SOUTH YORKSHIRE
PENSIONS AUTHORITY

Response To The Consultation "Local Government Pension Scheme (England And Wales): Next Steps On Investments" By South Yorkshire Pensions Authority

Introduction

South Yorkshire Pensions Authority is a unique LGPS Administering Authority being a democratically accountable single purpose local authority created in the aftermath of the abolition of the metropolitan counties in 1986, with the sole purpose of ensuring that funds exist to pay pensions when they become due. The Authority is responsible for the management of the South Yorkshire Pension Fund which has assets of £10.2bn and a membership of c176,000 working for 548 different employers as of March 2023. This makes it one of the largest funds within the Local Government Pension Scheme in the United Kingdom and indeed one of the larger defined benefit pension schemes in the UK.

The Authority is a shareholder and investor in the Border to Coast Pensions Partnership, having prior to pooling successfully managed most of its assets in house, and consequently had a very low, arguably artificially low, cost base. As the Authority also managed the assets of the South Yorkshire Transport Fund (which has subsequently been absorbed into the Greater Manchester Pension Fund) it was unique in England up to 2018 in being a regulated LGPS Fund. SYPA's participation in Border to Coast was by no means a given and the Authority debated long and hard before coming to a decision and was also subject to considerable pressure to take an alternative course. The key deciding factors were the presence of an FCA regulated entity at the centre of the Border to Coast approach and a commitment to internal management which assisted the Authority in addressing the sustainability of its operating model, while minimising the additional costs involved in doing so.

At the time of writing over 70% of the South Yorkshire Fund's assets are held in investment products provided and managed by Border to Coast, including all listed assets. Of the remaining assets the vast bulk are legacy alternatives which will be reinvested with Border to Coast on realisation and real estate which will transition into pooled products during latter part of 2023 and 2024. The remaining assets which it is currently planned will be no more than 5% of the value of the Fund will be made up of local investments within our Place Based Impact strategy, which is specifically designed to support "levelling up" and a portfolio of directly held agricultural land which will act as a carbon offset as well as providing a steady income return. Work is currently underway to place this latter portfolio into an investment structure that would allow it to become part of a pooled natural capital product if there were sufficient demand for and it met the criteria for inclusion in such a product.

The Authority's core objective is to ensure sustainable and affordable payment of pensions for our scheme members, as is the case for our 10 partners in Border to Coast. We welcome this consultation on the future of LGPS investments and believe it is an important contribution to how we can collectively build on some of the good practice that has evolved across the LGPS since 2016.

The Authority has benefitted significantly from its participation in Border to Coast over and above the original objectives set out for pooling. Partner Funds and the operating company are collectively developing innovative and effective investment propositions – such as 'Climate Opportunities', which is delivering investment to drive the transition to Net

Zero. Our collective scale also increases our influence as an active steward – whether on executive pay, climate change, or on driving standards in Responsible Investment and ESG disclosure.

While significant progress has been made, our evolution is not fixed. We recognise the need to review and adapt how we operate, both as a Partnership and an individual Fund to reflect both our individual development and to meet the various dynamic challenges that may impact us in pursuit of paying pensions in an affordable and sustainable manner.

Our response starts from the fundamental principle that the money which the Authority manages is not public money but the accumulated savings of our 176,000 members and therefore the best interests of those members rather than any political objective must predominate in our investment decision making.

The key messages in our response are:

- We see the approach to pooling outlined in the consultation as reflecting the approach taken by Border to Coast (and some other pools).
- We welcome the encouragement to complete the pooling of listed assets generated from the proposed March 2025 deadline and have already met that requirement.
- While we understand the Government's desire to see consolidation amongst the Pools, we do have some concerns about the impact of such a process on business as usual and the potential for it to destabilise the current eco-system.
- We are supportive of steps to improve the consistency and transparency of reporting and note the need to ensure compliance to achieve a clear and consistent picture of performance and impact across the LGPS.
- We see considerable investment opportunity in the "levelling up" agenda and already have a plan in place to achieve an allocation of 5% of the Fund to a Place Based Impact strategy and support efforts to achieve consistency of reporting in this area.
- While cautious about the allocation of 10% of the Fund to pure play Private Equity in terms of our risk appetite we already allocate more than 10% of the Fund to the more broadly defined "growth capital" which would be supportive of the Government's policy intent.
- Across many of the questions raised there are challenges around securing compliance with current guidance and the process of implementing the Government's proposed changes will need to take this into account.
- The additional requirements outlined in this consultation may exacerbate the resourcing challenges within Funds.

