

Call for evidence description – Submission from LGPS (E&W) Scheme Advisory Board

Scale and Consolidation

Q5 - To what extent has LGPS asset pooling been successful, including specific models of pooling, with respect to delivering improved long-term risk-adjusted returns and capacity to invest in a wider range of asset classes?

Asset pooling was intended to deliver benefits of scale, improved governance and decision making, reduced costs and improved value for money, and capability to invest in infrastructure.

SAB's [Scheme Annual Reports](#) show that LGPS funds generally hold more diversified portfolios than before pooling began. There are various drivers of this shift in asset allocation but funds certainly seem to now have the capacity and capability to invest in infrastructure and private markets.

Funds operate in a challenging recruitment and retention environment. Pools offer additional resource to assist with reporting, stewardship and due diligence on investments in asset classes where funds have less experience, such as private markets investments. For the pools with an FCA regulated company managing assets directly, rather than the platform model, partner funds have benefitted from their pool's additional in-house resource.

Lower costs were an expected benefits of scale and all pools can demonstrate that they saved costs for their partner funds. We do not recognise the Government's claim that fees for LGPS funds have increased by 70% since 2017. Despite our best efforts we are unable to understand how this figure was calculated from publicly available data.

In any event, the investment fees paid by the LGPS annually are driven largely by performance and size of AUM. It is to be expected that since AUM have grown significantly since 2017 then the fees in cash terms are higher. The standard basis for comparison of investment costs would be basis points and we are happy to work with MHCLG to conduct the necessary analysis to provide accurate comparative data. This would also need to take into account the shift into inherently more expensive asset classes such as infrastructure.

The SAB's Code of Transparency, established in 2017, was ground-breaking across the investment industry. It also led to an increase in disclosed fees, because it brought to light the full amount of fees actually charged. This additional disclosure is positive and allows fees to be better managed.

In relation to governance and decision-making, pools have developed and fine-tuned their governance arrangements over time to better suit the needs of their particular partner fund mix. All pools have transparent governance models which keep the partner funds – their owners/shareholders – at the centre.

The Board believes that implementing the Good Governance recommendations would be the most effective way to improve pool performance. This would support creation of a truly collaborative model, where funds take a strong and active role in the governance of pools and hold pool executives to account.

As each pool is at its own stage of development, and investment performance can

only be assessed over the long-term, it is too soon to evidence which pooling model delivers greatest value for partner funds.

Having effective member representative within the pool's governance structure is something the SAB strongly believes should be a requirement of any pool model. Only one pool does not have a permanent member representative in their governance structure, and SAB has raised this with that pool.

Costs vs Value

Q2 - Is there a case for Government interventions, aimed at employers or other participants in the market, designed to encourage pension schemes to increase their investment budgets in order to seek higher investment returns from a wider range of asset classes?

Decisions on asset allocation are the key driver of value in LGPS and SAB would be cautious about anything which distorted the proper consideration of the funds' fiduciary duty. The simplest way to increase the amounts invested in growth assets is to have a strategy to ensure the greatest number of eligible members are enrolled in the scheme (reducing opt-outs), and to protect eligibility through full implementation of the New Fair Deal policy, to protect members facing outsourcing or retendering.

The key concern for most employers in the LGPS (which are mainly but not exclusively local authorities of various types – there are also academy trusts, further education colleges and other admitted bodies), is that their employer contribution remains affordable. The Board has [calculated](#) that the average employer contribution across the LGPS (in England and Wales) is now 21% which compares very favourably to the employer contribution in the other large public sector pension schemes – which are all unfunded. Many LGPS employers contribute to more than one public sector scheme and are well aware of what good value LGPS is.

It is expected that employer contributions will continue the downward trend following the 2025 triennial fund valuations. This is largely due to sound investment decisions over the last valuation period, which have seen strong investment returns, and reducing liabilities due to rising gilt yields.

Most LGPS funds were in surplus at the 2022 valuation, many for the first time. This has resulted in increased pressure from some employers for their fund to “lock in” those gains and alter their investment strategies to de-risk and move to more defensive asset classes. LGPS funds have been very successful at seeking higher investment returns over the long-term, fully recovering the losses suffered in the global financial crash. However, given uncertainties over the future, many funds are likely to resist calls to derisk and continue to target strong returns. However, in this context, this may not be the time to incentivise a move into asset classes like venture capital as suggested. We would again emphasise the importance of holding to the fiduciary duty which ensures contributions are invested in the best financial interests of scheme members and employers. The primary purpose must be to achieve the required returns to pay pensions when they become due, minimising the need for additional funding from employers or local taxpayers.

Investing in the UK

Q1 - What is the potential for a more consolidated LGPS and workplace DC market, combined with an increased focus on net investment returns (rather than costs), to increase net investment in UK asset classes such as unlisted and listed equity and infrastructure, and the potential impacts of such an increase on UK growth?

