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SOUTH YORKSHIRE PENSIONS AUTHORITY

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Diana Terris
Clerk

18 Regent Street
Barnsley
South Yorkshire
S70 2HG

www.southyorks.gov.uk

NOTICE OF AUTHORITY MEETING

You are hereby summoned to a meeting of the South Yorkshire Pensions Authority to be held at the offices of South Yorkshire Pensions Authority, 18 Regent Street, Barnsley on Thursday 16 February 2017 at 10.00 am for the purpose of transacting the business set out in the agenda.

A handwritten signature in black ink that reads "Diana Terris".

Diana Terris
Clerk

This matter is being dealt with by: Gill Richards
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Tel: 01226 772806

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Distribution

Councillors E Butler, B Curran, S Ellis, H Mirfin-Boukouris, J McHale, A Sangar, M Stowe, Z Sykes, P Wood, J Wood, R Wraith and K Wyatt

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SOUTH YORKSHIRE PENSIONS AUTHORITY

**16 FEBRUARY 2017 AT 10.00 AM AT THE OFFICES OF SOUTH YORKSHIRE
PENSIONS AUTHORITY, 18 REGENT STREET, BARNSELY, S70 2HG**

Agenda: Reports attached unless stated otherwise

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SOUTH YORKSHIRE PENSIONS AUTHORITY

16 FEBRUARY 2017

Report of the Clerk, Treasurer and Interim Fund Director

LOCAL GOVERNMENT PENSION SCHEME (LGPS) REQUIREMENTS FOR ASSET POOLING

1.0 PURPOSE OF REPORT

- 1.1 To seek authority for the South Yorkshire Pensions Authority to pool its LGPS assets with 12 other Funds in a newly created wholly owned local government regulated asset management company - Border to Coast Pensions Partnership Limited (BCCP Ltd) as its chosen means of achieving regulatory compliance.

2.0 RECOMMENDATIONS

- 2.1 That the Authority meets the regulatory requirements to pool Pension Fund assets by:
1. Agreeing to be a member of the Border to Coast Pensions Partnership (BCPP) and to adopt its arrangements, by authorising the Clerk and the S151 officer in consultation with the Interim Fund Director to finalise the approval and execution, where required, of all legal documents necessary to give effect to the decisions below:
 - i. entering into the Inter-Authority Agreement between the Authority and the administering authorities of the other Pool Funds
 - ii. entering into the Shareholders' Agreement between the Authority and the administering authorities of the other Pool Funds and Border to Coast Pensions Partnership Limited
 - iii. agreeing the Articles of Association to be adopted by Border to Coast Pensions Partnership Ltd.
 2. Approving the establishment of the Border to Coast Pensions Partnership Joint Committee as a formal Joint Committee under section 102 of the Local Government Act 1972 in accordance with and to carry out the functions as set out in the Inter-Authority Agreement.
 3. Approving the subscription by the South Yorkshire Pension Fund of 1 Class A voting share in the asset management company, Border to Coast Pensions Partnership Limited.
 4. Appointing the Chair of the Authority as the shareholder for BCPP Ltd.

5. Approving the subscription by the South Yorkshire Pension Fund for such number of Class B non-voting shares in the Border to Coast Pensions Partnership Limited as shall be necessary to ensure that the Authority contributes by way of equity one twelfth of the minimum regulatory capital requirement of the company as determined by the requirements of the Financial Conduct Authority (FCA).
 6. Appointing the Chair to represent the Authority on behalf of the Fund at the Border to Coast Pensions Partnership Joint Committee meetings.
 7. Authorising the Clerk to make the consequential changes required to the Constitution to reflect these new arrangements.
- 2.2 To note that the Authority will act as agent for the Sheffield City Region Combined Authority (SCRCA) to exercise the investment of the South Yorkshire Passenger Transport Pension Fund (SYPTPF) in the BCPP Pool under a delegated agreement. The SCRCA does not intend to become a shareholder in BCPP Limited. The reason for this is that it would not be seen as cost-effective for SCRCA to incur associated costs of shareholding nor to subscribe for the regulatory capital of BCPP Limited.

3.0 BACKGROUND

South Yorkshire Pension Authority (SYPA)

- 3.1 SYPA is the administering authority for the South Yorkshire Pension Fund (SYPF). As at 31 March 2016, SYPF had assets of £6.22bn and a Funding level of 86%. There were 346 contributing employers from the public and private sector, and over 148,000 active, deferred pensioner and pensioner members.

Local Government Pension Scheme Asset Pooling

- 3.2 Following three years of consultation up to November 2015, the Government issued an Investment Reform Criteria and Guidance document inviting proposals for pooling. Estimated annual savings were assessed as £200m - £300m across the Local Government Pension Scheme (LGPS).
- 3.3 In the July 2015 Budget, the then Chancellor announced the Government's intention to work with (LGPS) administering authorities to ensure they pool investments to reduce costs while maintaining investment performance.
- 3.4 The Criteria and Guidance published in November 2015 required all LGPS administering authorities to submit to Government initial and detailed proposals by 19 February 2016 and 15 July 2016 respectively.
- 3.5 On 14 January 2016 the Authority agreed a preferred pooling partner subsequently named the Border to Coast Pensions Partnership (BCPP), on the basis that this represented the best arrangement for the Authority. The Authority is a joint signatory to both the BCPP initial and detailed proposals. The latter having been reported to the Authority on 30 June 2016.

- 3.6 Eight separate investment pools submitted detailed proposals to Government by 15 July 2016, including BCPP. The other seven pools are as follows (figures as at 31 March 2015):
- Central - a group of funds in the Midlands, with assets of £34bn
 - Brunel - a group of funds in the South West, with assets of £22bn
 - ACCESS - a South East based group of funds, with assets of £36bn
 - Wales - all 8 funds in Wales, with assets of £12bn
 - Northern - Merseyside, Greater Manchester and West Yorkshire, with assets of £36bn
 - London - all 33 London boroughs, with assets of £25bn
 - Local Pensions Partnership - Lancashire, London Pension Fund Authority and Berkshire, with assets of £14bn
- 3.7 On 1 November 2016 the Local Government Pension Scheme (Management and Investment of Funds) Regulation 2016 came into force. These Regulations mandate that the 89 separate Local Government Pension Scheme Funds in England and Wales combine their assets into a small number of investment pools.
- 3.8 Those Regulations require each LGPS administering authority to formulate, having taken proper advice, an investment strategy and to publish a statement of that strategy no later than 1 April 2017. That investment strategy must include the administering authority's approach to pooling investments including the use of collective investment vehicles and must be in accordance with guidance issued by the Secretary of State.
- 3.9 The Guidance states that each LGPS administering authority must commit to a suitable pool to achieve benefits of scale and must confirm their chosen investment pool meets the Investment Reform and Criteria issued in November 2015. The Secretary of State has direction and intervention powers if he is not satisfied that an administering authority is complying with its obligations in relation to the Regulations.
- 3.10 The Secretary of State approved BCPP as meeting the requirements of the Investment Reform and Criteria document by letter (**Appendix A**) dated 12 December 2016.
- 3.11 There is an extremely challenging timetable in order to meet the Government's expected timetable for the start of the Pools. For the Pools to be able to manage from April 2018 there is a need to create a fully FCA regulated company and that will require core systems and processes. This, in turn, will require dedicated staff who will themselves be subject to FCA scrutiny. As a result, the BCPP is looking for firm commitment before March 2017 so that progress can be made.

