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Local Government Pension Scheme (England and Wales): Next steps on investments

Dear Sir / Madam,

We welcome the opportunity to respond to the consultation and have provided commentary against all the questions within the Appendix on behalf of the West Sussex Pension Fund. A separate response has been provided on behalf of the ACCESS Pool.

The LGPS is in a unique position to deliver excellent value for money, outstanding performance, and access to a range of asset classes. This has been furthered by the establishment of asset pools, which have acted with a high degree of professionalism in delivering additional benefits to Authorities.

The West Sussex Pension Fund's investment structure of large balanced mandates has always supported benefits of scale, even before the expectations about asset pooling were codified. Following the 2015 Investment Reform, the Pension Committee were instrumental in forming the ACCESS pooling arrangement. The selection and monitoring of third-party managers is the responsibility of the operator, with the pool providing direction on the requirements of the investment solutions needed for each fund to implement their investment strategy. Since its establishment the Pensions Committee have taken action to transfer all its listed assets into the ACCESS pool. Whilst pooled solutions are being developed, other investments held by the Pension Fund, but which are outside the formal pooling arrangement, benefit from LGPS or consultant scale discounts.

In considering any further guidance or Regulation, we feel the following points are key:

- **Administering Authorities, rather than pool operators, have statutory responsibility to invest for the purpose of paying pensions to LGPS scheme members:** Matters of governance in the LGPS need to be considered on their own merits and with proper regard to the unique legal status of the LGPS, and the role of the 89 individual Administering Authorities – which is clearly set out in Regulations. Ensuring that a LGPS pension fund has sufficient assets to meet pensions liabilities in the long term is the primary responsibility of those charged with managing the fund i.e., the Administering Authorities. Pool operators however are not accountable to Scheme members, employers, and taxpayers, and it is fundamental for this to be acknowledged.

- **Supporting a single model for pooling cuts across the statutory powers on which pooling has evolved:** In the 2015 Investment Reform Criteria, the Government invited authorities to determine how their pooling arrangements would be constituted and operate, including any legal structure, the work to be carried out internally and services to be hired from outside. We have understood the evidenced approach set out by ACCESS had been approved by Government. The Pensions Committee remain of the view that this flexibility should be maintained. The focus on a single preferred approach could result in a concentration of risk, stifle innovation and inhibit LGPS funds from implementing strategies that meet their individual requirements.

- **Whilst the levelling up agenda is supported, the Supreme Court has determined that LGPS assets are not "public money"[1] and accordingly that the boundaries of Government's statutory powers are clear**: We support the aims and ambitions of the levelling up agenda and note the socio-economic challenges are not restricted to any one region of the UK, although there are a number of targeted interventions which could be invested in within West Sussex to support the twelve medium-term levelling up missions locally (living standards, research and development, transport, digital connectivity, education, skills, health, well-being, pride in place, housing, crime and local leadership). However, investments made by the Pension Fund must always be considered against the Pension Committee's primary role. We would therefore caution against the Government being too prescriptive or setting a requirement that authorities should invest up to 5% of their assets in levelling up opportunities. It is important that the boundaries of Government's statutory powers remain clear - it may only tell authorities how to invest and not what to invest in. Instead, decisions regarding determining investment strategy, asset classes, investment objectives and risk appetite should remain with individual administering authorities. It is then individual administering authorities' responsibility to demonstrate that the decisions have been taken and acted on proper advice, and in the best term interest of scheme beneficiaries. Any centrally determined ambition - with no consideration of local requirements - could result in suboptimal investment strategies and funding outcomes which will ultimately have a detrimental impact on the taxpayer and could be challenged. The same is true for the ambition to allocate 10% to UK private equity.

- The West Sussex Pensions Committee remain committed to maintain its property mandate outside any pooling, reflecting its highly tailored portfolio and value for money considerations.

I would welcome a conversation about the consultation, our response, and the responses of others – and how this is expected to present in Regulations and guidance. However, I hope that the comments made are helpful at this stage.

With best wishes

Taryn Eves

[1] R v Secretary of State (Palestine Solidarity Campaign Limited) [2020] UKSC 16, paragraph 30.

Appendix

Question 1: Do you consider that there are alternative approaches, opportunities or barriers within LGPS Administering Authorities' or investment pools' structures that should be considered to support the delivery of excellent value for money and outstanding net performance?

[Reference: Para 9 to 16 of the Consultation]

Possibly.

Our experience is that the current approach delivers excellent value for money and outstanding performance. There is a risk that adopting a single model of pooling stifles innovation and erodes local control and democratic accountability.

