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Controlled

Response emailed to:LGPensions@communities.gov.uk

Dear Sir or Madam

Local Government Pension Scheme (England and Wales): Fit for the future

Derbyshire Pension Fund (the Pension Fund/Fund), which is administered on behalf of over 350 scheme employers and over 95,000 individual members, is pleased to provide a formal response to the above MHCLG consultation.

The response has been approved by Mark Kenyon, Derbyshire County Council's Director of Finance, and Councillor David Wilson, Chair of the Pensions and Investments Committee, on behalf of Derbyshire County Council as the administering authority of the Pension Fund.

The Fund supports pooling the investment management of LGPS assets to add value to the underlying pension funds which exist to pay benefits for their members.

As a member of the LGPS Central Pool, which is comprised of eight Midlands LGPS funds and LGPS Central Limited, the FCA regulated company set up by the pool to manage its investments, the Fund looks forward to continuing to transition the management of its assets to the Pool where it provides value for money.

It is vital that administering authorities, which remain responsible for managing fund liabilities and which are democratically accountable to fund stakeholders, retain the decisions on the timing of transitions to the pools and on the level of delegation to give to their relevant pooling company.

Administering authorities of LGPS funds owe a fiduciary duty to scheme employers, whose liabilities are largely backed by local taxpayers, and to scheme members, who benefits are paid by the LGPS funds when they fall due.

The focus must remain on adding value, with the potential for more robust governance arrangements, access to a wider range of investment opportunities and enhanced stewardship activities, and the delivery of improved net relative performance, compared to the relative performance the individual funds could achieve, the overriding objectives.

The LGPS holds a unique position amongst the largest public sector pension schemes in the UK as a funded rather than a 'Pay as You Go' scheme. It has a history of successful collaboration between funds, of working with a range of 'best in class' advisers and investment managers, a willingness to embrace new asset classes and a focus on long term investment returns which have all contributed to the current healthy funding position across the Scheme.

Whilst administering authorities of LGPS funds remain responsible for ensuring that there is sufficient funding to pay members' pensions, it is difficult to see the justification for mandating the delegation of the majority of investment decisions to pooling companies where LGPS funds are effectively captive clients.

The model of pooling set out in the consultation would result in a significant increase in the activities of the pooling companies within a very short period of time, increasing the risk of sub-optimal solutions being developed to meet the proposed timetable.

The Fund's response to the consultation reflects the belief that LGPS funds, with their responsibility for managing fund liabilities and their accountability to local stakeholders, should retain responsibility for deciding which remaining investment decisions to delegate to their pooling company and for determining their own value for money transition timetables.

Yours faithfully

Dawn Kinley

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The following questions have been answered on the basis that the term ‘pools’ refers to the joint partnerships of partner funds and pooling companies (partner funds and collaborative management arrangements in the case of those pools which do not include an FCA regulated company).

Question 1: Do you agree that all pools should be required to meet the minimum standards of pooling set out above?

We agree that all pools should be required to meet minimum pooling standards which would include administering authorities (AAs) remaining responsible for setting an investment strategy for their fund.

Our comments on the other minimum standards proposed are set out in responses to the relevant questions.

Question 2: Do you agree that the investment strategy set by the administering authority should include high-level investment objectives, and optionally, a high-level strategic asset allocation, with all implementation activity delegated to the pool?

We do not believe that the prescribed full delegation of investment strategy implementation as proposed by MHCLG is the appropriate solution for LGPS funds.

Administering authorities of LGPS funds, with their fiduciary duty to act in the best interests of their scheme employers and scheme members, are best placed to decide on the appropriate level of delegation.

LGPS funds remain responsible for managing fund liabilities, which are backed by their scheme employers, and remain responsible for strategies related to ESG matters (most commonly responsible investment and climate strategies). Administering authorities of LGPS funds remain democratically accountable to fund stakeholders.

Recognising that the knowledge and responsibility for individual funds’ liabilities, funding and ESG objectives and cash flow requirements rests with the LGPS funds, they should be able to determine the level of granularity on investment strategy implementation that is delegated to their pooling company.