4.0 POOLING PROPOSALS

Overview

- 4.1 The BCPP is proposed to be formed of 13 LGPS Funds with combined assets of over £40 billion at 30 September 2016. Fund values totalling £35.9m were included in the proposal to Government as they were based on data as at 31 March 2015 and are set out in the table below.

BCPP Partners:	Fund Value at 31/03/2015 (£bn)
Bedfordshire Pension Fund	1.7
Cumbria Pension Fund	2.0
Durham Pension Fund	2.3
East Riding Pension Fund	3.7
Lincolnshire Pension Fund	1.8
North Yorkshire Pension Fund	2.4
Northumberland Pension Fund	1.1
South Yorkshire Pension Fund	6.3
South Yorkshire Passenger Transport Pension Fund	0.2
Surrey Pension Fund	3.2
Teesside Pension Fund	3.2
Tyne and Wear Pension Fund	6.4
Warwickshire Pension Fund	1.7
BCPP TOTAL	35.9

- 4.2 In developing the BCPP proposal in response to the Government's pooling requirements, both the independent specialist legal and cost/benefit advisors concluded that the most appropriate approach, given the constituent make-up of the partner Funds of BCPP, was for a separate vehicle to be established in the form of a wholly owned 'Teckal' compliant company, which would be regulated by the FCA. Teckal refers to an established legal ruling allowing Authorities (under certain circumstances as explained in para. 4.21 below) to enter into contracts with other public bodies without the formalities and costs of competition under the Public Contracts Regulation 2015.

Financial Assessment

- 4.3 Empirical evidence from independent cost consultants CEM Benchmarking shows that if appropriately implemented, larger asset pools can achieve material benefits in fee savings and/or in transaction costs, plus they generally have improved governance structures. Specialist external advice acquired for BCPP further supports this.

- 4.4 The proposal submitted to government in July 2016 outlines that the BCPP set up costs are expected to be between £2.28m and £4.15m – of which SYPF will be responsible for 1/12th i.e. between £190k and £350k. These amounts will be payable over the lead-in period up to formal operation of the newly created asset management company, scheduled for April 2018.
- 4.5 The initial savings projections detailed in the proposal (high and low case) show that once operational the full annual savings to BCPP are estimated to be between £52.4m to £22.4m per year by 2030 (i.e. when all the alternatives in closed ended funds have run off and have been reinvested through BCPP Ltd). For SYPA savings begin to exceed costs in either year 3 (2020) or year 7 (2024); high and low case scenario.
- 4.6 The annual savings estimated for the South Yorkshire Pension Fund by 2030 are between £5.3m and £1.2m (high and low case). Due to the relatively low existing internal management costs, SYPA faces a share of set up costs and a ‘pool’ share of operating costs which will initially be higher than our base costs in the first years of operation. Payback would be achieved in the best case scenario by 2020 and in the worst case scenario by 2030 (i.e. when the expected reduction in management fees via ‘pooling’ outweigh the set up and ongoing costs of operating the ‘pool’).

Legal Assessment

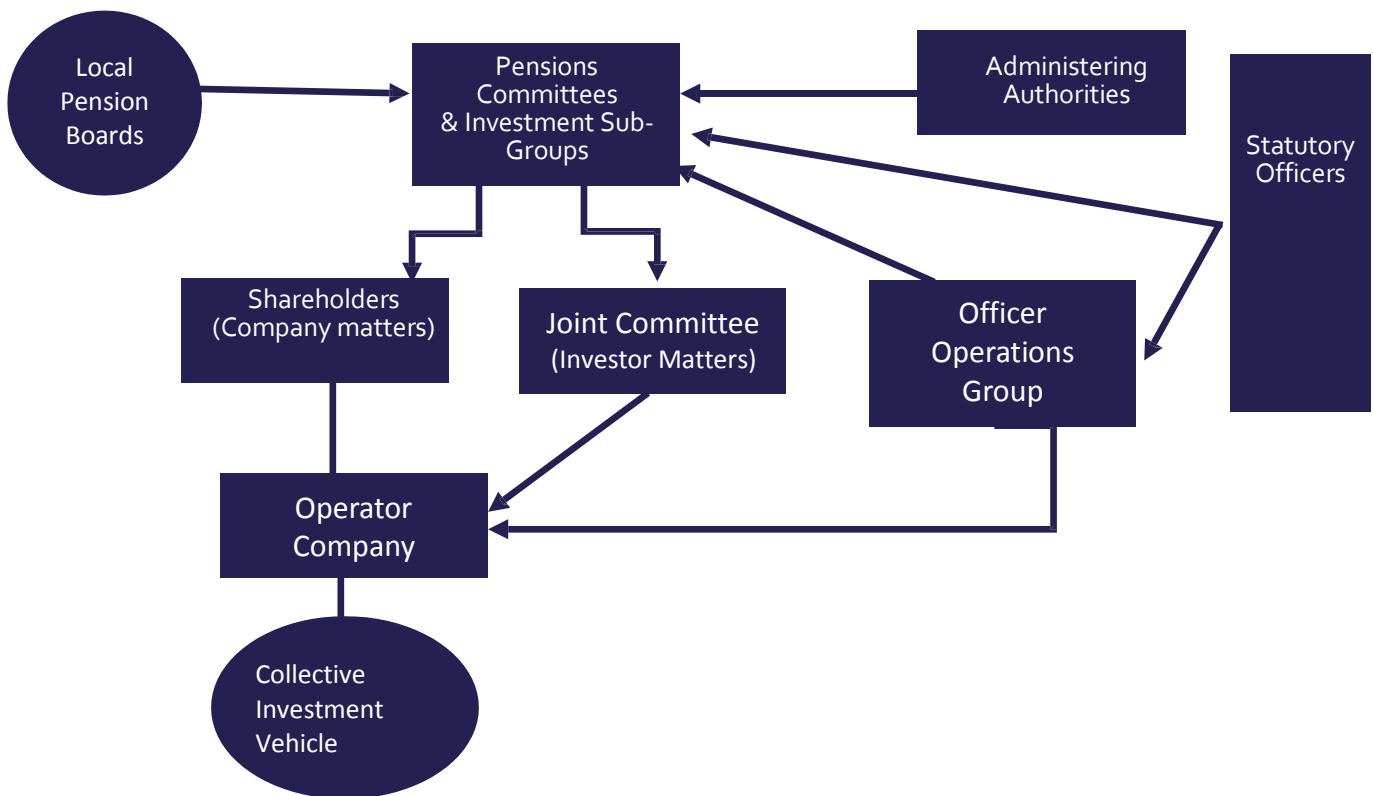
- 4.7 The work to develop the BCPP pooling proposal through the establishment of BCPP Ltd has been supported by two sets of external lawyers. Eversheds has been appointed to advise the newly constituted company and to support its set up. Squire Patton Boggs has been appointed to advise the Partner Funds in reaching their decision to approve the arrangements, to ensure the interests of the Partner Funds are reflected in the constitution of the company and the Shareholders’ Agreement, and to ensure that the governance arrangements, specifically the Joint Committee, are fit for purpose.
- 4.8 The Summary of Pool Governance Structure document, attached as **Appendix B** gives a general description of the arrangements, and draws out key themes and their implications. It has been prepared by Eversheds and approved by Squire Patton Boggs. It refers to documentation, described elsewhere in this Report, including the Shareholders’ Agreement and the Inter-Authority Agreement and has been negotiated with the benefit of legal advice from both firms. Monitoring Officers, Section 151 officers and other representatives from all administering authorities have been engaged in the process of developing and finalising the documentation in what has been a very challenging timetable. Due to the challenging timescales for approval of all the legal documents delegation to the Clerk and the S151 officer in consultation with the Interim Fund Director is recommended to finalise any agreements as necessary.
- 4.9 Squire Patton Boggs have produced a legal summary of the issues and conclude that “the proposal to participate in the BCPP Pool and to subscribe for shares in BCPP Limited is in compliance with the statutory obligations which fall upon the Authorities, and there are no obstacles to the structure which has been proposed”.

