LGPS: next steps on investments – response to consultation

Hymans Robertson LLP provides independent pensions, investments, benefits and risk consulting services, as well as data and technology solutions, to LGPS stakeholders, employers, trustees and financial services institutions. We've been advising local government pension clients for over 100 years and currently advise over half of the sector. We're committed to helping our clients manage their investments effectively by informing decisions about strategic allocations, the implementation of their strategies, and their engagement with LGPS pools and third-party managers to deliver better outcomes.

We're supportive of aspects of this consultation, notably the aim to accelerate and expand the scope of pooling. Significant time and money have been invested in current pooling arrangements, which have delivered significant benefits in many areas. In our view, it's logical to build on what's been achieved and seek to maximise those benefits. However, we believe that some of the specific proposals are not the best way of achieving the desired outcomes for LGPS stakeholders.

As long-term investors, we also believe the LGPS should use its investments to support the UK economy, including Levelling Up – in many cases, it already does. However, given the core purpose of the LGPS, we believe such investments should be driven primarily by the quality of the available investment opportunities and suitability as part of each authority's locally decided investment strategy and asset allocation, rather than pressure to finance other public policy initiatives.

We've provided a more detailed response to each question raised, but the key points of our response are as follows:

- **Increased scale**. There are significant benefits of scale in investment management, particularly in reducing costs and building specialist expertise. Larger pools may not be the only or best way of delivering further scale benefits. We're also conscious of material diseconomies of scale such as greater business complexity as the scope of pools increases, and less effective decision making as the number of partner funds increases. We also note that the size of individual mandates matters more than the overall size of each pool in determining economies of scale.
- We recommend further work to establish definitively the optimal scale for pools before any conclusions are reached on consolidation. This work should also consider optimal mandate size, effectiveness of procurement and differences between asset classes as well as benchmarking against an appropriate international peer group.
- We're supportive of cross-pool collaboration as a mechanism to achieve scale benefits in certain asset classes, as it will be less disruptive than full mergers. We believe collaboration will add most value in asset classes where it's hard for individual pools to achieve the required scale (e.g. infrastructure), where specialist expertise is required, and/or where proven capability already exists in one of the pools.
- **Transition timetable.** We support the proposal to set a target timescale for administering authorities to transition listed assets to their LGPS pools. However, we believe certain types of asset, such as passive investments and certain property assets, should be held outside pools, but under pool management and oversight. Each exception should be carefully justified, but requiring all assets to transition is likely to lead to significant additional costs and/or inferior investment outcomes. We also believe that pools and partner funds should be free to set target dates that reflect their own particular circumstances.
- **Governance and decision-making.** We welcome the confirmation that the important decisions regarding setting investment objectives, risk appetite and high-level investment strategy including asset class allocation should remain with LGPS funds. This will enable funds to discharge their fiduciary obligation to set an investment strategy that is appropriate to their own liabilities and funding approach. However, we do

not believe that the proposal for funds to delegate all other investment decisions is practical or desirable. Certain implementation decisions, such as setting mandate parameters, are so tightly linked to objectives and risk appetite that they should be taken by LGPS funds not determined solely by pool companies.

