

Pension Fund Committee

14 September 2023

Local Government Pension Scheme Consultation: Next Steps on Investments



Report of Paul Darby, Corporate Director of Resources

Purpose of the Report

- 1 This report provides a briefing on the Department for Levelling Up, Housing and Communities (DLUHC)'s consultation on next steps for LGPS investments.
- 2 The report seeks to outline the implications of the key provisions in the consultation, principally: the completion of asset transition into the existing LGPS pools, DLUHC's ambition for greater scale through fewer pools, and direction over how LGPS Funds should invest.

Executive summary

- 3 Since 2025, the Pension Fund has worked in collaboration with 10 local authority partners to pool its c£3.5bn assets through its chosen pooling company, Border to Coast Pension Partnership. As of this summer, the Fund has pooled all of the liquid assets in its investment strategy. The Fund has benefitted from the availability of a Private Markets programme through the pool, extensive Responsible Investment resource, and has generated cost savings which are reported annually in the Fund's Annual Report and Accounts.
- 4 More widely however, progress on pooling has stalled across much of England and Wales. Despite a clear policy intention to deliver pooling, in the absence of guidance or regulation, many Administering Authorities have chosen to retain their assets outside of their respective pool.
- 5 In light of the lack of progress, DLUHC is consulting on pooling consolidation, setting Administering Authorities a deadline of 2025 to pool liquid assets and introducing enhanced reporting requirements on pooling progress. It is proposed that a smaller number of larger pools

would provide greater economies of scale, and that greater collaboration should be pursued. In a wide-ranging consultation, the government also seeks to direct LGPS Funds in the way in which they invest. In particular, targets are proposed for allocations to investments which support UK Levelling Up and allocations to Private Markets more generally.

6 The consultation runs until 2 October 2023.

Recommendation(s)

7 The Committee are asked to:

- a) note the report and provide any comments on the consultation, and
- b) authorise the Corporate Director of Resources to respond to the consultation in consultation with the Chair and Vice-Chair of the Committee.

Background to Pooling - Border to Coast Pensions Partnership

- 8 In the summer budget 2015, the Chancellor announced the intention for administering authorities to bring forward proposals for pooling Local Government Pension Scheme (LGPS) investments, to deliver reduced costs while maintaining overall investment performance. Subsequently, the Department for Communities and Local Government issued 'Investment Reform Criteria and Guidance,' inviting proposals for LGPS asset pooling.
- 9 The guidance required administering authorities to submit detailed proposals to the Government by 15 July 2016. Following the submissions of proposals for eight separate LGPS asset pools, the Local Government Pension Scheme (Management and Investment of Funds) Regulation 2016 came into force on 1 November 2016. Under the Regulations, each administering authority was required to formulate and publish an Investment Strategy Statement (ISS), which was to include the approach to asset pooling including the use of collective investment vehicles.
- 10 On 12 December 2016, the Secretary of State wrote to the Fund and its pooling partners, approving the proposals for Border to Coast Pensions Partnership - 'BCPP'. The proposals set out for BCPP were for 12 LGPS Funds (subsequently reduced to 11 following Northumberland-Tyne & Wear merger), with combined assets at the time exceeding £35bn, to pool those assets. In developing the proposals for BCPP, specialist legal advice and that of cost consultants concluded that the most suitable vehicle for the BCPP pool was a wholly owned company regulated by the Financial Conduct Authority (FCA).
- 11 BCPP limited was subsequently established as a regulated asset manager in 2018, with the aim of making a difference for the LGPS by providing cost-effective, innovative, and responsible investment opportunities that deliver returns over the long-term. This is on behalf of the more than 1.1 million LGPS members, over 2,800 employers, and the millions of taxpayers associated with the Partner Funds. BCPP is led by Chief Executive Rachel Elwell, who has overseen the growth of the company which now has in excess of £40bn assets under management.
- 12 BCPP have subsequently developed a range of investment sub-funds to enable the underlying local authority Partner Funds to implement their investment strategy through the BCPP pool. To support this implementation, BCPP have developed a significant Private Market programme, providing Partners access to opportunities across Private Equity, Infrastructure, and Private Debt. Additionally, BCPP have

launched an innovative Climate Opportunities Fund. To the end of 2022/23 Partner Funds have committed £12bn across the programme.

