Next steps consultation

I am responding to this consultation on behalf of Merseyside Pension Fund. On 26 September, Pensions Committee considered and discussed the consultation and approved the following response be made.

In responding to this consultation, Merseyside Pension Fund (MPF) confirms its commitment to the principle of asset pooling in the LGPS. Since 2016, the fund has been working successfully with its Northern LGPS pooling partners to deliver the criteria for investment reform set out in the November 2015 guidance. To date, substantial progress has been made and significant cost savings and efficiencies achieved through the pooling of assets and collaboration on investment initiatives. MPF anticipates delivering further efficiencies through its pool as opportunities arise.

Chapter 2: Asset pooling in the LGPS

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?

In establishing the 8 LGPS investment pools, LGPS funds have taken account of the criteria set out by government in the original pooling consultation and developed pool structures that accord with their investment philosophies and beliefs. Very considerable progress has been made since 2015 which is recognised in this consultation. Any material changes to guidance in this area may have the effect of inhibiting further progress in delivering value for money and good net performance.

Good governance is fundamental to the success of any initiative. For effective delivery of investment pooling, it is important that the roles of the investment pools and LGPS funds are clarified and aligned appropriately and we are supportive of revised guidance setting clear standards on how pools and partner funds should interact. We note that opportunity was not taken to include in this consultation proposals to implement the recommendations contained in the action plan relating to the Scheme Advisory Board’s Good Governance in the LGPS project and would encourage the department to address this matter as a priority.

In the case of Northern LGPS, a prescriptive approach could have the effect of increasing costs without a commensurate level of financial benefit. We support the government’s ambition for greater collaboration and joint working between pools and the potential to grow in-house investment management. Indeed, recent research by CEM identifies that cost savings are driven as much by implementation decisions as scale with both having a part to play.

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?

Progress to date suggests that, in the main, LGPS funds have been transitioning assets to pools as and when pools implement asset mandates that fulfil LGPS funds’ requirements. In this context, a deadline could be a blunt instrument and result in suboptimal investment decisions being implemented. As recognised in the draft guidance (section 19), it is important, therefore, that any deadline should recognise this and the need for pools to provide asset strategies that accord with LGPS funds' investment requirements.

With regard to the transition of assets to the Pool, we welcome the distinction made between pooled assets, assets which are under pool management and un-pooled assets. We believe the Investment Strategy Statement (ISS) reporting requirements are reasonable and additional guidance in relation to the content of the ISS will be helpful.

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?

In principle, we support the various aspects set out in the consultation as key to progress and the efficient implementation of investment strategy. Setting Investment strategy is a very significant decision for LGPS funds. As noted in our response to question one, good governance is fundamental to the success of pooling and it is important that funds engage with their pool (assuming their pool has the necessary expertise) when setting their strategic investment strategy.

Pool companies play an important role in the implementation of investment strategy and it is right that they are a party to discussions, as there is a risk funds could create an investment strategy the pool is unable for fulfil effectively. Funds should engage with their pool when setting their strategic investment strategy, alongside investment consultants and other interested parties.

It is already recognised that there is the potential for conflicts of interest with investment consultants and fiduciary managers and it seems reasonable that guidance should acknowledge that there is scope for this to arise in relation to advice from pool companies. Particularly where strategic advice is concerned, pools should not usually be the sole source of advice for funds.

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?

Training and development is an important underpin to good governance in the LGPS. In 2010, MPF adopted the CIPFA Knowledge & Skills framework which sets out some best practice in respect of LGPS training and reporting. More recently, the Good Governance in the LGPS review opines helpfully on this area noting that respondents believed that requirements for Committee should be on a par with Local Pension Boards. We would hope that recommendations from the Scheme Advisory Board in relation to the Good Governance review, which include this important area of training and development, are put in place.

Effective participation in Pension Committee meetings, associated sub-groups and training puts considerable demands on elected Members' time and resources. It would be helpful if this commitment was recognised in guidance and encouraged the provision of enhanced allowances (contingent on fulfilling training/attendance requirements) to reflect this.

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 support the reporting proposals. MPF has reported its assets on this basis for a number of years in its annual report. The area of greatest challenge is achieving a consensus on the reporting of net returns against a consistent benchmark. There are many hurdles, some of the main ones being:

1. Reporting net returns does not provide context around the risk taken.
2. Globally, there are more benchmarks than assets which makes benchmark selection difficult.
3. There are a range of approaches to the benchmarking of unlisted assets.
4. Benchmark providers charge for the provision of benchmark data so any proposal should not have the effect of LGPS funds incurring additional costs.