- We also believe the collaborative approach to implementation that's been employed to date, involving funds and pools in challenge and compromise, has delivered better solutions and investment outcomes for members.
- The consultation implies that there is one preferred approach to pooling. We have concerns that 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. The current pooling landscape provides funds with access to a range of alternative approaches to pooling, which have all demonstrated benefits across governance, excellent value for money, outstanding performance and access to a wider range of asset classes. So we disagree with the proposal in Q3 that guidance should "set out fully" how pools and funds should interact. Existing guidance is sufficiently prescriptive.
- We're also concerned by the proposal that pool companies should advise funds on investment strategy. Funds are required to take proper advice, and we believe it should come from diverse and independent sources and be informed by in-depth knowledge of funds' assets and liabilities. Pool companies should work with funds to understand requirements and consider potential strategy implementation options that meet those requirements. We believe the proposal for pool companies to advise on investment strategy is inappropriate. This would create captive versions of the traditional fiduciary manager model, which is known to create conflicts of interest in the private sector, and would weaken accountability for investment outcomes.
- LGPS funds put significant effort into maintaining high standards of investment governance, but we accept there is always scope for improvement. We agree training is a key element of good governance, but most funds already have clear and effective policies on this matter. We believe attention should also be given to other areas such as decision-making processes and delegation of authority. The Good Governance review identified opportunities in these and other areas, and we urge the government to take forward its recommendations.
- **Reporting.** We agree transparency is critical and so are generally supportive of the proposals to sharpen up reporting on asset allocation, net returns, and progress on pooling including cost savings achieved. Reporting requirements should be standardised across the LGPS and set at a level of granularity that balances the need to provide meaningful and comparable data with the workload involved in preparing reports. We urge the government to consider carefully how the data collected is presented and used, to avoid known pitfalls. Performance league tables, for example, can encourage funds to take unnecessary risks.
- **Levelling Up and investing in private equity**. We welcome the clarity provided on the definition of Levelling Up investments, which recognises that the causes of deprivation and unfulfilled potential are complex and that the solutions will involve action (and investment) on many fronts, across all regions of the UK. We also note the government wishes to see LGPS funds doubling their allocation to private equity. Both classes of investment have a role to play in long-term investment portfolios such as the LGPS. But we do not agree with the proposal to set allocation targets (or quantitative ambitions), which we believe fundamentally conflicts with the principle that LGPS funds remain responsible for setting high-level investment strategy. We believe the imposition of external targets may lead to sub-optimal investment outcomes. Given their fiduciary responsibilities, we believe LGPS funds need to make their own decisions to invest in particular asset classes, taking account of their own liabilities, time horizon, cashflow, funding level, employer contribution affordability, return requirements and risk appetite.

- We do believe the government can and should focus on facilitating the origination of new investment opportunities in these asset classes in the UK. Actions in areas such as streamlining planning systems, long-term infrastructure planning, redesigning regulatory frameworks, innovative risk transfer solutions and continued support for world-class research will increase the attractiveness of UK investments to global capital. We believe the LGPS should invest in the UK because of the abundance of attractive investment opportunities, not to meet arbitrary targets.

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Objectives of the consultation

The consultation is focused on five key areas: proposals to accelerate and expand pooling, including additional reporting requirements on progress and plans for pooling; new requirements for funds to invest up to 5% to support levelling up in the UK; an ambition for the LGPS to increase investments in unlisted equity to support growth; proposed amendments to the LGPS regulations on the use of investment consultants in line with the CMA order; and some technical changes to the definition of investments within LGPS regulations.

Across the areas covered by the consultation, we believe there are also five key themes, which are reflected in our comments and responses to the consultation questions: accelerating pooling, capturing the benefits from increased scale, strengthening governance, promoting best practice and financing support for levelling up and faster economic growth. We expand on these themes in the remainder of this consultation response.

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?

Current position

Before considering alternatives to the management and governance of the LGPS, it's important to understand the current approaches that have been implemented since the introduction of pooling. Each administering authority remains responsible for setting their own investment and funding strategy but has sought to invest an increasing proportion of their assets through their chosen LGPS pool. There are two main pooling models currently adopted by the LGPS:

- LGPS-owned pool manager – where a pool is structured as an FCA-regulated entity, which is owned by the underlying administering authorities. The pools under this approach will have responsibility for the design and set-up of all the investment solutions offered to their funds. They may or may not have in-house investment management capabilities but will be responsible for selection and monitoring of any third-party managers.

- LGPS-governed pool with rented operator – where a pool is formed with a joint committee, set up under legal terms such as an inter-authority agreement, representing the underlying administering authorities. The committee has responsibility for the selection and monitoring of a rented operator, who will set up investment solutions that the funds will invest through. Each authority contracts separately for the provision of the required services. 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.