2023 Government Consultation – ‘LGPS – Next Steps on Investment’

- 13 Despite government policy intention, progress on pooling has been mixed, with some LGPS Funds not yet having pooled any assets. There has long been an expectation of guidance to provide clearer direction on pooling requirements and reporting, but an expected consultation had been continually delayed. Similarly, the Scheme Advisory Board (SAB)’s Good Governance recommendations have yet to be progressed into either Statutory Guidance or regulation by DLUHC; with conversations continuing with SAB as to how this can be achieved.
- 14 Meanwhile, in its February 2022 White Paper, ‘Levelling Up the United Kingdom’, DLUHC set out its intention for how opportunity could be spread more equally across the UK. Within its provisions, the paper set out the UK Government’s intention for LGPS Funds to “publish plans for increasing local investment, including setting an ambition of up to 5% of assets invested in projects which support local areas”.
- 15 Subsequently, in his July 2023 Mansion House speech the Chancellor announced the intention to consult on further consolidation in the LGPS. The consultation (‘LGPS: Next steps on investments’), launched on 11 July 2023 and is wide ranging in its scope. Included, is a three-stage process in relation to concluding LGPS pooling as well as proposed direction of investment strategy including the Levelling Up ambitions first mooted last year.

Consultation – Conclusion of Asset Transition to Pools by 2025

- 16 As noted, progress on pooling has been mixed across England and Wales. Whilst the Durham Fund has successfully pooled all of the liquid assets within its investment strategy, and the Border to Coast pool managing or having oversight of 83% of Partner Funds’ assets, pace elsewhere has been much slower. In part, this pace may be driven by a lack of regulation or guidance – currently the only legal requirement regards pooling is for LGPS Funds to publish an approach to pooling and rationale for assets held outside of the pool.
- 17 Through the consultation the government seeks to accelerate pooling and sets out a proposal for all liquid assets held by LGPS Funds to be pooled by 31 March 2025 – this is not an issue for the Durham Fund, having reached this target already this year. A detailed rationale must be provided for any assets held outside for pool, to be included in the Investment Strategy Statement. It is expected that small allocations to local investment may continue to be held outside of the pool – this is the

only long-term holding that Durham would currently anticipate pooling. The Fund will therefore request that DLUHC make clearer that it is acceptable that such investments, which support other policy directives in the consultation, are retained outside of the pool.

- 18 Completion of LGPS asset transition by 2025 is seen by DLUHC as a major step forward, and the first stage of its process to conclude pooling. The consultation envisages Pools playing a greater role in advising Funds, though it should be noted that strategic asset allocation remains sovereign to the Pension Fund Committee of each LGPS Administering Authority. The Fund is actively working with Border to Coast however, to explore future strategy and how to best leverage the expertise at the pool.

Consultation - Consolidation

- 19 The original policy directive for pooling of LGPS assets aimed to deliver the benefits of scale, improved governance and decision making, reduced costs and excellent value for money, as well as capacity and capability to invest in infrastructure to help drive growth. LGPS Administering Authorities responded by coming together in groups of their own choosing to form 8 asset pools of varying size.
- 20 The consultation envisages internal investment management capability, which is already well established at Border to Coast, and, as part of a second stage - greater inter-pool collaboration. Whilst collaboration could be explored, it should be recognised that Border to Coast investment propositions are developed for the strategies of their Partner Funds – other LGPS Funds will have divergent strategies. Additionally, in Private Markets in particular, some Border to Coast offerings are capacity constrained – access to such propositions for external pool customers would create a tension between the interests of Border to Coast Partners and those customers.
- 21 Once the proposed asset transition is completed by 2025, 5 of the 8 existing pools (including BCPP) would be around £50bn and the remaining 3 pools would occupy the £25 billion - £40bn range. Whilst £50bn was previously the ‘target’ size for pools, the consultation outlines the ambition for greater scale through fewer pools. DLUHC express the view that the benefits of scale are present in the £50-75bn range and may improve as far as £100bn. The final stage of pooling then, would be consolidation.
- 22 Consolidation will give rise to potential governance challenges for both Border to Coast and its Partner Funds. Presently, the pool has 11 Partners who act as both shareholders and customers working with an agreed set of principles, including “one fund one vote” – irrespective of fund size. The governance structures and collective approach have

supported the success of pooling progress within Border to Coast and a collective approach to Responsible Investment. There is a risk that with a greater number of Partners, governance becomes more challenging.

