

TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 9

TEESSIDE PENSION BOARD REPORT

24 JULY 2017

STRATEGIC DIRECTOR FINANCE, GOVERNANCE & SUPPORT – JAMES BROMILEY

LGPS INVESTMENT REFORM (POOLING ASSETS) – UPDATE

1. PURPOSE OF THE REPORT

- 1.1 To follow up the reports on LGPS Investment Reform presented at previous meetings and inform Members of the Teesside Pension Board (the Board) of the latest developments in setting up the new Pool (BCPP – Border to Coast Pension Partnership).

2. RECOMMENDATION

- 2.1 It is recommended that Members note the report and pass any comments thought relevant or appropriate.

3. FINANCIAL IMPLICATIONS

- 3.1 The exact financial implications are not known at this time since only high level proposals have been produced. It is known there will be costs:
- To set up BCPP, particularly as it is required to be regulated by the Financial Conduct Authority (FCA);
 - To transfer the Fund's assets to the chosen Pool, although if this transfer is *in specie* this will be minimal; and
 - Once up and running, there will be management expenses for managing the new Pool shared by the Pool's partners.
- 3.2 A detailed estimate of the implementation costs was set out in the BCPP proposal which has previously been presented to the Board. Within this estimate, a worst case scenario cost to set up BCPP of approx. £4.2 million was calculated. This estimate was provided by Deloitte as part of their cost benefit analysis for BCPP's final submission. This cost is shared equally among the 12 shareholders/partners of BCPP, which equates to approx. £350,000 each.
- 3.3 It is anticipated that there will also be potential savings and other benefits:

- If an Authorised Contractual Scheme (ACS) structure is used, there are further savings to withholding tax on dividends received from French and Swedish equity investments;
- The scale of BCPP will potentially reduce the management costs of externally managed funds, including infrastructure related investments, to a lower cost making these funds more attractive investments than they are currently; and
- Access to a larger pool of investment professionals than is currently available to the Fund should improve resilience and provide a greater range of investment asset classes available to the Fund.

4. BACKGROUND

4.1 In his speech on the Comprehensive Spending Review on 25th November 2015, the Chancellor announced the release of the awaited consultation on pooling. Paragraph 1.138 states:

“The government will today publish guidance for pooling Local Government Pension Scheme Fund assets into up to 6 British Wealth Funds, containing at least £25 billion of Scheme assets each. The government is now inviting administering authorities to come forward with their proposals for new pooled structures in line with the guidance to significantly reduce costs while maintaining overall investment performance, with the wider ambition of matching the infrastructure investment levels of the top global pension funds”.

4.2 In summary, the DCLG’s criteria are:

- Asset pools achieve the benefits of scale – Pools should be £25 billion as a minimum.
- Strong governance and decision making – Pools need to be capable of managing investments and risk on behalf of Funds.
- Reduced cost and excellent value for money, with savings made across the LGPS.
- Improved capacity to invest in infrastructure – This is implied with the pools having greater scale than single Funds.

4.3 A report was presented to the Teesside Pension Fund & Investment Panel (the Panel) meeting held on 9 February 2016 where Panel Members agreed to partner with the Borders to Coast Pension Partnership (BCPP) pool. It was also agreed at that meeting that the Fund would submit the BCPP initial proposal to the DCLG, which was done on 19 February 2016. The initial proposal was well received, and provided the foundation to continue with the more detailed final submission.

4.4 The detailed proposal was presented to the Panel at the meeting held on 29 June 2016. The Panel agreed this version of the proposal and delegated authority to the Chair to review the final version and sign it on behalf of the Fund. The final BCPP proposal was

submitted to DCLG on 15 July 2016 for further consideration. Representatives from the DCLG, HM Treasury and independent advisors met on 8 September 2016 to consider BCPPs submission. The Minister for DCLG required a further meeting on 24 November 2016 before issuing his letter approving the BCPP proposal in December 2016.

4.5 At a subsequent BCPP Member Steering Group meeting on 30 September 2016 it was agreed to set up a detailed project plan, creating three Member sub groups who will report back to the main Member Steering Group, and begin preparation work in these areas:

- Operating Model – Asset servicing, ICT systems sourcing and implementation, FCA compliance, asset structuring, etc.
- People – Setting remuneration packages for senior executives, TUPE transfer of existing staff, recruitment of senior executives & staff, and securing suitable premises.
- Governance and Monitoring – Co-ordinating final approvals to approve the creation of the Joint Committee and final commitment by each Partner Fund to the acquisition of an equal voting shareholding in BCPP.

4.6 The latest meeting of the Member Steering Group/Joint Committee, was held on 6 June 2017. Members were updated on progress by BCPP on (further details below):

- Update on BCPP project delivery and implementation budget.
- Update on the governance documentation and incorporation of BCPP Ltd.
- Refinement of BCPP corporate entity and cost sharing principles.
- Development of the Target Operating Model (TOM) and asset template progress.
- Update on the property search.
- Options for terms & conditions of Employees of BCPP Ltd.
- Company committee structures and the roles of Non-Executive Directors.
- Governance requirements for BCPP Ltd. as a Financial Conduct Authority (FCA) regulated entity.
- Update on the Executive search, remuneration and recruitment process.