In addition to these core models, pooling has also been achieved through:

- Joint committee structures – leveraging scale and driving cost savings through joint ventures and targeted procurements directed by the pool.

- Collective procurement – for passive management or index-tracking solutions in particular, terms have been procured and negotiated by pools to allow partner funds to access extremely cost-effective investment solutions from third-party managers across a range of asset classes.

- Asset-class-focused investment solutions – developed for LGPS funds by LGPS funds and pools, which enable access to a specific asset class, e.g. infrastructure.

Alternative approaches

The wording of the consultation, particularly section 31, implies that there is one preferred approach to pooling, which is an expanded form of the LGPS-owned pool manager structure, whereby the pool would play a greater role in implementing investment decisions and providing strategic advice to its partner funds. While this would be an alternative to some of the existing arrangements, we do not agree that a single approach should be imposed by government. This fails to recognise that different pooling approaches have been implemented, which were appropriate given the needs and capabilities of their participating funds and have been successful in achieving pooling benefits. We have concerns that 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. The approach to pooling also needs to consider the requirements of each pool's stakeholders and what this means when developing solutions to meet their needs, as the same model may not work for a pool with, say, eight partner funds as it does for a pool with many times that number.

The current pooling landscape gives funds access to a range of alternative approaches to pooling that have all demonstrated benefits across governance, excellent value for money, outstanding performance and ability to access a range of asset classes. It's also too early to assess which models of pooling have been most successful in delivering these benefits most effectively.

Fewer, larger pools

There are significant benefits of scale in investment management, particularly in reducing costs and building specialist expertise. Larger pools may not be the only or best way of delivering further scale benefits. We are also conscious of material diseconomies of scale such as greater business complexity as the scope of pools increases and less effective decision-making as the number of partner funds increases. We also note that the size of individual mandates matters more than the overall size of each pool in determining economies of scale.

We recommend further work to establish definitively the optimal scale for pools before any conclusions are reached on consolidation. This work should also consider optimal mandate size, effectiveness of procurement and differences between asset classes as well as benchmarking against an appropriate international peer group.

We're supportive of cross-pool collaboration as a mechanism to achieve scale benefits in certain asset classes, as it will be less disruptive than full mergers. We believe collaboration will add most value in asset classes where it's hard for individual pools to achieve the required scale (eg infrastructure), where specialist expertise is required, and/or where proven capability already exists in one of the pools.

Opportunities

Pooling continues to present opportunities for LGPS funds to use their collective scale to develop innovative and effective investment solutions. This is reflected in the work plans for all the pools, regardless of whether they've adopted an owned or rented structure. We believe that further opportunities will be developed under current structures, with the current consultation providing additional momentum and focus.

The consultation highlights the potential for some pools to be specialists in particular asset classes, allowing other pools to benefit from this through accessing these capabilities. If appropriately managed, this could be an opportunity, building on solutions that are already in place or in development, such as GLIL Infrastructure or the Climate Opportunities solution offered by the Border to Coast Pensions Partnership. When considering the aims of the consultation around levelling up and private equity investments, access to specialists in these areas may help in the development of investible opportunities, provide greater access and prevent LGPS funds potentially bidding against each other for the same investments.

We also believe there is an opportunity for pools to expand the range of implementation services they offer to aid the day-to-day management of funds' investment strategies in areas like foreign-currency hedging, cashflow management and reporting. This would help to ease the burden on fund officers and, in our view, bring greater benefits to the LGPS than pools providing strategic advice.

Barriers

The main barriers to pooling are in relation to illiquid and non-listed assets. The pools are working to develop solutions to these asset classes, but some barriers continue to slow progress. A prime example is in property, where careful consideration has been required around transition costs and tax implications for transitioning assets or constructing pool solutions. Any assistance government could provide in helping overcome these barriers would be much appreciated by all funds.

