Non-Executive Report of the: **Pensions Board** **Monday, 20 November 2023**	TOWER HAMLETS
Report of: Julie Lorraine Corporate Director, Resources	**Classification:** Open (Unrestricted)
Local Government Pension Scheme Consultation: Next Steps on Investments	

Executive Summary

On 11 July 2023, the Department for Levelling Up, Housing & Communities (DLUHC) issued a consultation on the Local Government Pension Scheme entitled "Local Government Pension Scheme (England and Wales) Next Steps on Investments". The Consultation is seeking views on proposals relating to investments of the Local Government Pension Scheme (LGPS) and covers the areas of asset pooling, levelling up, opportunities in private equity, investment consultancy services and the definition of investments.

The consultation ran until 2 October 2023. A copy of the consultation document is included as Appendix 1 to this report and the Fund's response approved by the Pensions Committee is included as Appendix 2.

Recommendations:

The Pensions Board is recommended to:

1. Note the Fund's consultation response (Appendix 1).

2. Note the summary report by Mercer (Appendix 3).

1. REASONS FOR THE DECISIONS

1.1 To ensure that the Pensions Board is notified of the Pension Fund Committee's views on the proposals within the consultation document shared with government.

2. ALTERNATIVE OPTIONS

2.1 There is no alternative to this report.

3. DETAILS OF THE REPORT

3.1 Tower Hamlets Pension Fund has pooled 61% of its strategic asset allocation through London CIV, while 20% of its assets is pooled under a fee arrangement via London CIV Pool.

3.2 The Fund has benefited from the availability of Private Markets investments like Renewable Energy Infrastructure fund and UK Housing fund via the pool. To date, the Fund has pooled all the liquid assets in its investment strategy bar Index Linked Gilts.

3.3 More widely however, progress on pooling across much of England and Wales have not been same.

3.4 The consultation is seeking views on proposals in:

- The acceleration and expansion of pooling with administering authorities confirming how they invest their funds and why. There is a proposal for a deadline for listed asset transition by March 2025 and going forward the government is seeking to see a transition towards fewer pools to maximise the benefit of scale.

- Funds will be expected to have a plan to invest up to 5% of assets to support levelling up in the UK.

- Proposals of an ambition to increase (10%) investment into high growth companies via unlisted equity, including venture capital and growth equity. Including suggestions that the DLUHC would support the LGPS in collaborating with the British Business Bank

- Proposed amendments to the LGPS's regulations to implement requirements on pension funds that use investment consultants. These amendments are needed to implement the requirements of an order made by the Competition and Markets Authority (CMA) in respect of the LGPS.

- A proposed requirement for funds to have a training policy for pension committee members and report against that policy.

- A technical change to the definition of investments within LGPS regulations. The amendment proposed will ensure consistency with the language used in regulation 4 of the 2016 Regulations, where unquoted securities investment partnerships are defined. The proposed amendment should also eliminate any ambiguity regarding regulation 3(1)b.

3.5 There are a total of 15 questions, and these are set out in the Appendix and the full consultation document can be found in a link in the linked document section of this report.

Next Steps

3.6 The consultation period ends on 2 October 2023. The expectation is that the Government may either announce the outcome of the consultation or give a strong steer as to its likely announcement in the Autumn Statement (expected to be in November). The Committee will be kept up to date with future developments on the guidance and /or regulations relating to LGPS investment pooling.

4. EQUALITIES IMPLICATIONS

4.1 There are no equalities implications arising from this report.

5. OTHER STATUTORY IMPLICATIONS

5.1 This section of the report is used to highlight further specific statutory implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration. Examples of other implications may be:

- Best Value Implications,
- Consultations,
- Environmental (including air quality),
- Risk Management,
- Crime Reduction,
- Safeguarding.
- Data Protection / Privacy Impact Assessment.

Environmental Implications

5.2 Tower Hamlets Pension Fund is making progress on monitoring climate risk by reporting appropriate carbon metrices, reports on TCFD on a voluntary basis as an early adopter and has regard to climate risk in making investment decisions.

Risk Management

5.3 The risks associated with the pension fund's investments are assessed in detail and considered as part of the strategic asset allocation, The pension fund's Investment Strategy Statement requires all external investment managers and London CIV to consider and manage all financially material risks.

6. COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 The Local Government Pension Scheme (LGPS) is a national pension scheme administered locally. Tower Hamlets Council is the administering authority for the LGPS which provides pensions and other benefits for employees of the Council, Tower Hamlets Homes, Academies, various catering and cleaning contractors and a range of employers within the Fund.

6.2 The LGPS is a ‘defined benefit’ scheme which means that members benefits are not calculated based on investment performance. Contribution levels for scheme members are set nationally, and contribution levels for scheme employers including the council are set locally by the scheme actuary.

6.3 Increasing the level of investments in the UK and in private equity may increase fees because the nature of investments means they are more expensive to manage than for example listed passively managed equity tracking funds. However, different types of funds provide diversification may enable the Fund to adopt the correct risk/return profile to meet its liabilities and for this reason a mix of investments that includes some asset types with higher costs may be appropriate.

