GOV.UK | Department for Levelling Up, Housing & Communities

Consultation outcome

Local Government Pension Scheme (England and Wales): Next steps on investments - government response

Contents

Summary

1. The UK has the largest pension market in Europe, worth over £2.5 trillion. It plays a critical role in providing safe retirement income as part of the social contract between generations. At the Chancellor's Mansion House speech on 10 July 2023, the government announced a series of measures to reform the pensions landscape, increase investment in UK businesses and improve UK capital market competitiveness.

2. Alongside the Local Government Pension Scheme England and Wales (LGPS) consultation, government announcements include: an industry-led

Mansion House Compact to drive greater investment into high growth companies from Defined Contribution schemes; a consultations on small pots and decumulation; a consultation response on a new Value for Money Framework for Defined Contribution schemes; and the issuance of two calls for evidence on productive investment by Defined Benefit funds and the role of the Pension Protection Fund and on pension trustee skills, capability and culture.

3. Following extensive engagement with external stakeholders, at Autumn Statement the government is announcing a comprehensive package of pension market reform that will provide better saver outcomes, drive a more consolidated pensions market and enable pension funds to invest in a diverse portfolio. The decisions set out in this response to the LGPS consultation form part of this wider package.

4. On the LGPS specifically, the key aims are realising the benefits of scale and seeking opportunities for returns in the United Kingdom with secondary beneficial effects. In our consultation we sought views on proposals in five areas:

- First, the government set out proposals to accelerate and expand pooling, with administering authorities setting out how they are investing their funds and why. We also proposed a deadline for asset transition to the pools by March 2025 and set out a direction of travel towards pools of at least £50 billion in assets to maximise benefits of scale.
- Second, the government proposed to require funds to have a plan to invest up to 5% of assets to support levelling up in the UK, as announced in the Levelling Up White Paper (LUWP) while providing good returns to the scheme.
- Third, the government proposed an ambition to increase investment into high growth companies via private equity, including venture capital and growth equity. The government believes there are real opportunities in this area for institutional investors with a long-term outlook, such as the LGPS.
- Fourth, the government sought views about proposed amendments to regulations to implement requirements on pension funds that use investment consultants.
- Finally, the government proposed to make a technical change to the definition of investments in LGPS regulations.

5. We received 152 responses from across the sector and have carefully considered all responses. We are grateful for all the time and thought of respondents in commenting on our proposals.

6. The consultation received a broad range of responses; it is clear that across the sector there is a collective commitment to making pooling work well and realising the benefits of greater scale and expertise. In addition, it is clear that LGPS investors are willing to seek out and invest in projects which have benefits for local communities where they make sense for the pension fund, and that this is in practice already taking place. It is also clear that there is an appetite to invest in high-growth sectors to the extent that this supports a fund's investment objectives. Proposals to increase the training requirements for the pension committees of LGPS funds, and to improve reporting and transparency of the scheme received wide support.

7. There were some proposals on which many or most responses expressed concern, notably the transition deadline of March 2025, aspects of the preferred model of pooling, and the 10% ambition for private equity allocation. The government's view is that setting clear and up to date expectations in guidance on these matters is essential to securing a step change in progress on pooling and associated benefits of scale, and does not cut across the fiduciary duties of funds. Guidance will not mandate investment in any particular assets, and the government's strong preference for progress on a voluntary basis, embracing the benefits of scale and striving to deliver returns.

8. The government also views the LGPS as being in a favourable position to make a greater contribution to UK growth. Scheme members are protected as their benefits are guaranteed in law and do not depend on investment returns. Many LGPS funds are in surplus, and the LGPS has over 2 million active members and remains open to new members. As a result, the LGPS has the freedom to invest for growth over the long term, unlike many private sector comparators. We encourage funds to consider what this should mean for their risk appetite and investment strategy, and to review the investment opportunities, particularly in private markets, which are available to them. We look to successes in Canada and Australia, where good pension outcomes have aligned with societal and economic benefits.

9. After having considered the responses, the government will now implement the proposals that we set out in the consultation to accelerate and expand pooling, and increase investment in levelling up and in private equity. We will:

- set out in revised investment strategy statement guidance that funds should transfer all assets to their pool by 31 March 2025, and set out in their ISS assets which are pooled, under pool management and not pooled and the rationale, value for money and date for review if not pooled.

- revise pooling guidance to set out a preferred model of pooling including delegation of manager selection and strategy implementation.
- implement a requirement in guidance for administering authorities to set a training policy for pensions committee members and to report against the policy.
- revise guidance on annual reports to include a standard asset allocation, proportion of assets pooled, a comparison between actual and strategic asset allocation, net savings from pooling and net returns for each asset class against their chosen benchmark.
- make changes to LGPS official statistics to include a standard asset allocation and the proportion of assets pooled and the net savings of pooling.
- amend regulations to require funds to set a plan to invest up to 5% of assets in levelling up the UK, and to report annually on progress against the plan.
- revise ISS guidance to require funds to consider investments to meet the government's ambition of a 10% allocation to private equity.

10. We will also amend regulations to require funds to set objectives for investment consultants and correct the definition of investment in the 2016 investment regulations. As proposed in the consultation, the Scheme Advisory Board (SAB) plans to expand their Scheme Annual Report to provide a report on the progress on pooling and on asset allocation across the LGPS. We will work closely with the SAB and relevant committees of the SAB to develop changes to regulations and revised guidance on investment strategy statements, pooling, governance, and annual reports.

11. More widely, we intend to monitor progress over the current valuation period (to 31 March 2025), based on fund annual reports, LGPS statistics, the Scheme Annual Report and other evidence. This monitoring will include progress on transition, governance and reporting and how effective these are in delivering improvements in efficiency, cost, and performance.

Chapter 1: Introduction

12. On 11 July 2023, as part of a package of measures to reform the pensions landscape, the government launched a consultation on proposals relating to the next steps for investments in the LGPS. The LGPS scheme is one of the world's largest funded pension schemes and a key player in global markets, investing around £359 billion worldwide. Its scale enables it to have a significant impact through its investments and gives it the potential to lead the market in innovation and transparency.

