Need a push?

Summary

• The government called for LGPS asset pooling to be complete by March 2025, and for the eight pools to become fewer, and larger in size, with assets of at least £50 billion.
• As of end 2022, 39 per cent of LGPS assets were in pools, with some asset classes not best suited for pooling. The government states that LGPS pooling has achieved net savings of over £380 million as of end 2022.
• The pooling process has been subject to some governance debate between the pools and the funds, but has 'progressed well', with some pools even working together.
• There is industry concern about the feasibility of the March 2025 deadline for pooling assets, and confusion about how pool mergers could potentially occur.

The government has confirmed its intention for the pooling of LGPS assets to be complete by March 2025, and for there to be fewer, but larger, pools in excess of £50 billion in size. But when push comes to shove, did the LGPS need further encouragement to pool its assets, or was it already heading in the right direction?

Phase 2 has begun. Not even a decade on since the 86 English and Welsh Local Government Pension Scheme (LGPS) funds were first required to bring their considerable assets *[approx. £364 billion of assets, according to latest figures]* together into 'pools', and less than five years since most pools were operational, the government is already urging them to speed up this transition.

In the November 2023 Autumn Statement, Chancellor, Jeremy Hunt, confirmed that there will be a 31 March 2025 deadline for the accelerated consolidation of all LGPS assets into pools.

He previously announced this intention in his July 2023 Mansion House reforms. The Department for Levelling Up, Housing and Communities (DLUHC) also consulted the industry on this and other LGPS reforms from July-October last year.

Also announced was the requirement for the funds to set out in their investment strategy statement (ISS) the assets that are pooled, under pool management and not pooled, along with the rationale, value for money and date for review for those assets not pooled.

The government will also revise pooling guidance to set out a preferred model of pooling, including delegation of manager selection and strategy implementation.

Pooling progress

So far, "moving assets into pools has been a marathon, not a sprint", London CIV CEO, Dean Bowden, states.

According to the DLUHC *Local Government Pension Scheme (England and Wales): Next steps on investments* consultation response, at March 2022, £145 billion, or 39 per cent of assets, had been transferred to the pools, with the percentage varying by pool from under 30 per cent (LGPS Central) to over 80 per cent (LPP). A further £114 billion, or 31 per cent, were under pool management and £34 billion, or 9 per cent, covered by plans to transition into the pools.

"Given it has been eight years since proposals started the pooling journey for the LGPS, it makes sense that the government considers progress and next steps," Aon principal investment consultant, Louis-Paul Hill, says.

For Barnett Waddingham principal and senior pensions consultant, Jeff Houston, the government's latest push for the LGPS to increase the movement of assets into pools was welcome, "as some people had taken their foot off the gas and pooling had run out of steam a little bit because there did not seem to be the pressure to do so from the government that there had been in the past".

However, this government push may not be welcomed by all. For instance, a poll of the Pensions and Lifetime Savings Associations' (PLSA) Local Authority Conference attendees in June 2023 found that 59 per cent were concerned about the potential for further mandatory consolidation.

The DLUHC *Next steps* consultation response acknowledged that there were some industry concerns, notably on the transition deadline of March 2025 and aspects of the preferred model of pooling, but it argued that setting clear and up-to-date expectations in guidance on these matters is essential to securing a step change in progress on pooling and associated benefits of scale.

While the PLSA is supportive to further LGPS asset consolidation, "it has to be done in a way that suits the LGPS funds", its head of DB, LGPS and investment, Tiffany Tsang, states, noting that the March 2025 deadline "is just too artificial".

Asset pooling had been moving at pace already, she adds, explaining that funds are at different points of the journey for different reasons, not least because of the amount of 'other' work for LGPS funds to contend with, such as implementing the McCloud ruling and preparing for dashboards.

Also, "some assets are better suited to pooling than others, so any expectation that all funds are going to have a significant amount of assets going through the pools by 2025 is just not realistic", Houston says.

Hill explains that funds with existing private market allocations, such as private equity, infrastructure, private credit and property, have typically kept these allocations outside of the pools given the closed ended nature of the investments. These allocations would typically range from 10-30 per cent of a fund's allocation.

"Also, funds that retain a passive, index-tracking, element have also tended to keep this outside of the pool given the economies of scale already achieved in this area. Passive management can range from 0-30 per cent of a typical allocation.

"Finally, we see some funds keeping certain asset classes or specific strategies outside of the pool because they remain an important part of their strategy and the pool does not offer a suitable sub fund. For example, liquid alternatives such as hedge funds and insurance linked securities and also equity protection. This type of allocation might range from 0-30 per cent," he adds.

"Moving assets into pools has been a marathon, not a sprint"

The way passive portfolios are viewed is one 'victory' from the consultation response, SPP Public Sector Group member and immediate past chair, Clifford Sims, says, as "the government originally criticised the way that funds had gone around saving costs in procuring external commercial providers rather than using their pool vehicles. This meant, according to the government, that the assets were not properly 'pooled' and only 'under pool management'".

"The proposal, that funds should move their passive assets to pool operators, would have been massively costly to implement and create significant market risk. It appears to have been quietly dropped in the consultation response," he adds.

