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

Consultation Response from LGPS Central Limited

29 September 2023

ABOUT LGPS CENTRAL

LGPS Central is one of eight investment pools formed in response to HM Government's call in 2015 for LGPS funds across England and Wales to pool their investment assets with the aims of:

1. Reducing investment management costs through economies of scale.
2. Improving access to alternative asset classes.
3. Enhanced investment governance.

LGPS Central Limited (LGPSC) was established to manage the pooled investment assets of eight local LGPS funds across central England: Cheshire Pension Fund, Derbyshire Pension Fund, Leicestershire County Council Pension Fund, Nottinghamshire Pension Fund, Shropshire County Pension Fund, Staffordshire Pension Fund, the West Midlands Pension Fund and the Worcestershire Pension Fund (together our Partner Funds).

The Company launched on 1st April 2018 and is being built so that it will ultimately have the capability to manage over £50 billion of assets on behalf of almost one million LGPS members and some 2,000 participating employers.

LGPSC creates the investment vehicles our Partner Funds require. Through professional investment management and external fund manager selection, we deliver the investment returns Partner Funds need to secure pension payments to their scheme members and dependents for the long-term.

Over the first five years of our existence, we have achieved a great deal. We are currently responsible for just over £26bn of Partner Funds' assets. This spans both public and private markets, encompassing 26 diverse investment funds managed both internally (through our in-house investment managers) and externally. Leveraging the combined assets of our Partner Funds, we have already generated gross cost savings of £64.0m and anticipate generating gross cost savings of over £326.0m within our first 15 years of operations.

At the heart of our work is a commitment to responsible investment. We believe that the integration of responsible investment factors supports long-term risk-adjusted returns and we have made responsible investment a core part of our investment process in every asset class and in every investment mandate we hold. The scale of combined assets in the Pool helps to make our responsible investment practices and interventions more effective.

LGPSC is jointly owned on an equal shares basis by its Partner Funds and is authorised and regulated by the Financial Conduct Authority (FCA) to operate as an Alternative Investment Fund Manager (AIFM). In this capacity the Company acts as the operator of a collective investment vehicle called an Authorised Contractual Scheme (ACS). We also manage other collective investment vehicles and provide discretionary and advisory services under our Markets in Financial Instruments Directive (MiFID) II authorisation.

EXECUTIVE SUMMARY

- Since the introduction of LGPS pooling in 2015, significant progress has been made in terms of cost savings and building investment management capabilities within FCA regulated pool companies. But we agree with government that there is more to do.

- We support further asset consolidation within regulated pool companies and recognise there is scope for expediting this.

- Whilst it may not be practical to transition all listed assets over to the pool companies by March 2025, we believe that it is possible and practical to make significant progress towards this ambition by then. We note, for example, that amongst the eight Partner Funds within LGPSC Pool, there are significant commonalities in the types of listed assets currently sitting outside the pool. For those with bespoke needs, we have good experience of providing dedicated solutions.

- Clear government guidance and greater collaboration between funds and pool companies are crucial to overcoming these barriers.

- To unlock the full benefits of pooling, LGPS funds should collaborate more substantially in determining and implementing investment strategies. This approach aligns with the policy objectives of pooling, evidence from overseas, and has been successfully implemented by pool companies in responsible investment.

- Given the growing demands on fiduciaries and their advisers, training is important for all. Pool companies could play an important role in delivering that training.

- We support transparency but emphasise the need for a clear purpose and well-defined criteria for data collection. Determining consistent benchmarks is challenging, and mandating benchmarks could influence investment decisions negatively.

- We support the continual improvement of the Scheme Annual Report.

- We strongly disagree that it is appropriate for government to mandate specific investment targets for specific asset classes. Pension funds exist first and foremost to pay pensions and should not be a conduit for government economic policy. Such an approach is at odds with fiduciary duties. Investment decisions should be made based on risk and return considerations and with the objective of paying members’ pensions.