13. The government believes that whilst long term stable returns in order to pay pensions for its members are the primary purpose of the investments, there is scope at the same time to deliver substantial benefits to the UK as a whole.

14. The consultation focussed on five key areas which could have the greatest impact on the scheme and enable the LGPS to deliver these significant national benefits. The five areas were asset pooling, levelling up, opportunities in private equity, investment consultancy services and the definition of investments. The consultation also covered increased scale, governance and decision making, as well as transparency and accountability.

15. The consultation closed on 2 October 2023 and we received 152 responses, including responses from 82 administering authorities, 14 individuals, 13 asset managers, 12 union responses, 9 advisors, 8 industry bodies, 8 asset pools, 4 campaign groups, 1 local authority which is not an administering authority and 1 law firm.

16. We are grateful for the helpful, detailed and informed responses from across the sector which have greatly assisted government in analysing our proposals and, going forward, will be valuable for informing the next steps for implementation. There were a wide range of views expressed around our proposals and further details of the responses to each question are set out in the document below.

17. The consultation responses were carefully considered, and this response summarises the comments received on each topic and outlines how we intend to proceed.

Chapter 2: Asset pooling in the LGPS

18. The government’s view is that accelerating consolidation of assets in the LGPS is crucial for ensuring the scheme is delivering value for money in the interests of scheme members, employers and local taxpayers. Stronger pools can also ensure the LGPS effectively uses its scale to deliver on responsible investment, management of climate risks, investment in levelling up, and investment in unlisted equities in support of UK growth. The government wishes to see existing pools build scale as quickly as possible by accelerating the pace of transition of liquid assets from the funds into the pools, building on and expanding on successes so far. We set out in the consultation proposals to drive greater scale, improve governance and decision making and deliver better transparency and accountability.

Driving greater scale through fewer pools

19. In question 1, the government asked for views on alternative approaches to pooling in the LGPS to that set out in the consultation. The proposed approach included setting a long-term direction towards fewer pools to deliver scale of at least £50 billion of assets under management.

Summary of responses

20. There were 140 responses to this question. Many respondents commented positively about the broad direction of travel of the consultation and recognised that the scheme needed to evolve to meet new challenges and opportunities. Respondents noted the importance of a well-funded, well managed and sustainable scheme, to which excellent value for money and net performance were critical. Respondents further noted achieving improved delivery and efficiencies create tangible benefits for scheme employers, and for taxpayers.

21. Some respondents felt that it was too soon to consider moving to fewer pools given their relatively short history, and they should be given longer to demonstrate their worth to the sector. A small number of respondents also questioned the transparency of decision making and the level of local accountability and scrutiny of pools, particularly larger pools. Other responses proposed that government should focus on supporting those organisations that had yet to make significant progress.

22. A number of respondents commented that reducing the number of pools could potentially have a negative impact. Particular concerns were raised around potential further transition costs and administrative burdens involved in a further merger of pools. A number of respondents said that greater collaboration between pools to provide suitable investment mandates, and the specialisation of some pools in specific areas of investment, should be seen as an alternative to amalgamation.

23. Respondents also said that pools will need to demonstrate value for money not only in relation to investment management fees but also in relation to the quality of the service they provide in areas such as reporting, responses to queries and other day-to-day work with funds. Respondents also said that funds themselves will also need to have adequate capability and resources with good governance, training and resourcing being key.

24. There were mixed views regarding the case for increasing pool scale. Some supported the drive to greater scale as a means of reducing costs, with several referring to the CEM research (PDF, 1,722 KB) paper “A Case for Scale: How the world’s largest institutional investors leverage scale to

deliver real outperformance" showing that lower fees were achieved at greater scale. Several responses argued that the case for scale was more effective where pools operate in-house management, referring to successes achieved by RailPen and the Universities Superannuation Scheme (USS), and to the academic research (PDF, 6.9 MB) paper "Scale Economies, Bargaining Power, and Investment Performance: Evidence from Pension Plans" (Devries, Kalfa, Timmermann and Wermers, 2023). Others pointed to the increased cost associated with internal management. There was a broad consensus that quality of governance was more important than scale at both the pool and fund level.

25. A small number of responses suggested that different models should be considered. This included a view by some respondents that imposing fund mergers would rapidly increase scale and decrease complexity. These responses pointed to the fact that each administering authority has its own administrator, advisors (legal, actuarial, investment, etc) and Local Pensions Board, which adds cost.

Our response

26. The government welcomes the detailed and wide-ranging responses to this question. A wide range of views were expressed with the majority of views supporting a strengthening of the current pooling model, rather than moving to a significantly different approach. We welcome the emphasis placed on the capability and resources of pools and funds and intend to strengthen the framework of guidance.

27. We understand the concerns expressed on moving to fewer pools and underline that there is no intention to take steps to mandate a move to fewer pools in the immediate term. The government's view is that the focus in the short term should remain on accelerating transition of assets, improving governance and ensuring greater transparency and accountability. But in the long term the government considers that transition of assets alone will not deliver the full benefits of pooling, as the benefits of scale are present in the £50-75 billion range and improve as far as £100 billion.

28. The Government Actuary's Department estimate that the LGPS could reach around £950 billion in assets in 2040. We should therefore look towards a smaller number of pools with assets under management averaging £200 billion in the future and government will work with funds and pools over the medium to long term to consider the pathway. In the meantime, we would like to see the pools move towards greater collaboration where this makes sense, and to consider specialisation,

building on existing strengths in particular areas of investment, in order to deliver further benefits of scale and limit unnecessary duplication.

A timetable for transition

29. In question 2, the government sought views on the setting of a deadline in Investment Strategy Statement (ISS) guidance for funds to transition all listed assets, as a minimum, to their pool within a reasonable timeframe. We considered that a reasonable timeframe for liquid assets to be transferred was by 31 March 2025, which is the end of the current local fund valuation period. We also proposed that transition of all assets should be targeted by this date, as pooling of illiquid investments may offer the greatest opportunities for reducing savings combined with higher returns.

