



LOCAL PENSION COMMITTEE – 8 SEPTEMBER 2023

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

CONSULTATION: NEXT STEPS ON INVESTMENT AND LGPS CENTRAL MEETINGS UPDATE

Purpose of the Report

1. The purpose of this report is to inform the Committee of a consultation paper issued by the Department for Levelling Up, Housing and Communities (DLUHC) on 11 July 2023, titled “Next Steps on Investment”, to seek the Committee’s views on the proposed responses to that consultation, and to seek approval for the Director of Corporate Resources to be authorised to finalise and submit the consultation response on behalf of the Fund by the required deadline of 2 October 2023.
2. The report also provides the Committee with an update regarding LGPS Central’s Joint Committee, Annual General Meeting, and other relevant matters.

Policy Framework and Previous Decisions

3. The Fund is a participating scheme in the Local Government Pension Scheme (LGPS) Central Pool (Central) alongside Cheshire, Derbyshire, Nottinghamshire, Shropshire, Staffordshire, West Midlands and Worcestershire. As set out in the Investment Strategy Statement it is the Fund’s intention to invest its assets through Central as and when suitable pool investment solutions become available.
4. Central has been in operation since 1 April 2018. As at 31 July 2023 Leicestershire County Council Pension Fund (the Fund) has circa £2.2bn invested in Central, as well as over £350m in uncalled commitments which will increase its overall pooled exposure. Outside of Central the Fund has £942m (as at 30 June 2023) invested in low cost passive equity with LGIM (Legal and General Investment Management). The Fund would consider these LGIM investments to be pooled given the investment management savings originally achieved from the joint procurement with other LGPS funds.

Background

5. The Government instigated the ‘pooling’ of pension funds in 2015 with the publication of criteria and guidance on pooling of LGPS assets. Administering authorities formed their own groups and eight asset pools were established, which are now all operational. The scale of each pool gives significant buying

power in the investment market, that would not normally be accessible to individual funds.

6. In July 2023 the Government launched a long-awaited consultation seeking views on proposals relating to LGPS investments, covering asset pooling, levelling up, opportunities in private equity, investment consultancy services and the definitions of investments.
7. The consultation proposes to accelerate and expand LGPS pooling, setting a March 2025 deadline for funds to transition all listed assets, at a minimum, to their pool. The Government has also confirmed a target for funds to invest up to 5% of assets to support levelling-up in the UK and has set an ambition for funds to have 10% of their assets invested in private equity. The deadline for consultation responses is 2 October 2023.

Main themes of consultation

8. There are five key areas within the consultation on [Local Government Pension Scheme \(England and Wales\): Next steps on investments](#). This report highlights the main issues, where the Fund is positioned and the proposed responses to be submitted on behalf of the Fund.
9. While the consultation does not look to mandate asset allocations and investment decisions, the Government has set expectations that funds set targets related to pooling, levelling up and private markets investments. Throughout the response on behalf of the Fund to the consultation, it will be made clear that its first priority is looking for appropriate risk adjusted returns; if investments presented good value and risk adjusted returns, the Fund would invest.
10. There will be arguments for and against the Government's proposals. From the Fund's perspective pooling and the benefits it receives in terms of value for money and net performance is supported. However, there remain some circumstances where there may be value in the Fund continuing to invest outside of the pool. This point will be emphasised in the response to the consultation as it is important funds are able to retain some flexibility to be able to take decisions that are different to other funds; a one-size-fits-all approach will mean that it is likely to fit no-one perfectly.
11. At the same time, it must be recognised that if LGPS funds look to implement niche individual investment strategies there is a risk of dilution of economies of scale if pools try to offer too many investment options. There will be room and opportunity for further collaboration between partner funds, pools and investment advisors in product development and strategic asset allocation setting which will be key in driving pooling forward.

