

Open Report on behalf of Pete Moore, Executive Director for Finance and Public Protection

Report to:	County Council
Date:	24 February 2017
Subject:	Lincolnshire Local Government Pension Scheme – Requirement for Asset Pooling

Summary:

After four years of research and consultation, in November 2016, the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 were enacted which require the 89 separate Local Government Pension Funds in England and Wales to combine their assets into a small number of investment pools. Current proposals should deliver £200m - £300m annual savings across the LGPS.

This report details the proposed next steps to ensure Lincolnshire County Council as the Administering Authority of the Lincolnshire LGPS can meet its regulatory obligations in this regard.

The above regulatory changes do not affect the sovereignty of the Lincolnshire LGPS and the pooling of Local Government Pension Scheme assets will have no impact on the employee contribution rates or pension entitlement of members of the fund (current employees, previous employees who are yet to draw their pension or pensioners).

The Council is asked to consider and approve that Lincolnshire LGPS pool its assets with 12 other Funds in a newly created wholly owned local government regulated asset management company - Border to Coast Pensions Partnership Limited (BCPP) as its chosen means of achieving regulatory compliance. BCPP is a partnership of 13 LGPS Pension Funds with assets totalling £35.9 billion, supporting 905,995 Scheme Members and 2166 employers (figures as at 31st March 2015).

The aim of the BCPP pooling proposal is to achieve the regulatory requirements to pool assets by collectively investing assets to:-

- deliver savings to the Partner Funds;
- improve governance by moving the asset management into a financially regulated entity;
- build capability and capacity to invest in infrastructure and other asset

classes to improve the risk adjusted returns of the partner Funds;

- through collaboration and consolidation of resource improve technical specialisms and resilience across the Partner Funds;
- use the scale of the pool to more effectively utilise our shareholder voting rights to drive corporate governance change in the companies the Funds invest in.

Council is asked to confirm participation in the BCPP pooling arrangement; approve the acquisition of a shareholding in the BCPP asset management company; nominate an individual to represent the Council as shareholder; approve the Lincolnshire LGPS contributing to the regulatory capital requirement of the company; establish a Joint Committee to co-ordinate the roles of the various Funds as investors; nominate an individual to represent the Lincolnshire LGPS at the Joint Committee meetings; make any consequential changes required to the Constitution to reflect these revised arrangements and approve the legal documentation necessary to give effect to the above.

Recommendation(s):

That the Council as administering authority of the Lincolnshire Local Government Pension Fund:

1 approve the adoption of Border to Coast Pensions Partnership (BCPP) Pooling Arrangement as the Council's chosen approach to meet the requirement to pool assets in the LGPS.

2 approve inclusion within the Lincolnshire LGPS Investment Strategy Statement of the BCPP 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 Statement

3 approve the subscription by the Council as administering authority for 1 class A voting share in Border to Coast Pensions Partnership Limited

4 appoint the Executive Director for Finance and Public Protection to exercise the Council's rights as a shareholder in Border to Coast Pensions Partnership Limited on behalf of the Council as the administering authority of the Lincolnshire Local Government Pension Fund;

5 approve the subscription by the Council as administering authority for such number of class B non-voting shares in the Border to Coast Pensions Partnership Limited as shall be necessary to ensure that the Lincolnshire LGPS 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;

6 approve the entering into of a Shareholder Agreement between the Council and

the Administering Authorities of the other Pool Funds and the company generally in the form attached at Appendix E and described within the Report;

7 approve the entering into of an Inter-Authority Agreement between the Council and the Administering Authorities of the Partner Funds generally in the form attached at Appendix C and described within the Report

8 approves the establishment as a formal Joint Committee under section 102 of the Local Government Act 1972 of the Border to Coast Pensions Partnership Joint Committee in accordance with and to carry out the functions set out in the Inter-Authority Agreement

9 appoint the Chairman (or Vice Chairman in their absence) of the Pension Committee to represent the Council on behalf of Lincolnshire Local Government Pension Scheme on the Border to Coast Pensions Partnership Joint Committee;

10 approve the changes to the Constitution set out in Appendix D this Report to enable Lincolnshire to be a partner on the Border to Coast Pensions Partnership Joint Committee and undertake all Fund activities in regards to being an investor in Border to Coast Pensions Partnership Limited in its capacity as an Asset Management Company;

11 authorise the Executive Director for Finance and Public Protection in consultation with the Chairman of the Pensions Committee 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 Pensions Partnership Limited, the Shareholder Agreement and the Inter-Authority Agreement

