

## APPENDIX III

### Local Government Pension Schemes

#### *High level detail on the governance arrangements and FCA regulation of the ACS Operator and the Pensions CIV Joint Committee*

##### 1. **Executive Summary**

It is intended that two UK based FCA authorised entities are set up: the investment fund itself (the "ACS") and the entity which operates this, the ACS Operator.

Those local authorities who contribute capital to the ACS Operator will be shareholders of the ACS Operator and have typical shareholder rights e.g. around the approval and appointment of directors and others as agreed between the shareholders. Please refer to paragraph 4.2.1 of this note for further information on these rights. It is envisaged that those local authorities who participate in the ACS Operator will invest in the ACS in due course, although there is no obligation they do so.

A new joint committee (the "Pensions CIV Joint Committee") will be set up to act as a representative body acting on behalf of the participating local authorities. This will be set up by the local authorities using their powers in sections 101 and 102 of the Local Government Act 1972 and section 9EB of the Local Government Act 2000. It will allow the local authorities to streamline their decision making by delegating responsibility for decisions to the Pensions CIV Joint Committee, rather than requiring decisions from the individual local authorities. The Governing Agreement under which Leaders' Committee and the Grants Committee operate was entered into in pursuance of arrangements made under sections 101 and 102 of the Local Government Act 1972 and other powers that were relevant at the time. (The Agreement also sets out the Standing Orders, Financial Regulations and the administrative framework under which all London Councils' activities operate.) The establishment and use of a joint committee in this instance is, therefore, a familiar arrangement which is consistent with the provisions of the Governing Agreement. Please refer to paragraph 4.2.1 of this note for further information on the powers of the Pensions CIV Joint Committee.

The ACS Operator will be set up as a company using the powers in sections 1 and 4 of the Localism Act 2011. Sections 1 and 4 of the Localism Act 2011 provide power to set up the company and trade for commercial return. The local authorities need to ensure that they act reasonably in the exercise of their powers. This means that they would need to take account of all relevant factors, disregard irrelevant factors, observe any procedural requirements, act for proper

purposes, not act in bad faith, and not take a decision that no reasonable local authority could take.

Each local authority that decides to participate in the Pensions CIV Joint Committee and in the ACS Operator would need to recognise that the Pensions CIV Joint Committee would be collectively acting in the interests of all participating authorities in exercising their rights as shareholders of a company. Additionally, councillors or officers whom the local authorities nominate to serve as directors of the ACS Operator (if any) would be obliged to act in the best interests of the company and they would need to be satisfied that there would not be a conflict of interests when they balance this duty with their role as a councillor or officer of the local authority that nominates them as a director.

## 2. **The ACS Operator**

### 2.1 Key functions of an ACS Operator

The key functions for which the ACS Operator is responsible are:

- 2.1.1 Investment management of the portfolio of assets of the ACS - this includes front office functions (i.e., day to day decisions about the composition of the funds' portfolios), middle office functions (such as trade processing, portfolio accounting, pricing and valuation and client reporting), back office functions (such as income and tax reclaim collection and settlement management), and the entering into of contracts with brokers and other market participants. These functions will almost certainly be delegated – the investment management to a series of investment management houses and the middle and back office functions to parties with the relevant expertise and infrastructure.
- 2.1.2 General administration functions– i.e. setting up and generally operating the ACS on a day-to-day basis. The obtaining and maintaining FCA authorisation, appointing and overseeing auditors and regulatory compliance monitoring, tend to be carried out internally and will require detailed knowledge of the FCA Rules as they relate to FCA authorised funds. Other functions e.g., dealing with orders for subscriptions and redemptions of units in the ACS by investors, record keeping and fund accounting services, tend to be outsourced to third parties who have the relevant expertise.
- 2.1.3 Risk and compliance functions – a separate risk and compliance functions to monitor and assess compliance with the FCA Rules is required and tends not to be outsourced. These functions have a high level of responsibility and personal risk attached.

2.2 Where any functions are delegated/outsourced, the ACS Operator needs to be able to demonstrate to the FCA that it can supervise such delegations.

### 2.3 **Governance**

The directors of the ACS Operator and those people who perform certain key functions (the chief executive, compliance officer, the money laundering officer, customer function, potentially client assets officer) have to be approved by the FCA and the performance of the functions carries personal responsibility. The responsibility to ensure that such persons are competent and retain FCA approval lies with the ACS Operator.

