering authorities based on the actual assets in the sub fund structure and asset allocation provided by each administering authority.
External Legal and Professional Support	These are external costs and will be charged on receipt of the invoice to each sub fund or to a governance head depending on the nature of the expenditure incurred.	These are external costs and will be charged on receipt of the invoice to each sub fund or to a governance head depending on the nature of the expenditure incurred.
Investment Costs, including research custodian etc	These costs will be charged directly to the sub funds.	These costs will be charged directly to the sub funds.
FCA Fees	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
Company Board Costs including board pack	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
External Audit - Corporate	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
External Audit - Investments	These costs will be charged directly to the sub funds.	These costs will be charged directly to the sub funds.
Internal Audit – Corporate	Governance cost to be split evenly and invoiced at the start of the year.	Governance cost to be split evenly and invoiced at the start of the year.
Internal Audit - Investments	These costs will be charged directly to the sub funds.	These costs will be charged directly to the sub funds.
External Management Fees	These costs will be charged directly to the sub funds.	These costs will be charged directly to the sub funds.
Stock Lending	This income will be credited direct to the sub funds.	This income will be credited directly to the sub funds.

NB – In the table where costs are to be allocated into sub funds based on either actual assets or notional values from information supplied, this will only apply to assets transferring into the BCPP pool. For the avoidance of doubt this will exclude the passive assets. Where a reference is made to notional assets this means the assets as at 31st March 2017 which the administering authorities have indicated will be invested in the asset allocation sub fund structure.

Transition Costs

2.0 The table above is not intended to cover the costs of transitioning the assets from the individual funds into the sub fund structures. It is recognised that further work on this area needs to take place to ensure that the costs of

transition are clearly identifiable and each administering authority pays its appropriate share.

2.1 The following high level principles have already been agreed.

- **Transition costs on initial inception of a sub fund.**

Day one transition costs will be shared based on the value of each sub funds' assets under management (AUM) transferring into each sub fund (all costs of transitioning in will be allocated out by AUM within each sub fund). This applies to both internally and externally managed sub funds.

This cost sharing will be in the sub fund where the assets are moved into not the asset class where they have come from. This has already been agreed by the administering authorities as the most equitable basis as all will have access to future savings generated from improved fee structures, and therefore it would be unfair to benefit from savings of scale without sharing the costs required to access those savings.

- **Transitions after inception of the sub fund.**

Where an administering authority undertakes a future strategy review or assets reallocation and moves sub funds, the administering authority will bear the full costs of the transition.

2.2 It is assumed that all administering authorities will act in good faith. However, if there is evidence to suggest that an administering authority undertakes not to enter a sub fund at inception to avoid their share of allocation of initial costs, but requests to join at a later date, then, through the Joint Committee, the other administering authorities reserve the right to request that a proportionate "late joiners" fee is applied.

2.3 Due to the sensitivity of this issue and as it is an administering authority issue rather than a BCPP issue, it is deemed appropriate that the Officer Operations Group pull together the required guidance on how this will be monitored. Ultimately there are dispute resolution measures incorporated in the Shareholder Agreement that could be used to make final determinations where consensus cannot be achieved.

2.4 The proposed approach to transitions assumes a sharing of costs to ensure that each administering authority picks up its fair share of the transition costs. This could be classified as cross subsidisation and it has been agreed appropriate legal advice will need to be sought in advance of any transition.
