

LGPS POOLING CONSULTATION

Introduction

1. On 11 July 2023 the Department for Levelling Up Housing and Communities (DLUHC) issued the long-awaited pooling consultation, Local Government Pension Scheme (England and Wales): Next Steps on Investments.
2. The consultation seeks views on proposals relating to the investments of the Local Government Pension Scheme (LGPS). It covers the areas of asset pooling, Levelling Up, opportunities in private equity, investment consultancy services and the definition of investments.
3. The consultation proposes to accelerate and expand LGPS pooling, with a March 2025 deadline for funds to transition all listed assets, as a minimum, to their pool. The Government has also confirmed a target for funds to invest up to 5% of assets to support Levelling Up in the UK and has set an ambition for funds to have 10% of their assets invested in private equity. The deadline for consultation responses is 2 October 2023.
4. This report provides an overview of the key proposals within the consultation, and the key issues that will form the basis of the Fund's response.

Recommendations

5. The Committee is asked to:
 - a) Review and comment on the key issues identified with the consultation proposals;
 - b) Subject to comments from the Committee, agree the key issues identified as the basis for the Fund's response to the consultation and delegate the final submission of the response to Fund officers.

Report Detail

6. The consultation contains proposals in three main areas outlined in the following table.

	Proposals
Asset Pooling	<ul style="list-style-type: none"> • Acceleration of pooling • 31 March 2025 deadline to transition at least all listed assets • Potential transition to fewer pools • Delegation of investment strategy implementation to pool companies
Levelling Up	<ul style="list-style-type: none"> • Funds to publish a plan for investing up to 5% of assets in projects which support levelling up anywhere in the UK. • 12 medium term “levelling up missions” set out to define investments which count towards the 5% target. • Funds to report on progress against their plan in the annual report.
Private Equity	<ul style="list-style-type: none"> • Funds to consider investments to meet the government’s ambition of 10% of the LGPS being invested in Private Equity.

Asset Pooling – Increased Scale

7. The government has clearly stated it wants to see pooling move further and faster to substantially increase scale and drive better value for money. Several next steps for achieving scale are proposed:

- Accelerating the pace of transition of liquid assets to pooling;
- Pool companies expanding in-house capabilities to reduce or replace the use of private sector investment managers;
- A direction of travel towards a smaller number of pools to achieve a target of more than £50 billion in funds directly invested by any one pool;
- Pools to consider specialisation, building on the strengths of particular areas of investment – particularly in the context of the full suite of Private Markets asset classes;
- Clearer delegation to pool companies on investment strategy implementation, whilst recognising investment strategy decision-making remains in the hands of the funds.

Detailed Consultation Proposals

8. The key proposals in respect of asset pooling set out in the consultation are as follows:

- Transfer of all listed assets to the pool by 31 March 2025 (i.e. by the start of the next triennial valuation cycle);

- All LGPS funds to set out in their Investment Strategy Statements:
 - Assets which are “pooled”, “under pool management” and “not pooled”
 - Provide rationale, value for money, and date for review of assets which are under pool management or not pooled;
 -
- To revise pooling guidance so as to set out fully how funds and pools should interact and promote a model of pooling which includes; delegation of manager selection, strategy implementation, advice, governance, transition of assets, new investments outside the pool and reporting;
- Have an investment-related training policy, and report against this;
- Revise guidance on annual reports to require greater clarity on progress of asset pooling, including reporting on the net savings from pooling.

