



IFoA response to Ministry of Housing, Communities and Local Government consultation - Local Government Pension Scheme: Fit for the future

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Key points

- We think that the choice between compelling or encouraging the proposed standards for pools should be based on what will actually achieve buy-in and timely implementation of the Government's objectives.
- In general transfers of assets should happen where value for money is demonstrably improved. That assessment should include consideration of the cost and feasibility of ongoing oversight at the AA.
- There is a case for the pool to assume oversight of legacy illiquid investments, particularly if AA resource and specific knowledge diminishes over time.
- We recognise Government's desire to see pooling completed quickly. We note however that LGPS funds will have their next actuarial valuation as at 31 March 2025 and most AAs will need to review their fund's investment strategy once the valuation results are available. This will not only give AAs a problem of bandwidth, but a potential difficulty in implementing strategy revisions whilst assets are simultaneously transitioning to pools.
- There is merit in using local and regional knowledge to identify investment opportunities. Significant resource is likely to be needed to assess and implement these investments through pools, however, and there is a tension between the scale benefits of consolidation and the perceived desire to have impact at a small-scale, local level. AAs must ultimately have regard to their fiduciary duty.

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The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Ministry of Housing, Communities and Local Government's consultation *Local Government Pension Scheme (England and Wales): Fit for the future*. This response is by members of the IFoA Finance and Investment Board and Pensions Board and is written in the public interest.

IFoA's response covers the questions posed in Chapters 2 and 3 of the consultation paper on LGPS pooling and Local investment. We have not commented in detail on the proposals in Chapter 4 on Governance of funds and pools, but we are generally supportive of these, noting that they are closely aligned with previous recommendations from the Scheme Advisory Board.

Question 1

Do you agree that all pools should be required to meet the minimum standards of pooling set out above?

We think that in order to achieve Government's objectives, the choice between compulsion and encouragement should be made with a view to what will actually achieve buy-in and timely implementation.

Question 2

Do you agree that the investment strategy set by the administering authority should include high-level investment objectives, and optionally, a high-level strategic asset allocation, with all implementation activity delegated to the pool?

Figure 1 at Paragraph 32 provides a very helpful framework for the hierarchy of decisions within an LGPS fund, or indeed any pension fund. We agree that the highest level of decision-making, that is the setting of investment objectives such as required rate of return, investment risk appetite and liquidity requirements, should be made by the Administering Authority acting in its fiduciary capacity. In making these decisions, the AA must ensure that it allocates sufficient time and resource, in the form of its Pension Committee and supporting officers, and takes appropriate advice. We agree that once Pools are configured in the way Government envisages, they will be an appropriate source of such advice, though not necessarily the only source (see Question 5 below).

To the extent that an AA has a clear preference for a particular aspect of implementation, such as its own approach to local investment or to responsible investment, it should remain free to express this, as many LGPS funds currently do, whilst satisfying itself that it is consistent with its overall fiduciary duty (see Question 3) and that it is implementable in an efficient way within the envisaged pooled arrangements. This is one matter on which the Pool might usefully provide advice.

In theory, strategic asset allocation (SAA) can be delegated by the AA once it has set its strategic objectives, either to its Pool or to an advisor acting either for the pool or for the AA. This may be seen as analogous to following a Fiduciary Management approach, well established in the private sector and also in some other multi-employer schemes such as Railpen. In practice, many Administering Authorities are likely to wish to maintain involvement in the SAA process for the foreseeable future, and Pools are likely to wish to consult them in any case.

Delegation of all implementation beyond high-level SAA is likely to be efficient use of AA time provided, once again, that the AA is satisfied that its Pool has the skill and expertise to take it on. The AA will need to retain sufficient expertise to be able to monitor and hold the Pool to account for this implementation, or procure advisors to help it do so.

Question 3

Do you agree that an investment strategy on this basis would be sufficient to meet the administering authority's fiduciary duty?

We agree that setting investment strategy in this way is capable of meeting an AA's fiduciary duty and is likely to enable it to do so if pooling proceeds as Government envisages. However, fiduciary duty should be considered by a fiduciary in the context of its own circumstances from time to time and with regard to appropriate legal advice. No blanket or permanent assurance can therefore be given.

Question 4

What are your views on the proposed template for strategic asset allocation in the investment strategy statement?

We recognise the logic of focusing AA attention at the strategic level and resisting the temptation to over-specify allocations which, individually, are of secondary long-term significance (such as, for instance, the split between different kinds of credit or between regional equity markets). One approach taken by funds such as the New Zealand Superannuation Fund is to specify a very simple Reference Portfolio (in their case a passive portfolio of 75% Global Equities, 5% New Zealand equities, 20% Global Bonds in 2023). This does not prevent management from investing in a much wider range of assets under delegated authority but provides a comparator against which to judge the success of the actual portfolio over suitably long time frames.

