Pensions Committee

2.00pm, Wednesday, 25 September 2024

UK Government Pensions Investment Review – Call for Evidence

Item number 7.6

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note this paper and provide comment on the draft LPF submission.

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UK Government Pensions Investment Review – Call for Evidence

2. Purpose

2.1 The purpose of this report is to inform the Committee of the UK pensions investment review launched by the UK Government, the scope of phase 1 of that review, and the intention for a response to be provide by LPF.

3. Background

3.1 The UK Government announced their Pensions Review on 20 July and have launched a call for evidence to all interested parties with a short deadline of 25 September, including a number of questions focussed on LGPS investment.

3.2 The UK Government have made the growth of the UK economy their priority and are looking to the UK pensions industry to help. This builds on moves by the previous UK Government including the Mansion House Reforms that, amongst other objectives sought to encourage greater investment into UK and private equity markets that could boost retirement incomes (for members of defined contribution pension schemes) and boost the UK stock market and economy.

4. Main Report

4.1 The Chancellor has launched a landmark pension review to boost investment, increase savers returns and tackle waste in the pensions system. The Chancellor has appointed the Minister for Pensions to lead the review. The review will focus on defined contribution workplace schemes and the Local Government Pension Scheme.

4.2 The review will also work closely with the Minister of State at MHCLG to look at how tackling fragmentation and inefficiency can unlock investment potential of the £360m LGPS in England and Wales.

4.3 The Terms of Reference of the first phase of the review is attached at Appendix 1.

4.4 In its initial stages the review will be considering evidence on a range of questions including those set out in Appendix 2. Answers to these questions will guide stakeholder engagement with more targeted questions being considered with particular stakeholder groups.

4.5 As a successful Fund within both the Scottish LGPS and in the wider UK context, we believe we can contribute meaningfully to this review. Appendix 3 includes our draft response.

4.6 The Board and Committee are invited to comment on this response prior to it being finalised and submitted. The deadline for submission is 23:59 on 25 September.

5. Financial impact

5.1 There is no current cost to submitting evidence to the review. Without certainty of the outcome of the review, its applicability to the Scottish LGPS and any time frame for implementation the cost, or benefit, is unknowable.

5.2 The Committee are aware that the internal investment capability of LPF is a significant cost advantage, and the collaborative efforts with like-minded funds generate additional benefits to each Fund. Whilst the investment strategy of LPF is focussed on investing assets to the benefit of employers and members of the Fund, it currently has significant investment in the UK across equity, bond, infrastructure and property markets.

6. Stakeholder/Regulatory Impact

6.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

7. Appendices

Appendix 1 – Terms of Reference
Appendix 2 – Call for Evidence Description
Appendix 3 – LPF Draft Submission

Appendix 1

Terms of Reference

1. Background

1.1 The Chancellor has launched a landmark pension review to boost investment, increase saver returns and tackle waste in the pensions system. The Chancellor has appointed the Minister for Pensions to lead the review. The review will focus on defined contribution workplace schemes and the Local Government Pension Scheme.

1.2 The review will also work closely with the Minister of State at MHCLG Jim McMahon to look at how tackling fragmentation and inefficiency can unlock the investment potential of the £360 billion Local Government Pension Scheme in England and Wales, which manages the savings of those working to deliver our vital local services, including through further consolidation.

2. Policy Remit

2.1 The first phase of the review will focus on developing policy in four areas:

- Driving scale and consolidation of defined contribution workplace schemes;
- Tackling fragmentation and inefficiency in the Local Government Pension Scheme through consolidation and improved governance;
- The structure of the pensions ecosystem and achieving a greater focus on value to deliver better outcomes for future pensioners, rather than cost; and
- Encouraging further pension investment into UK assets to boost growth across the country.

3. Further guidance

3.1 In developing its recommendations, the review will have regard to:

- Boosting the returns for pension savers.
- Improving the affordability and sustainability of the Local Government Pension Scheme in the interest of members, employers and local taxpayers.
- The role of pension funds in capital and financial markets to boost returns and UK growth.
- Any implications for wider Government financial stability policy objectives such as with respect to the gilt market.
- Fiscal impacts, which will need to be considered in the context of the public finances.
- The progress already made on in-train policy initiatives such as the Value for Money Framework and other live reform programmes.

- A wide range of external viewpoints, including employers, trade unions, the pensions industry, financial services, local government and consumer voices.

