PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

LOCAL GOVERNMENT PENSION SCHEME (ENGLAND AND WALES): NEXT STEPS ON INVESTMENTS

PLSA RESPONSE

2 OCTOBER 2023

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ABOUT THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

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EXECUTIVE SUMMARY

Asset pooling in the LGPS

- LGPS Funds have a fiduciary duty to their members and employers to invest assets with an appropriate risk profile, so they can fulfil the promise of paying pensions when they fall due. Pooling has been a successful endeavour, with net savings so far of over £380 million and a forecast of over £1 billion by 2025.

- While the PLSA agrees that increasing pools scale could be beneficial for Funds - which is substantiated by the fact that 39% of assets have been transferred successfully to pools - there are concerns about the intentions of building “scale as quickly as possible”. As the responsibility and risk of investments remains at a Fund level, we urge that assets should be transitioned to pools in an efficient and well governed manner, without artificial timelines which could be detrimental to value. Nevertheless, the PLSA encourages Funds which have not engaged with their pools to start doing so.

- The PLSA would support that the “Good Governance Review”, which is being developed for some time now, is implemented as soon as possible and considers how to strengthen the relationship between partner Funds and pools.

- There are also investment considerations which should be taken into account. The PLSA has been made aware by its members of passive investments which were made outside of the pool and are already benefitting from large discounts on fees - with the latter being accelerated due to the advent of pooling. The majority of these assets benefit from oversight from pools, and there is no obvious value for them to be replicated.

- The PLSA and its LGPS members would prefer not having a specific deadline for asset transition. Instead, Funds should create a plan for the transition of their unlisted and listed assets, including the detailed rationale for assets that will remain outside of the pool, to be provided in the Investment Strategy Statement (ISS). Assurances should be given by Funds that they are complying with their plans. We would support the Government setting up a timeline for this plan to be presented.

- On the specific characteristics proposed by Government to be included in the revised guidance on interaction between Funds and pools, PLSA members have strong views in relation to the proposal of pools “actively advising funds regarding investment decisions”. At the moment, Funds believe that some pools do not have enough in-house expertise to provide this type of advice. Moving to such structure could also create conflicts of interest, which would put Funds in a position to identify/manage these (which is already the case with investment consultants).

LGPS Investments and Levelling Up

- PLSA members believe the best way Government can guarantee more investments are made in assets which can comply with Levelling Up missions is to support the creation of the right opportunities in the market for LGPS Funds, while considering enacting regulatory change or setting up fiscal benefits for Funds.

- LGPS Funds have a long-standing relationship with their local community, and in recent years, due to an increase in impact investments, an increasing number of Funds have committed to assets which can be classified as “Levelling Up” investments. As the consultation correctly identifies, LGPS Funds have already invested £27 billion in infrastructure assets.

- Since Levelling Up is not an asset class in itself, Funds would prefer if Government considered how these investments can be mapped using the existing asset classes, and what current reporting areas could be used for this purpose.

- Some of our members have strong views on the ambition to have Funds invest 5% of their assets in Levelling Up assets. This is due to the fact they believe such ambition set by Government would impact their fiduciary duty.

- While we are supportive of the idea of Funds investing in other pools products, there are several issues that need to be taken into account, such as product design, increase in costs, products limited in capacity, pools in-house capabilities and the fact Funds may be better served by investing in asset managers’ offerings via their pool directly.

Investment opportunities in private equity

- All LGPS Funds will have assessed opportunities in private equity and private markets as part of their strategic allocation design. This is best practice across the private sector as well, and is reaffirmed by figures which show an overall allocation of 4.3% to private equity in the LGPS (figures from SAB for England and Wales). Strategic allocations are periodically reviewed, and for some Funds these investments will make more sense than for others. Due to this, and the fact that a specific target allocation will impact the Funds’ fiduciary duty, the PLSA does not consider an ambition of 10% should be set.

- Our members would also like to point out that the focus should be on growth capital in private markets as a whole instead of just focusing on private equity. This objective can be achieved through equity, but also by debt or credit assets, among other asset classes. Having a ‘private capital’ focus allows investors to build private market risk appetites which suits their own circumstances, rather than pushing everyone to a more narrowly defined and therefore potentially crowded part of the market with more volatile returns.

