Emma Reynolds MP
Minister for Pensions
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

25 September 2024

Dear Minister

Pensions Review 2024 Phase 1: Call for Evidence

I am pleased to enclose our response to the Call for Evidence in support of the first phase of the Pensions Review. Border to Coast is a partnership of 11 Local Government Pension Scheme (LGPS) funds (our Partner Funds) responsible for c. £64bn of assets, over 1.1m members and 3,100 participating employers.

We have delivered against the original policy intent of pooling, to drive down investment costs, improve governance and develop the capacity and capability to support infrastructure investment. Of the £45bn of investments directly pooled through Border to Coast, over £10bn is currently invested in the UK and this will increase with the launch of our UK Real Estate fund (expected to grow to c. £4bn). We are investing in areas such as housing, transport, energy and growth finance. Examples include:

- Through a £90m commitment to the Quinbrook Renewables Impact Fund (QRIF), we are supporting the largest portfolio of stability pathfinder synchronous condenser assets in the UK as part of the continued decarbonisation of the electricity supply grid.
- We are supporting Gwynt y Môr**,** a £2bn wind farm, providing 1,950GWh of renewable power a year to the grid; enough to power 430,000 households. Our investment is via our c.£89m commitment to Macquarie GIG Renewable Energy Fund II.
- An investment from which we have recently exited was through Endless, who invested £17m in Findel Education, based in Cheshire. They successfully doubled the business over three years through developing the management team, aligning employees, and focusing business models.

We support the Government's determination to harness the scale of the LGPS for the benefit of savers and the UK economy. Setting clear desired outcomes for the LGPS, to be achieved against realistic timelines, is the best way to mitigate the risk of inertia that may come from introducing change in different parts of the LGPS simultaneously, and the resource challenges that would pose.

In setting those outcomes, Government can build on available foundations. The pathway to completing pooling was set out in response to the 2023 *Local Government Pension Scheme: Next steps on investments* consultation. Implementing the Good Governance recommendations would support targeted action where needed to drive higher standards.

Pools, whether LGPS or wider asset owners, working at sophisticated scale can engage and work with the Government to address long-term brakes on UK growth and disincentives to domestic investment.

The benefits of scale

There is considerable evidence that scale in relation to pensions investments supports efficiency, greater expertise (including in-house investment capabilities) and access to a broader range of opportunities, including private markets investment. Border to Coast is a strong example of scale being deployed effectively to support Partner Funds in this way.

However, scale is not the sole driver of success. International evidence points to an investment premium linked to effective governance that provides clarity on roles and responsibilities and supports the effective deployment of capital. A strong focus of our strategic development is enabling our Partner Funds to harness the benefits of scale, allowing limited resources to be deployed most effectively.

Investing at scale has delivered cost savings for the level of commitments we have received. As we continue to develop our capabilities, the expertise we deploy is allowing us to develop approaches such as Climate Opportunities and UK Opportunities, enabling us to support smaller scale investments and more targeted strategies. Larger pools of assets enable greater sophistication, which in turn enables better engagement and influence to make the market, not just be a passive recipient.

In pursuing scale and greater UK investment, Government must be mindful of the investment ecosystem and avoid a situation where UK investors are competing to bid up the price of UK assets to the ultimate disbenefit of stakeholders. In the LGPS context, the administrative responsibilities of funds must be a prime consideration. It is essential that achieving investment scale is not pursued in the absence of consideration for the administration of pensions and the quality of service that can be delivered to members and employers. Our collective purpose is to ensure that members receive their pensions.

Partnership

Border to Coast’s success is not simply based on scale and expertise, but on the strength of our partnership. It has needed committed and capable LGPS funds with a shared vision, where all Partner voices are heard and recognise the power of compromise when setting policy and direction.

In respect of UK investment, we combine the skills of the pool with the local knowledge and connections of Partner Funds through collaboration to support greater capital deployment in the UK, helping local stakeholders to engage with the investment industry to present investment opportunities.

