

## **SOUTH YORKSHIRE LOCAL PENSION BOARD**

**15 MARCH 2018**

### **Report of the Fund Director**

#### **POOLING UPDATE**

1) Purpose of the report

To update members of the Board on progress towards the pooling of the Fund's assets within the Border to Coast pool.

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2) **Recommendation**

**a) That the Board note the progress being made towards BCPP becoming operational.**

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3) Background information and Analysis

3.1 This report provides a public summary of the progress being made in making BCPP operational. Papers being considered confidentially at the BCPP Joint Committee meeting which was held on 13<sup>th</sup> March are contained in a confidential appendix, elsewhere on the agenda.

**Key Areas of Progress**

3.2 Key decisions since the last meeting include the completion of shareholder resolutions, recommended by the Company's Board in relation to:

- The company's pension arrangements which the Authority considered at its last meeting, and
- The appointment of KPMG as the auditor for both the company and its investment structures. As this follows a procurement process it is essentially a routine matter.

3.3 The company continues to build up the team with staff moving into key roles such as Head of Finance and Head of Operations, while also putting in place key infrastructure such as operational bank accounts and accounting systems. As a result of this progress BCPP is now in a position to draw down the cash flow loan from the Authority which was agreed in principle some time ago and which is guaranteed by the shareholders.

3.4 As previously reported the company has secured a permanent office base very close to the main line station. While negotiation of the lease is ongoing design work and the work necessary to ensure the space is fitted out in line with the required timetable is in hand. It is expected that the Company will move in during May and in the meantime staff are operating from a temporary office nearby.

### **Investment Related Progress and Issues**

- 3.5 Other key developments in terms of the Company's investment related activities include:
- The appointment of Northern Trust to provide a range of middle and back office services including, depositary, custodian and transfer agent. Essentially these functions provide the facility for BCPP to undertake transactions within the various fund structures that it is looking to create.
  - The selection of Bloomberg as the key investment operational IT platform.
  - Submission of the application for approval of the company by the FCA. This is a pre-requisite to being able to seek approval for the ACS and its various sub funds.
  - Completing the outline ACS prospectus.
- 3.6 These are all important practical steps towards BCPP being able to "run money" in line with the planned timetable. However, there is a significant amount of work remaining and there are key risks around the processes run by the FCA where delays outside BCPP's control could knock the programme off the critical path. Alongside these key practical steps BCPP have identified seven key pieces of strategic work which need to be undertaken prior to the scheduled June "go live".
- Agreeing the sub funds to be launched, and then completing all the various pieces of paperwork required in order to get them approved (see below).
  - Defining the Border to Coast investment process, which will require significant input from the three funds with existing in house teams, and a number of workshops have been arranged to support this process.
  - Governance for approving asset transitions (see below).
  - The approach to transition management.
  - The process for selecting external managers.
  - Design of reporting and the oversight process for BCPP.
  - The what, how and when of Alternatives capability. This is a particularly important piece of work for South Yorkshire as this is the area where any savings which the fund might accrue from this process are likely to occur.
- 3.7 Individually each of these are significant pieces of work which need to be undertaken alongside building the infrastructure of a new business. This places considerable pressure both on the team within BCPP and on the teams within the individual pension funds. As a result of this the BCPP team have been giving thought to how best to mitigate some of the risk that exists around the process for rolling out sub-funds with a view to reducing both overall workload and costs bearing in mind that the marginal cost of a sub fund is £75-£100k, and that Northern Trust can only launch up to 4 sub funds for BCPP each quarter.
- 3.8 These proposals, which in essence moves internally managed assets into the pool within a simplified series of sub funds more quickly were discussed by the Investment Board at its meeting on 8<sup>th</sup> March. The Board's views will be reported at the meeting. An initial discussion with the Fund's advisers indicated that while there was understanding for BCPP's proposals as a pragmatic approach there were a number of concerns:

- The fact that the reduced number of sub funds could become the final answer almost by default and consequently the need for a written commitment to the eventual launch of the full agreed menu of funds, subject to stakeholders agreeing prior to work on the fund launch commencing that the sub fund is still required.
- The danger that during the transition phase there will be a tendency to “hug” the benchmark and thus effectively generate passive performance at a period of increased costs. In South Yorkshire’s case this would give “less performance for more cost”.
- The difficulty within the arrangements proposed of maintaining the various portfolio tilts for example in the case of South Yorkshire to mid-cap in the UK and towards Asian emerging markets overseas. Arguably these are tactical calls, but equally it can be argued that these are strategic calls about the type of investment that is most likely in the medium to longer term to meet the growth objectives for which the Fund holds equities.

3.9 Fundamentally the issue here is about the fact that BCPP is proposing to move away from a position agreed with all funds of mirroring their initial asset allocation, although they do make the reasonable point that funds will be reviewing their allocations after the 2019 valuation which is during BCPP’s transition phase. This goes to a key debate in the evolution of pooling which has not been resolved, which is how to define strategic asset allocation.