- The Government does have a role to play if it wants those LGPS Funds which have identified private equity/private markets as a fit-for-purpose investment, to increase their allocations. If the LGPS and private capital is being asked to make large, long-term, capital investments, the Government should consider offering corresponding long-term guarantees and/or the necessary policy certainty to protect these potential investors.

INTRODUCTION/GENERAL COMMENTS

The Pensions and Lifetime Savings Association (PLSA) welcomes the opportunity to respond to the Department of Levelling Up, Housing & Communities (DLUHC) consultation on next steps on investments in the Local Government Pension Scheme (LGPS) in England and Wales.

The PLSA conducted a survey with its members and consulted with its Local Authority Committee and several LGPS and pool members on the proposals set out in the consultation. We welcome the discussion over the Government's proposals in the document, as we believe it is important to progress the work on pooling of investments.

The LGPS is one of the few remaining open, funded defined benefit schemes in the UK, at a time more companies are now offering defined contribution (DC) schemes, while Funds are facing an increase in regulatory and governance complexity.

Due to this, it is of the utmost importance that LGPS Funds are supported by pools to make the best of their investment decisions, which is why we see this consultation as a positive step in this journey. However, the main goal of LGPS Funds - to invest assets with an appropriate risk profile to be able to fulfil their pensions obligations to their members – cannot be forgotten.

We have concerns that some of the proposals, as they currently stand, will negatively constrain LGPS Funds fiduciary duty, while adding additional layers of regulation and reporting that might not be the best way to encourage greater investment in UK productive finance.

RESPONSE TO CONSULTATION QUESTIONS

Asset pooling in the LGPS

> **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?**

1. LGPS Funds have a fiduciary duty to their members and employers to invest assets with an appropriate risk profile, so they can fulfil the promise of paying pensions when they fall due. Pooling has been a successful endeavour since it has fulfilled its main objective - providing significant cost savings due to the increased scale – with the consultation pointing out net savings of over £380 million which have already been delivered, with annual savings of £180 million, and total net savings are forecast to be over £1 billion by 2025.

2. While the PLSA agrees that increasing scale of pools could be beneficial for Funds, there are concerns about the intentions of building "scale as quickly as possible", as mentioned in the consultation. As the responsibility and risk of investments remains at a Fund level, we urge that assets should be transitioned to pools in an efficient and well governed manner, without artificial timelines, which could be detrimental to value, and considerations should be given to ensure the transitioning of assets is in fact the best option for each Fund. Nevertheless, the PLSA encourages Funds which have not engaged with their pools to start doing so.

3. In a recent survey of PLSA LGPS members[1], 45% of respondents believe the main reason Funds are reluctant to transfer assets to a pool are due to the pool being perceived to not have all of the investment options that are needed. Other reasons include partner funds not readily cooperating with one another on investment strategy (33%) and the governance structuring not enabling quick decisions (30%). Furthermore, five per cent feel the governance structure within some pools is not suitable for their Fund's needs. However, it is important to note that a quarter of respondents did not identify any reasons why they would be reluctant to transfer assets to pools.

4. Therefore, the PLSA would support that the "Good Governance Review", which is being developed for some time now, is implemented as soon as possible and considers how to strengthen the relationship between partner Funds and pools.

5. There are also investment considerations which should be taken into account when making a decision of transferring assets to a pool. Nearly half (45%) of the survey respondents rejected such a move because they felt it would not represent value for money. A quarter also feel it may not contractually be possible (25%) and could be detrimental to return on investment (28%). Some 23% of respondents did not choose any reason in this survey question.

[1] Survey of 41 PLSA members, with the large majority (90%) being LGPS Funds in England and Wales. These results represent mostly Fund views, only one pool replied to the survey.

6. The PLSA has been made aware by its members of passive investments which have been made outside of the pool but which are already benefitting from large discounts on fees, with the latter being accelerated due to the advent of pooling. The majority of these assets benefit from oversight from pools, and there is no obvious value for them to be replicated by a pool. However, not all passive investments are the same, and consideration should be given to transfer assets such as factor-based investments, if there is better value for money to be had in a pool.

