Local Government Pension Scheme (England and Wales): Next steps on investments

LPFA CONSULTATION RESPONSE

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Contents

Consultation name: Local Government Pension Scheme (England and Wales): Next steps on investments

Submission deadline	Details	Contact
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This consultation seeks views on proposals relating to the investments of the Local Government Pension Scheme (LGPS). It covers the areas of asset pooling, levelling up, opportunities in private equity, investment consultancy services and the definition of investments.

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Who are LPFA

About London Pensions Fund Authority (LPFA)

LPFA is responding to this consultation as an Administering Authority and a £7.6 billion Local Government Pension Scheme (LGPS) pension fund for over 120 London based employers and 97,000 members. Together with co-shareholder, Lancashire County Council, LPFA set up the Local Pensions Partnership (LPP) pool in 2016. LPP consists of an administration business (LPPA) and an investment arm (LPPI). LPPI is the Pool in the context of this response.

LPPA is the pensions administrator of choice for public sector, fire and police pension schemes and helps over 2,100 employers and 660,000 members make sense of their pensions and save for their retirement.

LPPI, the regulated investment business, now manages approximately £25 billion in assets for its clients and focuses on delivering sustainable and long-term growth for LGPS Funds (Funds). They are a signatory to the LGPS Code of Transparency, the UK's Stewardship Code, the Taskforce for Climate Relations Financial Disclosures and the United Nations Principles for Responsible Investment.

As long-term, responsible investors, LPFA and LPPI have both made net zero commitments.

About our ethos

When LPFA was established in 1989, we not only took on responsibility for administering the former pension schemes of the GLC and Inner London Education Authority (both disbanded by then), but also for the payment of benefits to former GLC/ILEA employees who had been diagnosed with an asbestos-related disease. We also provide a compensation payment service on behalf of London boroughs and related organisations. In many ways, LPFA has been supporting consolidation and collaboration since 1989.

We have been fully pooled since 2021 and recognise the value that pooling, and scale, bring to our members. Working with LPPI, we have delivered over £65 million[1] in fee savings for LPFA Fund alone and our administration costs-per-member are one third less than pre-pooling levels.

However, as a Fund in one of the smaller LGPS pools, we also know the value that agility, cross-pool and cross-Fund collaboration brings.

In 2015, working with the Greater Manchester Pensions Fund, we set up GLIL, a £3.6 billion infrastructure fund. Lancashire County Pensions Fund, Merseyside Pension Fund, West Yorkshire Pension Fund and Nest are all now participants. Via GLIL, participating Funds have access to larger and more numerous investment opportunities than they would investing alone, improving outcomes for members.

In 2020, we set up the London Fund with London CIV and LPPI to help solve some of the capital's housing, digital, energy and infrastructure challenges while delivering returns for our members. More information can be found here.

We are also a committed responsible investor and have made a public commitment to being a net zero fund by 2050 or before, with significant progress by 2030. In line with our commitment to transparency, more information is on our website.

Executive Summary

Given our beginnings as a consolidator and with a unique governance model, LPFA believes strongly in collaboration within the LGPS and has always been willing to embrace constructive change within the sector. LPFA entered into "pooling" before it was mandated and not only contributed all its assets to its pool but agreed to adopt a fully outsourced fiduciary management model for its pool (whilst retaining control over setting its Strategic Asset Allocation). It has also outsourced its administration function and supports 17 other public sector clients participating in the LPPA administration business.

Accordingly, the LPFA is very supportive of the broad direction of travel towards greater efficiency and cost-effectiveness in the LGPS implied by the current consultation. Indeed, in many respects, LPFA considers that the Government can go even further to achieving its aims with additional reforms.

Unlike private sector schemes which are ultimately funded by a single (or group of) commercial employers and each of which has its own rules, the LGPS is a national scheme with a single set of rules and is funded, in the main, by public bodies with tax raising powers. LGPS is already one scheme with over 6 million members and assets of approximately £369 billion, but, in England and Wales, remains 85 separate Funds.

Each of the 85 Funds are "owned" by an administering authority (which has its own staff and advisers), runs its own pension administration and back office, has different actuaries, accountants, advisers and lawyers, and is governed by a pensions committee very largely

[1] Figure as at 31 March 2022, total net savings since pooling commenced.

made up of elected councilors supported by a separate statutory body in a Local Pensions Board.

