Public Document Pack

Agenda

Dorset County Council

Meeting:	Pension Fund Committee
Time:	11.00 am
Date:	9 January 2017
Venue:	HMS Phoebe Room, Town Hall, Bournemouth, Dorset, BH2 6DY

John Beesley (Chairman)	Bournemouth Borough Council
Mike Byatt (Vice-Chairman)	Dorset County Council
Andy Canning	Dorset County Council
Ronald Coatsworth	Dorset County Council
May Haines	Borough of Poole
Mike Lovell	Dorset County Council
Peter Wharf	Dorset County Council
John Lofts	Dorset District Councils
Johnny Stephens	Scheme Member Representative

Notes:

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- **Public Participation**

  Guidance on public participation at County Council meetings is available on request or at http://www.dorsetforyou.com/374629.

  Public Speaking

  Members of the public can ask questions and make statements at the meeting. The closing date for us to receive questions is 10.00am on 4 January 2017, and statements by midday the day before the meeting.

Debbie Ward
Chief Executive

Contact: Liz Eaton, Democratic Services Officer
County Hall, Dorchester, DT1 1XJ
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Date of Publication:
Thursday, 22 December 2016

1. **Apologies for Absence**

To receive any apologies for absence.

2. **Code of Conduct**

Councillors are required to comply with the requirements of the Localism Act 2011 regarding disclosable pecuniary interests.

- Check if there is an item of business on this agenda in which you or a relevant person has a disclosable pecuniary interest.
- Inform the Secretary to the Joint Committee in advance about your disclosable pecuniary interest and if necessary take advice.
- Check that you have notified your interest to your own Council's Monitoring Officer (in writing) and that it has been entered in your Council's Register (if not this must be done within 28 days and you are asked to use a notification form available from the clerk).
- Disclose the interest at the meeting and in the absence of a dispensation to speak and/or vote, withdraw from any consideration of the item.

Each Councils' Register of Interests is available on Dorsetforyou.com and the list of disclosable pecuniary interests is set out on the reverse of the form.

3. **Minutes** 5 - 10

To confirm and sign the minutes of the meeting held on 24 November 2016.

4. **Public Participation**

(a) Public Speaking

(b) Petitions

5. **LGPS Investment Reform and Pooling - Approval of the Full Business Case for the Brunel Pension Partnership** 11 - 160

To consider and approve the Full Business Case for the Brunel Pension Partnership (attached).

6. **Governance Changes to Hedging Instruments** 161 - 176

To consider a report from Insight Investments setting out the impact of regulatory changes for hedging instruments (attached).

7. **Proposals for future changes to Employer Contribution Rates** 177 - 186

To consider the results of the 2016 actuarial valuation and discuss the proposal for future changes to employer contribution rates (attached).

8. **Dates of Future Meetings**

To confirm the dates for the meeting of the Committee in 2016:-

1 March	-	Committee Room 2, County Hall, Dorchester
21 June	-	Committee Room 1, County Hall, Dorchester
13 September	-	Committee Room 1, County Hall, Dorchester
23/24 November	-	London (venue TBC)

9. **Questions**

To answer any questions received in writing by the Chief Executive by not later than 10.00 am on 4 January 2017.

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Dorset County Council

Pension Fund Committee

Minutes of the meeting held at Insight Investments,
Queen Victoria Street, London on Thursday, 24
November 2016

Present:
John Beesley (Bournemouth Borough Council) (Chairman)
Mike Byatt (Dorset County Council) (Vice-Chairman)
Andy Canning, Mike Lovell, Peter Wharf (Dorset County Council) and John Lofts (District Council Representative).

Officer Attendance:
Richard Bates (Fund Administrator), David Wilkes (Finance Manager) and Tom Wilkinson (Interim Chief Treasury and Pensions Manager).

Manager and Advisor Attendance:
Graeme Muir (Barnett Waddingham, Actuary), Alan Saunders (Independent Adviser), James Clifton-Brown, Ian Wilson (CBRE Global Investors), Gary Wilkinson, Diane Stanning (Insight Investments), James Stoddart, Jonathan Plat, Paola Binns (Royal London Asset Management), Joanne Wheatley and Ralph Karels (Allianze Global Investors).

(Notes:These minutes have been prepared by officers as a record of the meeting and of any decisions reached. They are to be considered and confirmed at the next meeting of the Pension Fund Committee to be held on **Monday, 9 January 2017**.)

Apologies for Absence

59 Apologies for absence were received from Ronald Coatsworth (Dorset County Council), May Haines (Borough of Poole) and Johnny Stephens (Scheme Member Representative).

Code of Conduct

60 There were no declarations by members of disclosable pecuniary interests under the Code of Conduct.

Minutes

61 The minutes of the meeting held on 12 September 2016 were confirmed and signed.

Matters Arising

62 Minute 47 – Investment Reform and Pooling (Project Brunel)
Members agreed that the Committee needed a formal standing agenda item for future meetings to discuss Project Brunel, and an additional meeting be held on 9 January 2017 to consider the Full Business Case.

Public Participation

63 Public Speaking
There were no public questions received at the meeting in accordance with Standing Order 21(1).

There were no public questions received at the meeting in accordance with Standing Order 21(2).

Petitions
There were no petitions received at the meeting in accordance with the County

Council's Petition Scheme.

Pension Fund Annual Report 2015/16

64 The Committee received the Annual Report for 2015/16 from the Fund Administrator. The Finance Manager (Treasury and Pensions) confirmed that the report would be posted on the Fund's website.

Noted

2016 Actuarial Valuation

65 The Committee received a presentation on the 2016 actuarial valuation from Graeme Muir, Barnett Waddingham, the Fund's Actuary. The Actuary shared indicative results of the valuation, updated from the presentation he gave to the last meeting of the Committee on 12 September 2016. He explained that the results showed the overall position for the Fund and that individual rates for each Fund employer would need to be certified by 31 March 2017 at the latest.

The Actuary said that the average employer's contribution rate (including deficit contribution) was expected to increase from 18.6% at the last valuation to approximately 21%. He summarised the main reasons for the increase as a reduction in the discount rate from 6.0% to 5.4% due to a more pessimistic outlook for investment returns than at the last valuation, a reduction in the deficit recovery period from 25 to 22 years, and significantly lower than anticipated take up of the 50/50 option by scheme members. He also highlighted the need to show an improved funding level driven by the likely Section 13 comparison work undertaken by the Government Actuaries Department (GAD).

The Fund Administrator commented that contributions would need to increase but in a stepped way. The Chairman suggested that the Fund Administrator discuss with the Actuary and circulate a proposal for annual stepped increase to members. It was agreed that this proposal should be added to the agenda for the additional meeting of the Committee on 9 January 2017.

Resolved

That a proposal for stepped annual increases in employer contribution rates be prepared for consideration at the additional meeting of the Committee on 9 January 2017.

Property Portfolio (CBRE)

66 The Committee considered a report from James Clifton-Brown and Ian Wilson, CBRE Global Investors, the Fund's property manager. Mr Wilson agreed to produce a report updating progress and risks relating to the Cambridge Science Park development project.

The Chairman thanked CBRE for the training session they provided for Committee members on 23 November 2016.

Resolved

That CBRE produce a report updating progress and risks relating to the Cambridge Science Park development project.

Liability Hedging Portfolio (Insight Investments)

67 The Committee considered a report from Gary Wilkinson and Diane Stanning, Insight Investments, who had the mandate for the liability matching strategy. Mr Wilkinson highlighted the forthcoming regulatory changes leading to a requirement for a clearing house for inflation swaps, the resulting daily collateral requirements and margin payments on currency hedging transactions. It was agreed that Insight Investments would produce a report for discussion at the additional meeting of the Committee on 9

January 2017.

The Chairman thanked Insight Investments for hosting the Committee meeting and for the training sessions provided for Committee members 23 November 2016.

Resolved
That Insight Investments produce a report on the impact of regulatory changes to inflation swaps and foreign exchange hedging to be discussed at the additional meeting on 9 January 2017.

Corporate Bond Portfolio (RLAM)

68 The Committee considered a report from James Stoddart, Jonathan Platt and Paola Binns, Royal London Asset Management (RLAM) on the corporate bond portfolio. Mr Platt said that he believed that long term interest rates had reached their low point and would start rising. However he did not expect rates to return to previous 2000 to 2007 levels because world growth was still not particularly strong and political pressures in Europe were growing and returning to the fore.

The Independent Adviser asked about the current quarter's performance and Mr Platt replied that it had been a strong quarter to date, showing a reversal against previous quarters. He added that RLAM's strategy was targeting less liquid asset backed investments, and was moving away from positioning against the benchmark.

Noted

Global Equities Portfolio (Allianz)

69 The Committee considered a report from Joanne Wheatley and Ralph Karels, Allianz Global Investors, who were appointed to the smart beta global equities mandate in December 2015. Ms Wheatley described Allianz as an active manager looking to take positions and that performance had been improving against benchmark in a challenging environment.

Mr Karels reminded members of Allianz's five factor approach of 'Value', 'Momentum', (earnings) 'Revision', 'Growth' and 'Quality', with Value still the core factor. The Independent Adviser added that Value stocks could go in and out of favour, could turnaround quite quickly and that Allianz's approach had performed very well over time.

Noted

Fund Administrator's Report

70 The Committee considered a report by the Pension Fund Administrator on the allocation of assets and overall performance of the Fund up to 30 September 2016.

The Independent Adviser presented his report and provided a commentary on the investment outlook, and how it was likely to affect each asset class. He commented that the result of the EU referendum had marked the end of a 34 year bull market in gilts. We would now see an expectation of higher inflation and rising government bond yields, and he questioned whether this would dampen returns from property and equities. The general view was that equities were now quite richly priced. The overall outlook was that economic growth would be sluggish, but positive.

The Fund Administrator highlighted the very strong absolute performance of the Fund's assets over the financial year to date, but he told members that the value of the Fund's liabilities would also have increased over this same period. He highlighted that the Fund had lost a useful performance comparator following State Street's decision to discontinue providing LGPS average return information and that LGPS National Frameworks had been asked to procure a replacement provider.

The Fund Administrator told members that an investment consultant would be engaged to review the Fund's strategic allocation to asset classes shortly after the results of the triennial valuation were known. Members asked that the results of this review be discussed at the March or June 2017 meeting of the Committee.

The Chairman updated the Committee on progress with Project Brunel. He stressed that a key priority of the Shadow Operations Board (SOB) was the containment of costs, both transitional and on-going, including taxation. Members were informed that a meeting to discuss Project Brunel with the Minister for Local Government, Marcus Jones MP, was scheduled for 30 November. He proposed that the Full Business Case for Project Brunel be considered at the additional meeting on 9 January 2017. The Committee would then make recommendations to the County Council's Cabinet as administering authority, on 1 February 2017, with recommendations being considered by the County Council on 16 February 2017.

Resolved

1. That the activity and overall performance of the Fund be noted.
2. That no changes to asset allocation be made at this time.
3. That the results of the review of the strategic allocation be considered at the March or June 2017 meeting of the Committee.
4. That the Full Business Case for Project Brunel be considered at the additional meeting on 9 January 2017 including the proposal on employer contribution rates and to discuss the report from Insight Investments on the changes to call margins and collateral requirements for hedging instruments.

Pensions Administration

71 The Committee received a report by the Pension Fund Administrator on matters relating to the administration of the Fund. The Interim Chief Treasury and Pensions Manager informed the Committee that the backlog of aggregation cases had decreased from 1,832 at 1 September 2016 to 1,723 at 31 October 2016, and that the Pensions Benefits Manager would formulate a team plan to address the remaining backlog.

Noted

Other Manager Reports

72 (a) UK Equity Report

The Committee considered a report by the Finance Manager (Treasury and Pensions) which summarised the performance of the internally managed UK equities portfolio, the AXA Framlington Fund and the Schroders Small Cap Fund.

The Finance Manager (Treasury and Pensions) highlighted that the return from the internally managed passive portfolio was outside the agreed tolerance of +/- 0.5% for the quarter and the financial year to date, although still within this range for the 12 months, 3 years and 5 years ending 30 September 2016. He believed this was a result of volatility in the weeks after the referendum result and expected performance to return within the agreed range in the next quarter. The position would be monitored very closely and internal procedures would be reviewed.

The Finance Manager (Treasury and Pensions) also highlighted the performance of AXA. Although the absolute and relative performance for the quarter had been positive, this had not been sufficient to fully recover from the poor returns of the previous quarter. The Independent Adviser commented that AXA's performance had been adversely affected by their high exposure to domestically focused mid cap stocks relative to their benchmark.

Noted

(b) Global Equities Report
The Committee considered a report by the Finance Manager (Treasury and Pensions) which summarised the performance of the three Global Equities managers Allianz, Investec and Wellington. It had been a good quarter for all three managers in absolute terms and relative to their benchmarks, but the performance of all three managers was still below benchmark since inception in December 2015.

Noted

Dates of Future Meetings for 2017

73 **Resolved**
That meetings be held on the following dates:

9 January 2017	Town Hall, Bournemouth
1 March 2017	County Hall, Dorchester
21 June 2017	County Hall, Dorchester
13 September 2017 (tbc)	County Hall, Dorchester
22/23 November 2017	London (to be confirmed)

Questions
74 No questions were asked by members under Standing Order 20(2).

Meeting Duration: 10.00 am - 1.00 pm

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Pension Fund Committee

Dorset County Council

Date of Meeting	9 January 2017
Officer	Pension Fund Administrator
Subject of Report	**LGPS Investment Reform and Pooling – Approval of the Full Business Case for the Brunel Pension Partnership**
Executive Summary	In July 2015, the Government announced that they intended to work closely with the Local Government Pension Scheme (LGPS) funds to pool their investments and significantly reduce costs. The Dorset County Pension Fund has therefore been working with 9 other neighbouring LGPS funds to establish an investment company to manage the partner funds' assets, which are currently valued at over £25 billion. A submission to Government in July 2016 established the outline business case for the company, Brunel Pensions Partnership Limited. This report presents the full business case, which projects potential savings for the Fund of £74m over the next 20 years, with a breakeven point in 2021/22.
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: Extensive use of finance industry expertise has been drawn on during the development of the Full Business Case, fully details can be found in the body of the report.
	Budget:

	Projected savings in investment management and running costs of £74m over the next 20 years, which will accrue directly to the Fund.
	Risk Assessment: A full risk assessment has been made and the project risk register is presented as an exempt item at Appendix 8.
	Other Implications: None
Recommendation	That: i) The Brunel Pension Partnership investment pool be developed, funded and implemented substantially in accordance with the terms and provisions described in the said Business Case, and more particularly that: • a FCA regulated company to be named Brunel Pension Partnership Limited be established, and that the company be operated with all necessary and appropriate arrangements as to its ownership, structure, governance and services capability; • a new supervisory body comprising representatives of the Council and all other participants in the Brunel Pension Partnership be established to ensure oversight of the Council's investment and participation in the Brunel Pension Partnership; • that Dorset County Council as administering authority owns a 10% share in Brunel Pensions Partnership Limited; ii) The Chief Finance Officer and Chief Legal Officer be authorised and granted delegated powers to undertake such tasks as they think appropriate to progress implementation of investment pooling, and to take such decisions and do all things deemed necessary in order to support the Pension Fund Committee and to promote the interests of the Council with respect to pooling, which without limitation shall include informing and advising the Pension Fund Committee on the continued viability and suitability of investment pooling in light of any developments, financial or otherwise, in the period up to the establishment of the Brunel Pension Partnership. iii) Subject to the above, all such matters be carried out with the aim of achieving a target date for investment pooling of 1 April 2018, and otherwise subject to such intermediate

	steps and timescales as may be considered appropriate and necessary by the Pensions Committee.
Reason for Recommendation	To ensure that the Fund has the appropriate management arrangements in place.
Appendices	Appendix 1: Full Business Case (FBC) – Executive Summary Appendix 2: FBC Document List Appendix 3: FBC Glossary of Terms **The public should be excluded during consideration of Appendices 4 - 8 because their discussion in public would be likely to lead to the disclosure to members of the public present of exempt information as defined in the paragraph detailed below of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended):** **3. Information relating to the financial or business affairs of any particular person (including the authority holding that information)** **and since it is considered that, in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information, in that disclosure at this time is likely to prejudice the future negotiations to set up the pooling arrangements**. Appendix 4: FBC Financial Case Appendix 5: FBC Economic Case Appendix 6: FBC Commercial Case Appendix 7: FBC Management Case Appendix 8: FBC Risk Register
Background Papers	Brunel working papers
Report Originator and Contact	Name: Tom Wilkinson Tel: 01305 224366 Email: thomas.wilkinson@dorsetcc.gov.uk

1. Introduction

1.1 Following the Government's announcement in the July 2015 budget statement that they intended to work with Local Government Pension Scheme (LGPS) administering authorities to ensure that they pool investments to significantly reduce costs, considerable work has been undertaken by the Dorset County Pension Fund, in conjunction with 9 neighbouring funds, to set up the Brunel Pension Partnership.

