

AGENDA ITEM 6 (APPENDIX A)

MIDDLESBROUGH COUNCIL

AGENDA ITEM 12

COUNCIL

15 February 2017

Pooling of Pension Fund Assets

Strategic Director Finance, Governance and Support - James Bromley

PURPOSE OF THE REPORT

1. This report informs Council Members, acting as Members of the Administering Authority of the Teesside Pension Fund, of the reforms to the Local Government Pension Scheme and the implications for the investment of the Teesside Pension Fund.
2. The report seeks approval to acquire a shareholding in the new, regulated asset management company and set up a Joint Committee to act as a supervisory body to ensure the Teesside Pension Fund's investment issues are appropriately considered.

BACKGROUND

Teesside Pension Fund

3. Middlesbrough Council is the Administering Authority for the Teesside Pension Fund since 1996, taking over this responsibility from Cleveland County Council in 1996. To carry out this function, the Council delegated responsibility for the management and stewardship the Fund to the Teesside Pension Fund and Investment Panel, assisted by the Teesside Pension Board.
4. The Teesside Pension Fund provides a pension service for approximately 70,000 members (i.e. current employees, former employees who are not yet drawing a pension, and pensioners) across over 150 separate employers within Teesside including local authorities, colleges, academies and other not for profit organisations.
5. The Fund is financed by contributions from employee and employer contributions and holds assets that fund the current and future liabilities of the pension payments for members of the fund. As at 31st March 2016, Teesside Pension Fund held assets totalling £3.2 billion to help meet these liabilities.

Local Government Pension Scheme Asset Pooling

6. Following three years of consultation, in October 2015, the former Chancellor set out the final stages of the plans to legislate that all assets of the 89 Local Government Pension Funds in England and Wales be pooled into a few larger asset pools. In response to this, in July 2016, eight separate investment pools submitted proposals to Central Government. On 9 February 2016, Teesside Pension Fund and Investment Panel agreed to being included within the submission for the Border to Coast Pensions Partnership (BCPP).
7. The legislation which mandates pooling came into effect on 1st November 2016. Following this, on 13th December 2016, Marcus Jones, Undersecretary of State for Local Government, gave his written support that the governance structures and operating principles as proposed in the July submission for the creation of the BCPP met the required criteria (Appendix 1).
8. It is recommended that Council formally approve BCPP as its pooling option to provide compliance with the legislation mandating pooling.
9. The BCPP new pooled entity is now required to push forward with these proposals and set up a separate regulated asset management company, appoint staff (including TUPE transfer where appropriate) and develop the corporate and governance structures that will enable the pooling of the partners' assets by April 2018. At this stage, there is potential for TUPE transfers from Teesside Pension Fund into the BCPP.

Border to Coast Pension Partnership

10. The BCPP is proposed to be formed of 13 Local Government Pension Funds with combined assets of £35.9 billion (at 31st March 2015) as set out in the table below:

BCPP Partners:	Fund Values at 31 March 2015 (£ billion):
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

BCPP Partners:	Fund Values at 31 March 2015 (£ billion):
Tyne and Wear Pension Fund	6.4
Warwickshire Pension Fund	1.7
BCPP TOTAL	35.9

Table 1. Local Government Pension Funds within the Border to Coast Pensions Partnership

11. Once established there will be a need for each partner Fund to distinguish between its role as a shareholder, which is a new function, and its role as an investor in a collective investment vehicle. The two are fundamentally different functions.
12. Shareholder functions relate to ownership of BCPP Limited and are subject to company law and key company documents.
13. Investor rights relate to the partner Funds investment in the BCPP asset pool 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.
14. While it is acceptable, and to ensure consistency and understanding it is in many regards desirable that the two functions be undertaken by the same individual there needs to be a clear separation between the functions and an understanding of how any potential conflicts would be managed. It is up to each Partner Fund to decide who will fulfil these roles.
15. Whilst Fund assets will transfer to BCPP, Teesside Pension Fund retains responsibility for the management and stewardship of the Fund, including setting the investment strategy and asset allocation of the Teesside Pension Fund. BCPP will be responsible for managing investments in line with the investment strategy and asset allocation as instructed by each Partner Fund.
16. The table below summarises the changes of how BCPP and the Fund will initially operate, after management of all bonds and equities transfers to BCPP:

TASKS & RESPONSIBILITIES	TPF	BCPP
Maintaining adequate accounts and prepare the Annual Report & Accounts	✓	
Ensuring the Fund is managed and administered in line with regulations, etc.	✓	
Actuarial Valuation	✓	
Monitoring the overall investment performance	✓	
Set the long term investment strategy, tactical (quarterly) asset allocation and monitor asset allocation performance	✓	
Authorising the appointment of key suppliers and consultants to the Fund	✓	
Managing assets transferred to BCPP		✓
Collection of investment income due from transferred assets		✓
Implement the correct tax treatment for equities/bonds		✓

