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

Draft Consultation response from Staffordshire Pension Fund

The Pensions Committee of the Staffordshire Pension Fund welcome the opportunity to provide their response to the Government's consultation on the Next Steps for Investments in the LGPS.

We are fully supportive of the principle of pooling investment management, but our priority remains to exercise our fiduciary duty in safeguarding the assets of the Staffordshire Pension Fund, which are ultimately owned for the benefit of our 120,000+ scheme members and to ensure we pay them the benefits due to them, as they become due for payment.

There are several terms used in the consultation which would benefit from clearer definitions and a greater understanding by Government of what they mean to LGPS Funds in practice. E.g., pooled assets, assets under pooled management and the implementation of investment strategy.

Asset Pooling in the LGPS

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?**

- *An alternative approach to pooling is not necessary given that the regulated entity structure across the LGPS Central pool works well. However, there is a need to address the inconsistencies in the different pooling structures, to enable fairer comparison.*

- *The cost of making changes to the current number of pools may be prohibitive given the potential for significant transition costs in the unwinding of investments and asset transfers.*

- *Strategic Asset Allocation has evolved in response to LGPS Funds' changing needs and the current economic environment. Pooling has resulted in compromise and has led to a narrowing of investment choice in some instances. To accommodate these changes, a flexible approach should be considered by government and LGPS Funds should still be permitted to invest outside of their pools, where this can be justified on a cost and value for money basis.*

- *It is important that the right products are available for an LGPS Fund to invest in both now and in the future. LGPS Central and its Partner Funds have been very conscious of ensuring this is the case. Investments and assets under management (AUM) will naturally flow into the management of pool companies where suitable products are available. The development of a* *comprehensive range of suitable products in which Partner Funds can have the confidence to invest will take time.*

- *Bigger isn't always better and the pooling report cited was not conclusive on this. Indeed, increasing the scale of assets under management at pool companies may limit the potential to invest in the very asset classes government is trying to encourage i.e., UK venture private equity, where not all funds are big enough to accept the large levels of commitment that pools would need to make to deploy capital effectively and efficiently.*

- *The focus should continue to be on net performance and value for money, not simply cost savings. The level and cost of resources required at pooling companies is greater than initially envisaged in 2016 and this has increased the costs to LGPS Funds significantly whilst at the same time reducing the amount of potential savings available.*

- *One barrier to increasing the effectiveness of pooling is the level of resources required within LGPS Funds themselves to support the governance requirements and manage the risks around the pool companies, both as shareholders and as clients. The proliferation of reporting requirements being advocated. e.g., TCFD, TNFD, DLUCH reporting have also added to the level of resources required at LGPS Funds.*

- *Whilst the ability to invest across pools may appear to prove beneficial, we are concerned that increasingly complex governance structures will further diminish local accountability to LGPS scheme members and more importantly local taxpayers (see answer to question 8).*

<u>Question 2.</u> 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?

- *No. This is an arbitrary deadline linked to the Actuarial Valuation cycle and which we believe will lead to sub-optimal outcomes across the LGPS. Whilst we note the government's ambition to move assets into pools more quickly this is better happening when the right products are available for LGPS Funds to invest in.*

- *LGPS Funds will naturally review their Strategic Asset Allocations in line with the output from Actuarial Valuations and these will also consider the suitability of the products offered by the pool in which they are able to invest. Any enforcement across products or timing may mean that LGPS Funds are forced to invest in underperforming or unsuitable products at an inappropriate time.*

- *The introduction of any deadline will lead to multiple and unnecessary transitions of assets, at significant expense and potential loss of performance. Resources, both at pooling companies and at LGPS Funds, may not be available to support transitions, which take time to plan. This will also lead to increases in cost due to the short time frame and scarcity of resources within* *the transition management industry. Too much transition activity in a short space of time may also impact equity markets. LGPS Funds may have to consider the need to disinvest/invest via cash to meet any unrealistic and imposed deadline, which is clearly a most inefficient and risky way of investing scheme members assets.*

- *A more sensible, medium-term approach should be taken for the movement of liquid assets into pool company products. Government should accept that the best and most cost-effective solution may be for LGPS Funds to hold assets outside of the pool company, until such time that there are suitable pooled products in which they are able to invest. We acknowledge that LGPS Funds would need to justify this on a cost and value for money basis in the ISS.*

- *Given recent funding levels, many LGPS Funds are reducing their exposure to listed assets in favour of Private Market investments where commitments and drawdowns can be spread over investment periods of several years. This comment should be viewed in conjunction with previous comments about asset transition and the availability of suitable products.*

<u>Question 3.</u> 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 above?