Question 3: Do you agree that an investment strategy on this basis would be sufficient to meet the administering authority’s fiduciary duty?

We do not believe that implementing an investment strategy on the basis set out in the consultation would be sufficient for the administering authority to meet its fiduciary duty.

Question 4: What are your views on the proposed template for strategic asset allocation in the investment strategy statement?

As noted above, we believe that administering authorities of LGPS funds are best placed to decide on the appropriate level of delegation on investment strategy implementation.

For Derbyshire Pension Fund, the proposed template for strategic allocation is too high level and doesn’t recognise the different characteristics of the asset classes that make up the buckets with their ability to deliver different investment objectives.

For example:

- the listed equity bucket is too broad (taking no account of geographical exposure, active/passive management or style factors)
- the credit bucket is too broad (taking no account of geographical exposure, credit type)
- the UK government bonds bucket does not recognise the very different characteristics of conventional and index-linked bonds

Question 5: Do you agree that the pool should provide investment advice on the investment strategies of its partner AAs? Do you see that further advice or input would be necessary to be able to consider advice provided by the pool – if so, what form do you envisage this taking?

Individual LGPS funds should be able to determine how they procure investment strategy advice.

We believe that there is a clear conflict of interest in pooling companies providing investment advice to LGPS funds at the same time as being responsible for implementing funds' investment strategy.

There is a clear risk that the overriding objective will be to align funds' investment strategies in order to reduce the number of products required to a 'one size fits all' rather than to meet the funding objectives of the individual partner funds.

There is also a clear risk of stifling the innovation that results from a diverse range of advisors that are subject to competitive procurement.

LGPS funds currently have access to independent, high quality, competitively priced investment advice from a diverse range of sources. Divergent advice stimulates discussion on asset allocation and on product development, supporting the achievement of better outcomes, and it reduces scheme-wide risk.

It is difficult to see the justification for mandating LGPS funds to take 'principal advice on their investment strategy' from their pooling company (which would likely require the investment of significant time and resource for pooling companies to be able to deliver), and for proposing that pools should seek to procure advice on behalf of their partner funds in the meantime where there is no existing capability.

To ensure continued robust independent input into the management of Derbyshire Pension Fund's assets and a continued ability to scrutinise the decisions of the pooling company, we would expect to continue to procure the advice of an independent investment advisor. We would also expect to retain the ability to procure the advice of an investment consultation for periodic asset/liability studies.

Question 6: Do you agree that all pools should be established as investment management companies authorised by the FCA, and authorised to provide relevant advice?

Derbyshire Pension Fund is a member of the LGPS Central Pool which is comprised of eight Midlands LGPS funds and LGPS Central Limited, an FCA regulated company set up to manage its pooled investments.

Whilst we took the decision to become part of a pool based around an FCA regulated company, we note that the Government's initial pooling guidance enabled pools to determine their own model. We also note that in the 'LGPS in the UK: Learnings from International Peers' report it states that there is no best way to pool.

We believe that the focus should be on the outcomes for the underlying funds, rather than on the pooling delivery model given there appears to be no clear evidence that that any one pooling model is better than the others.

Question 7: Do you agree that administering authorities should be required to transfer all listed assets into pooled vehicles managed by their pool company?

We agree that listed assets should be transferred into pooled vehicles managed by their pool company where it provides value for money. Value for money considerations include the availability of suitable products, investment management capacity, risk appetite, an assessment of operational resilience and expected relative net investment performance.

It is noted that transitions need to take into account market timing, the objective of minimising transition costs, and, potentially, the timetable of fellow investors.

Investments in commercial pooled passive products which pool the investment of assets from a wide and diverse customer base, offer low cost LGPS-wide fees, provide operational resilience and the diversity of operational risk, and offer access to a wide and constantly evolving range of products with very strong associated stewardship activities.