Governance

- 4.10 There will be a need for each partner Fund to distinguish between its role as a shareholder, which is a new function, versus its role as an investor in a collective investment vehicle. The two have fundamentally different functions.
- 4.11 Shareholder functions relate to the ownership of BCPP Limited and are subject to company law and key company documents. Because the Authority as a corporate body cannot exercise its rights as shareholder directly, it will need to act through a nominated shareholder representative who will either vote by attendance at shareholder meetings of the company or by signing written resolutions as permitted by company law.
- 4.12 Investor rights relate to the investments in the asset pool within BCPP Ltd as a 'customer'. There will be a need for a collective forum to discuss common investor issues. It is proposed that this is through a Joint Committee consistent with public law requirements.
- 4.13 An Authority Member will need to be appointed to this Committee. To effectively represent the Fund, the Member of this Committee will need to be conversant with SYPA's investment strategy and asset allocation strategy, performance expectations and risk appetite.
- 4.14 It is acceptable that the two functions be undertaken by the same individual, but it is not necessary. It is up to each Partner Fund to decide who will fulfil each of these two roles.

Constitution

- 4.15 It is proposed that the Authority's constitution be updated to reflect these new appointments of shareholder representative and the Joint Committee representative. An appropriate conflicts policy will need to be in place where they are filled by the same representative.
- 4.16 The diagram below details the proposed governance structure of BCPP and how the various control groups are envisaged to interact with each other. These various elements of the governance structure are described below and in more detail in **Appendix B**.
- 4.17 The Company will operate under FCA regulated vehicles in a contractual relationship with each of its investors who will have legal rights under English law.



- 4.18 The focus of the Joint Committee will be on ‘investor’ issues of the Partner Funds (as distinct from shareholder issues). Investor rights relate to the investment in BCPP Ltd as governed by legal documents for each investment e.g. constitutive deed, application form, key investor information, prospectus and FCA handbook of rules and guidance. Investor rights cover such matters as the right to withdraw from the investments, investor reporting (including frequency and content) and investor voting rights.
- 4.19 The Joint Committee will formally be established by all of the Partner Funds signing an Inter-Authority Agreement. This Agreement sets out the role, Terms of Reference and Constitution of the Committee. It also establishes an Officer Operations Group drawn from officers of administering authorities of the Pool to support the working of the Joint Committee with technical advice, as well as a secretariat to provide administrative support.
- 4.20 The Inter-Authority Agreement also provides for one of the Partner Funds to act as Host Authority. In particular, the Authority that acts as Host Authority will be responsible for entering into contracts on behalf of the Joint Committee. This is necessary because the Joint Committee has no separate legal identity. In recognition of the fact that the Host Authority will take on liabilities and risk on behalf of all the Partner Funds, the Inter-Authority Agreement contains indemnity clauses so that this liability and risk is shared. There is no expectation that the Joint Committee will enter into contracts to any significant extent but it may, for example, need to commission specialist advice on occasion.

Teckal

- 4.21 As described in paragraph 4.2, the most appropriate way forward is considered to be the creation of a wholly owned Teckal compliant company, operating a fully regulated structure under the FCA.
- 4.22 To ensure the Partner Funds can transfer their assets to and enter into contracts with BCPP Ltd without some form of competitive procurement (which seems wholly inappropriate given the purpose of the Pool) it will need to be 'Teckal compliant' i.e. adhere to Regulation 12 of the Public Contracts Regulations 2015. As each administrative authority is a contracting authority for the purpose of the 2015 Regulations adherence to these public procurement rules is the individual responsibility of each of the individual Authorities, not the new company.
- 4.23 Under Regulation 12 of the Public Contracts Regulations 2015, contracts entered into between a local authority and a Teckal compliant company are exempt from the application of public procurement law where the following conditions are met:
- i. the contracting authority exercises control over the Teckal compliant company (either solely or jointly with other authorities) which is similar to that which it exercises over its own departments;
 - ii. more than 80% of the activities carried out by the Teckal company are carried out in the performance of tasks entrusted to it by the contracting authority or other bodies which the contracting authority controls; and
 - iii. the Teckal compliant company is not directly privately owned.
- 4.24 It is through the exercise of a number of shareholder reserved matters that the Authorities demonstrate a controlling influence and therefore Teckal compliance. This element of the operation of the company is governed by a Shareholders' Agreement which regulates the relationship between the Partner Funds as shareholders and between the Partner Funds collectively and the company. The Authority, as administering authority, is being asked to authorise the South Yorkshire Pension Fund to enter into this Shareholders' Agreement.
- 4.25 As BCPP Ltd will be a Teckal compliant company there will be many more matters reserved to the control of the shareholders acting collectively than would be the case in a normal company.
- 4.26 The exercise of these rights will be governed by the Articles of Association of the company and company law. This means that different voting arrangements from 75% majority to unanimity can be attached to different types of decisions on reserved matters.