This may require a mix of internal candidates and external experts to ensure the required level of expertise and independence is achieved.

### 2.4 **Regulation**

2.4.1 The ACS Operator is authorised by the FCA to perform certain activities appropriate to operating an ACS.

2.4.2 On an ongoing basis the ACS Operator must comply with the relevant provisions in the FCA's Handbook (<http://fshandbook.info/FS/index.jsp>) (the "FCA Handbook"), which sets out in detail the high level standards and requirements that are applicable to regulated firms in terms of operating their businesses and organisational requirements, senior personnel, systems and controls, delegation, conflict management, interaction with customers, market conduct, remuneration, disclosures, investment restrictions and borrowing powers, and capital adequacy etc.

## 3. **Application for FCA authorisation**

The process for obtaining FCA authorisation for the ACS Operator is a separate and distinct process from that of setting up and authorising the ACS itself (although it may be possible to run these concurrently).

The FCA will only provide authorisation if it is satisfied that certain threshold conditions are met: whether the proposed ACS Operator has appropriate resources (including financial resources and that all the above functions can be carried out by the ACS Operator directly or on an outsourced basis) in relation to the activities it wishes to carry on, whether a firm is fit and proper to carry out the proposed activities and whether the proposed business model is suitable.

The ACS Operator's proposed procedures and policies also need to be submitted to the FCA, including: a compliance manual, and a compliance monitoring programme, risk management, Internal Capital Adequacy Assessment Process

("ICAAP"), conflicts management etc and in addition to these certain draft documents and agreements (e.g., investment management agreements) will also be required.

The amount of capital the FCA will require the ACS Operator to have will be dependent upon the quantum of assets which the ACS Operator will manage (further detail on the capital requirement is given in the Report considered by Leaders Committee on 11 February 2014).

Each participating local authority will need to seek approval from its Full Council (unless approval can be given under delegated authority) for contributing capital to the ACS Operator. Further information about this is in the following section.

#### **4. The Pensions CIV Joint Committee**

##### **4.1 Formation**

4.1.1 A new joint committee, the Pensions CIV Joint Committee, will be set up to act as a representative body to act collectively on behalf of the local authorities participating in the ACS (as shown in the structure diagram at Schedule One). The Pensions CIV Joint Committee will be formed of representatives of those local authorities participating in the ACS. Should all the London local authorities participate, this role would be performed by the Leaders' Committee (and the Governing Agreement would need to be varied to delegate functions involving the exercise of sections 1 and 4 of the Localism Act 2011 to that joint committee). The Pensions CIV Joint Committee will need to have terms of reference which set out the powers of the Pensions CIV Joint Committee and the functions for which it is responsible (i.e., the functions relating to acting as a representative of the shareholders in the ACS Operator). The terms of reference will be agreed in accordance with the Governing Agreement of London Councils which established Sectoral joint committees and made provision for additional Sectoral joint committees to be established. Clause 7.2 of the Governing Agreement referred to "Each Sectoral joint committee established hereunder from time to time" and provided that such committees would discharge the functions delegated to them by the local authorities which agreed to subscribe to them and would act in the collective interests of those local authorities. "Sectoral joint committee" is defined in the Governing Agreement as "a joint committee appointed under section 102 Local Government Act 1972 to discharge functions which a minimum of three and a maximum of 32 of the London Local Authorities have agreed to delegate to it, whose terms of reference have been approved by ALG (as it then was known) and which shall operate in relation to ALG, in accordance with this

Agreement". The Governing Agreement provides for standing orders and rules of debate and procedure for the conduct of meetings of the Leaders' Committee and says that these also apply, wherever appropriate to any Sectoral joint committee (as well as other committees and forums that are mentioned). Therefore, appropriate provisions in those standing orders would apply to the new Pensions CIV Joint Committee. The standing orders and rules of debate and procedure have been amended since they were adopted and are kept under review. Although some of the provisions would not be relevant to the new Pensions CIV Joint Committee, it would be clear which provisions apply.