30. Under the proposals, funds would work with their pool to ensure that they fully considered all the opportunities available through the pool for their assets. A detailed rationale for each asset remaining outside the pool including value for money considerations would need to be provided in the ISS if the asset would not be pooled by March 2025.

Summary of responses

31. There were 141 responses to this question, of which 18% were supportive, 26% were broadly in favour but said the March 2025 deadline was too soon, 40% were opposed and 16% were neutral.

32. Among those who were supportive there were a range of comments. Some said this proposal would create momentum to deliver the benefits of pooling including professionalism. Others suggested we could go further, for example by mandating or closely monitoring progress. One suggested pooling could be achieved in months, not years. Many suggested that focus should be on funds who were failing to take advantage of opportunity, rather than punishing those who had put in place adequate plans. Some argued that low expertise among some pension committees, overreliance on external investment consultants, and organisational inertia were holding the LGPS back from realising the potential gains from pooling.

33. Those who were broadly in favour but felt that March 2025 was too soon made a range of comments. Firstly, several responses pointed out that the next actuarial valuation will take place with an effective date of 31 March 2025, and normally an investment strategy review would take place following the valuation. Their view was that requiring changes to be made by March 2025 would mean making changes within the life of the existing ISS. Some said that the pools themselves may not have capacity or sub-

funds to properly absorb the additional assets. Others suggested that an unrealistic timing could have a detrimental impact on funds, as the need to meet the deadline would force suboptimal decisions to be made. A small number pointed out that if all funds are competing for similar investments at the same time the competition could have a market impact, increasing prices.

34. There were other constructive comments from those who were broadly supportive of the proposal. These included a request for clarity on the definition of listed assets and the government's expectations with respect to unlisted assets. Several suggested "as soon as practically possible" was a more suitable wording given the different obstacles faced by funds, and others suggested that banning appointment of new listed asset managers would be more effective. Others pointed out there may be more benefits to focussing on unlisted assets, and that by prioritising listed assets the government is missing an opportunity. Many responses said that jointly procured passive funds were already managed with low fees, and as such would not benefit from transition.

35. Those who were altogether opposed had a broad range of views. Some responses argued that a fund's fiduciary duty means they should already be seeking the best opportunities which are available to them, and that it was inappropriate for government to be influencing their decision making. They argued that the government's attention should be more focussed on what funds felt was not provided by their pool, and that government should not assume that funds are reluctant. Many respondents said that the right investments were not always readily available in their pool and that upfront transition costs could outweigh any long-term benefits of pooling. Others challenged the case for scale and argued that the guidance should be based on a more strongly evidenced case.

36. Some respondents felt that funds should be permitted to invest a small proportion, not normally more than 5%, of a fund's assets outside the pool in local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member. These responses argued that these investments should not be subject to any guidance requiring transition by 2025. We comment on this in our answer to Question 9.

Our response

37. Having carefully considered responses, the government will draft guidance to implement the proposal. The proposals set out in the consultation were to have a requirement in Investment Strategy Statement (ISS) guidance to either transition assets by March 2025, or to set out a

detailed rationale for each asset remaining outside the pool including value for money considerations. This is effectively a “comply or explain” regime, which does not mandate particular investment choices.

38. The government accepts that a March 2025 deadline will be a significant challenge for some pools and funds to achieve but our view is that a step change is necessary to deliver the benefits that greater scale will deliver. A delay to March 2026, as proposed by some respondents, would risk pushing significant action on transition into the next valuation period.

39. The government also accepts that for certain assets transition will difficult or undesirable by March 2025. This may include jointly procured passive funds. In those cases, a detailed rationale for each asset remaining outside the pool including value for money considerations would need to be provided in the ISS in line with existing guidance if the asset is not intended to be pooled by March 2025. The rationale should include why it is not appropriate to pool the asset by March 2025, and the plan with regard to pooling that asset. We would also expect the rationale to set out when the decision will be reviewed on each asset and what the plan is to transition by a later date.

Governance and decision making

40. In question 3, the government sought views on revising guidance on pooling to ensure all funds participate in a strong partnership with their pool and with other partner funds, and delegate effectively to their pool. The government’s view is that delegation of strategy implementation and manager selection will allow the pool to deliver the benefits of scale. We do not propose any change to the responsibility of funds for setting investment strategies.

41. We proposed revised guidance on pooling to confirm and strengthen the existing guidance on delegation of manager selection and strategy implementation. It would also provide revised guidance on governance, including member representation, transition of assets and new investments outside the pool. We also proposed that guidance should set out a model of pooling including a number of aspects which we consider key to progress. The summary below covers the responses to the question and the comments on each characteristic.

Summary of responses

42. There were 140 responses to this question. There were several parts to the proposal with varying levels of support, but on the broad question of whether guidance should recommend a model of pooling 62% were opposed, 17% supportive and 21% neutral. Many supported the proposal to issue revised guidance regarding pool and fund interaction. Many referred to the model we proposed as a fiduciary management model, and some respondents suggested that while fiduciary management could be appropriate and successful for some funds it was not appropriate for all. Several responses said that guidance was not a legally enforceable means of delivering the government's objectives. Others felt that the proposals were unbalanced, largely targeting administering authorities, rather than pools.

43. There were a wide range of views on the aspects of the proposed model of pooling, set out below for each aspect.

Pools should operate as a single entity which acts on behalf of and in the sole interests of the partner funds. For this reason, we do not see inter-pool competition as a desirable progression. This does not preclude the potential for inter-pool collaboration, which is encouraged by government.

44. This characteristic was broadly supported by most respondents. Most respondents agreed that pools should act in the sole interests of their partner funds, and some noted that this was an important prerequisite for exemption from the requirement to run a public procurement under the Public Contracts Regulations 2015. A minority were concerned that other considerations such as responsible investment would be excluded from pool decision making. Some respondents viewed inter-pool competition as desirable, arguing that funds would benefit from cross pool investment, and that inter-pool competition might help to reduce the number of pools in the long run. Some responses interpreted "single entity" as implying a specific model of pooling centred on a pool company owned by the participating funds which they did not support.