4.7 Attached as Appendix A is a high level project plan showing progress made since receiving ministerial approval. The key change to note is the change of proposed “go live” date to 1 June 2018, a slippage of two months.

5. BCPP – OPERATING MODEL

5.1 The key areas of scope within this workstream are summarised in the table below:

Core Activity	Description	Status
Tax and Financial Services tender	Tender for external consultancy services covering the tax and financial considerations relating to the Operating Model and asset structuring	Completed
Operating and Regulatory Model tender	Tender for external consultancy services covering the selection of the depository, FCA compliance and ICT design and implementation	Completed
Operating Model	FCA approved process, selection of depository and associated service providers, and design, testing and implementation of ICT (in conjunction with external advisor(s))	Ongoing & to plan
Asset allocation template	Design of the asset allocation template detailing the sub-funds to be offered – to be approved by the Joint Committee	Ongoing & to plan
Sub-fund prospectuses	Drafting of the prospectus for each sub-fund – to be approved by the Joint Committee and reviewed/approved by the FCA	To commence in summer 2017
Transition planning	Timetable for transition of assets and selection of appropriate external transition managers	To commence in summer 2017
Resource planning	Determine the appropriate level of resources to manage the proposed sub-funds – linking with the people workstream	To commence in summer 2017

5.2 All external advisors for the workstream are now in place:

- Legal (Eversheds Sutherland);
- Tax and Financial Services (Deloitte); and
- Operating and Regulatory Model (Alpha FMC)

5.3 The aim of this workstream is to build an approved FCA Operator. The Target Operating Model works from the order management system for each sub-fund transaction through settlement to custody and update of the asset/accounting records at BCPP. It will also feed internal control systems at BCPP's Depository which will carry out the reconciliations needed to ensure the assets are safe and correct.

5.4 The current direction is for BCPP to build its own Operating Model, as this gives it greatest flexibility, particularly with investment options and external manager choice. Most rented options are prohibitive and can restrict choices over investments and external managers/other suppliers, and this option was dismissed by the Member Steering Group.

- 5.5 At this stage the Model is looking at acquiring ICT systems and procuring from suppliers that are already FCA approved. By piecing these together into an overall Target Operating Model, time is saved obtaining approval from the FCA for these parts of the overall jigsaw with only the interfaces and links needing to be tested rigorously to pass FCA inspection.
- 5.6 A consequence of this approach is that until the full picture is pieced together, the administration and accounting staffing requirement at BCPP cannot be determined as the exact tasks required are not yet fully known.
- 5.7 Where the Fund currently procures services from a Custodian to keep safe custody of our equities, bonds, etc., BCPP will procure services from a Depository (e.g. HSBC Bank, Northern Trust or State Street). A Depository will procure services including sub-contracting custodian services from a Custodian. It is common that the Custodian is part of the same company group as the Depository.
- 5.8 In this arrangement, the Depository will put in place internal controls needed to pass FCA approval and will carry out many of the checks the Fund currently carries out as part of our validation controls to prove the accuracy and integrity of our asset data. Whereas our checks are usually completed on a monthly basis, because BCPP is managing client investments, these checks will be carried out on more of a rolling basis, ultimately to provide BCPP's clients with sub-fund unit prices as frequently as required.
- 5.9 In addition to safe custody, a Depository has a legal requirement to act as a policeman for the FCA, and ensure that each sub-fund of BCPP is in compliance with the FCA approved prospectus. In this respect, it is acting in a similar manner as a Trustee for BCPP and the clients/customers of BCPP. To carry out this function effectively, a Depository has greater checks and controls in place than the usual customer/supplier Custodian relationship.
- 5.10 The asset servicing provider will value the underlying assets and provide a unit price for the sub-fund unit trust. Again, it is usual for this to be part of the same company group as the Depository since, in order to achieve FCA approval, the Depository is required to ensure accuracy and timeliness of pricing, and have in place adequate FCA approved audit and validation checks.
- 5.11 The asset allocation template currently being developed is sufficiently flexible to allow the Teesside Fund to continue to invest with a very similar asset allocation as now. This has been developed over time with input from the Fund's Officers and Investment Advisors, and presented to the Chair of the Panel at a Member Steering Group meeting. It is also flexible enough to allow the Fund to make some changes to its investment strategy ahead of the pooling date, should these be needed.

