

Subject	Accountability Arrangements in the Context of Investment Pooling	Status	For Publication
Report to	Local Pension Board	Date	13 February 2020
Report of	Fund Director		
Equality Impact Assessment	Not Required	Attached	No
Contact Officer	George Graham Fund Director	Phone	01226 772887
E Mail	ggraham@sypa.org.uk		

1 Purpose of the Report

- 1.1 To provide the Board with the opportunity to discuss the operation of accountability arrangements in relation to the pooling of investments within the Border to Coast Pensions Partnership.

2 Recommendations

- 2.1 Members are recommended to:
- a. **Note and comment on the contents of this report.**

3 Link to Corporate Objectives

- 3.1 This report links to the delivery of the following corporate objectives:

Investment Returns

To maintain an investment strategy which delivers the best financial return, commensurate with appropriate levels of risk, to ensure that the Fund can meet both its immediate and long term liabilities.

Effective arrangements for the management of the pooling process contribute to an increased likelihood of delivering the returns required to meet the Fund's liabilities.

Responsible Investment

To develop our investment options within the context of a sustainable and responsible investment strategy.

Responsible investment is central to the Authority's investment beliefs and it is therefore important that any arrangements for oversight and accountability in relation to pooling are equally applicable to this area of activity.

Effective and Transparent Governance

To uphold effective governance showing prudence and propriety at all times.

The Authority has an obligation to ensure that its governance arrangements including the arrangements it has in place in relation to the pooling process are effective and are constructed so as to maximise the likelihood of the desired outcomes.

4 Implications for the Corporate Risk Register

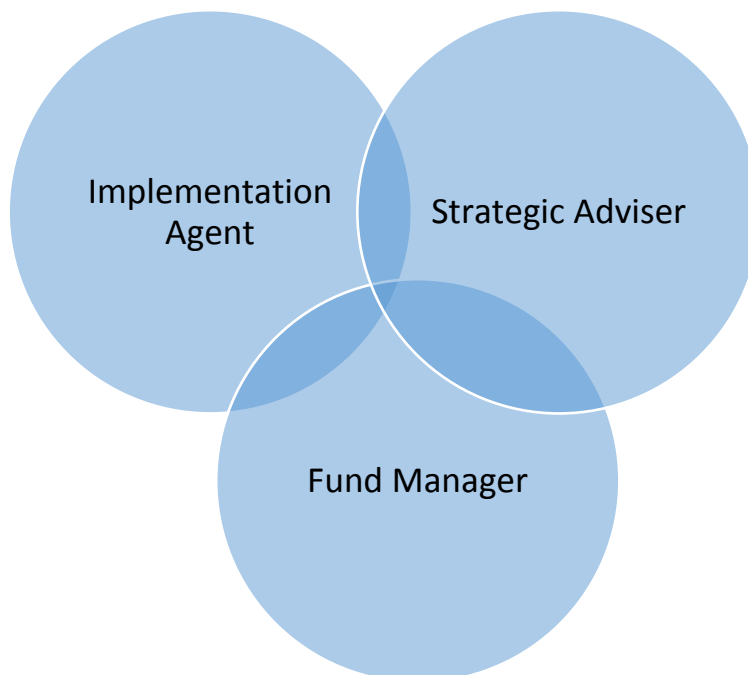
- 4.1 The actions outlined in this report relate to the identified risk of failing to exercise appropriate oversight over Border to Coast. However, as this report is for discussion there are no specific implications in terms of the score attached to that risk.

5 Background and Options

- 5.1 At a recent meeting of the Board officers were asked to produce a report setting out the arrangements for accountability in relation to Border to Coast as the operating company for the LGPS pool in which the Authority participates. Board members expressed a desire for greater clarity and understanding of the arrangements in place, and their role, if any, in those arrangements.
- 5.2 Before going into the detail of the arrangements in place and the specific roles of the different actors within those arrangements it is perhaps best to put the concept of accountability in context by expressing it in practical terms. In essence what we are seeking to explain is “how do we fire someone when something goes wrong?”
- 5.3 Simplistically prior to pooling SYPA could either pick a new external fund manager (as was done when the bond portfolio moved from Henderson to RLAM) or take a mandate in house. Should an internal manager have failed in some way the solution would either be to allocate the mandate to a different member of the internal team, or to externalise it. For funds that were managed entirely externally prior to pooling the single option of switching to a different manager was all that was available.
- 5.4 On one level if the issue is about a single mandate then the options remain the same, in effect change the manager either by switching to a different Border to Coast product (for example from an internally managed mandate to an externally managed one), or seek to influence the company with other investors to change the internal manager. However, our relationship with Border to Coast is not just about single investment mandates and SYPA wears “different hats” at different times in its relationship with Border to Coast.
- 5.5 At different times SYPA fulfils each of the following roles in relation to Border to Coast
- An investor in regulated products
 - A limited partner within un-regulated products (while in essence this is being an investor there are some important technical differences and rights have to be exercised in different ways)
 - A shareholder, which gives the Authority a vote in key decisions such as the approval of the Company’s budget and strategic plan.
- 5.6 Clearly there may be times when the roles of shareholder and investor come into conflict. For example, if the company made a trading error which caused loss to investors then under the relevant regulations and policies the company would have to