Pools should be actively advising funds regarding investment decisions, including investment strategies.

45. A majority of responses were opposed to this proposal. Some suggested that it would be improper for pools to advise as they would have a conflict of interest, or that pools would have difficulty in advising appropriately. Some suggested that it was important to use a broad range of advisors. Several argued that a fund's right to seek its own sources of advice was part of its fiduciary duty. Some said that not all pools had the requisite Financial Conduct Authority permissions to provide advice. Some were concerned that the Competition and Markets Authority (CMA) would

raise questions on the lack of a public procurement process to ensure competitive provision.

Pools should be equipped to implement an investment strategy as instructed by their partner fund. An investment strategy should be interpreted to mean a broad instruction regarding asset classes and level of risk. It should not include an excessive number of classes, or choice of specific assets.

46. Responses were divided in relation to this point. Many welcomed the clarity that strategic decision making should remain the responsibility of administering authorities, and that the pools should be capable of implementing the required investment strategy. Some said that we should be more specific that manager selection should be left to pools. However, some suggested that the distinction between strategic decision making by funds and implementation by pools was not clear cut, and that administering authorities might respond by setting more detailed strategies.

Pools should expect funds to invest via their existing sub-funds where possible. This avoids an unfavourable scenario whereby an excessive number of similar sub-funds undermine the purposes and benefits of pooling.

47. A broadly even number of responses supported and opposed this characteristic. Many were sympathetic to increasing efficiencies by encouraging a smaller number of sub-funds. However, some argued that pools may not always offer suitable choices, that transaction costs would outweigh the savings, or that a bias in favour of existing sub-funds would lead to suboptimal decisions. One pool argued that reducing the number of external investment managers, not the number of sub-funds, created efficiencies. Others suggested this point would run counter to the statutory requirement to invest in a diverse portfolio of assets.

Pool governance structures should be equipped to take quick decisions as opportunities present themselves, within the delegated remit of the fund.

48. There were few comments on this point. Several sought clarity that such decisions should only be made by the pool within the delegated remit of the administering authority and in respect of investments within pool vehicles. Several respondents argued that such decisions should not be delegated to pools.

Our response

49. Having considered responses carefully, the government has decided to revise guidance on pooling as proposed. This will set a clear direction for all funds to move towards delegation of strategy implementation and manager selection, in order to deliver the benefits of scale for all. We recognise there are several current models of pooling, and that all have some benefits, but the government's view is that in the medium and longer term certain key characteristics are essential for progress, although there may be transitional costs for some pools. Progress towards this model will be monitored and reviewed.

50. The revised guidance will therefore include a preferred model of pooling which we will expect pools to adopt over time. This model will be based on characteristics and outcomes rather than prescribing particular structures and will make clear that inter-pool collaboration is encouraged to deliver further benefits of scale. The partner funds will remain in control of their pool, and this will be important in ensuring that it delivers the products and services which the funds wish to have, and the financial and non-financial benefits of scale for all. The requirement to act in the best interests of funds will not prevent pools from adopting policies for example on responsible investment where at least a majority of partner funds agree. Progress towards this model will be monitored with ministers taking a role in reviewing change and engaging pools as necessary.

51. The government does not consider that it would be a conflict of interest for the pool companies owned by LGPS funds to provide advice on investments, or that a public procurement is required, as they controlled by their partner funds, exist to provide services to the funds and do not benefit financially if funds take their advice. Where there is an external pool operator, pools may procure investment advice through a separate contractor to avoid a conflict of interest.

Improving training for pensions committee members

52. In question 4, the government sought views on proposals to set out in guidance that administering authorities should have a training policy for pensions committee members and report against it. The government's aim is to help authorities ensure that pension committee members have appropriate knowledge and skills to make decisions and to make good use of professional advisors.

Summary of responses

53. There were 136 responses to this question of which 91% were supportive of the proposal with many respondents commenting that the proposals would be welcomed across the scheme. Respondents commented that increasing training amongst pension committee members would be of benefit to committees, enhance scrutiny, better inform decision making, and build confidence with scheme members. Some responses pointed out that under the existing statutory guidance for annual reports (issued by CIPFA in 2019) funds should already be reporting the training undertaken by pensions committee members.

54. Many funds stated that they already have well established training plans in place and have made training mandatory for committee members, but that this is not universal. A number of respondents reported issues around recruitment, retention and high turnover of members which could risk the effective administration and oversight roles of committees.

55. A number of respondents commented that any proposed guidance should refer to existing requirements and best practice, including the CIPFA Knowledge and Skills Framework and Guidance, MiFID II requirements, and the requirements for local pension board members. The Scheme Advisory Board encouraged the government to set out a timetable for the implementation of its recommendations on training and pensions expertise, and many other respondents endorsed this approach.

Our response

56. We will revise guidance on annual reports and on governance to require all funds to publish formal training policies for pension committee members, to report on training undertaken, and to align expectations for pension committee members with those for local pension board members. Given the role and responsibilities of committees, including setting the investment and funding strategies for funds, it is essential that members of committees should have the appropriate training, knowledge and skills to undertake their role.

Transparency and accountability

57. In question 5, we sought views on increasing transparency of asset allocation, pooling, returns and savings, in order to provide transparency on progress of pooling by fund, by pool and across the scheme. The proposals also aimed to provide the consistency needed to support an overall view of

asset allocation across the scheme and to minimise the burden of reporting on funds.

Annual reports and LGPS statistics

58. This consultation sought views on proposals to revise guidance on annual reports to require greater clarity on progress of pooling including a summary asset allocation, a comparison between actual and strategic asset allocation, a report of the net savings from pooling, through a standardised data return. We sought views on whether to require funds to report the returns achieved by each asset class against a benchmark across funds.

59. We also proposed to introduce a requirement to include commentary in the annual report on the progress of asset transfer against implementation plans and the approach to pooling set out in the ISS, in order to ensure funds are transparent and accountable on the progress of asset transition.