Despite significant progress in pooling, there remain areas of the LGPS where barriers to progress and the Government's aims exist. The sector remains highly fragmented with multiple functions and decisions still taken unilaterally across the 85 Funds. There remains a lack of financial and investment expertise in a number of LGPS Funds.

Structurally, many Funds continue to operate models that proliferate investment funds ("funds") and replicate processes, resulting in embedded inefficiencies within pools.

Given there is only one LGPS with one set of rules, the current system has inefficiencies and will benefit from wider reform towards which this consultation on investment pooling can make a significant contribution.

We believe enhancements in four key areas can facilitate greater efficiency within the LGPS and support the Government's aims, namely Consolidation, Professionalisation, Delegation and Collaboration. We have outlined these in more detail below but will also refer to these throughout our responses:

> **Consolidation –** tackling the legacy fragmentation within the LGPS in England and Wales by incentivising the merging of Funds to boost savings, simplify governance structures and produce more efficient decision making. LPFA envisage a move towards consolidation of pools but believe this must be preceded by further consolidation of some of the Funds first to maximise benefits. Mergers have already reduced the number of LGPS Funds from 89 to the current 85.
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> **Professionalisation –** moving towards a model with independent Boards consisting of politically independent individuals with pensions expertise, overseen and selected by elected councillors. To begin with, consideration could be given to embedding independent professional chairs to pension committees, but this should not be seen as an "end solution".
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> **Delegation –** simplifying pooling and maximising its benefits by moving to a fully outsourced fiduciary management model and encouraging Funds to see the benefits of participating as clients, rather than always as shareholders.
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> **Collaboration –** Strengthening the LGPS and its pools through the promotion of collaboration, best practice and the ability for cross investment (by both pools and Funds). Greater collaboration on administration and back-office functions in addition to the investments would increase efficiency savings and enhance value for money for scheme members.

Within the LGPS system, investment pooling has brought considerable success but has not achieved all of the benefits originally envisaged. Consolidation of the investment pools could have potential advantages in the future, but these are secondary to Fund amalgamations and implementing changes designed to make the existing pools fully effective, especially since each of the pools has a different underlying model.

We believe the amalgamation of a number of Funds and a move towards a governance model made up of independent individuals with pensions or financial expertise appointed by elected politicians can deliver significant benefits to the LGPS.

Further, adopting a fully outsourced fiduciary management approach ("Delegation") under which all day-to-day investment decisions and manager selection is left to specialists within the pool can provide efficiencies and further drive professionalisation. Each Fund would have responsibility for determining its Strategic Asset Allocation (within a relatively limited set of broad asset classes) to reflect its individual circumstances, but the implementation of that strategy would be left to the Pool. Pools would no longer need to offer the extremely wide range of investment options they currently make available so as to enable individual Funds effectively to keep their chosen investments within a pool “wrapper”.

LPFA also believes a shift away from the ubiquity of shareholder status for Funds in pools would be a positive step to support future consolidation of Funds or even Pools. The current shareholder status of all Funds within Pools is a barrier to consolidation that feeds the proliferation of products outlined above whilst complicating governance. In practice, some Funds could obtain the “control” they need (including in relation to areas such as responsible investment) as clients of their pool under an appropriately drafted asset management contract, though clearly this will differ between Funds.

Under this model, the pools would potentially develop greater expertise and would be able, and should be encouraged, to collaborate (“Collaboration”) to enhance offerings further. Pools (or individual Funds) would be encouraged to invest in other pools which offered greater expertise in a particular area without incremental fee implications.

Over time, a single pool holding all LGPS investments might be considered but we suggest it is too early for such a development.

The Government’s aim of ensuring all assets are contributed to the pools is important to the realisation of efficiencies. LPFA fully supports this goal, alongside its other suggested reforms to maximise the benefits of pooling.

While LPFA is supportive of the broader aims of maximising pooling benefits and delivering for members, we do have concerns about the mandating of asset allocation that we believe could be counter productive. It is important to remember that the primary purpose of any pension scheme (including the LGPS) is to ensure that its members receive the pensions for which they have worked and which they deserve. This must be the criteria against which those charged with governing each Fund should make decisions.