6. BCPP – PEOPLE/PROPERTY

- 6.1 The People sub-group has tendered for and contracted with a recruitment consultant (Odgers & Berndtson) to assist with creating the remuneration packages for the senior Executives and Non-Executives of BCPP and recruiting to these positions.
- 6.2 At the Member Sub Group meeting on 31 January 2017, the outline remuneration package for the Executives and Non-Executives for BCPP were discussed. The draft outline packages agreed were taken back to each Fund and agreed for the following posts:
- Executive posts:
- Chief Executive Officer
 - Chief Operating Officer/Chief Finance Officer
 - Chief Investment Officer
- Non-Executive Posts:
- Chair
 - 2 x Non-Executive Directors
- 6.3 Adverts for the Chair and Chief Executive Officer posts have closed and interviews are due to take place in June/July 2017 for the Chair and July 2017 for the Chief Executive Officer. The remaining two Non-Executive Director positions were advertised in April with interviews due to take place in July 2017. The remaining Executives were advertised in late June 2017 with interviews planned for September 2017.
- 6.4 The remuneration package and job description/person specification for the final senior position of Chief Risk Officer is being developed. This position is not a Board Member, therefore the package does not require shareholder approval, only Board approval. This post was also advertised in late June 2017 with interviews planned for September 2017.
- 6.5 At the last Member Steering Group/Joint Committee meeting on 6 June 2017, Members agreed outline terms and conditions for the remaining staff of BCPP Ltd. This included an outline BCPP package proposal which allows staff to either take part in the LGPS, but receive a lower pay rate, or take a defined contribution (DC) pension and receive a higher pay rate, with the total cost to BCPP of both options equal when employer contributions for the LGPS or DC scheme are included.
- 6.6 The premises search has begun with the appointment of WSB Property Consultants LLP, a Leeds based property agent, to assist with the search, narrow down the choices to a few and assist with negotiating the terms of a lease. The current position is to look for premises on a ten year lease, with a break option after five years. Properties in the centre and outskirts of Leeds are being investigated, with central Leeds currently favoured as the cost differential is not as great as first envisaged and communication links in central Leeds are much better.

7. BCPP – GOVERNANCE & MONITORING

- 7.1 The sub-group for Governance and Monitoring have procured legal advice from Eversheds Sutherland LLP for BCPP Ltd. and Squire Patton Boggs (SPB) LLP for each Fund. Eversheds Sutherland LLP have prepared the key documents needed for the Pool to function (Articles of Association & Shareholder Agreement for BCPP Ltd., and an Inter-Authority Agreement for the Joint Committee) with SPB LLP reviewing on behalf of the Funds.
- 7.2 A standard report was prepared for each Administering Authority to obtain authority from each partner Council to set up the Joint Committee to oversee the investment activities of BCPP and for each Council to acquire the required shareholdings. The Fund's report was presented to full Council on 15 February 2017 and the recommendations agreed (including the Minister's approval letter). All reports were presented to the administering authorities of each BCPP partner before the end of March 2017.
- 7.3 All the required documents are now at a state of agreement for all Funds. BCPP Ltd. was incorporated on 31 May 2017, and the Shareholder Agreement and Inter-authority Agreement are now signed and sealed by all shareholders/partners, and executed on 6 June 2017.

8. TEESIDE PENSION FUND – TRANSFORMATION PLAN (ASSETS)

- 8.1 The key risks to assets is the continued management of existing investment assets, the identification of assets to transfer to BCPP and the actual transfer itself, monitoring the investment management of BCPP in the future, and management of any legacy assets not initially transferred, e.g. direct property.
- 8.2 To start mitigating the asset risks, which assets will transfer to BCPP for management and which assets will remain for the Fund to manage will be identified. There are three issues with this:
- i. BCPP does not have a definitive timetable ready yet for receiving assets and start managing them. This dependency is causing uncertainty over the on-going management of assets and how long the current arrangements are required;
 - ii. For BCPP to create a relatively low cost, active management in-house team, they need to create this from the existing staff of three internally managed Funds in BCPP (Teesside, East Riding and South Yorkshire Funds), plus additional new staff where needed. At this stage, this is an unknown entity without a track record of working as a collective; and
 - iii. The Minister's approval letter states "*I expect every administering authority 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 management selection to the pool.*" To our knowledge, the Minister has not set what he considers the criteria for a "*strong VFM case*", but for the Teesside Fund it is

recognised that the current arrangements for management of quoted equities and bonds is cost effective and has a strong long term performance track record.

