

TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 7

TEESSIDE PENSION BOARD REPORT

24 APRIL 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 That Members review and note the report, and pass any comment.

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 Panel. 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 £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 that make 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 types 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, i.e. saving must be made across the LGPS.
- Improved capacity to invest in infrastructure – this is implied with the pools having greater scale than single Funds giving greater bargaining power when making infrastructure investments.

4.3 A report was presented to the Panel meeting held on 9 February 2016 and 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 the Member Steering Group meeting on 30 September 2016 it was agreed to set up a detailed project plan, create 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.

5. OPERATING MODEL

5.1 The sub group looking at the Operating Model has now appointed tax advisors (Deloitte LLP), legal and FCA application advice (Eversheds Sutherland LLP) and advice for procurement of the new Depository and Asset Servicer, and the set-up of the investment systems and software applications (Alpha).

5.2 The sub group has also analysed the existing asset allocations of the Partner Funds in order to start the process of building an asset template for the Partner Funds to invest in. The proposed template has like for like options for the Teesside Fund's current asset classes, except for a small allocation for overseas corporate bonds; a suitable alternative (multi asset credit) is available.

6. PEOPLE

6.1 The People sub-group has contracted the recruitment consultant (Odgers & Berndtson) to assist with creating the remuneration package for and recruiting the senior Executives and Non-Executives of BCPP. In addition, preparations have started to search for suitable premises in Leeds and TUPE of existing staff.

6.2 At the Member Steering Group on 31 January 2017, the outline remuneration package for the Executives and Non-Executives for BCPP were discussed. The outline, draft packages agreed to take back to each Fund for agreement are 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 The Investment Panel ratified the draft packages at their meeting on 8 March 2017 and this was relayed back to those co-ordinating the recruitment search for BCPP.
- 6.4 The People sub-group has begun work on making arrangements to receive staff from the three internally managed Funds (East Riding, South Yorkshire & Teesside), with BCPP using Eversheds Sutherland LLP to assist. A newsletter has been produced and issued to all pension staff from all the Partner Funds.
- 6.5 The search for premises is about to begin, looking for space to accommodate approx. 60 staff in either central Leeds or its outskirts.

7. GOVERNANCE & MONITORING

- 7.1 The sub-group for Governance and Monitoring have procured legal advice from Eversheds Sutherland LLP for BCPP 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. These documents are almost at a state of agreement for all Funds.
- 7.2 A standard report has been 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 have now been agreed by the Councils of the administering authorities of each BCPP Partner and full Joint Committee & shareholder meetings are planned for 25 April 2017.
- 7.3 At one meeting of the BCPP Partners, an expression was made that the Joint Committee should allow the Trade Unions to participate as non-voting Members, and represent Scheme Employees. This Board supported this view and expressed this to the Chair of the Investment Panel ahead of the Panel meeting.
- 7.4 The Investment Panel discussed and agreed that their preference is for Trade Unions to have non-voting observer status at the Joint Committee. The Chair of the Investment Panel was empowered by the Investment Panel at their meeting on 8 March 2017 to represent this view to BCPP, when appropriate.

8. TEESSIDE PENSION FUND – KEY RISKS

- 8.1 Clearly there are risks to the Fund of pooling the investment of its assets with BCPP. A transition plan is in development to identify and mitigate these risks. Middlesbrough Council runs a project management framework and the transition to pooling of assets will be run in accordance with the framework.

- 8.2 A presentation & project plan will be brought to a future meeting, but an overview of the key risks are:

Staffing:

- 8.3 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 Finance section. All current staff in Loans & Investments are listed for TUPE (Transfer of Undertakings (Protection of Employment)). 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 Pension Board & Investment Panel, monitor the activities of pension administration, and key parts of the Fund's Report and Accounts would not be completed.
- 8.4 In addition, as the service in Middlesbrough could effectively close and move to Leeds, staff are looking at protecting their future. This has detrimentally effected morale in the Section and key staff have already left the service leaving gaps in skills & knowledge to run the section. This problem is further increased as there is inevitably key man risk with a small section of staff.
- 8.5 The transition plan will look at creating an effective strategy to identify the immediate and future (post-pooling) requirements of the Fund, and implementing this to mitigate the above risks. This will involve creating an effective staffing structure to manage the transition to the pool, the activities of the pool after the transfer of assets, manage the assets not transferred and carry out the other governance and accounting work required. In addition, all HR options will be explored to retain existing staff for as long as is needed, and supplement them with additional resources to ensure the investment assets continue to be managed effectively in the interim.

Assets

- 8.6 Linked to staffing risks, 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 transferred, e.g. direct property.
- 8.7 The key to mitigating the asset risks is identifying the assets to transfer to BCPP for management. There are three issues with this:
- i. BCPP does not have a detailed timetable ready yet for receiving assets to start managing them, however, this is being prepared at a high level to start with. This dependency is causing uncertainty over the on-going management of assets and how long current arrangements are required;
 - ii. For BCPP to continue with low cost, active management by an in-house team at BCPP, they will need to create this team from the existing staff of three internally

managed Funds in BCPP, plus additional new staff where needed. At this stage, this is an unknown entity without track record of working as a collective, however it is accepted that the track records of the three individual funds is exemplary; 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 Teesside, 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. It is proposed to seek clarification as to Teesside's position and whether there is an option for delay, and to hold a workshop on 28 April 2017 with the Investment Panel Members, with the Chair and Deputy Chair of the Board invited:
- to gauge the appetite for delaying transfer of assets,
 - if the decision is to not transfer, does the Panel wish to adapt the current investment strategy to take some risk out of the current arrangements, and
 - to agree an outline of new staffing structure which meets the needs of the Fund in the period up to transfer of assets, over the transfer period, and to manage the "legacy" assets after the equities and bonds are transferred.

Governance & Accounting

- 8.8 Again, linked to staffing risks, currently the Fund is managed at officer level through the Loans & Investments section. The transition plan needs to address this and retain key skills and knowledge required to continue to manage the Fund, post pooling, otherwise the Fund will be vulnerable to breaching LGPS regulations and unable to produce accurate and adequate Annual Report & Accounts.

CONTACT OFFICER: Paul Campbell (Head of Investments & Treasury Management)

TEL. NO.: 01642 729024