However, asset pooling can provide a further opportunity to deliver savings, but it is within a wider framework. The consultation has proposed to insert an arbitrary definition of "pooled assets" (which are owned by the pool in their capacity as asset manager) as a preferred approach to "assets under pool management" (which are assets where the pool has some management or oversight arrangement without ownership). Considering those "assets under pooled management" as "non-pooled assets" could be a barrier to achieving the fullest benefits of scale, the appropriate local control and accountability and the ability to implement a locally determined investment strategy.

Examples of where the LGPS has successfully delivered excellent value for money outside the definition of "assets under pool management" are set out below:

- The National LGPS Frameworks is open to all LGPS Funds, LGPS Pools and administering authorities and the wider public sector nationally, for the procurement of services from a wide range of qualified providers and is a direct example of funds with shared interests and visions collaborating effectively to deliver benefits both locally and nationally across the entire LGPS. In September 2022 there were £163m+ projected savings for the lifetime of the contracts in place. Following establishment of the ACCESS pooling arrangements, the eleven participating Authorities agreed a collective procurement for a passive manager via a National LGPS framework. This created significant purchasing power and through effective procurement resulted in a discount to market pricing.

- Managers have also provided adviser discounts and discounts to LGPS investors, which means Authorities can secure fee reductions because of the LGPS's place as an investor and its scale, irrespective of region or pool alignment.

In addition to existing opportunities to deliver savings through scale, current arrangements also provide the opportunity for Administering Authorities to build long term relationships with leading industry providers who deliver excellent net performance. However, when there are longer periods of underperformance, Administering Authorities have recourse to deal with and concerns through appointment and transition decisions of third-party managers. If there is a transfer of powers from the statutory asset owners (the administering authorities) to the pool operating companies as implied in the consultation, the ability for those who are given the fiduciary responsibility to scheme members, scheme employers and local council taxpayers (i.e., Administering Authorities) becomes extremely limited and this is a key concern of the Pensions Committee.

Question 2: Do you agree with the proposal to set a deadline in guidance requiring administering authorities to transition listed assets to their LGPS pool by March 2025?
[Reference: Para 17 to 20 of the Consultation]

No.

The requirement to transition listed assets to the ACCESS pool has already been met by the West Sussex Pension Fund. However, this reflects the Fund's own investment strategy. A transition of listed (or any) assets to respective LGPS pools must always be considered against achieving clear benefits for Administering Authorities and local requirements.

If a deadline is introduced through guidance, it is appropriate that this deadline is limited to active listed assets, as the easiest and least costly to transition. Redemptions from the respective LGPS pool following March 2025 should also be acknowledged.

The consultation has specifically differentiated between "pooled assets" and "assets under pooled management". It also highlights other arrangements such as passively managed assets held under insurance contracts. Our response in Q1 highlights why this arbitrary definition of "pooled assets" should be avoided and the need to acknowledge that assets may be held under pool management, or not pooled, for sensible reasons.

Question 3: Should government revise guidance so as to set out fully how funds and pools should interact, and promote a model of pooling which includes the characteristics described?
[Reference: Para 22 to 32 of the Consultation]

No.

We do not believe there is one single, best approach and the focus should be on outcomes. Success should ultimately be demonstrated by long-term performance after costs against a benchmark established by investors. All pools should also be able to demonstrate strong governance, professional management, long-term strategic planning and implementation and firm regulation. Through the model adopted by the ACCESS pool:

- There remains a clear link through the governance structure adopted, between the pool and the local Pensions Committee.

- ACCESS Authorities have effectively outsourced most of the complexity and Regulatory requirements to best in class third parties who have the experience and scale themselves to deliver professional management - whether it is in relation to the Pools operational functions or investment management.

- ACCESS has delivered its strategic plan from the initial submission to government in July 2016 and realised the benefits outlined including establishing a FCA authorised Collective Investment Vehicle and Joint Committee, a significant shift in governance arrangements with the Operator responsible for selecting and contracting with managers and a discount to market on fund manager fees. Pools were in a supranational negotiating position at establishment which has provided opportunities to provide discounts to the market.

Core to any guidance is the responsibility Authorities have for setting the investment strategy of their funds, after taking appropriate advice. This is acknowledged through the consultation.

The Investment Strategy Statement sets out each Administering Authorities policy on asset allocation, risk, and diversity, amongst other things to achieve the best long-term interests of scheme beneficiaries and taxpayers. Administering authorities are expected to be able to demonstrate that those responsible for making investment decisions have taken and acted on proper advice and that diversification decisions have been taken in the best long term interest of scheme beneficiaries.

Investment decisions are currently made within a prudential framework with less central prescription.

However:

- Implementation of the investment strategy at pool level is broad and undefined within the consultation and any separation between the high-level allocation decisions and implementation is not as clear-cut as the consultation suggests. It is necessary to ensure that any guidance fully recognises the role within Regulation of the democratically accountable Administering Authorities who owe a fiduciary duty to scheme members, scheme employers and local council taxpayers.