Asset pooling

12. The Government has made clear that it wishes to see pooling move further and faster to substantially increase scale and drive better value for money. It is the Government's view that benefits of scale are present in the £50-75bn range and improve up to £100bn, which could eventually lead to further proposals by the Government to subsume or merge pools.
13. Partner funds within Central have assets under management of £55bn. As at 31 March 2023, 49% of those assets have been transitioned to the pool, whereas another 32% are currently externally passively managed. When looking to compare pooling levels across the LGPS there is a clear lack of consistency with reporting what constitutes pooled, under pool management and not pooled, with some pools including investments like external passive products, which Central does not do.
14. It is proposed that in the response to the consultation the Fund objects to any proposal to subsume Central into another pool or vice versa. This is largely due to cost, complexity, timing and issues around accountability and governance. Instead, there are plenty of opportunities remaining for collaboration with partner funds, investment advisors and pools to support the primary aims of funds and pooling objectives.
15. The Government proposes to set a deadline requiring administering authorities to transition all listed assets to their LGPS pool by March 2025. As presented to the Committee in June 2023 Leicestershire is the second most pooled fund within Central. As at 31 July 2023 the Fund has over £2.2billion in pooled products. While the Fund continues to hold £900m in external passively managed funds through LGIM. Historically, the Funds LGIM investments have been considered to be pooled given the savings originally achieved, which is unlikely to be bettered by Central given the scale of LGIM, and the breadth of products available.
16. The Government will need to be clear on whether such low-cost external passive holdings can be classed as pooled, given the different approaches across pools.
17. Furthermore, it is considered that a deadline to pool is not achievable. While the Fund considers its strategic asset allocation annually, often asset allocations are most fundamentally reviewed following actuarial valuations; the next such valuation for the Fund being in March 2025. Fund's must also consider transition costs, timing and what is most appropriate for a fund.
18. It is proposed that the Fund's response identify opportunities where funds and pools can instead interact further. This includes making the most of any areas where funds can align their approaches, such as involving pools in the development phase of the strategic asset allocation processes, while retaining ultimately any approval of the SAA at a local level. As well as consider whether it would be appropriate to procure one joint investment advisor firm

per pool, which could support cost reduction and possible alignment of investment approaches.

19. The Government further proposes a requirement for administering authorities to have a training policy in place. Given that the Fund already has a Training Policy in place is proposed that this be supported along with any additional formal guidance which can further support the Committee in discharging its functions.
20. Government also proposes further guidance for reporting on pooling levels and net returns. However, it is important that any comparison exercise recognises funds have different approaches to risk and return as dictated by their funding levels. There also needs to be guidance on how savings achieved are reported, which may be difficult if funds are not pooling like-for-like investments.

Levelling Up

21. The Government's Levelling Up White Paper (LUWP) sets out its ambition for LGPS funds to invest in projects that aim to tackle the uneven distribution of opportunity in the UK.
22. The consultation provides clarity on the definition of a "levelling up" investment, identifying 12 medium-term levelling up missions: living standards, research and development, transport, digital connectivity, education, skills, health, well-being, pride in place, housing, crime and local leadership. Local investment is defined as supporting **any** local area within the United Kingdom. The consultation asks whether respondents agree with the proposed definition. As highlighted earlier the Fund must stress its primary purpose in paying pensions.
23. It will also be key that the Government clearly define what would contribute a 'measurable contribution', as it is hard to think of many UK based investments which would not feasibly fit in some way under the levelling up ambition, even if an investment was not made expressly for that purpose.
24. The Government proposes amending regulations to require funds to set a plan to invest up to 5% of assets in levelling up the UK, including a timeline, and to report annually on progress against that plan. It is proposed that pool companies assist decision-making over investments made locally, in order to avoid any actual or perceived conflicts of interest between funds and administering authorities.
25. It is proposed the Fund disagree with this requirement. Any investment would need to stand independently on its own merit and within the Fund's SAA and meet the fiduciary duty. There is also a concern that if all funds look to invest in this way it could result in pools and funds competing for the same investments. If there is not sufficient supply for opportunities this could result in higher bid prices, and ultimately lower returns.

26. While there are not currently reporting mechanisms to reflect levelling up missions, the Fund has previously worked with LGPS Central and external investment managers to understand its exposure to the UK, as reported to the June Local Pension Committee, a summary of which is set out below.
27. Within equity, infrastructure and property the Fund's investment in the UK is well above the UK's market share. It is important to note that it is not clear from the consultation which asset classes could be considered as part of the measurement of levelling up indicators which the Government will need to clarify. Across the Fund's portfolio UK exposure currently equates to circa 21%.