1. Background

Lincolnshire Pension Fund

- 1.1 The Lincolnshire Local Government Pension Fund (Lincolnshire LGPS) provides a pension service for 75,000 members (i.e. current employees, former employees who are not yet drawing a pension, and pensioners) across 235 separate employers within Lincolnshire including local authorities, academies and other not for profit organisations.
- 1.2 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, the Lincolnshire LGPS held assets totalling £1.76 billion and liabilities of £2.29 billion. Investment strategy and asset performance is a contributing factor assessed in the triennial valuation which sets the following three years employer contribution rates. These rates determine the cost of current service contributions (% of pay) and the deficit amounts (calculated as a cash lump sum) for each employer within the Lincolnshire Fund.

- 1.3 For Lincolnshire, current projections would see 66% of the investments transitioned into the pool by 2020 with the remaining by 2038. The BCPP pooling proposal estimates ongoing savings to the Lincolnshire Fund of £1.7m once all the assets are transitioned and achieves payback in four years (worst case scenario).

Pooling – The Legal Background

- 1.4 In the July 2015 Budget the Chancellor announced the Government's intention to work with the Local Government Pension Scheme administering authorities to ensure they pool investments to significantly reduce costs while maintaining overall investment performance. Following three years of consultation, in November 2015, the Government issued an Investment Reform Criteria and Guidance document inviting proposals for pooling. In response to this, in July 2016, eight separate investment pools submitted proposals to Central Government with Lincolnshire LGPS being included within the submission for the Border to Coast Pensions Partnership (BCPP).
- 1.5 The decision that Lincolnshire LGPS should be included within the BCPP proposal was approved by the Pensions Committee on 7th January 2016 on the basis that it was the only pool that met the Committee's agreed pooling principles set out below:
- Every Fund in a pool will have an equal voice in the pool, regardless of size.
 - Internal management capabilities are beneficial and reduce costs, however, in a pool these must sit separately from the Funds and must be FCA regulated and subject to the same due diligence as any external manager.
 - Any local investment must meet the minimum investment criteria of the pool and provide an equal or greater return (on a risk adjusted basis) than can be found elsewhere in the market.
- 1.6 On 1 November 2016 the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force. Those Regulations required each administering authority to formulate, having taken proper advice, an investment strategy and to publish a statement of that strategy no later than 1 April 2017. That investment strategy must include the administering authority's approach to pooling investments including the use of collective investment vehicles and must be in accordance with guidance issued by the Secretary of State.
- 1.7 The Guidance on Preparing and Maintaining an Investment Strategy Statement states that all administering authorities must commit to a suitable pool to achieve benefits of scale and must confirm their chosen investment pool meets the Investment Reform and Criteria issued in November 2015.

The Secretary of State has direction and intervention powers if he is satisfied that the administering authority is failing to comply with its obligations in relation to the investment strategy.

- 1.8 This Report seeks full Council approval (in its capacity as Administering Authority to the Lincolnshire LGPS) to the BCPP pooling arrangement as the pool to be included in the Council's investment strategy to meet the requirements of the Regulations and Guidance. The Secretary of State approved BCPP as meeting the requirements of the Investment Reform and Criteria document by letter dated 13th December 2013 (Appendix A). The report also seeks approval to a number of consequential practical steps necessary to implement the BCPP pooling arrangements in accordance with the formally approved proposal. It should be noted that the wider investment strategy will be reported to the Pensions Committee on 8 March 2017 for approval prior to the 1 April 2017 deadline.

Border to Coast Pensions Partnership (BCPP)

- 1.9 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.

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

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

- 1.10 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 separate vehicle to be established in the form of a wholly owned Teckal compliant company, operating a fully regulated structure under the Financial Conduct Authority (FCA).

