LGPS Investment Consultation

Our consultation response can be summarised through six specific recommendations which we set out within this document. The three underlying principles that have driven these recommendations are set out on the next page.

We provide more detailed explanation within specific answers to each questions

If you would like to discuss any aspect of our consultation response please contact:

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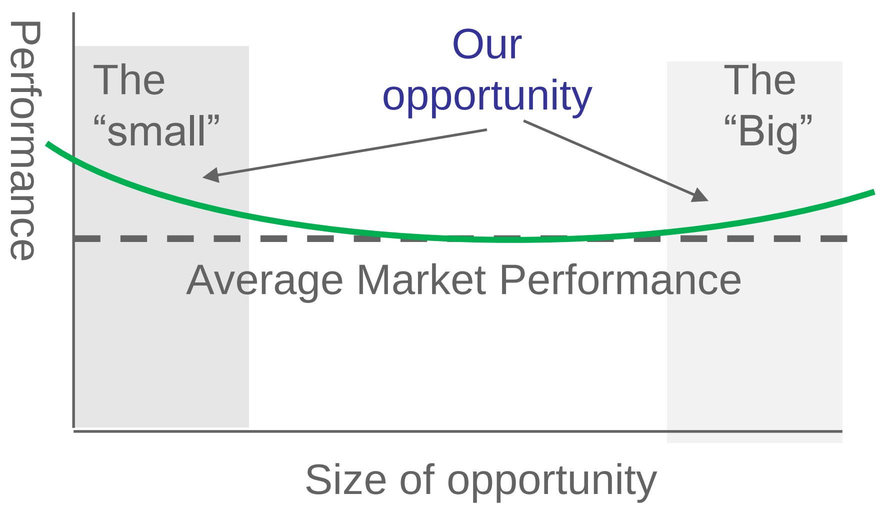
The principles underpinning our thinking

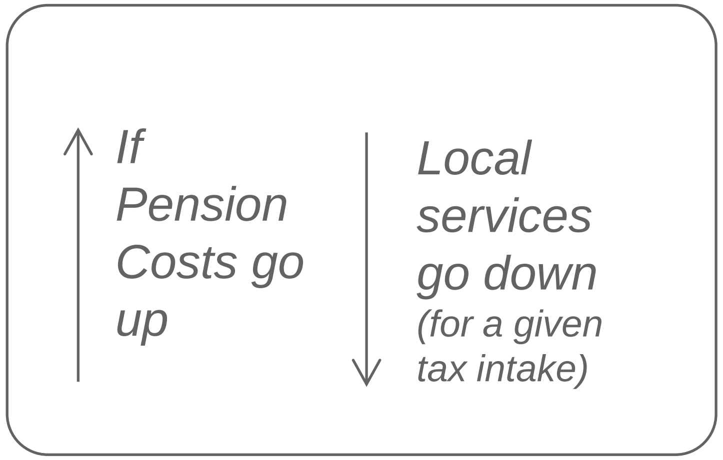
Outperformance achieved from both large and small-scale private opportunities



We believe sustainable outperformance against market can be achieved through both large-scale private investments (e.g. Large Infrastructure) and small-scale private investments (e.g. Venture)

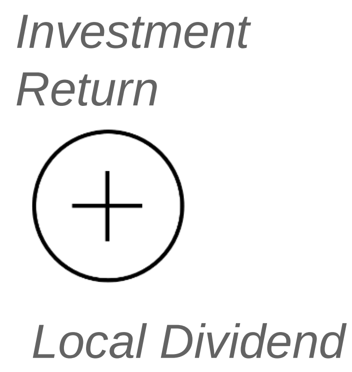
*note a Fund may allocate a large proportion of assets to "small" scale investments

Our primary Fiduciary Duty is to Local Residents



The constituent who stands to benefit / suffer the most from out / under performance of the Fund are local taxpayers and users of local services. This is therefore the group we believe we owe our primary Fiduciary Duty towards – but we feel this position is unclear in law.