7. COMMENTS OF LEGAL SERVICES

7.1 There are no direct legal implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report

- NONE.

Appendices

- Draft consultation response (Appendix 1)
- DLUHC Consultation (Appendix 2)

Local Government Act, 1972 Section 100D (As amended)
List of “Background Papers” used in the preparation of this report
‘Local Government Pension Scheme: Next Steps on Investments’ available online at:
Local Government Pension Scheme (England and Wales): Next steps on investments - GOV.UK (www.gov.uk)

Officer contact details for documents:
Miriam Adams, Interim Head of Pensions and Treasury Ext 4248

Appendix 1

Local Government Pension Scheme (England and Wales): Next Steps on Investments Consultation
London Borough of Tower Hamlets Pension Fund Response

Further guidance from central government on next steps on investment within the public sector is valued by The London Borough of Tower Hamlets. The London Borough of Tower Hamlets Pension Fund ('the Fund') is a key supporter of the London CIV asset pool, with 81% of strategic asset allocation pooled.

Greater clarity on the relationship between clients and asset pools would therefore be of significant importance to the fund. The Fund broadly supports the government's move toward to levelling up investments, with 5% of Fund assets already committed via London CIV in UK Housing fund and 6% in London CIV Renewable Infrastructure fund which has some assets in the UK.

However, The Fund would urge caution with regard to being too prescriptive on asset allocation and has concerns over the 10% target to private equity, alongside the government's ambition for 5% within infrastructure and 5% to levelling up.

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?

The London Borough of Tower Hamlets Pension Fund agrees that pooling is a suitable strategy for smaller LGPS Funds to gain entry into alternative investments, achieve economies of scale and value for money.

There is also further scope for increased pooling of assets, collaboration between pools and sharing of skills and knowledge within the LGPS.

It is important to note that there are challenges within pooling that impact LGPS's ability to fully transition assets into the pool companies. LGPS Funds invest in a large range of assets, some of which are extremely specialised, and others are particularly long term focused. Thus, pool companies may not always be able to offer appropriate investment solutions.

While it is noted that the government is keen to focus on fee reduction, the Fund believes that the focus should be on investment outperformance against a relevant benchmark net of fees.

The priority for all LGPS Funds is maximising the return on investment to pay pensions in full and on time.

Focusing on the absolute fees may provide some assistance in selecting products, but the overall value added to Funds should be considered as more relevant and useful information.

In some cases, the costs of an asset class/manager may be greater, but these may be justified by the higher returns or safely consistent returns. Therefore, it would seem counterintuitive to transition, or possibly have to liquidate, those existing assets into pools at the expense of long-term performance.

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?
The Fund does not disagree with a deadline to transition listed assets to their LGPS pool. However, there should be a degree of flexibility, recognising that this may not be possible for all funds. The Fund also notes that 2025 is a triennial valuation year therefore Funds would not generally look to make significant investment changes until after the valuation cycle.
Investment regulations required take time and may be subject to further consultation, a March 2025 deadline does not allow sufficient time for consultation, changes and communication.

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?
The London Borough of Tower Hamlets Pension Fund does not believe that the interaction between funds and pools should be fully prescribed. Funds are responsible for setting their own strategic asset allocation and what works for one fund does not necessarily work for another. As with asset allocation, investment advisers are selected on their suitability for each fund. There is potential for conflict between the advice received from a pool and the advice received from the investment advisor for individual scheme Funds.
The strengthening of relationships between pool companies and clients is vital to the success of pooling, so to insist upon a certain style of interaction between pools and funds would not be conducive to this result. In summary, effective collaboration between a fund and a pool companies should be possible without the need for guidance on how interactions should take place.

Additionally, pool companies may not always have suitable strategies/sub-funds on offer on their platforms, or the ability to adequately resource these strategies. There is concern that the increased demand on the pool companies may be significant, especially those with a large number of clients.

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?
Tower Hamlets Pension Fund agrees that it is of utmost importance that Committee members have the required skills and knowledge to make informed investment decisions.
While pension fund committee members are not currently mandated by legislation to undertake training, the Fund already has a training policy in place and would support new legislation that provides a framework for enforcement that would improve the level of expertise and knowledge across LGPS committees.

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?

The London Borough of Tower Hamlets Pension Fund broadly agrees with the proposals regarding reporting. However, we strongly stress that LGPS Pension Funds are already under significant pressure with existing reporting requirements, and it is anticipated this has a potential to increase further due to the introduction of climate risk reporting in 2024/25. Current reporting requirements within the pension fund annual reports include a section on pool companies which incorporates performance, returns, costs and net savings.

It should be recognized that there are already substantial time constraints in this area and additional reporting requirements could delay the sign off of the pension fund annual pension fund report and accounts by external auditors.
If this reporting requirement were to be implemented, an accompanying guidance note, and template would be desirable.

Question 6: Do you agree with the proposals for the Scheme Annual Report?
The London Borough of Tower Hamlets considers that in the event that the changes to reporting in question five are implemented, then the Fund would agree that a uniform set of statistics to achieve comparability between funds is reasonable.