As we further develop our partnership, we are committed to supporting Partner Funds with additional resilience, capacity, and capability that maintains the affordability and sustainability of the LGPS. Our recently agreed 2030 strategy sets out the shared vision across our partnership.

Policy supportive of investment

Whether through creating larger pools of capital or incentivising investment decisions, the success of any attempt to increase UK investment whilst honouring fiduciary duty will be constrained by the extent to which there are sufficient investment opportunities and a policy and regulatory environment which provides long-term certainty.

We welcome initiatives the Government is undertaking to address long-term challenges in relation to planning, infrastructure and skills as well as building capabilities, including the UK Infrastructure Bank, British Business Bank, and National Wealth Fund, that will contribute to supporting a pipeline of investable projects and creating sustainable public-private partnership models. However, the impacts of these will be realised in the longer term; addressing disincentives in the tax system, including stamp duty on UK equities and reform of ISAs, may have shorter term benefits.

We would of course be happy to discuss the points raised in our response with you further.

Yours sincerely

Rachel Elwell

CEO, Border to Coast Pensions Partnership

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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?**

   1.1. In relation to pensions investments, scale has the potential to deliver significant benefits for savers and asset owners. Properly structured, it can deliver specific goals, such as more diverse capital allocation across private and public markets, accompanied by the tools necessary for success: notably, strong governance and oversight; investment expertise; and sophisticated procurement methods.

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

   1.3. The study found the most important features of funds for determining value added are:

      1.3.1. Active management: Investors with more actively managed portfolios have created more value add.

      1.3.2. Internalisation: Investors that manage more of their assets inhouse rather than with external managers have produced more value add.

      1.3.3. Economies of scale: All things being equal, larger investors have outperformed smaller investors.

   1.4. This is supported by "Scale Economies, Bargaining Power, and Investment Performance: Evidence from Pension Plans" (March 2023)[1]. This demonstrates the benefits of economic scale in pension plan investments (particularly those with in-house investment capabilities): large plans have stronger bargaining power over their external managers in negotiating fees as well as access to better-performing funds, relative to small plans. They use this power to produce higher gross and net-of-fee return performance, particularly in private asset classes. Economies of scale in investment costs are particularly large for passively managed accounts and for publicly traded assets and are significantly lower for actively managed accounts and alternative (private) asset classes.

   1.5. In pursuing scale and greater UK investment, Government must be mindful of the investment ecosystem as a whole and avoid a situation where UK investors are competing to bid up the price of UK assets to the ultimate disbenefit of stakeholders. Whilst capable of mitigation, the potential for diseconomies of scale and concentration risk (including increased systemic risk, herding of investment choices, and loss of connection to local expertise, insights and relationships that can enable niche local investment) need to be considered and addressed.

   1.6. Government should also be clear that LGPS funds do not just manage assets, they administer pensions, and therefore the risk that ill-considered scale poses to the quality of service that can be delivered to members and employers.

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

   No response

[1] Scale Economies, Bargaining Power and Investment Performance: Evidence from Pension Plans

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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?**

   No response.

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

   No response.

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**

   5.1. Pooling successfully has required committed and capable LGPS funds with a shared vision, where all Partner voices are heard and recognise the power of compromise when setting policy and direction.

   5.2. The key to long term success in relation to pensions investment is good governance; this is highlighted by the World Bank's study of the Canadian system[2]. The "governance premium" is currently thought to be c. 0.6% pa additional return (and could be as high as 2% p.a.); this relates primarily to clear delegation of investment decision-making with strong oversight and scrutiny[3]. As much as 90% of long-term investment performance is driven by asset allocation. As such, value is driven by Partner Funds focussing on Strategic Asset Allocation, with implementation, including manager selection, delivered through Border to Coast.

   5.3. Our partnership approach is exemplified by our fund co-development process which, informed by clear understanding of Partner Fund requirements, avoids unnecessary proliferation of sub-funds with associated costs and resource requirements and creates future opportunities to scale.