- Levelling up is a broad concept, and any investment label associated with it should be carefully defined to avoid subjective interpretations. "Levelling up washing" should be prevented.

- While we support collaboration and flexibility among pool companies, measures should be in place to prevent competition "by the back door”. Any such collaboration should be on a Pool-to-Pool basis and not at Pool to pension fund basis.

In conclusion, LGPSC acknowledges the significant progress achieved in LGPS pooling to date. However, there is still much work to be done in the short term, and we encourage both funds and pools to expedite the pooling process. Looking ahead, the longer-term success of LGPS pooling hinges on increased collaboration between funds and pools to maximize the benefits for all stakeholders. We believe that by working together more closely and aligning implementation of investment strategies, LGPS funds and pools can continue to evolve, delivering excellent value for money and outstanding net performance in service of its members and beneficiaries.

LGPSC LTD RESPONSE TO SPECIFIC QUESTIONS

Individual comments are made below relating to the specific questions contained within the consultation document.

Q1. 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?

Since the inception of LGPS pooling in 2015, LGPS pools have made significant progress. For instance, LGPS Central Limited has achieved substantial gross cost savings of £64 million since its launch in 2018 to March 2023 and is on track to reach total gross savings of £326 million by March 2034. We successfully manage diverse investments across public and private markets, managed internally and externally, amounting to approximately £20 billion, while also offering advisory services on another £6bn and Responsible Investment services, all within an FCA regulated investment management company and framework.

We strongly support the proposed acceleration of asset consolidation within regulated pool companies and believe this can unlock further value for LGPS funds. However, it is important that this is executed carefully to avoid unintended consequences and ensure maximum benefits for all stakeholders.

We perceive that a barrier to accelerating pooling lies in how LGPS funds implement their investment strategy through pool companies; pool companies in many cases are seen as investment product providers. An alternative model where pool companies are strategic partners in supporting LGPS funds define and implement their investment strategies could encourage further collaboration and reduce the number of investment products required. Addressing this barrier will require funds to increase collaboration as strategies are designed and implemented, and ahead of defining product needs.

We also believe that the absence of clear direction from government on the direction of pooling may have been a barrier. It is therefore helpful that government is now setting out its ambitions and expectations for pooling for both LGPS funds and their pool companies.

We acknowledge that a longer-term outcome of fewer Pool Companies may be a logical longer-term outcome. However, we believe there is considerable potential to be unlocked from the current pool entities through opportunities for collaboration and growth, given their unique strengths and specializations. Prioritizing collaboration and sharing expertise will continue to be highly beneficial.

Q2. 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?

LGPSC supports the government's aim to expedite pooling for the benefits of scale.

Our analysis shows that there are significant commonalities in the types of listed assets currently held by our Partner Funds currently sitting outside of the LGPSC Pool. Whilst it may not be possible to pool all listed assets by the proposed deadline, we firmly believe that it is possible to make significant progress towards pooling these assets within the Company by March 2025 given the commonalities referred to and our experience of establishing funds to date. Given our now five years of experience, there is scope to expedite our approach to building and launching new products.

We recognise that Partner Funds may also have specific needs that cannot be accommodated within a pooled or ACS structure. In this case we note those special needs can be accommodated within the pool Company. This would allow the specific Partner Fund to gain from our lower cost base, the collective benefits of our expertise, and our RI approach, for example. We have successful experience of being able to offer such bespoke approaches for our Partner Funds.

Bringing investments such as those held in collaboratively procured, passively managed insurance contracts under pool management will avail the funds of that expertise. Over the long-term, active engagement and opportunities to re-tender will ensure on-going optimal cost and investment outcomes. Alongside this approach, government must be clear on what it expects from Pool Companies and individual funds and the consequences of not pooling.

Q3. 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?

We believe it would be helpful for Government to issue revised guidance on how pool companies should operate. LGPSC believes that the characteristics mentioned in paragraph 31 of the consultation align with the policy objectives of pooling and will help support the delivery of excellent value for money and outstanding net performance.