Mandating asset allocations could place restrictions on how each Fund considers its own cash requirements. With many Funds now cashflow negative and requiring reliable flows of investment income, mandating allocations could be prohibitive to the ability of some Funds to meet their primary obligation of paying benefits as the asset class does not produce reliable investment income. As LGPS Funds continue to mature, the significance of this issue will only increase.

Further, investment decisions should not be mandated to reflect political policies, objectives, priorities or views, whether international, national or local as it could open long term and independent investment decision making processes to shorter term political priorities which can be subject to change.

Good governance and effective and professional management of Funds, pools and ultimately the LGPS will produce strong investment decision making and effectively diversified strategies to meet the needs of members. LPFA, for example, already invests around 8% of its portfolio in private equity and participates in two collaborative funds, GLIL and the London Fund, which invest in many assets that meet the Government’s levelling up definition.

In summary, LPFA strongly supports the Government's aim of maximising pooling benefits, but we believe more can be done. If the Government goes further by consolidating within pools, building expertise and effective fiduciary management as well as promoting collaboration, it could deliver its aims and more. We believe our four areas of focus can produce additional efficiencies and tackle the legacy barriers to pooling that can deliver improved performance.

For the avoidance of doubt, whilst LPFA believes its unique operating and governance model demonstrates that the proposals we are making can work, it recognises and fully accepts the possibility that its own status and position may need to change were those proposals to be more-widely adopted.

Our recommendations in full

To provide a straightforward overview of our core recommendations regarding the LGPS consultation, we have organised the recommendations and their rationale into a table below by theme.

The full recommendations with supporting evidence and analysis can be found in the Responses section.

Recommendations	Rationale
Consolidation	
Create the conditions to incentivise the further merging of Funds	By creating the conditions in which Funds are encouraged to merge, the Government can reduce fragmentation in the LGPS, reducing costs and improving efficiency. Indeed, a small number of Funds have already followed this path this in recent years
Professionalisation	
Appoint independent Boards with individuals of relevant skills to manage the Funds instead of Pension Committees	Establishing dedicated, independent Boards staffed with experts can improve the quality of oversight and enable better decision making
Delegation	
Adopt Fiduciary Management for the investment pools	Delegating investment decision making responsibility within the boundaries set by a strategic asset allocation would reduce governance costs and enable more efficient investment of fund assets
Not all Funds need to be shareholders in their investment pools	Simplifying governance structures through the adoption of a 'client model' for some Funds as opposed to an automatic 'shareholder model' would reduce governance costs without compromising the quality of oversight
Collaboration	
Encourage collaboration between Funds on a wide range of matters including investments, administration and back-office functions	Enabling greater collaboration between Funds will reduce spending on back office and administrative functions while providing Funds with greater opportunities for asset investment

Question Responses

The following section provides LPFA's full responses to questions outlined in the open consultation on the Local Government Pension Scheme (England and Wales). LPFA has answered questions that impact it, both directly and indirectly.

Chapter 2: Asset pooling in the LGPS

Question 1: Do you consider that there are alternative approaches, opportunities or barriers within the LGPS administering authorities' or investment pools' structures that should be considered to support the delivery of excellent value for money and outstanding net performance?

LPFA has always been a strong supporter of pooling and, more broadly of greater collaboration within the LGPS. Indeed, our pool (LPPI) was the first to be established and we have transferred all of our assets to it. LPPI operates on a fully outsourced fiduciary management model. We have also "pooled" (i.e., outsourced) our administration function. As at 31 March 2023, we understand that LPPI has the highest percentage of pooled assets in the LGPS.

Our commitment to pooling and a fiduciary management model has delivered significant benefits to our members and employers through materially reduced costs. As of 31 March 2022, total savings by LPPI from pooling amounted to £113 million. This represents 30% of the total savings from pooling across the LGPS even though LPPI accounts for only 6% of LGPS assets. Investment performance has also been strong with LPFA's performance being ranked very high in the PIRC table for the most recent year and more noticeably, top quartile performance over 5 years.

These disproportionate and substantial savings are the result of a number of factors. In addition to all our assets being pooled and the fiduciary management model, LPFA's unique governance structure and the comparatively small number of shareholders in our pool, have facilitated quick decision making in relation to investments.