Summary of responses

60. There were 136 responses to this question and most were supportive of the proposals. On the proposal that funds should report basic asset classes in a consistent way there was broad support, with 81% supportive and 12% expressing opposition. Most agreed it would be helpful to have consistent reporting between funds to promote transparency and to enable the collation of a scheme-wide report. Some said the template should be drafted with the help of fund practitioners and the Scheme Advisory Board. Others said it would be important to ensure that the categories are not ambiguous to help ensure consistency and ease of completion. Some suggested using the same categories as private Defined Contribution and Defined Benefit schemes, as external fund managers are already familiar with these reporting regimes. We identified no objections to the proposal to require compare actual and strategic asset allocations.

61. On the proposal that funds should report the assets pooled, there was broad support, with 67% supportive and 19% expressing opposition. Several expressed concern that funds with a low proportion pooled would be considered to be under-performing, even if there were valid reasons not to pool. A frequent example was jointly procured passive arrangements, where management fees are already very low and there would be little to be gained by transferring to an asset pool. Others suggested that the categories “pooled”, “under pool management” and “not pooled” were not clear. Some suggested other categorisations, such as dividing assets between discretionary and advisory mandates.

62. With regards to the proposal that funds should report savings from pooling there was also broad support, with 63% supportive and 17% expressing opposition. However, many respondents felt that savings should be calculated by comparing costs against those achievable in the current market, rather than a historic baseline. Several respondents referred to the work of the SAB Cost Transparency Initiative as a good example of best practice. Several felt that there was already too much focus on the cost savings generated by pools, where there should be more focus on pool performance in a broader sense including returns.

63. Some respondents expressed concerns over the additional reporting burden. However, others pointed out that funds are largely already reporting this data in their annual reports and other data provided to the government.

64. The second part of the question sought views on whether funds should report on asset returns against an appropriate and consistent benchmark. There was a consensus that such an approach would be highly difficult to implement fairly, and 55% of respondents were opposed compared to 32% supportive. The primary reason for the opposition was that a consistent benchmark would not take account of the different objectives of different investment strategies. Some suggested that benchmarking could influence decision making in an unhelpful way by incentivising strategies to closely track the benchmark. Others pointed out that even a fair benchmark for each asset class would be an incomplete measure of good performance as it would not capture the suitability of the strategy, only the performance against the strategy. For this reason, some suggested that a more appropriate benchmark would be the actuarial return required by their funding strategy applied to the whole fund return, as this would encapsulate the overall performance of the fund at macro level including the strategy. There was no clear consensus on an alternative approach.

65. Others felt we could go further on promoting good practice and transparency. Several suggested that transparency should focus on two key questions, the suitability of the strategy and the ability of the fund to implement the strategy. Several suggested there should be a means of showing pool performance, including a dashboard approach centred on the value for money delivered by the pool.

Our response

66. We will revise guidance to implement the proposed changes working with the Scheme Advisory Board. We believe that these measures will ensure that data and commentary on the progress of pooling and on asset allocation is available earlier, is consistent across the scheme and between

LGPS statistics and annual reports. We recognise there may be increased costs arising from a change to the asset classes reported, but these can be met from the fund, and costs should be reduced by having a single standard set of data. We consider some additional costs can be justified to ensure better public accountability. The government will collaborate with the Scheme Advisory Board to consider the design of the annual return, noting the preference for consistency with other defined benefit and defined contribution schemes. This will include consideration of reporting on exposure to UK and global markets.

67. Where passively managed funds are held by funds outside the pool, we will expect funds to set out in their investment strategies, the nature of the arrangement, the value for money case for retaining outside the pool, and the date when the arrangement will be reviewed. If there is oversight by the pool, funds should set out how that oversight is exercised. Funds should report assets held in passive arrangements with pool oversight as under pool management.

68. We also asked for views on whether to require funds to report returns achieved by each asset class against a consistent benchmark and on how this could be implemented. In the light of responses highlighting the difficulties of setting benchmarks across the scheme, we intend to require funds to report performance for each asset class against the benchmark of their choice in their annual reports but not to seek to establish consistent benchmarks.

Scheme Annual Report

69. In question 6, the government sought views on our proposals for the Scheme Advisory Board (SAB) to expand their Scheme Annual Report to provide a report on the progress of pooling and on asset allocation across the LGPS. The SAB produces a Scheme Annual Report which aggregates information from fund annual reports to provide a single source of information for members, employers and other stakeholders.

Summary of responses

70. There were 130 responses to this question, of which 79% supported the proposals and 4% were opposed. Respondents responded positively to the proposal to expand the Scheme Annual Report to provide a report on the progress on pooling and on asset allocation across the LGPS. Respondents also commented that consistent reporting across all funds will make the production of Scheme Annual Reports easier and will provide a helpful picture of LGPS-wide asset allocation. A number of respondents

said that it would be important to ensure that the SAB is sufficiently resourced to undertake the work.

Our response

71. We welcome the comments received in response to this question. We believe that expanding the content of the Scheme Annual Report to include an update on pooling will be useful for stakeholders and that the single standard set of data discussed above support this.

72. We have agreed with the SAB that they will incorporate this change into the Scheme Annual Report in future years by including a table which divides assets by category as well as by pooling status (pooled, not pooled or under pool management).

Chapter 3: LGPS investments and levelling up

73. In the Levelling Up White Paper (LUWP) the government set out its aim to level up the UK by spreading opportunity more equally across the country and bring left behind communities up to the level of more prosperous areas. One way in which this can be achieved is by ensuring that some of the funds managed by institutional investors such as the LGPS flow into projects that help deliver levelling up projects while also offering attractive returns.

74. The government has set an ambition in the LUWP for LGPS funds to invest up to 5% of their assets under management (AUM) in projects which support local areas. To implement this ambition, the government is asking LGPS funds to work with LGPS asset pools to publish plans for increasing their local investment.

Definition of levelling up investments

75. In question 7, we asked for views on a proposed definition of levelling up investments. The definition was intended to help LGPS funds and pools in considering how they could invest in a way that promotes growth, supports levelling up, and supports them to pay pensions.