- *No. We believe a flexible approach is required. The current arrangements in place across LGPS Central work well for Partner Funds. Collaborative discussion is already happening across the LGPS Central pool to agree how we can move forward together in partnership. The pooling company will continue to assist Partner Funds to implement their investment strategies by providing suitable products for them to invest in, selecting funds for pooled vehicles and appointing and monitoring investment managers.*

- *There continues to be a focus by Government on cost savings, as opposed to 'net' performance. There is evidence that supports the fact lower fees are not always achievable when the overhead cost of the pooling company is considered. The move to invest in Private Market asset classes will generally increase fees and may also limit the amount of future savings that can be achieved due to the aggregated 'LGPS' fees that are offered across the industry.*

- *We agree that collaboration but not competition between pool companies will deliver a better outcome for the LGPS.*

- *Pool companies should **<u>not</u>** be actively advising LGPS Funds regarding investment decisions, including investment strategies. This not only represents a conflict of interest but fails to recognise the fact that the fiduciary duty for managing the assets and paying LGPS benefits is the responsibility of the individual LGPS Fund. Accountability to the scheme member and the local taxpayer remains with LGPS Funds. Therefore, independent investment advice is more consistent with this responsibility.*

<u>Question 4.</u> Should guidance include a requirement for administering authorities to have a training policy for pensions committee members and to report against the policy?

- *The Chartered Institute of Public Finance and Accountancy (CIPFA) publish a Key Knowledge and Skills Framework for Pensions Trustees, which we and many other LGPS Funds have already adopted. Recommendations about training were also made in the Good Governance Project carried out on behalf of the Scheme Advisory Board.* LGPS Scheme Advisory Board - Good Governance (lgpsboard.org)

- *It would be beneficial for Government to endorse the Good Governance Project recommendations thus ensuring there is no duplication of existing training guidance and that there is consistency between all interested parties across the LGPS.*

<u>Question 5.</u> Do you agree with the proposals regarding reporting? 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?

- *We agree in principle with the Government's ambition to have consistency of data reported across the LGPS to enhance clarity and transparency.*

- *Whilst we agree that reporting net returns for each asset class against a consistent benchmark would be helpful, we also recognise that this will be a challenge and subject to numerous complications (i.e., benchmarks to be set at an asset class level or by implementation method (active/passive management), benchmarks net or gross of fees etc).*

- *Clear guidance and reporting templates to ensure consistency and avoid duplication of other reporting should be provided, save increasing the demands on LGPS Fund resources further.*

- *We recognise that this will be a complex exercise that will take careful thought, time, and resource to develop. We would suggest that a working group is established to explore these reporting requirements further.*

<u>Question 6.</u> Do you agree with the proposals for the Scheme Annual Report?

- *We agree in principle to a single set of consistent data being published by the SAB on behalf of the LGPS, subject to previous comments on complexity and not further burdening already stretched resources.*

LGPS investments and levelling up

<u>Question 7.</u> Do you agree with the proposed definition of levelling up investments?

- *The definition of levelling up is subjective and suitably broad to provide sufficient scope to classify a large range of UK investments as contributing to the Government's levelling up agenda. However, any levelling up investments must still meet the required risk / return profile of an LGPS Fund and not compromise their fiduciary duty.*

- *Whilst we acknowledge the Government's ambition for LGPS Funds to invest up to 5% of their assets in projects which support local areas, we caveat such with the following comments:*
    - *The primary focus of any LGPS Fund is to pay pensions;*
    - *The 5% is not an additional 5% to investments already made that meet the definition;*
    - *Any investment should stand independently on its own merit and work within an LGPS Fund's Strategic Asset Allocation;*
    - *Any investment should take into account an individual LGPS Fund's appetite for risk - small local investments are likely to be more risky;*
    - *These types of investments can be more costly to set up and monitor;*
    - *There is likely to be a limited number of, and investment capacity in, these investments and this has the potential to increase competition to invest, drive up costs and reduce returns;*
    - *There will need to be an assessment of the investment return from these investments versus the risk being taken;*
    - *Larger pools may not be able to invest in smaller local UK investment vehicles;*
    - *There may be local conflicts of interest;*
    - *These are potentially illiquid assets to invest in at a time when many LGPS Funds are looking for sources of positive cashflow; and*
    - *In view of the above 5% should not be a prescriptive or hard target.*

<u>Question 8.</u> Do you agree that funds should be able to invest through their own pool in another pool's investment vehicle?