Current barriers to improvement within LGPS

In spite of significant progress, there remain areas of the LGPS where opportunities for greater cost effectiveness and efficiency exist. The sector remains fragmented with 85 LGPS Funds in England and Wales, each of which has its own staff, advisers and governance arrangements.

Furthermore, shifts towards pooling, even if well-intentioned, remain slow and often at surface level with Funds continuing with individual strategies and investment decision making within pools. The inefficiencies of multiple agencies and funds are being masked by the veneer of pooling with many Funds still making individual investment decisions but simply holding the investment within a pool "wrapper".

The knowledge and expertise required to make effective investment decisions is becoming more onerous and complex in the pensions industry, requiring dedicated investment professionals with specialist expertise to achieve appropriate returns for the Fund and its members. Fund governance in the LGPS is still dominated by Pensions Committees made up of elected representatives. Where investment decisions and fund selection within asset classes is being set at Fund level by individuals without significant financial or pensions expertise, this takes up valuable political time and potentially leads to sub-optimal investment decision making.

Previous attempts to address these issues, primarily through asset pooling, have had real benefits but LPFA supports further reform to significantly improve the governance, expertise and structure of LGPS pools which we believe will deliver significantly enhanced efficiency and cost savings.

LPFA perspective on delivering value and performance in the LGPS sector

LPFA strongly supports the direction of travel underlying the consultation, specifically around accelerating pooling, promoting collaboration, improving governance and driving consolidation. Indeed, in some respects, we do not consider the proposals go far enough.

We believe that an additional focus on four key areas of reform of the LGPS can build an underlying structure and framework for LGPS to maximise the benefits of pooling: Consolidation, Professionalisation, Delegation, Collaboration. We have outlined these in more detail below.

For the avoidance of doubt, whilst LPFA believes its unique operating and governance model demonstrates that the proposals we are making can work, it recognises and fully accepts the possibility that its own status and position may need to change were those proposals to be more-widely adopted.

Consolidation – *tackle the legacy fragmentation within pools by incentivising the merging of Funds to boost savings and simplify governance structures and decision making.*

LPFA supports the promotion of merging Funds.

At present, to run its Fund, almost all of the 85 LGPS Administering Authorities in England and Wales, has its own staff to deal with administration and back-office matters, its own advisers (investment, actuarial, legal, etc), its own Local Pensions Board, and takes up time and capacity of local councillors and Officers.

Establishing 8 “investment pools” was an attempt to address one aspect of this inefficiency (which has only been partially successful).

Merging some Funds could produce even more savings and, with the right governance structure, lead to better decision making. It would also help solve the problem of retention of, and a lack of, specialist staff that many LGPS Funds are facing. This model would still allow for the different funding positions of each Fund to be taken into account.

Whilst consolidation of the investment pools could also have potential advantages in future, these are secondary to Fund amalgamations and implementing changes designed to make the existing pools fully effective. These changes include ensuring all assets are contributed to the pools and a fully outsourced fiduciary management approach adopted (as discussed below) under which all day-to-day investment decisions and manager selection is left to specialists within the pool. Each Fund would have responsibility for determining its Strategic Asset Allocation (within a relatively limited set of broad asset classes) to reflect its individual circumstances, but the implementation of that strategy would be left to the pool. It should be noted that mergers have already reduced the number of Funds from 89 to the current 85.

Pools would no longer need to offer the extremely wide range of investment options they currently make available so as to enable individual Funds effectively to keep their chosen investments within a pool “wrapper”.

LPFA also believe a shift away from the ubiquity of shareholder status for Funds in pools would be a positive step to support future consolidation of Funds or even Pools. The current shareholder status of all Funds within Pools is a barrier to consolidation that feeds the proliferation of products outlined above whilst complicating governance. In practice, many funds could obtain the “control” they need (including in relation to responsible investment) as clients of their pool under an appropriately drafted asset management contract. This is especially the case for those Funds with more limited resources.

Under this model, the pools would develop greater expertise and would be able, and should be encouraged, to collaborate to enhance offerings further. Pools (or individual Funds) could therefore invest in other pools which offered greater expertise or value in a particular area. Clearly, fee structures within pools would need to adapt to reflect this cross investment.

That expertise might well be internal to the pool but could extend to specialisation in the selection of external fund managers where that would produce better results.