Bowden suggests 2026 to be a safer bet for moving all assets into pools "when you consider the cyclicality of pension fund oversight (e.g. triannual reviews) and the number of pension committees between now and then. As for private market assets, it's important to identify realistic timelines that consider longer lock-in periods for existing holdings".

Hill also does not believe that administering authorities would be supportive of a firm deadline for transition that may be less than 12 months from the point that relevant guidance is available, and therefore "would not wish to see financial or other penalties for administering authorities that are unable to meet this timescale".

The government has stated though that it will consider action if progress is not seen, including making use of its existing powers to direct funds.

This 'comply or explain' approach will require a lot of time and resource for LGPS funds to justify in their annual reports why certain assets are outside the pool, Houston warns.

However, Local Government Pension Scheme Advisory Board (LGPS SAB) board secretary, Jo Donnelly, states that the board and its secretariat are working with DLUHC on how best to amend existing guidance to make the requirements as clear and workable as possible.

Challenges

Any extra guidance is sure to be appreciated, as both the initial round of pooling, and this next push, have had issues to address.

For instance, Sims notes the high turnover at a board level in some of the pools, and that "the governance of the pools has been the subject of varying degrees of tension, which is perhaps not surprising, given the transfer of investment powers that the government wanted to see (at a day-to-day level) from the authorities to the pool operators".

There has been debate around asset allocation and implementation, Houston agrees. While the LGPS fund deciding the asset allocations and the pools implementing these decisions sounds simple, there is a 'grey area' as to what constitutes implementation – for instance when deciding what geographical region or business sector within equity investing, he says.

"The government's preferred model is for the pool to make the majority of these decisions but that is not mandatory," Houston adds.

Also, "the government's response to the consultation suggests they believe there is no conflict for pools owned by LGPS funds to provide advice on investment strategy and that the pools have a role to play in avoiding any perceived conflict of interest in relation to local investments", Hill says.

"We remain sceptical and believe it will be really important that appropriate governance structures/processes and procedures are in place to provide reassurance to stakeholders that any conflicts are identified and appropriately managed and we hope government will support this through the updated guidance," he adds.

Working together

Despite these issues, not only are pools seemingly working well; they are also working well together.

For instance, London CIV partnered with LPPI in 2020 to launch The London Fund, which aims to generate positive social and environmental outcomes for Londoners, while at the same time delivering sustainable long-term risk-adjusted returns. It has so far invested over £87 million in affordable housing, infrastructure, clean energy, and community regeneration projects.

The DLUHC's consultation response highlighted how it would like to see more collaboration like this, "where this makes sense, and to consider specialisation, building on existing strengths in particular areas of investment, in order to deliver further benefits of scale and limit unnecessary duplication".

However, Hill notes that it currently appears difficult for underlying funds to use pools outside of their originally chosen pool for some of their investments.

"We understand the logic for these barriers during the set-up phases but as we move to business-as-usual we believe it would be helpful for underlying funds to be able to choose which pools to use for different asset classes," he explains.

The LGPS SAB response to the DLUHC *Next steps* consultation also highlighted the potential for "additional costs to arise as a result of investing in another pool's product through the 'home' pool, which would seem to run counter to the cost-saving aims of pooling".

Cost savings and other benefits

After all, cost savings is arguably the main reason for LGPS asset pooling.

According to the DLUHC consultation response, pooling set up and running costs of around £400 million to 2022 have been fully covered by savings. Net savings of over £380 million have already been delivered, with annual savings of £180 million, and total net savings are forecast to be over £1 billion by 2025.

It also states that significant expertise and capacity have been developed in private markets and infrastructure investment, giving funds access to the higher returns in these markets. In particular, UK and global infrastructure investment has grown from below £1 billion to around £27 billion.

However, Hill says that a pool's structure should not just be greater benefits of scale, but should be "compatible with administering authorities' legal duties and investment objectives that are typically to maximise risk-adjusted returns".

"For example, using existing sub funds at pools could maximise economies of scale but it could miss investment opportunities in asset classes offering attractive investment returns because a sub fund does not yet exist," he explains.

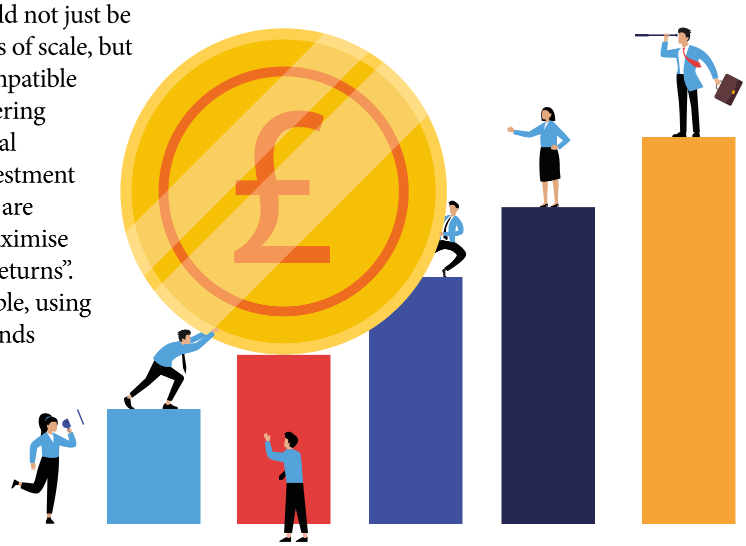
More generally, by outsourcing much of the manager selection and monitoring role to the pools, LGPS funds have benefitted from focusing more on strategy, responsible investment policies and asset allocation decisions, Hill adds.