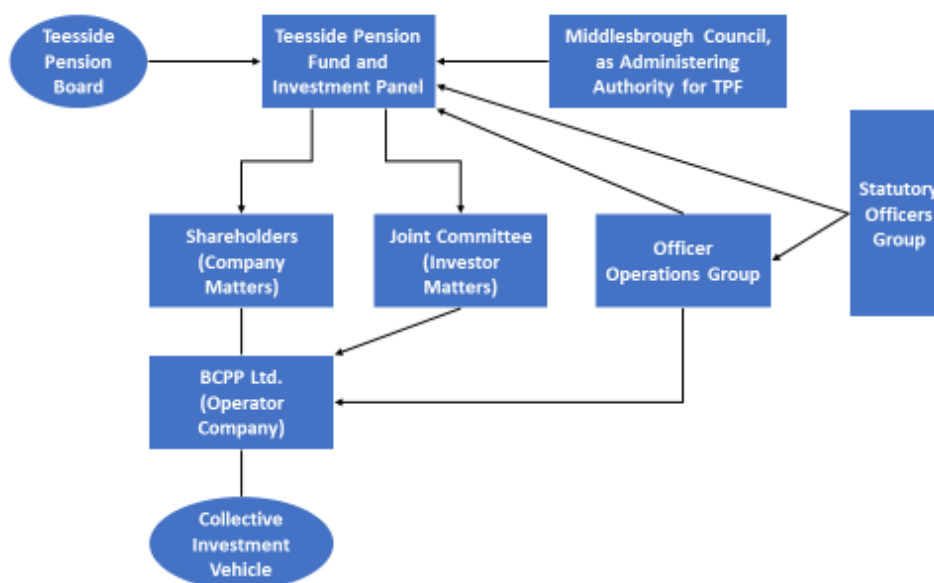
TASKS & RESPONSIBILITIES		TPF	BCPP
Responsibility for performance of transferred assets			✓
Valuation of sub-Fund units			✓
Monitoring & reporting sub-Fund performance			✓
Regularly report sub-Fund investment strategy, activity and performance			✓
Compliance with responsible ownership requirements			✓
Managing cash & legacy assets, and monitor performance of these investments		✓	
Disclosing the Fund's transactions and valuation		✓	

Table 2. Split of responsibilities between Border to Coast Pensions Partnership and the Teesside Pension Fund

17. For the Teesside Pension Fund this will require considerable change from the existing investment management arrangements. Planning is underway to manage the transition to allow BCPP management of the assets, and have adequate officer arrangements in place for the Fund to function after April 2018.

BCPP Governance Model

18. The diagram below details the proposed governance structure of the BCPP asset management company and how it is envisaged it will interact with the various control groups within the Partner Funds.



19. An explanation of the above model is attached in Appendix 2 to this report and a summary of pool governance structure, drafted by Eversheds LLP is attached in Appendix 3.
20. Following the government's approval in November 2016 to proceed with development of the BCPP, each of the 12 Administering Authorities within the pool (that are to acquire a shareholding) are currently reviewing their respective governance arrangements and progressing through the appropriate internal governance

arrangements. It is anticipated that the final approval meeting is the 22nd March 2017 and that the documents will be executed at that point.

21. Further work is required to set up BCPP (Asset Management Company) and ensure its FCA registration. This will include finalising contract terms between BCPP and respective Administering Authorities.

EQUALITY IMPACT ASSESSMENT

22. There is no equality impact assessment required with the implication of this report.

LEGAL CONSIDERATIONS

23. 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 Shareholder Agreement, and to ensure that the governance arrangements, specifically the Joint Committee, are fit for purpose.
24. The Summary of Pool Governance Structure document, attached as Appendix 3, 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 Shareholder 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.
25. Due to the challenging timescales for approval, the legal documents are currently in draft form and are subject to change before finalisation. This report therefore recommends delegation to the Head of Legal & Democratic Services (Monitoring Officer) in consultation with Strategic Director Finance, Governance and Support (S151 Officer).
26. Squire Patton Boggs have produced a legal summary of the issues at Appendix 4 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”.
27. As referred to earlier in paragraph 17, this reform causes a considerable change to the Fund’s investment management arrangements. Currently, eleven staff are employed to manage the investments of the Fund. As this function will move to BCPP, TUPE (Transfer of Undertakings (Protection of Employment)) applies to these

affected staff. Following formal approval of the BCPP proposed pooling solution, an initial meeting has been held with Human Resources who confirmed to staff TUPE applies at this stage and set out the implications and their rights. BCPP have engaged a legal firm (Eversheds LLP) to assist them with the transfer of these affected staff. In addition, a plan is in development to ensure the Fund has adequate staffing resources to manage the activities of BCPP, any assets not immediately transferred to BCPP for management and to assist in other matters relating to the management and governance of the Pension Fund.

FINANCIAL CONSIDERATIONS

28. The Teesside Pension Fund will bear the cost of purchasing, as an investment, 1 Class A share of £1, and the cost of the Class B non-voting shares, at a cost of one twelfth of the regulatory capital requirement (€10 million), as determined by the Financial Conduct Authority. All other costs to set up the operator company will be paid out of Teesside Pension Fund monies, and have been previously reported to and agreed by the Teesside Pension Fund and Investment Panel.

RECOMMENDATIONS

29. The Council as administering authority of the Teesside Pension Fund is recommended to:
30. Approve the participation by the Council, acting as the Administering Authority for the Teesside Pension Fund, in the Border to Coast Pension Partnership Pooling Arrangement as the Council's approach to pooling investments in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and the Guidance on Preparing and Maintaining an Investment Strategy.
31. Approve the subscription by the Teesside Pension Fund for 1 class A voting share in the Border to Coast Pension Partnership Limited.
32. Appoint the Mayor (or whomever he decides to nominate) to exercise the Council's rights as a shareholder in BCCP Limited on behalf of the Teesside Pension Fund.
33. Approve the subscription by the Teesside Pension Fund for such number of class B non-voting shares in the Border to Coast Pension Partnership Limited as shall be necessary to ensure that the Council contributes by way of equity one twelfth of the minimum regulatory capital requirement of the company as determined in accordance with the requirements of the company's regulators.
34. Approve the entering into of a Shareholder Agreement (see latest draft in the background documents) between the Council and the Administering Authorities of the other Pool Funds and the company generally in the form described within the Report.

