Report to Buckinghamshire Pension Fund Committee

Date:	27th September 2023
Reference number:	N/A
Title:	**DLUHC LGPS Pooling Consultation**
Cabinet Member(s):	N/A
Contact officer:	Mark Preston, Assistant Director of Finance (Pensions, Procurement and Revenues & Benefits)
Ward(s) affected:	None specific
Recommendations:	**The Committee are asked to CONSIDER the draft response to DLUHCs LGPS Pooling Consultation and AGREE the final response.**

1. Executive Summary

1.1 The Chancellor of the Exchequer Jeremy Hunt delivered his Mansion House speech on 10th July2023, in which he set out a number of planned changes to the UK pensions industry aimed at boosting investment into the UK economy, including a number of far reaching reforms for the Local Government Pension Scheme (LGPS).

1.2 There were three main headlines in the Chancellor's speech for the LGPS:

- *A consultation on a 10% allocation to Private Equity for the LGPS*
- *A consultation on the consolidation of LGPS Assets into the Pools by March 2025*
- *A direction to set an LGPS minimum asset pool size of £50bn*

1.3 On the Tuesday following the Mansion House speech, the government launched a more detailed consultation on the LGPS proposals. The consultation runs from 11th July 2023 to 2nd October 2023.

2. Main content of report

2.1 This report looks at each of the main proposals and the key elements of the consultation document in turn.

10% Allocation to Private Equity for the LGPS

2.2 When this was first announced in the Chancellor's speech, there was a wide belief that what he meant was that there should be a 10% allocation by LGPS Pension Funds to Private Markets. Private Markets includes Private Equity, Private Debt and Infrastructure investments and the Buckinghamshire Pension Fund already has 13.3% invested in Private Markets, including 4.5% in Private Equity. The new strategy has a longer-term ambition to increase Private Market investments to 16%, but reducing Private Equity exposure slightly to 4%.

2.3 It is clear from the consultation document that the government ambition is to increase Private Equity exposure alone to 10% for each LGPS fund. This isn't something that the Buckinghamshire Pension Fund will be able to do without increasing the overall risk profile of their investment strategy given that Private Equity is a higher risk investment category.

2.4 The consultation document makes reference to the fact that Private Equity has been one of the better performing asset classes for LGPS Funds, but as the old saying goes "past performance should not be taken as an indicator of future performance". The reason why the Pension Fund Committee has reduced sightly its allocation to Private Equity going forward is that as an asset class, it is less appealing than other asset classes.

2.5 Private Equity investment in particular is a very illiquid investment as it involves making capital commitments over an extended period of time that can be drawn down as and when investment opportunities arise. Draw down can take several years and even after investment, it can take a number of years before any returns are seen.

2.6 The government ambition in effect would double the current Private Equity investment allocation. That means having double the demand for good-quality Private Equity opportunities in the marketplace, which is going to be difficult to achieve.

2.7 <u>Conclusion</u> - The Buckinghamshire Pension Fund can be supportive of the ambition to invest at least 10% in Private Markets as part of the diversification of LGPS funds, as it is already doing so, but it would be difficult to support an ambition of 10% in Private Equity alone without compromising on its risk exposure and fiduciary responsibilities.

Consolidation of LGPS Assets into Pools by March 2025

2.8 The government consultation document claims that on average there has only been 40% of LGPS assets transferred into the LGPS Pools. The fundamental basis for pooling was the saving in investment management fees and the ability to develop expertise in the pools that would be difficult to achieve in individual funds.

2.9 The Buckinghamshire Pension Fund has 96% of assets transferred into Brunel pooled funds. From a practical perspective, this is 100% of what we are able to transfer as the remaining assets are the legacy Private Equity investments that the Buckinghamshire Pension Fund made prior to pooling arrangements and will take some years to mature and to receive the return of cash. The Buckinghamshire Pension Fund has met the pooling fees savings target and those cumulative savings are now in excess of the original costs of transition.

2.10 Brunel currently has approximately 85% of the Pension Fund partners assets transferred in total, so is well positioned for having all assets that can be transferred, being transferred by 31 March 2025.

2.11 <u>Conclusion</u> – The mandating of the transfer of LGPS Assets into the Pools (excepting the gradual exiting from any illiquid assets without penalties being incurred) is a good thing for the LGPS as a whole, but the Buckinghamshire Pension Fund has already achieved this.

Setting a Minimum LGPS Asset Pool Size of £50bn

2.12 The Brunel Partnership has demonstrated that pooling can deliver economies of scale in terms of investment fee saving and the development of internal expertise that wouldn't be possible without pooling (Brunel has its own private markets team and is recognised for its responsible investment approach). Brunel currently has c£35bn of assets under management. If 100% of assets were transferred into Brunel, this would still only be c£40bn. However, with growth, a scale of £50bn could easily be achieved in a few years' time, without incurring additional costs.