There may be potential for more consolidation in the LGPS, but we are unclear whether this question refers to consolidation of investment pools or LGPS funds. If pools, then it is not obvious why further consolidation would drive “increased focus on returns” or further changes in asset allocation.

LGPS funds have always focused on risk-adjusted net returns rather than purely on costs, and recent [research by the Pensions Policy Institute](#) showed that the Scheme level is already one of the most diversified and ambitious pension schemes in the UK. While private sector DB pensions are the biggest investors in UK productive assets by value (£250bn), public sector DB schemes (essentially the LGPS) are the biggest investors in UK productive assets by proportion of funds (31%). At the same time, data from the Purple Book¹ suggests that equity investment in private sector DB schemes fell from 41% in 2011 to 18% in 2023.

Focussing on consolidation risks being a distraction that potentially leads to inertia around efforts to increase the level of pooling in LGPS. Why would a fund transition illiquid assets to their pool if they believe that pool may no longer exist a few years' time? Forced merger or consolidation should be avoided at all costs, as it is highly unlikely to lead to better outcomes, even over the longer term.

Where fund mergers have happened, these have taken years of collaboration and cooperation both before and after the transfer of functions from one fund to another (as usually happens, rather than an equal merger). It is important, as with investment pools, that any expectation around fund consolidation is conscious of all the risks involved in change and gives sufficient time for risks to be worked through, keeping the interests of scheme members at the forefront.

Although, it may be largely accepted that 87 funds is not ideal, the debate should acknowledge that being based in local government is important to many members and employers. Particularly in terms of accountability, democracy and accessibility.

The LGPS is a well-run scheme. It has very few complaints referred to the Pensions Ombudsman. The complaints are most commonly about ill-health retirement (due to the ill-functioning tier systems) whereas in private sector schemes complaints are more likely to be about administration. This fits with the Pensions Regulator's [report](#) which shows LGPS to be performing very well in relation to industry standards of governance.

The Board would like to see evidence-based decisions using comparable data. The new LGPS annual report guidance will help with KPI reporting from this year. The Board would also suggest commissioning a study of administrative effectiveness/efficiency not just between LGPS funds, but including other comparable schemes, eg other public sector schemes and maybe even Railpen or

¹ The Purple Book 2023, DB pensions universe risk profile. Available at: <https://www.ppf.co.uk/-/media/PPF-Website/Public/Purple-Book-Data-2023/PPF-The-Purple-Book-2023.pdf>

USS.

Question 3. *Is there a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC and LGPS funds to UK assets or particular UK asset classes, taking into account the priorities of the review to improve saver outcomes and boost UK growth? In addition, for the LGPS, there are options to support and incentivise investment in local communities contributing to local and regional growth. What are the options for those incentives and requirements and what are their relative merits and predicted effectiveness?*

SAB would prefer the option of Government action that increases the incentives to invest in UK assets. Ideally that could be done by increasing the volume of financially viable projects for funds to invest in. Government could achieve this through policy change in the tax system or devising a form of financing that guarantees minimum return on projects that would otherwise be deemed too risky for a pension fund to invest in. Anything which is seen to dilute the fiduciary duty or distort the decision-making process at the expense of returns is likely to be resisted by funds, other scheme employers and member representatives. It also risks having a detrimental effect on asset prices and returns as LGPS funds are “herded” into an inadequate supply of opportunities.

LGPS member benefits are statutorily guaranteed, they are not “savers” in the same way that members of DC pension schemes are and their pension is treated as deferred pay, rather than an investment pot. The investment performance of their LGPS fund is irrelevant to their benefits, which are paid in full regardless.

Some LGPS funds, like the South Yorkshire Pension Authority, have [a long history](#) of investing in their local areas. Others have needed their pool to be able to realise their desires to do so, [as was the case with the Cornwall fund](#). New ground is being broken in [working with metro mayors, as in Greater Manchester](#). This interest in local investment by LGPS funds is not an accident and nor is it typical of the pensions industry. No doubt this is due in part to investment decisions being taken by a committee made up of local councillors, elected to represent local areas. Again, implementation of our Good Governance recommendations would support local investment by a wider range of funds by ensuring that all decision-makers have the skills and knowledge to discharge their functions confidently and properly manage potential conflicts of interest.

LGPS funds often have a deep understanding about how their local economy works, which gives them a competitive advantage over other investors. But the key barriers are scale and supply of opportunities: we would like to see a deeper consideration of what can be done collectively to address those. Additionally, UK infrastructure projects have to be competitive with other opportunities around the world. We believe that central Government should take a more active role in this space, outlining a clear industrial strategy, supporting transition – similar to those offered in other jurisdictions (like the significant funding commitments announced by the European Union and the US Government).