35. Approve the entering into of an Inter-Authority Agreement (see latest draft in the background document) between the Council and the Administering Authorities of the Partner Funds generally in the form described within the Report.
36. Authorise the Head of Legal and Democratic Services (Monitoring Officer), in consultation with the Strategic Director Finance, Governance and Support (S151 Officer), to agree the Articles of Association (see latest draft in the background papers) to be adopted by Border to Coast Pension Partnership.
37. Approve the establishment as a formal Joint Committee under section 102 of the Local Government Act 1972 of the Border to Coast Pension Partnership Joint Committee in accordance with and to carry out the functions set out in the Inter-Authority Agreement.
38. Appoint the Chairman (or Vice Chairman in their absence) of the Teesside Pension Fund and Investment Panel to represent the Council on behalf of Teesside Pension Fund on the Border to Coast Pension Partnership Joint Committee.
39. Authorise the Head of Legal and Democratic Services (Monitoring Officer) to make the necessary changes to the Constitution to enable Middlesbrough Borough Council, as the administering authority for the Teesside Pension Fund, to be a partner on the BCPP Joint Committee and undertake all Fund activities in regards to being an investor in Border to Coast Pension Partnership Limited in its capacity as an Asset Management Company.
40. Authorise the Strategic Director Finance, Governance and Support (S151 Officer) in consultation with Head of Legal and Democratic Services (Monitoring Officer) to finalise the approval and execution, where required, of all legal documents necessary to give effect to the above decisions including the Articles of Association of Border to Coast Pension Partnership Limited, the Shareholder Agreement and the Inter-Authority Agreement

BACKGROUND PAPERS

41. The following background papers are attached as appendices to the report:
 - Appendix 1 – Minister’s Letter Approving the BCPP Proposal
 - Appendix 2 – Border to Coast Pension Partnership Governance Model
 - Appendix 3 – Summary of Pool Governance (Eversheds LLP)
 - Appendix 4 – Squire Patton Boggs Legal Opinion (Summary)
 - Draft Shareholder Agreement of Border to Coast Pension Partnership
 - Draft Inter-Authority Agreement of Border to Coast Pension Partnership
 - Draft Articles of Association of Border to Coast Pension Partnership

AUTHOR

Paul Campbell – Head of Investments and Treasury Management
Tel. No. 729024



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

Department for Communities and Local
Government
4th Floor, Fry Building
2 Marsham Street
London SW1P 4DF

Tel: 0303 444 3460
Fax: 020 7828 4903
E-Mail: marcus.jones@communities.gsi.gov.uk
www.gov.uk/dclg

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.

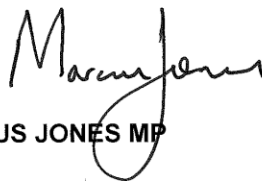
I therefore expect every administering authority in England and Wales to participate in a pool. I also expect authorities to place all assets in their chosen pool, unless there is a strong value for money case for delay, taking into account the potential benefits across the pool, and to delegate investment 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.

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,

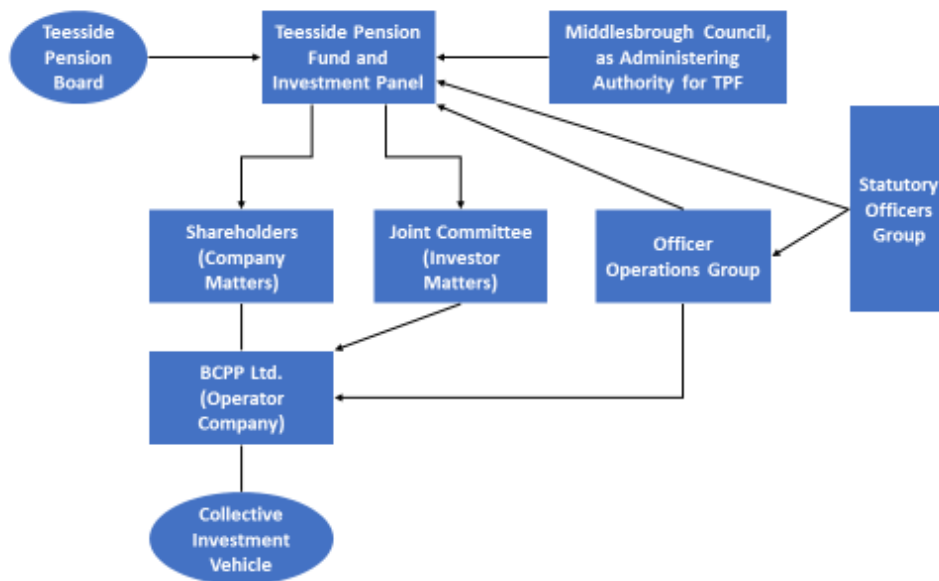


MARCUS JONES MP

Participating funds:

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

BCPP Governance Model



The key components of the above governance model are below:

Teesside Pension Fund and Investment Panel (the Investment Panel)

1. As per the delegations agreed in the Council's Constitution, the Investment Panel is the Council Committee delegated to exercise all matters in relation to investing the Pension Fund's assets. The primary role in this regard is setting and monitoring the total portfolio asset strategy, i.e. deciding the proportion of the Fund that is invested in equity investments, bonds, commercial property, etc. The asset strategy drives the greatest proportion of the Fund's total return. Setting an appropriate asset strategy is also how a Fund ensures its requirements from its investments, i.e. its asset strategy, is aligned to its funding requirements as independently assessed by the Fund's Actuary. Responsibility for this role does not change under pooling.
2. The Pool will offer a template of asset allocation choices and the Investment Panel, having received appropriate external advice, will determine the appropriate asset allocation for the Teesside Pension Fund from within the template. Determination of the final asset template is an iterative process to ensure it meets both the needs of the Partner Funds and also delivers the savings anticipated. The template is currently in draft format and to ensure it meets Teesside's needs, feedback has been provided by both Officers of the Fund and both external Independent Investment Advisors.
3. The Investment Panel currently has delegated power to make investment manager arrangements for the Teesside Pension Fund, including whether to continue to manage the investment assets using its own employees or hire

external managers and which external managers to hire. It is, therefore, at the Investment Panel that many of the current mandates, including the internal management arrangements, will need be terminated so that revised mandates can be awarded to BCPP. This will be actioned over a period of time with a large proportion of the Fund's holding expected to transfer in the first two years of operation (April 2018 - 2020).

4. The Investment Panel will take on a new responsibility; that of reviewing the minutes of the BCPP Joint Committee and providing the Teesside representative with feedback for input into future meetings.

BCPP Joint Committee (Investor Matters)

5. This Committee will ensure BCPP Partner Funds investment issues are appropriately considered by the Board of Directors of the Asset Management Company (BCPP Ltd.). Each Partner Fund will have one representative on the Joint Committee. It is expected that they will exercise scrutiny over the investment performance of the Company. It will also retain an advisory role over the functioning of the company. Its meetings will be governed by local government law and privacy determined accordingly. Voting will be by simple majority.
6. 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 the pool as set out in the Terms of Reference of the Joint Committee and other legal documents, 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 pooled vehicle, investor reporting (including frequency and content) and investor voting rights (including on proposed changes to the pooled vehicle).
7. As a section 102 Committee, each Fund's representative on this Committee has to be an Elected Member. To effectively represent the Fund, Members of this Committee will need to be fully conversant with the Funds asset strategy; performance targets and Funds investment risk appetite. It is proposed for Middlesbrough Council that the Chair of the Teesside Pension Fund and Investment Panel (or Vice Chair in their absence) will act on behalf of the Teesside Pension Fund at the Joint Committee.
8. To reflect the creation of the Joint Committee, and the shareholder responsibilities, it will be recommended to Council that the Constitution be updated to amend the Terms of Reference of the Pensions Committee.

Shareholder Group (Company Matters)

9. Each Partner Fund will become a shareholder of the Company (the "Operator"). As the Council cannot attend shareholder meetings to exercise its voting rights in person, it these will need to be exercised by a delegated representative at each meeting.

10. In contrast to the Joint Committee the representative delegated to exercise the voting rights of the Council can be either an Elected Member or an Officer. It is proposed that Council is asked to agree that the Mayor (or whomever he decides to nominate) has the delegated authority to vote on behalf of the Council's shareholding at BCPP (Asset Management Company) shareholder meetings.
11. It will be necessary that prior to exercising the Council's voting rights the delegated representative clarifies the views of the Council so as to ensure they are voting in accordance with the Council's wishes.
12. In exercising voting rights on behalf of the Council as Shareholder, the appointed representative will also be supported by the Council's s151 Officer and Monitoring Officer to ensure any matters of process governance or conflict are appropriately addressed.
13. As this is a wholly owned 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.
14. The role of the Administering Authorities as shareholders will be to provide oversight and control of the operation of the Company and is likely to include the:
 - Approval of the Annual Business plan.
 - Approval of budgets, fee models and the overall cost base and cost apportionment.
 - Appointment and removal Directors, including non-executive directors of BCPP.
 - 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 risk register.
 - Appointment of Auditor.
15. The exercise of these rights will be governed by the constitution of the company and private company law. This means that different priorities from simple majority to unanimity can be attached to different types of decision. Meetings will be held in private and once established it is anticipated that there will only be the requirement for an annual 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). The duties and responsibilities of being a shareholder mean that each Partner Fund has protection as it will have limited liability (subject to regulatory capital requirements).
16. Generally as a shareholder there will be no involvement in day to day company operational matters which are carried out by the Board of Directors. The exercise and conduct of business by this group will be set out in Articles of Association, which will include consulting on key strategic and operational matters. Each

Partner Fund will also be required to agree to the terms of, and act in accordance with the Shareholders' Agreement.