Over time, a single pool holding all LGPS investments might be considered but we suggest it is too early for such a development.

Professionalisation – *moving towards a model with independent Boards consisting of politically independent individuals with pensions expertise, overseen and selected by elected councillors.*

Most of the 85 England & Wales LGPS Funds are linked to Councils and many have dedicated Fund Officers who have developed knowledge and understanding of LGPS investments, administration and pensions. However, the system remains overwhelmingly governed by councillors and Officers for whom the pension fund is only a part (in many cases only a small part) of their responsibilities. Although there is some training within the wider LGPS system, that system has no requirement for qualifications or knowledge-based assessment of sophisticated financial products, no governance threshold to meet, and no ongoing CPD to adhere to on an annual basis to keep skills and knowledge up to date.

Having the Fund run by a Board made up of appointed, independent individuals with relevant specialist skills (such as pensions administration, investment, ESG expertise, etc) and that can employ full-time staff at all levels to manage the Fund would lead to more effective decision making. It would also negate the short tenure of many councillors serving on pensions committees whilst avoiding potential political and investment related conflicts of local councillors.

. Indeed, if LGPS Funds were to merge, an independent Board may well be the most practical governance model. There would of course be a need for appropriate political oversight especially in the appointment (and where relevant, dismissal) of Board members as public money is involved but the Board would be responsible for the day to day running of the Fund. The precise form of political oversight might be different depending on the Fund so we do not wish to comment further but it would not be difficult to achieve in principle. LPFA is an example of such a model.

As part of a transition to such a model, consideration could be given to appointing suitably skilled and experienced pension professionals as Independent Chairs to pensions committees. These professionals could then help transition more appropriate training and best practice onto committees without any political or local considerations.

The above changes would lead to improved and faster decision making and minimise the possibility of conflicts of interest. This in turn would support the delivery of increasing value for money as well as improving performance. The impact of the above changes would also be enhanced by further consolidation of Funds and sharing of resources.

At the heart of this is the question of the appropriateness of the current approach to the concept of local accountability as part of broader professionalisation. LGPS is ultimately a national scheme and as the Government seeks to drive forward pooling and consolidation, as well as improving expertise to support the delivery of improved performance, the current approach to delivering local accountability may prove to be a hindrance.

Delegation – *simplifying pooling and maximising its benefits by encouraging an outsourced fiduciary management model and the ability for some Funds to exert their influence as clients, rather than as shareholders.*

Whilst pooling has had some success, pools have not yet produced the full savings that were originally anticipated for two main reasons: firstly, many Funds have not yet contributed all of their assets to their pool, an issue we address in our response to question two. Secondly, several of the pools have in practice designed a multitude of individual “offerings” so as to enable each Fund effectively still to make many of its own investment decisions but within a pool “wrapper”. This is both inefficient and a barrier to maximising the benefits of pooling.

LPFA believes that all pools should operate a completely outsourced fiduciary management model. With this approach, each pool would liaise with its clients to agree on a reduced number of asset classes it would make available (whether managed in house or outsourced to private sector investment managers, depending on the expertise within the pool). Each Fund would then decide on its Strategic Asset Allocation amongst those asset classes to reflect its own circumstances. The decisions as to which underlying investments to make or which external managers to hire would be made exclusively by the pool.

The pool of which LPFA is a part (Local Pensions Partnership Investments, LPPI) operates on this basis and has produced both strong investment returns and a disproportionate level of savings for the size of its asset base compared to other pools.

This approach would allow each pool to build up its own internal expertise across all asset classes (thus producing greater savings) whilst also facilitating the possibility of pools investing their monies with another pool and thus sharing expertise and best practice.

The benefits of delegation and consolidation could be further enhanced by changing the perspective that all Funds need to be shareholders of their pool. This is especially the case for those Funds with comparatively limited resources. Funds having the ability to shift their relationship to a client footing would simplify pool relationships further and enhance decision making processes. LPFA would suggest that appropriately crafted client service agreements could provide sufficient effective control for Funds (including in such areas as Responsible Investment, for example).