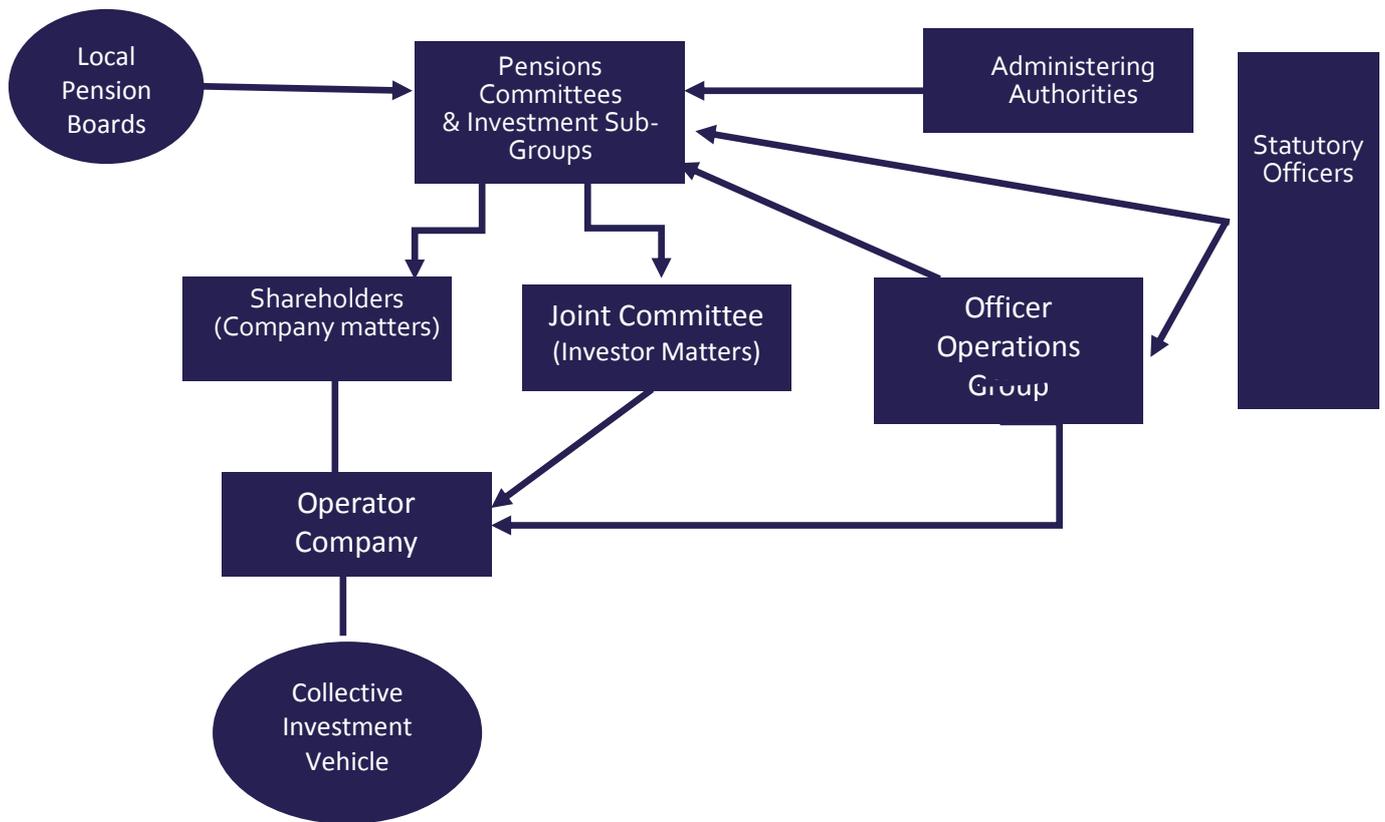
- 1.11 This structure is more fully described in the BCPP Governance section of this Report
- 1.12 The administering authorities forming the BCPP pool will now need to push forward with these proposals and set up a separate regulated asset management company, appoint staff (including TUPE transfer where appropriate) and develop the corporate and governance structures that will enable the pooling of the partners' assets by April 2018 which is the Government's deadline. At this stage, there are no expected TUPE transfers from Lincolnshire County Council into the BCPP.

BCPP Governance

- 1.13 A Summary of Pool Governance Structure document prepared by Eversheds, lawyers, is attached at Appendix B. This section draws out key themes and their implications.
- 1.14 In considering the governance structure there is a need for each partner Fund to distinguish between its role as a shareholder, which is a new function, versus its role as an investor in a collective investment vehicle. The two are fundamentally different functions.
- 1.15 Shareholder functions relate to ownership of BCPP Limited and are subject to company law and key company documents. Because the Council as a corporate body cannot exercise its rights as shareholder directly it will need to act through an individual acting as shareholder representative.
- 1.16 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. An individual will need to be appointed to this Committee
- 1.17 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.
- 1.18 In Lincolnshire it is considered that the role of the shareholder representative as described within Appendix B would best be filled by an officer as the role is circumscribed and decision-making will lie elsewhere within the Council, principally Pensions Committee. The role on the Joint Committee must be filled by an elected member and not an officer as a matter of public law.
- 1.19 Whilst Fund assets will transfer to BCPP Limited, Lincolnshire LGPS, through delegated responsibilities to the Pension Committee, retains responsibility for setting the investment strategy and asset allocation of the Lincolnshire Pension Fund. BCPP will be responsible for managing investments in line with the investment strategy and asset allocation as

instructed by each Partner Fund. While there will be some changes required from the current processes, much will remain as is, i.e. instead of overseeing a range of external managers, the Pensions Committee will oversee a range of BCPP sub-funds.