2.13 The size of the pools is less of a priority than ensuring that all assets are transferred into the LGPS pools, and this should be the primary focus to ensure that economies of scale are delivered throughout the LGPS.

2.14 The impact of increasing the minimum size of pools is that there would be fewer pools. There is a varied approach to pooling throughout the LGPS, which is recognised by the government. Without a government mandatory push, this is going to be difficult to achieve as there is a good chance that every pool will believe that their pool is the right model and will be looking to absorb other pools.

2.15 There is also the question of who is going to pick up the additional transitional costs, which will be on top of the transitional costs that have already been incurred by

LGPS Funds. These costs could still be significant with the possible redundancy of some LGPS Pool staff, investment transition costs of moving from one pool to another etc, but it is also highly likely that there will only be a very marginal cost saving on top of what has already been achieved.

2.16 The consultation talks about Pools working together and allowing funds to invest in other pool mandates via their own pool. This sounds like it could be the right approach to driving up scale rather than the consolidation and reduction of the number of pools. However, the size of Pools could be more volatile with inter-pool movements. What is most important about scale, is scale with reference to specific investment mandates, and in particular within Private Markets. There is very little to be gained in scale from Equities and other asset classes, but the expansion of Private Market Pooled vehicles through greater cross-pool collaboration could achieve the objectives the government are looking for.

2.17 <u>Conclusion</u> – This is something that should be reconsidered after March 2025, once effectively all LGPS Assets have been transferred into Pools. This will increase the scale of individual pools and together with asset growth, there will be a much better picture for the government to assess. Rather than full consolidation, cross-pool collaboration in the delivery of Private Market investment pools could be an opportunity for some limited additional efficiencies and greater scale of investment.

3. Other Aspects of the LGPS Consultation

3.1 On Tuesday 11th July, the day after the Mansion House speech a consultation was launched on LGPS proposals and these are summarised below.

Q1: Alternative Approaches, Opportunities or Barriers to Support the Delivery of Excellent VfM and Outstanding Net Performance

3.2 The transfer of remaining assets into Pools has to be the first target the government should be focussed on. The size of individual pools is of less importance and will be difficult to implement unless the government is prepared to meet the costs incurred of additional consolidation. There is very little additional opportunity to gain efficiency through scale, apart from maximising existing internal pool expertise in areas such as Private Markets. There is much more opportunity to achieve the benefits the government is looking for through the cross-collaboration of Pools to allow funds to invest in private market pools established in other LGPS pools.

3.3 The governance arrangements for the Brunel Pool are hampered by the additional and different governance arrangements that the Environment Agency are subjected to, which is very different to Local Authority Pension Funds. These could be reviewed to provide additional freedoms to the Environment Agency Pension Fund to recognise that it is operating in a predominantly Local Government arena.

Q2: Do you agree with the proposal to set a deadline to transition listed assets to their LGPS Pool by March 2025?

3.4 Yes. Buckinghamshire Pension Fund has already transferred all listed assets to our LGPS pool, Brunel Pension Partnership.

Q3: Should government revise guidance so as to set out fully how funds and pools should interact, and promote a model of pooling that it describes in the consultation?

3.5 Pools should operate as a single entity acting on behalf of the partner funds. Opportunities could exist for inter-pool collaboration for mutual benefit. The government states that it does not see inter-pool competition as a desired progression, however this is exactly the direction of travel if it wants to reduce the number of LGPS Pools.

3.6 We do not believe that pools should actively be advising funds on investment strategies and investment decisions. Best practice is for there to be a separation of duties. Each LGPS Fund has slightly different characteristics and maturity and investment advice is best provided independently to the LGPS Funds to ensure that any such decisions are in the best interests of the members and employers of that particular LGPS Fund. There is a risk that investment strategies by the Pools themselves could be biased towards what they are able to offer rather than what individual funds need. The optimum arrangement is for the Funds and the Pool to work closely together, so that the Pools can offer the investment products that enable Funds to deliver their investment strategies.

3.7 We agree that Pools should be equipped to implement an investment strategy as instructed by a partner fund, which is a broad instruction regarding asset classes and level of risk, but not an excessive number of asset classes or include specific assets.

3.8 Pools should expect to invest via their existing sub-funds where they already exist or develop a sub-fund in consultation with all the partner funds where there is a new strategy need.

Should guidance include a requirement for administering authorities to have a training policy for pensions committee members and report against that policy?

3.9 This is more for Pension Fund Committees rather than administering authorities per se, and this should be a requirement that is reported on in the Pension Fund Annual Report.

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?

3.10 We do not agree with all the proposals regarding reporting. We do agree that there needs to be transparency in reporting, however the level of reporting being advocated seems to meet an unnecessary level of detail and additional cost just to meet government curiosity rather than for any tangible benefit for any LGPS member, employer or local council tax-payer. Reporting on the progress to transition into LGPS Pools should be mandatory if the government is going to mandate transition by 31 March 2025. Levelling-up is not a tangible investment category and the definition is too nebulous and should be avoided. It has no place in Pension Fund reporting. There is a variable appetite to risk, even within certain investment classes so it is of limited benefit to try and shoehorn performance into a standardised set of benchmarking just to make it artificially easier to consolidate and make reporting comparisons.