Issues to be Considered in the Fund’s Response

9. The Fund currently has £1.2bn of assets in equities and fixed income that, under the proposals, would be required to transfer to LGPS Central by March 2025. The Fund also holds £1.6bn of collectively procured assets with Legal & General Investment Management which are also likely to form part of this requirement.
10. The proposed timescale of pooling all liquid assets by 31 March 2025 is challenging and the deadline is not supported by the Fund. While a quicker pace of pooling may lead to some benefits (e.g. lower investment fees) being realised sooner, it is likely to lead to rushed and inefficient asset transitions. New pooled funds may need to be set up to transition into and these will take time to design, procure investment managers and to launch. It may take a couple of years after the regulations are implemented for the necessary solutions to be implemented through the pools and assets transitioned into them.
11. A key issue for the Fund will also be establishing confidence that pooled investment funds are delivering against their performance targets; in some instances, existing LGPS Central funds need more time to demonstrate good investment returns over a reasonable period of time. Assuming comparable performance has been demonstrated, there will then be a significant logistical challenge to transfer across to the pool. All such transfers are costly, complex and time consuming and all require a transition manager to be appointed to minimise the considerable costs involved. With an arbitrary deadline in place this will be even more challenging, as all LGPS funds will require the services of a relatively small pool of transition managers during a short period of time in order to achieve the government’s timescales.
12. In response to the proposal regarding delegation to pools, the consultation confirms that decisions regarding setting investment objectives, risk appetite and high-level investment strategy will remain with LGPS funds. These are the most important investment considerations for any long-term investment fund, so it is critical that those decisions remain with funds as long as they are responsible for, and therefore have a fiduciary duty, to pay those pensions. However, the government is proposing

that all other investment decisions be delegated to the pools, including various implementation decisions previously taken by member funds.

13. The separation between the high-level allocation decisions and implementation is not as clear-cut as the consultation suggests. Many implementation decisions are critically dependent on the objectives, risk appetite, investment beliefs and policies on key issues such as net zero, which are set by LGPS funds. It will be challenging for pools to take such decisions with confidence and ensure that the solutions they develop are fully aligned with funds' requirements.
14. Currently, funds make a decision to invest in an asset class and then work with the pool and other member funds in partnership to agree on what the pool's solution in that asset class should look like. While compromise is required, member funds have the ability to influence the design of that fund to fit in with their requirements. If all investment decision-making is delegated to the pools, funds may lose the ability to influence the design of pool solutions and end up invested in funds that do not meet their high-level strategic needs.

Summary of Response

15. The Fund continues to be supportive of pooling and understands the Government's overarching objective to accelerate and expand LGPS pooling. However, the Fund is opposed the deadline of 31 March 2025 for the transition of all listed investments.
16. The Fund is also not supportive of the level of delegation to pools proposed in the consultation, particularly in respect of strategy implementation and investment decision-making.

Levelling Up

17. In its Levelling Up White Paper the government set out its ambition for LGPS funds to invest in projects that aim to tackle the uneven distribution of opportunity in the UK.
18. The consultation provides further clarity on the definition of a "levelling up" investment, identifying 12 medium-term levelling up missions: living standards, research and development, transport, digital connectivity, education, skills, health, well-being, pride in place, housing, crime and local leadership.
19. Regarding local investments, it is proposed that pool companies assist decision-making over investments made locally, in order to avoid any actual or perceived conflicts of interest between fund and administering authority.

Consultation Proposal

20. The proposal in respect of Levelling Up is to amend regulations to require funds to set a plan to invest up to 5% of assets in levelling up the UK, including a timeline to implementation, and to report annually on progress against the plan.

Issues to be Considered in the Fund's Response

21. The consultation confirmed that the “up to” 5% target includes current investments already made by funds, and that it will include all asset classes and all areas of the UK. The 12 missions that investments must address in order to count as Levelling Up investments also bring a level of detail, as does the confirmation that investments must still meet pension committees' fiduciary duties.
22. Following a recent exercise undertaken to review the Fund's exposure in UK investments, the Fund already holds a significant level of investments that appear to meet this criteria and therefore meet the overall 5% requirement. However, further clarity in the definition of Levelling Up investment is still required to determine whether the Fund's current UK investments would count as Levelling Up investments under the consultation definition.
23. If the Government is seeking direct investment in named UK projects with social impact targets, and if that definition were to be adopted, then very significant changes to the Fund's investment strategy and approach would be required.

Summary of Response

24. The Fund is generally supportive of the proposal regarding Levelling Up investment, and believes it already holds a significant level of investments that meet the proposed requirement. Further clarity in the definition of Levelling Up is, however, still required.

Private Equity

25. As part of his Mansion House speech, the Chancellor laid out plans to make UK pensions capital available to support UK companies whilst seeking to boost the retirement incomes of pension savers. The initiative focuses on providing investment in high-growth, innovative technology companies.
26. For the LGPS, the Government's ambition is to see broadly a doubling of the current allocation into private equity – targeting a 10% allocation to these investments. There is no explicit stipulation that these investments must be UK-based, although significant inference to this is ultimately made throughout.