While the Government's desire to achieve the implementation of its policy intent through statutory guidance is understandable, we do feel there are several areas where changes to the regulations will be required to deliver the policy intent, for example some of the issues with the current structure of annual reports flow directly from the existing regulations rather than guidance.

We also see it as regrettable, given the importance of governance to the successful delivery of the Government's policy intent in this consultation that there has been no comprehensive response to the Scheme Advisory Board's statutory recommendations in relation to the Good Governance Project, as we feel that significant progress in this area will assist in driving progress on the agenda reflected in this consultation.

We would welcome the opportunity to discuss any part of our response in more detail.

Turning to each of the consultation questions in turn.

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?

We recognise that the ecosystem in which the LGPS operates is changing and it is important to acknowledge and adjust to this, to ensure we can continue to collectively deliver for LGPS members. This includes:

- The increasing regulatory and governance complexity and burden on individual Funds.
- The maturing (and move to buy-out solutions) of the corporate DB sector reduces both the experience in, and wider sector support for, open DB schemes. This will, over time, reduce the pool of experienced talent the LGPS has traditionally recruited from. The PLSA research, "LGPS: Views from inside the scheme" highlighted the challenges individual Funds have in recruiting the right staff, across all aspects of their business.
- With the decline of open DB schemes, and the significant growth in DC schemes, a gradual and possible accelerating, decline in the knowledge and capacity of the wider sector (e.g., investment consultants) to support the open DB schemes and LGPS in particular (and their specific investment requirements which reflect the nature of the supporting sponsor covenant).

These issues can be addressed through:

- Engaged and informed Pension Committees and Local Pension Boards, supported by good teams of officers, with the right levels of delegation, resources, and support to develop, and manage the oversight of, their investment strategies.
- Well-resourced pools, with the in-house investment capabilities to support the development and implementation of the investment strategies of their Partner Funds. As centres of expertise these pools can provide wider support for Partner Funds.

However, in operating any system, good governance is fundamental. This can cover a wide range of issues but includes the establishment of a clear division of responsibilities, robust oversight and simplified, flexible decision-making, including effective delegations to specialists trusted to exercise sound judgement over the long-term. The importance of this is often underestimated. The "governance premium" is thought to be around 0.6% per annum additional return (and has been estimated as high as 1-2% p.a.) – as can be evidenced via asset owners with "good governance" (this relates primarily to clear delegation of investment decision-making with strong oversight and scrutiny by the asset owner board) based on research[1] over the last 20 years. We recognise that standards are variable with smaller schemes less likely to rate themselves as highly on a number of important measures of quality. While each fund and pool should consider their own governance frameworks, progress on bringing the 'Good Governance' review, and in particular the requirement for regular independent reviews of governance, into regulations will support all LGPS funds and progress should therefore be welcomed by all.

[1] Pension Policy Institute: "Defined Benefits: the role of governance"

Scale can deliver significant benefits. A 2022 publication[2] by CEM looked at the case for scale for pension schemes. Its findings were that asset pooling led to lower staff costs per assets invested (due to the ability to internalise certain investment capabilities) and to lower external management fees (due to the negotiating strength that comes from the value of mandates being placed, negotiated by professional investors whose interests are fully aligned with the ultimate asset owners).

However, scale doesn't always deliver additional benefits; seeking scale without addressing issues such as good governance, a common vision and culture (within the Pool and among Partner Funds), unnecessary complexity of investment strategies, and client needs, can either inhibit, or damage, a pool's ability to deliver.