4. Governance

4.1 The joint HM Treasury-Department for Work and Pensions Minister Emma Reynolds MP is leading the review.

5. External engagement with the review

5.1 The review secretariat will consult widely as it develops its analysis and policy options. Co-creation with industry and the Local Government Pension Scheme will be an essential part of the review process, as will expertise from leading voices and think-tanks.

6. Outputs and Reporting

6.1 The first phase of the review will focus on investment and report initial findings later this year and ahead of the introduction of the Pension Schemes Bill. The second phase will start later this year and alongside investment will consider further steps to improve pension outcomes, including assessing retirement adequacy. Ongoing policy development with respect to defined benefit workplace pensions schemes will remain separate from the review.

Appendix 2

Call for Evidence Description

Scale and consolidation

1. What are the potential advantages, and any risks, for UK pension savers and UK economic growth from a more consolidated future DC market consisting of a higher concentration of savers and assets in schemes or providers with scale?
2. What should the role of Single Employer Trusts be in a more consolidated future DC market?
3. What should the relative role of master trusts and GPPs be in the future pensions landscape? How do the roles and responsibilities of trustees and IGCs compare? Which players in a market with more scale are more likely to adopt new investment strategies that include exposure to UK productive assets? Are master trusts (with a fiduciary duty to their members) or GPPs more likely to pursue diversified portfolios and deliver both higher investment in UK productive finance assets and better saver outcomes?
4. What are the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors?
5. To what extent has LGPS asset pooling been successful, including specific models of pooling, with respect to delivering improved long-term risk-adjusted returns and capacity to invest in a wider range of asset classes?

Costs vs Value

1. What are the respective roles and relative influence of employers, advisers, trustees/IGCs and pension providers in setting costs in the workplace DC market, and the impact of intense price competition on asset allocation?
2. Is there a case for Government interventions, aimed at employers or other participants in the market, designed to encourage pension schemes to increase their investment budgets in order to seek higher investment returns from a wider range of asset classes?

Investing in the UK

1. What is the potential for a more consolidated LGPS and workplace DC market, combined with an increased focus on net investment returns (rather than costs), to increase net investment in UK asset classes such as unlisted and listed equity and infrastructure, and the potential impacts of such an increase on UK growth?
2. What are the main factors behind changing patterns of UK pension fund investment in UK asset classes (including UK-listed equities), such as past and predicted asset price performance and cost factors?

3. Is there a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC and LGPS funds to UK assets or particular UK asset classes, taking into account the priorities of the review to improve saver outcomes and boost UK growth? In addition, for the LGPS, there are options to support and incentivise investment in local communities contributing to local and regional growth. What are the options for those incentives and requirements and what are their relative merits and predicted effectiveness?

Appendix 3

LPF Draft Submission

About LPF

Lothian Pension Fund ('LPF') administers the Local Government Pension Scheme (LGPS) in Edinburgh and the Lothians. We're an asset-backed and multi-employer scheme with around £10 billion of assets, the second largest LGPS fund in Scotland, and a top 20 fund in the UK, serving c100k members and 56 active employers.

LPF retains operational autonomy from the Administering Authority of the Fund, the City of Edinburgh Council. This has been achieved through the creation of an FCA-regulated Investment firm and a service company which employs the staff running the fund. LPF also maintains its own core infrastructure, including office, IT systems and architecture. LPF manages nearly all of its assets internally through its team of investment professionals.

This structuring has allowed LPF to focus solely on the delivery of outstanding pension and investment services for the benefit of our members and their employers. We have also been able to leverage the benefits of our structure through collaboration with other LGPS in Scotland and Northern Ireland, managing assets and advising these partners funds for mutual benefit.

External validation of the success of the fund's strategy has been provided through:

- *CEM global benchmarking of pension schemes conclude LPF achieves higher than average investment return at lower cost and risk, while also providing higher quality administration services to our members and employers at lower cost than the peer group.*
- *LPF is the only LGPS which has been Pensions Administration Standards Association accredited, and achieves high scores in Customer Service Excellence assessments.*
- *LPF was awarded LGPS Fund of the Year (assets over £2.5bn) in 2023.*

<u>Scale and consolidation</u>

1. What are the potential advantages, and any risks, for UK pension savers and UK economic growth from a more consolidated future DC market consisting of a higher concentration of savers and assets in schemes or providers with scale?

   - LPF has no comment on this matter.

2. What should the role of Single Employer Trusts be in a more consolidated future DC market?

   - LPF has no comment on this matter.