There is a Local "Dividend" received through local infrastructure investment



Local investment may create a return (financial or non-financial) that benefits the local community in addition to the financial return made by the initial investors

Evolving the LGPS Investment Framework to improve outcomes

Regulations modified to encourage greater collaborations between the Pools and Funds so the big opportunities and best assets can be accessed – we think this will increase the overall level of pooled assets

The ability to allow for a ‘Levelling Up’ dividend in decision making where Local Taxpayers and / or employers benefit from the investment collaterally – we think this will increase and accelerate investment towards Levelling Up initiatives

Encourage investment in smaller Private opportunities as well as large – Funds are adept at discovering high value Private Assets locally. Encouraging and utilising this network of expertise, in collaboration with pools where possible, will help drive value for our taxpayers and increase investments towards Private Assets overall

Suggested actions to improve governance

Made explicit that Funds can rely on the Pools' due diligence – this will reduce our overall governance expense and help us build a closer relationship with our Pool. We would further recommend that Pool's obtain their own independent due diligence

Government commission a review on the potential for concentration risk from greater consolidation to fewer Fund managers - with greater concentration comes potential risk, we think this needs to be properly explored and understood as it may inform the extent of ultimate pooling

That the governance burden is supported by investment in centralised reporting tools (which could be co-ordinated by a Pool) – this will transform governance within Funds and allow clearer comparison between funds

Consultation Response - Pooling

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?

Regulation and guidance should be amended to encourage and facilitate greater collaboration between Pools so Funds can access the big opportunities and best assets – we think this will increase the overall level of pooled assets

It is currently unclear whether Funds can explicitly allow for the wider impact on communities when making investment decisions – regulations and / or guidance should give clarity on this point so Committees can be confident they are making robust investment decisions towards Local Investments – we think clarity on this will increase Levelling Up investment and expand on this point within questions 7 and 9.

Funds are adept at discovering high value Private Assets locally. Encouraging and utilising this network of expertise, in collaboration with pools where possible, will help drive value for our taxpayers and increase investments towards Private Assets overall – we acknowledge that this may drive activity away from pools and so would suggest a cap is placed on the allocation that could be sourced locally – say 10% of assets.

Guidance and regulation should make it explicit that Funds can rely on Pool's due diligence when investing into pooled funds if they so want. To support this, we suggest it should be a requirement that Pool's obtain independent due diligence on their Funds and that information can be shared with Pool shareholders.

We have a concern that as the proportion of pooled assets increases, so does the Concentration Risk (which may include governance risk) - we would like to understand what analysis the Government has undertaken to quantify this risk.

If no analysis has been undertaken, we believe it would be appropriate to commission a review of concentration risk of consolidating pools further (where risks relating to concentration could be wide ranging – e.g. concentration of governance / control / exposure to a particular asset class or manager).

Answer continued on next page

Consultation Response - Pooling

Question 1: (cont.)

There are 18,000 different LGPS employers, each with their own liability profiles and ability to absorb risk. For example, Barnet has a significant Post 92 university within our Fund with a much shorter liability profile and a narrower band to absorb risk than the Council – not all employers within the LGPS can absorb the same level of risk or have the same risk appetite.

Recognising this, and also noting that the responsibility for setting overall strategic allocation sits with Funds, the structure of Pooling should be flexible enough to allow tailoring towards each employer's specific risk appetite and financial position. e.g. around duration, cash flow matching and hedging. If the Pool is unable to provide this flexibility then Funds must be able to seek alternative solutions, otherwise it may not be possible to meet their Fiduciary duty - consolidation is a potential barrier to this if it creates too much homogeny or the unit of investment becomes larger.

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?

Given our progress towards Pooling so far, we believe this timescale is achievable and reasonable and agree it will create momentum for Pooling more generally and so are supportive.

We think that there may be inevitable costs of transition for some funds who are not so progressed with Pooling, but this needs to be balanced with the wider benefits that Pooling brings to offset these costs.

One caveat, we currently hold around 20% of assets with LGIM using a passive index tracking approach. We presume that these assets would not be counted as requiring a switch to “pooled” assets.

Consultation Response - Pooling

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 above?

Yes. Regulation and guidance should be amended to encourage and facilitate greater collaboration between Pools so that Funds can access assets with greater scale.

Some additional comments:

Some employers within a Fund have very different covenant profiles (tax raising / non-tax raising) and timeframes (some employers are mature, others are immature) and so capabilities within pools need to reflect this. For example, Barnet has a significant Post 92 university within its Fund and it is likely we will adopt a notional portfolio for the University that is different to other employers within the Fund to reflect their maturation profile and risk appetite.

Investment markets can change rapidly which can, in turn, impact on the shape of strategic allocation a fund may wish to employ. For example, Barnet has taken a recent decision to reduce its listed equity allocation and invest towards listed credit to help consolidate and stabilise its surplus position. Pool governance should allow client funds to react swiftly to changes to strategic allocations if applicable

Pools should be flexible enough to allow for specific liability requirements, e.g. around duration, cash flow matching and hedging. If the Pool is unable to provide this flexibility then Funds must be able to seek alternative solutions, otherwise it may not be possible to meet their Fiduciary duty.