76. The proposed definition was that an investment would meet the levelling up requirement if:

- it makes a measurable contribution to one of the levelling up missions set out in the LUWP; and
- it supports any local area within the United Kingdom.

Summary of responses

77. There were 138 responses to this question, and 64% were supportive of the definition. Supportive comments welcomed the broad definition as it includes investments across a wide range of asset classes, within diverse investment strategies. Others welcomed the aim of levelling up in the UK by spreading opportunities more equally across the country and bringing communities left behind up to the level of more prosperous areas through boosting productivity, growing the economy and raising living standards across the UK.

78. However, several respondents felt that the definition was too vague, open to interpretation and inconsistencies in its application, in particular by external fund managers. These responses asked for clarity by defining what constitutes a “measurable contribution” and what the term ‘local’ means, and whether deprived areas should be prioritised. Some said that we should say explicitly that investments which support the transition to renewable energy would qualify. A number of respondents noted that many levelling up investments would be too small scale for pool investments and suggested that they should be made outside the pool.

79. Some respondents referred to the idea of “levelling up bonds,” a suggestion made by the Scheme Advisory Board to stimulate investment by replicating the green gilts model. Green gilts are issued by the UK Debt Management Office to help fund projects to tackle climate change, rebuild natural ecosystems and support jobs in green sectors, and raised £9.9 billion in 2022-23. Respondents argued that the success of this model could be replicated with a levelling up focus.

Our response

80. The government welcomes the broadly positive response on the definition of levelling up. We note the requests for additional clarity and will ensure to address this in guidance. However, we will also maintain the principle that a broad definition allows administering authorities to seek out opportunities which they feel will have beneficial impacts. We note the comment that the definition is not one that investment managers are currently working with. Government’s view is that the definition is sufficiently broad to allow administering authorities to work with fund managers and agree mandates which suit them. Some responses suggested the creation of “levelling-up bonds” but we do not consider that a new financial instrument is necessary. The government’s aim is principally to increase investment in levelling up projects which are more difficult to fund through listed markets.

81. We recognise that some levelling up investments in local projects may be below the necessary scale to attract pool investment, and so some funds may wish to continue to invest outside the pool. However, pools also may be able to conduct due diligence with the benefits of scale and may help funds to manage any potential conflicts of interest arising from investing locally. We therefore encourage funds to consider investing in projects which support levelling up through their pool.

82. We will work with the Scheme Advisory Board to develop draft guidance for further consultation.

Enabling investment to support levelling up

83. In question 8, the government asked for views on whether funds should be able to invest through their own pool in another pool's investment vehicle. Some pools do not currently have internal asset management capacity, or the range of investment vehicles required to meet the needs of their partner funds. To increase the range of options available to funds to deliver investment in levelling up, we proposed that funds should be able to invest through their own pool in investment vehicles provided by other pools.

Summary of responses

84. There were 144 responses to this question, of which 65% supported the proposal. Respondents cited the benefit of having access to an increased number of investment products, in addition to a wider range of specialist investment expertise. Similarly, respondents were supportive of increased collaboration between pools and thought that this would support an increase in the rate of assets being pooled. Many responses said that pools cannot be experts in all areas in a way which is cost effective, so allowing cross-pool investment in this way would support specialisation and efficiency.

85. A number of responses were supportive of the principle of investing in another pool but would prefer to allow direct investment in another pool's fund in order to reduce layers of fees and complexity.

86. Some respondents raised concerns around the potential for conflicts of interest to arise for pools, between serving their partner funds and attracting business from other pools. Some respondents suggested that there should be a focus on developing the expertise and range of products available within current pools, and only when there is no other option should a fund invest in another pool.

Our response

87. We will revise guidance on pooling to set out the circumstances in which it would be appropriate for LGPS funds to invest through their pool in another pool's investment vehicle. We note that some respondents expressed a preference to invest in a different pool directly, but the government's view is that investment in other pools should be made only through a fund's own pool in order to prevent potentially wasteful and costly competition between pools. Allowing investment in pools other than their own by without going through their pool could also undermine the relationship between pools and their partner funds and reduce pools' incentive to act in the interests of their partner funds.

Requirement to publish plans for increasing local investment

88. In question 9, the government asked for views on the proposed requirements for the plan to invest up to 5% of assets under management in projects that support levelling up across the UK. This would be published by LGPS funds under proposals set out in the Levelling Up White Paper (LUWP).

89. We proposed that the plan should take account of the fund's investment and funding strategy statements and be reviewed at least every three years in line with the local valuation cycle. We also proposed that the plan should include:

- the fund's current level of investment in levelling up investments
- a plan to increase levelling up investments to deliver an allocation of up to 5% of AUM including the timeline to delivery
- the fund's approach to working with their pool to reach their chosen allocation

Summary of responses

90. There were 138 responses to this question, of which 53% were opposed and 25% were in favour. Many responses were on the principle of setting an expectation for funds on investing in levelling up. Many responses said that levelling up investments could form part of a diversified portfolio and that social impact was already an important consideration for funds.

91. Some argued that appropriate investments were already permissible and indeed being made but considered that any requirement to invest in levelling up could cut across funds' fiduciary duties. Some respondents were concerned that setting an expectation on investing in levelling up could result in lower quality investment or investment at higher prices unless the supply of investable opportunities could be increased to meet the demand.

92. Most responses on the proposed requirements for the plan preferred the suggestion that the Levelling Up plan could be part of the Investment Strategy Statement (ISS) rather than a standalone document. Some responses questioned whether funds could adopt a target either lower or higher than 5% in their plans.

93. Many pointed out that levelling up assets can come from a number of different asset classes including property, infrastructure, private equity and private credit. They said that such assets should be considered for investment on the same criteria as other assets within the same class. Some respondents said that levelling up assets did not share similar characteristics in the same way as an asset class and could not form part of an investment strategy as a result.

Our response

94. We will revise guidance on investment strategy statements to require funds to have a plan to invest up to 5% in levelling up projects. These investments are generally expected to provide good returns but may include investments with lower returns made under existing guidance on non-financial factors in investment. The government considers that public markets investments in providers such as housebuilders, construction, utilities companies would generally not eligible.