- 8.3 A workshop was held on 28 April 2017 to clarify the position of the Investment Panel over the future of the Fund's investment management arrangements, i.e. managing the Fund's assets in the long term and in the period up to BCPP taking over investment management responsibilities. The Chair and Deputy Chair of the Board were also in attendance to provide their views from the Board's perspective.
- 8.4 The workshop attendees were presented with the potential benefits and risks of different investment strategies available to the Fund (see Appendix C). Agreement was reached to comply with the spirit of the new legislation and pool our investments with BCPP. The preference is to invest in the internally managed sub-funds for Equities and Bonds once they are available, and these sub-funds have passed due diligence checks around safe custody, asset servicing and valuation and adequate investment management arrangements can be clearly demonstrated (e.g. staffing quality and resilience).
- 8.5 As an interim measure, and given the current staffing risks discussed at previous Board and Investment Panel meetings, it was agreed at the workshop that the Strategic Director Finance, Governance & Support and Head of Investments & Treasury Management are authorised to deviate from internal management, where considered necessary, and make greater use of pooled funds. In order to facilitate this, additional resources will be needed to appoint a Transition Manager and, potentially, additional consultancy support to assist the Fund with this transformation.
- 8.6 Pooled funds will reduce the number of holdings of the Fund by effectively outsourcing management of certain parts of the Fund, and replacing a large number of holdings with units in a single unit trust equivalent to the value of the transferred holdings. For example, the existing (approx.) £1.2 billion UK Equity portfolio (with shares owned in over 200 individual UK companies) could be replaced with units in a single unit trust to the same value. This reduction in investment asset lines will reduce the administration and accounting required, alleviating some of the pressure on the Investment Administration and Accounting team.
- 8.7 A set of criteria will be devised to assist the Strategic Director Finance, Governance & Support and the Head of Investments & Treasury Management identify the most appropriate investment markets to change. This criteria will centre on:
- Current investment management arrangements;
 - Resilience of investment management arrangements;
 - Impact on the portfolio from both an investment management and administration and accounting support perspective;
 - Complexities of markets and current difficulties with administration and accounting arrangements for these markets; and
 - The estimated timing that sub-funds will be made available from BCPP.

- 8.8 The extent of the change needed will also be determined by the Strategic Director Finance, Governance and Support and Head of Investments & Treasury Management. The number of holdings and overall size of assets under internal management will be reduced to a manageable level with current staffing resources available. This should alleviate future disruptions in managing the Fund's assets, however at current resource levels there will still be occasions where spikes in some tasks or reduced resource levels for holiday/sickness cause disruption, e.g. trading may need to be suspended if there is a back-log of trades to book on assets records and the accounting system.
- 8.9 It is proposed to use passive pooled funds where needed (i.e. unit trusts that exactly track an underlying index, e.g. the FTSE All-share index) and until a suitable investment sub-fund is available from BCPP. The benefits and risks of using passive funds are stated in Appendix C.
- 8.10 Additional resource will be required to meet the on-going investment management fee (between approx. 0.01% and 0.02% of assets under managed, depending on which investment market is managed using the passive fund, e.g. with one specific external fund manager, an Asia Pacific ex-Japan Index Fund would cost 0.0255% of approx. £600 million assets, or approx. £153,000 p.a.).
- 8.11 There will also be additional costs incurred to adjust the Fund's existing portfolio of holdings to a revised portfolio which is an acceptable match to the underlying index before an *in specie* transfer of this portfolio of assets to the (passive) external investment manager is carried out. There will be some future savings from reduced transaction costs once the Fund owns units in the passive unit trust (amount unknown as future transaction activity are dependent on unpredictable market and company specific conditions).
- 8.12 The choice of external investment manager will be identified on an investment market by market basis, and on the basis of the most suitable pooled fund which passes the Fund's due diligence tests and best fits the Fund's customised benchmark.
- 8.13 The criteria and initial extent of transformation to pooled funds will be carried out in July 2017, with preparations made to transform the Fund over the following months, as soon as suitable pooled funds are identified, and a Transition Manager and any additional consultancy support required have been procured.
- 8.14 The other benefit from this approach is that the transition from passive pooled funds to BCPP sub-funds will be simple as the difficult parts of the Fund's long term transformation from internal management to BCPP-managed funds will be completed sooner while there is more certainty over staffing resources. Also, it is unclear at this time how some investment markets could be managed once staff have transferred to BCPP. There is currently an inception of a plan for those staff transferred to BCPP to keep monitoring the Fund's assets and communicate transactions back to the Fund for staff there to execute the transactions recommended by BCPP staff. This option is currently being discussed by the internally managed funds affected (Teesside, South Yorkshire and East Riding) to assess if this is a feasible option.

9. TEESSIDE PENSION FUND – TRANSFORMATION PLAN (STAFFING)

- 9.1 The current staff managing the Pension Fund are mainly in the Loans & Investment Section, with pension administration services outsourced to Kier Business Services and some of the accounting function carried out by the Council's Financial Governance and Revenues Section. Almost all current staff in Loans & Investments have a significant proportion of their work in the function that will be carried out by BCPP in future and therefore transfer under TUPE (Transfer of Undertakings (Protection of Employment)).
- 9.2 Should staff move to BCPP under TUPE, the Fund will not have staffing resources to manage the activities of BCPP and the legacy assets not transferred (cash, property, etc.), service the Board and the Investment Panel, monitor the activities of pension administration, and key parts of the Fund's Report and Accounts would not be completed.
- 9.3 In addition, as the service currently provided in Middlesbrough could effectively move to Leeds, some staff are looking at protecting their future as this change of location and/or other factors of leaving local government or working for BCPP do not appeal to them. This has detrimentally effected morale in the Section and key staff have already left, leaving gaps in the skills, knowledge and experience needed to run the Section. This problem is further increased as now there is inevitably key man risk with a smaller number of staff.
- 9.4 The staffing transformation plan creates a strategy to identify the future (post-pooling) staffing requirements of the Fund, and implementing this plan should help mitigate the above risks. The staffing structure (see Appendix D (ii) for the first draft, proposed staffing structure post pooling) will enable the Fund to manage the activities of the pool after the transfer of assets, manage the assets not transferred to the pool and carry out the other governance and accounting work required.
- 9.5 In addition, all HR options will be explored to retain existing staff for as long as is needed, and supplement them with additional resources, either staff resources or additional financial resources to transform the investment assets into units in pooled funds which are simpler to manage. This is to ensure the investment assets continue to be managed effectively in the interim. The next step is to agree a suitable staffing review that:
- Allows the Fund to continue to be effectively managed up to BCPP taking over this responsibility;
 - Provides sufficient resources to continue to manage the Fund after the initial transfer of equities and bonds to BCPP; and
 - Has sufficient flexibility in the future staff review and consultation to reduce redundancies, and:
 - Allow those staff who wish to continue with an investment related career in Middlesbrough to do so, and