1.20 The diagram below details the proposed governance structure of BCPP Limited and how it is envisaged it will interact with the various control groups within or established by the Partner Funds. These various elements of the governance structure are then described in more detail together with the legal documents which will give effect to those elements of the governance structure.



1.21 **The Pensions Committee** - per the delegations agreed in the Council's Constitution, the Committee is the body delegated in the Council 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. The asset strategy rather than investment manager selection drives between 90-95% of 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. However, practically how that allocation is exercised will change.

- 1.22 BCPP Limited will offer a template of asset allocation choices and the Pensions Committee, having received appropriate external advice, will determine the appropriate asset allocation for Lincolnshire 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 Lincolnshire's needs feedback has been provided by both Officers of the Fund and the Fund's Investment Consultant, Hymans Robertson.
- 1.23 The Pensions Committee is also the body with the delegated powers to terminate and hire managers. If the full Council approves the BCPP pooling proposal as set out in this Report many of the current mandates will need to be terminated so that revised mandates can be awarded to BCPP Limited. It is therefore at Pensions Committee that decisions will be taken on termination of existing mandates and their replacement with revised mandates on offer through the template. This will be actioned over a period of time with 66% of the Funds holding expected to transfer in the first two years of operation (April 2018 - 2020).
- 1.24 The Committee will be required to take on a new responsibility; that of reviewing the minutes of the BCPP Joint Committee and providing the Lincolnshire representative with feedback for input into future meetings. It will also have a role to play in determining the position the Council will take as Shareholder of the company.
- 1.25 **BCPP Joint Committee** - will ensure BCPP Partner Funds investment issues are appropriately being managed by BCPP Limited. Each Partner Fund will have one representative on the Joint Committee. It is expected that they will exercise an oversight role in relation to the investment performance of the Company. It will also make recommendations to the Partner Funds through their Pensions Committee on the functioning of the company and the relationship between the company and the Funds as investors. Its meetings will be governed by local government law and privacy determined accordingly. Voting will be by simple majority.
- 1.26 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 governed by legal documents for that investment e.g. constitutive deed, application form, key investor information, prospectus and FCA handbook of rules and guidance. Investor rights cover such matters as the right to withdraw from the investments, investor reporting (including frequency and content) and investor voting rights in relation to investments.
- 1.27 As a section 102 Committee, each Fund's representative on this Committee has to be an Elected Member and cannot be an officer. 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. Following discussions at the Pensions Committee it is proposed that for Lincolnshire County Council the Chair of the Pensions

Committee (or Vice Chair in their absence) acts on behalf of the Lincolnshire LGPS at the Joint Committee.

- 1.28 The Joint Committee will formally be established by all of the Partner Funds signing the Inter Authority Agreement attached at Appendix C. This Agreement sets out the role, Terms of Reference and Constitution of the Committee. It also establishes an Officer Operations Group drawn from officers of the Pool to support the working of the Joint Committee with technical advice and a secretariat to provide administrative support.
- 1.29 In addition, the Agreement provides for one of the Partner Funds to act as Host Authority. In particular, the Authority that acts as Host Authority will be responsible for entering into contracts on behalf of the Joint Committee. This is necessary because the Joint Committee has no separate legal status. In recognition of the fact that the Host Authority will thereby take on liabilities and risk on behalf of all the Partner Funds, the Inter Authority Agreement contains an indemnity at clause 7.3 to the Host Authority from the other Partner Funds so that this liability and risk is shared equally. There is no expectation that the Joint Committee will enter into contracts to any significant extent but it may, for example, need to commission specialist advice on occasion. A Partner Fund can withdraw from the Inter-Authority Agreement on giving twelve months' notice on condition of making reasonable payments to reflect the actual losses caused by or anticipated as a result of the withdrawal.
- 1.30 To reflect the creation of the Joint Committee, and the shareholder responsibilities, it is recommended to Council that the Constitution be updated to amend the Terms of Reference of the Pensions Committee. The proposed amendments are attached to this Report at Appendix D.
- 1.31 **Shareholder Functions** - Each Partner Fund will become a shareholder of BCPP Limited. As the Council cannot attend shareholder meetings to exercise its voting rights in person, these will need to be exercised by an individual on its behalf. This may be done either by attendance of the individual at a general meeting of the company to vote or by the signing of written resolutions in accordance with company law.
- 1.32 As set out in the note at Appendix B, the shareholder representative will not be exercising delegated authority but will instead be exercising the Council's shareholder rights in accordance with instructions determined in advance by the Council. In contrast to the Joint Committee the representative exercising the voting rights of the Council as shareholder can be either an Elected Member or an Officer. Given the very limited degree of discretion afforded to the representative, it is proposed that Council agree that an Officer is appointed to exercise the rights of the Council as shareholder of BCPP Limited. It is proposed that this be the Executive Director for Finance and Public Protection.
- 1.33 It will be necessary that prior to exercising the Councils voting rights the shareholder representative ascertains the views of the Council so as to ensure they are voting in accordance with the Council's wishes.