95. The 5% is not intended to be a maximum, and funds may invest more than 5% if they consider it appropriate within a diversified strategy. They may invest less than 5% if they do not consider there are sufficient opportunities for good returns. The purpose of the expectation is to act as a guide and encourage funds to consider for themselves what an appropriate allocation would be.

96. We have considered the concerns raised on fiduciary duty, but the government's view is that the requirement to set a plan to invest in levelling up does not mandate investment and does not cut across fiduciary duty. We agree with respondents that levelling up is not an asset class, and different types of investment could support the goals of levelling up. Funds

should consider the suitability of levelling up assets in the same way they consider other assets of the relevant asset class.

Reporting requirements on levelling up investments

97. In question 10, the government asked for views on the proposed reporting requirements on levelling up investments. These were to require funds to report annually on their progress against their plan in their annual report, to provide transparency and accountability on investments made by funds. The section of the annual report on levelling up would be expected to include:

- the percentage of AUM invested in levelling up projects compared to the fund's plan for that year, the percentage in the previous year, and the ambition set by the fund
- the amount and type of levelling up investments that have been made through the fund's LGPS pool, and outside the pool
- a narrative account explaining the changes in AUM allocated and the progress against the fund's plan, and the rationale for investing through the pool or outside the pool.

Summary of responses

98. There were 134 responses to this question, of which 42% were opposed and 37% were in favour. Some said that improved transparency was beneficial for members and employers and could help funds to make sure that their investments were delivering levelling up in line with objectives. Some suggested that funds should adopt best practice via the Place Based Impact Reporting Framework.

99. Many respondents were concerned about the burden of additional reporting requirements and suggested that these reporting requirements could be phased in over a longer, potentially a 3-year period. Some argued that it would be difficult for external fund managers to know the exact proportion of assets in their fund which fulfilled the criteria. Respondents pointed out that there would be costs associated with the proposal including procurement and training.

Our response

100. We will revise guidance on annual reports to include guidance on reporting progress against the fund's plan. Given the concerns raised on the additional burden and the need for clarity to assist data collection, we

will expect data to be reported on a best endeavours basis and will work closely with the SAB and practitioners to design a reporting template.

Chapter 4: Investment opportunities in private equity

101. In question 11, we asked for views on whether funds should have an ambition to invest 10% of their funds into private equity as part of a diversified but ambitious investment portfolio. We also asked whether there are barriers to investment in growth equity and venture capital for the LGPS which could be removed. The government proposed that LGPS funds and pools should double their current allocation into private equity, with a total ambition of 10% investment allocation, as part of a diversified but ambitious portfolio. This ambition would help drive investment, in a way that allows everyone in the UK to benefit from growth, by boosting LGPS investment returns, incentivising companies to grow and list in the UK, and grasping productive opportunities of the future.

102. We proposed that LGPS funds should consider such private equity opportunities, including growth equity and venture capital, as part of the regular review of their investment strategy statement. The new ambition would be set out in revised guidance on investment strategy statements.

Summary of responses

103. There were 144 responses to this question and 84% were opposed to the proposal including many who thought that the government was proposing to mandate investment in private equity. The most cited reason for opposing the proposal was a perceived conflict with funds’ fiduciary duties. Numerous respondents said that a government ambition of 10% investment in private equity, even if not mandatory, was inappropriate and that local funds should be free to make their own choices locally, after considering their individual circumstances and risk appetites. Several respondents also expressed concern about private equity as a higher risk asset class, and about impacts on investment costs and liquidity.

104. The definition of private equity was a concern to some respondents. Some respondents assumed that the ambition would only include UK private equity. Some considered that a broader set of private markets investments should be included in order to support UK growth more effectively, and in particular that private debt also provided good returns to funds while providing companies the valuable capital they need to scale up.

105. Most respondents did not identify particular barriers which were preventing investment in private equity in addition to high cost or risk. Some said that suitable investments in private equity were not available, or that there was insufficient scale or pipeline of opportunities in the UK market to attract greater investment. Others pointed out that as funding levels have recently improved at the 2022 actuarial valuation, some funds would be more inclined to de-risk their asset allocations.

106. Many responses indicated that private equity was an important asset class for their fund, and that a significant amount of private market investment was made through asset pools. Some reported that these investments were made as parts of diversified portfolios and that they supported local projects which could be categorised as levelling up.

Our response

107. The government is committed to unlocking capital to support growth businesses whilst improving returns for pension funds. This forms part of a wider package of measures to reform the pensions landscape which aims to improve outcomes for pension savers, strengthen the diversification of pension fund investments and increase the finance available for the high-growth companies in all parts of the UK.

108. The LGPS is largely well funded and has a very long-term time horizon, unlike most private sector defined benefit funds, which are typically closed and much more mature. The government believes the LGPS is therefore well placed to benefit from these more illiquid but potentially higher-return investments, with a view to improving the financial stability of local councils over the long term.

109. The government wishes to ensure that LGPS investments reflect an appropriate long-term balance of risk and return for a large open scheme with members mainly employed by tax-backed employers. A prudent adjustment in risk appetite on a proportion of investments is necessary in order to secure higher returns as well as contributing to UK growth. Investment in the UK is particularly welcome but it is not proposed to restrict this ambition to investments in private equity in the UK.

110. The government has carefully considered the responses to the consultation. However, setting an ambition to invest 10% in private equity would not mandate investment. Administering authorities would be under the same requirement as currently to act in the interests of members under their fiduciary duty. Investments in private equity should only be made as part of an appropriate and diversified investment strategy which aims to

provide good returns in the interests of scheme members, employers and local taxpayers.

111. The government will therefore set a new ambition for funds to invest 10% of assets in private equity in revised guidance on investment strategy statements. This will help improve access to finance for high-growth companies all across the UK, including areas where businesses face particular challenges accessing the capital they need to grow. LGPS investment into innovative local companies stands to increase potential returns while boosting growth and jobs in local areas.