1.2 Regular reports have been brought to this Committee at all stages of the process, with additional engagement events also being held to provide the opportunity for Committee members to provide input to the proposals. As required by Government an initial joint submission from the ten Brunel funds was approved by this Committee in February 2016 and a more detailed response in June 2016 which was submitted to the Government in July 2016.

1.3 Following the July 2016 submission of what was in effect an Outline Business Case, work has been continuing on developing a Full Business Case for the Brunel Pension Partnership. The Full Business Case (Appendix 1 to this report) has now been completed and needs to be approved by each of the ten administering authorities in order that the establishment of the company can be progressed. Each Authority will consider the Full Business Case amended to show their individual Financial Case, as well as the overall position for the pool.

1.4 A significant amount of work supports the Full Business Case, and a full list of the supporting documents is included as Appendix 2 to this report. Appendix 3 sets out a glossary of the key terms used throughout the documents. The business case itself is set out in five sections and each of these is supported by a more detailed case which is included in the confidential Appendixes 4 to 7. The current risk register is included at Appendix 8. If Members wish to access any of the unpublished additional supporting information listed in Appendix 2, they are invited to contact the Interim Chief Treasury and Pensions Manager who will make it available to them. Appendixes 4 to 8 contain commercially sensitive data relating to each of the Funds and the proposed company.

1.5 **The public should therefore be excluded during consideration of Appendices 4 - 8 because their discussion in public would be likely to lead to the disclosure to members of the public present of exempt information as defined in the paragraph detailed below of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended):**

> **3. Information relating to the financial or business affairs of any particular person (including the authority holding that information)**

and since it is considered that, in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information, in that disclosure at this time is likely to prejudice the future negotiations to set up the pooling arrangements.

2. Full Business Case and Cost Model

2.1 The Full Business Case seeks approval to establish a company called Brunel Pension Partnership Ltd (Brunel Company or BPP Ltd), regulated by the Financial Conduct Authority (FCA). It comprises five sections:

- The Strategic Case;
- The Financial Case;
- The Economic Case;

- The Commercial Case;
- The Management Case.

2.2 The Full Business Case was reviewed by the Finance/Legal Assurance Group (FLAG), comprising the Chief Finance Officers and Monitoring Officers of each of the ten administering authorities during November 2016 and signed off by the Shadow Oversight Board (SOB), comprising the chairmen of the ten funds on 23 November 2016. The business case has been put together with significant work by officers of the ten administering authorities, supported by professional expertise provided by PwC (operational and financial support), Osborne Clarke (legal support), Alpha (FCA expertise), JLT (project support) and Bfinance (investment advice).

2.3 The Strategic Case focuses on the legal and regulatory requirements as well as the costs and benefits of pooling. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016 No 946) came into force on the 1 November 2016. These regulations provide the legal basis which requires LGPS funds to pool their investments. They also include provision for the Secretary of State to intervene if he does not believe an Authority has complied with the Regulations and the accompanying guidance.

2.4 The Financial Case is drawn from a complex financial model that has been developed by the Brunel partnership in conjunction with PwC, which analyses the costs and savings for the partnership as a whole and for each of the individual funds. The model allows scenario testing, changes to individual assumptions and the removal of individual funds from the partnership for sensitivity analysis and stress testing the proposal. The core model analysis shows the breakdown between funds of a total of £550m forecast cumulative net savings over the next 20 years.

2.5 The Economic Case examines two potential models for how to set up the Brunel Company, either to ‘rent’ it from a commercial provider or ‘build’ it. An analysis was carried out as part of developing the Outline Business Case to consider the relative merits and limitations of each model, examining them against accountability, procurement and staffing factors, and costs. The analysis showed that the build model had advantages over the rental model, especially relating to accountability to the constituent Pension Funds.

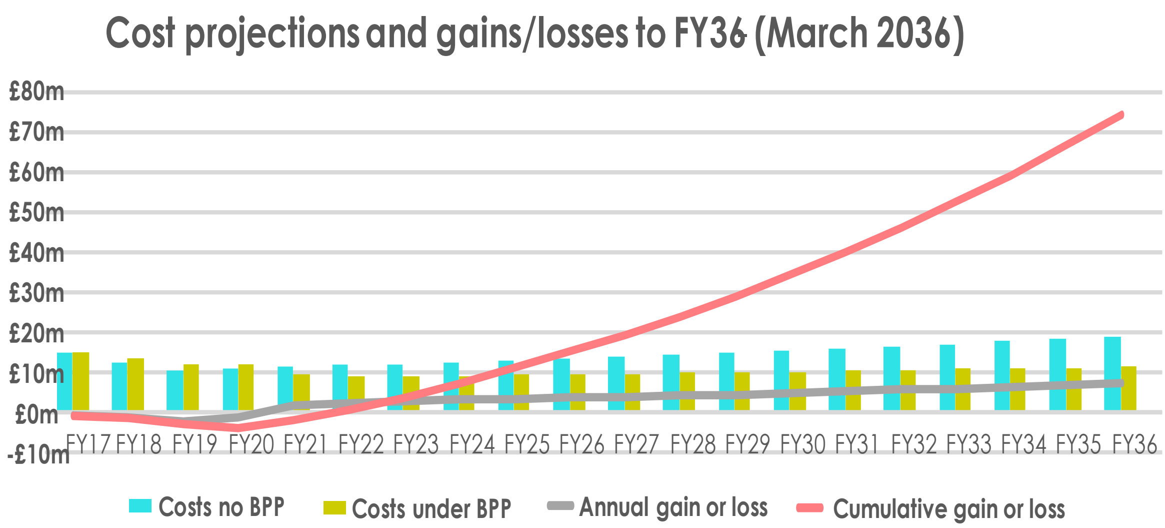
2.6 The Commercial Case sets out the structure of the Brunel Pension Partnership as well as the governance and contractual arrangements that will exist. The Brunel Company will be set up as a “Hamburg Waste” type joint working arrangement between public authorities and therefore fall within the exemption in the Public Contracts Regulations 2015 in relation to its appointment by the founding funds to manage the investments of the funds. The 10 founding Administering Authorities will be equal shareholders in the company. The company will be managed by the company board with a chairman, three other non-executive directors, a chief executive officer and three operational directors. The governance arrangements will include an Oversight Board representing each participating fund’s pensions committee.

2.7 The Management Case looks at the project management that will be required to set up Brunel Pension Partnership Ltd including recruitment of staff, legal and physical set up, procurement of third party providers including the administrator/custodian, definition and set up of the services, and obtaining Financial Conduct Authority (FCA) authorisation. It also covers the work to establish the arrangements for governance of the company by the Administering Authorities and to implement the client side governance, organisation and process changes.

3. Dorset County Pension Fund Costs and Benefits to 2035/36

3.1 The Financial Case for Brunel has been derived from the financial model put together by PwC. The core model forecasts cumulative savings for the Dorset County Pension Fund of approximately £74m over the next 20 years, which has a discounted present value of approximately £39m. This results in a breakeven point in the 2021/22 financial year. The savings are summarised in the following table and graph:

Core model	Breakeven year	Total 20 years net gain to FY36		Running annual rate of net saving in FY25	
		£m	Discounted value £m	£m	bps of AUM
Dorset County Pension Fund	FY22	74.3	38.7	3.7	11.8
Combined Pool	**FY23**	**550.1**	**279.5**	**27.8**	**8.9**



3.2 The Brunel Pension Partnership costs include estimated costs of transitioning assets. These are being shared by all the Pension Funds pro rata to their allocation to each asset class, to ensure that no individual fund is disadvantaged by, or benefits from fund manager selection by the Brunel company. Other costs include the taxes involved in transitioning assets into the Brunel company and the operating costs of the Brunel company itself.

3.3 The actual asset transition costs for the company will not be known until the investment managers have been appointed, and will depend on the number of investment funds that need to be transitioned and the market conditions over the period of transition. The transition of assets is expected to begin in April 2018 through to 2020 for the majority of assets, although illiquid alternative assets such as Property and Private Equity will need a longer transition timetable.

3.4 The savings will be achieved through reduced direct investment costs, predominantly investment manager fees, expected to be payable once the Brunel company is operational. In addition there are some savings that the administering authorities expect to make as a result of no longer needing to carry out tasks internally because of services provided by the company. In the case of the Fund, this will be through reduced custodian and performance reporting costs.

3.6 The Financial Case also outlines the opportunity for additional benefits from improved performance. This would result from improved diversification between managers and better risk management that could be achieved from investing in greater scale. In addition, there is a further opportunity to make savings should the company undertake internal management of some active equity investments. This would reduce external manager fees and could therefore further increase the savings. There will also be increased opportunities for co-investments in property, infrastructure and private equity.

3.7 There are also a number of non-financial benefits resulting from the proposal. These include significantly improved resilience, improvements in reporting and benchmarking, improved resources for risk analysis including all economic, social and governance risks, and improved knowledge sharing.

4. Conclusion

4.1 Government policy, now brought into effect by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, requires the Fund to pool its assets. In light of this, the Fund has already committed to participating in the Brunel pool through the decisions made at previous meetings of this Committee. This Committee now needs to approve the Full Business Case to set up the Brunel company in order that the pooling proposals can progress to the implementation phase.

4.2 Although investment pooling is being driven by the central government agenda, the financial modelling that has been undertaken demonstrates that there are significant net savings opportunities for the Fund in entering into the Brunel Pension Partnership. The detailed business case sets out the structures and governance arrangements that will be put in place, which will ensure that the Brunel company provides value for money to the Fund.

4.3 The Committee is therefore asked to approve the resolution to set up the Brunel company. Further reports will be brought to this Committee as the project progresses.

Richard Bates
Pension Fund Administrator
December 2016

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Project Title: Project Brunel

Brunel Pension Partnership

Full Business Case – Dorset

VERSION HISTORY

Version	**Date Issued**	**Brief Summary of Change**	**Owner's Name**
Final Draft	08/11/16	Final Draft presented to BPP Finance and Legal Assurance Group (FLAG)	Dawn Turner
Final V1.0	15/11/16	Updates from FLAG feedback	OC/PwC/Project Office
Final v1.1	17/11/16	Incorporating feedback following FLAG review	Project Office
Final v1.2 Dorset	22/11/16	Updated in line with Financial model v5 Individual fund details and annex references for PCs included.	Project Office

Contents

1. INTRODUCTION

1.1 Background and Context

The Full Business Case **(FBC)** has been prepared to inform a decision by the Dorset County Pension Fund Committee on a proposal for Pension Fund investment pooling by means of a newly established pooling arrangement, to be called the Brunel Pension Partnership **(the BPP)**. At its core will be a new Financial Conduct Authority **(FCA)** regulated company, Brunel Pension Partnership Limited **(the Brunel company).**

Having first explained the background to investment pooling for Pension Funds in the Local Government Pension Scheme (**LGPS**), and also the essential features of the BPP proposal, the main focus of the FBC is on the financial viability and economic merits of that proposal. The outcomes of a detailed Financial Model are set out and have been subjected to ***independent professional assurance***. The impacts of legal and other matters relating to the formation, governance and operation of the BPP and the Brunel company are also set out and subjected to ***independent professional assurance***. All aspects have also been subjected to review by Chief Finance Officer/ Chief Legal Officer representatives from the 10 bodies engaged in the Brunel pool.

A summary of the key conclusions emerging from the FBC is provided immediately below. A major point to be emphasised at the outset is that ***the FBC indicates that there are significant financial savings and other efficiencies to be gained which support accepting the proposal to continue to establish an investment pool for the 10 bodies*** (i.e. quite apart from any regulatory imperative to pool). These derive principally from the ***enhancement in scale, skills, and resources that investment pooling will bring***. The pooled investment of approximately £25bn of assets under the BPP model ***will open up new opportunities across a range of performance metrics***.

Having listed the key conclusions, the remainder of this FBC is divided into five sections dealing with the Strategic, Financial, Economic, Commercial and Management Cases. Detailed consideration of these has been undertaken by Chief Finance and Chief Legal Officers on behalf of the Dorset County Pension Fund.

1.2 Key conclusions from the Full Business Case

These are, as follows:

- On an aggregated basis, the Financial Model indicates that net savings exceeding £0.5 billion are achievable by 2036, with annual savings exceeding annual costs by March 2021 and breakeven two years later. The timing is largely down to the timetable to transition active fund management after 2019 as this yields the largest saving potential.
- On an individual Fund basis, the Financial Model indicates that net savings are achievable, with the level of such savings varying between Funds mainly to reflect the historic differing approaches to investment

and risk resulting in different portfolios. This means there will inevitably be differing savings that will be obtained on fee renegotiations.

- New Regulations have set out a clear legal framework making investment pooling mandatory for all LGPS funds in England and Wales, from April 2018.
- Regulations are very clear that the responsibility for individual fund investment strategy remains with the individual Administering Authorities.
- The BPP will represent a collaboration of the Dorset Council and nine other LGPS Administering Authorities based broadly in the South West of England.
- The Brunel company will be set up as a new FCA regulated entity, to be owned equally by each of the ten Administering Authorities.
- The Brunel company will implement the investment strategy of each BPP Pension Fund by selecting and monitoring external Manager Operated Funds.
- An initial review of the set-up, governance and operation of the BPP investment pool has confirmed its legal robustness and viability.
- Further development work, including on financial, legal and FCA regulatory matters, will be undertaken in the next development phase of the BPP investment proposal (i.e. up to anticipated implementation in April 2018).
- The current proposals and the documents associated with the current proposals are first drafts which are yet to be properly discussed and scrutinised by the Administering Authorities.
- The next phase of the BPP project will be work-intensive, and continued project resource will be required to ensure its successful delivery.

1.3 Professional advice and assurance

Professional advice and assurance on the financial elements of the BPP investment pooling proposal has been provided by PricewaterhouseCoopers LLP (**PwC**) and other advisers. From PwC, this has primarily related to preparation of the Financial Model and its outcomes, the financial case and taxation advice. Bfinance UK Limited (**bfinance**) has advised on potential investment fee savings and investment transition costs. Additional financial markets advice has been provided by Alpha Financial Markets Consulting (**Alpha**).

Professional advice and assurance on the legal elements of the BPP investment pooling proposal has been provided by Osborne Clarke LLP (**Osborne Clarke**). This has primarily related to the law and investment pooling, the set-up of the Brunel company, FCA authorisation, procurement and employment matters. Further legal assurance has been provided by obtaining the legally privileged opinions of Leading Counsel (QCs) on the FCA authorisation and procurement law aspects.

Both PwC and Osborne Clarke have provided a statement of assurance to each of the BPP Administering Authorities.

2. STRATEGIC CASE

2.1 Introduction

The purpose of the Strategic Case is to identify the drivers for investment pooling. It sets out the case for change, taking into account in particular the Government's policy imperatives and the regulatory requirements relating to pooling.

2.2 Background to LGPS investment pooling

In May 2014, the Government published a consultation which set out how savings might be achieved by LGPS funds through greater use of passive management and pooled investment. Following that consultation, the Government invited all LGPS Administering Authorities to develop ambitious proposals for pooling of their assets.

In July 2015 the Budget Red Book contained a statement as to what was required, and in November 2015 more detailed guidance was issued. A key point to emerge was that each pool should have assets of around £25 billion.

The proposal to establish the BPP developed accordingly. Through project based joint-working initiatives led by the local pension officers and overseen by two sponsoring bodies[1] the 10 Administering Authorities comprising the BPP have collaborated to test the proposition of establishing a new LGPS investment pool. This will include the Funds of the Environment Agency (Active and Closed) and those of nine Local Authorities (Avon, Buckinghamshire, Cornwall, Devon, Dorset, Gloucestershire, Oxfordshire, Somerset and Wiltshire).