BCPP Asset Management Company (“the Operator”)

17. 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 model, given the constituent make-up of the partner Funds of BCPP, was for a wholly owned Teckal compliant company, i.e. adhere to Regulation 12 of the Public Contracts Regulations 2015, operating a fully regulated structure under the Financial Conduct Authority (FCA).
18. The BCPP Asset Management Company will primarily be responsible for the actions of the internal investment teams and hiring / firing external investment managers with a view to ensuring the performance of each of the sub-funds meets the asset allocation and performance requirements of the Partner Funds.
19. Subject to approval from the respective Administering Authorities, the BCPP Asset Management Company would be owned by the 12 local authorities as Administering Authorities within the investment pool with each local authority, each authority having 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 Pension Fund and as a closed Fund in full run off there is no advantage from changing this arrangement and incurring the additional cost of acquiring a shareholding.
20. To ensure FCA compliance there will be no direct Administering Authority representation on the BCPP Company Board of Directors.
21. To ensure the Partner Funds can transfer their assets to the new BCPP Company it will need to be “Teckal” compliant. As the contracting body, adherence to these public procurement rules will be an individual responsibility of each of the individual Authority, not the new company.
22. Under Regulation 12 of the Public Contracts Regulations 2015, contracts within a Teckal 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.

23. It is through the exercise of the above unanimous shareholder reserved matters that the Council demonstrates a controlling influence and therefore Teckal compliance. The key ones being:

- Approval of the Annual Business Plan.
- Appointment and removal Directors, including non-executive directors of BCPP.
- Approval of the Initial Strategic Plan and each Subsequent Strategic Plan.
- Approval of budgets, fee models and the overall cost base and cost apportionment.

24. The BCPP Company will receive an Operator Fee from the Administering Authorities, which is intended to cover the Company's operating costs. The exact amount and method of calculating the Fee have not yet been determined. To the extent that the Fee represents a commercial charge in consideration for services that the Company provides to the Administering Authorities, at market value (i.e., there is no over-compensation), and/or is a charge that a private investor similarly placed would expect to pay, it would not constitute State aid. In the alternative, a State aid risk would be avoided provided that the Company is not active on the market, such that any "aid" it receives could not give rise to a distortion of competition.

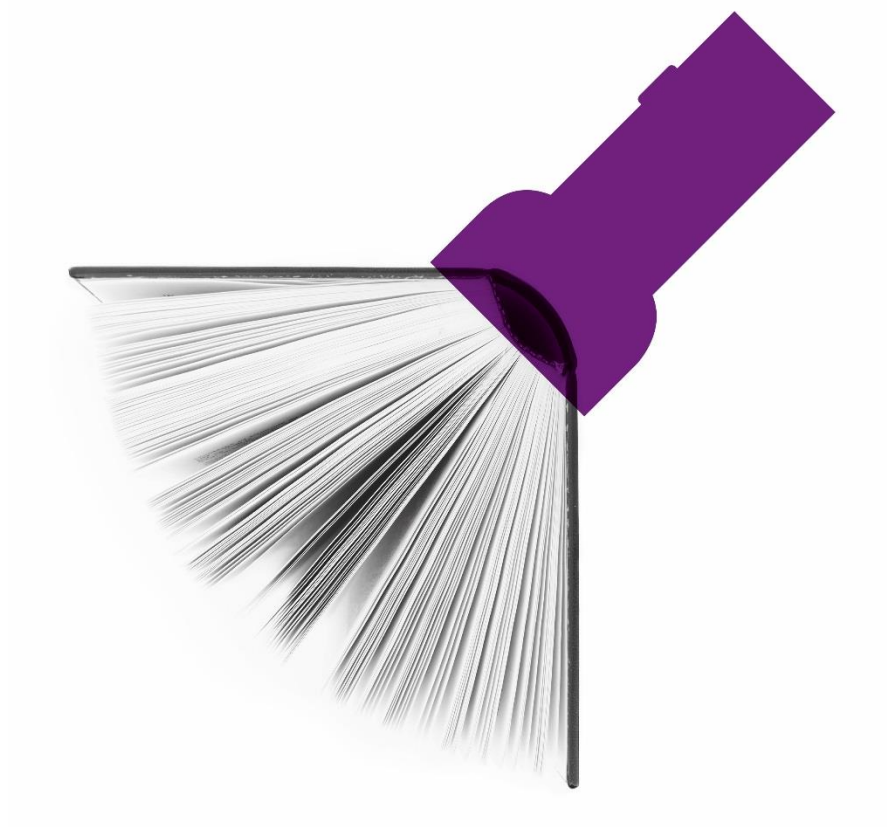
25. BCPP (Asset Management Company) will be required to operate under Local Authority Regulations, the Financial Services and Markets Act 2000 (FCA compliance) and the Corporate Governance Code.

26. It is proposed that the Board of Directors will comprise of 3 Executive Directors and a Chairman and 2 Non-Executive Directors. Each of these directors are required to be noted on the Financial Conduct Authority (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 to ensure the non-executive Directors carry the proportionate vote that the Chairman has the casting vote should this be required.

Border to Coast Pensions Partnership

Summary of Pool Governance Structure

[INSERT DATE] 2017



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.