Question 7: Do you agree with the proposed definition of levelling up investments?
Whilst the Fund welcomes the definition of “Local” within the levelling up framework to be ‘UK-wide’. The London Borough of Tower Hamlets Pension Fund broadly agrees with the definition but would seek that it is clarified further regarding two areas of ambiguity.

Firstly, the examples given alongside the definition would suggest that the investments made must be directed to a particular cause.
It would be the Fund’s position that all of the UK should be classed as local and the investments made can be indirect, i.e., through a pooled fund with an investment manager rather than directly into a specific project.
It is vital that the size of individual pension funds and their scope to access various types of investment are considered.

Question 8: Do you agree that funds should be able to invest through their own pool in another pool’s investment vehicle?
Whist larger pools may offer the potential for greater economies of scale, assets under management should not be the only consideration, the London Borough of Tower Hamlets Pension Fund agrees broadly that it makes sense that pools should collaborate with other asset pools to offer broader asset ranges to clients, especially for pools which do not have either the size or expertise to invest within all asset classes.
It should be noted, however, as pool owners, it is the responsibility of individual funds to direct their own asset pools if this is an avenue that they wish to pursue. All client assets should be unitised and held within their respective asset pools.
LGPS pool structures broadly differ, pools differ in method of operation, specialisms, strengths, and weaknesses.

The Fund also believes that a larger number of partner funds with a wider spectrum of committee views may potentially lead to diseconomies of scale regardless of pool size and pool mergers could also be more costly and retention of staff over short to medium term may act as a barrier to further investments in pools until any pool mergers have been completed.

Question 9: Do you agree with the proposed requirements for the levelling up plan to be published by funds?
LGPS Pension Funds are already under substantial pressure with current reporting requirements and any additional reporting requirements may not be realistic for all Funds.

Question 10: Do you agree with the proposed reporting requirements on levelling up investments?
Whist the London Borough of Tower Hamlets Pension Fund appreciates that a voluntary framework requires transparent reporting to assess compliance, in aggregate the reporting recommendations for both the annual report and Investment Strategy Statement represents a significant reporting burden which is likely to result in significant increase in time and costs for producing and auditing the report. The Fund welcomes reporting templates.

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?
The London Borough of Tower Hamlets Pension Fund disagrees with this notion. The government's ambitions for a 10% allocation to private equity, 5% to infrastructure and 5% in levelling up investments, contradicts the LGPS schemes principle that Administering Authorities are responsible for setting the investment strategy and could potentially limit the extent to which Administering Authorities can manage pension fund affordability and contribution stability and manage liability profile of the employers in the scheme.

While a 10% allocation to private equity may be suitable, in terms of risk/return appetite, for some funds, it will not fit all LGPS investment strategies and future funding and pensions outflow obligations.
It is critical to stress that the LGPS's principal duty is to pay pensions in full and on time, and no action that could jeopardise the Fund's ability to do so should be taken.

The Fund believes there are several challenges to investment within the private equity asset class, including, but not limited to, the following:

- Practical issues in defining private equity, particularly if it is the government's intention to exclude other private market investments such as infrastructure from the definition.
- Liquidity: private equity assets are illiquid and if funds lock too much of their portfolio into these asset classes, liquidity issues may arise in the future.

- Complexity and specialism: private equity investments, particularly venture capital, is an asset class where the Pension Fund may not have specialism. LGPS funds may incur considerable external advice costs.
- Cost: typically, the cost of managing private asset classes is more than listed asset classes, and there would need to be appropriate returns to justify it.

- Risk/returns: The majority of LGPS schemes are now fully funded and many are taking the decision to de-risk their strategic asset allocations.
- Private equity assets hold considerably more risk than traditional asset classes, and thus the return must warrant the additional level of risk taken.

It is also important to note that, in regard to all the government ambitions (10% allocation to private equity, 5% to infrastructure and 5% in levelling up investments), some LGPS funds may already be undertaking these actions under other titled allocations and should not have to be part of a brand-new allocation awarded.

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?
The opportunity to collaborate with the British Business Bank would be assessed equally alongside all other investment opportunities presented to the London Borough of Tower Hamlets Pension fund.
However, the Fund believes this would be a more appropriate discussion for the pool companies because collaboration is unlikely to be feasible on an individual fund level.

Question 13: Do you agree with the proposed implementation of the Order through amendments to the 2016 Regulations and guidance?
The Fund agrees with the consultation's proposal for Administering Authorities to set and review strategic objectives for their investment consultants. The Fund already sets these objectives for its advisers.
In respect of the consultation's reference to pools providing investment advice to LGPS Funds, the London Borough of Tower Hamlets Pension Fund believes that it is for the Fund to decide from whom it receives advice from.

Question 14: Do you agree with the proposed amendment to the definition of investments?
The Fund agrees.

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.
The recipients of the LGPS cover a wide range of individuals and by its very nature could disadvantage several groups if this a ring-fenced reserve of deferred pay is jeopardised by taking a level of risk beyond that which is necessary to generate returns.
The Fund also notes that underperformance of investments could in the long term impact contribution rates and employer affordability therefore impacting the affordability of the LGPS as a whole.