Asset Class	Invested in UK within each Sub-Fund	Undrawn Commitments estimated to be invested in UK within each Sub-Fund
Equity		
Non-Pooled UK Equity	£190m	
LGPS Central Global Active	£37m	
LGPS Central Climate MFF	£63m	
Private Equity		
LGPS Central PE		£6m
Non-Pooled PE	£30m	
Infrastructure		
LGPS Central	£24m	£36m
Non-Pooled	£77m	£11m
Multi Asset Credit		
LGPS Central	£33	
Non-Pooled		
Private Debt		
LGPS Central	£16m	£78m
Non-Pooled	£44m	£4m
Property		
UK Direct (Pooled)	£99m	£60m
UK Indirect (Non-Pool)	£251m	
Fixed Income		
UK Linked Bonds (non-pool)	£248m	
Investment Grade Bonds (pool)	£41m	
Investment Grade Bonds (non-pool)	£14m	
Total	£1.23bn	£1.43bn
% of £5.7bn AUM	21%	25%

28. Given the estimated exposure to the UK across all asset classes, it is likely that the Fund already exceeds the 5% and therefore, if this proposal were to be implemented, the only impact on the Fund would result in increased reporting requirements from investment managers and LGPS Central which may ultimately result in increased costs and a reporting burden for an issue not directly linked with the Fund's fiduciary duty.

29. The Government has recognised many funds will already have some investments which contribute to levelling up, and in some cases, this may exceed 5%, and some funds may wish to increase their investment above this threshold, which “will be for funds to decide the appropriate level of investment and types of investments”. The Fund would agree with this statement; however, this must ultimately precede all investment decisions and is a matter for local consideration and determination by the Local Pension Committee subject to the aim and purpose of the Fund, which is to maximise investment returns within reasonable risk parameters.
30. It is not the role of the Fund to put non-financial beliefs, such as political, ethical, moral, social, and local preference factors, above those of the employers funding the pension scheme.
31. By the Fund earning a commercial return it supports local authorities (and other employers) to keep employer contributions lower than they otherwise could be. This assists those employers that may wish to support local priorities directly and take into account non-financial factors over and above any requirements to achieve commercial returns. The Fund cannot do this as it is limited in its fiduciary duty and other factors that may complicate matters such as conflicts of interest, and additional governance and monitoring impact of each new manager appointment.

Investment Opportunities in private equity

32. As part of the Mansion House speech, the Chancellor laid out plans to make UK pensions capital available to support UK companies whilst seeking to boost the retirement incomes of pension savers. The initiative focuses on providing investment in high-growth, innovative technology companies.
33. For the LGPS, the stated ambition is to target a 10% allocation to growth equity and venture capital. There is no explicit stipulation that these investments must be UK-based, although significant inference to this is ultimately made throughout the consultation.
34. It has subsequently been clarified by Government ministers that it is possible that a fund may be able to legitimately claim that an investment in UK-based private equity contributes to both the ambitions for LGPS investment in private equity, as well as the levelling up requirements.
35. The Fund currently targets 7.5% in Private Equity (PE) and the majority of this is split between LGPS Central and Adams Street Partners. Of the £425m invested in PE, £30m (7%) is currently invested in the UK, this compares favourably to the UK share in the MSCI world index 4%.
36. While it is recognised PE can provide attractive returns, this must sit alongside other asset classes which on a risk adjusted basis may look as attractive (for example, core/core+ infrastructure).

37. It is proposed that the Fund disagrees with any proposal that prescribes allocation decisions. Ultimately it is for funds to agree their risk appetite with advice from their respective investment advisors and actuary. Funds must manage their liquidity levels, and while PE is often focused on high-growth companies these are also far riskier, especially in regard to venture capital, and have a higher management cost. Funds and pools could end up bidding up the price for a limited pool of UK based PE opportunities to the detriment of future returns.

Improving the Provision of Investment Consultancy Services to the LGPS

38. The essence of the Government's proposal is to clarify that all LGPS funds would be formally required to set objectives in relation to the Competition and Markets Authority's (CMA) Investment Consultancy and Fiduciary Management Market Investigation Order 2019 (the Order) for investment consultants.
39. It is proposed that the Fund supports this approach and already sets its investment advisor strategic objectives in line with the CMA which are presented to this Committee annually. However, the continued exclusion of LGPS pools should be questioned given the Government suggested elsewhere within the consultation that pools may be able to advise funds on strategic investment decisions.
40. The Fund will also ask that the Government provide guidance on the position of non-FCA regulated advisors and whether they can advise committees and what they can and cannot provide advice on, for example, investment matters, product selection and manager advice.