LGPSC acknowledges that LGPS funds have similar liability profiles and benefit structures, making a common approach to setting and implementing investment strategy theoretically possible. Indeed, while its reasonable to assume that funds with similar return expectations would develop similar strategies, in our experience individual funds have, in fact, employed different implementation approaches as advised by different consultants. This individuality poses a challenge to successful pooling and achieving policy objectives.

Currently, LGPSC focuses on identifying areas of commonality among clients to develop pooled products. However, this approach has limitations due to diverse implementation methods.

In our view, to unlock the full benefits of pooling, funds must collaborate more substantially in determining and implementing investment strategies. If funds can articulate their strategy needs consistently, pool companies can create streamlined products, simplifying implementation while allowing for individualised strategies. Generally, the key to successful pooling in the future for pensions is likely to involve accommodating different institutional requirements and investment strategies (return/risk/liquidity) in as few products as possible, bringing economies of scale across a number of dimensions.

This approach has been implemented successfully in the LGPS sector in the areas of responsible investment, generating significant additional value for clients.

Q4. Should guidance include a requirement for administering authorities to have a training policy for pensions committee members and to report against the policy?

LGPSC acknowledges that the role of fiduciaries (within the LGPS and beyond) is becoming ever-more complex. Training for all those who hold roles as fiduciaries – and those who support them – is essential. Within the context of LGPS pooling, we believe the pool companies are well placed to provide and support that training where appropriate.

We have already done so, for example in the area of responsible investment at our RI Summits and stand ready to offer further support if required.

Q5. 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?

Assets transferred and transition plans

We support transparency and accountability across the LGPS but believe that data collection should have a clear purpose, well-defined criteria, and not impose undue administrative burdens on funds or their pools. Defining 'assets under pool management' and clarifying collectively procured but not pool-managed assets is crucial as how these are determined will drive activity.

Net returns

Collecting investment returns data is reasonable but highly complex due to varying asset allocation strategies. Determining consistent benchmarks is challenging, as different funds may target different risk/return characteristics even within the same asset class. Risk-adjusted returns could facilitate better comparisons, but the approach is intricate and would likely require a number of different measures to ensure richness of data. We do not therefore agree that net returns will be a useful measure.

Publishing league tables of returns, especially short-term returns, can invite ill-informed commentary with the potential to distract from the day-to-day business of managing pool company assets.

If the government mandates benchmarks, it risks influencing investment decisions, potentially undermining the broader investment considerations and opportunities. As we have explained in answer to Question 9, it also risks the adoption of a short-term strategies which is at odds with the Government's desire for fiduciaries to adopt long-term investment strategies.

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

We support the continual improvement of this report for the benefit of all stakeholders.

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

We believe that there is significant potential for LGPS asset pools to invest in a way that supports economic growth, including levelling up. As we have already made clear, however, that should not mean government directing pension funds – whether LGPS or elsewhere – to invest in particular asset classes or to set proportions of a pension fund's portfolio that should be allocated to specific asset classes. Pension funds exist first and foremost to pay their members' pensions and should not be seen as a conduit for government economic policy. It is in this context that, using our public and private markets capabilities, we are working with our Partner Funds to understand what potential pooled levelling up investment funds could look like, taking into account both the investment opportunities and the risk and return requirements of our clients.

In this context it should be recognised that levelling up is not an asset class in itself, and there are no tangible investment characteristics that can be easily measured to determine if a particular investment supports levelling up. As such there is a large range of assets, across different assets classes that could be considered as meeting in part, or full, the Government's levelling up missions.

We consider the wording in paragraph 62 to be broad and that it leaves significant room for subjective interpretation on which assets could potentially be given a “levelling up” label. As a result, any statistics built around this approach may not compare like with like and therefore not provide useful, comparable, data.

