APPENDIX 1

Response to LGPensions@levellingup.gov.uk

Response by 2nd October 2023

Response on behalf of London Borough of Bromley (on behalf of organisation)

Submitted by Peter Turner, Director of Finance, London borough of Bromley.

The Council welcomes the opportunity to respond to the Next Steps on Investments consultation document.

The role of managing the pension fund is a critical function in the interests of the Council Taxpayers and members of the fund. The consultation paper recognises this and refers to '*while long term stable returns in order to pay pensions for its members is its primary purpose*' and is '*important to financial stability of councils*' and ultimately the interest of council taxpayers'.

However, the consultation paper refers to 'the Government believe there is scope to deliver substantial benefits to the UK as a whole at the same time'. The Council's response considers that such benefits must not be at the expense of the funds primary objective or a Council's fiduciary duty (achieving what is best for the financial position of the fund). Such conflict needs to be avoided and not part of any Government requirement that creates a clear conflict to The Fund's primary objective.

Bromley's Fund primary focus is on having sufficient resources for paying pensions whilst minimising the cost to the council taxpayer. This requires a long-term view of investments with the need to consider net overall returns ensuring that even with cost savings there is good performance (hence the emphasis on the net overall returns).

The fund is valued at around £1.3 billion and using benchmark data (PIRC), the long-term approach has resulted in the fund being the fifth best performer over 5 years, 2nd over 10 and 20 years and 1st over 30 years. The fund is also 115% fully funded. The fund has received national recognition for its performance and won various LAPF awards including the LGPS Investment Performance of the Year in 2017, the LGPS Fund of the Year (assets under £2.5bn) in 2018, commendation in 2019 and the final shortlist for 2020. Bromley also won the Pensions, Treasury and Asset Management Award at CIPFA's Public Finance Awards in 2019 and 2021 recognising the consistent high performance of the Fund.

The fund remains open minded to investing in higher risk, higher return asset classes, but the view remains that we should not be directed to invest in particular areas through future regulation, which could not only be detrimental to longer term investment returns but could also increase costs met by local council taxpayers.

RESPONSE TO QUESTIONS IN CONSULTATION DOCUMENT

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?

Although the creation of pools has led to longer term reduction in costs the impact of transitional costs has reduced the shorter- and medium-term impact of any savings. However, it should not be assumed that these pools have led to overall improved performance for pension funds particularly as there is no proof that larger AuM funds perform better. The best long-term performing LGPS funds are smaller funds such as Orkneys and LB Bromley partly through a high, long-term allocation to growth equities.

Given the current number of pools there needs to be a longer period of development rather than seeking to reduce the number of pools at the current time. In reality, any desire for a further round of consolidation will only further delay pooling. It brings into question why a fund would transfer its listed assets into a pool, with associated transition costs, only to find that it will need to incur further transition costs when the pool merges with another pool.

Reference to such changes could cause disruption at the current time and any uncertainty can impact on their ability to attract and retain high quality staff.

We have not seen Chair, CIO or CEO stability in any pool, highlighting the key person risk in even institutions with £50bn plus of assets. The majority of the successful asset managers have AuM a multiple of this and manpower and resources which would dwarf a £50-70bn pool. There is also no guarantee that pools can make better management selection choices than individual pension funds and, on that basis, may not add value. The consultation document refers to 'implementation decisions such as manager selection having a relatively small impact'. This may apply when looking at the average impact across the pension fund community but in Bromley's case our exceptional longer-term performance is driven heavily by the right choice of active fund manager for global equities. On that basis, pension funds should retain the right to procure the fund managers but there is value in consulting with the individual pool to assist. This leaves clearer accountability for performance with pension funds, but funds can still choose to recruit managers through the pools if they wish. Pension funds should be allowed to make that choice.

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?

Pension funds have to consider transitional costs and whether there are potential savings in costs from such a transfer. If there are shorter term investments, it may not be in the interest of a pension fund to have to transition all listed assets. For certain assets whether the pools do not offer ‘scale’ for the investment there could be no savings at all, transition costs having to be incurred and the fund effectively paying a management fee to the pool resulting in a net increase in costs to the fund.

You could also have a situation where the pool does not offer the portfolios which a fund requires, and it would not be right to alter investment strategies or other compromises in fund manager choices to meet the Government deadline and divert away from optimal investments for the fund.

Given any funds fiduciary duties this requirement should remain on a voluntary basis to ensure that the interests of funds are protected. On that basis a ‘one size fits all’ for transfer should not be prescribed.

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?

There is always value in guidance to provide better clarity and any guidance that supports the further development of funds and pools interacting is welcomed. However, it should focus on practical issues and be evidenced driven. The Scheme Advisory Board, through consulting with individual pension funds would be a good starting point for developing revised guidance.

Although the consultation refers to ‘we do not see inter-pool competition as a desirable progression’, we are concerned of the inherent risk of a ‘monopoly’ position created by funds not having a choice to change and inter-pool competition should be seen as creating healthy performance and have greater focus on meeting partner funds interest. The FCA regulation requirements could impact on the ability of partner funds to influence the pools and competition would create a welcome influence.

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?