- Allow those staff who wish to continue with a career in investment management or administrative and accounting support for equities and bonds to transfer to BCPP.

9.6 The current option being explored will:

- i. Delete existing vacant positions from the existing structure (see Appendix D (i)) but retain sufficient budget to cover temporary appointments in place to assist with the current workload.
- ii. Introduce the Investment Team (Legacy Assets) and Governance & Investment Administration Team (see Appendix D (ii)) alongside the existing structure, as discrete and separate parts of the Loans & Investments Section.
- iii. Ring-fence initial recruitment to the existing staff.
- iv. Should staff wish to remain at the Fund, allow them to express an interest in their preferred position, demonstrating how they meet that position's essential criteria.
- v. Where there are more expressions of interest for positions, a full application and interview process to fill these posts will be used.
- vi. Review the Section after this process and delete newly created vacant positions.
- vii. If there are still unfilled positions after this process, a normal recruitment process will begin to fill these.

9.7 If existing staff decide not to take part in the above, it is assumed they are favouring a move to work at BCPP. Also, if there is a situation where there are more staff applying than posts, then any unsuccessful staff will still be eligible to work at BCPP or apply for any unfilled positions in Loans & Investments.

9.8 So far, a number of meetings have been held with staff to discuss the implications of pooling, including a meeting with HR to discuss TUPE and a presentation from those currently building BCPP. In addition, engagement with Trade Unions has begun, providing them with information on the pooling project and discussing with them the staffing implications of pooling. These meetings will continue throughout the transformation process.

9.7 BCPP are proposing to start the staff consultation in 2018, ahead of the TUPE process (see Appendix A). It would be beneficial to the Fund and current staff to carry out our staffing transformation plan ahead of this TUPE process, preferably completing the staffing review by the end of 2017/start of 2018.

10. TEESIDE PENSION FUND – TRANSFORMATION PLAN (FURTHER COMMUNICATIONS)

10.1 Some communication has been held with the Fund's employers, via email. It is planned to present the transition plan to the four Local Authority employers in the Fund, and present details of pooling and the transformation plan at an Employers Forum the Fund is looking to arrange.

10.2 Pooling of the Fund’s investment assets does not have an impact on employee contribution rates or pension benefits, however, communication it is planned to the Teesside Pension Fund scheme members for information as part of the bi-annual newsletters to active members and pensioner members.

11. TEESSIDE PENSION FUND – TRANSFORMATION PLAN (SUMMARY)

11.1 The following table summarises the actions to be taken as part of the transformation plan:

Core Activity	Description	Target Date
Asset Management	Assess the current portfolio to decide the new ratio mix of internally management to pooled funds	July 2017
Asset Management	Procurement of Transition Manager to assist with the transformation plan for assets as part of transferring asset to BCPP or the chosen pooled fund provider	TBC
Asset Management	Procure services of a consultant to support and assist the transformation plan for assets	August 2017
Staffing	Refine the staffing transformation plan to determine a structure that is sufficient and capable of managing legacy assets and undertaking the Fund’s governance and investment administration functions	August 2017
Staffing	Implement the new staffing structure, after taking advice as to whether consultation is required	Sep - Dec 2017
Communications	Set up arrangement with the 4 Local Authority scheme employers to meet their Executives / Cabinets	Sep/Oct 2017
Communications	Article in the next editions of the Fund’s newsletters	Autumn 2017
Communications	Presentation to the Employer Forum	TBC

12. INVESTMENT PANEL APPROVALS

12.1 At the Investment Panel meeting held on 28 June 2017, the Panel Members approved the transformation plan proposed in Sections 8, 9 and 10; in particular:

- Delegate to the Strategic Director Finance, Governance & Support and Head of Investments & Treasury Management the authority to change the investment


management strategy from internal management to a mix of internal management and pooled funds to manage the whole equity and bond portfolios in the run up to pooling.