These arrangements already deliver benefits of scale to the LGPS and should be able to continue to exist alongside other pooling arrangements, where they provide value for money to the underlying pension funds. There are no obvious benefits to mandating that these assets should be invested in pooled vehicles managed by the pooling companies.

In the LGPS Central Pool, advisory agreements have been set up between the pooling company and the Partner Funds with respect to the Partner Funds' commercial pooled passive investments. This is a pragmatic solution agreed between both parties to increase the proportion of assets under pool management and the effectiveness of responsible investment and stewardship activities whilst retaining value for money arrangements for the relevant LGPS funds.

Question 8: Do you agree that administering authorities should be required to transfer legacy illiquid investments to the management of the pool?

We do not support mandating the transfer of the management of legacy illiquid investments to the pooling company. LGPS funds are best placed to determine the management arrangements for the run-off of their legacy illiquid assets. It is difficult to identify any added value of a forced transfer of all legacy illiquid assets to the management of the pooling companies, given the resource implications for the pooling companies (for carrying out due diligence on, and dealing with distributions and capital calls for, a very large number of private markets' vehicles) and the expectation that, in the ordinary course of events, the vast majority of illiquid investments will be held until maturity.

There is also a risk that holdings would be rationalised to a more manageable number by pooling companies, with LGPS funds potentially suffering the negative effects of the J-curve, shouldering all the initial costs without benefiting from subsequent long term returns.

It would be more efficient for the pooling companies to focus on plans for investing run-off monies.

Question 9: What capacity and expertise would the pools need to develop to take on management of legacy assets of the partner funds and when could this be delivered?

Each pool is best placed to answer this question with respect to its own circumstance. However, we would expect a significant build in capacity to be required (both people and systems) for the pooling companies to take on the management of legacy assets.

Question 10: Do you have views on the indicative timeline for implementation, with pools adopting the proposed characteristics and pooling being complete by March 2026?

The proposed timetable is not realistic and if implemented is likely to lead to excessive execution risk, with time pressured decisions and the incurrence of unnecessary costs.

Those pools which are based on an FCA regulated operating company start with an advantage in terms of operating model given the process of creating and building (and receiving FCA authorisation for) an investment management company to operate pooled investment vehicles takes at least 18 months based on the experience of the LGPS Central Pool.

However, the implementation of the government's proposed pooling characteristics within the indicative timetable is likely to lead to sub-optimal outcomes for LGPS funds across all pools.

A comply or explain model would allow decisions to be taken on the basis of adding value rather than meeting an arbitrary deadline.

Question 11: What scope is there to increase collaboration between pools, including the sharing of specialisms or specific local expertise? Are there any barriers to such collaboration?

There is undoubtedly scope to increase collaboration between pools. We fully support collaboration between the pools which could offer access to expanded investment expertise, increased resilience across the pools, an increased ability to achieve benefits of scale and an increased impact of responsible investment and stewardship activities.

In recent years, scheme-wide collaboration on investment activities seems to have been impacted by the pooling companies appearing less open to working together than the underlying partner funds, potentially due to an increasing sense that they are in competition with one another.

Question 12: What potential is there for collaboration between partner funds in the same pool on issues such as administration and training? Are there other areas where greater collaboration could be beneficial?

A significant amount of collaboration already takes place between the Partner Funds of the LGPS Central Pool with regard to governance/administration as well as to investment, principally via the LGPS Central Pension Board Chairs Group and the LGPS Central Strategic Admin Group. Experience and best practice is shared on all aspects of LGPS governance and administration.

Partner funds also periodically collaborate on training and have, for example, shared training materials for inducting new members onto pensions committees and pension boards and have undertaken a joint training session on employer covenants.

The Partner Funds are best placed to continue identifying opportunities for further collaboration to support the achievement of efficiencies/best practice.

Question 13: What are your views on the appropriate definition of 'local investment' for reporting purposes?

Ideally, we believe the appropriate definition of 'local investment' for reporting purposes would be investments based within a relevant pool's catchment area.