Given the significant investment value of individual pension funds and the impact of investment decisions on the overall cost to council taxpayers we agree that this should be included in the guidance. We do not want it to be too extensive so as to discourage councillors, with much to offer, from serving on pensions committee. There could be a risk, which needs to be managed carefully, of being unable to recruit councillors to join this important ‘stewardship’ committee.

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?

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

Regarding question 5 and 6 We support greater transparency and accountability and any further progress on using measurable data is supported. However, such data should not be used to put ‘pressure’ on funds to meet Government ambitions for investment/pooling which may have a detrimental impact on meeting the funds fiduciary duties.

Where there is reporting of ‘net savings achieved as a result of investing via the pool’, we are concerned that the current reporting does not accurately reflect the financial impact relating to other costs such as transition costs and depository costs which could be higher, as well as identifying savings compared with a funds existing negotiated management fees rather than using standard management fee rates. This clearly needs to be reviewed to provide the necessary confidence in any reported net savings figure.

Chapter 3: LGPS investments and levelling up

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

The definition is fairly broad, and it is important not to create additional resource demands through the classification of investments work to determine whether an investment meets the levelling up criteria. The focus should remain primarily on the best investments to meet the long- term objectives of the fund rather than being explicit about the proportion of investments expected to meet levelling up requirements. The approach to aim/meet a proportion of Government specified investment must not be a statutory requirement and therefore should be treated as guidance only and not result in Government intervention because the proportion of investment has not been achieved. Such measures distort accountability for the performance of the fund particularly if following a specified proportion has a detrimental effect on overall investment returns. Accountability should remain with the pension funds who have accountability to both members of the fund and the council taxpayer.

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

Yes, we do. We would prefer the option of having a choice to invest in different pools depending on the investment required and through competition and economies of scale that would deliver better cost savings. We have investment in Baillie Gifford global equities and so do many other funds. Why can't the investment be made through one of the pools only to provide greater cost savings due to scale? Realistically there is a risk that pools will wish to retain the specific investment individually given their individual management fee (AuM) for such investments?

Is any pool going to drop an asset class until they have failed at it and even then for a Fund to purchase another pools investments through its own pool will only add a further round of fees.

Having the restriction to stay within one pool reduces competition which ultimately could reduce potential cost reductions and net overall performance returns. Pools investing through another pool does rely on a high degree of collaboration between pools and without direct competition that becomes problematic.

At present, LCIV continue to work with single manager portfolios offering a total of 9 Global Equity portfolios at present, this approach undermines the argument for pools to provide an economy of scale.

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

We do not see the value in publishing such data and it creates a danger of a league table perception which could encourage funds to make further investments in levelling up which may not be in the best interest of the fund meeting its fiduciary duty.

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

As per response in Question 9.

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?

We do not believe that there should be any targets/direction for private equity or any other asset classes, given the fiduciary duty for pension funds and the need to meet their key objective to pay members pensions and reduce the overall cost to the council taxpayer.

There is no standard benchmark for private equity which measures overall performance and although there are headlines about high performance that may exclude some poor performing/failing private equity investments which are not recorded. It is also important to recognise that private equity has enjoyed success by creating additional leverage during a low borrowing rate period and realizing assets during that period to generate high dividends. UK has experienced low borrowing rates for over 14 years but that is expected to change for the future, which is supported by the significant increase in rates currently being experienced. It is also important to recognise that entering Private Equity when valuations are high will inhibit future returns.

As required by FCA 'past performance does not guarantee future results.' Therefore, there is no certainty that this would be the right investment choice for pension funds and creating ambitions/targets could effectively ultimately lead to a deterioration in overall performance of a fund due to the pressure to deliver the Government's ambition.

Many predictions indicate that private equity returns will be lower than the 12% or so they have been historically. In absolute terms, given leverage (at fund and operational levels, high beta and earlier stage companies) then higher returns are possible and one might expect a higher gross return over sufficiently long periods. However, this comes with a wider range of outcomes and a higher degree of risk, as well as higher fees.

In terms of supporting investment in the UK, the economy's GDP accounts for 2.06% of world GDP. Therefore even having an ambition to deliver a proportion of private equity investments could result in most, if not all, investments being outside the UK, given the global investments undertaken through LGPS pension funds.

Any asset class for investment is already considered as part of funds Asset Allocation Review which are normally undertaken at least every three years. Private Equity may add value. However, is there a need to specify any ambition when all types of investments (including private equity) are considered including cost (private equity has higher AuM), risk, reward, liquidity and investment timeframe. Therefore requirement to invest in any asset class should not be prescribed by Government, recognising funds fiduciary duties.

Private Equity does not deliver steady cashflow which has to be a consideration in pension funds asset allocation strategy. Any sell in a hurry could result in a LDI crisis as seen last autumn.

The average holding period for a private equity investment is 4-5 years, often then selling on to another private equity Fund. This does not fit with the ideals of long-term investment as stated in Bromley's own Investment Strategy Statement.

As a less transparent area of the market, ESG data is less disclosed and management less incentivised to act in accordance with best practice in this area.

Ultimately, there could be a place for (global) PE in the LGPS, without it having to be mandated. A well-resourced and sophisticated LGPS fund or Pool should be equipped to make that decision.

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 no objection to this suggestion and see potential benefits.

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 support this suggestion.

Chapter 6: Updating the LGPS definition of investments

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

We support any clarity on definitions within regulations.

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.

We have no comments to add.