Delivering the benefits of pooling can be challenging and requires an understanding at officer and elected member level of both the benefits and costs of compromise, and an ability to assess where such compromise does not have a material impact on the risk/return profile that the Partner Fund wishes to achieve. This also requires Partner Fund advisers to consider the benefits that come from pooling (in both investment outcomes and reduced ongoing governance / advisory costs) i.e., to consider implementation alongside model-based investment strategy advice. This in turn is linked to a sense of ownership and a view that the pool is a part of the system in which we operate, as opposed to be something "other" (which could lead to an adversarial approach being taken between the pool and its Partner Funds).

A key point for Funds is that they need appropriate capacity and capabilities to deliver their objectives. Indeed, we note the previous Communities and Local Government Committee report, "Local authority investments[3]", highlighted the dangers to Local Authorities on the over reliance on external advisers (and not sufficient in-house expertise). The pay differentials existing between funds and the private sector and emerging between funds and pools also challenge the ability to secure appropriate in-house expertise, which is necessary (and perhaps more important) even in an almost wholly outsourced operating model. In this context, individual Funds may also need to recognise how they can achieve the benefits of scale in delivering a robust and resilient operating model.

Turning to consolidation of the current pools, the international evidence backing the Government's intent is indisputable. However, the international comparators are often single entities or entities with relatively small numbers of partners. The larger the number of partners involved the more difficult it will be to achieve consensus and true collaboration and for the various partner funds to be genuinely "like minded".

The process of consolidation like any merger and acquisition (M&A) process has a range of inherent risks in terms of the bringing together of different cultures in the new entity and the fact of the process diverting management attention from ongoing operations, all of which have been the cause of failed M&A activity in the private sector. There are also likely to be significant short-term costs concerned with the winding up of existing pooled products which do not have a part in the "new world" the sharing of which is likely to become contentious, as well as difficulties in bringing together what in some cases are very different legal structures.

[2] A Case For Scale February 2022
[3] https://publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/164/164i.pdf

None of these issues are reasons not to consolidate simply risks to be aware of and to be managed in the process.

We would also draw attention to the risks posed by the Government's making such a clear statement of intent at this stage. The danger is that rather than see a neat three stage process of transition, collaboration, and ultimately consolidation the uncertainty about the future of certain pools created by this intent could destabilise the current arrangements.

That said, we believe that there are no technical barriers to increasing scale in the pools. Corporate activity to achieve scale within the asset management industry is commonplace albeit requires expertise and experience to achieve benefits and does generate not inconsiderable short-term costs.

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?

We support the principle of transferring, or having a clear path to transition, assets to pools, and we have already met the requirement set for listed assets. We believe that each funds' Investment Strategy Statement (ISS) should include a transition plan for assets to be transferred to the pools, as well as the composition and justification of any assets remaining outside the pool.

We would welcome clarity on the position of legacy illiquid assets particularly those in private markets. With fees already negotiated, and with typically no ability to adjust them post commitment, transferring these assets to the pool may simply incur new legal and tax costs. It may be more appropriate to agree that individual Partner Funds should not seek to make new illiquid investments outside their pool from a specific date, and the pools (where appropriate) support Partner Funds on the oversight of legacy illiquid assets as they run-off. This could be on a case-by-case basis – for example it is possible to transition English Real Estate assets with appropriate tax planning and achieve strong investment and business case benefits, although assets in Wales and Scotland cannot be transferred due to the absence of seeding relief provisions in relation to the devolved equivalents of Stamp Duty Land Tax, and this is an issue which we would like to see the UK Government pursue as it creates distortions in the UK investment market.

Clarity is also required on 'passive' investments, for those funds which invest in such products, although they are not and never have been a part of SYPA's asset mix, and therefore we leave it to others to comment on the detail of this point.