Shareholders' Agreement

- 4.27 Each shareholding Authority will subscribe for 1 Class 'A' voting share (nominal value £1) with equal voting rights i.e. 12 shareholders with one vote each. There will also be a requirement for regulatory share capital in the form of non-voting Class 'B' shares as explained in paragraphs 4.54 to 4.56. The Shareholders' Agreement (introduced in paragraph 4.24) identifies a number of shareholder reserved matters which can only be decided with the approval of either all of the shareholders (unanimous reserved matters) or a majority (defined as 75%) of the shareholders (shareholder majority reserved matters). The main reserved matters are listed below and it is through these reserved decisions in particular that the Partner Funds (administering authorities) will exercise a decisive influence over the strategic direction of BCPP Ltd.
- 4.28 The role of the administering authorities as shareholders will be to provide oversight and control of the operation of the Company and will include:
- approval of the Annual Business plan
 - approval of budgets, fee models, the overall cost base and cost apportionment
 - appointment and removal of directors, including non-executive directors
 - approval of the senior executive remuneration policy
 - approval of significant capital requirements
 - approval of significant transactions (e.g. mergers and acquisitions)
 - approval of any new entrants to BCPP and the terms of entry
 - determination of exit terms, including notice period and exit treatment
 - approval of conflict of interest policy
 - review of the risk register
 - appointment of the auditor
- 4.29 Other key provisions of the Shareholders' Agreement are:
- the Agreement will be governed by a number of shared objectives that are described in Schedule 2 of the Shareholders' Agreement. These include that the administering authorities will pool their assets through BCPP Ltd to meet the administering authorities' pooling obligations
 - any administering authority may withdraw on giving not less than 12 months' notice to expire on 31 March in any year. On withdrawal, the exiting shareholder must pay outstanding sums owed to the company
 - on withdrawal (i.e. full withdrawal from the Pool and not withdrawal of part funds under management), the company will buy back the shares of an exiting shareholder (subject to having the necessary capital) and the remaining shareholders will be required to adjust the regulatory capital caused by the withdrawal

- profits of BCPP Ltd lawfully available for distribution (after prudent consideration of the amounts required to be retained by the company) will first be used to reduce the Operating Fee (see paragraph 4.52) and then will be available for distribution to the shareholders unless the shareholders agree otherwise – further details to be worked up
- shareholders will use best endeavours to resolve disputes between themselves. If not resolved, they will be escalated with provision, ultimately, for binding arbitration
- if a shareholder is in material breach of the Shareholders' Agreement and the breach is not remedied, the shareholder in breach is required to sell its A share back to the company and the B shares will be bought by the company (subject to having the necessary capital)
- the Shareholders' Agreement may be terminated if all shareholders agree in writing, the company is wound up, such number of shareholders withdraw that the remaining shareholders inform BCPP Ltd that they are unable or unwilling to maintain the company's regulatory capital requirements, or the Board determine that the business of BCPP Ltd can no longer be carried on lawfully
- the company will provide information to the shareholders including quarterly financial and performance reports, annual accounts and an annual report of progress against the Strategic Plan

Articles of Association

- 4.30 In addition to the Shareholders' Agreement the other main document governing the operation of BCPP Limited will be the Articles of Association. The main provisions of this document of which Members should be aware are set out below.
- 4.31 It is proposed that the Board of Directors will comprise of 3 Executive Directors and 3 Non-Executive Directors, one of which will be the Chairman. Each of these directors are required to be noted on the FCA application with some required to be designated with approved person status. Following accepted good governance, and to protect shareholder interests, it is proposed that the Chairman has the casting vote to ensure the non-executive Directors carry the vote, should this be required.
- 4.32 No shareholder may transfer its shares (Class A or Class B) to any other person save to the company as part of a redemption of shares (for example on a withdrawal by that shareholder).
- 4.33 Meetings will be held in private, and once established there will be the minimum requirement for an annual shareholder meeting. However, as each shareholder will have more than 5% of the total shareholding they can call a meeting at any time (given the required notice period).

- 4.34 Subject to approval from the respective administering authorities, BCPP Limited will be owned by the 12 local authorities as administering authorities within the investment pool. Each authority will have 1 Class A voting share with equal voting rights. It should be noted that South Yorkshire Passenger Transport Pension Fund will have no shareholding or voting rights in the new company. Currently operational control is delegated to South Yorkshire Pensions Authority.
- 4.35 Given that the Authority's involvement in the company is driven by the pooling requirements affecting the Pension Fund legal advice is that it is proposed that this share is held in the name of SYPF.
- 4.36 The duties and responsibilities of a shareholder mean that each Partner Fund has protection as it will have limited liability (subject to regulatory capital requirements).
- 4.37 The shareholder representative will be exercising the Authority's rights in accordance with instructions rather than have any delegated authority. Appropriate support will be provided to ensure any matters of process, governance or conflict are appropriately addressed.
- 4.38 Generally as a shareholder there will be no involvement in day to day company operational matters, which are managed by the Board of Directors. The exercise and conduct of business by the Board is set out in Articles of Association, which will include consulting on key strategic and operational matters.

The Authority's relationship with the Sheffield City Region Combined Authority (SCRCA) and the South Yorkshire Passenger Transport Pension Fund (SYPTPF).

- 4.39 As referred to above this Authority currently manages the Passenger Transport Pension Fund through a delegated arrangement with the SCRCA (the responsible administering authority). SCRCA wishes to continue with this approach to invest the SYPTPF in the BCPP Pool, but does not intend to become a shareholder in BCPP Limited. The reason for this is that it would not be cost-effective for SCRCA to incur the associated costs of a shareholding nor to subscribe for the regulatory capital of BCPP Limited. External legal advice has been obtained which supports the intended manner of operation. Whilst there will need to be amendments to the contractual arrangements between SCRCA and SYPA as a result of the transfer of investment management services (and investment advisory services) to BCPP Limited, it is not considered that there are any obstacles to SCRCA's participation in BCPP under a delegated arrangement with this Authority. SCRCA can take advantage of the financial services exemption in the Public Contracts Regulations 2015, to avoid the need to engage in a procurement exercise in order to invest in BCPP. It is considered that SCRCA would be treated in no less advantageous way than any other investor in BCPP, notwithstanding the fact that it is not going to be a shareholder in BCPP Limited. This will mean building protections into the

Authorised Contractual Scheme's deed.