- Authority is also delegated to the Strategic Director Finance, Governance & Support to decide the extent of the change and which investment markets will be managed through pooled funds, and flexibility is allowed should circumstances change prior to pooling to allow the mix of internal management and pooled funds change to match the staffing resources in place.
- Delegate to the Strategic Director Finance, Governance & Support and the Head of Investments & Treasury Management the authority to procure a Transition Manager and any other additional consultancy support needed as part of the transformation plan, and which exceeds current budget.
- Authority is delegated to the Strategic Director Finance, Governance & Support to refine the proposed new structure and implement the staffing transformation plan as outlined in Section 9 of the report.

12.2 Middlesbrough Council's project management framework is currently being used to assist with project management of the transformation from internal management of the Fund to the pooled solution provided by BCPP (see Project Brief – Appendix B). It was also agreed that this approach is continued and that this project is now split into two workstreams – Assets and Staffing.

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Project Brief					
Project Ref / Title:	<i>Transition Plan - Pooling of Pension Assets</i>	Version:		Outcome:	
Project Sponsor:	<i>James Bromiley</i>	Project Manager:	Paul Campbell		
Programme:	<i>Not applicable</i>	Proposed Start Date:	Mar-17		
Project description					
<p>To transfer the arrangements for management of the Teesside Pension Fund's investment assets (currently £3.9 billion) to the new pooling company set up by 12 partners (incl. Teesside) - Border to Coast Pension Partnership (BCPP). BCPP is in the process of setting itself up and will not be ready to receive assets to manage for some time (approx. June 2018 at the earliest). In addition, Teesside needs to start the process of transforming itself to manage the Fund with BCPP, and decide whether it is in its best interests to transfer assets in their current form to BCPP for management, transform the existing assets to another form (e.g. unit trusts) as part of a de-risking exercise ahead of BCPP taking over management of investment assets or delay the transfer of assets (if this is possible & acceptable to DCLG). In addition to this, Teesside will need staff in the future to management the relationship with BCPP & manage pension fund cash and any other legacy assets.</p>					
Scope of the project					
<p>The Loans & Investments Section currently manages the investments of the Teesside Pension Fund. It includes 17 FTEs (cost centre 10137), of which the predominant function of 16 FTEs is to manage investments, and as such it is probable/likely that all 16 can transfer to BCPP under TUPE. A staffing review is required to set out the staff resources required in the lead up to asset transfer, over the transfer period and post transfer (i.e. managing BCPP, cash & other legacy assets).</p>					
Outline business case					
<p>Compliance with SI 2016 No. 946 LGPS (Management & Investment of Funds) Regulations 2016. As part of these new regulations, the Secretary of State for CLG can take over the running of the Fund, if its investment strategy, including its approach to pooling, is considered inadequate.</p>					
Business change needed					
<p>MBC delegates responsibility for management of the Teesside Pension Fund to the TPF & Investment Panel (Panel). The Panel currently has authority to decide on investment management arrangements, and has supported an internal management model, using employees of MBC to manage the majority of investments of the Fund. The new LGPS regulations require each Fund to select and name a pool and commit to pooling investments of assets; the Panel has chosen BCPP. In addition, and as a consequence of transferring the function of managing the Fund's investment assets to BCPP, it is probable/likely that the existing staff managing these assets will transfer under TUPE to BCPP.</p>					
Costs					
Costs (Revenue)	Up to £350,000 paid by the Teesside Pension Fund, representing 1/12th of the maximum estimates cost (£4.5 million) of setting up BCPP.	Funding (Revenue)	Nil		

Costs (Capital)	Class A shares at a cost of £1 to acquire the Fund's share of ownership of BCPP Ltd., and Class B shares at a cost of €833,333.34 as 1/12th share of the €10 million required to be set up as the required regulatory capital for an investment management company of the structure proposed by BCPP. Both paid by Teesside Pension Fund.			Funding (Capital)	Nil
Estimated Cost Benefit					
Projected Funding (£)	Project Cost (£)	Additional Income (£)	Cost Reduction (£)	Cost / Benefit (£)	Payback Period (Mth)
Nil	Nil	Nil	Nil	Nil	Nil
Benefits - Non-financial or Non-cashable (e.g. staff time)					
Measure	Description		Current	Target	
Regulations	Compliance with LGPS Regulations		There is a dependency on BCPP to be ready to receive investment assets. TPF proposals regarding use of BCPP when sub-Funds are available and pass the Fund's due diligence test.	Full compliance	
Resilience	Based on the plans for staffing at TPF (if internal management continued) and BCPP (if assets transferred to BCPP to manage), greater resilience to management of the Fund's investment assets.		Risk with current staffing situation in the run up to pooling. Staff numbers may reduce to a point where the Fund cannot be managed effectively. Mitigating by exploring a plan of transforming the investment assets to units in unit trusts (passive funds) which require much less intensive management and	Resilience across all investment asset groups.	

		administration / accounting.	
Additional withholding tax savings.	The ACS structure will deliver additional tax savings on withholding tax with French & Swedish equity dividends.	Currently taking advantage of LG Pension Fund exemptions. For France and Sweden, these rates are not as favourable as for an ACS Manager.	Small increased return on French / Swedish equity assets.
Reduced investment management fees for externally managed funds.	Access to greater bulk purchasing power with the larger BCPP.	There is some movement by the Fund Management industry to respond to the call for reduced fees for LGPS Funds. The Fund will seek to take advantage of these reduced rates whenever it invests in external funds between now until a pooled solution is available. These new investments must be in line with the investment strategy set by the Panel and meet the Fund's due diligence checks.	Access to new funds, which so far are deemed too expensive.

