Philip Latham
Head of the Clwyd Pension Fund / Pennaeth Cronfa Bensiynau Clwyd

To: Emailed to pensions.review@hmtreasury.gov.uk

Cronfa Bensiynau
CLWYD
Pension Fund

Date/Dyddiad: 25 September 2024

Our ref/Ein Cyf: HMT-Clwyd

Name/Enw: Philip Latham

Email/Ebost:
philip.latham@flintshire.gov.uk

Pensions Investment Review: Call for Evidence

The Clwyd Pension Fund ("the Fund") welcomes the opportunity to respond to the Call for Evidence set out by HM Treasury, the Department for Work and Pensions and the Ministry of Housing, Communities and Local Government ; requesting responses to three themes covered in the first phase of the Pensions Investment Review: Scale and consolidation, Costs versus Value and Investing in the UK.

The Clwyd Pension Fund Committee ("the Committee"), which has delegated responsibility from Flintshire County Council to carry out the function of Scheme Manager and Administering Authority for the Fund, has agreed the following response in relation to this Call for Evidence.

Please note we have only responded to the LGPS specific points within the responses to the questions set out within the Call for Evidence.

Yours sincerely,

Philip Latham

Head of the Clwyd Pension Fund
Clwyd Pension Fund

Consultation Questions and Answers

Scale and consolidation
1. What are the potential advantages, and any risks, for UK pension savers and UK economic growth from a more consolidated future DC market consisting of a higher concentration of savers and assets in schemes or providers with scale?
We understand this to be a specific DC market related question (not LGPS nor Additional Voluntary Contributions related), therefore no answer provided.

Scale and consolidation
2. What should the role of Single Employer Trusts be in a more consolidated future DC market?
We understand this to be a specific DC market related question (not LGPS, nor Additional Voluntary Contributions related), therefore no answer provided.

Scale and consolidation
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?
We understand this to be a specific DC market related question (not LGPS nor Additional Voluntary Contributions related), therefore no answer provided.

Scale and consolidation
4. What are the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors?
We understand this to be a specific DC market related question (not LGPS nor Additional Voluntary Contributions related), therefore no answer provided.

Scale and consolidation
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?

By way of background, the Fund has a highly diversified investment strategy split:

- 15% Sustainable Active Equities,
- 12% Multi-Asset Credit,
- 11% Tactical Asset Allocation,
- 29% Private Market assets (8% Private Equity, 6% Infrastructure, 3% Private Debt, 4% Property and 8% Local/Impact assets),
- 28% Risk Management assets and
- 5% in Strategic Liquidity and Cash.

The Committee would highlight that our Private Markets allocation, which we have invested in for many years (outside of the Wales Pension Partnership "WPP"), is well-aligned with the Government's ambitions for the LGPS to invest in UK productive assets.

We have looked to maximise the level of investment made via the WPP, subject to our specific investment strategy requirements. To date, we have pooled all our listed assets in Sustainable Active Equities and Multi-Asset Credit, which equate to around 27% of total assets. The Committee is particularly pleased that the WPP agreed to our request that the WPP Investment Solutions Provider, Russell Investments, developed a sustainable equity fund, which all eight WPP Constituent Authorities now invest in. This fund is still in its infancy given the inception date of July 2023. Inception performance for the Multi-Asset Credit fund dates back to August 2020, which also remains relatively short.

Overall, the Committee believes the performance track record of these funds is not long enough to properly evaluate whether pooling has been able to deliver improved long-term risk adjusted returns. The Committee understands this to be a common feature across the LGPS pools, as many strategies have only recently started to build a track record of live performance.

The Committee appreciates that it takes significant time and effort for appropriate investment offerings to be launched by WPP. As new Private Market funds have been launched (for example in Private Equity and Infrastructure) that meet our strategy requirements, the Fund will make future commitments. Nevertheless, there remain key parts of our investment strategy that cannot be currently invested in via the WPP, including our Tactical Asset Allocation, Risk Management and Local/Impact assets. These asset classes are crucial components for us being able to manage our risk and return to achieve our funding (keeping employer costs affordable and stable) and Responsible Investment objectives. The Fund is committed to working with the WPP to see if it can develop suitable investment offerings for our requirements, so that we can pool more assets in the future.

The WPP is a unique geographic collaboration representing all the LGPS in Wales. The pre-existing excellent working relationship between the Welsh LGPS Administering Authorities is reflected in the design of the operating model and the governance structure of WPP with the decision-making process (one fund one vote) ensuring local and collective objectives can be delivered via the WPP swiftly and successfully. WPP operates an outsourced model which is different from many other LGPS pools. This ensures that best in class specialists can be sourced for key roles.

Costs vs Value

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

We understand this to be a specific DC market related question (not LGPS nor Additional Voluntary Contributions related), therefore no answer provided.