Question 14: Do you agree that administering authorities should work with their Combined Authority, Mayoral Combined Authority, Combined County Authority, Corporate Joint Committee or with local authorities in areas where these do not exist, to identify suitable local investment opportunities, and to have regard to local growth plans and local growth priorities in setting their investment strategy? How would you envisage your pool would seek to achieve this?

We would expect potential local investments to be considered on the same basis as all other LGPS fund investments in terms of potential risk and returns and in terms of determining an appropriate allocation to the asset class in funds' investment strategies.

It is not clear from the proposal, whether administering authorities would be expected to fulfil merely an introductory role to pooling companies or whether they would be expected to filter proposals.

It is unlikely that the majority of administering authorities would have the resources to undertake even initial 'filtering' due diligence on proposals from the bodies listed above to identify suitable local investment opportunities to present to pooling companies.

However, it could be advantageous to take advantage of administering authorities' local relationships to provide links between local opportunities and potential sources of LGPS capital and using pools to filter opportunities, whilst resource intensive, could remove potential conflicts of interest.

Pools should be given the time and flexibility to develop a solution for this proposal.

Question 15: Do you agree that administering authorities should set out their objectives on local investment, including a target range in their investment strategy statement?

As noted above, we would expect local investments to be considered on the same basis as all other LGPS fund investments in terms of potential risk and returns and in terms of determining an appropriate allocation to the asset class in funds' investment strategies.

If an LGPS fund determined that an allocation to local investment was desirable, it would be appropriate for any related objectives and target range to be included in its investment strategy statement.

Question 16: Do you agree that pools should be required to develop the capability to carry out due diligence on local investment opportunities and to manage such investments?

Pooling companies and partner funds should work together to determine the most effective solution for carrying out due diligence on local investment opportunities and for managing such investments.

Given the due diligence skills required for assessing the financial, operational, commercial, managerial, legal and technical capabilities of small companies/partnerships, it is likely that pooling companies would need to buy in this capability.

Question 17: Do you agree that administering authorities should report on their local investments and their impact in their annual reports? What should be included in this reporting?

We would expect reporting on local investments to be largely consistent with reporting on LGPS funds' other investments in the annual report.

Whilst recognising that impact reporting on local investments would likely be of particular interest to the stakeholders of LGPS funds, it is noted that development of objective reporting on the impact of investments remains a work in progress

Question 18: Do you agree with the overall approach to governance, which builds on the SAB's Good Governance recommendations?

Yes, we agree with the overall approach to governance, which builds on the LGPS Scheme Advisory Board's Good Governance recommendations.

Question 19: Do you agree that administering authorities should be required to prepare and publish a governance and training strategy, including a conflict of interest policy?

We agree that administering authorities should be required to prepare and publish governance and training strategies and a conflicts of interest policy.

Derbyshire Pension Fund already has all three strategies/policies as separate documents. To ensure greater clarity (with each matter appropriately covered) and for flexibility in terms of keeping strategies/policies current, we believe that separate documents would be more effective.

Question 20: Do you agree with the proposals regarding the appointment of a senior LGPS officer?

We agree with the proposals regarding the appointment of a senior LGPS officer.

Guidance would be welcomed on whether this role would be a 'statutory officer' role or a 'proper officer' role delivering statutory responsibilities or whether it is intended that the role will be underpinned by regulation/guidance rather than statute.

It is presumed that the reference in paragraph 95 to the proposed senior officer being involved in the local authority's budget-setting process refers to budget setting for the relevant LGPS fund.

Question 21: Do you agree that administering authorities should be required to prepare and

publish an administration strategy?

Yes, we agree that administering authorities should be required to prepare and publish an administration strategy. Derbyshire Pension Fund already has a published Pension Administration Strategy.

Question 22: Do you agree with the proposal to change the way in which strategies on governance and training, funding, administration and investments are published?

Yes, we agree with the proposal to change the way in which strategies on governance and training, funding, administration and investments are published.

Question 23: Do you agree with the proposals regarding biennial independent governance reviews? What are your views on the format and assessment criteria?