Updating the LGPS Definition of Investments

41. The Government proposes to make a technical change to the definition of investments within LGPS regulations, adding the word "partnership" to their definition of unquoted securities investments:

"Reg 3(1)(b) a contribution to a limited partnership in an unquoted securities investment partnership."

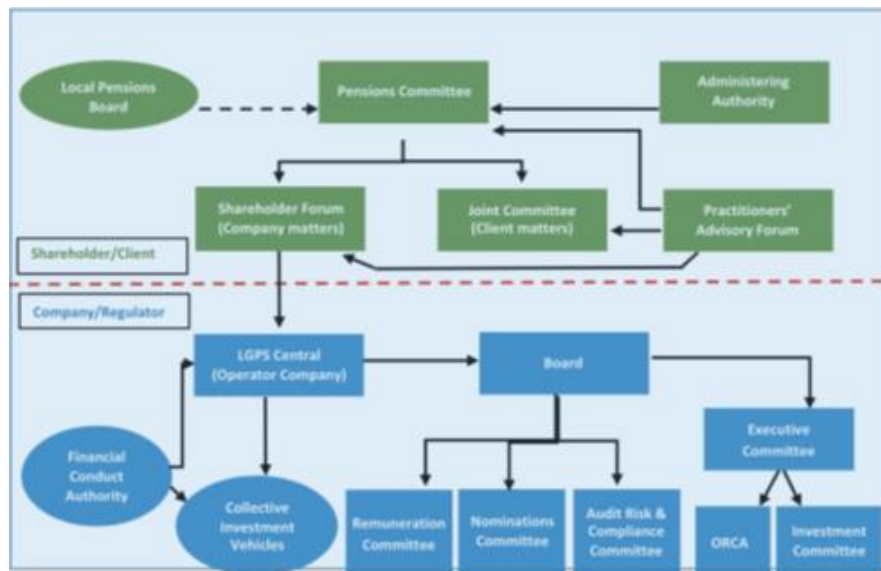
42. It is proposed that the Fund support this change.

Next Steps

43. The deadline for consultation responses is 2 October 2023. Officers welcome any comments on the proposed responses outlined above. The Fund will continue discussions with LGPS Central and partner funds including at a "moving pooling forwards" day.
44. LGPS Central will respond, alongside partner funds, and a joint response will be developed.

LGPS Central Joint Committee and General Meeting Update

45. As part of LGPS Central, Leicestershire County Council Pension Fund (Fund) is a stakeholder from two different perspectives:
- a co-owner of the company (shareholder); and
 - a recipient of investment services.
46. These interests are managed through the Shareholders' Forum and the Joint Committee as well as Leicestershire Pension Fund's Funding Strategy Statement, Investment Statement Strategy and Conflict of Interest Policy.



47. The Joint Committee (JC) deals with the 'Investor' functions related to Fund's investment in the collective investment vehicles. The JC meets twice a year. It is comprised of eight members, representing each of the partner funds. These representatives may be different to those on the Shareholders' Forum, who are dependent on the authority.
48. The JC is a public forum for councils within the pool which had oversight of the delivery of pool objectives, delivery of client service, delivery against the LGPS Central business case and to deal with common investor issues. It also provides assistance, guidance and recommendations to the individual councils, taking into consideration the conflicting demands and interests of the participants within the pool. The JC does not have delegated authority to make binding decisions on behalf of the participating councils.
49. The supervisory body of Central is the Shareholders' Forum, which focuses on shareholder issues. The Shareholder's Forum includes representatives from each of the eight pension funds. The members are usually elected representatives, typically the Chairs of the Local Pension Committee, but this is at the discretion of the individual funds.
50. The Shareholders Forum meets at least twice a year to agree certain reserved matters, and provides a greater degree of control than for most

private companies. Their powers as shareholders are set out in a Shareholder Agreement and include:

- Amending or adopting new strategic plans
- Admitting new members to the Pool
- Appointment and removal of Directors
- Approve accounts and appoint auditors
- Approving capital expenditure over £5million

51. The Shareholders' Forum normally precedes general meetings of the company, allowing discussions to take place in advance of decisions being made at the meeting.