A further barrier is in relation to the development and structuring of investible opportunities that have the right balance of risk and reward. The initial consultation on pooling was focused on providing better access to infrastructure investments. While LGPS allocations to infrastructure have increased in recent years, this is an example of an asset class where origination of new opportunities remains extremely challenging despite the self-evident need to upgrade infrastructure. In particular, in light of the focus of the current consultation on levelling up and private equity, support from government in helping to develop and create investible opportunities would increase the potential for greater pooling, which would be aligned to the aims of both funds and government.

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?

We support the proposal to set target dates for authorities to transition listed assets to their LGPS pools. However, we believe that the definition of pooled assets, the conditions for maintaining holdings outside pools and the target date for each pool require further consideration. Without this, there is the risk of significant additional costs and/or inferior investment outcomes. We believe the following areas need to be considered as part of the guidance.

Definition of pooled assets

The consultation has specifically differentiated between pooled assets and those under pooled management, stating that pooled assets are owned by the pool in their capacity as asset manager, while assets under pool management are assets where the pool has some management or oversight arrangement without ownership. It also highlights other arrangements such as passively managed assets held under insurance contracts.

We have concerns over this definition of pooled assets and the implications this could have for achieving the transition by the proposed deadline.

Firstly, the definition of pooled assets is not technically correct. Pooled assets are owned by funds, which are managed by pools under an investment management agreement, not by the pools themselves. Secondly, and more importantly, is the implication that non-pooled assets do not enjoy the benefits of pooling notably economies of scale and robust oversight. This is not the case. In particular, passive or index-tracking solutions are largely provided through pool-led negotiations and with support of the National Frameworks, which means all LGPS funds are already able to access high quality index-based solutions that provide excellent value for money. The solutions also provide tax-efficient investment solutions and allow funds to benefit from the wider scale of the index-tracking managers, including their expertise in responsible investment and engagement.

For example, the consultation focuses on the benefits of scale and increasing pool sizes to £50–75bn. The largest index-tracking manager employed by LGPS funds has index-based assets under management of over £450bn through which funds already experience significant cost savings as well as strong governance, stewardship and engagement benefits.

Viewing these assets as non-pooled and requiring these assets to be moved to alternative arrangements within LGPS pools by 2025 would pose significant risk, higher management costs, potential misalignment of locally determined investment strategies and transition costs.

Rationale for not pooling

While we support the proposal to set targets for pooling listed assets, there are some circumstances under which we believe that some assets should not be pooled. This is also reflected in the consultation, as it includes proposals for funds "to provide a rationale, value for money and date for review for assets which are under pool management or not pooled".

In reality, assets may be held outside for sensible reasons, such as where it's uneconomic for the pool to offer a solution that meets funds' specific requirements in critical areas including diversification of risk or the transition to net zero. While we acknowledge the need for funds to make compromises in order to capture the benefits of pooling, legitimate reasons not to pool are likely to remain. Flexibility in this area would be welcome and is likely to improve investment outcomes.

We also believe that pools and partner funds should be free to set target dates for pooling listed assets that reflect their own particular circumstances. It takes time for pools to design robust solutions in collaboration with partner funds, carry out any necessary procurement (fund managers and other service providers) and launch products. Some pools may already have other specific and necessary projects in their 2024 business plans.

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?

Interaction of funds and pools

For the reasons set out below, we disagree with the proposal that guidance should "set out fully" how funds and pools should interact. Existing guidance is already sufficiently prescriptive.

We welcome the confirmation that the important decisions regarding setting investment objectives, risk appetite and high-level investment strategy should remain with the LGPS funds. These are the most important investment considerations for any long-term investment fund. Therefore, it's critical that those decisions remain with administering authorities, given that they have a fiduciary obligation to set an investment strategy that is appropriate to their own liabilities and funding approach, and ensure pensions are paid.

However, we do not support the proposed guidance that all other investment decisions should be delegated to the pools, including a range of implementation decisions previously taken by partner funds.

We believe that the separation between the high-level allocation decisions and implementation is not as clear cut as the consultation suggests. Many implementation decisions are critically dependent on the objectives, risk appetite, investment beliefs and policies on key issues such as net zero, all of which are set by pension committees. It's very hard for third parties, i.e. pool companies, to take such decisions with confidence and ensure that the solutions they develop are fully aligned with funds' requirements. Hence we believe funds must retain significant influence in these areas.

