This response is made on behalf of East Sussex Pension Fund (ESPF, the Fund) in its capacity as scheme manager of an LGPS Fund.

Our response to the call for evidence is set out below and we would be pleased to expand, clarify or discuss any of the comments made.

Where this response uses the term LGPS fund the term should be taken to refer to the administering authority (scheme manager) as set out in the Local Government Pension Regulations 2013.

Scale and Consolidation

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

This question specifically targets the DC market, which is outside the scope of ESPF's response.

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

This question specifically targets the DC market, which is outside the scope of ESPF's response.

Question 3
What should the relative role of master trusts and GPPs be in the future pensions landscape? How do the roles and responsibilities of trustees and IGCs compare? Which players in a market with more scale are more likely to adopt new investment strategies that include exposure to UK productive assets? Are master trusts (with a fiduciary duty to their members) or GPPs more likely to pursue diversified portfolios and deliver both higher investment in UK productive finance assets and better saver outcomes?

This question specifically targets the DC market, which is outside the scope of ESPF's response.

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

This question specifically targets the DC market, which is outside the scope of ESPF's response.

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

The introduction of pooling in 2015 set out 4 criteria for Pools to deliver - Scale, Strong Governance, Reduced costs and increased infrastructure investments.

This has been delivered successfully across the LGPS with 8 pool structures all acting in the best interest of the underlying Funds and scheme members

Pooling has successfully delivered

- economies of scale - lower negotiated investment management fees, £180m savings delivered annually and joint procurement savings.
- Increased investment in illiquid asset classes including Infrastructure
- significant collaboration - sharing of best practice and improvement in governance and policy and reduced the administrative work at a Fund level where the pool can deliver for all funds.

The LGPS has significantly grown from £290bn (2019) to £366bn (2022) due to the strong returns achieved and robust management.

The LGPS is “in a strong financial position with most funds in surplus at 31 March 2022”. (GAD August 2024).

Growth and funding levels are a good indication that returns are meeting the requirements of LGPS funds to deliver pensions.

Fees are a % of AUM not fixed. Productive assets i.e. private equity and infrastructure have higher % fees than liquid assets.

The ACCESS pool has demonstrated significant cost savings based on a review of the 2023 CTI data. This established the costs of ACCESS listed assets as 28bps compared to a benchmark of 45bps, resulting in a saving of 17bps or £49m per annum. 5 year annualised performance as at 31/03/2024 was 9.8% which exceeded the benchmark by 0.9%.

ESPF can only comment on the model ACCESS has set up. ACCESS is an outsourced model using competitive market testing for suppliers; this enables best-in-class third parties for cost effective implementation across all asset classes. This model ensures a high level of due diligence, accountability and transparency is maintained and a level of competition between the managers.

ACCESS, has met all the deliverables set out at the outset of pooling and is continuing to develop best in class offerings for the Funds.

ACCESS has delivered a range of liquid asset classes and has rolled out a number of illiquid asset classes in the last year. ACCESS has been creating opportunities to invest in wider asset classes to meet its investment strategy including the current work on private credit and recent procurement to UK direct property. ACCESS has also rolled out natural capital and global property offerings which although not yet invested in give the Fund a more diverse range of strategies to consider.

ESPF considers pooling as facilitating the Fund’s Investment Strategy by providing a suitable range of options to invest, with best in class managers, at a reduced cost, with greater governance, greater transparency, greater accountability and maintaining a suitable diversification of risk. The ACCESS pool delivers success in these areas.

Costs vs Value

Question 1

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

This question specifically targets the DC market, which is outside the scope of ESPF's response.

Question 2

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

ESPF has not had any employer question its investment budget or investment strategy. To date government communication around the need to pool LGPS assets have been to reduce investment management costs.

The LGPS already invest in a wide range of asset classes including on average 30% to illiquid or private markets.

The experience Employers communications relate to the contribution rates that they pay as all employers in the LGPS have constrained budgets with the local authority employers having significant budget gaps to deliver fundamental services to communities.