Costs vs Value

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?

The Fund has long invested a substantial proportion of its portfolio in Private Market assets. Key to this has been the Committees' long-term philosophy, the alignment of Private Market assets to our Responsible Investment objectives, and the objective of achieving appropriate levels of returns for acceptable levels of risk, liquidity and costs. This has been made possible from our strong emphasis on governance, transparency and taking professional investment and funding advice that is specific to our own requirements. Through our Local/Impact portfolio, we have long advocated that we can invest to help support economic growth and have wider positive social and environmental impact. This has been evidenced from analysis by The Good Economy *(as at 31 March 2024)*, which analysed the Fund's Impact and Place-Based assets in Wales and the UK. The analysis shows our assets have been able to:

- Support 73 businesses through equity or debt financing, 20 within Wales.
- These businesses account for over 15,280 jobs, with 8% of jobs in Wales.
- Create at least 1,380 new jobs, with 11% in Welsh businesses.
- Create 2,540 homes for over 6,300 people. 26% of homes are Affordable.
- Support senior living homes for up to 338 residents.
- Provide accommodation for c. 1,700 students.
- Support 35 education facilities, including 2 Special Education Needs ("SEN") schools.
- Create an additional 2,804 child spaces for nursery school places.
- Support 3 health facilities and 1 water and waste facility.

- Support 67 real estate projects, 36 of which are commercial real estate projects supporting employment space for an estimated 7,440 people (28% in the most deprived local authorities in the UK).
- Support 662 permanent and 109 seasonal Real Living Wage jobs.
- £80m committed to the development of clean energy projects in Wales.

The Committee is of the view that as we already invest in UK productive assets, we do not require intervention from the Government to encourage this. The returns from our Local/Impact portfolio have been strong with the allocation returning 16.3% p.a. over the three years to June 2024. Further, the Committee would be concerned if the Government introduced guidance on investing that we consider not appropriate for achieving our specific financial and wider Responsible Investment objectives, which it has been highly successful in achieving (as evidenced above). It is not appropriate for the Government to force individual LGPS funds to take a higher level of investment risk than required (unless the risk is fully underwritten by central UK Government in some way), particularly in an environment where many LGPS funds (but not all) have strong funding positions, which should not be put at undue risk. This could, in turn, result in increased employer contributions (therefore impacting local taxpayers). The Committee is concerned that mergers in the sector (whether at individual authority or pool level) would restrict our ability to continue to successfully achieve our objectives. Our experience to date, shows that investing solely via a pool does not enable us to invest in the way that we believe is appropriate to meet our objectives.

Investing in the UK

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

It would be helpful for the Government to be clearer exactly what it means by more consolidation in the LGPS and net investment in UK assets (referring to specific asset classes).

The Committee firmly believes that investing in UK Private Market asset classes (e.g. Renewable Energy, Affordable Housing etc) can have a wider positive economic and social impact, as evidenced by our own experience (please see response to question 2. Cost v Value). Our concern with greater consolidation is this will restrict our ability to successfully invest locally in Wales, Northwest England and the Clwyd region.

It is not clear how investing in listed UK equities directly leads to economic growth given that; (1) the FTSE All-Share index is not representative of the UK economy, and (2) investment would predominantly involve trading in shares on a secondary market, not primary issuance. The Committee would welcome further clarification from the Government on this.

For the LGPS, investing more in UK productive Private Market assets could be achieved from the following structure:

Core proportion of UK productive Private Market assets to be invested via the National Wealth Fund ("NWF"). Individual LGPS funds could invest a proportion of assets directly with the NWF. This would allow the NWF to allocate capital in an efficient way that is in-line with specific Government ambitions. This would save the need for the current LGPS pools to newly design and build expensive investment teams, with the capabilities required to invest in-line with Government ambitions. This would potentially allow for:

(1) greater scale of investment in UK productive assets;

(2) significantly reduce set-up and ongoing costs;

(3) less complex set-up (including superior ability to attract and retain market leading professionals) and ongoing resilient implementation;

(4) deployment of capital in a co-ordinated way and at a quicker pace, and;

(5) eliminates the risk of assets becoming "over-valued" from pools competing with each other to invest in similar assets.

Ongoing role for pools and individual LGPS funds. A number of pools and individual LGPS funds (such as the Fund) have already proven their ability to successfully invest in UK productive assets, in particular, in specific local regions in the UK. There are significant benefits in having a framework that continues to allow this flexibility, combined with investment via the NWF. The key benefits could be:

(1) greater flexibility and nimbleness. As asset pools become larger, there could be diseconomy of scale challenges (e.g. lack of local investments) that need to be addressed. Allowing some "local" flexibility in decision-making would result in quicker deployment of capital in targeted areas;

(2) allowing flexibility for local investments would arguably increase the chances of broader parts of the UK to benefit from economic growth in a more consistent way, and;

(3) this would continue to allow individual LGPS funds to invest in a way to designed to achieve their own specific goals in relation to Net Zero ambitions and local impact investing.