reimburse the relevant investors. Given the financial structure of the company this would represent a cost to the shareholders. Arguably the tension that this situation creates should make the company more aware of the potential issues caused by such situations and therefore seek to avoid them. However, in the real world it is simply not possible to eliminate such occurrences, even though we seek to minimise them.

- 5.7 Border to Coast have produced and makes publicly available a Governance Charter (included as an appendix to this report) which sets out the roles of the different players in the overall governance and oversight of the partnership which is available on the Company's website. This charter is subject to annual review and approval by the Joint Committee to reflect changes which occur as the Partnership develops and matures. What this emphasises is that Border to Coast is ultimately the expression of the wishes of the 12 partner funds, thus we are Border to Coast and Border to Coast is us, the existence of a company as a legal entity simply gives things a more concrete form.
- 5.8 While having properly documented sets of roles and responsibilities and a framework of rules is crucial to demonstrating good governance in practice any collaborative endeavour of this sort depends as much for its success on the relationships between the different parties and individuals and open and effective communication. Officers spend significant time seeking to manage the relationship both with Border to Coast as an organisation and with the other 11 partner funds. This seeks to ensure that the products that are developed meet the needs of SYPA to the greatest possible extent and that the current range of products is being managed effectively to deliver in line with expectations. This process of ongoing dialogue, which reflects strong relationships, is intended to ensure that SYPA has early warning of any issues and can then engage with the company to ensure that they are being addressed. This is a significantly enhanced version of the way oversight is generally exercised over external managers. However, we do need to recognise that Border to Coast is not just an external manager in terms of its relationship with SYPA and the diagram below seeks to set out the differing roles that the Company/Partnership play in relation to SYPA.

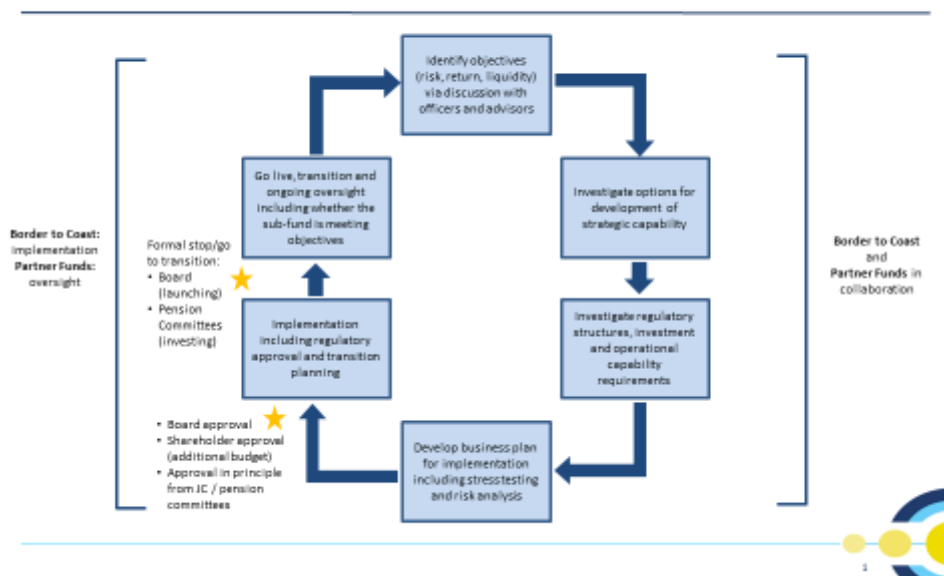


- 5.9 There is no fundamental conflict between these roles but the fact that Border to Coast is fulfilling all these roles does create specific risks for the Authority in terms of being

dependant on one organisation in so many ways and also presents challenges for Border to Coast in terms of being able to maintain capabilities across a diverse range of functions each of which has its own regulatory and “back office” requirements. In terms of the “concentration” risk for the Authority this is mitigated by ensuring that we do not rely on one source of advice so that we can take our own decisions having weighed advice from a number of sources. Given that pooling was explicitly intended to remove funds from the areas of implementation and fund management there is no option but to tolerate the concentration risk in these areas. It is also the case that as a Fund that was largely internally managed prior to pooling these “concentration” issues existed previously so in reality for SYPA there is perhaps less change than for other funds, although the greater number of individuals involved within Border to Coast could also act as a risk mitigant in this respect.