   5.4. Our model is built to deliver the objectives of our Partner Funds as long-term investors. As such, Responsible Investment principles are embedded into our investment approach. We launch strategies with a focus on long-term outcomes such as Climate Opportunities, investing £2.6bn in projects and businesses that are expected to make a material contribution to decarbonising the global economy.

   5.5. As an open DB scheme, illiquid assets such as Private Markets have a clear role in the LGPS investment strategy. However, historically many LGPS Funds were either too small or didn't have the capabilities to invest in private markets. For example, prior to pooling our 11 Partner Funds had invested c.£2.3bn in infrastructure; since launch, we have committed over £5bn. Our private markets programme has received Partner Fund commitments totalling £16bn.

   5.6. Our scale enables a more efficient and effective approach to investing in private markets, accessing a broader range of managers while managing costs. Our strong team with good connections across the industry, together with our clear investment and governance processes, has helped build a reputation as a sophisticated investor. This supports access to new strategies, capital constrained funds, and co-investment opportunities, helping to reduce costs significantly (by c. 30% vs typical institutional investor private market costs).

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[2] https://documents1.worldbank.org/curated/en/780721510639698502/pdf/121375-The-Evolution-of-the-Canadian-Pension-Model-All-Pages-Final-Low-Res-9-10-2018.pdf

[3] https://www.pensionspolicyinstitute.org.uk/research-library/research-reports/2017/2017-02-13-briefing-note-89-defined-benefits-the-role-of-governance/

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5.7. Pooling delivers capacity, capability, and resilience for our partnership. We believe the best way to deliver long-term sustainable value on behalf of multiple Funds is through the creation of an FCA-regulated organisation. This enables provision of investment management, associated tax efficient pooled vehicle operations, and advisory services through a centre of expertise focussed on and delivering for the LGPS. It also enables stability of governance structures for investment decision-making.

5.8. Research into value for money by asset management data company ClearGlass Analytics[4], ranked Border to Coast number one in its efficiency index of over 1,000 pension schemes globally. Our leading position is due to scale, governance and blend of internal and external management.

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?**

   No response

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?**

2.1. In general, a shift away from a focus on cost towards the value delivered and net of fees risk adjusted returns would be welcomed across the industry as enabling a shift away from lowest common denominator investment strategies.

2.2. Specifically, we strongly recommend that Government moves away from an evaluation framework which emphasises costs as the benchmark for the success of pooling. We are pleased to have delivered £105m savings since our 2018 launch and to be on track to deliver over £500m by 2032. However, the continued benchmarking of savings against 2016 is increasingly irrelevant, both in terms of the changing economic environment in which the LGPS operates and the evolving policy objectives for pooling including greater UK and private markets investment, with its widely recognised higher cost in delivering improved outcomes.

2.3. The success of pooling should be benchmarked against a framework focused on value for money in terms of net of fees investment performance, active stewardship, and the broader contribution made by the pool to the capacity, capability and resilience of the LGPS. Should the Government seek to measure commitments to 'productive assets', the term should be clearly defined. We would highlight that as an FCA-regulated asset manager, we already comply with the FCA's Assessment of Value requirements.

2.4. In the LGPS context, seeking higher returns would be driven by employers looking for return to drive lower contribution rates, albeit LGPS contribution rates are already materially lower than those in unfunded public sector schemes. As LGPS employers ultimately carry investment risk, the guidance on consultation on the production of the Investment Strategy Statement might helpfully require employers to be explicitly consulted on the balance between risk and return, and the potential implications for contributions.

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[4] https://henrytapper.com/2023/06/03/how-pooling-can-deliver-vfm-chris-sier-looks-at-border-to-coast/

2.5. As the private DB market continues to mature and become a smaller part of the pensions landscape, it is essential regulation (and guidance for the LGPS) continues to recognise the need and desirability of the remaining open private sector DB and LGPS funds to continue to take appropriate risk. We would welcome thoughtful guidance to support the LGPS in considering the appropriate level of investment risk.