3.10 Having established which assets will transition to which sub funds in what timescales BCPP will be in a position to produce a comprehensive prospectus for the Authorised Contractual Scheme (ACS) the legal fund structure in which the assets will be held. This document has to be approved by the FCA and is highly technical. Consequently BCPP have recommended that the Officer Operations Group rather than the Joint Committee approve the document. The Joint Committee’s view will be reported at the meeting.

3.11 A further aspect of the process of moving assets to the new pooled vehicles which needs to be defined is the due diligence process to be undertaken before each client fund authorises transfer of its assets. It is important for South Yorkshire and the other client funds that this is not a simple process of nodding things through simply because the same people will be running the money in the new world as in the old world, or because a commitment has already been made to BCPP. SYPA will want to be assured that:

- BCPP has investment guidelines for any sub fund in place which reflect the product we have agreed in principle to buy. For example our current equity mandates broadly target a return of benchmark plus 1% so if BCPP were looking to put our assets in a sub fund targeting benchmark plus 2% then that would be a significant change in risk profile. In addition to the pure investment guidelines material will need to be provided which sets out the likely tracking error, portfolio concentration and so on and any limits which BCPP intends to apply to these.
- BCPP has a robust investment process and appropriate means of monitoring adherence to that process.
- BCPP has robust arrangements for the custody of assets, the processing of trades in and out of any sub-fund and remitting any income due to the Fund.

- 3.12 All of this will require detailed review by SYPA. Given conflict of interest rules this work cannot be carried out by the transferring staff and will therefore have to be carried out by staff remaining with SYPA, who may need to call on the Independent Advisers for assistance. BCPP intend through early engagement with the client funds to be able to provide a standard set of information to all clients which reduces the burden of the due diligence process. While it is right that each fund has to carry out their own process having a common basis on which to do this should make this a less burdensome task. Given the timescale for this work and the timing of meetings it is recommended that subject to consultation with the advisers authority be delegated to the Fund Director in consultation with the Chair and Vice Chair to authorise the transfer of assets to the BCPP investment structures when they become operational.

#### **Staffing Matters**

- 3.13 A process of engaging with staff within the three internal investment teams has begun with a workshop designed to identify differences between the investment processes used by each team with a view to arriving at a common process which will meet the requirements of clients. Over the coming months staff within these teams will increasingly be drawn into “new world” activity, for example procurement exercises for service providers, such as a proxy voting service. This is an inevitable part of the process that is being undertaken and it is wholly in SYPA’s interest that members of the current team engage in such activity in order that our views and requirements are properly addressed.
- 3.14 Now the Company has agreed its terms and conditions detailed work on the TUPE process can begin with the exchange of information on current terms and conditions and the design by the Company of “measures” to address any items where there is a mismatch that cannot be accommodated.
- 3.15 Following agreement of the Company’s pension arrangements and the approval of BCPP as eligible for admission to the South Yorkshire Fund by the Secretary of State the Authority will need to complete the guarantees to the Fund in relation to BCPP’s participation and to the Company protecting BCPP’s regulatory capital from any pension deficit.

#### **Non-Executive Directors**

- 3.16 The Joint Committee was asked to agree the appointment of two additional Non-Executive Directors to be elected by the Joint Committee at its next meeting using the exhaustive ballot process. These roles will be remunerated by the Company at £10-15k per annum. Members should note that there are a range of conflict of interest issues which might limit their involvement in some facets of the authority’s business (for example the Investment Board) should they wish to consider putting themselves forward for these roles.

#### **Tax Strategy**

- 3.17 Following approval by the Company’s Board and the Joint Committee the Tax Strategy will be published on the Company’s website. This sets out, as a matter of good governance, BCPP’s overall approach to taxation, which is broadly to pay the right amount, at the right time, in the right place. The strategy does, however, recognise the potential for Corporation Tax in particular to represent a “drag” on the shareholder pension funds and therefore identifies the need to engage with HMRC and government around this unintended consequence of pooling, although as there will be tax losses in the early years of operation this is not immediately urgent.

#### 4) Implications

##### 4.1 Financial

The proposals being made by BCPP could result in a reduction in the costs incurred in setting up the various sub fund structures and the level of costs to be recovered through fees going forward. However, given SYPA's low cost starting point this simply reduces the scale of the cost increase the Authority faces in this area.

At this stage it is anticipated that the set up costs will be within the resources previously agreed by the participating funds.

##### 4.2 Legal

There are no legal implications.

##### 4.3 Diversity

There are no diversity implications.

##### 4.4 Risk

This Board is the formal decision-making body for investment issues relating to the Fund. It has the responsibility to ensure that the Fund maintains an investment strategy that obtains the best financial return, commensurate with appropriate levels of risk, to ensure the Fund can meet both its immediate and long term liabilities.

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**Background papers** used in the preparation of this report are available for inspection at the offices of the Authority in Barnsley

**Other sources and references:** BCPP