7. There are also several examples of legacy investments with long-dated maturities, such as private markets, in which there is no rationale for transfer, and in fact there would be a negative outcome if these assets transitioned to the pools. With fees already negotiated, and with typically no ability to adjust them post commitment, transferring these assets to the pool may simply incur new legal and tax costs.

8. There are also other investments Funds are making that currently cannot be conducted by pools (though we would expect capabilities to develop over time as Funds' needs become clearer). For example, most Funds make investments on a liability risk basis, not always and uniformly for growth, which are tailored to the Fund's needs and cannot be done by the pool at this moment in time.

9. LGPS Funds have many differences among themselves, such as their employer base, cashflow and investment beliefs, which means not all pool investments would necessarily be suited for the myriad of Fund strategies. However, some pools of course do have the capabilities to tackle these fund strategic variations and there may be scope to explore how all pools could be shifted into that capability space. Some of the areas where the investment beliefs differ include the following:

- Role of active management: Some Funds believe it adds value over the long term while others do not
- Emerging markets: Funds have different levels of comfort in their level of allocation in this asset class, and some prefer a regional approach
- Diversification and complexity: Some Funds utilise a wide range of assets for diversification benefit and others have a simpler structure
- Private market illiquidity premium: There is a range of views and evidence on the long-term net risk adjusted return and caution over the additional governance budget required to invest in these assets
- Use of derivatives: Some Funds have implemented equity protection strategies and use these and other strategic overlays for managing their asset allocation and risk exposure (including currency); others are less comfortable with these products and/or take a longer-term perspective
- In-house management: Requires a higher level on resource and governance and can bring increased operational risk but also the benefits of lower overall cost and greater control
- Responsible investment: Most Funds have adopted a policy of engagement over divestment, but some have divested in certain areas and have exclusion policies in place

- Net Zero: There is a range of targets among Funds and across the pensions industry, with some strategies more focused on “greening” their portfolio aligned with own transition plans, while others may take a longer-term approach, championing initiatives which may catalyst wider transition and generate improvement over time.

10. The PLSA fully supports the Government’s intention to promote collaboration between pools, and agrees more initiatives such as the London Fund and GLIL Infrastructure would be positive and welcomed by LGPS funds. An option which could be considered are Shared Servicing Agreements, which would provide an organic transition to full collaboration between pools. However, going forward, and if merger of pools is considered, our members point out to the potential concentration risk that could occur – since more Funds would be investing in the same assets - and how important diversification of investments is for the success of the LGPS.

11. The PLSA would also like to caution in regard to the definitions used in the consultation relating to pooled assets and assets which are under pool management, which says the following: “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.” We would like to see the definitions amended to reflect that all pooled assets, independent of their category, are owned by the Funds and then invested by the pools. What the pools own is the investment vehicle.

12. In our members view, it would make more sense to distinguish between assets under pool management (invested in an investment vehicle owned by the pool), pooled assets (which are managed by the Fund but supported by the pool), and un-pooled assets (which are fully managed by the fund).

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?

13. The PLSA is supportive of LGPS Funds transitioning their listed assets to pools if they have not done so, providing this is not done at a detriment to the investments and the Funds’ investment strategies. That said, our members consider March 2025 to be a very ambitious deadline and the PLSA does not support that the Government proceeds in this way due to the issues explained below.

14. The PLSA pool members, on one hand, have signalled the timeline is not sufficient for them to set up new sub-funds which are needed to invest the additional listed assets they will be managing for their partner funds. There are also Responsible Investment (RI) strategies which need to be considered when setting up these funds, which are often different across LGPS Funds.

15. On the other hand, our Fund members also have doubts in relation to the feasibility of complying with this deadline. In a recent survey, while almost half (46%) said it is likely they can comply with the timeline, one in seven (17%) say it is unlikely and a quarter are unable to say (22%).

16. The PLSA and its LGPS members would prefer not having a specific deadline for asset transition. Instead, Funds should create a plan for the transition of their unlisted and listed assets, including the detailed rationale for assets that will remain outside of the pool, to be provided in the Investment Strategy Statement (ISS). Assurances should be given by Funds that they are complying with their plans. We would support the Government setting up a timeline for this plan to be presented.

