Summary
• The local government pension schemes have been tasked with creating pooling mechanisms by April 2018. After that, they must be ready to transfer their assets into the eight new pooled fund structures, with most assets to be transferred by mid-2020.
• Marshalling enough resources to finish the process has been a challenge, but LGPS funds are well placed to meet the April 2018 deadline.
• The next challenge will be reviewing and consolidating the LGPS' myriad investment mandates, as well as setting up robust governance processes.

Light at the end of the tunnel

Louise Farrand provides an update on the challenge of LGPS pooling

Light is beginning to appear at the end of the tunnel for the local government pension scheme. The government has tasked the funds that make up the monolith scheme with pooling their assets in the name of greater efficiency.

Schemes must have constructed pooling mechanisms by April 2018, and start transferring their assets into the eight newly-created pools from April 2018 onwards, with the majority of assets to be transferred by mid-2020. The 2018 deadline is looming, fast.

Establishing a pooling process for long-established pension funds' investments was always going to be a challenge. Timing and resources are tight. Not everyone tasked with pooling was in favour of the initiative in the first place. And in many cases, pooling involves ripping up long-standing relationships with investment managers, as well as well-established governance processes.

Striking a balance

"Resourcing is a constant challenge," says State Street head of UK pensions and banks, asset owner solutions, Andy Todd. "There is a day job to be done as well. I think in practice what is happening is specific individuals have been identified within each member fund or from the leading member funds within each pool and they are now focused entirely on pooling-related matters."

The focus on pooling comes at a cost, says River and Mercantile's associate director for UK institutional, Jason Wood. "I know a lot of *[LGPS]* officers would love to be spending more time on investment and they haven't been able to because of the resources spent on pooling … That is a cost that is difficult to put a figure on."

But all this work will pay off in the long term, argues Kempen Capital Management LGPS relationship manager, Mili Parekh. "It is evident that the pools are working extremely hard to achieve their live dates on time. Given the vast change this presents to the LGPS community and the quantum of work involved – on top of their day jobs – I believe it is fundamentally important to take the time needed to get the establishment stage right, and the pools are doing just that."

Resourcing is a challenge for LGPS Central, where incoming chief executive Andrew Warwick-Thompson is hoping to at least double the pool's asset management team from 30 to 60-70 people. "We start with a ready-built asset management team, but we will need to expand that quite considerably, first of all to refocus as a full-service investment management team that can serve eight clients."

A key issue is finding the right talent at the right price. "One of the challenges is that LGPS until now has managed to recruit in house and they have done that in reference to LGPS pay scales. Those are substantially lower than open market rates for asset managers," says Warwick-Thompson.

He adds: "That isn't necessarily a bad thing – I think people in the open market in the private sector are paid far too much as investment managers and as we start to see people challenging fees and demanding greater transparency; they will come under pressure on their fees and their salaries. Nonetheless, I think that is a challenge and we have done a lot of work with partner funds to explain what we need to do in order to become a regulated FCA asset manager, and we need to pay higher salaries than was the norm.

"We are pitching our deal at the same time as all the other pools and there is a bit of a talent shortage frankly. We will find out in the next six months how great a challenge that is."

Built to last

The investment and operational implications of collaboration are huge, and each fund has responded differently to the challenge. "There isn't one collective that is doing the same as another," observes Local Pensions Partnership (LPP)'s chief executive, Susan Martin.

While some consolidated funds are opting to outsource their investment management, others are setting up new structures to serve members.

"There is no one right way," says JLT Employee Benefits' senior investment consultant and LGPS adviser, Nick Buckland. "It is what works best for the underlying funds, and I think each of the pools have done something which will work best for them."

Buckland continues: "In terms of how they will go about pooling the assets, it is a massive challenge. The underlying funds within each pool probably have more than a hundred fund manager mandates with a different range of fund managers and they want to consolidate that into something manageable, which will achieve the economies they are looking to get."

On the bright side, funds are making good progress, says Todd. The pools have become much more granular in recent months, he reports. "For the most part all of *[the six pools]* have either gone out to tender or are in the final stages of tender on the asset servicing side. The operating models have been well-defined, and the pools are in a place where they are moving towards the final design and into the build phase of their operating models."

The build may be in place. However, the hiring of managers and the consolidation of invested assets is still to come for most LGPS pools, points out Todd.

The long and winding road

It is an unsettling time for investment managers, as pools review their existing mandates and try to generate cost savings for members by negotiating deals with their increased bulk buying power. As Todd puts it: "There will be fewer mandates but the mandates that remain will be far larger. The investment managers that are retained or newly employed by the pools will have far larger mandates to manage, but clearly there will be far fewer investment managers across the LGPS."

Wood adds: "I think there is a lot of pressure on the asset management industry now and it is a good time for asset managers and the LGPS to face each other in a room. Fees should and will come lower."

As schemes review their investment strategies, it's the perfect time to re-evaluate, says Wood. "The trend we have noticed in the past 12 months has been an increase in interest in looking at a passive allocation, but with protection as well. All the LGPS have a triennial actuarial valuation and the latest one for almost all LGPS funds puts them in a much better funding position than they have ever been. A lot of them have been looking at a way to protect that funding level without losing equity returns."

Warwick-Thompson is seeking to make savings in specific areas. "About 30 per cent of the targeted cost savings we plan to make come from alternatives. The way we will do that is through a combination of having much tougher negotiations with some of the external asset managers, but I suspect we will probably bring quite a lot of it in house. When you add together all the alternative investment mandates we have within the pool and the costs we are paying to external managers, you can very quickly see a business case for hiring your own team."

A related challenge will be developing the necessary governance. "One of the other things I am particularly interested in is making sure we have extremely robust governance around making the decision of what we bring in house and what we outsource. We need to be able to demonstrate that our decisions are in our clients' best interests," says Warwick-Thompson.

He adds: "Not only we do we have to make sure we have our clients' best interests in mind, we need to be sure we are delivering substantial returns net of fees on a long-term basis. Our governance has to be very tough indeed and whilst you can make a business case for bringing it in house on the basis of cost, that's only one part of the equation. We need to be able to produce returns that prove it was the right decision to bring it in house."

There may be light at the end of the tunnel, but the challenge is still in finishing the journey. As the LGPS leaders are all too aware, all eyes will be on them as they continue to walk down this path.

Written by Louise Farrand, a freelance journalist