Consultation Proposal

27. The proposal in respect of private equity is to revise Investment Strategy Statement guidance to require funds to consider such investments to meet the Government's ambition of a 10% allocation to private equity in the LGPS.

Issues to be Considered in the Fund's Response

28. The Fund currently has an actual allocation of 7% to private equity vs the target allocation of 5%. The current private equity portfolio is very well diversified with a large proportion invested in the world's largest private equity market (the USA), with approx.

9% of the private equity portfolio invested in companies located in the UK. While the wording throughout the private equity section discusses opportunities to support the UK, the requirement is simply to invest 10% of assets in private equity, with no regional constraints. If the guidance is therefore taken to mean 10% investment in private equity globally then this could be delivered from a practical perspective over time. However, if the 10% target does apply to just the UK then this would significantly reduce the opportunities available to the Fund as an investor and would lead to a lot of money chasing a relatively limited set of investable opportunities in the UK at present.

29. It is possible that an LGPS fund may be able to legitimately claim that an investment in UK-based private equity contributes to both the ambitions for LGPS investment in private equity, as well as the Levelling Up requirements. Further clarity is therefore required from government in respect of this proposal.
30. The consultation also proposes that funds maintain local control of their strategic asset allocations and set them to best meet their own local circumstances. The requirement to invest 10% in a certain asset class appears to be a direct contradiction to this principle, and one that may conflict with the risk appetite of many funds.

Summary

31. The Fund is not supportive of this proposal, believing that strategic asset allocations are a decision for LGPS funds and that central Government should not intervene in such decisions.

Improving the Provision of Investment Consultancy Services to the LGPS

32. The essence of the government's proposal is to clarify that all LGPS funds would be formally required to set objectives in relation to the Competition and Markets Authority's (CMA) Investment Consultancy and Fiduciary Management Market Investigation Order 2019 (the Order) for investment consultants.

Consultation Proposals

33. The key proposals in respect of investment consultancy services are as follows:
 - Where the administering authority uses investment consultancy services in relation to its Investment Strategy Statement or for other matters, it must set strategic objectives for the investment consultancy provider;
 - Administering authorities must not enter investment consultancy services contracts or continue to receive such services from any provider unless the authority has set strategic objectives for that provider;
 - Administering authorities must review strategic objectives at least every 3 years or every time the ISS changes substantially;
 - Strategic objectives must have regard to guidance on setting objectives for providers of investment consultancy services issued by the Pension Regulator in November 2019.

34. The Fund is supportive of this proposal. There are established objectives already in place with its Investment Consultant, Mercer and, as such, this proposal is effectively 'business as usual.'

Updating the LGPS Definition of Investments

35. The government is proposing to make a technical change to the definition of investments within LGPS regulations, adding the word "partnership" to their definition of unquoted securities investments:

"Reg 3(1)(b) a contribution to a limited partnership in an unquoted securities investment **partnership.**"

36. As this is purely a technical change to clarify a definition, the Fund has no issues with this proposal.

Summary

37. The consultation seeks views on a number of proposals relating to the investments of the Local Government Pension Scheme (LGPS). It covers the areas of asset pooling, Levelling Up, opportunities in private equity, investment consultancy services and the definition of investments.
38. It is clear that there are a number of areas within the consultation that lack clarity and require further detail from government, particularly in respect of Levelling Up and private equity investment. The arbitrary deadline of 31 March 2025, proposed by government for the pooling of listed funds, also brings significant challenges for LGPS funds.
39. Whilst the Fund is supportive of pooling in general, there are a number of proposals within the consultation that the Fund does not support including; the proposed pooling deadline, the delegation of investment decision making and strategy implementation to pools and the requirement for a 10% allocation to private equity. The Fund also believes that the Consultation document does not adequately reflect the fundamental principle that all LGPS investments assets are held for the primary purpose of paying pension benefits. All other considerations must be secondary to this central purpose.
40. The deadline for consultation responses is 2 October 2023. Over the coming weeks, Fund officers will therefore be producing the final response for submission. The Fund's investment consultants, Mercer, are currently producing their draft response to the consultation and will share with the Fund once available.

THIS PAGE HAS BEEN INTENTIONALLY LEFT BLANK