17. The PLSA is pleased to see the Government plans to provide fuller guidance on the existing requirements for ISS in relation to pooling, including guidance on rationale, value for money and review for assets which are not intended to pool. We would also support the creation of a template for the ISS, since at the moment each Fund/consultant devises their own statement.

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?

18. The PLSA is supportive of revised guidance setting clear standards on how pools and partner Funds should interact, which is long overdue. However, considering there are three different type of pool models operating in the LGPS, these should be taken into account when setting up this guidance. For example, not all pools are FCA regulated and/or currently have the regulatory permissions to manage money and provide advice, with some having named an operator to do so.

19. On the specific characteristics which are being proposed to be included in the guidance, the PLSA members have strong views in relation to the proposal of pools "actively advising funds regarding investment decisions, including investment strategies". At the moment, Funds believe that some pools do not have enough in-house expertise to provide this type of advice. Moving to such a structure could also create conflicts of interest which would put Funds in a position to identify and manage these (which is already the case with investment consultants).

20. However, our members agree that pools are an important part for this discussion, as there is a risk Funds could create an investment strategy the pool is unable for fulfil, as mentioned elsewhere. The PLSA believes Funds should thus engage with their pool when setting up their strategic investment strategy, alongside investment consultants and other interested parties.

21. If the direction of travel is for pools to set up the necessary in-house expertise to provide advice to Funds, they should be FCA regulated, within a robust governance and oversight structure. There should be no room for conflicts of interests to rise (since pools would be advising on investments they will fulfil). To guarantee this, an external third party should provide oversight of the whole process of advice.

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

22. The PLSA supports the Government's intention of having each administering authority setting a training policy for committee members.

23. In a recent survey of PLSA LGPS members, although three-quarters (76%) believe that pensions committees know the expected standards of knowledge and understanding, only 48% believe pensions committees currently meet the knowledge and understanding requirements expected of them. Most feel members of Pensions Committees should be required to attend accredited training courses (92%).

24. The areas where pensions committees are seen to be the most lacking by the survey respondents include the law relating to pensions (42%) and the law relating to the discharge of functions by local authorities (36%). More than a quarter mention committee members are lacking knowledge of LGPS Employers, including their responsibilities to the scheme, and how their contribution rates are calculated (31%), and statutory duties of Administering Authorities (31%). Other areas mentioned include investment choices and implication for members (25%), fund management (22%), investment of assets (22%) and strategic asset allocation (21%).

25. Nevertheless, setting up a training policy for pensions committee members will not solve the issue. The current lack of training can be attributed to a high turnover of committee members – due to elections or other council demands - and time and resource constraints. The PLSA would support the implementation of the "Good Governance Review" recommendations, which has proposed enhanced training requirements for Committee members, on a par with Local Board members, since 2019.[2] Our members would also like to see regulators provide more clarity on training requirements for the LGPS.

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?

26. The vast majority of our members believe it is useful that the Government is proposing to require a single standard set of data on investments across annual reports and LGPS statistics (87%). Indeed, most feel it will be easy to show a comparison between actual and strategic asset allocation in their annual report (71%) and a progress update on pooling (64%).

27. As the Government rightly identifies, LGPS Funds have different set of reporting requirements, so we would support this new single standard set of data is designed in a way it can be used by funds to fulfil all their different current obligations. Guidance on how this data needs to be presented, what to include and, potentially, a template for Funds to complete would be greatly appreciated by Funds. The latter is due to the fact that our members have mixed views on how easy it will be to report on the net savings from pooling, with a third (32%) saying it will be easy and nearly a third (29%) saying it will be difficult.

28. In relation to the technical details of the new data set, we would like to refer our answer to question 1 in relation to the categorisation of assets – pooled assets and assets under pool management – and propose a different approach.