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?**

1.1. With assets totalling more than £425bn, the LGPS is one of the largest pension schemes in the world. Harnessing that scale in relation to the way those assets are invested has the potential to enable the LGPS to play a key role in supporting investment in the UK while meeting its fiduciary responsibility.

1.2. As is widely understood, and underlined in recent Pensions Policy Institute research[5], asset allocation is primarily driven by desired member outcomes and the membership and maturity of a scheme. Measures to drive investment in particular asset classes or geographies must be understood in that context.

Pools

1.3. Increased scale can deliver specific goals, such as more diverse capital allocation across private and public markets, accompanied by the tools necessary for success: notably, strong governance and oversight; investment expertise; and sophisticated procurement methods.

1.4. There is a clear link between scale and investment in a wider set of asset classes. Data from CEM highlights that a typical £1bn Fund invests 11% in private markets; a £20bn fund invests 20%; and a £100bn Fund invests 23%. While the cost of this asset class mix increases from 52.9bps for a £1bn fund, to 75.8bps for a £50bn fund, it then falls to 67.6bps for a £100bn fund. In its submission, the Investment Association points to data from the Purple Book[6] on private sector DB schemes in the UK showing increased allocations to private markets as scheme AUM increases.

1.5. Scale and sophistication have enhanced our ability to deliver productive finance in the UK. Our UK Opportunities strategy is designed to deliver productive finance in the UK. We have held workshops with local economic development offices, Homes England, UKIB and British Business Bank, seeking to build a two-way flow of information and engagement between ourselves, investment managers, and local stakeholders to create opportunities for investment. Larger pools of assets enable greater sophistication, which in turn enables better engagement and influence to make the market, not just be a recipient.

Funds

1.6. Our progress to date, creating the largest asset manager outside London and Edinburgh, has required commitment from our Partner Funds, who understand the resource and capability required to succeed, and the power of compromise to ensure pooling is successful for all.

[5] 'Pension scheme assets – how they are invested and how and why they change over time'
[6] The Purple Book 2023

1.7. Strong governance is key and we note the final draft of Good Governance provisions set out a mechanism for assessing individual funds on a range of factors through a biennial Independent Governance Review (IGR). The introduction of an IGR can enable the identification of poorly governed Funds. Those Funds that fail to meet the high standards expected would be expected to find a solution or be the subject of targeted action.

1.8. Local accountability is a key principle of the LGPS and Government should be mindful that LGPS Funds are responsible for the administration of pensions which must be carefully considered as part of any structural change.

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?

2.1. The LGPS is already a significant investor in the UK. For our Partner Funds, of the £45bn of investments directly pooled through Border to Coast, over £10bn is currently invested in the UK and this will increase with the imminent launch of our UK Real Estate fund which has the potential to grow to £4bn.

2.2. The long-term decline in domestic investment in the UK market, particularly in relation to UK-listed equities, has been well-chronicled and factors include:

2.2.1. Long term historic underperformance – by way of illustration, the average annual total return from 1998 to 2023 for the FTSE All Share was 5.15%, and the MSCI World was 7.73%. This performance differential is due to a mix of relative valuation multiple contraction but also lower earnings growth

2.2.2. Structure – FTSE is skewed to old economy sectors (Energy, Materials, Financials (inc. investment trusts) etc.) with less exposure to growth (Tech, Healthcare etc.)

2.2.3. Lack of dynamism – minimal IPOs, overseas takeovers of growth companies, companies moving listings to higher valued markets

2.2.4. Complex and expensive listing requirements – ensure listing requirements are consistent with international standards and balance interests of both business owners, operators and equity market investors

2.2.5. Stamp Duty on share transactions – this currently raises c.0.3% of UK Tax revenue but has a disproportionate negative impact on the economy. Revenues on this duty have remained broadly flat for 25 years[7]. There is a material cost disadvantage vs the US and several major European markets (UK: 0.5%, US and Germany: 0%, France: 0.3%).