In February 2016 eight pools, including the BPP, submitted their proposals to the Government. These submissions were strategic statements of intent. They were followed in July 2016 by much more detailed submissions from each pool, setting out how they were intending to pool their assets and the rationale for the approach being adopted. Each of the Administering Authority's Pensions Committees approved the BPP submission to Government.

The BPP submission included details about the key structural elements for the BPP pool. Since July, work has been ongoing to develop the BPP proposal in readiness for launching the new pool in April 2018.

2.3 Regulatory reform

[1] Shadow Oversight Board with representatives from each Administering Authority; and Finance and Legal Assurance Group comprised of Chief Finance Officers and Chief Legal Officers.

The regulatory framework for investment pooling has been confirmed in the recently made Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (**LGPS Investment Regulations 2016**). These provide that each Administering Authority must formulate an Investment Strategy Statement which must (a) be in accordance with Secretary of State (**SoS**) guidance, and (b) include "the authority's approach to pooling of investments, including the use of collective investment vehicles and shared services". The guidance states that "all authorities must commit to a suitable pool to achieve benefits of scale", and they "must confirm that their chosen investment pool meets the investment reform and criteria published in November 2015".

The SoS is given back-stop powers to intervene if an authority fails to act in accordance with the guidance and following consultation with the authority. These permit the SoS to make a direction requiring: that the authority changes investment strategy; that the authority invests specified assets as directed; that the investment functions of the authority are exercised by the SoS; that the authority complies with an instruction from the SoS relating to the exercise of its investment functions.

Legal advice from Osborne Clarke has confirmed that these regulatory provisions mean that the Government has set out a clear framework making investment pooling mandatory for all LGPS funds in England and Wales.

2.4 The case for change

The consultation for the new draft LGPS Investment Regulations 2016 was accompanied by criteria for pooling. This outlined four areas that underpin the case for change. These are now described, along with a brief statement (in bold) of how the BPP measures up against those criteria:

- Benefits from economies of scale to be derived from large pools of assets of a minimum of £25 billion. The total LGPS assets under management (**AUM**) in England and Wales at that time were in the region of £180 billion.

  Funds in the BPP pool had assets of about £23 billion at 31 March 2015, and these were valued at over £25 billion at 31 October 2016.

- Improved decision making and better risk management, achieved from stronger governance, for the long-term interest of Funds' members.

  The BPP has agreed 12 investment principles that will underpin all the governance and operating arrangements across the whole partnership. These were reported to all fund Committees/ Boards in earlier phases of this project and include long termism, responsible stewardship and openness and transparency. The BPP's governance arrangements will be constructed to

meet the highest standards, including those required by the FCA for a regulated entity.

- Reduction in costs and improved value for money from both the fee savings achieved by funds investing together and reducing manager churn by focusing on long term performance.

  The BPP Funds currently have almost 100 different managers and around 170 mandates between them. These will be replaced by about 22 outcome focused investment portfolios, which will deliver the BPP Funds' investment strategy requirements and significantly reduce the number of managers and mandates. Annual fee savings of £20 million are projected to be made by March 2021, rising to £30 million by March 2027.

- Increasing capacity and capability to invest in infrastructure by making long term strategic collaborative plans across the LGPS to invest in infrastructure making this asset allocation more attractive (lower risk) and beneficial (increased returns for less cost).

  The eight LGPS pools have formed a Cross Pool Collaboration Group, with an Infrastructure sub-group looking at a national approach to infrastructure. While in its infancy, this is likely to yield improved access to better infrastructure investment, both from the collective opportunity BPP brings as well as a national investment vehicle.

2.5 Imperative of investment pooling

The main strategic driver for investment pooling is the Government's decision to progress this as a policy, as now required under the LGPS Investment Regulations 2016. The case for change is underpinned by legal advice from Osborne Clarke, and has been recognised by all other Administering Authorities in England and Wales and the other pools they have formed or are now forming.

3. FINANCIAL CASE

3.1 Introduction

The purpose of the Financial Case is to set out the financial implications of investment pooling. It is informed by a detailed Financial Model, which focuses on the estimated savings from pooling both on a whole pool basis and an individual Fund basis. It represents the key evidence supporting this Business Case and the BPP proposal generally.

3.2 The BPP financial model – three key metrics

PwC have created a sophisticated Financial Model that has been provided to each Administering Authority's pension and financial officers. The Financial Model compares the current situation for each Administering Authority to the situation following the transition of assets into the Brunel company, projecting annual net costs or net savings until 2036.

There are three key metrics from the Financial Model:

- **The annual running rate of net saving once the initial structural development and asset transition costs have been met**. Net savings are fee savings plus other savings less operational costs, each evaluated on an annual basis. The metric can be expressed as a cash amount or as a percentage of assets under management in the relevant year: we have used the year to March 2025 (FY25).
- **The year of breakeven**. This metric estimates when each of the BPP Pension Funds will reach the point when the anticipated fee and other savings will start to exceed the set-up (structural development and asset transition) costs and operational costs.
- **The total net savings measured against a broadly 20 year period** to financial year ending 31 March 2036 (FY36). This metric measures the net savings each of the Brunel Funds will accrue, both on a discounted and an undiscounted basis, over that period.

The information and assumptions underlying the Financial Model are described in more detail in the Financial Case.

3.3 The core model

The core model presents a base case of the financial outputs, and is intended as a prudent and reasonable projection of the total anticipated savings from the transitioning of assets into the BPP pool. The core model relies on the key assumption that fee savings will be driven by fewer investment mandates and an extensive programme of fee negotiations, with other savings accruing from reduced expenditure by Administering Authorities.

On that basis, the core model projects-:

- that annual net savings by FY25 will be **£27.8 million pa** across the Administering Authorities, representing 0.089% (**8.9** basis points **bps pa**) of assets then under management;
- the breakeven year, by which cumulative savings will have exceeded cumulative costs will be the year to March 2023, **FY23,** in fact relatively early in that year; and
- an aggregate net saving to FY36 across all ten Administering Authorities of **£550 million**, which has a discounted present value of **£280 million**.

The position on the three metrics (i.e. the annual running rate of net savings, the breakeven year, and the net savings by FY36) differs between the ten Administering Authorities, depending mainly on differing projected fee savings. These differing fee savings depend on the differences between the projected fee levels, after renegotiation, and existing fee levels, with fee savings harder to achieve if existing fee levels are already low. This is largely due to individual Administering Authorities having historically taken differing approaches to investment strategy and risk. This independence will remain and the base core model simply looks at savings from today's position. The other information on which projections are based varies much less between Administering Authorities.

For ease of comparison, the following table states assets under management (AUM) in March 2016 and the annual running rates of savings projected by the core model for FY25, both on a combined pool basis and on an individual Administering Authority basis.

Core model	Assets under management (AUM, £m, at 31 March 2016)	Running annual rate of net saving in FY25	
		£m	bps of projected AUM in FY25
Avon	3,739	3.5	6.8
Buckinghamshire	2,164	6.1	20.4
Cornwall	1,464	1.1	5.6
Devon	3,299	5.2	11.3
Dorset	2,273	3.7	11.8
Environment Agency*	2,954	2.8	7.4
Gloucestershire	1,687	0.7	3.0
Oxfordshire	1,824	1.1	4.2
Somerset	1,592	1.5	6.6
Wiltshire	1,826	2.1	8.3
Combined Pool	**22,822**	**27.8**	**8.9**

*includes £219m for the EAPF Closed Fund which is not expected to benefit from fee savings. Therefore the Closed Fund assets are not used in the calculation of the net saving as expressed in basis points of AUM.

On an individual fund basis this would mean a breakeven point for the combined fund of 2023 and for Dorset of 2022 as follows:

Core model	Breakeven year	Total 20 years net gain to FY36		Running annual rate of net saving in FY25	
		£m	Discounted value £m	£m	bps of AUM
Dorset Pension Fund	FY22	74.3	38.7	3.7	11.8
Combined Pool	**FY23**	**550.1**	**279.5**	**27.8**	**8.9**

PwC has provided financial assurance to the Administering Authorities that the core model has been constructed using prudent and reasonable assumptions. More detail of such assumptions and the modelling methodology is set out in the Financial Case. This has been checked and assessed by each Administering Authority's Chief Finance Officer/ Section 151 Officer.

3.4 Sensitivity on core model

A sensitivity analysis of the core model metrics has been undertaken. This analysis has considered several important variables, as follows:

- Variable 1: fee savings achieved by the Brunel company being plus/minus 2 basis points (0.02%) when compared with the midpoint the fee savings identified in the core model for each Administering Authority (the overall midpoint being 8.9 bps for the Combined Pool).

- Variable 2: asset transition costs, which include tax costs, being in total plus/minus £15 million when compared with the asset transition costs used for the core model.
- Variable 3: annual operational costs for the Brunel company being £1 million pa higher than the annual operational costs used for the core model.
- Variable 4: a transition delay such that liquid assets take three years to restructure rather than the two years used in the core model.
- Variable 5: underlying market asset performance differing significantly from the steady 4% pa growth used for the core model. Three variations are considered: a 20% equity market crash in 2020, and steady growth at rates of either 3% pa or 5% pa.

The table on the following page expresses the impact of these five variables on a combined pool basis. The top row, shaded, shows the core model. Other rows show individual variations, with downside sensitivities lightly shaded and upside sensitivities unshaded:

Table 1.3.4a Impact on Core Model of 5 Variables – Combined Pool Basis

Combined (all ten Administering Authorities)		Breakeven year	Total 20 years net gain to FY36		Running annual rate of net saving in FY25	
			£m	Discounted value £m	£m	bps of AUM
Core model		FY23	550	280	27.8	8.9
Variable 1: fee savings	**- 2 bps pa saving**	FY24	387	188	20.5	6.5
	+ 2 bps pa saving	FY22	714	371	35.2	11.2
Variable 2: asset transition costs, incl tax	**+£15m on total transitional costs**	FY24	535	266	27.8	8.9
	- £15m on total transitional costs	FY22	565	293	27.8	8.9
Variable 3: + £1m pa Brunel Company running costs		FY23	526	263	26.6	8.5
Variable 4: transition delay		FY24	507	256	26.3	8.4
Variable 5: market asset performance	**Equity market crash in FY20**	FY23	458	228	23.5	8.7
	-1% pa (3% pa total)	FY23	441	219	24.6	8.6
	+1% pa (5% pa total)	FY23	680	352	31.3	9.2

The key conclusions emerging from the sensitivity analysis are as follows, including comments on mitigation:

- **The fee renegotiations will be critical to the overall results.** The core model targets an overall improvement in fee savings that leads to net savings, after operational costs, of 8.9 basis points (0.09%) by FY25. A reduction of 2 basis points (0.02%) in savings in variable 1 is the largest effect illustrated, impacting all three key metrics of running annual rate of net saving, breakeven and 20 year net gain.
- **Fee renegotiations are a largely symmetrical sensitivity.** Hence the upside potential on the three key metrics in variable 1 further emphasises the importance of successful fee negotiations.
- **Asset performance by the markets is crucial.** The more assets under the aegis of the Brunel company, the more pooling will deliver; conversely, a lower asset base will render pooling less beneficial. There is an element of a fixed cost being spread here, as evidenced by the annual running rate of saving in FY25, if expressed as basis points of AUM (assets under management), changing little between the three scenarios considered within variable 5. At a high level, investment performance by markets cannot be altered by the Brunel company: some mitigation may be possible through strategic asset allocation at the Administering Authority level. Ultimately, investment performance has balancing contribution implications that have not been modelled.
- **Transition delay should be avoided.** Delay by a year, variable 4, would outweigh the impact of £15 million higher asset transition costs, variable 2. This can be seen in both breakeven year and total gain over 20 years. Neither variable has much impact on the running annual rate of saving projected by FY25.
- **Asset transition costs including tax could push back the breakeven year.** The £15 million extra indicated just moves breakeven from FY23 to FY24, so that there would be a substantial gain by the end of FY24. There will be choice as to how much cost to incur: more radical asset reorganisation may be justified in terms of higher fee savings or higher performance expectations. However, action to pursue recognition of this impact and alternative arrangements for UK tax impacts should and will be pursued with Central Government to see if some of this variable can be mitigated.
- **Asset transition costs including tax are a broadly symmetrical sensitivity**. So the upside potential demonstrates that a saving is possible. There would be a concern that pursuing some saving could reduce the longer term effectiveness of portfolio construction.

- **Brunel company operating costs should be controlled**. If they changed by £1 million a year as illustrated by variable 3, they would have a somewhat greater impact on the 20 year net gain than transitional costs increasing by £15 million

The table on the following page expresses the impact of these the five variables for the Dorset County Pension Fund only. Commentary is being provided in individual covering papers and the text of this document, other than for the table itself, is not being altered between Administering Authorities:

Table 1.3.4b Impact on Core Model of 5 Variables – Dorset County Pension Fund Only

Dorset County Pension Fund		Breakeven year	Total 20 years net gain to FY36		Running annual rate of net saving in FY25	
			£m	Discounted value £m	£m	bps of AUM
Core model		FY22	74.3	38.7	3.7	11.8
Variable 1: fee savings	**- 2 bps pa saving**	FY23	57.8	29.5	3.0	9.4
	+ 2 bps pa saving	FY21	90.8	48.0	4.5	14.1
Variable 2: asset transition costs	**+£15m on total transitional costs**	FY22	73.1	37.6	3.7	11.8
	- £15m on total transitional costs	FY22	75.5	39.8	3.7	11.8
Variable 3: + £1m pa Brunel Company running costs		FY22	71.9	37.0	3.6	11.4
Variable 4: transition delay		FY23	68.7	35.7	3.6	11.3
Variable 5: asset performance	**Equity market crash in FY20**	FY22	61.9	31.8	3.1	11.5
	-1% pa (3% pa total)	FY22	59.9	30.7	3.3	11.3
	+1% pa (5% pa total)	FY22	91.4	48.3	4.2	12.1

3.5 Future opportunities – risk mitigation

There is international evidence that investment at greater scale can provide opportunities to improve overall investment performance through a range of mechanisms, including risk mitigation. This has not been examined in the core model. Nonetheless, the potential can be seen by considering the core model sensitivity analysis: if the opportunity can be captured to the extent of just 5 basis points (0.05%), then the total net gain projected by FY36 would increase by approximately 60%.

3.6 Future opportunities – internal management

Additional analysis has been undertaken to assess the opportunities that may be available if the Brunel company undertakes internal management (i.e. undertaking dealings in individual stocks and other assets, in addition to making investments into Manager Operated Funds). A move to internal management could only happen with the consent of all the Administering Authorities based on circumstances at the time. It is therefore only a prospective and contingent opportunity at this point.

Subject to that, the Financial Case analyses the potential opportunities that may be offered by internal management, which in summary are greater savings owing to the potential substantial reduction in fees.

Any decision to move to internal management would require the case to be made that the fee savings would be accompanied by investment performance expectations remaining at least in line with those that external managers were providing. Such a case would be easier to make for some asset classes than others.

3.7 Core model – foundation of the Full Business Case

The core model, including the sensitivity analysis outlined above, is foundational to the FBC. It is this core model which should substantially inform a decision to proceed with the BPP investment pooling proposal.

This section of the FBC has dealt with the headline points relating to the core model, and sets out the main conclusions. Further and more detailed analysis is set out in the Financial Case.

4. ECONOMIC CASE

4.1 Introduction

The purpose of the Economic Case is to describe the options considered for investment pooling, and to provide evidence that the most economically advantageous approach to meet the Administering Authorities service needs on a value for money basis.

4.2 Options considered for the pooling entity

The Project Brunel initial proposal, submitted in February 2016, suggested a structure whereby a Collective Asset Pool would be overseen by a Joint Committee. This proposed structure was an alternative to an overarching Authorised Collective Scheme (**ACS**), which would have had additional complexities and costs of establishment and operation and would not have provided a structure consistent with all types of pooling

This proposed structure was later developed following the Secretary of State's March 2016 response. This required that a single and separate entity be at the heart of final pooling proposals, and that it should have responsibility for selecting and contracting with investment managers independently of Administering Authorities (which would retain responsibility for setting their detailed Strategic Asset Allocation). A further clear requirement set out in the Secretary of State's response was that the pooling entity must be FCA regulated.

The Secretary of State's response led to a discussion of how best to operate this entity, now conceptualised as the Brunel company. Two models were under consideration, being either to rent it from a commercial provider or for the Administering Authorities to build it and shape its structure and governance through a shared ownership arrangement.