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

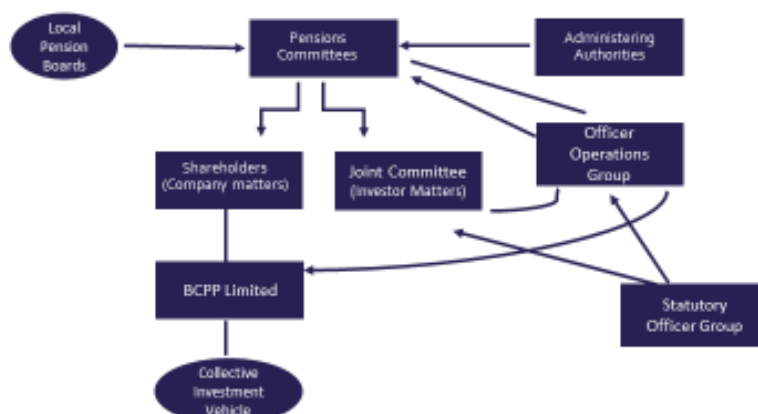
- Border to Coast Pensions Partnership Limited's Articles of Association,
- the Shareholders' Agreement; and
- the Inter Authority Agreement (containing the BCPP Joint Committee's Terms of Reference and Constitution and the Terms of Reference for the Officer Operations Group and the Statutory Officers 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 Border to Coast Pensions Partnership Limited, the Shareholder Representatives, the BCPP Joint Committee, the Officer Operations Group and the Statutory Officers Group).
- 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 Governance Model



Border to Coast Pensions Partnership Limited

- 1.3 Border to Coast Pensions Partnership Limited is a private company limited by shares. The company was incorporated in England and Wales on [*insert date*] with registered number [*insert number*] under the Companies Act 2006. Its registered office is at [*insert registered office*]. 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 by which the shareholders exert control over the company and its board of directors.
- 1.4 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.
- 1.5 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. Directors are appointed (and can be removed) by the authorities as shareholders. The directors have to produce an annual business plan including an annual budget for approval by all of the shareholders.
- 1.5 The company will have twelve shareholders, Bedford Borough Council, Cumbria County Council, Durham County Council, East Riding of Yorkshire Council, Lincolnshire County Council, Middlesbrough Borough Council, Northumberland County Council, North Yorkshire County Council, South Tyneside Council, 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.

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 Border to Coast Pensions Partnership Limited. 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 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 authorities' relationship with each other as shareholders and regulates certain aspects of the affairs and their dealings with Border to Coast Pensions Partnership Limited. The Agreement provides the framework for the 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. In particular, the Shareholders' Agreement provides that certain key strategic shareholder decisions require 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. Decisions requiring 100% approval include (without limitation):
- 2.4.1 approving the company's annual business plan including its annual budget;
 - 2.4.2 appointing and removing directors of the company
 - 2.4.3 admitting any new LGPS administering authority as a new member of the company or as a new investor in the BCPP Pool;

- 2.4.4 extending the activities of the company outside the scope of its business;
 - 2.4.5 closing down any operation of the company's business;
 - 2.4.6 altering any of the provisions of the Articles of Association or any of the rights attaching to the shares;
 - 2.4.7 allotting, reducing or cancelling any of the company's share capital; and
 - 2.4.8 passing a resolution to wind up the company.
- 2.5 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 shareholder meetings need to be kept separate from BCPP Joint Committee meetings.
- 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.
- 2.7 Because an 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 an officer or a member since no delegated powers are being exercised.
- 2.8 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 comment then the representative may have to exercise some discretion. That exercise of discretion should, so far as possible, reflect the known views of the authority.
- 2.9 The representative, if an elected member, may be the same individual that represents the authority on the BCPP Joint Committee. Ordinarily the interests of each authority as a shareholder in Border to Coast Pensions Partnership Limited ought to be completely aligned with the interests of the authority in its capacity as an investor/customer in the Pool, so conflicts of interest are unlikely to arise. However, if they do, 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 authority to decide and should common appointments be made an appropriate conflicts policy will be required.

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 Border to Coast Pensions Partnership Limited 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 Border to Coast Pensions Partnership Limited) and therefore each authority will have investor rights afforded by its contractual agreement(s) with Border to Coast Pensions Partnership Limited.
- 3.3 For example, in the case of the ACS, the contractual relationship between an administering authority and Border to Coast Pensions Partnership Limited 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 Border to Coast Pensions Partnership Limited, for example equivalent documentation relating to other collective investment vehicles that Border to Coast Pensions Partnership Limited may operate and/or asset management agreements where Border to Coast Pensions Partnership Limited 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 a year (with support from the Officer Operations Group) to consider and advise the administering authorities on investor issues such as:
- 3.6.1 service delivery by Border to Coast Pensions Partnership Limited and any action needed to be taken in relation to its performance; and
 - 3.6.2 BCPP Pool related investment issues, for example adopting common approaches to investment policies (for example common social, environmental and corporate governance policies or policies on voting rights).
- [INSERT ANY OTHER AREAS TO BE AGREED]
- 3.7 The BCPP Joint Committee would not make binding decisions on any of these issues but would make recommendations back to each administering authority for each authority to decide. Where any issues do need to be resolved by the BCPP Joint Committee, these will be decided by a majority vote of those present. Each administering authority represented on the Joint Committee exercises one vote.
- 3.8 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.
- 3.9 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.

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 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 [Border to Coast Pensions Partnership Limited]; and

- 4.2.4 act as a conduit for the BCPP Joint Committee to communicate back to the respective authorities and/or direct to [Border to Coast Pensions Partnership Limited] as appropriate.

5. Statutory Officers Group

- 5.1 The Statutory Officers Group will be made up of one or more statutory officers from each administering authority, e.g. the section 151 officer and/or monitoring officer. The Statutory Officers Group will support the BCPP Joint Committee and the Officer Operations Group from the perspective of the administering authorities.
- 5.2 Like the Officer Operations Group, the Statutory Officers 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.