There is also the potential for “levelling up washing” where interpretations are stretched in order for specific investments to be labelled as levelling up to increase their attractiveness to LGPS funds. We have seen the dangers of that in respect of ESG investment and would not wish to see that replicated here.

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

We strongly agree with the sentiment expressed in paragraph 31 of the consultation document that competition among pool companies would be unhelpful. There is already a good degree of collaboration between the pool companies, for example with the principals meeting on a regular basis to share experiences. We therefore believe there is potential for pools to access other pool's products or to collaborate in other ways to support efficient long-term returns.

There will be a need, however, to be careful that this doesn’t introduce competition “by the back door” whereby pools actively seek to market their products directly (or indirectly) to LGPS funds with which they have no relationship as this could provide a material distraction for the efficient operation of pools and pool companies. We believe, therefore, that opening up the pools beyond their founding partner funds should be on a pool-to-pool basis and not a pool-to-individual-LGPS fund basis.

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

As we have noted above, we do not support government mandating or setting targets for the investments in specific asset classes or approaches, including levelling up. LGPS funds are global investors with fiduciary duties to meet the needs of fund members and participating employers. Mandating specific investments or asset classes may be at odds with these duties which require careful consideration of risk and return for each investment.

It is crucial to reiterate that 'levelling up' is not an asset class. Emphasising non-investment characteristics in decision-making could lead to negative consequences.

For these reasons we do not believe that requiring levelling up plans to be published will be meaningful or provide any useful comparable data. Moreover, setting plans and timetables for investments without a clear investment case may result in poor decision-making that could have negative consequences for LGPS funds and their members. LGPS finds are long-term investors in order that they can meet their long-term liabilities. The approach set out in the consultation paper risks taking a short-term approach and would be counter to Government’s stated intentions elsewhere, including in *Pension trustee skills, capability and culture* call for evidence which rightly emphasises the need for long-term decision making by fiduciaries.

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

As we have described elsewhere, reporting on plans and timetables for investments without a clear investment case may result in poor decision-making and we do not, therefore, think this proposal should be taken forward.

Q11. 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?

LGPS funds are committed to fulfilling their fiduciary duties and aligning investments with the needs of fund members and employers. Investing in private equity and other private markets assets is one way of achieving this goal.

Within the LGPS Central pool, approximately 20% of assets, equivalent to £11 billion, are already held by Partner Funds allocated to long-term illiquid assets, including private equity, private credit, infrastructure, and property. These allocations have been made to diversify investment returns and have undergone rigorous risk and return assessments and have been made with reference to the specific strategic asset allocations of our Partner Funds.

However, mandating specific investment targets or asset classes may not always be suitable, as each investment requires careful evaluation based on risk and return considerations.

We identify a number of key barriers to general investments in private market investments:

- **Higher Minimum Investments:** Private market investments often demand larger minimum capital commitments, limiting access for smaller investors.

- **Complex Due Diligence:** Evaluating private market opportunities involves intricate due diligence, necessitating thorough analysis of financials, management teams, business models, and market potential.

- **Limited Information Transparency:** Private companies disclose less financial information than public counterparts, posing challenges for informed decision-making.

- **Management and Oversight:** Private investments may require active management and oversight, which can be demanding for investors lacking the time, expertise, or resources.

It is for this reason that LGPSC is ideally placed to support our Partner Funds in their private markets investments. We have an expert team of 13 professional investment managers offering 13 specialist funds, including manager of manager and co-investment funds, providing clients access to private markets. Our specialist team, supported by our FCA-regulated investment management business, effectively navigates these barriers.

The Company is currently deploying over £4 billion of client commitments in private markets, with expectations of further growth as legacy private market investments are reinvested into the pool company as and when they run off.

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

We welcome all opportunities to meet with potential partners and investors to support out Partner Funds' needs.

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

We agree that amending the 2016 Regulations would be an appropriate implementation route.

Q14. Do you have any comments on the proposed amendment to the definition of investments?

We have no further comments on the definition.

Q15. 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 do not believe there are such groups.