- If pools were to have sole responsibility for designing and implementing solutions, it would be harder for member funds to secure the solutions they require to meet their high-level strategic needs and which critically depend on the objectives, risk appetite, investment beliefs and policies of Pension Committees.

- It is a concern that the government proposes that Pools should be actively advising funds regarding investment decisions, including investments strategies. It is not clear how this would supplement or contrast to the appropriate advice that Authorities should gain themselves when making investment decisions and there is a risk around conflict of interest. It is a responsibility of local authority pension funds to take proper advice (under existing Regulation), and it is appropriate that this is from an independent source, rather than an asset pool.

- We are also concerned about accountability with any move towards asset pools building teams, and the infrastructure around them, and the ability of these relatively new participants to the market to compete in mainstream asset classes and more efficient markets. Underperformance could easily outweigh the benefits of lower fees and, where asset management is provided by an in-house management, it may be more difficult for investing funds to adequately hold their investment managers to account.

- Further consolidation to achieve scale will be costly and disruptive, so any guidance on an optimal scale must be evidence based and reflecting different asset class. There could also be diseconomies of scale. It is understood that portfolio size and relationships drive fees, rather than the aggregated size of an investor. The number of stakeholders within a pool also presents the risk to its effectiveness, rather than an efficiency.

Question 4: Should guidance include a requirement for administering authorities to have a training policy for pensions committee members and to report against the policy.
[Reference: Para 32 of the Consultation]

Yes.

Many funds including West Sussex, already have policies and extensive training programmes in place, focused on ensuring appropriate training for those on the Pensions Committee and officers. These reflect recommendations within the *Good Governance: Phase 3 Report* to the Scheme Advisory Board from February 2021.

Question 5A: Do you agree with the proposals regarding reporting?
[Reference: Para 38 to 43 of the Consultation]

Yes, in principle.

If the Scheme Advisory Board is to collate information on an annual basis, then it makes sense that asset categories are broadly defined to support consistency.

It is already expected through guidance that information is provided on pooled assets. Net savings could be provided but we feel there would be a greater benefit if there was an evolution in thinking about pooled asset costs, with comparisons being against the current market rather than the historic costs paid. In this context all pools are doing very well.

However,

- Additional reporting will need to be balanced against the workload it will place on officers, as greater detail in reporting is likely to take greater resource to complete.

- It will be important to consider with some caution, the role of the Local Pension Advisory Board and the national Scheme Advisory Board to consider qualitative information relating to performance, fees, and progress of asset transfer against implementation plans.

- It is also not appropriate to compare fund to fund or pool to pool, because of the variations in structure, asset classes under management and remit.

Question 5B: Should there be an additional requirement for funds to report net returns for each asset class against a consistent benchmark, and if so how should this requirement operate?

[Reference: Para 42 of the Consultation]

No.

It is not felt appropriate that a consistent benchmark can be provided across funds given differing objectives. Defining an appropriate benchmark is for investors, fund managers, consultants, pool operators and ultimately the FCA to determine on a case-to-case basis. We therefore do not feel that any regime to compare easily between pooled and non-pooled assets will work in practice.

Question 6: Do you agree with the proposals for the Scheme Annual Report?

[Reference: Para 44 to 45 of the Consultation]

Yes, in part.

It is important that the LGPS is transparent.

In addition to comments made in response to Q5A, clarity is sought on the objective of the report and its audience to inform how this should be developed.

Members or employers are most likely to be interested in their local fund approach and outcomes.

Question 7: Do you agree with the proposed definition of levelling up investments.

[Reference: Para 57 to 60 of the Consultation]

The clarity offered by the consultation is welcomed.

However, we do have concerns about how this definition of a levelling up investment aligns with investment strategy considerations, necessitates that that Fund should have a levelling up investment plan and how investing in levelling up may conflict (or be perceived to conflict) with the Pensions Committee's fiduciary duty to scheme members, scheme employers and local council taxpayers.

Although individual investment classes will have varying degrees of suitability in the context of an authority's funding and investment strategies, the overall aim of the fund must be to consider suitability of an investment against the need to meet pension obligations as they fall due. Assessing the suitability of different investment classes involves several factors including, for example, performance benchmarks, appetite for risk, policy on non-financial factors and perhaps most importantly, funding strategy. What constitutes suitability should clearly remain a matter for individual administering authorities to consider and decide in the light of their own funding and investment strategies.

Investment decisions can only be a matter for local consideration and determination, subject to the aim and purpose of a pension fund to maximise the returns from investment returns within reasonable risk parameters.

Therefore, administering authorities must take and act on proper advice in assessing the suitability of their investment portfolio and give full details of that assessment in their Investment Strategy Statement.

