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HM Treasury
Pensions Review Team

Our Ref: MPF/PJW

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Please ask for: Peter Wallach

Date: 25 September 2024

Dear Pensions Review Team

Pensions Investment Review: Call for Evidence

I set out below Merseyside Pension Fund's response to the call for evidence. Responses have been limited to those questions relevant to the LGPS and to the Fund's experience.

Merseyside Pension Fund and the Northern LGPS Pool

MPF is the 6th largest fund in the LGPS in England & Wales. As at 31 March 2024 MPF had assets of nearly £11bn, over 200 participating employers and around 150,000 scheme members.

MPF is part of the c£61bn Northern LGPS Pool ('NLGPS') alongside Greater Manchester Pension Fund and West Yorkshire Pension Fund. The NLGPS governance model reflects the scale of the individual underlying partner funds and the sizeable and experienced internal investment teams at each of the funds. The Pool shares the combined resources of the funds to research and monitor investments, whilst investing collectively in asset classes where there is clear overlap using pool vehicles such as GLIL (a c£4bn open ended fund investing in direct UK Infrastructure, which has been developed collaboratively with the LPP pool) and NPEP – a company created by NLGPS to make collective private equity investments, including lower cost co-investment.

<u>Scale and consolidation</u>

To what extent has LGPS asset pooling been successful, including specific models of pooling, with respect to delivering improved long-term risk-adjusted returns and capacity to invest in a wider range of asset classes?

The introduction of asset pooling was a significant change in the structure of the LGPS and it has been delivered successfully by the Northern LGPS Pool (NLGPS) in accordance with the government's criteria.

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Pooling has provided the opportunity for all LGPS funds to have access to asset classes that they may have been precluded from primarily due to limited resources, expertise and scale. A broader asset choice should aid diversification and risk management. However, as these asset classes relate primarily to private market investments which are characteristically longer-term in nature, it is arguably too soon to assess their influence on long-term risk adjusted returns.

As one of the largest funds in the LGPS, prior to the advent of pooling, MPF was already investing in a wide range of asset classes with significant exposure to the UK. Due to the existing scale of the three NLGPS partner funds, the vast majority of the benefits of pooling are in respect of private market assets which tend to carry heavier investment fees. Membership of Northern LGPS pool has given MPF the scope to generate further economies of scale and to share resources to make increasingly direct investments. The Pool has established vehicles making collective investments in private market assets, in particular infrastructure and private equity. MPF has £500m in GLIL, a direct infrastructure vehicle predominately invested in core UK infrastructure - Home - Glil

MPF has committed £590m to NPEP, a collective private equity vehicle, which has enabled MPF to significantly increase its participation in co-investments which bring a significantly lower fee load. - Northern Private Equity Pool LP Holdings | Northern LGPS.

MPF invests individually as well as collectively with its partner funds into UK housing. To date £108m has been invested in UK housing and assisted living through the Fund's investment programme and further £164m through its commercial loan book. These figures do not include a recent sale of land (£62m) to a housebuilder following MPF gaining planning approval for the construction of 635 dwellings.
NLGPS' net cost savings to 31 March 2024 are calculated to be £216.5m, the majority of which derive from the GLIL direct infrastructure vehicle.

Costs vs Value

Is there a case for Government interventions, aimed at employers or other participants in the market, designed to encourage pension schemes to increase their investment budgets in order to seek higher investment returns from a wider range of asset classes?

The primary focus of the LGPS has been on fiduciary duty and achieving the best net of fees, risk-adjusted returns. We are not aware that LGPS funds are constrained by investment budgets notional or otherwise although the cost disclosure initiative has ensured a focus on driving down investment costs.

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Investing in the UK

What is the potential for a more consolidated LGPS and workplace DC market, combined with an increased focus on net investment returns (rather than costs), to increase net investment in UK asset classes such as unlisted and listed equity and infrastructure, and the potential impacts of such an increase on UK growth?

MPF's experience with GLIL suggests that collaboration between LGPS pools and funds is much quicker to achieve and can be as effective as consolidation in increasing investment in UK infrastructure. GLIL has delivered the additional benefit of attracting investment from NEST as well as capital from the six funds of the two pools which established it. GLIL has operated at an all-in-cost of less than 0.3% p.a. which is considerably less than the typical infrastructure fund.

An emphasis on value rather than costs may be helpful in moving the focus from costs to net of fee returns as private market investment tend to have materially higher investment costs. Risk-adjusted investment returns, net of fees, is a very important consideration for MPF when undertaking due diligence on investment opportunities. As is typical of many LGPS funds and pools, MPF has significant investments in UK assets (including local investments). In our experience, the limiting factor for local investment is more to do with the availability of assets of a suitable quality and less to do with costs although smaller scale projects generally bring a heavier fee load and greater demands on resourcing.

MPF's involvement in the NLGPS Pool has enabled us to introduce co-investment into the private equity portfolio and cease making any fund-of-funds investments, both of which have reduced manager fees.

It is rather difficult to assess the likely impact of increased investment in the UK by UK pension funds on UK economic growth, particularly as businesses' operations have become increasingly international. Investing domestically would ameliorate the risk arising from fluctuations in sterling against other international currencies. There is likely to be a positive effect from an increased capital allocation to the UK provided investment returns are comparable to those achieved from investing more overseas.

What are the main factors behind changing patterns of UK pension fund investment in UK asset classes (including UK-listed equities), such as past and predicted asset price performance and cost factors?