A detailed analysis was carried out by PwC to consider the relative merits and limitations of each model, examining them against three groups of issues: accountability; procurement and staffing; and costs. The PwC analysis showed that the build model would have advantages over the rental model, especially on accountability. It would also generate less uncertainty around the future roles of investment officers.

It was recognised that the build model brought its own challenges, particularly around procurement and staffing. These are considered further in the Commercial Case section that follows. Overall, however, the build model was the preferred option under the PwC analysis.

4.3 Operational costs of the Brunel company

Whilst the Commercial Case examines a wide range of issues, the Economic Case evaluates how the Brunel company development and operational costs affect the Financial Case. The key point has been consolidated into the sensitivity analysis in the Financial Case: additional operational costs will need to be evaluated against the additional asset performance or fee saving they can generate.

PwC has identified that the most economic case would suggest that the Brunel company is situated in the Bristol area (a formulation which includes Bath). This followed analysis that compared several geographies, including London, Swindon, Taunton and Exeter, evaluating them under the headings of infrastructure, human resources and operational matters.

The Bristol area includes the largest city in the Brunel geography, with good transport links to the Administering Authorities and acceptable links to suppliers, notably those in London. Office space is relatively affordable and staffing implications, including remuneration levels, are favourable. In building up costs used in the core model therefore, indicative costs have been used for prices of accommodation in the Bristol/ Bath area.

5. COMMERCIAL CASE

5.1 Introduction

The purpose of the Commercial Case is to set out the proposed structural arrangements for the BPP. The focus is on relevant ownership, governance and contractual matters, and how these will serve the requirements of the BPP Administering Authorities.

5.2 Brunel Pension Partnership structure

The main structural components of the BPP are, in summary:

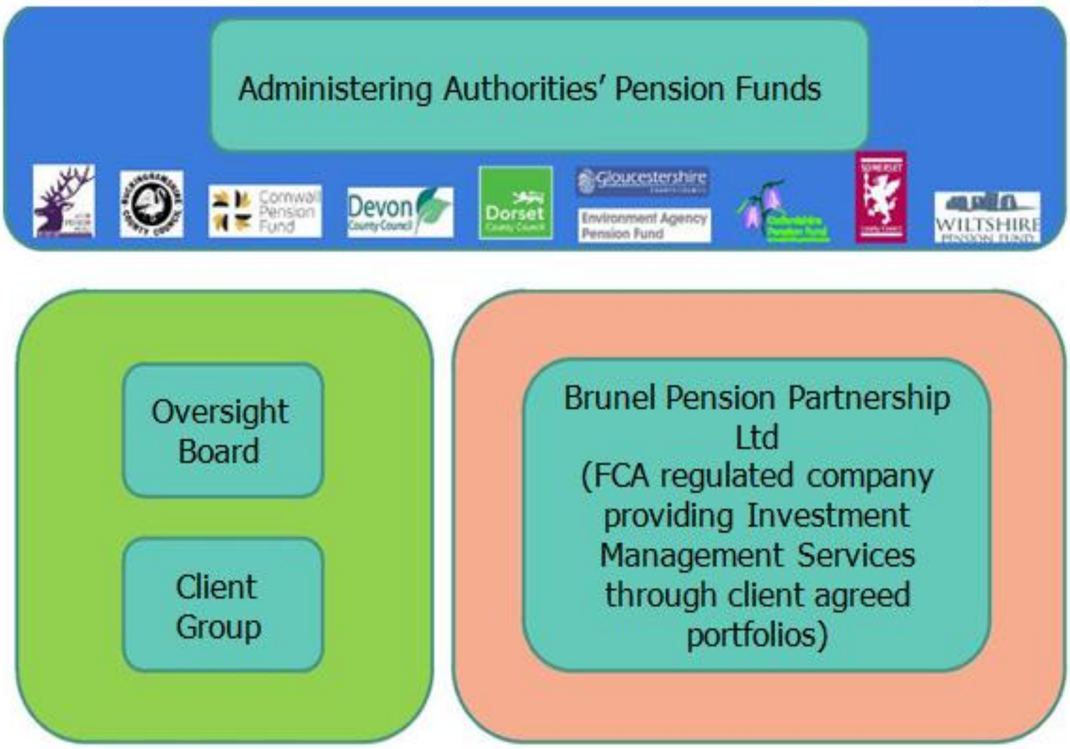
- **BPP Administering Authorities:** They will each retain sole responsibility for setting the detailed Strategic Asset Allocation for their Fund and allocating their assets to the investment portfolios provided by the Brunel company.
- **Brunel Pension Partnership Limited:** This will be a new FCA regulated company which will be wholly owned by the Administering Authorities. It will be responsible for implementing the detailed Strategic Asset Allocations of the BPP Funds by investing Funds assets within defined outcome focused investment portfolios. In particular it will research and select the Manager Operated Funds needed to meet the requirements of the detailed Strategic Asset Allocations. These Manager Operated Funds will be operated by professional external investment managers.
- **Oversight Board:** This will be comprised of representatives from each of the Administering Authorities. It will be set up by them according to an agreed constitution and terms of reference (however, it will not be a Joint Committee under S102 LGA). Acting for the Administering Authorities, it will have ultimate responsibility for ensuring that the Brunel

company delivers the services required to achieve investment pooling. It will therefore have a monitoring and oversight function.

Subject to its terms of reference it will be able to consider relevant matters on behalf of the Administering Authorities, but will not have delegated powers to take decisions requiring shareholder approval. These will be remitted back to each Administering Authority individually. Further work on issues such as how this will operate, the Shareholder Agreement, and appointments will be clarified and brought back to each Administering Authority to approve at a later date.

- **Client Group:** This will be comprised primarily of pension investment officers drawn from each of the Administering Authorities. It will be responsible for providing practical support to enable the Oversight Board to fulfil its monitoring and oversight function. In effect, it will provide a client-side link between the Oversight Board and the Brunel company, and will draw on Administering Authorities finance and legal officers from time to time.

The following illustration shows the key structural components of the Brunel Pension Partnership in diagrammatic form:



5.3 Governance arrangements

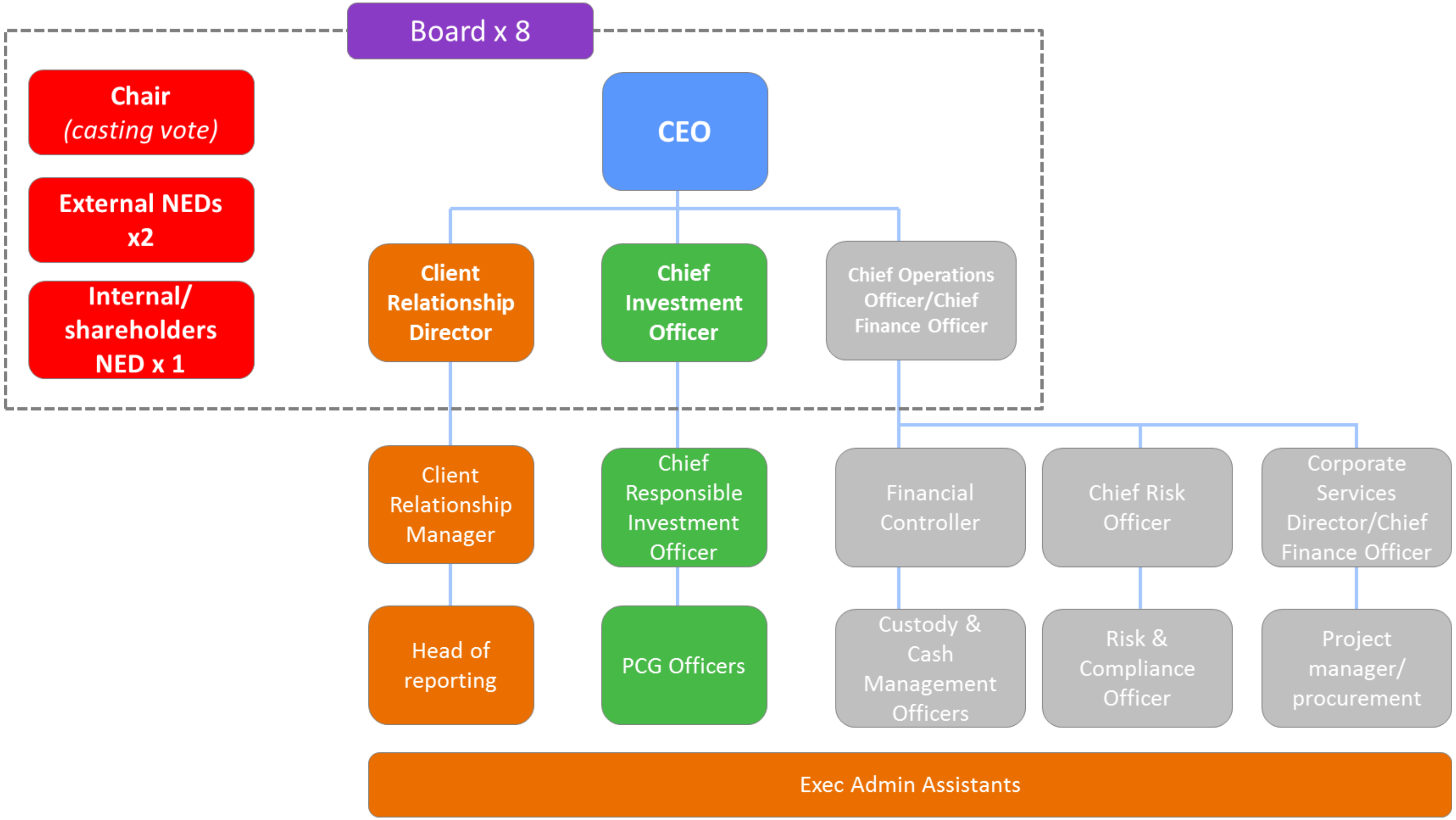
Much of the detail relating to the BPP's governance arrangements will be set out in three key documents: **Articles of Association** of the Brunel company; **Shareholders' Agreement** between the Administering Authorities; **Terms of Reference** for the Oversight Board. These documents will address issues such as powers of the company, shareholder control through reserved matters, exit arrangements and procedures of the company. The current proposals that are reflected in the commercial case are based on a first draft of documents produced by Osborne Clarke which are yet to be properly discussed and scrutinised. Osborne Clarke will advise on the drafting of these documents, working with Chief Legal Officers accordingly. The project timetable has an indicative time for these to be put in place of Spring 2017.

Standing behind these key documents will be the other requisite documents such as conflict of interest policy and terms of reference for the Brunel company's committees. Its FCA regulated status will require it to have high standards of internal governance and compliance, with a particular focus on risk management.

The proposed operating model for the Brunel company includes a board which will be made up of four non-executive directors (independent chair, plus two externally recruited non-executives and one shareholder representative non-executive), with three or four executive directors (chief executive officer, chief finance/operations officer, chief investment officer and (yet to be confirmed) client relationship director). Various committees (audit, remuneration, risk and compliance) will be required, as will other statutory roles, such a company / board secretary.

This board will be responsible for three business units, which will relate to the following: investments (including responsible investments), operations and finance (including risk and compliance), and client relationships (including reporting). A programme of external and internal recruitments will be implemented to ensure that the senior and other supporting roles are staffed by suitably qualified and experienced personnel.

The operational structure diagram below set outs the proposed high level operating structure of the Brunel Company.


Board x 8
Chair
(casting vote)
External NEDs x2
Internal/ shareholders NED x 1
CEO
Client Relationship Director
Chief Investment Officer
Chief Operations Officer/Chief Finance Officer
Client Relationship Manager
Chief Responsible Investment Officer
Financial Controller
Chief Risk Officer
Corporate Services Director/Chief Finance Officer
Head of reporting
PCG Officers
Custody & Cash Management Officers
Risk & Compliance Officer
Project manager/ procurement
Exec Admin Assistants

5.4 Contractual arrangements

The contractual relationship between the Administering Authorities and the BPP will be set out in a comprehensive **Services Agreement.** It will define the investment pooling and related services which the Brunel company will perform, and the contractual terms which will apply to the delivery of those services.

The core contractual obligation of the Brunel company will be to define and set up portfolios reflecting the detailed Strategic Asset Allocations of the BPP Administering Authorities, and to select investment managers who are capable of operating suitable Manager Operated Funds for each portfolio. The Brunel company will be required contractually to maintain its FCA regulated status.

In support of that core contractual obligation, the Brunel company will offer a number of subsidiary services to the Administering Authorities. These services will cover such matters as custody and investment administration, financial performance reporting, responsible investment, investment research, investment accounting, risk management, transition management, cash management, etc. Where appropriate and necessary, the Brunel company will contract with third party service providers to procure services that will not be provided internally (e.g. custody, transition management, HR services).

5.5 Brunel company and procurement issues

A legal review has concluded that a decision by the Administering Authorities to enter into the Services Agreement, and thereby procure the services of the Brunel company, will be exempt from the application of the public contract procurement procedures (as set out in the Public Contracts Regulations 2015). This legal review was undertaken by Osborne Clarke, and included obtaining a legally privileged opinion from Leading Counsel (a QC) who specialises in procurement law. The Osborne Clarke advice and the QC opinion have been provided to Chief Legal Officers.

5.6 Brunel company and FCA authorisation

In order to meet this core contractual obligation the Brunel company will need to be FCA regulated. A key consideration in that respect is being clear on the FCA permissions that will be required, taking into account the Brunel company's activities. A legal review has concluded that there is a very strong likelihood that the BPP will involve the creation of a Collective Investment Scheme, with the Brunel Company acting as the operator. This legal review was undertaken by Osborne Clarke, and included obtaining an opinion from Leading Counsel (a QC) who specialises in FCA regulatory law. The Osborne Clarke advice and the QC opinion have been provided to Chief Legal Officers.

The project timetable allows for the appropriate permissions to be obtained from the FCA. The Brunel company will be required contractually to maintain its FCA regulated status, and as such its board of directors will have to maintain compliance with the FCA's applicable rules and procedures for a regulated entity carrying out activities of the type envisaged.

5.7 Personnel implications

A legal review by Osborne Clarke of the relevant employment law has reached an initial conclusion that the Transfer of Undertakings (Protection of Employment) Regulations 2006 **("TUPE")** will not apply if employees currently employed in the pension functions of any of the Administering Authorities move to the Brunel company as a result of any selection and employment process. The position on TUPE will be confirmed when any employee migration from an Administering Authority to the Brunel company takes place.

The Cabinet Office Guidance on Staff Transfers in the Public Sector **(COSOP)** sets out a framework for TUPE-style protections to be afforded to employees involved in public sector reorganisations, in circumstances where there is not a relevant transfer within the meaning of the TUPE legislation. While local authorities are not legally bound to observe COSOP, it is intended that, so far as possible, the principles of COSOP will be adhered to.

In summary, subject to the detailed legal advice, it is envisaged at this stage any employees who move from employment with an Administering Authority to the Brunel company will receive TUPE-equivalent protection.

5.8 Risk allocation

Under the BPP structure, the Administering Authorities will retain the key investment risk of designing the detailed Strategic Asset Allocation for their Fund. Taking that into account, the Brunel company will provide to the Administering Authorities the key investment management services of selecting, appointing and monitoring the investment managers operating the various Manager Operated Funds. Related services, also provided by the Brunel company, will include such matters as custody, performance reporting and transition management services.

While as noted the key investment risk will be retained by the Funds, it is apparent that the Brunel company will take on a contractual risk for providing investment management and related services to the Administering Authorities. Previously, the tasks of selecting, appointing and monitoring fund managers has been undertaken by local pension funds, with input from external professional advisers where necessary.

Where relevant services cannot be provided by the in-house resources of the Brunel company third party service providers will be appointed (for example, providers of custody, performance analytics, data management and investment accounting services). To that extent, the risk transfer to the Brunel company will be mitigated by the appointment of third party service providers.

The directors of the Brunel company will owe the normal fiduciary and other duties that any director owes to an FCA regulated company. Additionally, all staff will owe contractual duties to the Brunel company as their employer, and as set out in their individual employment contracts. During the next development phase the use of possible risk mitigation arrangements, including Directors' & Officers' liability insurance and Professional Indemnity insurance, will be investigated and agreed.

5.9 Charging mechanism

In the Financial Model, Brunel company costs are assumed to be split between the ten Administering Authorities using an equitable approach to cost sharing. This allows for approximately half of the costs to be split equally between the ten Administering Authorities and the remainder to be split in proportion to assets under management. This modelling is intended to capture the ultimate reality of Brunel company operation, when the pricing policy for its services is likely to contain both fixed and marginal elements.