5.10 Any collaborative endeavour’s success is also highly dependent on the understanding and ability of the participants to compromise. The acceptance by the Authority of the fact that it needed to pool its assets as part of this initiative despite the likely medium term impact on costs was a major compromise and SYPA, together with other partner funds, will need to continue to compromise as the pooling process continues to develop and evolve. Managing the process of achieving consensus and acceptance of compromise means that the earlier stages of product development may well take somewhat longer than would be ideal but it does mean that all partner funds are then committed to the success of the product and therefore the process creates a stronger partnership. The diagram below sets out the process of product development.

A collaborative approach



5.11 During this process the lines of accountability are not for Border to Coast but for officers in the same way as they always were. In these areas SYPA’s scheme of delegation allows very wide scope to the Fund Director and Head of Investment Strategy. However, this scope has been and will continue to be exercised judiciously and a process has been arrived at where members of the Authority agree the principle of investment in a particular product subject to due diligence. In arriving at this decision

the Authority is in essence approving the broad product design and is supported in this by its Independent Advisers. At the next stage officers and the Independent Advisers consider the detailed due diligence information supplied by Border to Coast and if satisfactory a formal commitment to invest is made. This represents an appropriate division of duties between officers and members with the Independent Advisers providing appropriate checks and balances and providing a level of assurance to members of the Authority.

5.12 Border to Coast's ongoing performance is monitored within the Authority in a number of ways, listed below. It is, however, also important to bear in mind that the Company's senior management and Board owe duties to both shareholders and investors and therefore actively monitor activity, while in addition the depository has a role in protecting investor interests in relation to the various pooled vehicles.

- Through ongoing review of monthly and quarterly reports by officers and the independent advisers data from which then features in reports to the Authority. This data feeds both the investment performance reports and the Responsible Investment Update.
- Through oversight of the Company's overall performance by the Joint Committee on which SYPA is represented by its Chair.
- Through the regular dialogue between officers and the company.
- Through a formal annual review of the performance of SYPA's investments with the Company undertaken by the Investment Advisory Panel. This is similar to the process that would be undertaken with any external manager. The next of these meetings is currently scheduled for June and a formal annual review report following this will be presented to the Authority in September.
- Through regular presentations by Border to Coast to meetings of the Authority covering performance, product developments and other issues such as responsible investment.

5.13 Any of these particular aspects of the overall monitoring process could generate a "flag", or requirement for further action or escalation. This might be a request for further more detailed information or the need for a focussed discussion with senior management about the actions they propose to deal with a particular issue. Where necessary and appropriate the information resulting from such processes would be reported to the Authority, and in all cases a formal note of discussions and their conclusions is maintained.

5.14 The other area which the Board wished to discuss was its own role, if any, in the arrangements holding Border to Coast to account. Given the Board's role is specifically focussed on governance and compliance rather than actual decision making any role will be indirect. Fundamentally the Board will wish to be assured that the Authority has effective processes and controls in place which ensure that:

- Decisions to invest funds in specific products are made following an appropriate due diligence process (this would apply to any decision of this sort not just one involving Border to Coast).
- Arrangements are in place for the regular monitoring of performance, the identification of key issues.
- Arrangements exist to escalate and seek action on issues both on behalf of the Authority and in conjunction with other partner funds.

- That any arrangements or decision making processes operate with appropriate transparency.

5.15 Members of the Board are invited to discuss means by which they might gain such assurance in addition to review of key documents such as the Governance Charter and reports made to the Pensions Authority.

6 Implications

6.1 The proposals outlined in this report have the following implications:

Financial	None this report is solely for discussion
Human Resources	None
ICT	None
Legal	The relationship with Border to Coast as a company is codified in a number of legal agreements on which the Authority received appropriate legal advice at the time. These agreements involve all 12 partner funds in addition to, in some cases, the Company.
Procurement	The legal structure created for Border to Coast reflects the Teckal provisions in procurement law meaning that Border to Coast as it is controlled by the collective of its local authority owners can be awarded work directly in the same way as an internal department.

George Graham

Fund Director

Background Papers	
Document	Place of Inspection
Border to Coast Governance Charter	https://www.bordertocoast.org.uk/app/uploads/2019/03/Border-to-Coast-Governance-Charter-v1.0-13-3-19.pdf