Currently, funds decide to invest in an asset class and then work with the pool and other funds to agree what the pool's solution in that asset class should look like. While compromise is necessary, funds have the ability to influence the design of that fund to fit in with their requirements. The current approach actively encourages strong challenge between funds and pools. If all investment decision-making is delegated to the pools, funds may lose the ability to influence the design of pool solutions, resulting in funds that do not meet their high-level strategic needs.

We believe that a collaborative approach between pools and partner funds, involving challenge and compromise, has delivered better solutions and investment outcomes for clients. If pools were to have sole responsibility for designing and implementing solutions, it would be harder for funds to secure the solutions they require and to ensure proper oversight of the pools.

We’re also concerned by the proposal that pool companies should advise funds on investment strategy. Funds are required to take proper advice, and we believe it should come from diverse and independent sources and be informed by in-depth knowledge of funds’ assets and liabilities. Pool companies should work with funds to understand requirements and consider strategic implementation options. We believe the proposal for pool companies to advise on investment strategy is inappropriate. This would create captive versions of the traditional fiduciary manager model, which is known to create conflicts of interest in the private sector, and would weaken accountability for investment outcomes.

And in this case, partner funds would not fully benefit from the protections recommended by the CMA in its 2019 review. In the interests of full disclosure, we should, of course, highlight our commercial interest in this area.

The consultation sets out a model whereby collaboration between pools would be mediated by pools, not funds. We understand the aim of this is to reduce the risks of partner funds picking and choosing different pool solutions, thereby creating unhelpful competition between pools. We are supportive of this aim, but we believe that further consideration needs to be given to structural issues including product design processes, the layering of fees and the management of capacity constraints. Channelling investment in another pool’s vehicle through their own pool would help enable this to be facilitated in an orderly way. We see channelling as a governance mechanism rather than a structural issue, as creating extra layers of fund structure would add to costs unnecessarily.

Model of pooling

The consultation implies there is a single preferred model of pooling. However, we don’t believe there is one single best approach, and we do not agree that a single approach should be imposed by government.

Through the pooling process so far, a number of operating models have been developed. There’s clear evidence that all models are delivering the key pooling benefits of lower fees, improved net-of-fees returns, better governance and access to a wider range of assets. Some alternatives allow for greater accountability by making it easier to address underperformance e.g. by replacing the investment manager.

There are also important lessons to learn from progress made so far, which we believe were missed in the development of this consultation, such as the benefits of involving partner funds in fund design processes from an early stage.

We believe that moving towards a single operating model exposes the sector to unnecessary concentration risk and may stifle innovation. We also believe that further experience with the different models is needed before sufficient evidence can be gathered to support adopting just one approach.

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?

We support a requirement to develop formal training policies and increase the level of training provided to pension committees. Committee members have onerous fiduciary obligations and are responsible for taking significant decisions on a wide range of increasingly complex investment decisions. Many administering authorities already have training policies and extensive training programmes in place, but increased focus on this area across the LGPS is likely to be beneficial.

Each administering authority should consider what training topics are to be covered, the frequency of training sessions and the medium in which they should be delivered, to maximise participation and reflect the knowledge, skills and needs of their committee. Administering authorities work hard to ensure engagement in training, and a number of training tools are already used by pension committee members, including working closely with their pool. Ideally, this should be in line with the most topical issue, or where a pension committee is likely to be required to make a decision with regard to their administering authority's participation in the pool.

LGPS funds put significant effort into maintaining high standards of investment governance, but we accept there is always scope for improvement. Training is part of the solution, but we believe attention should also be given to other areas such as decision-making processes and delegation of authority. The Good Governance review identified opportunities in these and other areas, and we urge the government to take forward its recommendations.

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?