We support the principle of independent governance reviews of LGPS funds to provide assurance to stakeholders and to promote the sharing of good practice.

Taking into consideration the existing strong governance within the LGPS and the resource requirement for carrying out reviews of 86 funds, a review cycle of every four years would be more appropriate.

We would welcome the opportunity to comment on any proposed review format/assessment criteria. A starting point could be to consider LGPS funds' self-assessment against the Pension Regulator's General Code of Practice.

Question 24: Do you agree with the proposal to require pension committee members to have appropriate knowledge and understanding?

Yes, we agree with the proposal to require pension committee members to have appropriate knowledge and understanding. Members of our Pensions and Investments Committee and our Pension Board, together with senior officers involved in the management and administration of the Fund, are all subject to Derbyshire Pension Fund's Training Policy.

Question 25: Do you agree with the proposal to require AAs to set out in their governance and training strategy how they will ensure that the new requirements on knowledge and understanding are met?

As noted earlier, we would prefer to retain separate governance and training strategies for greater clarity. We support administering authorities setting out how they will ensure the new requirements on knowledge and understanding are met in the relevant document.

Question 26: What are your views on whether to require administering authorities to appoint an independent person as adviser or member of the pension committee, or other ways to achieve the aim?

We believe that it would be appropriate for each administering authority to make an assessment of its requirements with respect to advice for its pensions committee and to have flexibility in sourcing any advice required.

It is noted that Derbyshire's Pensions & Investments Committee highly values the specialist advice it receives from the Fund's independent investment adviser and from the Fund's actuary.

Question 27: Do you agree that pool company boards should include one or two shareholder representatives?

We would welcome the addition of one or more shareholder representatives to the boards of the pooling companies, particularly as it is proposed that more decisions about the assets of LGPS funds should be delegated to these organisations. This would support greater alignment of pooling company interests with the interests of the underlying LGPS funds/scheme employers/scheme members.

Partner Funds would be best placed to determine how to select the appropriate representatives to provide constructive challenge and informed strategic guidance to the executive team as non-executive directors of pooling company boards.

Question 28: What are your views on the best way to ensure that members' views and interests are taken into account by the pools?

LGPS funds are best placed to continue engaging with members to understand their views. Shareholder representatives on pooling company boards and trade union representatives on pool joint committees should help to represent the views of members within LGPS pools.

However, it is noted that the proposals set out in this consultation are likely to make it more difficult for member views to be considered.

For example, climate and responsible investment strategies are typically agreed by administering authorities of LGPS funds following consultation with stakeholders. If the model of pooling set out in the consultation is adopted, LGPS funds within a particular pool will ultimately need to move to common climate and responsible investment strategies. It is difficult to envisage how views would be sought from all underlying members within a pool during the formulation of such common strategies.

Question 29: Do you agree that pools should report consistently and with greater transparency including on performance and costs? What metrics do you think would be beneficial to include in this reporting?

We fully support the greater proposed transparency with respect to performance and transaction costs which would ensure that all pooling companies meet the same level of transparency in these matters as commercial investment management companies.

Although the options for holding a pooling company to account for poor performance are already limited (noting that LGPS funds do not have the ultimate sanction of being able to transfer the management of their investment assets elsewhere), and would likely be weakened further should the proposals set out in the consultation be implemented, it remains important for Partner Funds to have the relevant performance information to be able to challenge pooling company managements.

Common metrics that we believe should be reported publicly and consistently by pooling companies include:

- performance of individual products, against benchmark and target, since inception, and on a rolling basis over 3 months, 12 months, 3 years, 5 years and 10 years
- independent value-for-money assessment, compared with other pools and other investment managers outside of the LGPS
- climate metrics and ESG scores of all products (where the information is available) and a summary of stewardship activity
- a common scorecard of governance and operating KPIs

Question 30: Do you consider that there are any particular groups with protected characteristics who would either benefit or be disadvantaged by any of the proposals? If so, please provide relevant data or evidence.

We do not consider that there are any particular groups with protected characteristics who would either benefit or be disadvantaged by any of the proposals.