3.11 There is limited benefit to keep reporting on savings made through pooling. Once mandating has taken place, there will be a driver to pool. Existing pooling has demonstrated the financial benefit of pooling, however the further the start of pooling is consigned to history the less accurate and beneficial the monitoring of this measure becomes. Strategies have changed significantly since pooling started over 4 years ago and it is nigh on impossible to accurately measure the level of savings achieved compared to what would have happened without pooling.

3.12 Ownership of Assets – owned by Pool, Managed by the Pool, outside the pool.

Q6: Do you agree with the proposals for the Scheme Annual Report?

3.13 We agree with the proposals for the Scheme Annual Report as defined by paragraph 45.

Q7: Do you agree with the proposed definition of levelling up investments?

3.14 The definition of what constitutes levelling up investments is something that the government needs to determine, however it doesn't have any place in the responsibilities of the LGPS Pension Funds. It is not a recognised asset class and therefore should not be the consideration of LGPS Pension Fund Committees. The sole consideration for the pension fund committees is their fiduciary responsibility to ensure that there is sufficient returns on LGPS assets to meet the future liabilities of its members on behalf of the members and employers of the scheme. It is not the responsibility of pension funds to deliver government policy.

3.15 The sole consideration for investment is the due diligence that is carried out by the LGPS Pools on any potential investments and whether the risk/return profile is sufficient to meet the needs of LGPS Pension Funds.

Q8: Do you agree that funds should be able to invest through their own pool in another pool's investment vehicle?

3.16 Yes. If a Fund's existing pool does not have an investment product that meets its investment strategy needs, then before the pool develops such a investment product, there should be an emphasis on identifying whether such a product exists in another pool. This would ensure that cost efficiencies are maintained, and with it being via the existing pool, it allows the pool to still be able to report on the performance of the entirety of a Pension Fund's investment assets.

Q9: Do you agree with the proposed requirements for the levelling up plan to be published by funds?

3.17 No. Levelling-up is not an asset class and as such has no place in the investment strategy of an LGPS Pension Fund. It is not the role of an LGPS Pension Fund to deliver a political policy in this way.

3.18 Reporting on the delivery of a government policy is not the responsibility of LGPS Pension Funds. This is introducing additional bureaucracy into the pensions administration process that has nothing to do with investment strategy and performance.

3.19 There is a risk that there is undue local pressure on LGPS Pension Fund Committees to support sub-optimal investment opportunities because it forms part of a local growth and development strategy rather than it being a strong investment opportunity.

3.20 Due to the move to pooling, there is no longer sufficient capacity or skills locally to undertake such due diligence, after all this is one of the key benefits of developing these technical skills within the pools themselves.

3.21 There should at most be guidance for local authorities who identify potential local investment opportunities to approach their relevant pool and submit them for independent due diligence to ensure that appropriate opportunities for investment are considered as part of an investment mandate. This is predisposing that the opportunities are of sufficient scale to warrant consideration by the Pools.

Q10: Do you agree with the proposed reporting requirements on levelling up investments?

3.22 No. See above.

Q11: Do you agree that funds should have an ambition to invest 10% of their funds into Private Equity as part of their diversified but ambitious investment portfolio? Are there barriers to investment in growth equity and venture capital for the LGPS which could be removed?

3.23 No. 10% in Private Equity is too narrow a definition. Pension funds should have the ambition to invest at least 10% in Private Markets, including Private Equity. We believe that investment in Private Debt and Infrastructure will help to deliver the governments overall ambition of investment in this area and is much more appropriate in terms of the diversification of risk in LGPS Pension Funds.

3.24 The main barrier to investment is the availability of sufficient quality investment opportunities, which is a much more complex issue than just having an increase in the amount of available investible capital – including government incentives and taxation regime.

3.25 As mentioned in the consultation document this is an ambition to double the amount of investment from LGPS funds. Without a significant increase in the availability of the investible universe, it will just mean that there is more cash chasing lower quality opportunities.

Q12: Do you agree that LGPS should be supported to collaborate with the British Business Bank and to capitalise on the Bank's expertise?

3.26 Yes. Greater collaboration between LGPS Pools and the BBB can only be a good thing if it facilitates good quality investment opportunities.

Q13: Do you agree with the proposed implementation of the Order through amendments to the 2016 Regulations and guidance?

3.27 Yes, we support the setting of strategic objectives for investment consultants.

Q14: Do you agree with the proposed amendment to the definition of investments?

3.28 Yes.

Q15: Do you consider that there are any particular groups with protected characteristics who would either benefit or be disadvantages by any of the proposals? If so please provide relevant date or evidence.

3.29 No.

4. Next steps and review

4.1 The views of the Pension Fund Committee will be incorporated into the consultation document before submission.