Stronger together

With the government pushing for the pooling of local government pension scheme investments, Natalie Tuck speaks to the Local Pensions Partnership about why it came into being, and how other funds can get involved

Tell us about the partnership, how did it come into being?
In 2014, a full year before the then-Chancellor announced his plans for the pooling of local government pension schemes, the London Pensions Fund Authority (LPFA) and Lancashire County Pension Fund (LCPF) began developing their own ideas for pooling their resources.

The two schemes had similar investment philosophies, with both looking to move away from traditional asset allocations and increase investments in alternative assets, such as private equity, property and infrastructure.

But there was more to it than simply pooling our assets. We quickly realised there were enormous potential benefits to the funds and their members in a 'not-for-profit' organisation providing cost-effective management both of assets and liabilities, and with the critical mass to deliver significant economies of scale and improvements across all our operations, from investment management to pension administration.

So what began as a prospective pooling of assets between like-minded pension funds, soon became a much more comprehensive entity, providing end-to-end pension services to clients among LGPS schemes and beyond.

What some people may not know, for example, is that as well as managing investments for LPFA and LCPF, we also provide pension administration services to 10 LGPS schemes, and seven emergency service pension schemes.

How does the partnership work logistically? In terms of governance what remains separate? What challenges did the funds have to overcome to be able to partner?
Our shareholders, through their respective trustee boards, retain their local accountability, with control of strategic decisions such as asset allocation, contribution rates and risk appetite.

Our governance structure enables them, however, to delegate the day-to-day implementation of effective and independent investment decision making to LPP.

As with any innovative project, it is vital from the start to maintain trust and confidence among stakeholders. While this should not be underestimated as a challenge, a more onerous task in our case was the process of creating an organisation, from scratch, that required us to navigate the complex and challenging processes needed to achieve FCA approval, in parallel to the day-to-day tasks of managing the portfolios. The fact we were able to do so successfully is testament to the commitment, hard work and expertise of all involved.

What is the partnership's investment strategy? Can you tell us about some investments you have made? How has it been making joint decisions on investments?
LPP's investment strategy is built around our investment philosophy, which has two key aims: to help clients achieve a faster reduction in pension deficits by maximising risk-adjusted investment returns and lowering costs; and to deliver stable and sustainable investment outcomes to meet clients' long-term pension funding requirements.

We are committed to investments that not only produce strong risk-adjusted returns for the benefit of our shareholders, clients and their members, but that can also make a tangible difference to people's lives. So, for example, we have already committed significant investments to housing projects and to new rolling stock for hard-pressed commuter rail services.

A little over a year since receiving FCA accreditation, we already have three new investment funds or structures up and running – a £5.6 billion Global Equity fund launched in November last year, a £1.8 billion Private Equity structure launched last April and, most recently, a Global Infrastructure Fund. Other funds such as credit, fixed income and total return are in the pipeline.

The potential challenge of implementing "joint investment decisions" is not really a challenge because we have been able to assemble a talented and integrated investment team with the skill and experience to make effective investment decisions on behalf of our clients. This governance structure is one of our key strengths, and there are already encouraging signs that this approach is delivering tangible results, in the form of strong investment returns with significant cost savings.

How can other funds get involved with the partnership?

Investors can join us as shareholders, or ask us to manage their assets as clients.

If the former, funds retain their sovereignty, and would not have to pay any set-up costs – that's all been done. Nor would they have to contribute to regulatory capital requirements.

In the latter case, the structure and processes are all in place for investors, whether public or private sector, to use us as they would any other FCA regulated investment manager. The fundamental difference with LPP is that we are a not-for-profit organisation, so we don't have to worry about paying dividends. Any surplus not re-invested in the business is passed back to clients, through an annual rebate.

I was interested to see former Pensions Minister, Richard Harrington's comments last year about greater collaboration between corporate pension funds. When I chaired The Pensions Regulator, our data showed that, on average, smaller private sector defined benefit schemes had higher running costs per member and weaker investment performance. So there are clear benefits of greater size, through pooling or other collaboration, in improving cost and performance. It was encouraging that the FCA's recent report on the asset management industry included a recommendation that the Department for Work and Pensions should review and, where possible, remove barriers to pension scheme consolidation.

"In our experience, done properly, bringing talent in-house is more cost effective. The saving on fees paid to external managers more than offsets, by a very large amount, the cost of higher remuneration for in-house talent, generating significant savings for funds"

The process we are undergoing is one which we believe not only the LGPS, but the wider pensions community, can learn and benefit from. We have been able to share joint learning with our LGPS colleagues through the Cross Pool Collaboration Group – a valuable collaboration that has at its heart the best outcome for employers and scheme members. What we have learnt is that grouping together is by no means a simple process, but the complexity hides the very significant benefits that this journey brings.

A number of corporate pension schemes have already asked about our not-for-profit partnership and the LGPS pooling activity. Given our experience I would encourage corporate funds to consider greater collaboration and where appropriate coming together with like-minded funds. The advantages are becoming evident, and it would be a shame if members of corporate schemes did not have the opportunity to enjoy similar benefits.

What does the partnership see as the biggest challenge facing public sector schemes right now and what can be done about it?

For us, one of the biggest challenges, as mentioned above, was setting up the new structure and going through the entirely necessary, but complex, business of FCA registration, while continuing to maintain business as usual.

Another challenge, particularly for funds looking to build their in-house investment capabilities, is finding and retaining the right talent. Remuneration for investment professionals in the private sector is much higher than public sector norms. But the higher salaries of external managers are paid (albeit less transparently) from the fees paid by their clients.

In our experience, done properly, bringing talent in-house is more cost-effective. The saving on fees paid to external managers more than offsets, by a very large amount, the cost of higher remuneration for in-house talent, generating significant savings for funds. Given the difficult choices councillors are having to make about local public services, it is not hard to understand why, even when accepting the economic logic, they find agreeing such higher salary structures a difficult decision.

Written by Natalie Tuck