Summary
- In the March 2015 Budget, former-Chancellor of the Exchequer George Osborne announced that Local Government Pension Schemes were to pool together their investments, replacing the 89 funds with six wealth funds worth £29 billion-plus.
- This was designed to plug the £47 billion LGPS deficit and stimulate pension fund investment into infrastructure.
- A number of LGPS investment consolidation has already begun to occur.
- The LGPS investment pooling comes with a number of concerns, such as investment size restrictions, the potential difficulty in switching positions and the decline in the autonomy for schemes to make their own appropriate investment decisions.
- Good governance is considered critical to ensuring the process runs smoothly.

A pool of opportunity?

As LGPS funds start pooling together into six multi-billion-pound wealth funds, Lauren Weymouth explores why the aim has been so controversial and what risks and opportunities lie ahead

The Local Government Pension Scheme (LGPS) has been subject to debate for years, as regulators and the government have been looking for ways to reform its operational and administrative effectiveness at the same time as delivering the best investment returns.

Following extensive discussions in the March 2015 Budget, former-Chancellor George Osborne announced the government was intending to work with the Local Government Pension Scheme's administering authorities to pool together LGPS investments; getting the ball rolling in a movement that is designed to make up for the stubborn £47 billion deficit in the LGPS.

The plan was introduced with the aim of creating six new multi-billion-pound British wealth funds, with a minimum value of £29 billion, to replace the 89 separate funds that currently exist.

More than just pooling together the assets of a number of small schemes, consolidating LGPS funds is also about the government's wider plans to plug more money into funding for roads, bridges and railways across the country.

Pensions Management Institute president Kevin LeGrand explains how large parts of UK infrastructure is in need of upgrading, such as the railway network (including HS2), power stations and affordable rental housing. "Therefore," he notes, "the government is inevitably looking for investors".

For years, the government has been trying to attract funds for infrastructure projects from private-sector pension schemes, but with little to no success, as many schemes have been too small to be able to invest into infrastructure on their own.

However, LeGrand suggests the LGPS has "considerable funds" at its disposal and needs to find a home for them that can provide a good return and these types of investments "usually offer a steady income stream, which should provide a good match for liabilities such as pensions in payment". So, he adds, "there is a potential synergy there".

But, much like any great change to public-sector pensions, LGPS pooling has been met with controversy. If the pooling works well, millions of pounds could be saved across the country. And if it doesn't, then the wrong investments could lead to the loss of millions of pounds, reducing LGPS members' retirement savings in the process.

running the schemes at that level."

Scepticism

Naturally, in such a new and risky environment, industry campaigners have fought for the LGPS to have freedom over its investment decisions, in order to act in the best interest of its members.

Trade union Unison has consistently argued that despite not being opposed to pooling funds together on a grander scale, it is "less enthusiastic" about the government being able to direct where members' money is invested.

"Making pension funds plough assets into the latest government initiative could very well mean poor returns for workers in the LGPS pension scheme," Unison general secretary Dave Prentis argues.

"Funds should not have to risk gambling away their members' retirement incomes by subsidising an infrastructure project that should be funded from government coffers or by the private sector," he adds.

Industry figures have also argued that the new governance structure needed to be put on top of existing local structures could lead to further potential for conflict, inconsistency and confusion between the governance layers. Furthermore, Unison argued it is also concerning that there were no proposals to include trade union/scheme members in the governance of 'common investment vehicles'.

However, Aries Insight director Ian

Risky business

The Pensions Policy Institute highlighted one of the main risks as size restrictions on certain investments or funds. "Similarly," it stated in a briefing report earlier this year, "larger funds can be too big to fill their target allocation within a preferred manager or direct investment opportunity". It stated other risks as difficulty in switching in and out of the large position and possible delays in execution of investment decisions.

Additionally, LeGrand highlights how a number of these projects are not "spade-ready", so there could well be a delay between the investment being made and the returns starting to be paid.

"It is also concerning as to whether the actual investments available are properly matched to the needs of the scheme," he adds.

"There is also a wider concern around pooling the funds themselves. Currently there are many funds, which are arguably not as efficient as they could be because of duplication of administration and through the potential loss of economic muscle that would be expected to accompany a larger fund. The pooling of funds however means giving up a degree of autonomy at the local level, which is not always regarded favourably by those

Neale argues that, from an outsider's point of view, the government's LGPS aims do not seem "particularly controversial", claiming even Unison admits that LGPS funds were "not efficiently managed and there was evidence of significant room for improvement".

Better together

In fact, many local pension funds are already starting to get on board. Shortly before the announcements were made, the Local Pensions Partnership was formed – a collaboration between the Lancashire County Pension Fund and London Pensions Fund Authority – with the aim of creating a hub for LGPS funds to manage assets and liabilities together and to reduce deficits.

Since then, the two funds have already created a £1.2 billion UK property pool, with the intention of investing in housing development in West London, student housing and retirement home investments, as well as an investment made by the LPFA in an East London housing development project, Pontoon Dock.

Furthermore, in July 2016, the government received a proposal from nine Midlands-based local government pension funds to create a multi-asset investment pool known as LGPS Central. The funds include local authority schemes in Cheshire, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands and Worcestershire.

In these instances, the government requires four criteria: scale, governance, infrastructure investment, cost savings and value for money. In this case; the LGPS Central pool exceeded the government's requirement of a minimum £29 billion in assets with a total of £34 billion across the funds.

Fresh opportunities

But to continue successfully, and to generate the best investment results, good governance is absolutely crucial. Notably – as Pensions and Lifetime Savings Association DB policy lead Helen Forest Hall points out – because investing in infrastructure in particular "requires dedicated skill, expertise and resource".

"Scale has the potential to deliver best value and better governance, but these things are not automatic," Forest Hall explains. "Scale has to be managed properly or its potential will not be realised. Good governance is critical to getting this right and we know from talking to our members that getting the governance structure right is a keen concern.

"Structured correctly, pools should be able to give local funds confidence that their investments are being managed properly and that there are sufficient options for investment to meet their strategic asset allocation."

State Street head of UK pensions and banks Andy Todd agrees, adding that pooling resources should not only be viewed as a cost-saving measure, but also as "an important means of developing new capabilities and opening up fresh opportunities".

Regardless of skepticism surrounding LGPS pooling, it's clear that the intentions are positive and have the potential to drive down cost and open up new opportunities for smaller funds, all while helping to improve and build up Britain's infrastructure.

But as Todd concludes: "Finding the right partner to complement the attributes of a particular pension fund will be the key to ensuring this strategy pays off."

Written by Lauren Weymouth, a freelance journalist