Softer, non-investment, factors such as achieving Net Zero and / or wider ESG considerations would also need to be reflected in fund choice, with the ability of Administering Authorities to influence these outcomes within the pooling framework.

We believe that the flexibility for Funds to retain some autonomy for a proportion of their asset allocation at a local level will lead to better investment outcomes and greater allocation to Private Assets as expressed under question 1. and expanded within questions 11.

Consultation Response - Pooling

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?

Yes.

Question 5: 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?

Yes. The inefficiency in analysing LGPS data is largely due to the inconsistency and manual nature of record-keeping across client Funds.

We believe that the Sector has the scale and opportunity to invest in world class, centralised, automated and online systems, utilising AI where all asset information across all LGPS Funds can be stored to allow broad analysis.

This investment could be funded through a one-off levy on Funds.

This system could enable users to generate relevant reports based on various metrics, such as specific funds or asset classes, risk analysis, climate reporting etc.. Additionally, the system should be capable of generating template reports that comply with CIPFA's requirements and broader reporting standards and support increasing FOI requests in relation to asset data.

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

Yes.

Consultation Response – Levelling-up

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

Yes, however, we think a lack of clarity on what constituents LGPS funds owe their primary Fiduciary Duty will mean decision making when considering Levelling Up investment may be difficult.

This is because levelling up opportunities (which funds may view as complex with an unclear payback and, therefore, high risk) are likely to look unattractive relative to alternative (perhaps simpler) investment opportunities that generate a higher return for a given level of risk. In general, infrastructure investments that support economic regeneration are supported by underpins, guarantees or other incentives provided from government – e.g. in the Renewable Energy market.

We believe a way of allowing Pension Fund Committees to make a more complete case for Levelling Up investments is for it to be made explicit that any wider community benefits (economic or otherwise) can be (but don't have to be) considered within the overall business case for the decision.

We would articulate this as allowing funds to recognise a "Levelling Up Dividend" when making investment decisions. We would argue that this is consistent with a fund's Fiduciary Duty where the benefits of the dividend flow through to local residents and / or users of local services, either directly or indirectly.

There may be governance challenges in applying this approach and we would only advocate this approach for 'up to 5%' of assets suggested within the consultation.

We would suggest that the framework for considering this is consistent with a council's broader policies around considering investments which generate wider social value.

Consultation Response – Levelling up

Question 8: Do you agree that funds should be able to invest through their own pool in another pool's investment vehicle?

Yes, we believe regulations and guidance should be modified to encourage greater collaborations between the Pools and Funds so the big opportunities and best assets can be accessed – we think this will increase the overall level of pooled assets.

Question 9: Do you agree with the proposed requirements for the levelling up plan to be published by funds?

Yes, but we would be clear that unless guidance is clarified as to whom we owe our primary Fiduciary Duty towards, our Pension Fund Committee may find it challenging to take into consideration any wider community benefits when making Levelling Up investment decisions. In practice, this may mean finding Levelling Up investment opportunities challenging from a risk / return perspective (when considered relative to other investable opportunities).

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

Yes, but we would ask that investment is made centrally to develop tools to support reporting being automated (as far as possible) and consistent across Funds.

Consultation Response – Private assets

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?

Yes, subject to a fund's liquidity requirements and not compromising a fund's overall Fiduciary Duty around risk / return appetite, which should reflect employer's risk appetite (e.g. a 'closed non-tax raising employer approaching cessation may not be comfortable with the risk exposure implied by a Private Equity holding).

Many LGPS Funds have significantly increased their holdings towards private assets and we have some concern that sourcing opportunities solely through a pooling structure may inhibit access to smaller early stage opportunities. We believe sustainable outperformance through private investment is possible through large scale <u>and</u> small scale opportunities. Funds are adept at discovering high value Private Assets locally, which have typically been smaller in scale. Encouraging and utilising this network of expertise, in collaboration with pools where possible, will help drive value for our taxpayers and increase investments towards Private Assets overall.

Pools should be encouraged to expand their skill set to be able to provide oversight and governance services to monitor and manage Private Assets sourced locally.

Funds should be encouraged to work with pools to transfer Private Assets sourced locally towards its pool.

Consultation Response – General

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?

No comment.

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

No comment.

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

No comment.

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.

We do not believe there are any particular groups with protected characteristics that would be disadvantaged or benefit from the proposals.