As noted under Question 2 above, in practice many Administering Authorities will wish to retain more involvement in Strategic Asset Allocation and some kind of table like Table 2 at paragraph 37 will need to be produced. It is important that the AA and the Pool have a clear, shared understanding of the purpose and definition of each line in the table. For instance UK Government Bonds might be short-dated conventionals held for liquidity purposes or long-dated inflation-linkers held for liability matching purposes – the two have very different characteristics, potentially much more different than, say, listed and private equity.

Some aspects of the table seem intended to capture liquidity preferences e.g. splits between public and private assets and allocation to cash. We suggest that these preferences are better established as part of the AA's investment objectives. Specifying a cash allocation at the strategic level will usually be a drag on performance (or conversely a boon to the Pool in meeting its benchmark). A demarcation between public and private assets would need to have very wide tolerances to allow not only for lags in marking to market but also the undesirability of forced sales – or purchases - of private assets. The distinction between money committed to private markets and the amount actually invested at any point also needs to be well-understood by all parties. Systematic over-commitment is generally required in order to have money in the ground.

Taking these factors together, we suggest that Table 2 is better seen as an exemplar of the level of detail which might be appropriate, with actual SAA components being agreed between each pool and its Administering Authorities.

Question 5

Do you agree that the pool should provide principal investment advice on the investment strategies of its partner AAs? Do you see that further advice or input would be necessary to be able to consider advice provided by the pool – if so, what form do you envisage this taking?

LGPS Funds vary considerably in size, and somewhat in funding levels, maturity profiles and liquidity requirements. However, pooling effectively removes size as a differentiator between AAs, and in other respects the differences are not so great as to be incapable of parameterisation. It is also helpful that all LGPS funds have essentially the same benefit structures.

One might expect there to be efficiency gains, therefore, in coordinating the investment advice to AAs within pools and potentially also between pools. However, it is likely that some of these efficiency gains are already being captured through the consulting firms operating in the LGPS market and potentially shared with their clients. Indeed, there is probably more concentration of advice at present, at organisational level, than there would be if each of the eight pools served its own client base exclusively.

We recognise nevertheless some potential benefits in advice being procured for all AAs within a pool from one source since this makes it much more likely that it will be provided in a form which is implementable through the pool as a scale solution. The pool may be a natural place to coordinate the procurement of such advice, therefore, but it is important that the advice is not limited to what the pool wishes to implement. To the extent that pool staff are employed in the provision or procurement of advice, they should be separate from those carrying out investment management.

It is important that AAs maintain access to highly skilled investment advisors at a time when the focus of advice to private sector funds has naturally turned much more towards journey plans and risk transfer solutions. It may be that it makes sense for some of these skills to become housed within pools over time, but this may have implications for resourcing and remuneration structures within pools. These issues are similar to those which arise from in-house investment management.

It will also be important for AAs to retain access to independent advice as a second opinion to supplement the skills of its own pension committee. The existing practice of appointing independent advisors to pension committees is likely to continue to be helpful, but there is likely also be a role for investment consultants to play. It remains to be seen whether such work is attractive enough for firms to allocate resource to the LGPS in future.

Question 6

Do you agree that all pools should be established as investment management companies authorised by the FCA, and authorised to provide relevant advice?

We regard this primarily as a policy matter for Government to determine in consultation with AAs. Trustees of trust-based schemes are required to delegate day-to-day investment decision-making to authorised persons, and in practice large schemes have often set up their own FCA-registered firm so to do, though these tend to be more lightly regulated (OPS registrations) than the pools (AIFMs, where regulated). There has historically been no such requirement on AAs, but this may over time come to seem anomalous as other pension assets are increasingly clustered in large, regulated entities such as insurers and master trusts.

Question 7

Do you agree that AAs should be required to transfer all listed assets into pooled vehicles managed by their pool company?

Under the proposal for continued AA involvement at strategic level only, there is a logic to listed assets being held at the pool. However, transfer should not be forced where unnecessary costs would be incurred. In particular, many AAs have passive portfolios which track market-capitalisation-based indices. These are generally run at very low fees by commercial providers, often through their own pooled vehicles such as life

funds. There would be costs in unwinding such arrangements which might not be made good by future savings, if any.

In general transfers of assets should happen where value for money is demonstrably improved. That assessment should include consideration of the cost and feasibility of ongoing oversight at the AA.

Question 8

Do you agree that administering authorities should be required to transfer legacy illiquid investments to the management of the pool?

There is a case for the pool to assume oversight of legacy illiquid investments, particularly if AA resource and specific knowledge diminishes over time. Whether such an illiquid investment can safely be pooled with other AAs will depend on the nature of the investment, its compatibility with AA investment strategies, the discoverability of a fair price at which to make the transfer, and a fair allocation of the cost of ongoing management. This may be feasible for, say, an institutional real estate portfolio, but less likely for some other bespoke illiquid assets.