[2] "Good Governance in the LGPS", Hymans Robertson, July 2019 <https://www.lgpsboard.org/images/PDF/GGreport.pdf>

29. While we understand the rationale behind the idea of setting benchmarks for each asset class, we believe it will not be practical to achieve. Funds' investment strategies are highly correlated with risk, funding position and liabilities, which means they will have different objectives for each Fund. There is a danger that returns are taken out of context – and could lead to inappropriate short term investment decisions being made.

30. The PLSA would support, instead, bringing the current thinking in other areas of the UK pensions system to be leveraged and applied to the LGPS. Lessons from the Value for Money work conducted by the Department for Work and Pensions and the FCA should be taken and consideration should be given how these could be applied to pooling, ensuring these structures are fit for purpose and are producing benefits to members.

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

31. The PLSA agrees with the changes to the Scheme Annual Report, provided the Scheme Advisory Board is well-resourced to undertake this work and it does not impose an extra burden on Funds to supply this data.

32. In a survey recently published, PLSA LGPS members noted an increase in their reporting requirements, with over half (54%) of respondents feeling that the legislation/regulatory requirements are too complex to execute, while two in five (43%) continue to feel legislation/regulatory requirements hinder them from doing their job effectively. We would appreciate if this new requirement were joined up with the single standard set of data mentioned in the question above, so it does not add volume and complexity to LGPS Funds reporting requirements.

LGPS Investments and Levelling Up

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

33. LGPS Funds have a long-standing relationship with their local community, and in recent years, due to an increase in impact investments, more and more Funds have committed to assets which can be classified as "Levelling Up" investments.

34. Among our members, a quarter say they already invest 5% or more in levelling up assets (25%), with almost half (47%) saying they do not. This does not mean, however, they have not invested or are not planning to invest in these assets.

35. In relation to the definitions used in the consultation, 66% are likely to say that an appropriate measure for defining how an investment meets the levelling up requirement is that "the investment supports any local area within the UK" than those who an appropriate measure is "the investment makes a measurable contribution to one of the levelling up missions set out in the Levelling Up White Paper" (58%).

36. Since Levelling Up is not an asset class in itself, Funds would appreciate if Government considered how these investments can be mapped using the existing asset classes, and consider what current reporting areas could be used for this purpose. Doing otherwise may create

additional and unnecessary complexity and paperwork for the LGPS. We know as well that resourcing to fulfil all of the growing regulatory demands for the Scheme is a consistent challenge for Funds across the country.

37. Some of our members have strong views on the fact Government is setting up an ambition to have Funds invest 5% of their assets in Levelling Up assets. While a third (30%) of survey respondents are supporting the plan, two in five are against this requirement (39%). This is not due to the nature of these investments – as we established, the large majority of Funds are looking into these opportunities – but due to the fact that they believe such ambition set by Government would impact their fiduciary duty.

38. In fact, legal advice from Nigel Giffen QC to SAB in 2014 said the following:

- The administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the fund (balancing risk and return in the normal way).
- However, so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund. In taking account of any such considerations, the administering authority may not prefer its own particular interests to those of other scheme employers, and should not seek to impose its particular views where those would not be widely shared by scheme employers and members (nor may other scheme employers impose their views upon the administering authority).

39. Due to this, the PLSA would support closer engagement between Government and LGPS Funds to determine best practices in relation to Levelling Up and private markets investments (addressed in question 11) which will not impact Funds fiduciary duties by stipulating a specific, targeted requirement. Additionally, many member Funds we spoke with for this consultation have indicated to us that they already invest roughly 5% into what would qualify as Levelling Up, which would make a mandatory target also unnecessary.

40. Besides the issues with fiduciary duty, if all LGPS Funds comply with the suggested Government targets – 5% for Levelling Up and 10% for Private Equity (or private markets, as mentioned in question 11) – this would probably mean there would be more capital to be deployed than there are appropriate products to meet demand.

41. PLSA members believe the best way Government can guarantee more investments are made in assets which can comply with Levelling Up missions is to support the creation of the right opportunities in the market for LGPS Funds, either by enacting regulatory change or by setting up fiscal benefits for Funds.

42. There are numerous examples of LGPS Funds investing in local assets and private markets, so we present a couple of case studies in the two areas the Government wants to see more initiative from Funds, as a way to showcase best practices already being developed in these areas.