Joint Committee Update 11 November 2022

52. A virtual meeting of the Joint Committee (JC) was held on 11 November 2022 and streamed live. It was attended by councillors and partner fund representatives as well as a number of LGPS Central employees. The Chair of the Local Pension Committee represented the Fund at the meeting and was elected Vice-Chair. There were a number of actions agreed, or reports noted which are listed below:

- Scheme Advisory Board (SAB) Update: Among other updates the SAB had noted a long-term increase in the number of members opting out of LGPS, particularly those with over two years' service. Those affected seemed predominantly younger and lower paid members, the Board would consider whether any action can be taken to address this.
- Practitioners Advisory Forum update.
- Risk Register
- LGPS Central Update overview of fund performance, recruitment and retention, business maturity and the future.
- The Committee noted Central's Net Zero 2050 commitment, and how Central were progressing requirements to show how investment portfolios progressed towards targets set.

Shareholders Forum and General Meeting Update 28 February 2023

53. A general meeting was held on 28 February 2023, preceded by a Shareholders' Forum. The following approvals were made:
54. The Strategic Business Plan and Budget for 2023/2024 and Regulatory Capital Statement. This includes the:
- Annual budget
 - Profit and loss forecast
 - Capital expenditure forecast
 - Balance sheet forecast

The total operating budget increased by 12.3% from the prior year (2022/2023) to £15.2m (including £1.92m of costs driven by assets under

management). This compares to an RPI figure of 12.6% (as of September 2022) which is the default reference figure in the Shareholders' Agreement relating to year-on-year rollover of the budget.

Governance costs are charged equally to partner funds, reflecting the equal shareholding, and investment related costs are charged on the basis of assets under management.

Key focus areas for the business were also set out:

- Existing management of existing assets
- Transitioning new assets into the pool
- Responsible investment and engagement
- Grow partner fund relationships
- Operational resilience
- Recruitment motivation and retention

55. Remuneration packaged for the Chair and Non-Executive Directors: The Shareholders agreement requires LGPS Central to seek approval of its shareholders to increase the Chair and Non-Executive Directors (NED) remuneration. The Remuneration Committee assessed criteria of the NED remuneration and ultimately recommended an overall percentage increase in line with staff remuneration costs at 6.5%. As well as an increase for those with chairing responsibilities.
56. Individual Remuneration packages for Executive Directors: The Shareholders agreement requires LGPS Central to seek approval of its shareholders for Directors' remuneration. The Remuneration Committee also considered executive directors remuneration following the Framework for Executive Directors previously agreed with Shareholders. The outcome of which recommended Executive Directors are paid within the recommended LGPS Central pay award structure.

LGPS Central Joint Committee 21 July 2023

57. There were a number of reports and updates noted which are listed below:
- Scheme Advisory Board update including on the code of transparency, the Boycott, Divestment and Sanction bill, confirmation from government that there would be no new duties on funds until 2024 at the earliest with regards to climate reporting, and the next steps on investment consultation.
 - Practitioners Advisory Forum Update: No recommendations had arisen from the audit which was positive, noting Cheshire West and Chester Council was leading on the annual investment audit. That the annual cost saving review continued, and the cost sharing model.
 - Pool Risk Register, it was noted it was last updated pre consultation thus did not reflect developments.
 - LGPS Central Update: John Burns, interim CEO presented on the key focus areas for 2023/24 with a view on Central's development journey since 2018.