Broader range of investment assets available.	With BCPP, it is planned that (in time) there will be access to greater specialist resources which should allow access to a broader range of investment assets, e.g. co-investment opportunities.	Such investments are not currently viable for the Fund to invest in.	Access to new investment assets which are currently not considered viable.		
Initial Project Categorisation Rating					
Benefit %	Complexity %	Full Fwork or POAP	Comments		
22%	67%		Look to split the project into 2 (Assets and Staffing) after key decision is made by the Panel on which assets will transfer to BCPP.		
Risks					
Risk Description	Owner	Likelihood (1-5)	Impact (1,2,3,5,7)	Risk Score	Mitigating Actions
Staffing - Period up to Asset transfer and/or TUPE of staff	PC	5	7	35	Plans being developed to transform the existing asset structure to units in unit trusts (passive funds), if needed.
Staffing - Key Man Risks within the L&I team	PC	5	7	35	New staffing structure will look to address this in the longer term. Additional resource required to assist with pooling project - approved by S151. Plans being developed to transform existing asset structure to units in unit trusts (passive funds), if needed.
Assets (continued management up to pooling)	PC	5	7	35	Investment Panel and Board workshop provides guidance and agreement in principle over the future investment management strategy, including an interim solution through greater use of unit trusts (passive funds).
Transfer of Assets to BCPP	PC	5	7	35	Investment Panel and Board workshop and June Panel meeting will set the strategy for use of the pool as an investment management solution & transition management arrangements with BCPP and a (potentially) procured transition manager and/or TPF Custodian.

Asset management post pooling	PC	5	7	35	New staffing structure will look to address this in the longer term.
Pension Fund Governance & Accounting	PC	5	7	35	New staffing structure will look to address this in the longer term.
Progress before Official Sign-off (June Panel)	PC	5	7	35	Investment Panel & Board workshop provides guidance and agreement in principle over the future investment management strategy, including a pooling solution.
Conflict of interest risk	PC	5	7	35	Investment Panel & Board workshop to provide guidance and agreement in principle on the future investment management strategy.

Key Milestones

Activity / Milestone	Start Date	End Date	Resp
Preparation for Panel & Board Workshop	Mar-17	Apr-17	PC
Workshop with Panel & Board Members	Apr-17	Jun-17	PC
Finalised Decision on Asset Transfer	Jun-17	Jun-17	PC
Development of PID/split into two projects (Assets & Staffing)?	May-17	Jul-17	PC

Approvals

Project Sponsor:		Date:		PMO:		Date:	
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Appendix C

Asset	Strategy	Existing Resource	Future Delivery	Benefits	Risks
<p>Equities £2,945m 80%</p>	<p>Active management UK & Overseas In-house team Long term reduce allocation (to 70%)</p>	<p>Mgmt.: >4 WTEs (est. 5 WTEs) Admin.: Under-resourced & needs investment to meet potential future demand</p>	Fund	<p>Experience & track record Already set-up Provides VFM (lower cost) Control retained Shareholder governance ownership Engagement through LAPFF</p>	<p>Non-compliance with LGPS regulations MiFID II Broker/Research Resilience & key man risk (Mgmt. & Admin.) when matched against BCPP Requires investment (staffing & systems) New Custodian (very complex) to implement & project manage (how can we backfill posts?/consultant costs to provide near turn-key solution?/effect on trading activity?) Staff retention problems (new competitor in Leeds) – are they to be replaced? Resources restrained MBC Recruitment – can we get the right staff & how long to train them? No staff base to draw from for Legacy Assets / Governance (Mgmt. & Admin.)</p>
			Pool	<p>Compliance with LGPS regulations BCPP proposal shows resilience Built on LGPS experience & track record Provides greater investment options? Direct engagement Existing staff to potentially draw from for Legacy Assets / Governance (Mgmt. & Admin.) New Custodian less complicated to implement & project manage</p>	<p>No track record (at Pool) No guarantee LGPS teams will gel Costs estimated (£5.8 to £10.1 m p.a. shared by 12 Funds) Start date unknown for sub Funds ACS – transparency gone Shareholder governance may be compromised</p>
			Ext. Manager (IMA)	<p>Experience & track record Reduced internal staffing required (Mgmt. only) Management resilience?</p>	<p>Expensive Transition risks and costs Churning? Shareholder governance may be compromised</p>