- 1.34 In exercising rights on behalf of the Council as Shareholder, the appointed representative who is the Council's s151 Officer will be supported by the Monitoring Officer to ensure any matters of process governance or conflict are appropriately addressed.
- 1.35 As this is a Teckal-compliant company there will be many more matters reserved to the control of the shareholders acting collectively than would be the case in a normal company.
- 1.36 The role of the Administering Authorities as shareholders will be to provide oversight and control of the operation of the Company 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 of Directors, including non-executive directors of BCPP.
 - Approval of the director 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.
 - Approval of Conflict of Interest policy.
 - Appointment of Auditor.
- 1.37 The exercise of these rights will be governed by the Articles of Association of the company and private company law and the Shareholders Agreement. 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 shareholder meeting. However as each shareholder will have more than 5% of the total shareholding they can call a meeting at any time (given the required notice period). 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). 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 a Shareholders' Agreement. More detail is set out in the section relating to BCPP Limited below.
- 1.38 **BCPP Limited** –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, operating a fully regulated structure under the Financial Conduct Authority (FCA).

- 1.39 BCPP Limited 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.
- 1.40 Subject to approval from the respective Administering Authorities, BCPP Limited will be owned by the 12 local authorities as Administering Authorities within the investment pool. Each authority will have 1 Class A voting share with equal voting rights. It should be noted that South Yorkshire Passenger Transport Pension Fund will have no shareholding or voting rights in the new company. Currently operational control is delegated to South Yorkshire 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.
- 1.41 This class A voting share could be held by the Council in its capacity either as Administering Authority or in its general capacity. Given that the Council's involvement in the company is driven by the pooling requirements affecting the Pension Fund it is proposed that this share is held in the capacity of the Council as Administering Authority.
- 1.42 To ensure FCA compliance there will be no direct Administering Authority representation on the BCPP Limited Board of Directors
- 1.43 To ensure the Partner Funds can transfer their assets to and enter into contracts with BCPP Limited without competition it will need to be "Teckal" compliant i.e. adhere to Regulation 12 of the Public Contracts Regulations 2015. As each Administering Authority is a contracting authority for the purpose of the 2015 Regulations adherence to these public procurement rules is an individual responsibility of each of the individual Authorities, not the new company.
- 1.44 Under Regulation 12 of the Public Contracts Regulations 2015, contracts entered into between a local authority and 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.
- 1.45 It is through the exercise of a number of shareholder reserved matters that the Council demonstrates a controlling influence and therefore Teckal compliance. This element of the operation of the company is governed by a

Shareholder's Agreement which regulates the relationship between the Partner Funds as shareholders and between the Partner Funds collectively and the company. Council is being asked to approve the entering into by the Council of the Shareholder Agreement. That Agreement is attached at Appendix E and the key terms are described below.

1.46 As stated above the Shareholder Agreement identifies a number of shareholder reserved matters which can only be decided with the approval of either all of the shareholders (unanimous reserved matters) or a 75% majority of the shareholders (shareholder majority reserved matters). The reserved matters in question are to be found at Schedule 1 (Parts A and B) to the Agreement at Appendix E, the key ones being:

- Appointment of initial Directors, including non-executive directors of BCPP (unanimous).
- Approval of the Initial Strategic Plan and each Subsequent Strategic Plan (unanimous).
- Approval of budgets, fee models and the overall cost base and cost apportionment (unanimous).
- Appointment of subsequent Directors and removal of Directors (shareholder majority)

It is through these reserved decisions in particular that the Partner Funds will exercise a decisive influence over the strategic direction of BCPP Limited.

1.47 BCPP Limited 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 overcompensation), 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.