The charging mechanism that will actually apply when the BPP becomes operational will be decided after taking into account a range of alternative charging methodologies, and will be determined by agreement between the Administering Authorities.

5.10 Development costs and implementation timescale

Under the project timetable the indicative time for the Brunel company to be set up with appropriate ownership and governance arrangements is Spring 2017. Work on the development of its operational capability will continue in the interim period.

The Memorandum of Understanding (MoU) agreed between the Administering Authorities in September 2015 stated that the Brunel project development costs would be split equally between the participating funds (i.e. a tenth each). It has cost £1.2m (£0.12m per fund) to take matters to the FBC stage, including the preceding Strategic and Outline Business Cases (submissions to Government in February and July).

A new MoU has been drawn up and reviewed by the Finance and Legal Assurance Group (to be ratified by the Shadow Oversight Board), to cover the period from December 2016 until the permanent Brunel company arrangements are in place. This update will refresh arrangements on collaborative working, decision-making and cost allocation during that period. The MoU includes provision for charging the time of officers assigned to BPP project roles. Up to this point the cost of such officer time has been absorbed by each Administering Authority.

Development costs will continue to be allocated to Administering Authorities on an equal share basis. The initial projected future development costs up to April 2018 are £3.3m (£0.33m per fund). This includes working and regulatory capital for the Brunel company of £2.0m (£0.2m per fund). Any change in the development budget will be subject to approval by Administering Authorities. The Brunel company will also have operating costs as it builds capability from its inception in 2017, which will be invoiced separately.

6. MANAGEMENT CASE

6.1 Introduction

The purpose of the Management Case is to describe how the BPP proposal will be delivered successfully. The focus is on effective project management during the next phase, including proposals for addressing relevant risks for the Administering Authorities and the successful delivery of the challenges of change management for a project of this nature.

6.2 Project management arrangements

The level of project management resource required to ensure the successful delivery of the BPP proposal will be kept under regular review. The next development phase is likely to be demanding with a significant amount of work to be done on a range of matters. These will include setting up the Brunel company's governance and contractual arrangements, addressing all relevant operational matters including staff recruitment, and preparing for submission of the FCA application.

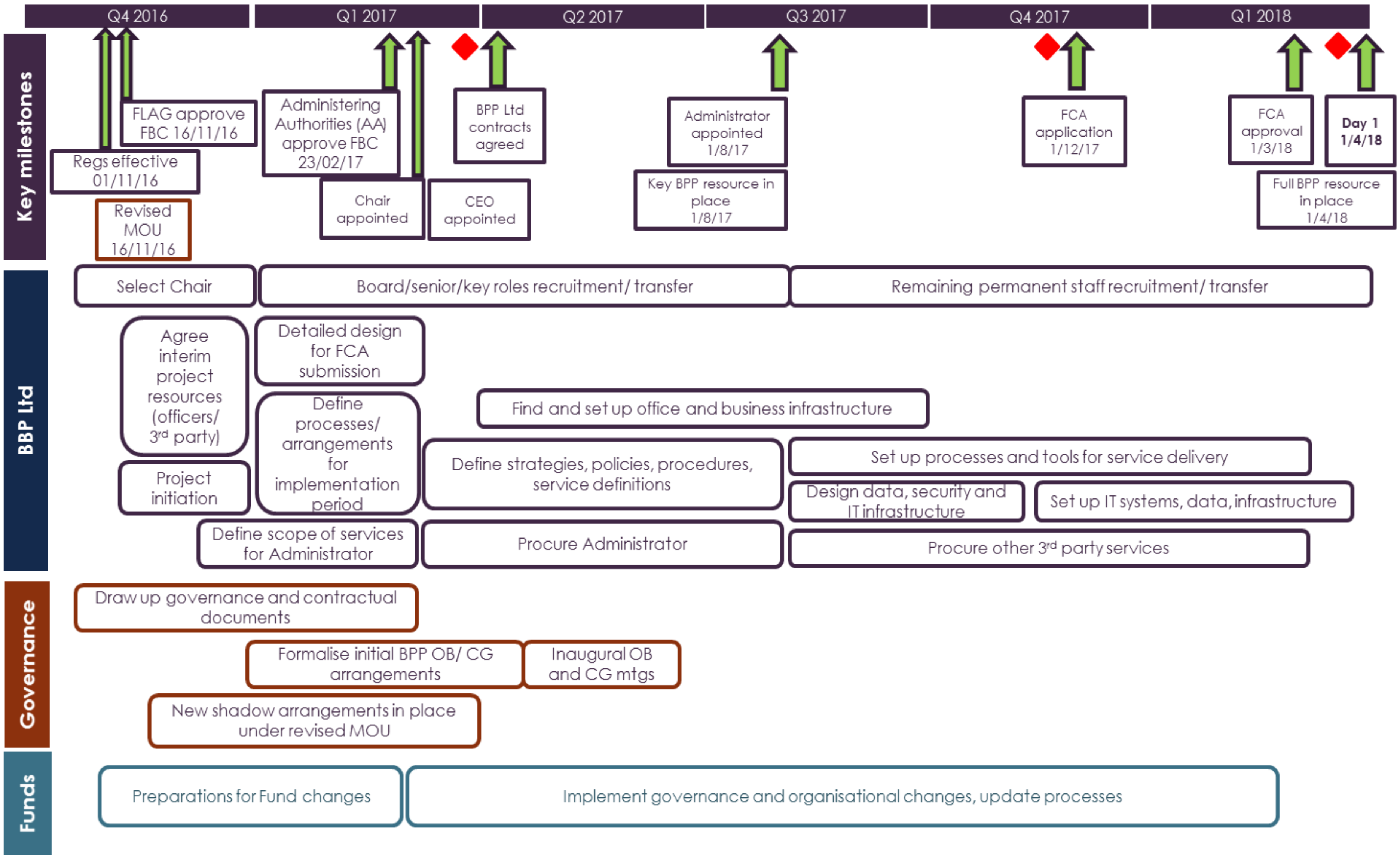
A particular challenge will be ensuring that these tasks can be delivered in parallel with the appointment of the Brunel company's leadership team, including the Chair. The permanent staff appointments will take place throughout the remainder of the project, so the project structure will evolve during the lifecycle of the project. They will be key in providing continuity of leadership and direction while other resource changes are underway.

Any non-permanent assignments of officers to support the Brunel company set-up and resourcing will be progressed on an interim basis.

Conflicts of interest may emerge, and if so they will be carefully managed by establishing clear accountabilities and resource allocation.

The following diagram provides an indicative overview of the programme activities and the key milestones:

Brunel Pension Partnership – Stage 3b: implementation **PLAN 1 - Key decision points and high level activities** ◆ = formal review points



Page 45

6.3 Benefits realisation and risk management

The delivery of the expected benefits of pooling will be through the operation of the Brunel company and the services it delivers to the Brunel Funds. It will be monitored by the Oversight Board and Client Group, using the reporting activities provided by the Brunel company.

A comprehensive risks register is already in place and will continue to be maintained by the Project Office. The risks will be further categorised to identify those risks directly to the Funds and those directly applicable to the Brunel company. The risks will be reported to the programme and project management teams through regular status reports. Very high risks or those requiring urgent action to manage will be escalated as needed. A summary of the risks and a copy of the risk register is attached at Annex 2.9.3a and 2.9.3b.

6.4 Project milestones and gateways

Meetings of the Brunel Administering Authorities are scheduled to take place between 2 December 2016 and 23 February 2017. At these meetings Resolutions for in principle decisions to approve investment pooling will be considered, with appropriate delegations being granted to progress the next development phase. The approval by Administering Authorities of these Resolutions will mark a key milestone in the establishment of the BPP investment pool.

Further formal reviews that the project has progressed in line with the provisions agreed in the FBC will be held prior to the key milestones. These include the appointment of the Brunel company Chair (early 2017), set-up of the Brunel company and agreement of the key shareholder and other corporate documents (by Spring 2017), submission of the Brunel company's FCA application (by November 2017), and operational readiness for commencement of pooling (by April 2018).

Project Title: Brunel

(Brunel Pension Partnership)

Full Business Case (FBC)

Document List

LIST OF FULL BUSINESS CASE DOCUMENTS

The Full Business case is made up of a number of documents, which are listed below.

The main Full Business case document has been written as a standalone document that can be provided to Councils with a subset of annexes.

Other forums may require the full set of the main FBC, the detailed cases and referenced documents.

The papers referenced in the cases are categorised into

- Annexes, which are primary references to read with the Full Business Case sections
- Supporting Information, which are secondary references providing further detail or background information.

Those papers that are commercially sensitive or legally privileged are noted as Part II/ Official Sensitive.

The full business case proposal documents are marked *. The details are subject to review during stage 3b

Main FBC and Detailed Cases

Part II or open	Type	Ref	Title	Description	FBC Sections
Open	**Index**	A1	BPP FBC Document List	This document. A full list of all documents forming the Full Business Case	n/a
Open	**Template**	FBC 1	BPP FBC [fund] template	Main FBC with the pool details and spaces for the individual tables and text markers, which need to be replaced with individual fund names.	n/a
Open	**Main FBC**	FBC (Avon)	BPP FBC Final (Avon)	Main FBC with pool and Avon Fund details	n/a
Open	**Main FBC**	FBC (Bucks)	BPP FBC Final (Buckinghamshire)	Main FBC with pool and Buckinghamshire Fund details	n/a
Open	**Main FBC**	FBC (Cornwall)	BPP FBC Final (Buckinghamshire)	Main FBC with pool and Cornwall Fund details	n/a
Open	**Main FBC**	FBC (EAPF)	BPP FBC Final (EAPF)	Main FBC with pool and EAPF Fund details	n/a
Open	**Main FBC**	FBC (Devon)	BPP FBC Final (Devon)	Main FBC with pool and Devon Fund details	n/a
Open	**Main FBC**	FBC (Dorset)	BPP FBC Final (Dorset)	Main FBC with pool and Dorset Fund details	n/a

Open	**Main FBC**	FBC (Gloucestershire)	BPP FBC Final (Gloucestershire)	Main FBC with pool and Gloucestershire Fund details	n/a
Open	**Main FBC**	FBC (Oxfordshire)	BPP FBC Final (Oxfordshire)	Main FBC with pool and Oxfordshire Fund details	n/a
Open	**Main FBC**	FBC (Somerset)	BPP FBC Final (Somerset)	Main FBC with pool and Somerset Fund details	n/a
Open	**Main FBC**	FBC (Wiltshire)	BPP FBC Final (Wiltshire)	Main FBC with pool and Wiltshire Fund details	n/a
Part II	**Detailed Case**	FBC 2	BPP FBC 2 Strategic Case	Detailed FBC – Strategic case section	
Part II	**Detailed Case**	FBC 3	BPP FBC 3 Financial Case	Detailed FBC – Financial case section	
Part II	**Detailed Case**	FBC 4	BPP FBC 4 Economic Case	Detailed FBC – Economic case section	
Part II	**Detailed Case**	FBC 5	BPP FBC 5 Commercial Case	Detailed FBC – Commercial case section	
Part II	**Detailed Case**	FBC 6	BPP FBC 6 Management Case	Detailed FBC – Management case section	

Annexes for Councils

Part II or open	Type	Ref	Title	Description	FBC Sections
Part II	**Annex**	1	BPP FBC 3 Financial Case	Detailed FBC – Financial case section	3.2 The BPP financial model 3.3 The core model 3.6 Future opportunities - internal mangement 3.7 Core model - foundation of the full business case
Open	**Annex**	2a	BPP Stage 3b Current Risk Register Summary	BPP Stage 3b Risks Summary as at October 2016	6.3 Benefits realisation and risk management
Part II	**Annex**	2b	BPP Stage 3b Current Risk Register details	BPP Stage 3b Risks Register as at October 2016	6.3 Benefits realisation and risk management

Full Set of Annexes and Supporting Information

Part II or open	Type	Ref	Title	Description	FBC Sections
Open	**Annex**	A1	FBC Glossary	Glossary of terms and acronyms	for all sections
Open	**Annex**	A2	FBC Bibliography v1	List of documents used in development of the FBC in addition to the Annexes and Supporting Information	for all sections
Open	**Annex**	2.9.3	BPP Stage 3b Current Risk Register Summary	BPP Stage 3b Risks Summary as at October 2016	Main FBC: 6.3 Benefits realisation and risk management Strategic Case: 2.9.3 High risks Management Case: 6.8 Arrangements for risk management
Part II	**Annex**	2.9.3b	BPP Stage 3b Current Risk Register Details	BPP Stage 3b Risk Register details as at October 2016	Main FBC: 6.3 Benefits realisation and risk management Strategic Case: 2.9.3 High risks Management Case: 6.8 Arrangements for risk management

Part II	**Annex**	3.1	[file name to be confirmed] (spreadsheet)	Financial model 5 from PwC*	Financial Case: 3.1 Introduction
Part II	**Annex**	4.6	BPP model - list of assumptions v3	Financial model assumptions from PwC*	Economic Case: 4.6. Economic appraisal
Open	**Annex**	6.4a	Project Brunel Stage 3b project plan - starting point draft v0.5 A3	Initial starting point draft for more detailed stage 3b plan *	Management Case: 6.4 Programme and project plans
Open	Supporting Information	2.2.2	New Investment Regulations Extracts	A: Investment Strategy Statement (2016 requirement) comparison of Investment Principles (2009) B: Extract of Investment Regulations (2016) regulation 8	Strategic Case: 2.2.2 Regulations reform 2.4.1.1 Operating within investment regs
Open	Supporting Information	2.2.3	MoLG letter to BPP Chairs on Feb Submission	Letter to BPP Chairs from Marcus Jones, minister for Local Government, regarding February 2016 Submission	Strategic Case: 2.2.3 Consultation response
Open	Supporting Information	2.4.1.2	Governance arrangements	Analysis of the existing funds' governance arrangements and the changes required for pooling *	Strategic Case: 2.4.1.2 Governance arrangements
Open	Supporting Information	2.4.1.4	Investment Principles	BPP Investment principles *****	Strategic Case: 2.4.1.4 Business strategies and pooling

Part II	Supporting Information	2.5.2	Funds' Existing and Future Arrangements v2.1draft	Summary of current arrangements, breakdown of resources and details of fund managers	Strategic Case: 2.5.2 Existing arrangements 2.4.1.3 Operational structures and primary activities
Open	Supporting Information	2.6.3	Project Pool Internal Management Benefits	Extract from Project Pool evaluation of the benefits of internal management	Strategic Case: 2.6.3 Developing active internal management capability
Open	Supporting Information	4.2	Rent Versus Build	PwC report: Analysis of rent vs build options for BPP	Economic Case: 4.2 Evaluation of the options
Part II	Supporting Information	5.1.2a	Legal summary of governance and structure	Osborne Clarke summaries of the key governance and contractual documentation*	Commercial Case: 5.1.2 Governance arrangements
Part II	Supporting Information	5.1.2b	Brunel appointment process 20161005	PwC report on proposed appointment process, roles and company structure*	Commercial Case: 5.1.2 Governance arrangements
Part II	Supporting Information	5.5.1	bfinance - Brunel business case review 20160929	bfinance evaluation of the business case, with portfolio assurance	Commercial Case: 5.5.1 Portfolio construction assurance
Part II	Supporting Information	5.5.2	Portfolio specifications (25 documents)	Portfolio specifications (with 25 documents for individual specifications and covering page) *	Commercial Case: 5.5.2 Portfolio specifications

Part II	Supporting Information	5.5.3	Asset allocation to portfolios	Asset allocations to portfolios for each fund *	Commercial Case: 5.5.3 Portfolio allocations
Part II	Supporting Information	5.6	Pension Fund Investment Activities and Brunel company Services	Pension Fund investment activities mapped to required services from Brunel company *	Commercial Case: 5.6 Required services
Open	Supporting Information	5.6.1.3a	Reporting and Monitoring Framework	Reporting and Monitoring Framework *	Commercial Case: 5.6.1.3 Reporting
Open	Supporting Information	5.6.1.3b	Sample Reports	Sample reports *	Commercial Case: 5.6.1.3 Reporting
Open	Supporting Information	5.6.2	Approach to responsible investment	Approach to responsible investment: regulatory and service requirements and delivery *	Commercial Case: 5.6.2 Responsible investment
Open	Supporting Information	5.8.1	Cost sharing Principles	BPP cost sharing principles *	Commercial Case: 5.8.1 cost sharing principles
Open	Supporting Information	6.4b	Stage 4 Timetable	Stage 4 (asset transition) high level timetable *	Management Case: 6.4 Programme and project plans
Open	Supporting Information	6.7	Benefits realisation plan v1	Financial and qualitative benefits realisation plan and measurement *****	Management Case: 6.7 Arrangements for benefits realisation and post project evaluation