The LGPS is required to ensure consistent, affordable and sustainable contribution rates for its employers. Seeking higher investment returns increase risk and volatility to employer contribution rates. The LGPS are well funded and already invested in a wide range of assets. The Government should expect questions on why this would be a suitable objective if such an intervention were to take place.

The PLSA has made recommendations for intervention, in different parts of the pensions market, which they believe will lead to higher investment in a wider range of assets. In relation to the LGPS these include the establishment of a pipeline of investable assets to invest to increase UK growth, provide policy certainty with a clear plan for the future of the UK economy.

Finalising long awaited policy and regulation on numerous topics will help the LGPS move in a considered direction of travel which has been lacking for many years in areas such as good governance and climate reporting.

Employers in the LGPS are looking for any intervention that provides greater stability and lower contribution rates. A government intervention that were aimed to direct investments of the LGPS into more volatile assets classes should also underwrite the potential down side of the Fund seeking higher investment returns.

Investing in the UK

Question 1

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

ESPF has seen no evidence that supports increased consolidation would increase investment in the UK within any asset category. Pools are already a significant size (£50bn for ACCESS) there is nothing to suggest further consolidation would increase UK assets.

As assets have increased the Fund and LGPS in general have moved away from concentration risks and increased diversification of risks moving to more global mandates.

Consolidation would require significant time and resources to implement, especially if it was to be mandated.

Geography of investments is viewed in line with fiduciary duties and liquidity needs. ESPF invest 7% property allocation into the ACCESS UK Property Fund which is transitioning to direct property. The Fund has a 4% allocation to UK Index linked gilts which are the closest investment linkage to the Funds liabilities, through the ACCESS pool.

Independent investment managers select the underlying positions of global mandates who are responsible for the investments of retail and other institutional investors giving them greater scale and has not directly led them to invest more into UK assets.

ESPF have infrastructure holdings that have significant UK investment. The Fund's open ended pool aligned global infrastructure manager has invested £5bn in the UK supporting more than 12,000 UK Job. They have also signed a MoU with the UK Government in August 2023 with the ambition to invest £10 billion in the UK by 2027.

Within the closed ended infrastructure Funds one fund has 57% invested into UK companies that are in the later stage development, construction and expansion of projects including broadband and network provision, UK grid scale batteries and EV charge point operations partially powered by renewable energy. Another has 72% invested in the UK in companies seeking to deliver premium rates through investing in essential infrastructure in the European mid-market here they are providing last mile gas, electricity and water connections to homes and business, UK telecoms infrastructure and rail freight operations.

The Fund invests in a global listed equity mandate which in the quarter to March 2024 returned 0.6% of which 1.6% returns were attributed to Northern America and the UK investments were the biggest detractors of performance with -1% returns.

The ESPF has not seen any evidence that shows that the provision of capital for UK registered companies equates to growth of the UK. Too much money trying to be invested in UK can decrease the attractiveness of the UK market as returns on investments are forced down which could prevent overseas investment if top down allocations are imposed.

ESPF are not opposed to investing more into the UK but the risk of this investment needs to be commensurate to return. There could be an opportunity for the Government to work with the LGPS into a sustainable product that makes the UK a better place to invest for all investors. This could form one or more activities such as government policy frameworks or incentives that could make UK investments more attractive, such as tax breaks or guarantees that de-risk these investments for LGPS Funds.

Question 2

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

ESPF has moved investment away from UK assets due to risk, not costs or past or predicted asset price. As Fund has grown the concentration of assets in single markets, in single mandates with single managers became too volatile for the scheme employers.

Whilst these were uncomplicated mandates that were relatively low cost this concentration of risks could impact on contribution rates. As assets became larger in the pension fund asset volatility in the fund starts to have a disproportional effect on the funding level of employers and their ability to cover deficits decreases.

Instead the Fund split mandates and looked to spread its risks by having investments with different managers that were best in class for the asset, that were also complementary in style and markets. This provided a diversification of risks and a more stable and predictable asset performance.