We also note the current guidance that up to 5% of assets can be invested outside the pool. We believe this flexibility should remain – particularly when it is supporting other relevant objectives, such as making local investments, particularly those that form part of Fund's plans to address the "levelling up" agenda. Given the Government's overall intent it would be appropriate for Fund's transition plans to set out a clear justification for assets remaining outside the Pool. Such a justification will need to reflect on the overall benefits in terms of the delivery of the investment strategy and not just on cost. For example, some investments might be retained as carbon offsets within an overall Net Zero strategy for the whole of a Fund's portfolio, or they might be local investments supporting the "levelling up" agenda, which cannot be made at a scale suitable for inclusion in a pool product. The vagueness in the consultation document around the potential scale of non-pooled assets is perhaps unhelpful in achieving the Government's intent as if there is no clear boundary within which funds should operate in this area there is the potential for this provision to be abused.

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?

We believe that with our 10 partners and the Border to Coast operating company we have developed a model of pooling which has successfully allowed us to meet the government's previously stated objectives for pooling. We support the approach set out in the consultation, which is reflective of the way we have sought to pool, developing a limited number of building blocks and tools, which are commercially viable and sustainable in the longer term, and which in different combinations allow Partner Funds to deliver their investment strategies. Setting out a set of core principles which any pooling arrangement has to meet should strike the balance between prescription and the understandable desire not to stifle innovation which will continue to drive progress in this area.

Any guidance needs, without being overly prescriptive to set a boundary for the acceptable level of granularity of asset allocation which has been central to the debate over “what is strategic asset allocation”, which seems to be the point of contention which in some places has frustrated the delivery of the Government’s original intent. Hopefully there would be consensus that “UK Small Cap Equity” is too granular while “Equity” is perhaps not granular enough. Defining the middle ground is likely to be difficult but it is important as the current vacuum in this area has created the issue which the Government now seeks to address.

While Administering Authorities are responsible and accountable for their investment strategies, any strategy must be capable of implementation, and in the world envisaged by the consultation implementation must be through the pool with extremely limited exceptions. Given this it is difficult to see how Administering Authorities can produce a strategy in isolation from the building blocks and tools provided by the pool. While there will continue to be a place for traditional investment consultants in the development of strategy this is likely to be very focussed on the asset / liability modelling which is used to consider the effectiveness of a particular strategy in achieving the required funding targets, which is a particularly technical area. A pool such as Border to Coast can play a significant role in supporting the development of strategy and its involvement in the process can assist in identifying the requirement for new tools or building blocks which might be required to implement the evolving strategies of all the Funds within a pool. There is a perception that pool entities are likely to be conflicted in discussions around strategy, but the reality is that they are no more conflicted than other advisers who are routinely involved in the process and Funds need to ensure that they have robust governance arrangements in place to manage potential conflicts, and to ensure that proper oversight and scrutiny take place.

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?

The key to a successful system of governance is ensuring decisions are made by the right people, with the right level of knowledge, at the right time, as emphasised in the Scheme Advisory Board's Good Governance proposals.

It is important that there is local accountability for the target returns, risk appetite, and investment beliefs that underpin the investment strategy to deliver cost effective and sustainable pensions.

As outlined in the consultation, and this is something we support, the role of a Pension Committee is to review and approve the investment strategy, and to provide oversight and scrutiny on how effectively this is being executed, not to make tactical and operational decisions or try to second guess those directly running money. To be effective in this role Committees will need to have in place appropriate delegation of functions which are not central to the setting of strategy to Officers, who have sufficient experience and knowledge to support the Committee. In turn, Officers (and Committees) can be supported by the centre of investment expertise that resides in the pool that they own, which is also responsible for the implementation and management of that Fund's investment strategy.

We believe that the knowledge and understanding of Pensions Committees in exercising their responsibilities for the oversight and scrutiny of investment strategy delivered by the Pool is, in addition to advice from officers, best supported by independent advisers who can act in a role akin to Non-Executive Directors (and, who should be set clear objectives in such a role).