- 4.40 Members will be aware from previous reports that officers are requesting permission to transfer responsibility for the role of administering authority for the SYPTPF to this Authority. An initial response from the Minister indicates a positive reaction to this proposal. If implemented, the transfer to SYPA would of course remove any issue about the need for separate arrangements for the SYPTF as it would become an integral part of the main SYPA fund.
- 4.41 There are also proposals from 'First Bus', the sole employer relevant to the SYPTPF, who have requested the Minister to consider consolidating all 'First Bus' LGPS funds under one 'host' administering authority- the Greater Manchester Pension Fund.
- 4.42 Thus there are two routes by which the SYPTPF investment management function may be transferred. Either would remove the requirement for a delegated arrangement with this Authority. However the timing and outcome of those proposals is not yet determined. Therefore the default position, operating under delegated arrangements with this Authority is covered lest the position be not formally resolved ahead of pooling becoming operational from 1 April 2018.

Operational Arrangements

- 4.43 The aim of the BCPP pooling proposal is to meet the regulatory requirements to pool assets by collectively investing and to:
- deliver savings to the Partner Funds
 - improve governance by moving the asset management into a financially regulated entity
 - build capability and capacity to invest in infrastructure and other asset classes to improve the risk adjusted returns of partner Funds
 - through collaboration and consolidation of resource improve technical specialisms and resilience across Partner Funds
 - use the scale of the pool to more effectively utilise shareholder voting rights to drive corporate governance change in the companies the Funds invest in
- 4.44 BCPP Ltd will be responsible for managing investments in line with the investment strategy and asset allocation requirements as instructed by SYPA and the other Partner Funds. Instead of overseeing a largely internally managed fund, the Authority will oversee a range of sub-funds managed by BCPP Ltd.
- 4.45 The Authority will retain responsibility for setting the investment strategy and the asset allocation of the Fund. Other activity such as valuations, the setting of employer contributions and pensions administration will also remain at the local level.

- 4.46 The key change is therefore that responsibility for the appointment, monitoring and termination of investment managers will pass from the Authority to BCPP Ltd.
- 4.47 It is generally accepted that over 80% of investment performance is driven by the investment strategy and asset allocation, rather than manager selection.
- 4.48 Changes are expected be actioned over an appropriate time to comply with pooling requirements, to coordinate with other Partner Funds to achieve optimal improvements in performance and costs. It is expected that by becoming a shareholder in BCPP that SYPA will give a commitment to using the Pool for investments and it meets the need to demonstrate an approach to pooling as required by the Secretary of State. However, the actual decision of how much to invest in funds managed by the BCPP will be done by the Authority at a later date. This issue will therefore be revisited at a later stage when individual Pension Funds are asked to contract with the BCPP. It is expected that all BCPP Pension Funds will work to ensure that the Pool has a good understanding of its clients' investment wishes and needs thereby providing confidence along this journey.
- 4.49 There will inevitably need to be some compromises in the arrangements as the Authority will be one voice amongst twelve. For example, in order to achieve benefits through economies of scale the number of sub-funds will need to be appropriate, i.e. not too many to lose these benefits but not too few to unduly restrict the asset allocation requirements of Partner Funds. To ensure the range of sub-funds meets SYPA's needs as far as possible, feedback has been provided by both Officers of the Authority and the Authority's Advisers.
- 4.50 BCPP Ltd will be responsible for the actions of its own internal investment teams and hiring/firing external investment managers with the objective of ensuring the performance of each of the sub-funds meets the requirements of the Partner Funds.
- 4.51 As an FCA regulated entity, BCPP Ltd will be required to operate under the Financial Services and Markets Act 2000 (FCA compliance) and the Corporate Governance Code, as well as local authority regulations.
- 4.52 BCPP Ltd will receive an Operator Fee from the administering authorities, which is intended to cover the Company's operating costs. The exact amount and the method of calculating the Fee have not yet been determined but will be on an equitable basis across the 12 participating shareholders.
- 4.53 FCA regulated businesses are required to hold regulatory capital designed to support the solvency of the company. There are detailed rules governing the minimum amount of regulatory capital required. The maximum regulatory capital that can be required is €10m and is based on assets under management. BCPP Ltd is expected to be at this maximum. It is proposed that this requirement is funded equally between the 12

administering authorities. The South Yorkshire Pension Fund's contribution is therefore likely to be in the region of £725,000 based on the Euro exchange rate at the time of writing of this report.

- 4.54 Contributions to regulatory capital can be made in one of two ways – either by way of equity (the purchase of shares in the company) or debt (by lending the money to the company). The Shareholders' Agreement proposes that the regulatory capital is provided by all of the administering authorities by them acquiring a class of shares in the company (Class B shares) to the value of their contribution. There are two main reasons for this.
- 4.55 The first is that the Pension Fund that accepts as its members, the employees of BCPP Ltd, through an admission agreement, will not be allowed in law to make its contribution by way of a loan. The second is that because loans rank higher than equity on an insolvency, then in this very unlikely event, one or more Partner Funds would have priority over the others.
- 4.56 As these arrangements are solely for the purpose of pooling Pension Fund assets, which are attributable to the Fund's employers, it is proposed that the contribution is made from the participating Pension Funds rather than Authority funds. This contribution will be held by BCPP Ltd and will earn a suitable rate of interest by way of dividend.

5.0 CONCLUSIONS

- 5.1 Following the Government's approval in December 2016 for BCPP to go ahead with pooling arrangements, each of the 12 administering authorities within the pool (that are to acquire a shareholding) will need to decide whether or not to formally commit to BCPP.
- 5.2 In anticipation of this, these authorities have been reviewing their respective governance arrangements and determining the necessary changes. This report seeks the approval of the Authority to commit to the new arrangements.
- 5.3 It is anticipated that the last of the 12 administering authorities meetings will be on 21 March 2017 and that the necessary documents will be executed shortly thereafter.
- 5.4 The administering authorities forming the BCPP pool will then need to progress these proposals and set up the regulated asset management company BCPP Ltd, ensure its FCA registration, appoint staff (including TUPE transfer where appropriate), find a suitable location to operate from, and implement the other necessary arrangements to facilitate pooling.

6. Implications

6.1 Financial

The financial implications are addressed in the report. Due to the relatively low existing internal management costs, SYPA faces a share of set up costs and a 'pool' share of operating costs which will initially be higher than our base costs in the first years of operation. Payback would be achieved in the best case scenario by 2020 and in the worst case scenario by 2030. The pooling of Local Government Pension Fund assets will have no immediate impact on employer or employee contribution rates or the pension entitlement of members of the fund (current employees, previous employees who are yet to draw their pension or pensioners). However, pooling aims to deliver savings at national and pool level to support longer term stability in contribution rates and overall scheme viability.