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

1.49 All FCA Regulated businesses such as BCPP Limited are required to hold regulatory capital designed to protect the solvency of the company. There are detailed rules governing the minimum amount of regulatory capital required. The maximum regulatory capital that can be required is €10m. BCPP Limited is expected to be at the top end of the regulatory capital requirements. It is proposed that this requirement is funded equally between the 12 Administering Authorities. Lincolnshire's contribution is

therefore likely to be in the region of £720,000 based on the euro exchange rate at the time of writing this report.

- 1.50 The Administering Authorities could make their contributions to regulatory capital in one of two ways – either by way of equity (the purchase of shares in the company) or debt (by lending the money to the company). The Shareholder Agreement proposes that the regulatory capital is provided by all of the Administering Authorities by them acquiring a class of shares in the company (Class B shares) to the value of their contribution. There are two main reasons for this. The first is that the Pension Fund that accepts as its members the employees of BCPP Limited will not be allowed in law to make its contribution by way of a loan. The second is that because loans rank higher than equity on an insolvency, then in this very unlikely event, some Partner Funds would have an advantage over the others.
- 1.51 It should be noted that there is a slight tax advantage to funding the regulatory capital by way of debt rather than equity as it can be offset against liability for corporation tax. However, the advantage is marginal given the amounts involved (c£50,000 across all the Partner Funds) and is not considered to outweigh the advantages referred to above.
- 1.52 Where the contribution to regulatory capital is made by way of equity it can be made either from the Pension Fund or from the Council's general budgets. It is proposed that the Lincolnshire contribution is made from the Pension Fund being held as an investment of the Fund earning a suitable rate of interest.
- 1.53 Other key provisions of the Shareholders Agreement are as follows:-
- The Administering Authorities undertake to each other that they will pool their assets through BCPP Limited to meet the Administering Authorities' pooling obligations
 - Any Administering Authority may withdraw on giving not less than 12 months' notice to expire on 31 March in any year. On withdrawal, the exiting shareholder must pay outstanding sums owed to the company and such sum as represents the contribution to the capitalised value of that proportion of the continuing and outstanding liabilities of BCPP which have been incurred before the withdrawal date and which is properly attributable to the exiting shareholder's share membership of BCPP.
 - On withdrawal the company will buy back the shares of the exiting shareholder (subject to having the necessary capital) and the remaining shareholders will be required to replace any reduced regulatory capital caused by the withdrawal;
 - Profits of BCPP Limited lawfully available for distribution (after prudent consideration of the amounts required to be retained by the company) will first be used to reduce the Operating Fee and then available for distribution to the shareholders unless the shareholders agree otherwise;

- Shareholders will use best endeavours to resolve disputes between them. If not resolved they will be escalated with provision ultimately for binding arbitration;
- If a shareholder is in breach of the Shareholders Agreement and the breach is not remedied and a majority of the other shareholders serve a default notice, the shareholder in breach is required to sell its A share back to the company and the B shares will be bought by the company (subject to having the necessary capital).
- The Shareholders Agreement may be terminated if all shareholders agree in writing, the company is wound up, such number of shareholders withdraw that the remaining shareholders inform BCPP that they are unable or unwilling to maintain the company's regulatory capital requirements or the Board determine acting reasonably that the business of BCPP Limited can no longer be carried on lawfully
- The company will provide information to the shareholders including quarterly financial and performance reports, annual accounts and an annual report of progress against the Strategic Plan

- 1.54 In addition to the Shareholder Agreement the other main document governing the operation of BCPP Limited will be the Articles of Association. The main provisions of this document of which members should be aware and which are not already described above are set out below.
- 1.55 It is proposed that the Board of Directors will comprise of 3 Executive Directors and 3 Non-Executive Directors, one of which will be the Chairman. Each of these directors are required to be noted on the 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.
- 1.56 No shareholder may transfer its shares (class A or class B) to any other person save to the company as part of a redemption of shares (for example on a withdrawal by that shareholder).
- 1.57 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 21st March and that the documents will be executed shortly thereafter.
- 1.58 Following this, further work is required to set up BCPP Limited in its final form and ensure its FCA registration. This will include finalising contract terms between BCPP limited and respective Administering Authorities.
- 1.59 Council are invited to give effect to Lincolnshire LGPS involvement in the BCPP pooling arrangements by approving the Recommendations in this Report.