Investing in the UK
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?
We invest c.38% of our total assets in the UK. This covers investments in Gilts, Private Equity, Property, Cash, Renewable Energy Infrastructure (predominantly in Wales) and listed equites (in our Tactical Asset Allocation portfolio). Specifically in relation to UK listed equities, the Committee believes the following factors explain why UK pension schemes have generally reduced their exposure to UK equities over time. The cumulative impact of these factors is the important issue, not necessarily one overriding one. **Diversification and maximizing the return opportunity set.** UK equities present a relatively small component of the global equity market (c.3-4%) and is materially underweight important sectors such as technology (e.g. relative to the US). UK equities have cumulatively underperformed global equities (ex UK) by 402.1% over the last 20 years (306.8% FTSE All Share v 708.9% MSCI World ex UK to 30 June 24. *Source: Refinitiv*). **Adoption of actively managed global equity mandates;** allowing discretion to managers to select stocks where they have highest conviction to outperform, agnostic to where companies are listed. **Investing in UK listed equities does not mean investing in the UK economy.** For example, companies listed in the FTSE 100 generate the vast majority of their revenue from outside the UK. **Unwelcome political instability.** Brexit and issues relating to political uncertainty have, arguably, not been conducive factors to make UK equities an attractive return opportunity. **UK private sector DB pension schemes de-risking.** As these investors have seen significant improvements in funding levels in recent years, they have been able to de-risk (protecting the security of accrued benefits for members) and no longer need to invest in listed equities (global or UK) to generate the returns required. This de-risking has increased pension fund ownership of UK corporate bonds and gilts. **Higher transaction costs when purchasing UK listed equities.** Given that Stamp Duty of 0.5% is incurred when purchasing UK listed equities (but not on non-UK equities) this is a factor contributing to UK listed equities being relatively less attractive. **Allocations to UK listed equities have reduced to help to fund higher allocations to Private Market assets.** The Committee would be concerned that if the Government gave guidance on how much LGPS

funds should be investing in UK listed equities then this would potentially compromise our ability to invest in UK Private Market assets, in particular Local/Impact assets.

Concerns over the alignment of UK listed equities to the Fund's Net Zero ambitions. The latter is particularly important to the Committee. Significant parts of the FTSE All-Share index are invested in sectors such as Oil, Gas, Mining, Utilities and Banks. The Committee has legitimate concerns about how well-aligned companies in these sectors are to helping achieve our Net Zero objective by 2045, or earlier.

The Committee believes that it is difficult to predict the potential future performance of UK listed equities. If the Government believes that there is a compelling rationale for why UK listed equities might outperform global equities over the long-term, the Committee would be very happy to consider.

Investing in the UK

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?

As demonstrated by the commitments to invest in UK Local/Impact assets that we have already made (equating to c.£184m), the Committee strongly believes in the potential benefits from investing in local communities contributing to local and regional growth.

The Committee would like to suggest the Government consider the following points, which we believe would be helpful to support further investment from the LGPS in UK productive Private Market assets, aligned with potential future Government policy.

Independent legal clarification on the consistency between fiduciary duty and Government guidance on how to invest.

The primary purpose of investors can be described as aiming to achieve a required investment return, specific to their unique circumstances, in an appropriately risk-managed way, to pay pensions when they become due, minimising the need for additional funding in the future.

If the Government were to mandate how LGPS funds should invest (e.g. having, say, 10% in UK Private Equity), this could result in investors having investment portfolios that are higher risk, more illiquid, and more expensive to manage than is appropriate for their circumstances. The Committee would welcome clarification how potential mandatory guidance, or legislation, on how to invest is consistent with our fiduciary duty. The Committee is concerned that current ambiguity over this issue is a material barrier to potential future investment decisions across the LGPS sector.

Central UK Government funded financial and risk management incentives

If the Government mandated the LGPS to invest in certain Private Market assets (e.g. higher-risk non-operational infrastructure) it would seem reasonable and fair that investors should be provided a financial incentive to compensate for the risk being undertaken. For example, central UK Government could look to encourage investment in the NWF by offering investors a bond-like coupon that is linked to a "CPI plus" type of return. This could be attractive to the LGPS given CPI-linked pension payments. Other forms of financial and risk management incentives could also be considered (e.g. to cover loss of value). Without some form of financial/risk management incentive, there is a real risk that LGPS funds could end-up in a worse position, meaning lower returns and higher costs for employers (and therefore local taxpayers), from the Government mandating LGPS investors to invest in a certain way.