As of 31 August 2024, UK listed companies comprised only 3.43% of the MSCI ACWI Index, with most of the largest UK companies earning the majority of their revenues from outside the UK. UK equities have historically been global players adding limited value to the UK economy. As part of its broader investment strategy, ESPF has fully embraced ESG investing. Aligning investments with sustainability goals, including the UK's net-zero targets, is essential for managing long-term risks and ensuring that the portfolio remains resilient in a changing regulatory and environmental landscape UK equities often have a strong weighting to the energy sector.

Therefore, significant allocations to UK listed equities would not align with the investment diversification principle, which is rightly emphasised in the Statutory Guidance on Investment Strategy published in July 2017.
UK listed equity returns have consistently underperformed global financial markets, particularly the US. The FTSE 250 index, has significantly lagged the MSCI ACWI index over the past five years.

The main aim of the ESPF has been to get the best return at an appropriate level of risk as such the fund makes investment decisions to try and achieve stable employer contributions.

As the Fund assets increased further the Fund has diversified further into other asset classes such as property, infrastructure, private equity and private debt.

ESPF invests purely into UK Property as the size of the portfolio means that there is a suitable number of UK properties that are available for investment. As this is a good match to the Fund's liabilities. Property Funds however tend to hold a small number of properties this is so they can manage the collection of rent, legal costs, transaction costs and maintenance work without this becoming onerous or a drag to the management of the properties. Therefore a larger mandate means that the values of properties increase rather than the number of properties. At some point the value of the properties needed to maintain diversity will require a global property portfolio.

ESPF is open to invest in UK Infrastructure, Private Equity and Private debt and has in the past invested in UK focused private debt funds.

Question 3

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

The main objective of the LGPS is to pay retirement benefits when they come due, LGPS benefits are calculated based on the regulations and not investment returns. The employers of the scheme underwrite the liabilities so any direction to invest in a specific asset class or geography should be underwritten by the government to protect the scheme employers from volatility and increased to contribution rates.
The LGPS is a funded scheme which keeps the employer contributions affordable and the scheme members protected as to their pension entitlements The LGPS is well funded reflecting the growth in investments and the good governance underlying Funds.

The fiduciary duty drives the Fund's investment strategy by ensuring that those making decisions are getting the maximum return for the risk it is taking. As long as the investments that are being considered provide the appropriate return then the Fund will take into consideration any other pertinent factors such as ESG and supporting Government objectives.

There are different incentives that could be used not just investment related and we would encourage the government to engage with the LGPS to understand the pressures it is under and ways it can help with these.

By enforcing top down requirements on the LGPS may weaken the funding position as a whole for the LGPS. If an investment can boost UK economic growth and improve risk adjusted net investment returns, then arguably the LGPS should already be considering and implementing this type of investment.

Where this isn't the case though, is it acceptable to make the LGPS give up a proportion of expected investment return, or take on additional risk that otherwise would not need to be taken, to achieve investment in assets linked to the growth of the UK economy.

The LGPS needs clarity on these points before being able to take a decision to favour assets linked to UK economic growth over assets not linked to UK economic growth. It bears a reminder at this point that the primary objective of the LGPS is ultimately to pay member benefits.

The LGPS should remain flexible in its asset allocation approach, keeping in mind that investment portfolios should be viewed holistically and return targets linked to objectives. They need to be able to adapt to changes in market conditions which have volatile in recent years. Opportunity that provides both the growth the Government wants and the investment opportunities that might generate, could be in assets not covered by any prescribed allocation which would in turn hinder the governments aims.

The Government needs to provide clarity on whether investment in UK assets or overall affordability or ability to pay benefits is the primary focus of the LGPS. The LGPS needs clarity on fiduciary duty in relation to whether non-investment return linked targets are required (or acceptable) and can form a part of the success criteria for asset allocation decisions.

The purpose of the LGPS is to pay benefits not to hold up the UK economy.