6.2 Legal

Legal implications are addressed in the report which recommends that the Clerk and the S151 officer in consultation with the Interim Fund Director be authorised to finalise the approval and execution, where required, of all legal documents necessary to give effect to the decisions in the report. The Authority's Constitution will need to be revised to reflect the new Shareholder and Joint Committee arrangements implicit with the BCPP pooling arrangements.

6.21 Further to paragraph 5.4 above it is expected that TUPE provisions will apply involving all investment management staff and possibly 'back office' staff who support the investment function. TUPE arrangements will be subject to legal and HR advice and are not required to be determined finally until closer to the transfer date.

6.3 Diversity

There are no diversity implications.

6.4 Risk

Pooling presents opportunities to reduce long term net costs and to increase capacity and capability including potential for wider investment opportunities. However, there will be higher costs in operating a FCA regulated body and success cannot be guaranteed. The Authority has considered the best option to be to sign up to the BCPP. Other options would have meant either joining another Pool or not to join any Pool and risk the Secretary of State exercising his powers of direction.

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BACKGROUND PAPERS

Final pooling submission reported to the Authority 30.6.16 with supporting appendices.

Various background legal papers referred to in the report, held by the Authority.



Department for
Communities and
Local Government

Cllr Denise Le Gal, Surrey
Cllr Sue Ellis, South Yorkshire
Cllr Doug McMurdo, Bedfordshire

Marcus Jones MP
Minister for Local Government

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On behalf of the participating funds listed at end

12 DEC 2016

Dear Councillors,

BORDER TO COAST PENSION PARTNERSHIP (BCPP): FINAL PROPOSAL

I would like to thank you and all the authorities involved in the proposed BCPP pool for your final proposal, which we discussed at our meeting on 24 November. I was glad to note your commitment to work together to secure benefits for all participating funds, building on your existing internal expertise. I appreciate the hard work and commitment from elected members and officers which the proposal represents, and welcome your determination to deliver on time.

It is now coming up to a year since we set the framework for reform of the investment function of the local government pension scheme, through the guidance and criteria for pooling published in November 2015. I am pleased that authorities across the scheme have responded to the challenge and come together to form partnerships of their own choosing based on a shared view of investment strategy. We do not underestimate the scale of the changes required, but the Government remains committed to pooling in order to deliver reduced costs while maintaining performance as well as to develop capacity and capability for greater investment in infrastructure.

I appreciate that overall costs are likely to rise in the early years, and that salaries are likely to be high for key senior roles within pool operators. But I consider that this is a price worth paying in order to achieve substantial savings, already estimated by the pools at £1-2 billion by 2033 or up to £200 million pa in the medium term. I am confident that as the reform beds in, there are further savings to be achieved.

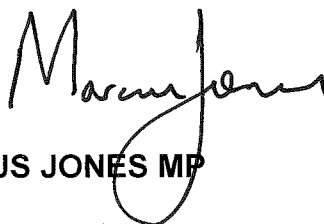
I therefore expect every administering authority in England and Wales to participate in a pool. I also expect authorities to place all assets in their chosen pool, unless there is a strong value for money case for delay, taking into account the potential benefits across the pool, and to delegate investment manager selection to the pool. In addition my officials will be consulting with all pools on the potential to work with the Local Pensions Partnership to help ensure it delivers the full benefits of scale.

I must also underline that all bodies effectively undertaking collective investments will need to be authorised at the appropriate level by the Financial Conduct Authority (FCA). I appreciate the significant costs and effort required to secure authorisation. However, given the scale and complexity of the pools, and the substantial public funds involved, scheme members and the local taxpayers who underpin the scheme have a right to expect the high level of assurance which is provided by FCA authorisation. Individual funds will continue to be responsible for their investment strategies and asset allocation and will continue to require high standards of governance.⁵

On the basis set out above I am pleased to confirm that I am content for you to proceed as set out in your final proposal. I hope you will continue to work closely with my officials, including on the concerns you raised relating to the Markets in Financial Instruments Directive II (MiFIDII).

Turning to the future, I appreciate there has been some delay this autumn, but I have no plans to extend the deadline for pools to become operational in April 2018. I will be reviewing progress of all the pools in spring and autumn 2017 and will expect to see a core team in place in spring 2017 and an application for Financial Conduct Authority authorisation, where not already in place, in autumn 2017. I look forward to seeing more detailed plans for delivering savings, and increasing your infrastructure investment in line with your stated ambition. I will also expect detailed plans for reporting, including on fees and net performance in each listed asset class against an index, standardised across the sector.

Yours Sincerely,



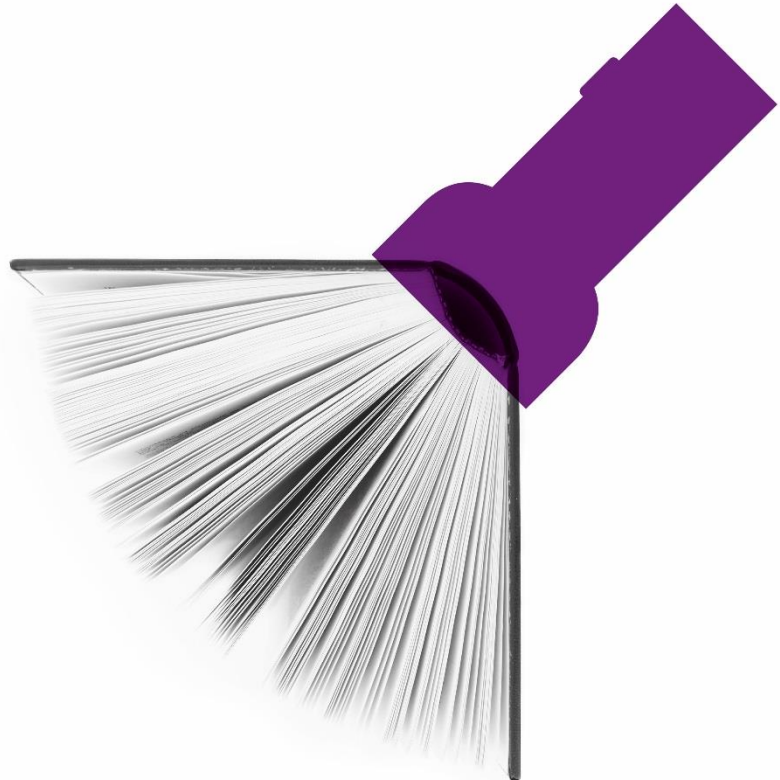
MARCUS JONES MP

Participating funds:

Bedfordshire
Cumbria
Durham
East Riding
Lincolnshire
North Yorkshire
Northumberland
South Yorkshire
South Yorkshire Integrated Transport Authority
Surrey Teesside
Tyne and Wear
Warwickshire

Border to Coast Pensions Partnership
Summary of Pool Governance Structure

25 JANUARY 2017



Border to Coast Pensions Partnership

Summary of Pool Governance Structure

This note has been prepared solely for the administering authorities participating in the Border to Coast Pensions Partnership Pool (“**BCPP Pool**”) to provide a summary explanation of the structure of the BCPP Pool governance arrangements and may be circulated by authorities when seeking approval for the structure. We do not accept liability to any other person other than the authorities in respect of this advice note.