CASE STUDY – GRAVITY LOAN

In July 2020, at the height of the Covid-19 pandemic, Merseyside Pension Fund (MPF) committed to a senior land and infrastructure loan in Somerset. The loan was secured against an existing strategic site in South West England known as "Gravity" and provided funding to refinance existing debt, finish the buildout of infrastructure, remediation, and fund enhanced planning.

The project's objective was to create the UK's first "Smart Campus" that would be technology and low carbon focused. The investment contributed to creating 616 acres for Storage & Distribution, Energy Generation, Manufacturing, R&D, and leisure. The initiative targeted occupiers in various sectors, including electric car manufacturing, e-commerce, food distribution, and life sciences.

In 2017, the site had gained Enterprise Zone status, valid until 2042. Businesses basing themselves on the site benefit from lower taxes, access to superfast broadband, and streamlined planning permission to facilitate local infrastructure.

In 2022, the Gravity Local Development Order (LDO) was adopted by Sedgemoor District Council (now Somerset Council). The LDO is a streamlined form of planning consent, contributing to the UK proposition to attract investors and new business to Somerset, as it provides certainty to inform decision-making.

Gravity is collaborating with Bridgwater & Taunton College to create a leading network of education and skills initiatives. Together, they developed a "Skills Charter" intended to outline principles and objectives from which individual Employment and Skills Plans for each occupier/site will be developed to deliver benefits to the local community, Gravity, and its occupiers. The objectives are to meet occupier demand for talent and provide strategic linkages into local schools, such as Bridgewater and Taunton College, to foster young people's ambition and provide the new workforce with support and training.

The Gravity site can also offer bespoke renewable and low-carbon on-site energy solutions. In addition, it has licences to abstract up to 1.1M m^3/year from the adjacent Huntspill River.

In 2019, Gravity was shortlisted by the Advanced Propulsion centre commissioned by the UK government to identify locations for Gigafactory sites. It resulted in its international promotion by The Department for International Trade. Gravity also had strategic ties with the Faraday Institute to attract battery producers to the UK, leading to discussions with global battery producers about potential factory requirements.

The efforts of promoting the site proved to be fruitful. In July, Tata Group announced that it had chosen Gravity for the location of its £4 billion electric car battery gigafactory. It will be one of the largest-ever investments in the UK automotive sector and is said to create up to 4,000 highly skilled jobs on-site. With an initial output of 40GWh, it will be one of the largest factories in Europe, providing almost half of the battery production that the Faraday Institution estimates the UK will need by 2030 to support its transition to zero emissions vehicles.

The gigafactory will secure UK-produced batteries for another Tata Sons investment, Jaguar Land Rover, as well as other manufacturers in the UK and Europe. It will supply JLR's future battery-electric models, including the Range Rover, Defender, Discovery, and Jaguar brands. Production at the new gigafactory is due to start in 2026.

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

43. The PLSA is supportive of the intention making Levelling Up investments through pools as a way of preventing conflicts of interest, which might arise if these investments are made directly via funds. We also agree that some pools currently do not have internal asset management capacity or the range of investment vehicles required for these investments.

44. While we are supportive of the idea of Funds investing in other pools products as a way to access investment opportunities, there are a number of issues that need to be taken into account:

- Pools offerings are designed for their partner Funds, which means they might not suit other Funds' needs.

- External pool customers would be subject to different pricing when compared to partner Funds. It can be expected external customers will have an added layer of costs.
- Some of the sub-funds offered by pools have a limited capacity and partner Funds should be prioritised, which means there might not be availability for external Funds.
- Pool structures have been developed to grow alongside their partner Funds' needs. If pools start to attend to external customers, they might not have the required capacity in various functions of the business.
- Funds may be better served by investing in asset managers' offerings via their pool directly.

45. Currently, there are other areas of collaboration between LGPS Funds/pools, such as passive investments being managed outside the pools (mentioned in our first answer) and National Frameworks, which allow Funds reduced procurement timescales and costs. Due to the constraints mentioned above, and these other collaboration examples, the PLSA would support further research from Government into this area. It is also relevant to point out that governance will have a big part to play in any collaboration/possible merger situation, so this topic should be considered under the "Good Governance Review".