112. Whilst the 10% ambition relates to private equity allocations, the government recognises the broader opportunities in private markets including, for example, private debt which may also provide good returns for funds whilst contributing capital for companies seeking to grow. It is for LGPS funds to decide what other investments outside of this ambition are appropriate for them in line with their risk management and fiduciary responsibilities.

British Business Bank

113. In question 12, the government sought views on whether the LGPS should be supported to collaborate with the British Business Bank (BBB). The BBB is a government-owned economic development bank that makes finance markets for smaller businesses work more effectively, allowing those businesses to prosper, grow and build UK economic activity.

Summary of responses

114. There were 128 responses to this question, and just over half (57%) supported the proposal. The British Business Bank was widely recognised as an effective organisation with a good investing track record in the UK, though some felt its track record was too short. Many said that they would only consider working with the BBB if it could offer suitable investment products. Some respondents pointed out that the BBB’s offer was likely to be more suited to pools than administering authorities. Some respondents asked why the government’s focus in the consultation was on the BBB and not other organisations.

Our response

115. To support LGPS in delivering against the 10% ambition, we will encourage LGPS pools to develop and strengthen partnerships with the BBB to explore opportunities in venture capital and growth equity. As the

Chancellor announced at Mansion House this year, the BBB is in the process of engaging industry to test the case for a government-led investment vehicle to support pension fund investment into high-growth companies by providing access to the BBB's pipeline of investment opportunities.

Chapter 5: Improving the provision of investment consultancy services to the LGPS

116. In question 13, the government sought views about proposed amendments to regulations and guidance to require LGPS funds to set and review strategic objectives for any investment consultants which they use. This would bring requirements on LGPS funds under LGPS regulations and guidance into line with requirements under an order made by the Competition and Markets Authority (CMA) in 2019 which already apply to the LGPS.

Summary of responses

117. There were 118 responses to this question, of which 94% were in favour of the proposal and 4% were opposed. Respondents commented positively that the proposals would be a prudent and valuable addition to LGPS regulations, promote transparency, accountability, and effective engagement with investment consultants. A number of respondents also noted that transferring the requirement from the CMA Order to the LGPS regulations would ensure a more consistent approach to investment consultancy services across the LGPS.

118. A number of responses noted that pool companies owned by LGPS funds are treated as in-house providers and are exempt from the CMA order, which excludes in house or wholly owned providers of investment consultancy or fiduciary management. Respondents questioned whether these pool companies should remain exempt in LGPS regulations and guidance. A few respondents requested clarity on whether investment advisers that are not part of FCA authorised entities or who are independent would be covered. Respondents also requested further guidance on the scope of the services that independent investment advisors may advise on.

Our response

119. We will bring forward amendments to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and associated guidance to implement requirements on LGPS funds that use

investment consultants. With regard to the application of the requirements to pool companies owned by LGPS funds, we that it would be good practice to set objectives for all investment consultancy providers including pools, and will set this out in revised guidance. The guidance will also make clear that all providers of investment consultancy services are covered including independent advisers and that such services include advice on investments, investment strategy statements, strategic asset allocation and manager selection.

Chapter 6: Updating the LGPS definition of investments

120. In question 14, we asked for views on a proposed technical change to the definition of investments within regulation 3(1)(b) and 3(4) of the 2016 regulations. This would correct an inconsistency in the definition of investment that the Joint Committee on Statutory Instruments identified in the 2016 regulations.

121. We proposed to add the word 'partnership' to regulation 3(1)b as follows:

- Reg 3(1)(b) a contribution to a limited partnership in an unquoted securities investment partnership.

122. The proposed amendment to regulation 3(1)b would ensure consistency with the language used in regulation 3(4), where unquoted securities investment partnerships are defined. The proposed amendment should also eliminate any ambiguity in regard to regulation 3(1)b.

Summary of responses

123. There were 83 responses to this question of which, 89% agreed that the technical change would help clear up ambiguity in the regulations. A number of respondents considered that such investment vehicles were too high-risk and inappropriate for the LGPS.

Our response

124. We will bring forward amendments to the regulations to make a technical change to the definition of investments within regulation 3(1)(b) and regulation 3(4) of the 2016 regulations. The proposed amendment provides consistency and clarity and fulfils a commitment the department has made to update the definition of investment as set out above at the earliest opportunity.

Chapter 7: Public sector equality duty

125. In question 15, the government asked for views on impact on any particular groups with protected characteristics, in order to help us ensure that the impact of any changes on groups with protected characteristics is properly considered, with proper regard to our obligations under the public sector equality duty.

Summary of responses

126. Of the 152 responses, 7% suggested a particular group with a protected characteristic would be affected. Several responses indicated that there were groups who could benefit from the proposals on levelling up, including older people via social housing investment, and people in deprived areas.

127. Some responses pointed out that the LGPS provides vital income to millions of people including high proportions a disproportionately high number of females, part-time workers, ethnic minorities and low-income workers. They argued it is therefore vital that the LGPS is well run for the protection of member benefits and expressed concern that future benefits could be affected if investment returns were lower as a result of changes to investments via the cost-control mechanism.

128. A number of respondents asked why the government had not prepared an Equality Impact Assessment alongside the consultation.

Our response

129. Most of the responses which expressed concern suggested that member benefits could be at risk as a result of the proposals. This is not the case as member benefits are guaranteed in statute and are unaffected by the performance of any LGPS fund.

130. Some referred to the cost-control mechanism, which is the process designed to ensure a fair balance of risk between scheme members and employers which can result in changes to the benefits members accrue. The cost-control mechanism does not depend on either historic or future investment returns, so scheme members should be reassured that the proposals in this consultation will not affect their pension benefits.

131. We believe that the reforms set out above will not affect any particular groups with protected characteristics adversely, as there will be no change to member contributions or benefits as a result. There may be an indirect

benefit to protected groups who live in deprived areas which benefit from levelling up investments. The changes relate to the investment of assets by local government pension scheme administering authorities. These authorities are all public sector organisations, so no impact assessment is required.