The BCPP Pool is the collective term for the range of collective investment vehicles (including an Authorised Contractual Scheme (“**ACS**”)) that may eventually be used to allow the administering authorities to pool their respective investments. The BCPP Pool will be run and operated by Border to Coast Pensions Partnership Limited (“**the Company**”).

This note is intended to be a summary of the BCPP Pool governance structure and the detailed and definitive provisions of the governance structure can be found in the following core documents:

- the Company’s Articles of Association,
- the Shareholders’ Agreement; and
- the Inter Authority Agreement (containing the BCPP Joint Committee’s Terms of Reference and Constitution and the Terms of Reference for the Officer Operations Group).

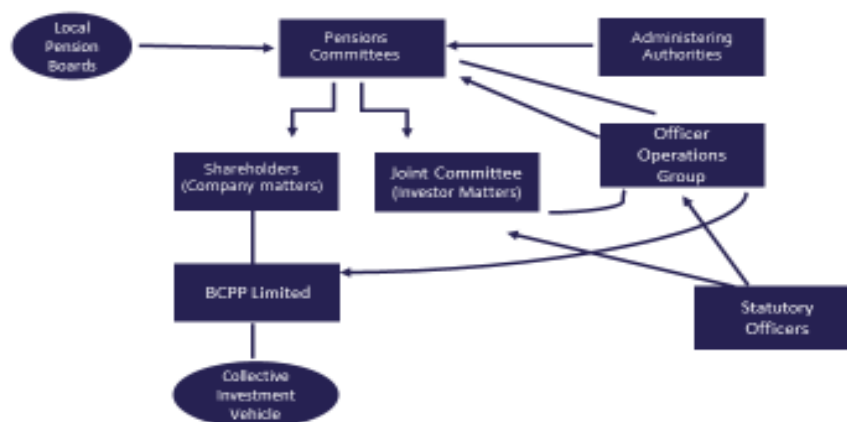
1. Background

1.1 We have been asked to provide a high level summary of the BCPP Pool governance structure, in particular setting out the roles of the structure’s key bodies, including the Company, the Shareholder Representatives, the BCPP Joint Committee, the Officer Operations Group and the Statutory Officers.

1.2 Please note that each administering authority still retains its core duties and responsibilities as an LGPS administering authority in respect of its own fund. Administering authorities may need to review their current pension committee structures to see if they will need changing once the BCPP Pool is established and/or to deal with the transition period whilst assets are being moved over to the Pool.

In broad terms the governance structure is summarised in the following diagram:

BCPP Pool Governance Structure



Border to Coast Pensions Partnership

Summary of Pool Governance Structure

Border to Coast Pensions Partnership Limited

- 1.3 The Company will be a private company limited by shares. The Company will be incorporated in England and Wales under the Companies Act 2006 and will have a registered office.
- 1.4 The Company's constitution is contained in its Articles of Association which defines the responsibilities of the directors, the kind of business to be undertaken, and the means, along with the Shareholders' Agreement, by which the shareholders exert control over the Company and its board of directors.
- 1.5 The Company will have twelve shareholders being, Bedford Borough Council, Cumbria County Council, Durham County Council, The East Riding of Yorkshire Council, Lincolnshire County Council, Middlesbrough Borough Council, Northumberland County Council, North Yorkshire County Council, The Council of the Borough of South Tyneside, South Yorkshire Pensions Authority (acting on behalf of itself and the Sheffield City Region Combined Authority), Surrey County Council and Warwickshire County Council. As such it will be a "controlled company" within the meaning of the Local Authorities (Companies) Order 1995.
- 1.6 The Company has been formed to act as an alternative investment fund manager to run and operate one or more collective investment vehicles (including an ACS) to allow the administering authorities to pool their respective investments. In due course the Company will become authorised by the Financial Conduct Authority. Unlike the Company, the ACS itself is not a separate legal entity but is a contractual arrangement.
- 1.7 The Company will be run by a board of directors which will comprise of a non-executive chair and two other non-executive directors and up to three executive directors. The directors are appointed (and can be removed) by the agreement of the administering authorities as shareholders.
- 1.8 The board of directors will meet at least four times a year. The directors have to produce an annual business plan including an annual budget for approval by all of the shareholders.

2. Shareholder Representatives

- 2.1 Company shareholder meetings will be the forum for dealing with the shareholder rights of the twelve administering authorities as individual shareholders in the Company. This is distinct from the Company's board of directors and also from the BCPP Joint Committee (see below).
- 2.2 At Company shareholder meetings each administering authority as shareholder exercises one vote. Certain major decisions (e.g. changes to the Articles of Association, rights in shares, buy-back of shares etc) which would have an effect on the shareholders' rights are usually required, through the Companies Act 2006, to be approved by the shareholders at a general meeting called by the directors of the Company.
- 2.3 The Shareholders' Agreement records the terms of the administering authorities' relationship with each other as shareholders and regulates certain aspects of the affairs and their dealings with the Company. The Agreement provides the framework for the administering authorities to act in a collaborative and coordinated way. To the extent that the Shareholders' Agreement conflicts with the terms of the Articles of Association then the Shareholders' Agreement prevails and the Articles may need to be amended accordingly.
- 2.4 In addition, the Shareholders' Agreement specifies the voting levels for various shareholder decisions. From a procurement perspective, it is important to retain sufficient control over the Company to address 'Teckal' issues.
- 2.5 In particular, the Shareholders' Agreement provides that certain key strategic shareholder decisions require either 100% or 75% approval of all the shareholders (as appropriate) before they can be approved at a shareholders' meeting. These are known as 'reserved matters' and are set out in the Shareholders' Agreement.