Consultation – Investment Direction

- 23 The consultation proposes that LGPS Funds should target an allocation to Private Equity of 10%. It is understood that this provision is included to ensure that risk remains on the table for LGPS Funds, in order to avoid de-risking at the cost of the taxpayer. Feedback from DLUHC would indicate that this provision is erroneously worded, and “Private Equity” should be taken to mean growth capital more broadly. The Fund will seek clarification that this is the intention, and this is a global allocation and not UK.
- 24 The Fund currently targets 10% to Private Markets, split broadly evenly between Private Equity, Debt and Infrastructure. Part of this allocation is invested thematically in ‘Climate Opportunities’ to support the transition to a low-carbon economy. Additionally, the Fund has a target allocation of 5% with an ambition of investing with impact, of which 0.5% has been committed to North-East SMEs. The Fund also has an allocation of 10% to Real Estate, split between Global and UK-specific allocations.
- 25 It is proposed that Funds will report performance for each asset class against a consistent benchmark. Whilst an intention to allow for greater comparability, there are undoubted pitfalls. Each individual LGPS Fund has its own investment strategy and risk appetite and may be seeking to deliver significantly different outcomes. There is a danger that returns are taken out of context – and could lead to inappropriate short term investment decisions being made. Focus on cost savings could similarly lead to unintended consequences, as Funds are directed to investment into more expensive asset classes. It is intended that such reporting would be captured in SAB’s scheme-wide Annual Report.
- 26 The consultation seeks collaboration between the British Business Bank and the LGPS. Border to Coast will consider the appropriateness of any such collaboration as well as other partners who can support deployment of growth capital. It should be noted that Border to Coast already has a well-established Private Markets team and investment programme. Additionally, the Durham Fund already invests alongside the commercial arm of the Business Bank through the North-East Regional Investment Fund.
- 27 The Pension Fund Committee members undertake significant training before participating in the Committee, and before any investment decision is taken. The Fund is also in the process of enhancing its ongoing training offer for members. The consultation would require the

Fund to formalise its training approach in a statutory policy document. Progression of the outstanding guidance from DLUHC on the Good Governance recommendations would offer a more holistic directive regards Committee training.

Consultation – Levelling Up Direction

- 28 Addressing the Levelling Up ambitions first set out in the 2022 White Paper, DLUHC set out a proposal that would require LGPS Funds to publish a plan for how they will invest 5% in projects that support Levelling Up. It should be noted that the requirement is UK-wide in its scope. Within the consultation, the Foresight Fund supported by Durham is held up as one of four examples of best practice.
- 29 To address the Levelling Up requirement, Border to Coast is currently developing a UK Opportunities fund. It is anticipated that investments within this BCPP fund will fully meet the requirements currently consulted upon.
- 30 It is recognised in the consultation however, that many funds already have investments which contribute to Levelling Up which in some cases will exceed 5%. The Durham Pension Fund is currently underweight its target allocation to Private Markets, and in its last investment strategy review set aside a 5% allocation with the ambition of increasing its impact investment. Following appropriate due diligence, the Fund will consider an allocation to BCPP's UK Opportunities but may need to deploy further capital outside of the pool to meet its ambition.