The movement away from the UK is driven by the investment principle of diversification, as well as gaining exposure to a wider opportunity set, rather than a particular view on the UK. There is considerable pressure to invest in global benchmark weights for risk and performance purposes. Given the US is the dominant geographical weight in any global benchmark, investing globally will naturally reduce the capital allocated for investment in other countries including the UK. MPF has traditionally been a big supporter of the UK and continues to overweight its allocation to the UK compared to the global benchmark

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MPF allocates its assets in order to achieve the most appropriate risk adjusted returns taking account of its liability profile, liquidity requirements and membership demographic. As the table below demonstrates, well over 40% of MPF's capital is committed to UK assets. As the investment returns from UK public market assets have lagged those of overseas markets for a number of years, and there is little evidence to suggest that this will change, strategically, MPF is likely to continue increasing its exposure to international markets at the expense of domestic assets.

The average annual growth from 1999 to 2024 for the FTSE All share was 7.73%, and the FTSE All-World was 11.62%. Over the 25 year period, this compounds to 227.23% against 476.18%

The table below details Merseyside Pension Fund's investments in the United Kingdom. The values include the value of undrawn commitments.

Table 1 (bid valuation basis)

£m Asset values as at 31 March 2024	**Total**
UK Listed Equities	1,400
UK Government Bonds	1,321
UK Infrastructure	733
UK Property	875
UK Private Equity	190
UK Private Debt	74
Total	**4,592**

Source: Northern Trust

It is also worth noting that the UK is not alone in experiencing a diminution in domestic investment. Investment in domestic markets has fallen in all the major pension countries from 67.1% in 2002 to 37.7% in 2022. The domestic allocation in the UK is above the average of the other countries.

1. Is there a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC and LGPS funds to UK assets or particular UK asset classes, taking into account the priorities of the review to improve saver outcomes and boost UK growth? In addition, for the LGPS, there are options to support and incentivise investment in local communities contributing to local and regional growth. What are the options for those incentives and requirements and what are their relative merits and predicted effectiveness?

The purpose of the LGPS is to provide pensions to members at a stable and affordable cost to employers. In the absence of any direction to the contrary, LGPS funds have a fiduciary duty to adopt the strategic asset allocation they deem will provide the best long-term return for an appropriate level of risk. Whilst past performance is no guide to the future, based on historic returns, it would be difficult for those charged with governance to favour investing in the UK relative

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to overseas without clear financial reasons to do so. MPF would not support proposals which impinged on the exercise by Members of their fiduciary duty.

When making large, long-term, capital investments, it is very helpful if there is policy certainty and/or Government guarantees as there is competition for MPF's investment capital across a range of asset classes and geographies.

Notwithstanding this, as set out in the previous question, MPF has significant investments in the UK and these include some substantial investments contributing to regeneration and growth in the Merseyside region. In 2016, with the agreement of its Pensions Committee, MPF launched the Catalyst fund with the intention of stimulating and identifying investment opportunities in the region. https://www.merseysidecatalystfund.org/

The investments are principally through debt financing which enables projects to be completed and the capital recycled into new opportunities. Currently, MPF has advanced around £100m to finance regional projects and an additional £20m to a fund providing finance to SMEs. These regional projects include the construction of the Mersey Heat district heat network, the regeneration of warehousing into residential accommodation and various industrial/mixed use investments. Because MPF was able to provide Mersey Heat with flexible financing terms on a patient capital basis, this supported the project team to navigate complex challenges over its development and construction phase.

MPF has felt able to implement this strategy within its fiduciary duty. A common issue of local investments is the small scale and often lower quality counterparts involved. Support and incentives to make local projects more viable would be helpful in increasing the availability of investible opportunities. Government entities taking first-loss positions or providing attractive tax benefits for UK investments would be examples. Similarly, incentives to stimulate the building of housing, industrial estates and commercial buildings by releasing government owned land/brownfield at a reasonable cost and streamlining and simplifying the planning process to enable local building projects to be started promptly, would aid decision-making.

In addition to its local investments, MPF has a current commercial loan book of around £250m in financing to 10 UK projects. An example of the types and purpose of these loans is provided in the Gravity Loan case study (page 29) cited in the PLSA's *Pensions & Growth: Creating a pipeline of investable UK opportunities* report.

Included in MPF's Private Equity Portfolio is £122m committed to UK Venture and Growth investment opportunities. This includes our investment in the Government-backed Clean Growth Fund, which contributes to MPF's climate solutions goal and has the potential to catalyse significant positive real-world climate impacts.

Another example of MPF working with our Northern LGPS partners on local investment is Northern Gritstone, an investment fund established with the assistance of the Universities of Manchester, Leeds and Sheffield with the dual purpose of supporting the commercialisation of science and IP-rich businesses

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originating from these institutions alongside funding the development of similar businesses based across the North of England. MPF is working with the Northern Gritstone team to support the inclusion of organisations in Liverpool City Region in this growing investment eco-system.

We are very supportive of the concept of the National Wealth Fund (NWF), particularly the intention for investors to be able to participate on a project by project basis. If the NWF is able to bring investors together to undertake projects that historically have been to large or long-term for many institutional investors and, at the same time, mitigate the risks of early-stage venture or unproven technologies, we believe it will have an excellent opportunity to catalyse the aggregation of capital from investors such as MPF.

Yours sincerely

P Wallach

Peter Wallach
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