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Project Title: Brunel (Brunel Pension Partnership)

Full Business Case (FBC)

Annex A1: FBC Glossary of Terms

Term	Previously referred as	Meaning
Administering Authority (AA) Administering Authorities (AAs)	also known as Participating Authority, Fund	Administering Authorities are the Councils or Boards who are accountable for the LGPS Funds within the pools.
Alpha FMC	not applicable	Specialist adviser - FCA authorisation
Alternative Investment Fund Managers (AIFM)	not applicable	An EU law on the financial regulation of hedge funds, private equity, real estate funds, and other "Alternative Investment Fund Managers" (AIFMs) in the European Union.
Articles of Association	not applicable	This document is required by company law, and will set out the constitution of the company and regulate the relationship between the Administering Authorities as shareholders and the Brunel Company. It sets out the powers and procedures of the Brunel Company.
Assets Under Management (AUM)	sometimes called funds under management (FUM)	This measures the total market value of all the financial assets which a financial institution such as a mutual fund, venture capital firm, or brokerage house manages on behalf of its clients and themselves.
Authorised Contractual Scheme (ACS)	not applicable	An investment vehicle and fund manager, based in the UK, that allows LGPS pension funds or other organisations with money to invest alongside each other - while keeping a clear record of who owns what.
Bfinance	not applicable	Specialist in Investment Markets - Financial
BPP Administering Authorities	Participating Authorities	Authorities participating in the Brunel Pension Partnership. They will each retain sole responsibility for setting the detailed Strategic Asset Allocation for their Fund and allocating their asset to the outcome focused 'portfolios' provided by the Brunel company
BPP model	Segregated CAP	The model of the proposal legal structure of the pool
Brunel Board	Brunel Manager Board	Board of executive and non-executive directors, leading the Brunel company
Brunel Company	CAP (Collective Asset Pool), Brunel Manager	The entity that will manage the pooled investments. It will be an FCA authorised company, with permission to act as operator of the Brunel CIS
Brunel Executive Directors (ED)	not applicable	Executive directors of the Brunel company
Brunel Pension Partnership Limited (BPP Ltd or Brunel company)	Brunel company or Brunel Manager	A new FCA regulated company which will be wholly owned by the Administering Authorities. It will be responsible for implementing the asset allocation strategies of the BPP Funds by investing Fund assets within defined 'portfolios'. In particular, it will research and select the investment funds needed to meet the requirements of the detailed Strategic Asset Allocations. These investment funds will be operated by professional external investment managers.
Chief Finance Officer (CFO)	not applicable	A corporate officer primarily responsible for managing the financial risks of the corporation. This officer is also responsible for financial planning and record-keeping, as well as financial reporting to higher management. In the Local Authorities this is the S151 officer.
Chief Legal Officer (CLO)	not applicable	The chief lawyer of the legal department, usually in a company or a governmental department who minimizes its legal risks by advising the company's other officers and board members on any major legal and regulatory issues the company confronts, such as litigation risks. In the Local Authorities this is the Monitoring Officer.

Term	Previously referred as	Meaning
Client Group	Shadow Oversight Group (SOG)	Group comprised primarily of Pension Officers drawn from each of the Administering Authorities. It will be responsible for providing practical support to enable the Oversight Board to fulfil its monitoring and oversight function. In effect, it will provide a client-side link between the Oversight Board and the Brunel Company and therefore as appropriate will also draw on administering authorities finance and legal offices.
Client Group (CG)	Shadow Operations Group (SOG) (change @ 01 April 2018)	Sub-committee of the Oversight Board, it is responsible for the client oversight of the Brunel manager on a day to day basis. It will include Fund officers with investment and contract management expertise.
Collective Investment Scheme (CIS)	not applicable	An investment scheme in which profits or income is shared through collective investment, and the participants of the scheme do not have any day-to-day control over the management of the assets or property.
Cross Pool Collaboration Group (CPCG)	not applicable	A collaborative group across 8 pools in the UK
Department for Communities and Local Government(DCLG)	not applicable	The UK Government department for communities and local government in England
Environment, Social and Governance (ESG)	not applicable	Refers to the three central factors in measuring the sustainability and ethical impact of an investment in a company or business.
FBC cases	not applicable	Strategic, financial, economic, commercial and management case.
Finance and Legal Assurance Group (FLAG)	not applicable	Finance and Legal Assurance Group (FLAG) with membership of each AAs equivalent to Chief Finance Officer (CFO) and Chief Legal Officer (CLO)) will sponsor the changes in the Funds and the arrangements for governance of the Brunel company.
Financial Conduct Authority (FCA)	not applicable	A financial regulatory body in the United Kingdom, but operates independently of the UK government, and is financed by charging fees to members of the financial services industry
Full Business Case (FBC)	not applicable	The doucment that captures the reasoning for the project. From this information, the justification for the project is derived
Full Time Employee (FTE)	not applicable	Employment in which a person works a minimum number of hours defined as such by his/her employer. Full-time employment often comes with benefits that are not typically offered to part-time, temporary, or flexible workers, such as annual leave, sick leave, and health insurance.
Government Actuary's Department (GAD)	not applicable	A department of the Government of the United Kingdom responsible for providing actuarial advice to public sector clients. It describes itself as providing "Actuarial analysis - For the public sector - From the public sector".
Her Majesty's Treasury (HMT)	sometimes referred to as the Exchequer, or more informally the Treasury,	The British government department responsible for developing and executing the government's public finance policy and economic policy.
Investment Strategy Statement (ISS)	not applicable	A set of rules, behaviours or procedures, designed to guide an investor's selection of an investment portfolio. Individuals have different profit objectives, and their individual skills make different tactics and strategies appropriate.
JLT Employee Benefits (JLT)	not applicable	Specialist adviser - Business case development/ project support
LGPS (Management and Investment of Funds) Regulations 2016 (Investment Regulations)	Draft LGPS (Management and Investment of Funds) Regulations 2016	Regulations 2016 (Investment Regulations) that came into effect 1 November 2016.
Local Authority Pension Fund (LAPF)	not applicable	One of the LGPS Funds and is part of the LPP pool.
Local Authority Pension Fund Forum (LAPFF)	not applicable	The UK's leading collaborative shareholder engagement group. The Forum provides a unique opportunity for Britain's local authority pension funds to discuss investment issues and shareholder engagement.
Local Government Association (LGA)	not applicable	An organisation which comprises local authorities in England and Wales. The LGA seeks to promote better local government; it maintains communication between officers in different local authorities to develop best practice. It also represents the interests of local government to national government.

Term	Previously referred as	Meaning
Local Government Pension Scheme (LGPS)	not applicable	A nationwide scheme and is a valuable part of the pay and reward package for employees working in local government or working for other employers participating in the Scheme and for some councillors. The Scheme is administered locally for participating employers through 99 regional pension funds
London Collective Investment Vehicle (London CIV)	not applicable	This pool consists of London's 32 boroughs and the City of London Corporation, but it is also open to the rest of the LGPS
LPP (London Pensions Partnership)	not applicable	This pool consists of Lancashire, Berkshire and the London Pension Fund Authority.
Management contract	Framework agreement	Legal contract between each Participating Authority and the Brunel company
Markets in Financial Instruments Directive II (MiFID II)		Investment firm under the Markets in Financial Instruments Directive (MiFID) means "any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis"
National Audit Office (NAO)	not applicable	An independent Parliamentary body in the United Kingdom which is responsible for auditing central government departments, government agencies and non-departmental public bodies. The NAO also carries out Value for Money (VFM) audit into the administration of public policy.
Net Present Value (NPV)	not applicable	The value in the present of a sum of money, in contrast to some future value it will have when it has been invested at compound interest.
Office of Government Commerce (OGC)	not applicable	A UK government office that supported the public sector in procurement and acquisition. Their goal was to improve value to taxpayer, and as part of their remit they provided useful best practice advice on delivery of projects and programs
Official Journal of the European Union(OJEU)	not applicable	The publication in which all tenders from the public sector which are valued above a certain financial threshold according to EU legislation, must be published
Osborne Clarke (OC)	not applicable	Specialist adviser - Procurement and Legal
Outline Business Case(OBC)	not applicable	The second stage in developing a case for change. It is preceded by the Strategic Business Case (SBC) and followed by the Full Business Case (FBC)
Oversight Board (OB)	Shadow Oversight Board (SOB) (change @ 01 April 2018)	The senior client/shareholder group that oversees the Brunel Manager on behalf of the funds. It is made up of the funds' Pension committee chairs and an independent Chair, as for the SOB.
Oversight Board (OB)	Shadow Oversight Board (SOB)	This will be comprised of representatives from each of the Pension Committees. It will be set up by the BPP Administering Authorities (i.e. the 9 Councils, with the Environment Agency). Acting for the Administering Authorities, it will have ultimate responsibility for ensuring that the Brunel company delivers the services required to achieve asset pooling.
Pension Committee (PC)	not applicable	The primary committee accountable for the governance of a LGPS Fund. The actual name of the committee varies between Funds but this is the most common description and therefore is used as the generic title for this type of committee. It will therefore have a monitoring and oversight function, and will be able to consider relevant matters on behalf of the Administering Authorities, but will not have delegated powers to take decisions, including decisions requiring shareholder approval.
Project Office (PO)	not applicable	Creates and maintains the plan, track and report progress.
Portfolio	Sub-group	The grouping of the asset types to be available for funds. For example, Global Equities Core, Hedge funds, UK Gilts, LDI.
Portfolio group	Sub-fund group	The higher level category of asset types. For example, equities, alternatives, fixed interest.
PricewaterhouseCoopers LLP (PwC)	not applicable	Specialist adviser - Financial
PRojects IN Controlled Environments(PRINCE 2)	not applicable	This is a de facto process-based method for effective project management. Used extensively by the UK Government, PRINCE2 is also widely recognised and used in the private sector, both in the UK and internationally

Term	Previously referred as	Meaning
Public Sector Comparator (PSC)	not applicable	A tool used by governments in determining the proper service provider for a public sector project. It consists of an estimate of the cost that the government would pay were it to deliver a service by itself
Risk Potential Assessment (RPA)	not applicable	Standard set of high-level criteria against which the intrinsic characteristics and degree of difficulty of a proposed project are assessed. Used in the UK public sector to assess the criticality of projects and so determine the level of OGC Gateway Review required.
S151 Officer	not applicable	An officer appointed under section 151 of the Local Government Act 1972 which requires every local authority to appoint a suitably qualified officer responsible for the proper administration of its affairs
Scheme Advisory Board (SAB)	not applicable	A body set up under Section 7 of the Public Service Pensions Act 2013 and The Local Government Pension Scheme Regulations 110-113. It will seek to encourage best practice, increase transparency and coordinate technical and standards issues.
Secretary of State (SoS)	not applicable	A guidance that includes "the authority's approach to pooling of investments, including the use of collective investment vehicles and shared services"
Senior Responsible Owner/Officer (SRO)	not applicable	Provide leadership and direction, bringing together the perspectives of the members of the sponsoring groups, to ensure the pooling initiative meets its objectives and delivers the benefits. Ensure (with input from each AA) the authority is in place to implement the changes. Ensure the aims of the change continue to be aligned with the direction of AAs and government.
Shadow Operations Group (SOG)	not applicable	This group provides officer activity, support and knowledge to project. This is the future Client Group.
Shadow Oversight Board (SOB)	not applicable	A group with representatives (usually the Chair of the Pensions Committee) from each Administering Authority
Shareholders' Agreement	not applicable	Agreement between the Administering Authorities relating to their shareholdings in the Brunel Company.
South West (SW)	not applicable	A mainly rural region with an extended coastline along the English Channel and Bristol Channel. Stonehenge, the famous prehistoric stone circle, is found in Wiltshire
Strategic Business Case (SBC)	not applicable	The stage in developing the case for changes and is followed by the Outline Business Case (OBC) and then the Full Business Case (FBC).
Transfer of Undertakings (Protection of Employment) (TUPE)	not applicable	Regulations which protect employment rights when employees transfer from one business ("the transferor") to another ("the transferee").
Value Added Tax (VAT)	not applicable	A tax on the amount by which the value of an article has been increased at each stage of its production or distribution.

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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Pension Fund Committee

Dorset County Council

Date of Meeting	9 January 2017
Officer	Pension Fund Administrator
Subject of Report	**Governance changes to Hedging Instruments**
Executive Summary	At the November 2016 Pension Fund Committee, the committee were informed of forthcoming regulatory changes in relation to hedging operations undertaken by pension funds. The committee commissioned Insight Investments to produce a report outlining what these changes were and how they would impact on the current hedging instruments currently employed by Insight in their inflation hedging operations and the impact on currency hedges.
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: EMIR regulations
	Budget: N/A
	Risk Assessment: N/A
	Other Implications: None

Recommendation	That: i) the committee note the report
Reason for Recommendation	To ensure that the Fund kept up to date on regulatory changes.
Appendices	Appendix 1: Insight Investments briefing note on Central Clearing and Other Regulatory Changes
Background Papers	None
Report Originator and Contact	Name: Tom Wilkinson Tel: 01305 224366 Email: thomas.wilkinson@dorsetcc.gov.uk

Dorset County Pension Fund

Central Clearing and other regulatory changes

December 2016

A BNY MELLON COMPANY℠

Insight INVESTMENT

Background on EMIR

In response to the financial crisis, in 2009 the finance ministers of the G20 countries committed to reform derivatives that are traded bilaterally or over-the-counter (OTC). The European Union implemented the G20 commitments by creating the European Market Infrastructure Regulation (EMIR). For users of derivatives, EMIR has three main impacts:

- OTC and exchange-traded derivatives must be reported to trade repositories
- certain OTC derivatives will be subject to mandatory central clearing
- non-centrally cleared OTC derivatives are subject to risk mitigation standards

EMIR came into force on 16 August 2012 but its implementation is still being phased in. The phase-in schedule is described later in this paper.

Insight[1] has prepared extensively for the introduction of the EMIR. We have been a leading voice representing European pension investors in seeking to protect pension interests. Insight has been proactive throughout the legislative process, identifying the issues and potential solutions and then lobbying to represent clients' interests. We continue to engage with market participants and pan-European policy-makers to influence and highlight any unintended consequences that may arise for our clients.

We set out below some thoughts on EMIR and its implications.

Please note that this paper is not intended to be legal advice or investment advice.

Summary and action points

This paper summarises the key aspects of EMIR and central clearing as it relates to your investments with Insight and also potential implications for your currency hedging mandate which is not managed by Insight.

In short the obligations under EMIR are those of the Qualifying Investor Alternative Investment Fund (QIAIF), the bespoke pooled fund in which you are invested. Dorset County Pension Fund (the Fund) does not have any direct obligations under EMIR as a result of its investment with Insight.

The QIAIF benefits from the pension scheme exemption and therefore does not need to clear at this stage. We are encouraging our segregated mandate clients to put in place the documentation for Insight's clearing platform in order to give them the option of cleared trading as and when appropriate; as a result, we have put in place clearing documentation for the QIAIF.

When the margin rules for non-centrally cleared derivatives come into force, Insight will ensure that the QIAIF complies with those requirements.

There are several actions for the Fund to consider as part of the regulatory changes:

- to discuss with Insight any collateral implications as developments evolve and in particular in the event that Insight choose to clear positions
- consider any additional investment restrictions associated with clearing should be included in the investment guidelines for the QIAIF.

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[1]Insight is the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Pareto Investment Management Limited (PIML), Cutwater Asset Management Corp. (CAMC), Cutwater Investor Services Corp. (CISC) and Insight North America LLC (INA), each of which provides asset management services.

- to the extent that you wish to, you/ or someone on your behalf may view the underlying clearing documentation.