We understand the proposals on reporting are designed to increase transparency of asset allocation, progress on pooling, returns and cost savings. The LGPS has always demonstrated transparency in both its governance and operation, and therefore we would support reporting that would enhance this. However, we note the following:

Consistency of reporting

Consistent reporting is a must to achieve an accurate LGPS-wide picture when combining all reported positions by the funds, as well as for meaningful comparisons between funds, if that is desired. We comment further on issues with comparisons later. Comparisons of performance between pools and between funds requires care. As well as consistent measurement, comparisons need to be like for like, meaning they have to be for comparable mandates with similar objectives, not simply the same broad asset class and certainly not at whole pool level because of the differences in asset types and their mix.

Consistency will require detailed reporting when it comes to asset allocations. However, this 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.

Detail is required as, across the full spectrum of asset classes, there is a significant number of sub-asset classes, as well as some potential for overlap. There needs to be clear guidance on asset class categories to ensure an accurate picture of asset allocation is developed.

When investing in any asset class, a wide range of potential strategies is available, with a broad spectrum of risk and return targets; benchmarks need to be tailored accordingly. For example, within infrastructure, solutions that invest in operating assets are expected to offer much lower risk and return characteristics than a solution that builds new infrastructure assets. This creates a challenge of finding a single suitable benchmark for that asset class, as well as for providing like-for-like comparisons across the LGPS. There's also a question of how returns should be calculated, which should focus on the purpose of collecting this information. Given the cashflows that move between asset classes within LGPS funds on a regular basis, for reasons such as rebalancing and cash calls from private markets funds, time-weighted and money-weighted return calculations will differ significantly. If the intention is to understand simply how individual asset classes are performing, and whether certain LGPS funds have made better investments in each asset class than others, then a time-weighted return would be more suitable. However, if it's also intended that funds' cashflow-timing decisions are reflected, then money-weighted returns would make more sense (it should be noted that many cashflows, such as capital calls from private market funds, provide no ability for funds to manage the timing).

To ensure consistency of reporting and reduce the burden on LGPS officers, it would be worth considering appointment of a third party that specialises in cost and performance measurement and benchmarking to gather, validate and present the data.

Resourcing and time commitments

The consultation acknowledges potential cost increases for funds in providing this reporting and states that this is justified by the increased transparency. However, there is no acknowledgement of the increased workload this will place on already stretched pensions teams within funds.

Pensions teams across the LGPS have been suffering for a number of years with smaller teams and increased workloads. Hiring into the sector has proven to be very difficult, particularly for funds outside larger metropolitan areas. This means that simply recruiting staff to assist with the increased workload of this reporting is unlikely to be a viable option for many.

While a standardised template would most likely help with minimising the workload impact for pensions officers, it’s important that this is done correctly. We strongly encourage the involvement of pensions officers in the process of developing any reporting templates, so that they can provide valuable feedback on what is likely to be achievable. Similarly, pools should support funds as much as possible in completing the required reports.

Potential risks of comparisons

While we’re largely supportive of increased transparency in the LGPS, we note that it can lead to misleading comparisons between funds in very different positions and with different beliefs and objectives. League tables of investment performance are known to have drawbacks. Funds that take less risk in order to protect strong funding positions and/or because they have less risk appetite can find themselves lower down performance league tables and under pressure to take more risk unnecessarily.

Providing returns by asset class can lead to similar issues. When investing in any asset class, a wide range of potential strategies is available, with a broad spectrum of risk and return targets. Funds targeting less risky strategies within an asset class may underperform peers for perfectly justifiable reasons but come under pressure for their relatively low returns.

Similarly, funds may begin to set asset allocations based on the LGPS average, rather than allocations reflecting their own position and circumstances. This could facilitate pooling but, given how diverse funds are in terms of employer mix, maturity and funding position, it could also lead to inferior outcomes for members and employers. We don’t think it’s appropriate to encourage funds to adopt the LGPS average asset allocation.

While these don’t amount to reasons not to improve transparency through reporting, they are risks that must be considered and guarded against. We urge the government to consider carefully how data will be presented and used when setting new reporting requirements.