- 4.1.2 Whilst the Leader of each participating local authority could be appointed as the representative on the Pensions CIV Joint Committee (and this would reflect the arrangements already provided for in the existing London Councils Governing Agreement, which states at clause 4.5 that each London Local Authority shall appoint its Leader as its representative to any Sectoral joint committee and shall be entitled to appoint deputy representatives in accordance with standing orders), it will be important to have a Councillor with the right skills set and time to devote to the responsibilities to ensure the relevant matters can be consulted on appropriately between the participating local authorities and the Pensions CIV Joint Committee. (As you know the existing London Councils arrangements provide for the appointment of Deputies.) In the event that meetings are required to deal with specialist matters e.g. discussions on investment matters such as the setting of original investment mandates by the ACS Operator (which is an FCA responsibility of the ACS Operator), we would recommend that a person with appropriate expertise attend such meetings, e.g., for investor matters, the Chair of the relevant Borough Pension Committee could be appointed.
- 4.1.3 There is an inherent conflict of interests in the structure that is proposed where representatives of the Borough Pensions Committee sit on the Pensions CIV Joint Committee as they will be both shareholder representatives of the ACS Operator and also make decisions on investments into the ACS itself. This inherent conflict will be managed in the terms of reference of the Pensions CIV Joint Committee and the conflicts policy of the ACS Operator which is required by the FCA.
- 4.1.4 One point to emphasise is that the interim board of directors is not intended to remain in place after FCA authorisation. It is temporary. It is there to steer the initial set up phases to assist in progressing the detailed work. The suggested interim directors are current Pensions

Working Group members and have been involved in this project from an early stage. The interim directors will be representing the local authorities and the proposed ACS Operator to facilitate it being established. Going forward new appointments will be made from candidates who are confirmed as suitable by the FCA. Selecting who these individuals may be, and deciding on the selection process, will be one of the tasks for the next phase of work and do not need to be considered by local authorities at this point.

## 4.2 **Roles and responsibilities**

4.2.1 Although, as shown on the structure diagram at Schedule One, there will be a level of information flowing between the Pensions CIV Joint Committee, the participating Councils and the ACS Operator it is important to note that the Pensions CIV Joint Committee will be a representative body acting on behalf of the shareholders in the ACS Operator collectively and its functions will be consistent with the provisions of the existing London Councils framework.

The decision to invest through the ACS in the future, as well as the size of investment and mix of assets, will remain with each Borough Pensions Committee. Any such investments will, of course, need to comply with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 which contain certain restrictions on the type of assets that can be invested in and the amount of fund property that can be invested in these assets. However, these are not matters which the local authorities are being asked to agree at this time. The decisions boroughs need to take now relate solely to the establishment of the ACS Operator and the associated Pensions CIV Joint Committee.

The Pensions CIV Joint Committee will take decisions in accordance with the functions which have been delegated to it by the participating local authorities. The Pensions CIV Joint Committee will have usual shareholder powers of appointing the directors (subject to FCA approval) and auditors of the ACS Operator, changing the articles of association of the ACS Operator, and the ability to wind up the ACS Operator. The Pensions CIV Joint Committee will act for the shareholders of the ACS Operator collectively, and the shareholders (i.e. the participating local authorities) will nominate the representatives of the Pensions CIV Joint Committee to act for them.

**5. Receiving services from the ACS Operator – Public Procurement**

- 5.1 The local authorities that participate in the ACS Operator are contracting authorities as defined in the Public Contracts Regulations 2006. Therefore, in usual circumstances, when they arrange to receive services from another entity under a contract in writing for consideration, they would need to procure the service provider through a procurement process which is compliant with the Public Contracts Regulations 2006 and associated legislation and the EC Treaty principles of non-discrimination, equal treatment and transparency, and compliant with the local authority's own standing orders or other rules relating to contracts.
- 5.2 However, it would be possible for there to be an arrangement for the ACS Operator to provide services to any of the participating local authorities if this arrangement were within the scope of the "Teckal" exemption. This is an exemption which was recognised in the case of *Case C-107/98 Teckal Srl v Comune di Viano* and which allows a contracting authority to receive services from an in-house company without being subject to public procurement if certain requirements are satisfied. The requirements are that the contracting authority must exercise over the company a similar level of control as it exercises over its in-house units (the control test) and that the company carries out the essential part of its activities for the contracting authority (the activity test).
- 5.3 Since it is expected that the ACS Operator would be wholly owned by the local authorities that intend to receive services from it and that it would be established to provide such services, it would be expected that the arrangement would be able to come within the scope of the "Teckal" exemption.

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### Schedule One – proposed structure