- *We agree in principle to investment by asset pools into other asset pools vehicles for very specific projects e.g., GLIL or 'national' projects in relation to levelling up. Guidance should be provided by government, so any assets invested this way are not 'double counted' in statistical returns.*

- *We are concerned that:*
    - *Local to one pool is not local to another which may provide rise to a conflict of interest;*
    - *Governance structures may get overcomplicated making fiduciary duty more difficult; and*
    - *There may be Shareholder versus Client concerns about risk exposures and capacity.*

<u>Question 9.</u> Do you agree with the proposed requirements for the levelling up plan to be published by funds?

- *Subject to the views we have expressed in our responses to the previous questions then we have no issue with the principle of the proposal that LGPS Funds publish a levelling up plan. However, we are concerned that there will be no visible pipeline to inform the plan. Can the Government assist by outlining potential projects that they become aware of?*

<u>Question 10.</u> Do you agree with the proposed reporting requirements on levelling up investments?

- *Subject to the views we have expressed in our responses to the previous questions, we have no issues in principle with the proposed reporting requirements on levelling up. However, we are concerned that any reporting requirements do not become too onerous with LGPS Funds having to look through their investment portfolios to compare UK investments to the 12 levelling up missions.*

- *There may be a limit to the depth of analysis possible, given available resources at LGPS Funds and the fact that the number of individual assets that require reporting on may run into the hundreds.*

Investment opportunities in Private Equity

<u>Question 11.</u> 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?

- *No, we do not agree.*

- *Private equity is a high-risk asset class, and we believe it should be for each individual LGPS Fund to decide if an allocation to private equity within their Strategic Asset Allocation and their risk appetite is appropriate. An LGPS Fund is ultimately accountable for their own funding and investment strategies and understanding the profile of their own liabilities.*

- *Private equity is an expensive, illiquid asset class. Many LGPS Funds are maturing and are now cashflow negative; private equity may not suit their liquidity needs.*

- *Asset pooling companies will likely lack the skills, networks, and connections to invest in venture private equity. Large in-house teams within the pooling companies would need to be established at significant cost, which would quickly erode any cost saving benefits. If this requirement was to remain then access would have to be via external managers, negating one of the Government's further pooling objectives.*

- *Barriers may be direct or indirect and include, risk profile and risk appetite, cost, liquidity, availability and suitability.*

- *It would be helpful if the Government could be clear as to whether they mean Private Markets more widely for the 10% allocation, private equity globally, UK private equity or specifically UK Venture private equity. If it is the latter, the UK venture market is very small and too much capital chasing too few opportunities could lead to dangerous price bubbles.*

- *Any increased allocation to Private Market asset classes generally will be more expensive and have limited impact on future cost savings.*

Question 12. Do you agree that LGPS should be supported to collaborate with the British Business Bank and to capitalise on the Bank's expertise?

- *We have no objection to exploring collaboration between the British Business Bank and the LGPS. However, we believe there should be no pre-requisite to invest, as there is still a need for alignment with an individual LGPS Fund's Strategic Asset Allocation, Investment Strategy, and risk appetite.*

- *We are unable to comment about secondary legislation but would re-emphasise the point that there should be no pre-requisite to invest.*

Improving the provision of investment consultancy services to the LGPS

Question 13. Do you agree with the proposed implementation of the Order through amendments to the 2016 Regulations and guidance?

- *We have no objection to this proposal given we already set and monitor strategic objectives for our main investment consultant. We review and report on these annually which aligns to best practice.*

- *We would appreciate some clarity from the Government on whether their intention is that this order be extended to investment advisers that are not FCA registered or to investment advisers who may act independently. Further guidance on the scope of the services that independent investment advisors can and cannot advise on. E.g., Strategic Asset Allocation versus specific product advice would also be appreciated.*

Updating the LGPS definition of investments

Question 14. Do you have any comments on the proposed amendment to the definition of investments?

- *We have no comments on this proposed amendment.*

<u>Question 15.</u> 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.

- *We are not aware that there are any particular groups with protected characteristics who would either benefit or be disadvantaged by any of the proposals in this consultation.*

29 September 2023
T&PF/MS/TB