For Pension Committees, a key component to this is an effective training policy, which is reported against as part of clear delegation of functions between Committee and Officers. SYPA has had such a policy in place for a number of years (available here) and reports on training undertaken as part of the annual report in line with the current guidance. This policy sets out a level of mandatory initial training and the expectation that members of the Authority and Local Pension Board will undertake the Pensions Regulator's recommended level of 15-25 hours of learning and development each year. The level of knowledge and understanding reflected in Authority and Board members' scores on the National Knowledge Assessment is also publicly reported and influences the development of training plans.

Any policy is, however, only as good as its delivery and in this case the ability of members to take advantage of the learning and development opportunities provided. Membership of a Pensions Committee will not be the only committee assignment that a councillor has and for many will need to sit alongside a full-time job so balancing the time commitment can be difficult. Nonetheless it would be sensible for Administering Authorities to take a similar approach to that taken by many councils in relation to planning and licensing functions of members not being able to participate in those committees unless they have undertaken a minimum level of training. This would be reinforced by the adoption of the Scheme Advisory Board's recommendation in relation to mirroring the knowledge and understanding provisions for Local Pension Board members for Pension Committee members in regulation.

As a separate authority all members of SYPA receive allowances which reflect the level of time commitment required both for meetings of the Authority and its committees and to undertake learning and development. This is unusual and reflects SYPA's unique circumstances. There is, however, perhaps a case that members allowance schemes more generally should be adapted to take account of the different degrees of workload, and in particular learning and development, that result from membership of a pensions committee.

We believe Government proposals in relation to the interaction of pools and funds, and the training of pension committee members are part of a whole range of steps required in relation to ensuring sound governance which should be addressed as part of a holistic response to the Good Governance Project report completed by the Scheme Advisory Board and the Board's associated recommendations to the Minister to ensure changes take place within a framework focused on delivering the best outcomes for LGPS members.

**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?**

Noting our introductory comments, we support the proposal to have standard reporting requirements (with clear and consistent definitions). However, it is evident from the simplest analysis of the current SF3 data that some funds are not complying with current guidance on the reporting of non-invoiced investment management costs, which therefore distorts any comparisons which might be drawn between funds. Any moves in this direction need to be accompanied by more active steps to address non-compliance and ensure consistency. Only the Department has the power to make this happen it is not something that can be outsourced to the Scheme Advisory Board which at best has the power of persuasion which has failed in the past as a means of resolving these issues.

In terms of cost comparison, we would draw attention to the need to make a distinction in reporting and official statistics between base fees and performance fees. The scale of the latter will very much depend on asset mix and while important any cost comparison needs to begin from the levels of base fee. We would also draw attention to an issue particularly affecting SYPA which is that our costs included in any comparison include £500 - £600,000 pa of irrecoverable VAT because the Authority does not benefit from the s33 status available to other administering authorities. Clearly such issues need to be understood when drawing any comparisons using this sort of data.

While we support reporting net savings, this needs greater consideration – specifically “against what?”. In calculating our savings, we are comparing our current position with (often) data from 2015/16 – which is not necessarily the market pricing we see today and does not necessarily reflect the changes in asset allocation over time particularly the move into more expensive private market assets, which is supported by other proposals in this consultation. There is a danger that this information becomes dated and irrelevant. Equally, a focus on cost may also drive unintended consequences (particularly given the desire from the Government to increase investment in more expensive asset classes, such as private markets). As the pooling journey continues, it may be appropriate to use other reporting mechanisms – for example the use of benchmarking of costs against global comparators using independent market experts such as ClearGlass Analytics and CEM. Mandatory participation in such exercises across the scheme would both increase their utility and provide an opportunity to reduce the cost of participation.

We have significant concerns about the proposals to produce standard reporting on investment returns, which we feel fails to recognise the fact that different funds will have different approaches to achieving their funding goal, some being prepared to accept significantly more volatility within their strategic asset allocation than others. Thus a single simplistic performance benchmark for each asset class where some mandates are targeting higher returns than others will be comparing apples and pears and be overly simplistic.

There is a danger in this proposal that returns are taken out of context – and could lead to inappropriate short term investment decisions being made. Each Pension Committee should be measured on two basic measures:

- Does it have the right strategy, based on its liabilities and current funding level?
- Does it have the right approach to implementing this strategy?