Resource and Value for Money Considerations

- 1.60 Empirical evidence from independent cost consultants CEM Benchmarking shows that if appropriately implemented, larger asset pools can achieve material benefits in fee savings and / or in transaction costs, plus they generally offer improved governance structures. The specific independent specialist external advice acquired for BCPP further supports this.
- 1.61 The proposal submitted to government in July outlines that BCPP set up costs are expected to be between £2.280m and £4.155m – of which Lincolnshire will be responsible for 1/12 i.e. between £0.190m - £0.346m. These amounts will be payable over the period to formal operation of the newly created asset management company, scheduled for April 2018. These costs and any savings will be attributable to the Pension Fund not the Council's wider budgetary provision.
- 1.62 The initial projections detailed in the proposal (high and low case) show that once operational the full annual savings to the pool are estimated to be between £52.4m to £22.4m per year by 2030 (i.e. when all the alternatives in closed ended funds have run off and are being reinvested by the pool). Payback is achieved within 2 to 5 years depending on scenario.
- 1.63 Specifically for Lincolnshire, the individual annual savings are expected to be £3.7m to £1.7m by 2030. The payback is achieved even at the worst case projections within four years.
- 1.64 In further support of the value for money case the BCPP pooling proposal offers benefits in addition to cost savings:-
- Increased scale which will enable additional resilience to be created in the internal teams.
 - Creation of centres of excellence.
 - Professionalised investment structures.
- 1.65 Regulated structures bring with them the requirement for enhanced investment governance and risk management structures and procedures.

Alternatives Considered

- 1.66 Council may either:
- Accept the recommendations within this report and thereby comply with the legislative requirement to pool assets of the Lincolnshire LGPS or;
 - Propose alternative arrangements for the pooling of assets of the Lincolnshire LGPS that comply with the legislative requirement for pooling of Local Government Pension Fund assets.

- 1.67 The Council cannot resolve not to pool its assets at all without being in breach of the 2016 Regulations and Guidance and therefore at risk of intervention by the Secretary of State.
- 1.68 If the Council were to propose alternative arrangements, the Council would have to start again with negotiating its entry into some other pooling arrangement. This would not be possible in time either to state in the Investment Strategy Statement its proposals for pooling as required by law or to have implemented its pooling proposals by 1 April 2018 which is the government's deadline
- 1.69 This too may potentially lead to Secretary of State intervention.

2. Legal Issues:

The Substantive Proposals

- 2.1 The work to develop the BCPP pooling proposal through the establishment of BCPP Limited has been supported by two sets of external lawyers. Eversheds have been appointed to advise the newly constituted company and to support its set up. Squire Patton Boggs have 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.
- 2.2 The Note attached at Appendix B giving a general description of the arrangements has been prepared by Eversheds and approved by Squire Patton Boggs. The documentation including the Shareholder Agreement and the Inter Authority Agreement has been negotiated with the benefit of legal advice from both firms. Monitoring Officers, section 151 officers and their representatives from all Administering Authorities have been informed and engaged in the process of developing and finalising the documentation.
- 2.3 Squire Patton Boggs have also provided a Note of legal advice which is attached at Appendix F and reflected in these comments. That Advice is also based on a Note on Regulatory Capital prepared by Eversheds and attached at Appendix G.
- 2.4 The body of the Report accurately sets out the legal background to pension pooling and identifies the Council's legal obligations.
- 2.5 The Council has power under section 1 of the Localism Act 2011 to acquire shares in a company established for the purposes for which BCPP Limited has been established.
- 2.6 The structure of the reserved matters set out in the Shareholders Agreement is sufficient to establish the decisive influence over the strategic direction of the company necessary for the company to be Teckal compliant and the company is considered to be Teckal compliant.

- 2.7 The provisions of the Articles and the Shareholders Agreement are sufficient to ensure compliance by the company with the requirements of the Local Authority Companies Order 1985.
- 2.8 There are no adverse State Aid implications of the payment by the Administering Authorities to BCPP Limited of the Operating Fee or the provision of regulatory capital.
- 2.9 The Council has power under section 102 of the Local Government Act 1972 to establish the BCPP Joint Committee in accordance with the Terms of Reference and Constitution set out in the Inter-Authority Agreement.
- 2.10 The recommendations set out in the Report are consistent with the fiduciary duties of the Council in its capacity as Administering Authority of the Lincolnshire LGPS. In particular, the holding of the 1 class A share by and the provision of a one twelfth share of the regulatory capital requirement for the company out of the Pension Fund are both within the Council's fiduciary duty
- 2.11 The appointments and delegations proposed within the recommendations are lawful and within the remit of the full Council.

