Diving head first

LGPS funds across England and Wales have begun pooling their assets into sovereign wealth funds, a legacy of former Chancellor George Osborne, but how is the process going and what challenges do the pools face? Natalie Tuck investigates

Summary

- After deciding on where and who to pool their assets with, Local Government Pension Funds (LGPS), and the newly-created pools have now begun pooling their assets.
- Although a lot of hard work has already been done, there is still a long way to go, and pooling is expected to take several years.
- The pools are taking their time with the creation of investment funds in order to get it right, but are aware that there will be teething issues in the future.
- It is clear that LGPS is very much a family, and everyone wants pooling to be successful.

Three years ago the government asked Local Government Pension Funds (LGPS) to take the plunge and pool their assets.

With two pools already in existence, the London CIV and Local Pensions Partnership, a further six have since been created. Former Chancellor George Osborne dreamed of the funds having a minimum of £25 billion each, which most of the pools have achieved. The largest pool, Border to Coast, has around £46 billion *[as at March 2018]* worth of collective assets. The Local Pensions Partnership and the Wales Pension Partnership have the least with £14.5 billion and £16 billion, respectively.

When the pools were initially announced, the government said that setting them up would cost an estimated £20 million, with £11 million in annual running costs. Following submissions to central government in July 2016, the pools and 91 funds have been working hard; the deadline to begin pooling assets was in April 2018.

In December 2017, following the proposals by the pools, Parliamentary Under-Secretary of State for Housing, Communities, and Local Government, Rishi Sunak, said pooling could achieve net savings of between £1 billion and £2 billion by 2033.

Where to dip your toes?

With 91 LGPS funds across England and Wales, and two pools already in existence when Osborne announced his policy, the funds had first to decide what funds they would partner up with.

It's clear that geography has played a big part in the formation of the different pools. The Brunel Pensions Partnership, for example, consists of several funds in the South West of England, and the Wales Pool consists solely of funds in Wales.

For others, such as the Local Pensions Partnership, and Border to Coast, geography has not been the primary focus for working together. In its submission to central government, Border to Coast used the term "like-minded beliefs". Its CEO Rachel Elwell, who was appointed after the creation of the pool, says it was managers at Cumbria, East Riding and Surrey, who "had some clear thoughts about how *[pooling]* ought to work".

"They went out and talked to people that they thought might be like-minded, in terms of what they thought this ought to look like, and then the funds went through a process of throwing their names into a particular pool."

Northern Trust head of LGPS pooling initiative, Ian Hamilton, says that the original interpretation of pooling was that the approach would be quite homogenous. "In reality, we saw different approaches to the structures they've put in place," he says.

"To be successful as a partnership, which effectively they are, they needed people that shared views on the same objectives and on the same outcome. Some of that was driven by geography, and some of that was driven by like-minded investors."

The pools have also had to make decisions on how they will go about pooling their assets. Hamilton notes that some are using an Authorised Contractual Scheme (ACS) vehicle as part of their solution.

Regulated by the Financial Conduct Authority (FCA), an ACS provides more certain positive tax treatment for users when investing cross-border and engaging with overseas tax authorities. "Some are using that ACS vehicle," says Hamilton. "Four of the pools started off using the ACS – another is evolving into using an ACS as part of their solution and another identified early that in their case, use of an ACS would not add value to their proposed pooling arrangement."

Some of the pools also give the option of in-house investment, which Hamilton says many of the funds won't have had before. Border to Coast is one of the pools with this option. Elwell notes that the pool took the "tough decision" to allocate to Leeds (despite it being in West Yorkshire, which isn't part of the pool) as the city has a strong presence of financial service companies.

A long distance swim

Pooling has now begun, a process that

will take several challenging years to complete. JLT Employee Benefits senior investment consultant, Nick Buckland, notes that each of the pools is progressing in very different ways, and at different speeds.