While the consultation provides a clear view on how funds should implement their strategy (paragraphs 29-31 in the consultation), it is relatively silent on assessing whether the Committee has the right strategy, and of course there may be several potential strategies which could achieve the same objective. There is a range of existing, and emerging, frameworks on doing this and we would welcome the opportunity to progress this (possibly though the Scheme Advisory Board).

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

We support clear and consistent reporting by the Scheme Advisory Board, provided the Board is sufficiently resourced to undertake the work and it is undertaken in such a way as to minimise the data collection burden on funds. However, we do accept that the current data collection by the SAB which involves the manual analysis of 86 annual reports is unsustainable given the increased reporting responsibilities the Government envisages placing on the Board both because of this consultation and the separate consultation on TCFD. Therefore, some form of simplified return which could encompass or replace SF3 (and perhaps be jointly owned by the Department and SAB) would seem to be a sensible way of reducing the burden on funds but making data available to the SAB. It may also be a means of making data available on a more timely basis given the current difficulty in gaining audit certification for many funds, although separation of the accounts of Funds from those of host councils could also result in more timely information provision.

We also note the broader issue of increased reporting for the LGPS. The research in the PLSA's "LGPS: Views from inside the scheme" found that over half (54%) of respondents feel that the legislation/regulatory requirements are too complex to execute, while two in five (43%) continue to feel legislation/ regulatory requirements hinder them from doing their job effectively.

This is not to diminish the fundamental role of transparency and reporting. This is essential to ensure accountability, and to drive best practice across the LGPS. However, simplicity is key. Indeed, we understand a recent review by SAB suggested that nearly a third of LGPS funds were not meeting their current annual report disclosure requirements, something will fundamentally have to change to bring this figure down to near zero.

Simply adding additional reporting requirements not only adds cost, but there is a significant negative impact for the intended audience of the scheme members due to the volume and complexity of information being published with our last annual report running to over 450 pages including appendices. Some of this volume could undoubtedly be reduced using hyperlinks to web versions of certain documents but the current regulations do not allow this, therefore simply changing the guidance will not address some of the core contributors to the problem with annual reports. While we understand the desire for the annual report to give users all the information, they might need in one place this is not the case for asset managers such as the pool entities which produce at least a corporate annual report and accounts (where they are a company) a stewardship report and a TCFD report. Allowing LGPS Funds licence to follow this sort of approach while meeting the basic requirements on what they should disclose might also help users of reporting find what they want more easily. We believe that the impact assessment of changes in guidance – in terms of cost, transparency, and in the ability of readers to interpret what is shared – should be taken in the context of the ongoing review of LGPS reporting requirements being undertaken by the Scheme Advisory Board.

Question 7: Do you agree with the proposed definition of Levelling Up Investments?

We agree with the definition outlined in the consultation. This is an issue which SYPA regards as extremely important as part of its investment strategy, not for policy reasons but because investments of this sort can deliver the returns we require from places where we would not normally look for them, which in the context of returns generally becoming more difficult to deliver is incredibly important.

That is not to say that the policy benefits are irrelevant, and we see achieving both return and positive impact as something that is supported by our scheme members and entirely in line with our overall fiduciary duty.

Through Border to Coast a new private markets strategy, 'UK Opportunities' is being developed. Set to launch in April 2024, this will provide Partner Funds with opportunities to invest in regions across the UK, including venture and growth capital, and will ultimately support the policy intent outlined in the Levelling Up white paper. We see this product as an important part of our overall Place Based Impact Strategy in conjunction with investments which are more targeted on South Yorkshire.

Under current guidance, individual funds have the flexibility to invest up to 5% outside the pool. The local and specific nature of these investments mean they may be of a small scale and unable to be effectively delivered through the pool. As such, this exemption allowing the making of these investments outside the pool should be maintained (although this should still be subject to regulatory permissions, resourcing, recognising the importance of managing conflicts of interest that may still arise, and the role pools can play in advising in relation to non-pooled investments).