Supporting Levelling Up - BCPP's UK Opportunities Fund

- 31 Supplementing the existing Private Markets programme, in April 2024 BCPP aim to launch their UK Opportunities Fund which will provide its Partner Funds with additional opportunities to invest in private market assets across the UK, such as venture and growth capital. UK Opportunities is being designed to provide a Private Markets investment strategy focused on providing attractive risk adjusted investment returns to Border to Coast's 11 Partner Funds. The Fund will target an 8% return for Partner Fund investors.
- 32 The UK Opportunities Fund will be a multi-asset UK strategy investing in areas such as Corporate Financing, Housing, Property, Infrastructure, Renewables, and Social Bonds. The nature of underlying investments should result in a range of positive impacts, which could include jobs created, new housing units delivered (residential, affordable, social, assisted), new commercial floor space, delivery of local infrastructure, renewable energy capacity, the provision of training including apprenticeships. It should be noted that the Fund will be a UK-wide

strategy with an expected tilt to BCPP regions, which range from the North-East to Surrey.

- 33 The UK Opportunities proposition will include an innovative mechanism whereby Partner Funds, and their local authorities, may submit potential investment opportunities for consideration by the sub-fund's underlying managers. Whilst the mechanics are being finalised, it is broadly welcomed by Partner Funds that the regions served by Border to Coast will have improved access to investment appraisal. It should be noted that neither Partner Fund nor BCPP Officers will be involved in the appraisal of such opportunities.
- 34 It is anticipated that the UK Opportunities sub-fund will have scale of between £0.5-£1bn and should provide a wide exposure to investments that have an impact within the regions that BCPP serves. BCPP recognise however, that it is unlikely that it will be able to fully satisfy all Partner Fund needs in this area. As a result, some Partner Funds may choose to make small, local investments outside of Border to Coast, subject to having available resources, the identification of investible opportunities and a suitable due diligence process.
- 35 Full training on the UK Opportunities Fund will be provided for the Committee in due course.

Supporting Levelling Up - Foresight North-East Regional Investment Fund

- 36 As part of its Private Markets allocation, the Durham Pension Fund Committee considered how it could successfully achieve an impact in the region, whilst generating an appropriate investment return. Having considered the success of SME financing in other regions, following a process of due diligence the Fund provided the £18m necessary cornerstone funding to Private Equity manager Foresight, to successfully launch the North-East Regional Investment Fund. The Fund was too small for BCPP's primary Private Markets programme and came too soon for the forthcoming UK Opportunities and was therefore transacted outside of the BCPP pool.
- 37 The Regional Investment Fund supports growth companies across all sectors, stages and transaction types with investments of up to £10m. Deployment of capital from the Fund is restricted to SMEs with headquarters or significant operations in County Durham, East Riding of Yorkshire, North Lincolnshire, North Yorkshire, Northumberland, Tyne and Wear, Teesside and West Yorkshire.
- 38 The Fund seeks to accelerate economic growth, delivering positive social and economic impact, and creating high-quality, local jobs. The Fund has made three investments since it launched in June 2022, with

a strong pipeline of further opportunities being considered. Following its launch at Hotel Indigo in Durham City, Foresight subsequently opened an office on Grey Street, Newcastle to support the deployment of the Fund.

- 39 The North-East Fund has successfully attracted additional capital, with a substantial commitment from British Business Investments, the wholly owned commercial subsidiary of the British Business Bank. After undertaking appropriate due diligence on the regional fund, Tyne and Wear's Pension Fund Committee recently provided significant support to the regional fund with a £30m investment. Commitments to the Fund now total £90m.
- 40 Foresight's regional strategies have created thousands of high-quality, local jobs and enabled growth companies across the UK to flourish and positively impact local economies. Returns for investors have been strong, and the North-East Fund will seek a 15% Internal Rate of Return – providing the region's LGPS Funds with a target return commensurate with the asset class. DLUHC single out Durham's investment in the Fund as one of four examples of best practice, in terms of LGPS support for Levelling Up.

Next Steps

- 41 Officers of the Durham Fund have joined a small Border to Coast working party to fully understand the implications of the consultation, and to draft a collective response, which the members of the Joint Committee will be asked to approve. The Joint Committee, constituted of all 11 Partner Fund Chairs, will meet in early September for a briefing on the consultation, ahead of their formal meeting on 28 September where the response to the consultation will be considered.
- 42 The Durham Committee is asked to provide its views and feedback on the consultation, and to provide delegated authority to Officers to respond in consultation with the Committee Chair and Vice-Chair.

Background papers

- 'Local Government Pension Scheme: Next Steps on Investments' available online at:
<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>

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