Regulatory timetables

EMIR is being implemented in three phases as follows:

Phase I: 2013 to 2014	Phase II: 2015 to 2018	Phase III: 2016 to 2020
Reporting and operational standards	**Mandatory clearing**	**New collateral requirements for non-cleared trades**
• Report all derivative contracts to Trade Repositories • Minimum operational standards • ***Insight has implemented on behalf of our clients***	• Requirement to clear certain derivative transactions • IRS mandated from 2016 and CDS mandated from 2017 and phased-in for different counterparty types • ***Temporary exemption applies for pension schemes until August 2017***	• Bilateral collateralisation requirements • Initial margin (IM) requirement likely to apply to the largest users of derivatives only • ***Only very large pension schemes (those with over €8bn of non-cleared swaps) likely to be caught for IM and only from 2020***
	Earliest timing: • For wider market: 2016 to 2018 • For pension schemes: expected earliest to be August 2017*	**Likely earliest timing:** • Variation margin: from March 2017 • Initial margin: phased-in from 2016 to 2020

*This may be delayed to August 2018 as the European Commission is consulting on extending the pensions exemption

Phase 1, which includes trade reporting and certain risk mitigation requirements, has been implemented by Insight in order to assist our clients to comply with their EMIR obligations. For example, in order to assist segregated mandate clients to meet their trade reporting obligations, Insight undertook an extensive project to enable us to report directly both trade data and collateral and valuation data to the UnaVista trade repository on behalf of our clients (rather than, for example, delegating reporting to a third party). With UnaVista, we were able to comply fully with EMIR's prescribed requirements and timetable. Further detail about our actions in relation to Phase 1 requirements are set out in our EMIR Implementation Update (available online).

Phase 2 relates to the mandatory clearing of certain OTC derivatives. We set out below the relevant timetables. However, pension schemes are able to use an exemption from mandatory clearing until at least August 2017 (and potentially up to August 2018 or beyond), which we describe below under the sub-heading "Pension Scheme Exemption".

European mandatory clearing timetable: interest rate swaps (IRS)

	Timing	Which trades are captured?
Entry into force:	21 December 2015	
Category 1: Clearing members	6 month phase-in: 21 June 2016	Trades executed from 21 February 2016 (frontloading)
Category 2[2]: Financial counterparties (>=€8bn)	12 month phase-in: 21 December 2016	Trades executed from 21 May 2016 (frontloading)
Category 3: Financial counterparties (<€8bn)	18 month phase-in: 21 June 2017 or 21 June 2019[3]	New trades only
Category 4: Non-financial counterparties	3 year phase-in: 21 December 2018	New trades only

- Pensions exemption overrides the above timetable
- Pension schemes will not be required to clear before August 2017 (and possibly not until August 2018 as the European Commission is considering extending the exemption further), and only for new trades executed from this point

There is also a similar timetable for clearing credit default swaps (CDS). Your mandate with Insight does not invest in CDS.

Phase 3 of the EMIR implementation relates to rules that will require the mandatory collateralisation of OTC derivatives from 1 March 2017. We explain these rules later.

[2]A counterparty shall be category 2 if it belongs to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives for the three months January, February and March 2016 is equal to or above €8bn. However, this test is not relevant for those benefiting from the pensions exemption.
[3]Category 3 clearing obligation for IRS is currently expected to start on 21 June 2017, although the European policy-makers are considering delaying this until 21 June 2019.

The pension scheme exemption

The pension scheme exemption is automatically available to EU pension schemes that are 'institutions for occupational retirement provision' (IORPs) and investment vehicles acting solely and exclusively in their interests (e.g. a single investor QIAIF). The pension scheme exemption means that:

- eligible pension schemes will not need to clear OTC derivatives centrally until at least August 2017 (there is currently a consultation underway to extend it until August 2018 and EU legislators may agree to amend EMIR to extend it further); and
- counterparty banks may be able to offer favourable pricing for non-centrally cleared OTC derivatives

Insight currently believes that there is value in pension schemes preserving the optionality to clear swaps at a later date when clearing may become more economically advantageous or made mandatory by regulators. However, we are encouraging all clients to put in place the clearing infrastructure to ensure that they can easily make the switch to clearing if that becomes advantageous or mandatory. As a result, we are ensuring that all Insight QIAIFs have the infrastructure to clear.

The pension scheme exemption exists because current clearing models require the mark-to-market of cleared derivatives to be daily collateralised in the form of cash variation margin (VM). European policy-makers recognised that requiring pension schemes provide VM in the form of cash was likely to result in an investment drag, as pension schemes would need to divest physical assets in order to create cash to meet margin calls. Indeed, a recent study commissioned by the European Commission[4] estimated that the costs to pension schemes of mandatory clearing would range from €2.3bn to €4.7bn annually and the expected impact could be up to 3.66% over 20 to 40 years on retirement incomes across the EU[5]. This is a disproportionate impact which potentially outweighs the benefits of mandatory clearing.

The pension scheme exemption is intended to exempt pension schemes from mandatory clearing whilst the industry develops alternatives to cash VM. We are therefore of the view that the pension scheme exemption should continue to be in place until a viable and appropriate VM solution is developed.

Further information on the pension scheme exemption and our lobbying efforts can be found in our paper: http://www.insightinvestment.com/global/documents/iisf/EMIR_pension_fund_exemption.PDF

4Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements: a report for the European Commission prepared by Europe Economics and Bourse Consult (referred to as the Europe Economics and Bourse Consult report in the following footnotes). http://ec.europa.eu/finance/financial-markets/docs/derivatives/150203-external-study_en.pdf
5Page 68, Europe Economics and Bourse Consult report.

How central clearing works

Until recently, most OTC derivatives were traded bilaterally, i.e. directly between two counterparties. An investment manager, acting on behalf of a pension scheme, will typically source prices for a potential transaction from a range of banks. The trade is executed directly with the bank that offers the best terms, and the bank and the pension scheme become the legal counterparties to the trade. The pension scheme is exposed to the risk that the bank counterparty might default on its payments agreed under the derivative contract.

Central clearing requires a central counterparty (CCP) to be the legal counterparty to the transactions. The rationale of regulators for mandating clearing is that CCPs are well-capitalised entities and provide continuity to a transaction even if a bank counterparty defaults. However, central clearing does not eliminate counterparty risk and does not eliminate the role of dealer banks for the investor community, including pension schemes

The trade flow for centrally cleared transactions is illustrated below at Figure 1. An investment manager, acting on behalf of a pension fund, will source prices for a potential transaction from a range of banks, in a similar way to how OTC derivatives are traded today. The trade is executed with the bank counterparty, called the 'executing broker', providing the best terms. This transaction is then 'cleared' by the CCP via a pension fund's designated clearing member bank. This is because only clearing member banks who are members of CCPs can enter into transactions directly with CCPs and therefore a pension fund will need a relationship with a clearing member bank to facilitate clearing. The end legal transaction is therefore between the pension fund and its designated clearing member bank, with corresponding transactions through the clearing chain to the executing broker. The CCP intermediates between the pension fund's designated clearing member bank and the executing broker acting in its capacity as a clearing member. This is a similar arrangement to that typically used for exchange-traded derivatives.

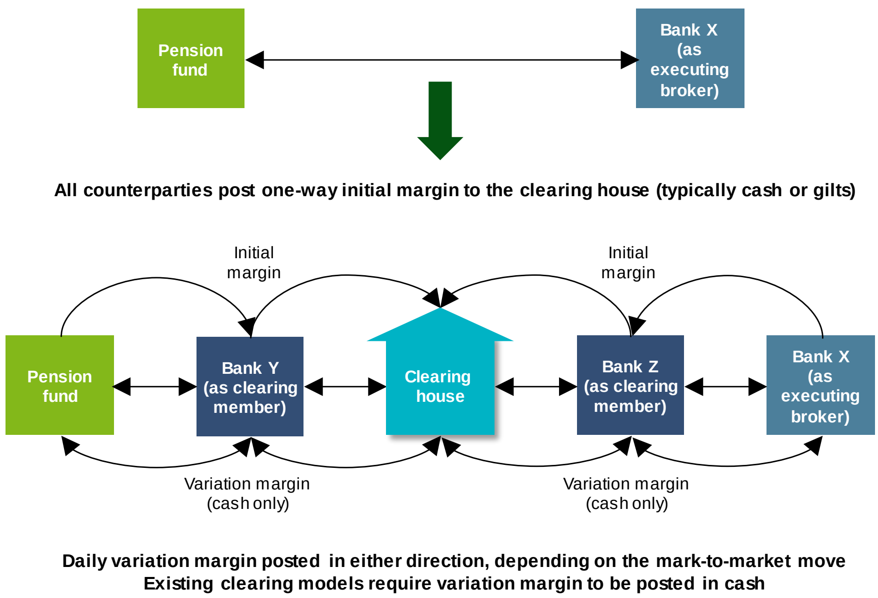
Figure 1.

Pricing is sourced from a wide panel of executing brokers

- Executing brokers can be any dealer bank

Transaction is centrally cleared

- Client accesses clearing house (also known as central counterparty or CCP) indirectly through its clearing member
- Client has counterparty risk to clearing member
- Key considerations include: (1) choice of clearing member; (2) ability to 'port' positions to an alternative clearing member; and (3) protection of margin and account structure



Cleared transactions require the posting of two types of margin:

- Initial margin (IM): This must be posted to the CCP at inception of the trade and is typically in the form of government bonds or cash. The CCP sets the rate of IM and can adjust its level through the life of the trade. A pension scheme posting IM as government bonds will still continue to receive the return on its bond. Typically, pension schemes do not post IM when trading OTC derivatives today.

- VM: This covers the daily change in the value of the derivative contract and must be posted in cash format only. Today, OTC derivative trades are collateralised in a similar way but collateral can typically be posted in government bonds or cash, and most pension schemes typically post government bonds. The move to cash-only VM would be a change for most pension funds.

Unlike bilateral OTC derivatives, cleared trades have only one pricing source: the CCP itself. This allows the exposure calculations and the settlement of VM to take place sooner. VM is typically settled on the morning of the next business day for valuations from the close of business the day before, and with zero minimum transfer amounts.

Because a pension fund will have counterparty exposure to its clearing member, some key considerations could include appointing a panel of clearing members, the ability to move positions and assets between clearing members (known as 'porting'), and the level of segregation of positions and assets at clearing member level and CCP level.

Insight's clearing platform

Insight has created an innovative, robust clearing solution to enable clients to maximise efficiencies, select clearing members and to manage position risk and collateral implications. Insight has appointed a panel of clearing members to provide clearing services for OTC derivatives to our clients and funds. We expect that our panel of clearing members will support mandatorily cleared products and other cleared products (e.g. inflation swaps) and will provide access to all major clearing houses authorised under EMIR (LCH, Eurex and others). The Insight clearing platform is operationally ready and available for clients to use and we have well-established processes to manage margin calls, including calculating and monitoring collateral buffers in order to maximise efficiencies for clients.

The legal framework for Insight's clearing platform is based around a uniform Master Client Clearing Agreement (MCCA) with each of our panel clearing members. The MCCA is an Insight standard agreement that embeds certain core terms that are essential to clearing and the protection of clients (e.g. type of account, treatment of margin and porting), and provides visibility of these terms to clients, whilst providing the flexibility for Insight to evolve the underlying client clearing documents over time as clearing members and clearing houses develop their offerings. Importantly, the MCCA structure also gives each Insight client access to the beneficial commercial terms that Insight has been able to negotiate with clearing members on behalf of all our clients, and all Insight clients are able to onboard with our panel of clearing members on substantially similar terms. Using our framework, clients can delegate decisions around whether to clear individual trades to Insight, in the knowledge that we will do so whilst upholding our commitments under our Order Execution Policy.

Further detail on our approach to central clearing, including an innovative educational guide, is set out on our central clearing website: http://www.insightinvestment.com/centralclearing/

Margin rules for non-centrally cleared derivatives

This section has relevance for your mandate with Insight and, in addition, given the implications in terms of the treatment of forward foreign exchange (FFX) positions may impact your currency hedging mandate which is managed elsewhere.

In March 2015, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (BCBS-IOSCO) issued an international framework for margining of non-centrally cleared derivatives, together with a timetable for implementation[6].

The BCBS-IOSCO framework has two basic requirements:

- VM: to collateralise on a daily basis the mark-to-market exposure of all non-centrally cleared OTC derivatives entered into on and from a specified compliance date (see below); and
- IM: a phased-in obligation to post and collect collateral in order to collateralise possible forward-looking losses for all non-centrally cleared OTC derivatives[7].

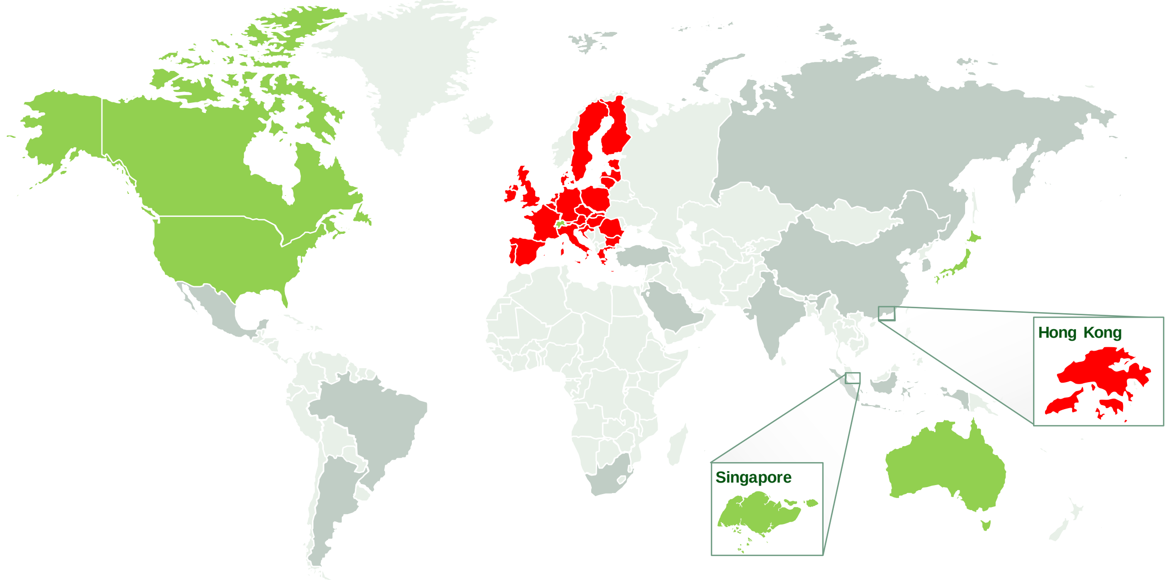
These changes are being implemented in the EU as part of EMIR, as part of the Dodd-Frank reforms in the United States and their equivalents in other jurisdictions. Broadly speaking, the VM rules come into effect on 1 March 2017, although there are slight variances in implementation timetable by product and from jurisdiction to jurisdiction. The IM rules are phased in until 2020 based on an entity's gross notional; we do not expect the Fund to be in scope for the IM until 2020 at the earliest.

Insight has commenced a comprehensive implementation programme to ensure that we can comply with the relevant rules on behalf of the QIAIF and to assist our clients in complying with their EMIR obligations. This includes changes to our trading documentation and operational processes. If you would like further details about the rules and the steps that we are taking, this can be found in our Implementation Update: margin for non-centrally cleared derivatives.

One significant variance in the global implementation of the rules is the approach to VM on physically-settled FFXs and swaps, as shown in the diagram below:

[6]See http://www.bis.org/bcbs/publ/d317.htm
[7]The scope of an OTC derivative can vary slightly from jurisdiction to jurisdiction.

VM on physically settled FX in selected jurisdictions



VM on physically delivered FX in scope

VM on physically delivered FX out of scope

The European Union differs from most jurisdictions in that EMIR will require VM on physically-settled FFX and swaps, although the timeline is expected to be:

- physically-settled FX swaps: 1 March 2017
- physically-settled FFX: 3 January 2018 (to be confirmed)

This will mean that entities established within the EU, including pension schemes and QIAIFs, must collect or post VM on physically-settled FFX and FX swaps by the relevant compliance dates. In turn, this will require the EU entity (or its investment manager) to have appropriate documentation and operational processes in place to collateralise the physically-settled FFX and FX swaps. Insight's policy is to collateralise both FFX and swaps from 1 March 2017. Whilst the European regulations state VM for FFX does not need to be exchanged until January 2018, the feedback Insight has received from a majority of counterparty banks is that they will expect their clients to exchange VM on both swaps and forwards from 1 March 2017.

