

Consultation Questions and Answers- Gwynedd Pension Fund

Scales 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?

Gwynedd Pension Fund has maximized the level of investment made via the Wales Pension Partnership (WPP) with 85% of the Fund's assets pooled or under pool management. Gwynedd's strategic asset allocation has historically been dominated by listed equities, but the pool has given the fund the opportunity to invest in a wide range of private market asset classes, facilitation of significant UK and local investments, and significant advances in responsible investment, including WPP becoming signatories of the Stewardship code. Gwynedd Pension Fund is committed to invest further into Wales, the UK and any levelling up opportunities and the WPP will be the key facilitator for these opportunities.

The WPP model uses an independent third-party fund operator with responsibility for investment manager appointments. This reduces conflicts, enables best in class operator and investment manager appointments, and obtains the scale benefits of the operator and its investment advisor. The design of this model allows the pre-existing excellent working relationship between the Welsh Administering Authorities to continue strongly. The decision-making process (one fund, one vote) ensuring local and collective objectives can be delivered via the WPP swiftly and successfully.

The current governance and pooling structure allows Gwynedd Pension Fund to comply with Welsh regulatory requirements e.g Welsh language Act, Well-being of Future Generations (Wales) Act and accounts and external audit regulation. This is a notable advantage to Gwynedd Pension Fund as we operate fully bilingually which could not be fulfilled with any other pool.

Many strategies have only recently started to build a track record of live performance and therefore it is still early days to properly evaluate long-term risk adjusted returns performance for the pooled investments. However, there is no doubt that WPP-established sub funds have been able to deliver significantly enhanced diversification for significantly reduced 'like-for-like' cost. The overall fees for Gwynedd Pension Fund have increased over recent years, however this is inevitable as the value of assets under management has increased along with increasing exposure to private markets, the Fund's members, officers, and independent adviser believe that WPP's funds provide excellent value for money.

Cost v's 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?

A push for higher investment returns can increase risk to employers who fund the LGPS since a sustained fall in the value of higher risk assets could cause an increase in employer contributions, and as a result impacting local taxpayers.

Considerations in seeking higher returns from broader range of assets include:

- 1) locally decided investment strategy appropriate to the liabilities of each individual LGPS fund (extent of surpluses, maturity of liabilities, cashflow positive or negative, appropriate diversification to reduce risk, etc);
- 2) level of risk acceptable to employers who fund the LGPS and agreed in locally decided funding strategies; and
- 3) fiduciary duty to pay pensions when due (which in turn leads to seeking appropriate risk-adjusted returns net of costs).

Gwynedd Pension Fund has increased allocations to a wider range of asset classes in order to diversify, notably private market assets. The WPP have established new sub-funds for private equity, infrastructure, and private debt which has allowed us to increase our proportion and therefore pooling has been key to this. We are also, along with the other LGPS funds in Wales invested in and are considering more allocations to local impact investments (private equity, infrastructure, and real estate), intended to support economic growth and have wider positive social and environmental impact, particularly in Wales. As we already invest in a wide range of asset classes, we do not require additional intervention from the Government to encourage this.

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?

Gwynedd Pension Fund and the WPP's declared intention since we voluntarily started pooling was to focus on net investment returns rather than costs.

We do not believe that the size of pools is stopping the LGPS from investing more in the UK. The limiting factors are:

- 1) availability and attractiveness of suitable UK investments relative to global investment options; and
- 2) fiduciary duty which requires LGPS funds to seek the most attractive risk-adjusted returns globally in each asset class it decides to invest in as part of its investment strategy.

As well as UK specific equity mandates, Wales has global mandates in listed and unlisted equities and in infrastructure that can invest in the UK. In those global mandates, allocations to the UK are reflective of investment manager views on the attractiveness of UK investment opportunities. In order to facilitate Welsh and UK investments within these mandates, the WPP have established a relationship with a number of allocators in order to link and promote viable local investments. If the pools were consolidated, then this arrangement would no longer take place.

Investment by LGPS pools in smaller scale, local opportunities is important. These could potentially cause additional UK growth, whereas investment by the LGPS in large-scale infrastructure for example could simply displace investment by international investors who will instead invest in other countries so that there is not a net increase in UK assets. We believe that consolidation and absorption of the WPP into a larger pool would likely make it more difficult to invest locally in the infrastructure of Wales.

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?

The primary driver of the shift away from UK investment is fiduciary duty – seeking attractive risk-adjusted returns in each asset class. This has led to greater diversification by geography across all asset classes and pursuit of the most attractive risk-adjusted returns from the global opportunity set.

We believe the following factors are relevant to the changing pattern from UK listed equities:

Diversification (reducing risk) and maximizing the return opportunity set. UK equities present a relatively small component of the global equity market (c.3%) and is materially underweight strategically important sectors such as technology (e.g. relative to the US). UK equities have cumulatively underperformed global equities ex-UK.

Adoption of actively managed global equity mandates; allowing discretion to managers to select stocks where they have highest conviction to outperform, regardless of where companies are listed.

Investing in UK listed equities does not mean investing in the UK economy. Some 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. With significant improvements in funding levels, 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.

Higher transaction costs when purchasing UK listed equities. Stamp Duty Reserve Tax of 0.5% is incurred when purchasing UK listed equities (but not on non-UK equities), which 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. We would be concerned that if the Government gave guidance on how much LGPS funds should be investing in UK listed equities, as this could reduce our ability to invest in UK private market assets.

Concerns over the alignment of UK listed equities to institutional investors' Net Zero and decarbonisation ambitions. Significant parts of the FTSE all-share index are invested in sectors such as Oil, Gas, Mining, Utilities and Banks. Institutional investors have legitimate concerns about how companies in these sectors are aligned to helping to achieve their funds' environmental aspirations.

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 Gwynedd Pension Fund strongly believes in the potential benefits from investment in local communities contributing to local and regional growth as demonstrated by our existing commitments to invest in UK assets.

There is a case for establishing additional incentives to encourage higher allocations to UK assets generally. Incentives could increase the relative attractiveness of investment in the UK and make it possible to invest more in the UK within existing fiduciary responsibilities.

If the government wishes to impose “requirements” (e.g. specific allocations to UK assets in aggregate or for specific asset classes) then it will be necessary to investigate the legal issues around the interaction of such requirements with fiduciary duties.

Incentivising local investment and thereby increasing its attractiveness could further increase allocations within the current constraints of fiduciary duty and provide additive investment in UK growth.