No evidenced rationale is included within the consultation document for the 5% allocation, and we would welcome this clarity from government.

Notwithstanding the above and whilst there is no formal screen or reporting to identify exposure to the levelling up missions the fund managers appointed by the Pool Operator and Administering Authority do invest in companies and sectors which align, including for example Social Housing.

Question 8: Do you agree that funds should be able to invest through their own pool in another pool's investment vehicle?
[Reference: Para 67 to 74 of the Consultation]

Yes, provided that the question relates to some investments (such as levelling up investments), rather than all asset classes.

Where opportunities exist and investment solutions align with objectives, asset pools may be better placed to build the necessary investment expertise to deliver investment opportunities and offer a layer of separation between the funds and the investments, helping to reduce any issues of conflicts of interest that can occur when investments are local to funds. This could also be achieved through established and experienced third-party investment managers.

It will be necessary for the Scheme Advisory Board to advise further on how these conflicts can be managed.

Question 9: Do you agree with the proposed requirements for the levelling-up plan to be published by funds?
[Reference: Para 75 to 77 of the Consultation]

No.

It is important that the LGPS is transparent. In addition to comments made in response to Q5A, any published plan could only be on a comply or explain basis given that the government has acknowledged that it will be for funds to decide on the appropriate level of investment and types of investment.

Question 10: Do you agree with the proposed reporting requirements on levelling up investments?

[Reference: Para 78 to 79 of the Consultation]

No

As noted in Q5A and Q9, the need to report on the assets under management invested in levelling up projects to provide accountability contradicts the idea that funds should decide on the appropriate level of levelling up investment considering the fund's investment and fund strategy and reviewed every three years.

Question 11: Do you agree that funds should have an ambition to invest 10% of their funds into private equity as part of a diversified but ambitious investment portfolio? Are there barriers to investment in growth equity and venture capital for the LGPS which could be removed?
[Reference: Para 84 to 87 of the Consultation]

No.

It is acknowledged that it is the ambition of Government for LGPS funds to invest 10% in global private equity as part of a diversified portfolio and to help drive business investment throughout the country. However, it is important, and referenced in the consultation, that each Fund will be different and will need to make its own investment decision based on potential risk and reward appetite – and investment / funding requirements.

In this context, it seems a direct contradiction for the consultation to indicate an ambition of 10% investment in private equity when Pension Committees should retain full flexibility to set their investment strategy according to their own specific circumstances, considering factors such as funding level, risk appetite and net cashflow position. No evidenced rationale is included within the consultation document for the 10% allocation. Private markets carry a higher risk profile – and dispersion of performance across managers can be significant. This is especially the case in concentrated growth equity and venture capital portfolios, and it is of importance that within a portfolio there is a diversification across private equity stages, including buyouts, and across geographies. We would welcome this clarity from government on their stated ambition.

We would highlight comments made in Question 7 relating to suitability of investments.

In terms of barriers, from an investment and risk management perspective, limiting the universe to UK will add risk and volatility to outcomes and there will be challenges with this market absorbing large amounts of funding, especially in venture where the ecosystem may not have the requisite depth outside of core venture/tech hubs. Investment in innovative UK companies operating in fintech, life sciences, biotech, and green technology sectors is not limited to investment in private equity. Private debt, for example, would also meet the ambitions set out by Government. By directing Funds to invest 10% in Private Equity, the Government is potentially creating a barrier to Funds investing in other asset classes that support the Government ambitions. An increased focus will require significant capacity and resource to ensure it is managed effectively and efficiently and that portfolios are suitably balanced and risk managed. There may be a challenge here given that pools are at varying stages of maturity in relation to their private market's offerings.

Question 12: Do you agree that LGPS should be supported to collaborate with the British Business Bank and to capitalise the Bank's expertise?
[Reference: Para 88 to 90 of the Consultation]

Yes.

LGPS funds should be supported to collaborate with the British Business Bank. However, this should not be an exclusive relationship.

Question 13: Do you agree with the proposed implementation of the [Competition and Markets Authority] Order through amendments to the 2016 Regulations and guidance?

[Reference: Para 98 to 103 of the Consultation]

Yes.

The West Sussex Pension fund already adheres to the practice in place with private sector Schemes.

Question 14: Do you agree with the proposed amendment to the definition of investments?

[Reference: Para 104 to 108 of the Consultation]

Yes.

We agree with and welcome the proposed amendment to the definition of investments to align the regulations and ensure consistency.

Question 15: Do you consider that there are any particular groups with protected characteristics who would either benefit or be disadvantaged by any of the proposals? If so please provide relevant data or evidence.

[Reference: Para 109 to 110 of the Consultation]

No.

We do not consider there to be any groups who would either benefit or be disadvantaged by these proposals.