Many liability hedging clients have been enquiring about using Insight to conduct their FX hedging in order to benefit from a shared collateral pool and provide more flexibility in meeting settlement amounts.

Any other issues

Insight has been a leader in actively representing the interests of our pension fund clients to regulators and the industry. Insight, and specifically Andrew Giles, Chief Investment Officer (CIO) - Solutions, has led the European pensions and investment industry's lobbying in respect of the move towards centralised clearing for swap contracts resulting from the EMIR. Insight played an instrumental role in securing the pension fund exemption for our pension scheme clients.

We continue to be very engaged in discussions with regulators, industry groups and other interested parties to influence the direction of future regulation to ameliorate the impact on our pension fund clients. For example, we have recently liaised extensively with industry groups and regulators about proposed rules under EMIR for margin on uncleared derivatives and the proposed rules for pre-trade transparency under MiFID II in order to highlight a number of issues that would negatively impact our pension fund clients.

A core element of our approach is to understand the structural impacts of regulatory change and to innovate to provide solutions for our clients in order to protect their broad economic interests. For example, mandatory clearing will create significant cash liquidity requirements for our pension fund clients. As a result, we have worked and are working closely with clearing houses and industry to find solutions to address the liquidity and transformation risks that would otherwise face our pension fund clients. This approach underlines Insight's proactive, solutions-focussed service for its clients.

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Pension Fund Committee

Dorset County Council

Date of Meeting	9 January 2017
Officer	Pension Fund Administrator
Subject of Report	**Proposals for future changes to Employer Contribution rates.**
Executive Summary	The results of the Dorset County Pension Fund 2016 valuation were received from the Fund's actuary, Barnett Waddingham in December 2016. Overall the funding level for the Pension Fund has increased from 82% to 83%, with assets valued at £2.249bn and liabilities at £2.701bn, giving a present value deficit of £0.452bn, up from £0.413bn at the March 2013 valuation. Overall the average employers' share of the cost of new benefits has increased from 13.3% of payroll to 15.7% per annum. However, there are variations amongst the different employers on both the funding level and contribution rates. The valuation does mean that in most cases employers will see their contribution rates increase and wherever possible the actuary has provided options to reduce the size of the increase in any one year to allow employers to arrive at an appropriate funding level. The actuary will agree with individual employers as to their exact arrangements and all rates have to be legally certified by 31st March 2017.
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: Pensions data, assets valuations, actuarial report

	Budget: There is no direct budget implication to the pension fund, although scheme employers will have to find additional budget at a time of reduced funding.
	Risk Assessment: The Funding Strategy Statement sets out the most appropriate strategy to minimise risks to the Fund over the long term.
	Other Implications: None.
Recommendation	That the Pension Fund Committee: i) Note the report and briefing note from Barnett Waddingham.
Reason for Recommendation	To ensure that the Fund has the appropriate funding arrangements in place.
Appendices	Appendix 1: Briefing Note from the Fund Actuary, Barnett Waddingham.
Background Papers	Scheme valuation 2016.
Report Originator and Contact	Name: Tom Wilkinson Tel: 01305 224366 Email: thomas.wilkinson@dorsetcc.gov.uk

Dorset County Pension Fund
2016 valuation
Employers' results

Background

As part of the 2016 actuarial valuation of the Dorset County Pension Fund, we have provided short results schedules for the individual employers.

This note is made up of two parts.

It first summarises the approach that we have taken in a few specific complicated cases and outlines the next steps that we feel would be appropriate for future exercises.

It then summarises which employers we have produced results schedules for and groups them according to the employer type and the effect of the new rates. For example, we have separated those that we have proposed stepping for and those that we have proposed immediate changes for.

Part 1 – Complicated employers

Partnership

In 2011, West Dorset District Council (WDDC) and Weymouth & Portland Borough Council (W&PDC) agreed to form a partnership which we understand involved all staff from the two councils working for the partnership. In 2015, we understand that a new partnership was entered between the above two councils along with North Dorset District Council (NDDC).

From discussions with Jason Vaughan of the Dorset Councils Partnership in March 2016, we further understand that:

- Both the 2011 and 2015 partnerships started with no deficit so the individual councils retain their own deficit;
- Any surplus or deficit accrued on the 2011 Partnership should be split 53% for WDDC and 47% for W&PDC;
- Any surplus or deficit accrued on the 2015 Partnership should be split 42% for WDDC, 37% for W&PDC and 21% for NDDC.

In these types of situations, to allow the different elements to be tracked, the members and cashflows would normally be coded on the administration and cashflow systems using new employer codes i.e. one for the 2010 partnership and one for the 2015 partnership. This then allows us to accurately apportion any surplus/deficit to the original councils.

Currently, the partnership members are all included under the Weymouth & Portland District Council code.

Our approach

We have taken the membership data for the three councils and made the following assumptions:

- All active members are assumed to be part of the 2015 Partnership.
- All non-active members that were active at 31 March 2013 and coded under either WDDC or W&PDC are assumed to be part of the 2011 Partnership. This means that members that left service between the start of the 2011 Partnership and 31 March 2013 will not be included on the 2011 Partnership code, although they should be. We have made this approximation to be consistent with the previous treatment at the 2013 valuation, until we receive full split membership data.
- All other non-active members are left on their original council code.

For the assets, we have taken the following approach:

- 2011 Partnership assumed to be fully funded at 31 March 2013.
- Cashflows for WDDC and W&PDC have been approximately split between the two councils and the 2011 Partnership for 2013/14 and 2014/15.
- Cashflows for WDDC, W&PDC and NDDC have been approximately split between the three councils, the 2011 Partnership and the 2015 Partnership for 2015/16.
- The transfer of assets from NDDC to the 2015 Partnership when the active members transferred has been calculated using membership data.
- The transfer of assets from the 2011 Partnership to the 2015 Partnership when the active members transferred has been assumed to be such that the 2015 Partnership was fully funded at 31 March 2016 on assumptions consistent with those used at the 2013 valuation.

Results

The 2011 and 2015 Partnerships are well-funded at 99% and 94% respectively. This reflects the broadly fully funded nature of the transfers made to them. The calculated deficit for each council is as set out below:

Deficit for each council	West Dorset	Weymouth & Portland	North Dorset
Own deficit	£5,798k	£7,007k	£1,984k
Share of 2011 Partnership	£68k	£61k	-
Share of 2015 Partnership	£1,215k	£1,070k	£608k
Total	**£7,082k**	**£8,139k**	**£2,592k**

Next steps

Although we believe that the above results are appropriate based on the data provided, the size of the transfers of staff mean that the results for each element above could be quite different. However, the total deficit across all bodies would be expected to be unchanged.

Given the uncertainty, we propose that all contributions from the councils are credited to their own section only until the data is resolved. This means that although the total contributions are based on the total deficit, in the short term, it will only be each council's own deficit that improves.

The data changes we require for more accurate results are:

- Members to be recoded to two new Partnership codes.
- Future cashflows to be allocated across all five codes.

The data changes that are not essential but would make the overall tidy-up process easier to complete and more accurate are:

- Extracts (with the new codings) at each transfer date.
- All cashflows since the start of the 2011 Partnership to be allocated across the five separate codes.

We appreciate that the historic cashflow work in particular is likely to be difficult and time-consuming but we believe that we can make reasonable estimates once we have clarity on which members should be on each code.

Tricuro

In 2015, Dorset County Council, the Borough of Poole and Bournemouth Borough Council formed a Local Authority Trading Company called Tricuro.

During the summer of 2016, as part of preparing the accounting disclosures for Tricuro, we had a number of discussions about the risk-apportionment between Tricuro and the three councils.

We understand that part of this involved the arrangements being updated and our current understanding is that

- Tricuro have no responsibility for any deficit (or surplus) that builds up in the Tricuro section.
- The contribution rate that Tricuro pay will therefore only be in respect of future service. This rate will be reviewed at each actuarial valuation.
- Any deficit (or surplus) that does form on the Tricuro section will be split between the three councils. This will be based on the councils' former members.

Our approach

This last point was only confirmed recently and, to fully allow for it, we would need more detailed data so we will have a discussion with the Administering Authority about the most appropriate approach. For the time being, we propose to split the surplus/(deficit) between the councils in proportion to the amount of liability that transferred originally.

Results

The Tricuro section has a surplus so it actually has a positive effect on the contributions for the three councils. The future service contribution rate for Tricuro is 17.7% of pensionable salaries and so this is the amount that Tricuro will need to pay from 1 April 2017.

As we understand that Tricuro are closed to new entrants, we would expect the membership to age and so the contribution rate for the cost of new benefits is likely to increase at future valuations.

The effect on the councils is shown in the next section.

Next steps

We discuss the cashflows for future exercises with the Administering Authority.

Pre-organisation liabilities

There are historic liabilities stored under employer code 990 and we understand that Dorset County Council, the Borough of Poole and Bournemouth Borough Council have 80%, 10% and 10% responsibility for these respectively.

The benefit payments for these members are currently recorded against Dorset County Council which means that, without any adjustments, Dorset County Council would end up having more assets taken off them than is absolutely correct. As the annual payroll for the pre-organisation liabilities is about £11m, this means that they were having the full £11m deducted rather than just their share, which would have been more like £9m so a difference of £2m each year. Similarly, this means that Bournemouth and Poole's assets would each be overstated by about £1m each year.

For this valuation, we have allocated the 2013 to 2016 cashflows for the pre-organisation liabilities between the councils in the 80%, 10% and 10% proportions. We have not carried out or allowed for any adjustments before 31 March 2013 at this stage and we suggest that we pick this up in January 2017.

Results

	Dorset	Poole	Bournemouth
Excluding Tricuro			
Assets	£656.1m	£308.6m	£360.3m
Liabilities (pre-organisation)	£105.8m	£13.2m	£13.2m
Liabilities (other)	£731.4m	£341.7m	£453.2m
Deficit	£181.2m	£46.3m	£106.2m
Tricuro surplus	£3.6m	£1.4m	£0.3m
Total deficit	**£177.6m**	**£44.9m**	**£105.9m**

Next steps

We think that it would be worthwhile revisiting previous valuation results to establish where the pre-organisation cashflows have been applied. As the councils are likely to step their contribution rate from their current level, it's unlikely that any adjustments would affect the final certified rates. We would be happy to discuss any of the approaches outlined in this paper and the follow-up actions that we have suggested.

Part 2 - The treatment of different employers at the 2016 valuation

For the below, we have generally only included employers with active members. Employers without actives should either now be the responsibility of another employer or part of the overall orphan section of the Fund.

As at previous valuations, we have ensured that the orphan section is fully funded by topping up the assets. This had the effect of reducing each active employer's assets by 0.01%.

Unitaries

Stepped

For the below councils, the contribution rate was due to increase by more than 1% in the first year. For Dorset County Council, a particular stepping approach had already been discussed and for the others, we assumed that the steps should be no more than 1% of pensionable payroll each year.

- (993) Dorset County Council (and the connected employers 814, 924, 930, 968 and 974)
- (900) Bournemouth Borough Council (and the connected employers 858 and 972)
- (907) Borough of Poole Council (and the connected employer 927)

Immediate change (no stepping)

For the first three below, we have not tried to step as the Partnership agreements mean that they are all linked so it's preferable for a consistent approach to be taken for all. For the others, it's because the contribution increase is less than 1% of payroll.

- (905) West Dorset District Council
- (906) Weymouth & Portland Borough Council
- (902) North Devon District Council
- (907) East Devon District Council
- (901) Christchurch Borough Council
- (904) Purbeck District Council

Bodies connected to unitaries that are not directly responsible for any deficit

We have presented the total contributions for the Partnership arrangement between West Dorset, Weymouth & Portland and North Dorset as contributions payable by the three councils. For the avoidance of doubt, the contribution rate payable in respect of the active members is 15.3% of payroll.

As set out in this paper, the rate for Tricuro is 17.7% of pensionable salaries.

Other taxpayer-backed bodies

Immediate change (no stepping)

For these, the rates in our schedules assume that the employers will move straight to the higher rates. In some cases the increases are significant and we would be happy to provide alternative scenarios.

- (890) Dorset Police and Crime Commissioners
- (976) Dorset Fire Authority

Colleges

For all of the colleges, we have assumed that the employers will move straight to the higher rates. In some cases the increases are significant and we would be happy to provide alternative scenarios (as we have done already for Bournemouth University).

Immediate change (no stepping)

- (922) Bournemouth University
- (942) Bournemouth & Poole College of Further Education
- (941) Arts University College at Bournemouth
- (943) Kingston Maurward College
- (970) Anglo-European College of Chiropractices
- (820) Weyco Services
- (944) Weymouth College

Admission bodies

Where rates need to increase, we have assumed an immediate change in all cases for admission bodies. In some cases the increases are significant and we would be happy to provide alternative scenarios.

Immediate change (no stepping)

The below employers have a deficit and the calculated total rate is higher than they are currently paying.

- (837) Care Quality Commission. It appears that the 2013 contributions did not target all of the deficit and this is likely to be because the connected employer's deficit was omitted by us from the deficit calculations.
- (805) Spectrum Housing
- (998) Synergy Housing Group
- (959) Magna Housing Association
- (982) Magna Housing Group
- (958) Care South
- (996) Poole Housing Partnership
- (961) Ansbury
- (957) Sovereign Housing Association
- (825) Mack Trading
- (933) Raglan Housing Association
- (836) Healthy Living Wessex

The below employer has a surplus. If it was a limited-term contract, we would look to pass this surplus back to the employer but as we do not currently know the length or if the transfer of staff was permanent, we have maintained the rate at the current level.

- (840) BH Live

Rates maintained

The below employer still has a deficit but the current contributions (with future increase) are projected to allow the deficit to be paid slightly under 22 years so we have maintained the rates.

- (800) Bournemouth Transport

Rate reduced

The below employer has a small surplus and their future service rate has come down (due to a change in the average age in their membership)

- (402) Wessex Education Shared Services

No rate provided yet

In the first batch below, we will send further queries.

- (815), (816), (817), (826), (827), (847) Various SLM contracts
- (846) Mouchel
- (813) Care UK
- (874) 1610 Ltd
- (864) Poole & Bournemouth Adult Learning
- (865) Action for Children
- (828) South Dorset Community Sports Trust
- (434) Dorset Arts Development
- (415) East Boro Housing Trust
- (438), (439) Millbrook Healthcare
- (408) Children's Society
- (486) Nviro
- (424) Colliton Club
- (413) Stour Valley and Partnership

In the following batch, the employer seems to have ceased although we have not carried out a cessation valuation.

- (809) etc. All Churchill contracts
- (804) Places for People
- (879) AQS Homecare
- (818) Dorset Lighting
- (892) Blue Ribbon
- (407) Barnardos
- (409) Churchill

Small admitted bodies pool

All of these employers are currently pooled and pay the same effective rate, although, as noted, one appears to have ceased since the last valuation.

We have proposed one fundamental change from the last valuation which is to express the deficit contributions as a percentage of payroll. Collecting contributions as monetary amounts is, overall, our preferred default approach for single employers as it means that the same total deficit contributions are collected regardless of changes in payroll. In a pool, however, the total deficit needs to be divided between the employers in some way when setting contributions. The most common approach is to work out the total contributions needed then divide it between the employers based on their payroll. At the 2013 valuation, we did this, then converted the amounts into lump sums. The potential problem with this approach is that the split of payroll might change significantly between valuation dates and the intended payroll split is no longer maintained.

Immediate change (no stepping)

We have produced a single schedule for all of the below employers.

- (925) Age Concern Bournemouth
- (948) Dorset Association of Town and Parish Councils
- (952) Dorset County Museum

No rate provided yet

The below employer seems to have ceased although we have not carried out a cessation valuation.

- (988) Bridport Museum Trust

Small scheduled bodies pool

These are the town and parish councils. They are pooled and pay the same effective rate.

For the small admission bodies pool, we discussed why we were proposing rates as a percentage of payroll for those employers. The same logic applies here and, in addition, the deficit lump sum amounts would be very small in some cases so we suspect that it would also be easier administratively to collect as a percentage of payroll.

We have not listed all of the employers in this pool here and have produced a single schedule for all town and parish councils.

Academies pool

There were nearly 100 academies at the 2016 valuation. They are pooled and pay the same rate.

We have not listed all of the employers in this pool here and have produced a single schedule for all academies. This is also the rate that will be paid by new academies that form between now and the next valuation.

We would be happy to discuss these results in more detail and provide alternative scenarios for various cases if it was helpful.

M Nay

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