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

Collaboration has been – and should continue to be – a hallmark of strength in the LGPS.

If a pool is unable to effectively develop and manage an investment proposition, there may be merit in sourcing this capability through another LGPS pool. However, it needs to be recognised that there are several implications that need to be fully considered and risks mitigated. These include issues such as:

- Proposition development – currently Border to Coast's propositions are designed with, and for, 11 Partner Funds who are both shareholders and customers, and who meet the, not inconsiderable, costs of proposition development directly. Care will be required should an external pool customer(s) wish to evolve existing propositions. The existing governance structures and processes may need to be reviewed to overcome this challenge.
- Niche strategies – certain investments may have capacity issues. For example, despite significant demand, the initial Border to Coast Climate Opportunities strategy was capped at £1.35bn. Care will be required in balancing the needs of shareholder customers vs external pool customers for capacity constrained investments.
- Cost model – as shareholders, existing customers principally manage risk through Border to Coast's regulatory capital. As non-shareholders, external pool customers would be subject to different pricing.
- Managing demand – in owning and building Border to Coast, there has been a structured approach to its growth –building capacity and capability to reflect Partner Funds long term needs. This is likely to be absent with non-shareholder customers and, in accepting external customers, there is a risk of managing in- and out-flows, potentially destabilising the ability to plan the required capacity in various functions of the business. There are also similar considerations regarding management of liquidity in certain propositions.
- Management of additional customers will require careful consideration, particularly noting the potential additional layer of due diligence costs that will be required as a regulated asset manager investing into another regulated asset manager's vehicle.

Nonetheless, if these issues are overcome, it would be easier to manage this on a pool-to-pool basis, than an individual fund-to pool basis.

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

The objective of individual Funds is to generate the appropriate risk adjusted returns to ensure they can operate the LGPS in an affordable and sustainable manner. Where ancillary objectives can be co-delivered without impacting these returns or increasing risk, such as those outlined in the Levelling Up White Paper, this is to be welcomed. Indeed, the 11 Border to Coast Partner Funds have within them seven of the ten most deprived areas in the Index of Multiple Deprivation (as reported in the 2019 English Indices of Deprivation). Levelling Up, effectively delivered, has the potential to create growth; including creation of jobs, drive productivity, improve people's quality of life and deliver better health and wellbeing outcomes. Nonetheless, LGPS assets are invested to deliver appropriate risk adjusted returns and should not be used to implement any Central Government policy objective – no matter how laudable it may be. We welcome the recognition in the consultation that each Fund is responsible for setting their investment strategy, designed to deliver the appropriate risk adjusted returns they require.

Any investment strategy and associated reporting on Levelling Up needs to be through the principal asset classes (e.g., Real Estate, Private Equity, Infrastructure, Private Credit, etc). This ensures that the risk adjusted returns for "levelling up" investments are considered on the same basis as any other investment in that asset class. "Levelling Up", or as we prefer to call it Place Based Impact can be reported on as a memorandum item achieving the Government's aim of transparency but maintaining the focus on delivering the returns required to pay pensions as the primary objective.

SYPA has already taken the decision to allocate 5% of the Fund to place based impact investments (see the policy document here) and this decision is reflected in our latest Investment Strategy Statement (here). While we understand the Government's desire to maximise investment through the pools and we will commit to the Border to Coast UK Opportunities Fund as part of our Place Based Impact strategy we do believe that in order to achieve the impacts that we want to see many of the investments in this area will need to be made outside of formal pool structures, although we accept that the pool may, subject to regulatory permissions, be able to provide advice and support in making such investments.

Question 10: Do you agree with the proposed reporting requirements on Levelling Up Investments?

We would refer to our previous comments about annual reports and the need to ensure consistency and compliance in reporting. As this is a new requirement there is an opportunity to start with a clean piece of paper and adopt existing industry wide best practice standards such as the Place Based Impact Reporting Framework. We have already adopted this and our latest reporting, which will be included in our 2022/23 Annual Report is attached as an appendix for information as an illustration of what is already being delivered in this space and of the impacts that investments of this sort can achieve.