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

46. LGPS Funds invest their assets with the goal to deliver appropriate risk adjusted returns, and their fiduciary duty – as mentioned before – cannot be put in question to fulfil a Government policy.

47. That said, the PLSA would support a plan for Funds to present a Levelling Up impact assessment instead of the plan proposed in the consultation. This document could be produced periodically (for example every three years), which would incentivise funds and pools to have something to report and would have impact without confusing the objectives of the scheme. This would also prevent a considerable increase in Funds' current reporting and regulatory requirements.

48. Consideration should also be given to who will be the target audience of the report, since experience in other areas of the pensions system, such as in DC with the Chair Statement and overall with TCFD reports, shows reports have become extremely complex and lengthy and not fit for purpose if the goal is to inform scheme members.

49. However, this assessment (or any type of Levelling Up plan) will need to have the following caveats:

- Levelling up is not an asset class in itself, so any investment strategy and reporting needs to be done through main asset classes, such as equity, fixed income, real estate, private equity, etc.
- There should not be any specific target allocation set by Government for funds to invest in these assets, since this will depend on the Funds own investment strategy, which is designed to deliver the appropriate risk adjusted returns, and is in line with their fiduciary duty.

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

50. The PLSA has no objection to this proposal, as long as the Government support reporting to be conducted by asset class where it pertains to assets that can be considered as contributing to the Levelling Up missions. Asset managers do not have data for classifying assets as “Levelling Up”, and it would take several years for them to be able to gather that information.

51. Considering that most pools/funds have not done a review on what assets can constitute “Levelling Up”, it will take some time for these assessments to be completed. We would like the Government to be mindful of this when setting up requirements in guidance.

Investment opportunities in private equity

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?

52. As the Government correctly identifies, having a diversified portfolio is crucial for the success of LGPS Funds, which is why the vast majority of PLSA Fund members currently invest in private markets (81%), among several other asset classes, with one in seven (17%) currently investing 10% or more in private equity.

53. All LGPS Funds will have assessed opportunities in private equity and private markets more generally as part of their strategic allocation design, based on the Fund’s potential risk and reward appetite, and made a decision in regards to these investments. This is best practice across the private sector as well. Strategic allocations are periodically reviewed, and for some Funds investments in these assets will make more sense than for others. Due to this, and the fact that suggesting a specific target allocation will impact the Funds’ fiduciary duty, the PLSA does not consider an ambition of 10% should be set.

54. Our members would also like to point out that the focus should be on growth capital in private markets as a whole instead of just focusing on private equity. Investing in growth capital can be achieved through equity, but also by debt or credit assets, among other asset classes. Having a ‘private capital’ focus allows investors to build private market risk appetites which suits their own circumstances, rather than pushing everyone to a more narrowly defined and therefore potentially crowded part of the market with more volatile returns, which could present concentration risks, asset bubbles and poor Value for Money.

55. Nevertheless, among our members, the vast majority say they already invest in unlisted equity (70%). Among those who don’t, one in ten say that it is due there being not enough unlisted equity opportunities, of sufficient calibre, for their fund or pool to invest in (9%). Other reasons given by respondents include:

- there is a lack of suitable, low-cost, investment vehicles/growth funds (9%),
- the Pensions Committee being concerned that unlisted equity results in certain high costs but uncertain high returns (6%),

- and the belief that unlisted equities do not have the right risk and return characteristics for the objectives of their fund or pool (6%).

56. Considering that around three-quarters of LGPS members feel that Pensions Committees have appropriate external support to make investment decisions, particularly in relation to unlisted equities (70%), and that Committees use investment consultants to an appropriate degree to support decisions around investment in these assets (69%), the issue lies with the risk/reward balance of these investments.

57. The Government does have a role to play if it wants those LGPS Funds which have identified private equity/private markets as a fit-for-purpose investment, to increase their allocations. If the LGPS and private capital is being asked to make large, long-term, capital investments, the Government should consider offering corresponding long-term guarantees and/or the necessary policy certainty - such as setting out a clear plan for the future of the UK economy - to protect these potential investors.