Houston highlights how the investment strategies of LGPS funds within the same pool are likely to differ – "and how much is it right to ask them to compromise in how they want to invest, in order to shave a couple of basis points off the fee"?

This difference is only likely to increase as funds tackle levelling up and climate change investment strategies in their own ways, he says, with varying interpretations and targets. The nature of local government, with administrations of varying political beliefs coming and going, can "radically change the make-up of how the funds want to invest, so a too-rigid structure to pooling would not make sense", Houston adds.

Fewer, larger pools

However, cost savings are a significant factor in the Chancellor saying in his Mansion House speech that he wants "to see a transition towards fewer pools to maximise benefits of scale".



The DLUHC *Next steps* consultation response states that once all LGPS assets are transferred into the current pools, five of the eight pools would be around £50 billion or higher at current values and the remaining three pools would occupy the £25 billion-£40 billion range.

"Completing the transition of assets would be a major step forward. However, we do not believe that this alone will deliver the full benefits of pooling in the long term. Our view is that the benefits of scale are present in the £50-75 billion range and may improve as far as £100 billion. As such, we should in future look towards a smaller number of pools in the region of or in excess of £50 billion in directly invested assets through merger," it states.

Donnelly notes that the headline reference in the Chancellor's Autumn Statement speech to LGPS pools of £200 billion by 2040 is based upon the Government Actuary's Department modelling that LGPS (England & Wales) assets will be worth around £950 billion by 2040. This implies four to five pools of £200 billion by that time.

"It is unclear why the reference to pools of £50 billion-plus in the short-medium term, as per the consultation, has not been retained – and risks confusion," she says.

The LGPS SAB response to the DLUHC *Next steps* consultation also warns that the government needs to "seriously consider how the messages in this consultation could negatively affect progress with pooling. If there is a prospect of some pools ceasing to exist in the near future, then that will give many funds occasion to pause transfers and reconsider their participation in that particular pool. This is precisely the opposite effect to what it is trying to achieve".

Over a third (37 per cent) of last year's PLSA LGPS conference poll respondents disagreed that the pools need to be consolidated at all, compared to 33 per cent who felt that pools do need to be consolidated.

How pool mergers would occur is currently unclear. As Houston says, "the government says they would like to see fewer pools in the future but have provided no plan or direction as to how we might go from eight to five, especially when they seem to be ruling out any sort of competition between the pools so that it might naturally happen over time".

"Some assets are better suited to pooling than others, so any expectation that all funds are going to have a significant amount of assets going through the pools by 2025 is just not realistic"

According to Sims, there are two routes by which those three pools could in theory be absorbed into the other five pools: (a) the partner funds could agree among themselves to find new pooling homes or (b) the government has a power to intervene and direct that each authority's assets be managed by another person. "Note that this power applies to individual authorities (not pools) and is subject to lots of checks and balances. It has never been used," he says.

"The obstacles to voluntary merger of pools are partly contractual and partly psychological. Every pool has been set up on the basis that it was built to last. The governance challenge would be to agree new arrangements and work out how the costs of new joiners of a pool should be recovered (given that those new members did not contribute to the pool's establishment costs). Asset-only mergers, where the liabilities remain with the original authority, would also cause headaches where control over asset allocation and accountability is handed to another party," Sims adds.

Evolution

Instead, without any further government intervention, Houston believes that "the LGPS will continue to do a good job with all suitable assets naturally entering the pools and the pools eventually reaching their funds' desired size".

As West Midlands Pension Fund, executive director of pensions, Rachel Brothwood, says: "Investment pooling continues to provide a great opportunity for the LGPS to be at the forefront of innovation and best in class management practices.

"As long-term investors we remain focused on delivering good and sustainable outcomes for our members and we will continue to evolve our pooling arrangements to ensure these are well placed to deliver our investment objectives and add value through active stewardship and operational resilience."

Meanwhile, Border to Coast chief stakeholder officer, Ewan McCulloch, states that "we recognise the importance of evolving how we operate – and ensuring we have an effective governance framework to ensure the right decisions are made in the right place at the right time.

"We welcome the discussion on how we can all ensure the LGPS can continue in a sustainable and affordable manner and, in doing so, support the six million hardworking people that depend on a LGPS pension in their retirement."

Bowden notes that the success of pooling so far has been the result of more effective working arrangements and gradual adjustments within the pooling 'ecosystem', and therefore "pool consolidation should be an organic process over a longer time horizon".

So, with these ongoing efforts and this extra motivation from the government, the LGPS does not seem to need any further pushes towards the pooling of its assets – but whether it will get another shove remains to be seen.

Written by Laura Blows