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

The Scheme Annual Report, in its current form, provides a lot of useful information on the overall position of the LGPS. However, as noted in the consultation, the consistency of the reporting that’s used to produce it could be improved. Greater transparency would be welcomed, particularly in terms of asset allocations. For example, in the 2022 report, 67.3% of assets were classed as being held in pooled investment vehicles, with no further information on what asset classes those pooled investment vehicles invested in. This largely defeats the purpose of this area of the report. Again, use of a third party specialist in cost and performance reporting and benchmarking could be helpful.

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

We welcome the clarity provided on the definition of levelling up investments, which recognises that the causes of deprivation and unfulfilled potential are complex and that the solutions will involve action (and investment) on many fronts, across all regions of the UK.

We believe levelling up investments have a role to play in long-term investment portfolios such as the LGPS. Indeed, depending on exactly which assets are considered to be in scope, we would assess many funds to be well on their way to achieving a 5% allocation, given that LGPS funds have typically been open to investing in the UK when suitable opportunities have arisen.

But we don’t agree with the proposal to set allocation targets (or quantitative ambitions), which we believe fundamentally conflict with the principle that LGPS funds remain responsible for setting high-level investment strategy. The imposition of external targets may lead to sub-optimal investment outcomes. Given their fiduciary responsibilities, we believe LGPS funds need to be free to make their own decisions to invest in particular asset classes, taking account of their own liabilities, time horizon, cashflow, funding level, employer contribution affordability, return requirements and risk appetite.

LGPS funds can, and do, consider the wider economic and social impacts of the investments they make, but we believe decisions to invest should be taken first and foremost on investment grounds. Where economic and social benefits are expected, we also believe it’s vital that the resulting impacts are quantified (in terms of local job creation, for example), tracked and reported.

We’re supportive of the focus on newly originated assets, as this typically allows funds and their managers to better structure the transactions, secure better returns and deliver greater social and economic impact. We note, however, that new origination has always been the preference of many managers active in this area. So we would urge the government to consider whether there are actions it could take to facilitate the supply of new opportunities. Actions in areas such as streamlining planning systems, long-term infrastructure planning, redesigning regulatory frameworks, innovative risk transfer solutions and continued support for world-class research could all help to increase the volume and quality of new investment opportunities.

Investing in these areas requires government action. Designing investment solutions for the LGPS requires specialist expertise, and we believe the pools have a key role to play in building the necessary capabilities.

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

As outlined in our response to question 3, we are supportive of cross-pool collaboration as a mechanism to achieve scale benefits in certain asset classes, as it will be less disruptive than full mergers. We believe collaboration will add most value in asset classes where it’s hard for individual pools to achieve the required scale (eg infrastructure), where specialist expertise is required, and/or where proven capability already exists in one of the pools.

However, the proposal needs to be carefully implemented. The consultation sets out a model whereby collaboration between pools would be mediated by pools, not partner funds. We understand the aim of this is to reduce the risks of partner funds picking and choosing different pool solutions, thereby creating unwanted competition between pools. We’re supportive of this aim, but we believe that further consideration is required to avoid the following issues arising:

- Unnecessary additional layers of fees, which is counter to the aims of cost savings and efficiency gains. This might be avoided by ‘investing through their own pool’ being a governance step rather than through two layers of pool vehicle, which would add costs.
- Capacity constraints on products focused on non-listed or illiquid markets.

- Misalignment of investment solutions with objectives, where solutions were originally designed and created for a different investor base.
- Further misalignment due to the increased separation between implementation decision-making and the setting of investment strategy.
- Competition for assets between pools offering similar products, which will serve simply to drive down returns for all.

We believe the greatest opportunity for pool via pool investments may be around levelling up investment solutions, but, again, our concerns would be around capacity in an area where investible opportunities with appropriate risk and return profiles may be difficult to find.