58. As mentioned in PLSA's Pensions & Growth: Supporting Pensions Investment in the UK (June 2023), it is essential to establish a rich, and continuous pipeline of enterprises needing investment for providers to bring to market and investors to choose from. The asset management industry should be encouraged to focus on sourcing UK opportunities and developing new investment funds and products. Both the opportunities and products need to be capable of established an appropriate risk and return profile for pension fund needs.

59. The PLSA members believe that the main incentive that will encourage pension committees to consider investing in productive assets is for Government to under-write some of the downside risk of such assets (66%).

60. The Government should also consider the creation of a low-cost growth fund run by the Government or the private sector or the creation of fiscal incentives. Initiatives like LIFTS, which alters the risk-return component of an investment, are appealing to pension funds provided the financial support by government is of a long-term nature. Enhancing the tax treatment of domestic investments, as they do in France and Australia, merits exploration.

61. As mentioned in Q7, we are including case studies in our response to highlight some of the work LGPS Funds have already developed in these asset classes, and how these have evolved over time.

CASE STUDY – WEST MIDLANDS PENSION FUND

The West Midland Pension Fund (WMPF) is the third largest Local Government Pension Scheme and one of the top 25 defined benefit schemes in the UK by asset size. The Fund has long strived to ensure that its asset allocation considers the widest opportunity set. WMPF started investing in private equity in the mid-1990's, but over the years, as both capability within WMPF grew, and the asset management industry innovated, WMPF's portfolio of private market assets has expanded to include infrastructure and private Debt, alongside special opportunities including those emerging through innovative partnerships and networks within its region.

WMPF private markets allocation (30/6/2023)

Asset	% of Portfolio	£million
Private Equity incl. Venture Capital	8%	1,445
Special Opportunities	1%	223
Private Debt	3%	568
Infrastructure	5%	1,038
Property	7%	1,366
Total	24%	4,639

Over the last 25 years, the Fund's strategic allocation to illiquids has steadily increased as a percentage of WMPF's return enhancing assets. More recently, the emphasis in both liquid and illiquids has been away from growth assets to income generating assets. This is in the context of an overall lower risk portfolio and one that is more liability aware and conscious of cashflows. In the private asset portfolio, this has resulted in reduced allocations to private equity and increased allocations to private credit and infrastructure with property held steady.

In terms of implementation, in the years prior to pooling, WMPF built an internal capability in private equity allowing it to generally invest as a limited partner rather than use the fund-of-fund route. This capability was expanded to include infrastructure and private credit. WMPF was pleased to seed the establishment of a private markets team and fund at its pooling partner LGPS Central when it was established in 2018. Subsequent to that, the Fund have made most new private asset commitments, bar a few local investments, via the pool. WMPF came into pooling with an established portfolio and capability across the Illiquid asset portfolio. Being able to transfer the capability to the pool, and add breadth and depth to this, has enhanced what was already a successful program which continues to deliver excellent risk adjusted returns.

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

62. We are supportive of the Government's initiative to explore ways in which the British Business Bank (BBB) can play a greater role in this area and have been facilitating roundtable discussions between the BBB and PLSA members. Indeed, we called for action on this issue in our report, Pensions & Growth: Supporting Pensions Investment in the UK.

63. The British Business Bank should be given an extended scope to support companies that need scale up capital, and to create or partner with funds that can bundle up the assets in a form that would be suitable for pension funds.

64. That said, we note that one of the main objectives of pooling is to reduce costs paid by LGPS Funds, and fees has been one of the deterrents for Funds to invest in private markets. As such, if the BBB is going to create an offering in this area, this should be offered on a cost only basis if the intention is to encourage greater participation in this part of the market.

Improving the provision of investment consultancy services to the LGPS

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

65. The PLSA agrees with the proposed changes. However, if the direction of travel is for pools to advise Funds on investment strategy, pools should not continue to be exempt from the requirement of the administering authority setting strategic objectives for the investment consultancy provider. In line with good governance and industry trend, strategic objectives are now becoming common practice across advisers.

Updating the LGPS definition of investments

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

66. No.

Public sector equality duty

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.

67. No.

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