Eversheds LLP

[INSERT] 2017

DRAFT



Borders to Coast Pension Partnership Limited: Legal Opinion

1. Background

In our capacity as legal advisers to the participant funds in the pooling arrangement known as Borders to Coast Pensions Partnership (the “**BCPP Pool**”), we have been asked to provide a legal opinion to each of the administering Authorities who have agreed to participate in that arrangement to support that participation (the “**Authorities**”).

We have reviewed and commented, on behalf of the Funds, on the following documentation:

- a summary of the governance arrangements prepared by Eversheds;
- a draft Shareholders' Agreement to be entered into by each of the participating funds in their capacities as Administering Authorities of those funds and Borders to Coast
- Pensions Partnership Limited (“**BCPP Limited**”);
- a draft Inter-Authority Agreement (“**IAA**”) between the Authorities; and
- a draft set of Articles of Association for BCPP Limited.

We have also seen copies of three advice notes dealing with the following subjects:

- Eversheds’ advice on the basis of LGPS participation and liability in case of default dated 20 December 2016;
- Eversheds’ advice on Regulatory Capital dated 12 January 2017, and
- Deloitte’s draft advice Regulatory Capital dated 23 December 2016.

2. Compliance with relevant legislation: Corporate Structure

The participation in the BCPP Pool involves the subscription for separate classes of shares in BCPP Limited on an equal basis by each of the Authorities.¹

The creation of two classes of shares, one of which will be voting (“**A Shares**”) and one nonvoting (“**B Shares**”), enables simplification of the treatment of voting and regulatory capital which is

¹ South Yorkshire Pensions Authority will be acting on its own behalf and that of the Sheffield City Region Combined Authority, which is the administering authority for the South Yorkshire Passenger Transport Pension Fund (the “**SYPTPF**”) which, it has been decided for economic reasons, will not become a shareholder in its own right.

necessary for the purposes of BCPP Limited gaining appropriate authorisation from the Financial Conduct Authority (the “FCA”) in order to conduct its business i.e. as an alternative investment fund manager.

In subscribing for the shares in BCPP Limited, each of the Authorities will be using their statutory powers under the Localism Act 2011 (in particular Sections 1 and 4(2)), respectively the general power of competence and the requirement on local authorities to use a company where it does something for a commercial purpose).² The other relevant statutory powers are contained in the Local Government Pension Scheme Regulations 2013 which designate (in schedule 3) the Authorities which are required to maintain and administer pension funds.

Because the purpose of participation in the BCPP Pool is to enable the Authorities to discharge their statutory investment powers (in respect of pooling of investments) by their pension funds, it is appropriate for both the voting A shares and the regulatory capital represented by B Shares to be held as investments of the Pension Funds.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (“2016 Regulations”) effectively ring-fence Pension Fund money from other assets of the Authorities under Regulation 4. This applies of course to benefit payments, which must be paid from the Pension Fund (Regulation 4(4)), but also to all income and capital gains arising in respect of investments held by the fund (Regulation 4(1) (c) and (d). Regulation 4(5) goes on to state that “any costs, charges and expenses incurred [in] administering a pension fund may be paid from it”, except for costs relating to pension sharing orders (i.e. relating to divorce cases). From a legal perspective we see no reason why the costs of investing in (including the future operation of) BCPP Limited cannot be charged to the Pension Fund, in the same way as other investment expenses, since these are incidental to the investment made.³

By investing in BCPP Limited and consequently the BCPP Pool, the Authorities will be complying with their other obligations under the 2016 Regulations.). Since the repeal of the previous regulations (the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009), there are no quantitative limits on the way in which each administering authority must invest its pension fund, other than a prohibition on investing more than 5% of the total value of that fund in entities which are connected with the relevant authority within the meaning of Section 212 of the Local Government and Public Involvement in Health Act 2007 or more generally by reference to the restriction on employment related investments under section 40 of the Pensions Act 1995. As explained in Eversheds’ note on Regulatory Capital, those tests will only apply to the Authority in whose pension fund BCPP Limited participates as an employer. Those restrictions will not be breached on mathematical grounds by that Authority (one twelfth of the regulatory capital requirement of EUR10 million being significantly less than the value of any of the Authorities’ pension fund assets).

Separately, there are obligations on each of the Authorities to formulate an investment strategy in accordance with Regulation 7 (the “**Investment Strategy Statement**”) and to comply with any directions by the Secretary of State under Regulation 8. Each Authority’s Investment Strategy Statement therefore must confirm that its participation in the BCPP Pool will discharge the statutory obligation under Regulation 7 (2) (d), (i.e. to state the Authority’s approach to pooling of investments, including the use of collective investment vehicles and shared services).

² As far as the SYTPF is concerned, the relevant references are to the Transport Act 1968, Sections 10A and 10B (6).

³ This is a legal, not an accounting, interpretation of Regulation 4. Please see Schedule 1 re the scope of our advice.

A further consequence of the corporate structure which is required for FCA purposes is that, because each of the Authorities will have a controlling influence over BCPP Limited, it will be a “controlled company” for the purposes of the Local Authorities (Companies) Order 1995. This (and the disclosure obligations flowing from that status) are reflected in the Shareholders' Agreement.