That being said, the Northern LGPS Joint Committee receives quarterly reports of the combined performance of the partner funds by asset class. This has involved some compromise in terms of benchmarks but is achievable. Should reporting pension funds feel the standard performance benchmark was inappropriate, this could be addressed in the narrative of their report.

This requirement could be seen as analogous to the current arrangements for the calculation of funding position against standard actuarial assumptions.

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

We agree with the reporting requirements. With the variety of reports that LGPS funds are required to make, we would support a new single standard set of data designed in such a way that it can be used by funds to fulfil all their different current obligations.

Chapter 3: LGPS investments and levelling up

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

The definition proposed is clear and broadly based. Over the years, MPF has made and continues to make substantial investments in its local area (Merseyside) as well as across the UK which fall within the definition proposed. Presently, we estimate that around 12% (£1.2bn) of the Fund’s assets are at work in levelling up type investments and committed capital is more than this.

We have enclosed examples of our levelling up investments along with this response.

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

Collaboration between and within LGPS pools and funds is already common particularly in private markets and delivers fee savings by, for example, collective negotiation with an external investment manager to provide a lower fee LGPS share class which is available to all LGPS investors. Collaboration brings benefits of scale, resource and helps reduce the potential for conflicts of interest in relation to local investments.

We agree that funds should be able to invest in another pool's investment vehicle. The requirement for this to be done through their own pool is almost certain to cause funds to incur an additional layer of fees. This is inimical to the original Pooling intention which was to reduce costs, move away from fund of funds and deliver fee savings. Taking account of proposals in question 3, consideration should be given to ways in which this can be achieved most cost effectively. It is difficult to see why there should be an objection to a pension fund investing directly in another pool's investment vehicle provided it has first consulted with its pool company. The final decision should lie with the pension fund.

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

MPF has more than twice the proposed 5% invested in levelling up assets. MPF has invested significant amounts in levelling up investments because it is consistent with our investment strategy and we do not see this changing in the foreseeable future. Notwithstanding this, the recognition, in the consultation, of fiduciary duty as underpinning any investment decision is important and the appropriateness of an allocation to levelling up assets will be a decision for each LGPS fund.

In our experience, most levelling up investments are through private market structures/vehicles. Hence, when calculations are undertaken, undrawn commitments and contingent liabilities as well as capital at work, are important considerations and should be included in the reporting of progress in a levelling up plan.

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

Yes. Although this will be an additional demand on fund resources, in our opinion, a considerable amount of 'levelling up' investment has occurred within the LGPS which is not necessarily recognised and this could be improved by reporting the extent to which levelling up investment is taking place.

Chapter 4: Investment opportunities in private equity

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?

As a maturing fund with an increasing requirement for income, these two factors, along with our funding position and appetite for risk, will be key determinants of our future exposure to all asset classes including private equity.

Currently, MPF has around 10% of its assets in a broadly diversified portfolio of private equity investments. This allocation has arisen from MPF's assessment of opportunities in private markets as part of our strategic allocation design, based on our appetite for risk and return. This is typically best practice across private and public pension funds. Strategic allocations are reviewed periodically, and for some LGPS 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 impinge upon pension funds' fiduciary duty, MPF does not agree that an 'ambition' target should be set. Indeed, based on our experience, we suggest the emphasis should be on growth capital in private markets as a whole, instead of private equity alone. Having a focus on 'private capital' allows pension funds to build private market portfolios which suit their own circumstances, rather than limiting options to a more narrowly defined and therefore potentially crowded part of the market with greater volatility.

To stimulate interest in UK-centric venture and growth equity, we would encourage the government to consider ways in which potential opportunities in growth equity can be made more appealing to investors by incentives such as the provision of first-loss capital or grant funding to encourage further investment in this area.

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?

We have invested alongside the BBB in the past and believe the BBB can play its part in assisting government in providing the types of incentive proposed in our response to question 11.

Chapter 5: Improving the provision of investment consultancy services to the LGPS

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

We already set strategic objectives for providers of investment consultancy services and would support the proposal not to include high-level commentary by actuaries or the like.

With regard to the consultation's reference to pools providing investment advice to LGPS funds, it is for LGPS funds to determine from whom they receive investment advice. However, from a governance perspective, we would argue that independent advice, scrutiny and oversight of the investment decisions taken by the pool is essential. In view of the proposals in question 3, it would seem appropriate in some circumstances that LGPS pool companies should be accountable against objectives.

Chapter 6: Updating the LGPS definition of investments

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

The proposed amendment will be helpful in eliminating any ambiguity.

Chapter 7: Public sector equality duty

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.

None.