Asset	Strategy	Existing Resource	Future Delivery	Benefits	Risks
			Ext. Funds (Active)	Experience & track record Reduced internal staffing required Management resilience?	Very expensive In-specie transfer? Shareholder governance compromised
			Ext. Funds (Passive)	Certain of performance Comparable cost to internal, active mgmt. Reduced internal staffing required	Performance from asset allocation decisions only Transition risks and costs (much less than Ext. Man. (IMA)) Shareholder governance compromised
Bonds £14m 0.5%	Active management UK Fixed, Index-linked & Overseas Bonds In-house team Long term increase allocation (to 12%)	Mgmt.: <1 WTE (est. <1 WTE) Admin.: Under-resourced & needs investment to meet potential future demand	Fund	Experience & track record Already set-up Provides VFM (lower cost) Control retained	Non-compliance with LGPS regulations MiFID II Broker/Research Resilience & key man risk (Mgmt. & Admin.) when matched against BCPP Requires investment (staffing & systems) New Custodian (very complex) to implement & project manage (how can we backfill posts?/consultant costs to provide near turn-key solution?/effect on trading activity?) Staff retention problems (new competitor in Leeds) – are they to be replaced? Resources restrained (particularly relevant when bond yield's pick-up) MBC Recruitment – can we get the right staff & how long to train them? No staff base to draw from for Legacy Assets / Governance (Mgmt. & Admin.)

Asset	Strategy	Existing Resource	Future Delivery	Benefits	Risks
			Pool	<p>Compliance with LGPS regulations BCPP proposal shows resilience Built on LGPS experience & track record Provides greater investment options? Existing staff to potentially draw from for Legacy Assets / Governance (Mgmt. & Admin.) New Custodian less complicated to implement & project manage</p>	<p>No track record (at Pool) No guarantee LGPS teams will gel Costs estimated (£5.8 to £10.1 m p.a. shared by 12 Funds) Start date unknown for sub Funds ACS – transparency gone</p>
			Ext. Manager (IMA)	<p>Experience & track record Reduced internal staffing required (Mgmt. only) Management resilience?</p>	<p>Expensive Transition risks and costs Churning?</p>
			Ext. Funds (Active)	<p>Experience & track record Reduced internal staffing required Management resilience?</p>	<p>Very expensive In-specie transfer? Investment Income?</p>
			Ext. Funds (Passive)	<p>Certain of performance Comparable cost to internal, active mgmt. Reduced internal staffing required</p>	<p>Performance from asset allocation decisions only Transition risks and costs (much less than Ext. Man. (IMA)) Investment Income?</p>
Property £254m 7%	Mix of direct property & indirect collective investment vehicles Non-discretionary external management agreement Long term increase allocation (to 10%)	Mgmt.: <1 WTE (est. <1 WTE) Admin.: Under-resourced (key man risk exists) & needs investment to meet potential future demand	Non-discretionary (Fund makes the decisions)	<p>Currently, experience at the Fund of this arrangement No ownership transfer needed in near future Existing staff to potentially draw from for Legacy Assets / Governance (Mgmt. & Admin.)</p>	<p>Resilience (existing staffing arrangement too small) Key man risk Staff retention until pooling</p>

Asset	Strategy	Existing Resource	Future Delivery	Benefits	Risks
			Pool	Access to other markets (long term) Potentially reduced fees (in-house solicitors?)	Pool not ready for direct property for 3-5 years Ownership transfer – tax? Unknown future investment strategy/staffing
			Discretionary	Experience & track record of mgmt. No ownership transfer needed in near future Reduced internal staffing required (Mgmt. only) Management resilience?	No experience at the Fund of this arrangement Admin resource still required Loss of control Transparency
			Ext. Funds	Experience & track record Reduced internal staffing required Management resilience?	Sale of existing portfolio? Expensive Lack of transparency Income? Management resource needed for PUTs/LLPs Admin resource for draw-downs & receipts (LLPs) Redemption timetable
Alternatives £59m 1.5%	Mix of direct ETFs (commodities) and funds/partnerships (absolute return funds & infrastructure) Long term increase allocation (to 5%)	Mgmt.: <1 WTE (est. <1 WTE) Admin.: Meets small current requirement & needs investment to meet potential future demand	Existing Mix	Control over investments (Limited) experience Actively drive investment over next 3-5 years Co investment potential with greater experience Existing staff to potentially draw from for Legacy Assets / Governance (Mgmt. & Admin.)	Resilience (existing staffing arrangement too small) Key man risk needs correcting Staff retention until final LLP investment run-off High LLP fees (but reducing all the time)
			Pool	Experience from other LGPS Funds Fee reductions through scale Co-investment (long term)	Pool not ready for 3-5 years? No clarity yet as to how the mechanics of investing will work

Asset	Strategy	Existing Resource	Future Delivery	Benefits	Risks
			Ext. Manager (IMA)	Quicker investment of cash? Experience & track record Reduced internal staffing required Management resilience?	Expensive Lack of transparency Income? Admin resource for draw-downs & receipts (LLPs)
Cash £401m 11%	Short term investments Long term reduce allocation (to 3%)	Mgmt.: <1 WTE (est. <1 WTE) Admin.: MBC provide	Fund	The Fund must still provide resources for cash flow and treasury management MBC provide?	