Equality Act 2010

- 2.12 Under section 149 of the Equality Act 2010, the Council must, in the exercise of its functions, have due regard to the need to:
 - * Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act
 - * Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it
 - * Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

The relevant protected characteristics are age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; and sexual orientation
- 2.13 Having due regard to the need to advance equality of opportunity involves having due regard, in particular, to the need to:
 - * Remove or minimise disadvantages suffered by persons who share a relevant protected characteristic that are connected to that characteristic
 - * Take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of persons who do not share it
 - * Encourage persons who share a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low

- 2.14 The steps involved in meeting the needs of disabled persons that are different from the needs of persons who are not disabled include, in particular, steps to take account of disabled persons' disabilities
- 2.15 Having due regard to the need to foster good relations between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to tackle prejudice, and promote understanding
- 2.16 Compliance with the duties in section 149 may involve treating some persons more favourably than others
- 2.17 The duty cannot be delegated and must be discharged by the decision-maker. To discharge the statutory duty the decision-maker must analyse all the relevant material with the specific statutory obligations in mind. If a risk of adverse impact is identified consideration must be given to measures to avoid that impact as part of the decision making process

Equality impacts have been considered and there are not considered to be any direct impacts arising from this Report. The Report considers governance arrangements which are neutral as between people with a protected characteristic.

Joint Strategic Needs Analysis (JSNA and the Joint Health and Wellbeing Strategy (JHWS)

- 2.18 The Council must have regard to the Joint Strategic Needs Assessment (JSNA) and the Joint Health & Well Being Strategy (JHWS) in coming to a decision

Regard has been had to the JSNA and JHWS and there are not considered to be any implications arising out of the matters discussed in this Report which relate to technical and highly regulated arrangements relating to the Council's capacity as administering authority of the Lincolnshire LGPS.

Crime and Disorder

- 2.19 Under section 17 of the Crime and Disorder Act 1998, the Council must exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent crime and disorder in its area (including anti-social and other behaviour adversely affecting the local environment), the misuse of drugs, alcohol and other substances in its area and re-offending in its area

Regard has been had to the matters referred to in section 17 and there are not considered to be any implications arising out of the matters discussed in this Report which relate to technical and highly regulated arrangements relating to the Council's capacity as administering authority of the Lincolnshire LGPS.

3. Conclusion

- 3.1 The Lincolnshire LGPS is legislatively mandated to the pooling of its assets. It is considered that this will commence from 1st April 2018.
- 3.2 It is proposed that the Lincolnshire LGPS formally pools its assets into the Border to Coast Pensions Partnership and takes a shareholding in this company and contributes to its regulatory capital requirements.
- 3.3 It is also proposed that the Council is appropriately represented on the Joint Committee of the BCPP to appropriately represent the Fund's views and the Council's Constitution is amended to reflect the changes.
- 3.4 The pooling of Local Government Pension Fund assets will have no impact on the pension entitlement of members of the fund (current employees, previous employees who are yet to draw their pension or pensioners).

4. Legal Comments:

The functions of the administering authority of the Lincolnshire Local Government Pension Scheme are Council and not Executive functions.

The proposals in the Report are within the remit of full Council.

The legal considerations to be taken into account are dealt with in detail in the Report

5. Resource Comments:

The Council is required by legislation to participate in one of a limited number of local authority pension fund pools. Regulatory capital to establish the company can legitimately be provided by the pension fund and will constitute a return earning investment for the fund. The financial analysis undertaken clearly demonstrates that material financial savings should accrue in fees paid by the pension fund in the medium to long term as a consequence of the pooling arrangement and, as such, it is likely to provide good value for money.

6. Consultation

a) Has Local Member Been Consulted?

n/a

b) Has Executive Councillor Been Consulted?

n/a

c) Scrutiny Comments

n/a

d) Have Risks and Impact Analysis been carried out??

Yes

e) Risks and Impact Analysis

See the main body of the Report

7. Appendices

These are listed below and attached at the back of the report	
Appendix A	Letter from Secretary of State 13 December 2016
Appendix B	Summary of Pool Governance Structure
Appendix C	Draft Inter-Authority Agreement
Appendix D	Amendments to Constitution
Appendix E	Draft Shareholders Agreement
Appendix F	Squires Patton Boggs Legal Advice
Appendix G	Note on Regulatory Capital

8. Background Papers

Document title	Where the document can be viewed
Investment Reform Criteria and Guidance November 2015	Pensions
Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016	Legal Services
Guidance on Preparing and Maintaining an Investment Strategy Statement	Pensions
Border to Coast Pensions Partnership Limited Draft Articles of Association	Legal Services

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