"There may have been an unrealistic view held that once the pools themselves were established then it would be a simple task to transition the management of the assets," he says. "This however, couldn't be further from the truth, and whilst a not insignificant amount of effort was needed to create the pool entities in the first place, the hard work of creating the portfolios, appointing managers and transitioning assets is, in reality, a much more demanding task, at least in terms of time required."

But pooling should not be looked at in a point in time, argues Hamilton. He states that the pooling of assets is going to take place over the next two to three years on a phased basis. "When you look at the quantum of assets involved, this could never be a point in time 'big bang', so it was always going to be a phased approach, and that's what they're all doing at the moment very successfully."

Elwell says the pooling at Border to Coast is going "really well" with the majority of internally-managed equities now transitioned. The pool has three equity funds live that are all internally managed, and is about to go live with its first externally managed fund – a UK equity fund.

"We've also made really good strides in agreeing with the partner funds on what the global equity offering will look like, so we will be starting work on building that next year." Elwell expects the pool will have around £10 billion worth of assets invested in it by the end of the year, and £20 billion by the end of 2019.

Same pool, different lanes

Although the LGPS funds are pooling their investments, when it comes to other areas they are still very much

independent. Buckland explains that each administering authority retains the responsibility for setting investment strategy/asset allocation at a local level via their pension fund committee.

"Pension fund committees, therefore, are continuing to undertake training on areas such as investment strategy, funding and risk management at a local level as each fund will have different characteristics to another, even if they appear broadly similar based on size of assets and liabilities," Buckland states.

One of the key elements of the original consultation was that asset allocation has to sit with the underlying investors, and manager selection will sit with the pool. But if pooling is to be successful, and economies of scale achieved, then how independent can funds be on asset allocation?

"There will no doubt have to be some compromise along the way," Buckland says, "and it may be that pool by pool the line between where the role of the fund stops, and where the pool starts may blur slightly, ultimately they will all be looking to achieve the same goals."

So far, Elwell says Border to Coast has not had a situation where the funds haven't been happy to invest, which she says, is down to how the funds are designed. From the very start, the pool makes sure it understands the funds' needs and how many investment funds need to be created.

"We talk about *[investment allocation]*," she says however, "partly because we need scale to make it worth doing, and also the fact that they're collective vehicles. You shouldn't really have just one investor, it's ok to start with, but for us we need to launch things that more than one fund is likely to use. For us that is a very collaborative process."

Going for gold

When you speak to anyone involved with the funds, either the pools themselves, or those in the industry that work with the pools, it is very clear that everyone wants pooling to be a success.

"The LGPS is a big family," Elwell says. "We have had so much support from the other pools. I have regular meetings with the other CEOs. Everybody is very supportive of each other because we want this to succeed, and that ethos in terms of the pools supporting each other has very much come from how the partner funds all worked together previously."

As Hamilton notes, a lot of the challenges are being considered up front, and it is apparent of the thought and detail that is going into creating the pooled investments. Those involved, however, do not shy away from the fact that as time goes by the pools will evolve and adapt, especially to the changing needs of the LGPS funds.

"I think that overtime as the pools develop, it would only be natural to evolve, and for maybe some of the elements agreed at the outset to be revisited, revised and enhanced and improved," Hamilton says.

Going forward, there is also a desire for the pools to leverage their investment power to make positive societal benefits. A white paper by Northern Trust on LGPS investment pooling notes that the collective purchasing power is £260 billion. Not only that, but due to its government sponsored status, the LGPS is likely to be under a higher pressure to make a "wider positive societal contribution than many other institutional investors."

Hamilton notes that the Merseyside of the Northern Pool is active in the ESG space, and each of the pools will have discussed ESG and developed a policy. "I think we are seeing momentum and that will only grow as the amount of assets grow, and the maturity of the pools evolves."

It's also a desire from the Border to Coast pool, Elwell says. She explains that the partner funds want to have a "consistent focus" on responsible investment and have a "voice that means that you can actually make a difference to the way that the industry works".

Written by Natalie Tuck