3. Fiduciary duties of the Authorities

DCLG's consultation paper on the 2016 Regulations (in their draft form) made it clear that the Government accepted that Administering Authorities, when exercising their statutory investment powers, did so under a fiduciary duty (to members and employers). There is nothing in the pooling arrangement that would conflict with that duty.

4. Procurement compliance

BCPP Limited is to be established as a company which is compliant with Regulation 12 of the Public Contracts Regulations 2015 (the (“**Regulations**”).⁴ This allows the Authorities to enter into contracts with BCPP Limited without observing the standard requirements of the Regulations, including most importantly the requirement for an open and competitive tender. This exception applies because: (i) each of the Authorities will exercise control over BCPP Limited jointly; (ii) its activities will be carried out solely in the performance of tasks entrusted to it by the Authorities; and (iii) there will be no private capital participation in BCPP Limited.

The essential element of joint control is evidenced through the list of reserved matters which is set out in Part A of Schedule 1 to the Shareholders' Agreement. In addition, the Shareholders' Agreement specifies that the business of BCPP Limited will be to act as an alternative investment fund manager for the Shareholders (clause 2), and there will be no private investment in the company. We are accordingly satisfied that the engagement of BCPP Limited by each of the Authorities will not require the procurement of those services to be provided by BCPP Limited to be competitively tendered.

It should be noted that compliance with the conditions set out above is an ongoing requirement in order to ensure that the Authorities continue to benefit from the exception in the Regulations. Any future changes to the nature of the Authorities' control over BCPP Limited, the scope of its activities or the entry of any private capital may therefore alter this analysis. For that reason we have drafted into the amendment clause in the Shareholders' Agreement a further protection that no amendment will be permitted that would have the effect of undermining the compliance of BCPP Limited with the Regulations.

5. State Aid

Each of the Authorities will pay BCPP Limited a fee, referred to as the operating charge, which we understand is intended to cover BCPP Limited's operating costs. The method of calculating the operating charge and its likely amount have yet to be determined. From a State aid compliance perspective, on the assumption that the charge represents a commercial charge in

⁴ The test is commonly referred to by reference to the leading case in this area, *Teckal Srl v Comune de Viano and Azienda Gas-Acqua Consorziale di Reggio-Emilia* [1999], whose principles have now been codified into Regulation 12.

consideration for services that BCPP Limited provides to the Authorities, at market value, and thus is a cost that a private investor in a similar position to the Authorities would expect to pay, it will not constitute State aid. In addition, if BCPP Limited will only act for the Authorities and not for any third parties (either public or private) – i.e., it will not be active on the market – any payment it receives from the Authorities is therefore not capable of distorting competition. It therefore would not constitute State aid. Since BCPP Limited will not, we understand, be tendering for business from other LGPS authorities or other investors, we do not consider that it would be active in this way.

6. Governance Model: Local Government Law Compliance

The Inter-Authority Agreement documents the terms on which each of the Authorities will participate in a joint committee under Sections 101 and 102 of the Local Government Act 1972. The statutory framework under the above sections contains no restrictions which have been breached by the proposals set out in the Inter-Authority Agreement and the terms of reference for the joint committee are therefore in keeping with the requirements of legislation (and with good governance).

7. Other statutory compliance

Both the Shareholders' Agreement and the Inter-Authority Agreement contain requirements on the Authorities and BCPP Limited (under the Shareholders' Agreement) to comply with other legislation which is applicable to local authorities in general terms. That includes the Equality Act 2010, the Freedom of Information Act 2000, the Environmental Information Regulations 2004, anti-bribery legislation and data protection legislation. Schedule 2 of the Inter-Authority Agreement, which sets out the constitution of the Joint Committee, also makes provision for the meetings of the Joint Committee to be open to members of the public unless it is necessary to exclude the public in accordance with Part VA of the Local Government Act 1972.

8. Conclusion

Based on the draft documentation which we have seen, we are satisfied 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.

Squire Patton Boggs (UK) LLP
[20] January 2017

DRAFT

APPENDIX 1: Scope of Advice

1. The advice in this report is provided only to the administering authorities participating funds (the “**Authorities**”) in Border to Coast Pension Partnership Limited (“**BCPP**”). It was prepared solely for the purpose of assisting the Authorities in accordance with the scope of our appointment to advise them on participating in BCPP. It is not advice to any other connected or stakeholder parties, auditors or other advisers, or other third parties (“**Third Parties**”). No part of this advice may be passed on to Third Parties without our written agreement but, if it is so passed, we accept no responsibility, and will have no liability in contract, tort or otherwise, to those Third Parties in relation to this advice.
2. This advice only considers the legal issues in relation to the proposed investment in BCPP by the Authorities. We have reached our conclusions based on an understanding of the law as at the date of this report. Accordingly, it is possible that this report will need to be updated if the law changes. However, we will only do so if we are specifically instructed to do so. We have not considered or advised on the tax efficiency of the matter or its commercial or accounting implications where we understand the Authorities have taken separate advice from Deloitte.
3. The documents on which this advice has been based are as set out in paragraph 1 of the report above. In accepting instructions from the Authorities we have not undertaken to review, nor are we responsible for reviewing, all or any elements of any other documentation (unless specifically agreed in writing) which may be relevant to specific Authorities. In particular, it is not within the scope of our appointment to review the constitutional documents of any of the Authorities. Accordingly, we do not accept liability should our advice be based on erroneous assumptions or documents or information with which we have not been provided.