In supporting the proposed requirement, we would draw attention to the fact that this reporting will require the assistance of specialist providers to analyse information from multiple fund managers. The number of providers in this marketplace is limited and they tend to be smaller businesses so there may be challenges in scaling up this activity across the whole of the LGPS in a relatively short timescale.

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?

Administering Authorities remain responsible for their investment strategies. As open DB pension schemes, it is essential that they develop appropriate diverse investment strategies designed to balance risk and return to ensure the LGPS remains affordable with stable employer contributions. As LGPS becomes an increasingly mature scheme liquidity, cashflow, and regular income, are becoming much more important aspects of investment strategy and a balance needs to be struck between all these factors in determining asset allocation.

As part of this approach, private markets can play an important role. While SYPA already had a mature private markets programme the creation of Border to Coast has moved this to the next level and significantly enhanced smaller Partner Funds' ability to access this asset class – leading to a £12bn programme across the pool to date.

We note the reference to private equity. It is our belief that this is a relatively narrow definition. Indeed, early-stage growth, especially that focused on tech, is relatively high risk. For investors who have not made meaningful or any previous commitments to private capital more broadly, this is a challenging entry point and risks disappointing or volatile returns/losses which could discourage future investment in private markets. Investments of this sort also tend not to generate the regular income that is increasingly necessary for funds that are cashflow negative.

A broader definition, covering 'growth capital' allows investors to build private market risk appetites which suits their own circumstances, rather than pushing everyone to a more narrowly defined and therefore potentially crowded part of the market with more volatile returns. Using this broader definition, we believe we are already investing around 10% of the Fund in assets which support growth. For example, Border to Coast's Climate Opportunities Fund is investing in businesses which are seeking to capture the opportunities presented by the transition to a No/Low Carbon economy.

The most effective way to encourage any investment in the UK is the provision of a stable investing environment through policy certainty. If the LGPS and private capital is being asked to make large, long-term, capital investments, the Government needs to offer corresponding long-term guarantees and/or the necessary policy certainty to protect these potential investors. Examples include policy certainty on renewable energy, transport and other climate transition considerations; improvements to the planning regime to accelerate development opportunities and to enable clearer partnership opportunities with Local Authorities; and the development of structures (perhaps with the support of BBB or UKIB) that enable risk sharing or return visibility.

While there is understandably a continued focus on costs, we recognise that private markets are a more complex and expensive asset class. In developing Border to Coast, we have built the capabilities and capacity to access these markets in an effective and efficient manner; and Border to Coast's latest annual report[4] highlights a c.24% reduction in base fees in this key asset class.

[4] https://www.bordertocoast.org.uk/wp-content/uploads/2022/07/Annual-Report-and-Accounts-2021-22.pdf

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?

There is a range of potential partners that can support the LGPS pools to deliver growth capital in the UK – the British Business Bank (BBB) and the UK Infrastructure Bank (UKIB) being two examples.

Given their state ownership and strategic focus to 'crowd in' other investors, these institutions may be well placed to support the LGPS pools source and commit to ventures that meet their normal investment criteria.

We do note that one of the key objectives of LGPS pooling was to reduce the fee burden paid by pension funds, and in a private market context, reduce the reliance on fund of fund structures which introduce an additional layer of fees and carry (profit share) expense. As such, any vehicle should be offered on a cost only basis if the intention is to encourage greater participation in this part of the market. Additional fee load will detract potential investors who are sensitive to fees. BBB will be investing balance sheet capital into all investments so a successful investment policy will deliver profitability for them without a reliance on fee income.

Question 13: Do you agree with the proposed implementation of the order through amendments to the 2016 Regulations and Guidance?

This approach has already been taken by many funds across LGPS on a voluntary basis and there is no logical reason to object to it.

Question 14: Do you agree with the proposed amendment to the Definition of Investments?

Yes.

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.

No.

For further information in relation to any of our responses please contact:

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