Border to Coast Pensions Partnership

Summary of Pool Governance Structure

- 2.6 It is intended that shareholders' meetings will be held at least annually (which is the minimum legal requirement) but may occur more often as required. Quorum for a shareholders' meeting will be nine unless a matter requires 100% approval (see below) when all shareholders will need to attend.
- 2.7 Decisions requiring 100% approval include (without limitation):
- 2.7.1 approving the Company's annual business plan including its annual budget;
 - 2.7.2 initial appointment of directors of the Company (with subsequent removal and appointments requiring 75% approval);
 - 2.7.3 admitting any new LGPS administering authority as a new shareholder of the Company or as a new investor in the BCPP Pool;
 - 2.7.4 extending the activities of the Company outside the scope of its business;
 - 2.7.5 closing down any operation of the Company's business;
 - 2.7.6 altering any of the provisions of the Articles of Association or any of the rights attaching to the shares;
 - 2.7.7 allotting, reducing or cancelling any of the Company's share capital; and
 - 2.7.8 passing a resolution to wind up the Company.
- 2.8 Company shareholder meetings are subject to the requirements of the Company's Articles of Association, the terms of the Shareholders' Agreement and general company law. They are therefore subject to different rules to a BCPP Joint Committee meeting (for example in relation to areas such as access to information and voting rules) and for this reason Company shareholder meetings need to be kept separate from BCPP Joint Committee meetings.
- 2.9 Because an administering authority cannot physically appear at a Company shareholders' meeting, it needs to appoint a person to attend the meetings on its behalf and to cast its vote or state its view. Such a person is representing the authority and acting on instructions from the authority. It does not therefore matter legally whether that person is a member or an officer since no delegated powers are being exercised.
- 2.10 Any individual attending in this role needs to be briefed and instructed before attendance and to report back after each Company shareholder meeting. In practice, if something occurs at the meeting itself which requires a shareholder decision or view then the representative, whether a member or an officer, may be required to exercise some degree of discretion. That exercise of discretion should, so far as possible, reflect the known views of the authority.
- 2.11 The representative, if an elected member, may be the same individual that represents the administering authority on the BCPP Joint Committee. Ordinarily the interests of each authority as a shareholder in the Company ought to be aligned with the interests of the authority in its capacity as an investor/customer in the BCPP Pool, so conflicts of interest are unlikely to arise. However, if they do arise, having different individuals to represent the authority at the Company shareholders' meetings and on the BCPP Joint Committee may help to reduce the potential for conflicts of interest between views as a shareholder and views as an investor/customer and may assist in retaining clarity of the governance functions being carried out. However, this is a matter for each administering authority to decide and should common appointments be made then an appropriate conflicts policy will be required.

Border to Coast Pensions Partnership

Summary of Pool Governance Structure

3. **BCPP Joint Committee**

- 3.1 The BCPP Joint Committee established under the Local Government Act 1972 will be the forum for discussing common investor/customer issues relating to the Company and the ACS.
- 3.2 Each administering authority, in addition to being a shareholder in the Company, will be an individual investor in the ACS (and any other pooled vehicles managed by the Company) and therefore each authority will have investor rights afforded by its contractual agreement(s) with the Company.
- 3.3 For example, in the case of the ACS, the contractual relationship between an administering authority and the Company is contained in a suite of key investor documents. This is made up of the constitutional deed, application form, key investor information, prospectus and FCA handbook of rules and guidance. The administering authority's investor rights are embedded in those documents and cover matters including the right to withdraw from the pooled vehicle, investor reporting (including frequency and content), obligations of the ACS manager to the investors and investor voting rights (for example, on proposed changes to the pooled vehicle).
- 3.4 There may be other arrangements creating other contractual relationships between an administering authority and the Company, for example equivalent documentation relating to other collective investment vehicles that the Company may operate and/or asset management agreements where the Company is managing assets that remain under the direct ownership of an administering authority.
- 3.5 The administering authorities are not delegating their key strategic asset allocation or other investment decision making powers or investor rights to the BCPP Joint Committee. Instead these will be retained for exercise by the individual administering authorities through their pension committees in the normal way, subject to consideration of any recommendations the BCPP Joint Committee may make.
- 3.6 The Terms of Reference and Constitution of the BCPP Joint Committee are set out in the Inter Authority Agreement. It is expected the BCPP Joint Committee will meet at least once a year (with support from the Officer Operations Group) to undertake the activities set out in its Terms of Reference. The activities differ during the set-up phase of the BCPP Pool and when the Pool becomes operational.
- 3.7 The BCPP Joint Committee would not normally make binding decisions on matters covered in its Terms of Reference but would make recommendations to each administering authority for each authority to decide. However the Constitution of the Joint Committee does allow for it to make decisions on matters delegated to it by the administering authorities should they wish to do so.
- 3.8 Where any issues do need to be resolved by the BCPP Joint Committee, these will be decided by a majority vote of those members present. Each administering authority represented on the Joint Committee exercises one vote.
- 3.9 Each authority will be represented on the BCPP Joint Committee by one of its elected members. In accordance with local government law principles, members cannot be mandated how to vote and therefore must use their own judgement when considering Joint Committee business. However, the views of the member's authority will be a factor in any decision.
- 3.10 Given the restricted the role of the BCPP Joint Committee, alternative and less formal arrangements to a joint committee structure could have been considered. However, a joint committee structure established under the Local Government Act 1972 provides a tried and tested structure that delivers a clear and transparent separation of shareholder matters and investor/customer matters.

Border to Coast Pensions Partnership

Summary of Pool Governance Structure

4. **Officer Operations Group**

- 4.1 The Group will be made up of an officer from each administering authority (such as a pension fund officer). The Group is not a legal entity but a working group of officers. The Terms of Reference for the Group are set out in the Inter Authority Agreement confirming how the Group will be comprised, operate and be resourced and funded.
- 4.2 As this is a working group of officers, no statutory functions can be delegated to the Group. The role of the Group is to:
 - 4.2.1 work with the BCPP Joint Committee to support the functions of the BCPP Joint Committee as set out in the BCPP Joint Committee's Terms of Reference;
 - 4.2.2 provide a central resource for advice, assistance, guidance and support for the BCPP Joint Committee (and also if requested for the administering authorities as a collective group of investors in the BCPP Pool);
 - 4.2.3 provide technical support at meetings of the BCPP Joint Committee, for example by proving and delivering performance management reports for the Joint Committee on all aspects relating to the provision of services by the Company; and
 - 4.2.4 act as a conduit for the BCPP Joint Committee to communicate back to the respective authorities and/or direct to the Company as appropriate.

5. **Statutory Officers**

- 5.1 In addition to the Officer Operations Group, Statutory Officers e.g. the section 151 officer and monitoring officer from each administering authority will individually and collectively support the administering authorities as shareholders, the BCPP Joint Committee and the Officer Operations Group.
- 5.2 It is not intended that there be a formal Statutory Officers Group but the relevant officers will exercise their statutory functions individually and/or collectively as the need arises.

Eversheds LLP

25 January 2017

Privileged and confidential

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