2.3. Investors have struggled to secure the necessary certainty and appropriate cost of capital in relation to assets in regulated industries. Regulatory reforms need to better reflect the potential impacts on the assumptions underpinning investments made with long-term time horizons and the consequent impact on investor confidence.

2.4. There are also challenges in the planning system, which have long acted as a disincentive to UK investment. The lack of long-term policy certainty, particularly in the case of infrastructure, has further been a hindrance. We hope the Government's proposals to strengthen the National Infrastructure Commission delivers progress. Government further has a fundamental role to play in supporting a pipeline of investable projects and creating sustainable public-private partnership models. Clear and stable industrial and skills strategies will also be important.

[7] https://www.peelhunt.com/news-insights/articles/stamp-out-stamp-duty/

2.5. Domestic allocation by pension funds is a matter of debate globally. Recent research examined the decrease in domestic investments by Canadian pension funds over the last decade and risks identified with mandating domestic investment.[8] Similarly, to focus overly on domestic investment is to ignore the benefits the UK enjoys from being part of a global investment ecosystem. Indeed, research highlights that while enforced domestic investment can deliver a short-term boost, it can ultimately harm local markets[9].

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?**

3.1. The LGPS has a fiduciary duty to scheme members and employers, and must ensure the sustainable and affordable payment of pensions. Requirements to invest in specific geographies or asset classes risks infringing on that. Given the factors set out above, no credible asset allocation model would result in dramatic short-term increases in UK allocations – particularly for listed markets. As highlighted above, enforced domestic investment can ultimately be detriment for the domestic market.

3.2. Further, such requirements may drive unfavourable outcomes including distorting effects as capital is driven into markets that are not ready to receive it, negatively impacting returns, and is withdrawn from other asset classes in a way that incurs potential loss of value and additional administrative costs. Imposing requirements also fails to address whether funds have the required capacity and capabilities.

3.3. The geographies our Partner Funds represent include seven of the ten most deprived areas in the Index of Multiple Deprivation, with a consequent motivation to channel investment which drives job creation, productivity and improved quality of life. However, 'local' impact needs to be delivered through a strategic and sustainable programme of investment. Our £0.5bn UK Opportunities strategy will invest in areas such as housing, transport, energy and growth finance.

3.4. Far from inhibiting local investment, our Partner Funds have concluded directing such investment through Border to Coast brings the benefits of investment expertise, and the potential to "crowd in" investment. It also reduces the concentration risk associated with Funds investing in the same region that ultimately provides the tax base. Our partnership approach facilitates relationship building between local authorities, funds and investors, with opportunities to raise the profile of local investment.

3.5. We strongly recommend any Government definition of local investment stresses investment in physical, social or intellectual capital in the UK, achieving the required investment returns for an appropriate level of risk. Any requirement in relation to private markets should encompass the whole range of private asset classes and across the capital structure, including real estate, private credit and infrastructure in addition to private equity.

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[8] 'Should Canada Require Its Pension Funds to Invest More Domestically?'

[9] "Is locking domestic funds into the local market beneficial? Evidence from the Polish pension reforms", Anna Zalewska, 9 Nov 2006

3.6. Policy certainty, building capabilities and addressing tax disincentives (such as those outlined above in Investing in the UK, Q2, and additionally with respect to differences in the treatment of SDLT across Scotland, England and Wales) are more likely to have positive impacts. For example, in terms of building capabilities, if the National Wealth Fund can help structure new projects with its catalytic capital, LGPS partners could potentially provide the next wave of capital into those projects.

3.7. The tax system can be used to help drive domestic saving to support UK economic investment and growth. As just one example, the total stock of Cash ISAs is nearly £300bn. These investments tend to deliver negative real returns, with savers losing 5% over the last 12 years[10]. It would be legitimate for the Government to explicitly support tax incentives for investments directed into 'productive capital'.

[10] https://www.thisismoney.co.uk/money/saving/article-12336199/Cash-Isa-savers-losing-money-gap-rates-inflation.html