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

It is proposed that funds will be required to publish their plans for investing in levelling up projects and to report on progress. The transparency this will provide is important and is to be welcomed. We support the proposal that the plans should take account of funds' investment strategies, as we believe any levelling up investments should be consistent with, and supportive of, overall investment strategy. We also agree that the pools, with the investment expertise they can develop, have a key role to play here and should be reflected in the plans.

We do not agree with the proposal to set a target allocation for levelling up investments. If one is set, we urge the government not to be prescriptive on timescales, as projects with meaningful impact take time to originate, structure and deliver well. We also note that developing these plans and meeting the associated reporting requirements represent additional workloads for already-stretched investment teams, and we urge the government to keep the reporting obligations as simple as possible.

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

As noted in our response to Q9, we're generally supportive of the reporting requirements and the transparency they will provide. We believe the specific requirements outlined are reasonable but suggest that some measure of the economic and social impacts produced by levelling up projects should be added, especially as impact is likely to be one of the factors considered in arriving at investment decisions. Projects vary greatly in terms of impact: a well-located development of new-build affordable housing meeting the latest environmental standards will have significantly greater impact than acquiring a portfolio of dated, existing housing, even though the capital cost may be similar. Quality, both in terms of impact and financial return, should be favoured over quantity.

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?

On balance, no, we don't agree that an ambition to invest 10% of funds into private equity should be imposed on funds.

Although it's stated as an ambition, the proposal implies that it will be a requirement for LGPS funds to invest 10% of their assets in private equity. We believe this is at odds with the earlier parts of the consultation, which maintain that the most important decision for funds is setting high-level investment strategy and that this responsibility would remain with LGPS funds.

We believe private equity has a role to play in long-term investment portfolios, including those of many LGPS funds. Carefully chosen investments can deliver returns well in excess of those available from public markets, while significantly boosting economic growth. But private equity investments, and venture/growth capital in particular, are among the highest-risk a fund can make, so any material allocation to these areas needs careful consideration.

We believe LGPS funds should retain the right and responsibility to set investment strategy according to their own specific circumstances, taking into account factors such as funding level, risk appetite and net cashflow position (annual benefit outgo less contribution income).

We expect that private equity will be an attractive investment for many LGPS funds. But the decision to invest and the target allocation should be based on an analysis of the funds' specific circumstances and driven primarily by investment, not public policy considerations.

Although it's not explicit in the consultation, we understand the desire is to create greater investment in the UK and, specifically, the growth equity and venture capital of high-growth businesses. When combined with the government's levelling up agenda, venture and growth capital investments do make sense. They provide capital at the grassroots of the economy, helping promising new businesses to get off the ground and grow, and creating jobs and economic growth.

However, from an investment perspective, limiting investments to just the UK would significantly reduce the opportunities available to investors and lead to concentration risk. Mandating investment in this area could also 'bid up' the value of these UK investment opportunities, reducing prospective returns for LGPS funds.

We believe the government should instead focus on creating a business environment that allows high-growth firms to flourish, and that the LGPS should invest in the UK because of the abundance of attractive investment opportunities, not to meet arbitrary targets.

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?

Yes, we agree that LGPS funds should be supported to collaborate with the British Business Bank.

Its network and expertise may help LGPS funds identify opportunities to invest in UK businesses, at national and regional levels. In particular, we believe that the regional focus of its investment funds could be attractive to LGPS funds, who, in our experience, are keen to make a difference 'on their own doorstep'. However, we don't believe that this should be an exclusive relationship; LGPS funds (most likely operating through their LGPS pools) should be free to work with other partners to achieve similar aims. And, as with all investments, LGPS funds (or managers acting on their behalf) should undertake their own due diligence.

LGPS funds consider a range of current and prospective investment options, and a number of funds already invest in public and private, debt and equity via professional investment managers. These managers have a track record and the depth of team and resources to allocate capital on behalf of the LGPS funds. An offering by the British Business Bank that is compelling to these managers would attract investment from the LGPS.

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

Yes, we welcome the proposed implementation of the Order through amendments to the 2016 Regulations and guidance.

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

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.

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