LGPS Central Non-Executive Directors

58. LGPS Central have a total of six NEDs, and further information can be found here: <https://www.lgpscentral.co.uk/our-people/>
59. The search for the two replacements NEDs was led by the Nominations Committee, which was established by Shareholders. Its responsibilities include recruitment of Board members and the appointment of senior executives. The Nominations Committee undertook an extensive exercise to identify suitable candidates and was outlined to the Shareholders.
60. Following the September AGM LGPS Central wrote to Shareholders for their approval of the two proposed NEDs to replace two outgoing NEDs whose terms of office were due to expire.
61. The two final candidates selected for the role of NED were Ciaran Barr and Ian Armfield, who will also act as Chair of the Audit, Risk and Compliance Committee. Both NEDs were ultimately appointed 1 November 2022 following shareholder approval.
62. Ian Armfield was invited to the Local Pension Board meeting in April 2023. His previous experience included more than 40 years' experience specialising in investment, risk management and pensions. He has spent most of his working life as an audit and risk assurance partner at PWC, non-executive director and Chair of Audit Committee at Keystone Investment Trust PLC since November 2012, and a previous board director at NEST. An extract from the meeting with the Local Pension Board is set out below:
63. The Board were reassured that LGPS Central's Audit Risk and Compliance Committee had oversight of risk management and assurance, proving appropriate scrutiny of the control environment, and focussed on the integrity of financial statements to ensure they had been appropriately and accurately prepared.
64. It was also noted there were internal auditors under the direct control of the LGPS Central Board, with KPMG used as external auditor for the internal audit, and who had a rolling plan of work that looked at all aspects of Central's operations, and ensured management followed up on any recommendations and improvements for operations on a timely basis. Members were informed that Central produced an AAFO120 report with information on the controls around certain investment management activities and were the first Pool to produce such a report.
65. As a regulated entity Central had to ensure it had sufficient regulatory capital and produced an annual statement to the regulator, Central reports it has sufficient assets and expect this to be the case for the medium term. Members were reassured there was nothing of concern to bring to the attention of the Fund. Members were further reassured there was a compliance monitoring programme, looking at a broad range of topics around

compliance, including investments, market abuse regulations, monitoring of fraud, and conflicts of interest. Priorities for the current year included, from a risk perspective, the automation of manual processes where possible, making them effective and smarter to reduce risk, and further scrutiny of suppliers, to ensure services were provided good value for money.

66. A Member queried that how Central monitored communication across all stakeholders effectively to ensure value for money. Members were assured that Central was a well-structured, organised business with good budgetary control, whereby detailed budgets were ultimately approved by partner funds.

LGPS Central Interim CEO

67. Following the departure of Chief Executive Officer (CEO) Mike Weston in May 2023 Central are seeking to appoint a permanent CEO. This process is being led by the Chair of the Board, and an executive search firm has been instructed and the Committee will be updated on progress.
68. In the intervening time deputy chief executive, chief operating and financial officer, John Burns, who joined the Board of LGPS Central in September 2017 has taken up the role of interim CEO.

Resource Implications

69. The Committee agreed the Fund's Budget of £47m for 2023/24 which includes a budget for LGPS Central of £1.216m alongside a delegation to the Director of Corporate Resources, following consultation with the Chairman of the Local Pension Committee, to be authorised to make minor amendments to the Fund's overall budget. The LGPS Central budget covers their governance, product development and running costs.
70. Government's pooling consultation will look to set the direction for the future structure for LGPS funds. It notes while pooling has delivered substantial benefits so far, progress needs to accelerate to deliver, and government stands ready to take further action if needed. This may result in a smaller number of pools in excess of £50bn (underlying pooled assets from Local Authorities) to gain benefits of scale, and/or expecting funds to accelerate the transfer of assets. The Fund will await the outcome of the consultation for further information on timescales, approach, expectations for cost savings, and increased reporting requirements which may impact Fund resources.

Recommendation

71. The Committee is recommended to:
- (a) Note the Government consultation titled 'Next Steps on Investment' and to comment on the proposed responses to be made on behalf of the Fund;

- (b) Authorise the Director of Corporate Resources, following consultation with the Chairman of this Committee, to prepare the detailed response to the consultation on behalf of the Fund, taking account of any comments made by the Committee, and to submit this to the Government by the deadline of 2 October 2023;
- (c) Note the update now provided regarding LGPS Central's Joint Committee, Annual General Meeting, and other relevant matters as outlined in the report.

Equality Implications

72. There are no equality implications arising from the recommendations in this report.

Human Rights Implications

72. There are no human rights implications arising from this report.

Background Papers

11 July 2023 Local Government Pension Scheme (England and Wales): Next steps on investments

<https://www.gov.uk/government/consultations/local-government-pension-scheme-england-and-wales-next-steps-on-investments/local-government-pension-scheme-england-and-wales-next-steps-on-investments>

3 March 2023 Local Pension Committee Pension Fund Business Plan and Budget 2023/23 (Agenda Item 11)

<https://politics.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=7202&Ver=4>

18 November 2022 Local Pension Committee Pension Fund Update – Budget 2022/23, LGPS Central Joint Committee and Annual General Meeting (Agenda Item 13)

<https://politics.leics.gov.uk/documents/s172317/Central%20budget%20JC%20and%20AGM%20update%20Nov%202022%20final.pdf>

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