Question 9

What capacity and expertise would the pools need to develop to take on management of legacy assets of the partner funds?

To the extent that legacy assets can be accommodated within existing pool structures, there are relatively few ongoing resource implications, though time and care must be taken with the transfer itself, which will require significant project management.

Some pools are already building up teams to manage private investments, usually in conjunction with external General Partners, often with a view to co-investing in particular deals. Similarly in real estate, pools may have a mix of internal and external expertise at hand or in mind. Pools will naturally need to ensure that they are appropriately resourced before taking on the management of any legacy assets and the cost of so doing needs to be considered in deciding whether to effect the transfer.

Question 10

Do you have views on the indicative timeline for implementation, with pools adopting the proposed characteristics and pooling being complete by March 2026?

We recognise Government's desire to see pooling completed quickly. We note however that LGPS funds will have their next actuarial valuation as at 31 March 2025 and most AAs will need to review their fund's investment strategy once the valuation results are available. This will not only give AAs a problem of bandwidth, but a potential difficulty in implementing strategy revisions whilst assets are simultaneously transitioning to pools.

Question 11

What scope is there to increase collaboration between pools, including the sharing of specialisms or specific local expertise? Are there any barriers to such collaboration?

It would not be efficient for eight pools to develop solutions for everything independently of each other. In fact, that is not what happens at present since in many cases commercial firms provide similar services to several pools and AAs. There is a danger, therefore, that if all pools are encouraged to develop in-house

capabilities, there will be more duplication. Centres of excellence would be one way of avoiding this, if pools and AAs could agree on their locations. As well as the examples cited by Government, IFM Investors was set up some decades ago as a partnership between Australian Superfunds and is now a large international infrastructure investor. Competition between pools could make collaboration of this nature harder to achieve.

Question 12

What potential is there for collaboration between partner funds in the same pool on issues such as administration and training? Are there other areas where greater collaboration could be beneficial?

Some AAs already cooperate and collaborate on issues such as administration. At LPP, this happens through the pool but in other places such arrangements are direct between AAs. There is doubtless further scope for such arrangements. However, Third Party Administration is a competitive industry and it is not clear to us that this is a market failure which requires intervention.

Question 13

What are your views on the appropriate definition of 'local investment' for reporting purposes?

Whilst some LGPS funds have some very localised investments, many AAs may feel that the most appropriate definition of local is the UK. This is still a very small part of the global opportunity set, but is at least large and diverse enough for AAs to be able to direct money towards projects which have a satisfactory risk and reward profile. If compelled to invest very locally, in the absence of enough attractive local projects, some AAs may struggle to reconcile this with their fiduciary duty towards LGPS members. At the very least, investments made across the geographical area of each pool should be considered local to all partner funds within that pool, but even this would be a very unlevel playing field given the different sizes and economic characteristics of pool geographies.

Question 14

Do you agree that administering authorities should work with their Combined Authority, Mayoral Combined Authority, Combined County Authority, Corporate Joint Committee or with local authorities in areas where these do not exist, to identify suitable local investment opportunities, and to have regard to local growth plans and local growth priorities in setting their investment strategy? How would you envisage your pool would seek to achieve this?

There is merit in using local and regional knowledge to identify investment opportunities, particularly as these are likely to be naturally diversified from those coming through traditional channels. Significant resource is likely to be needed to assess and implement these investments through pools, however, and there is a tension between the scale benefits of consolidation and the perceived desire to have impact at a small-scale, local level. AAs must ultimately have regard to their fiduciary duty.

Question 15

Do you agree that administering authorities should set out their objectives on local investment, including a target range in their investment strategy statement?

Government has previously suggested that AAs reserve 5% of fund assets for local investment, on some definition. This is a level which might not affect overall return expectations very much, either positively or negatively. To that extent, it could strengthen stakeholder legitimacy without seriously imperilling fiduciary duty. However, that will be for each AA to determine for itself. Government can of course require AAs to record their approach, but this will not necessarily lead to more local investment. If Government is clear that that is what it wants, then incentivisation and compulsion are more powerful mechanisms.

Question 16

Do you agree that pools should be required to develop the capability to carry out due diligence on local investment opportunities and to manage such investments?

As mentioned earlier, there is a tension between capturing the benefits of scale and allocating resource to local investment opportunities, which may be numerous but small. It may make sense for pools to outsource this function to specialist firms.

Question 17

Do you agree that administering authorities should report on their local investments and their impact in their annual reports? What should be included in this reporting?

Reporting might be more appropriate at pool level than AA level. Given the likely differences in local opportunities, the temptation to make comparison between AAs or pools in this regard should be resisted.

If you would like to discuss any of the points raised in this response please contact Matthew Levine, IFoA Policy Manager (matthew.levine@actuaries.org.uk / 07525 808150) in the first instance.