3. What should the relative role of master trusts and GPPs be in the future pensions landscape? How do the roles and responsibilities of trustees and IGCs compare? Which players in a market with more scale are more likely to adopt new investment strategies that include exposure to UK productive assets? Are master trusts (with a

fiduciary duty to their members) or GPPs more likely to pursue diversified portfolios and deliver both higher investment in UK productive finance assets and better saver outcomes?

- LPF has no comment on this matter.

4. What are the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors?

   - LPF has no comment on this matter.

5. To what extent has LGPS asset pooling been successful, including specific models of pooling, with respect to delivering improved long-term risk-adjusted returns and capacity to invest in a wider range of asset classes?

   - LPF has no direct comment on the success of LGPS asset pooling in England and Wales.
   - LPF has the scale to operate with its own internal investment management team that supports alignment of interests to the Fund as an asset owner by avoiding agency problems and operates at significantly lower cost than commercial external asset managers. The scale enables capabilities across most asset classes including equities, bonds, property and infrastructure.
   - LPF operating through its regulated asset management subsidiary LPFI has successfully leveraged its in-house investment expertise to the benefit of like-minded partner funds in Scotland and Northern Ireland. Operating in many ways like an LGPS asset pool its ownership and governance is set up to ensure it acts solely in the interests of the LGPS Funds without commercial motive.
   - This collaboration supports the partner (smaller) LGPS funds invest in a wider range of asset classes in a cost effective manner and enables LPF and these funds to operate most cost effectively which improves the affordability of the scheme

<u>Costs vs Value</u>

1. What are the respective roles and relative influence of employers, advisers, trustees/IGCs and pension providers in setting costs in the workplace DC market, and the impact of intense price competition on asset allocation?

   - LPF has no comment on this matter.

2. Is there a case for Government interventions, aimed at employers or other participants in the market, designed to encourage pension schemes to increase their investment budgets in order to seek higher investment returns from a wider range of asset classes?

   - LPF do not believe that the Government should intervene directly in the investment decisions of the Fund governing body through charge cap or investment budgets as this can have adverse consequences.

- When considering strategic and tactical asset allocation the governing body or its delegates should consider the expected investment return after tax and all investment charges and expenses giving appropriate consideration to investment volatility, and if relevant, funding volatility. Investment budgets, or investment fee caps, should therefore not be used to restrict investments provided there is a governing body with appropriate skills and competence to direct and oversee appropriate investment strategies and performance.

Investing in the UK

1. What is the potential for a more consolidated LGPS and workplace DC market, combined with an increased focus on net investment returns (rather than costs), to increase net investment in UK asset classes such as unlisted and listed equity and infrastructure, and the potential impacts of such an increase on UK growth?

   - To the extent that an increase in UK investments by the LGPS crowds out other investors then it is not clear how this will impact UK growth.
   - Whilst LPF and other large LGPS Funds, either directly or indirectly via the asset pools, already invest in UK asset cases including listed equity and unlisted equity and infrastructure, it is not clear that consolidation alone would lead to an increase in UK holdings. It may be that consolidation amongst smaller funds or greater use of asset pools would enable a wider range of investment from those funds, or access via external vehicles to be more cost effective.

2. What are the main factors behind changing patterns of UK pension fund investment in UK asset classes (including UK-listed equities), such as past and predicted asset price performance and cost factors?

   - For LPF the main factors behind strategic and tactical asset allocations are predicted asset price performance, cost and accessibility.

3. Is there a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC and LGPS funds to UK assets or particular UK asset classes, taking into account the priorities of the review to improve saver outcomes and boost UK growth? In addition, for the LGPS, there are options to support and incentivise investment in local communities contributing to local and regional growth. What are the options for those incentives and requirements and what are their relative merits and predicted effectiveness?

   - LPF already invests in local and regional opportunities but does so purely on the investment merits.
   - LPF are wary of diluting its clear investment objective to invest in order to pay pensions, with a strategic priority to earn an appropriate risk adjusted return as responsible investors, and in doing so to act in the interests of members and employers.

- Incentives that impact the risk/reward expectations could impact the proportion of assets invested locally and regionally but LPF believe it is critical that investment managers retain the ability to balance risk/reward within the investment risk appetite set by its governing body.
- Should the Government set direction in legislation or regulation the boundaries of this, and fiduciary duty would need to be clear. Were the Government to direct investments, this could lead to adverse impacts on returns or costs and therefore impact investment outcomes impacting members of DC schemes and employers of the LGPS