This approach would also allow individual Funds and pools to more easily access offerings from other pools if they wish. LPFA is a direct beneficiary of such an approach through its work with LPPI, particularly via GLIL and the London Fund. In the case of the London Fund, Partner Funds across 36 of the 85 England and Wales Funds have access to a significant return seeking, London centric investment vehicle that can make a real difference to Londoners and LPFA members alike.

Collaboration – *encouraging efficiency and cost savings within the LGPS by encouraging collaboration between Funds and pools on a wide range of matters including investments, administration and back-office functions.*

We agree that pure competition between pools is unhelpful but encouraging the pools to collaborate on offerings (especially if individuals pools have expertise in an area that another lacks) would represent progress. We suggest this, combined with the other reforms we are suggesting, constitutes a more effective option at this stage than forcing the existing pools with their current inefficiencies and very different underlying models to merge.

At LPFA we have embedded these principles in our approach as a Fund and in our relationship with our pool. LPPI's work with schemes outside our pool as part of GLIL and with the London CIV on the London Fund are examples of this.

Whilst the focus of collaboration historically has been on investment pooling, LPFA believes that Funds should also collaborate on such things as pension administration and back office functions as the potential savings are still material within the context of Local Authority budgets.

In particular, as the LGPS has a single set of Rules, outsourcing pension administration on a cost sharing basis amongst a number of LGPS Funds would also be more cost effective than each fund doing it internally (if costs are properly evaluated). The LPPA, the 'pooled' administrative function of which LPFA is a member, is again evidence of such collaboration working.

Question 2: Do you agree with the proposal to set a deadline in guidance requiring administering authorities to transition listed assets to their LGPS pool by March 2025?

Yes, LPFA supports the setting of a March 2025 deadline on the transition of listed Fund assets to LGPS pools. LPFA would note that deadlines have previously been helpful in accelerating the pace of reform in the sector.

The suggested date of March 2025 is of course when the next Actuarial Valuation is due and normal practice for Funds would then be to refine Investment Strategies in the following year. It may be that a March 2026 deadline is equally valid to allow full transition to be aligned with strategic direction of the Funds in one go, not over several moves.

We would also support re consideration of Valuation cycles moving from 3 years to 4 years to allow successful planning and execution of investment strategies in LGPS.

At LPFA we have seen first-hand the benefits of building a collaborative approach and properly pooling assets, driving savings for our members as well as improving our performance through scale. These benefits could be more fully realised across the LGPS with the transfer of all listed assets to pools.

However, the transition of all listed assets to pools would not alone be sufficient to deliver the full anticipated benefits. Reforming the underlying structures of the pooling system would also be necessary to address the existing barriers to reducing costs and improving efficiency.

As outlined in the response to question one, enhanced consolidation, professionalisation, delegation and collaboration each have a role to play in addressing the fragmentation, lack of expertise and onerous structures holding back the performance of Pools.

Question 3: Should government revise guidance so as to set out fully how funds and pools should interact, and promote a model of pooling which includes the characteristics described above?

LPFA agrees that guidance setting out how Funds and pools should interact would be helpful but we believe this guidance should be aimed at encouraging changes of mindset along the lines suggested in our responses to this consultation rather than setting out specific rules.

Specifically, LPFA believes that entrenching the principle of fiduciary management, where day-to-day investment decisions are made by professional experts, and reforming shareholder structures to reduce the complexity of decision-making processes, will be essential for the full realisation of the Government's aims. LPFA has set out how each of the Government's outlined proposals should be considered in light of these objectives below.

The characteristics are italicised with responses to each characteristic laid out below.

Pools should operate as a single entity which acts on behalf of and in the sole interests of the partner funds. For this reason, we do not see inter-pool competition as a desirable progression. This does not preclude the potential for inter-pool collaboration, which is encouraged by government.

LPFA agrees with the principle outlined but would add that in the current system, several of the pools have in practice designed a multitude of individual "offerings" to enable Funds effectively to make many of its own investment decisions but within a pool "wrapper". As pools grow in terms of assets and contributing partner Funds this will make for increasingly complex and constrained decision making on the part of the pool and reduces overall cost savings.

As we have stated above, LPFA believes that encouraging an outsourced fiduciary management model will be necessary if the Government is to simplify pooling and maximise its benefits. As a Fund we see the benefits of clear delegation to our pool, LPPI, whilst we, LPFA, still retain the responsibility for setting our strategic asset allocation.

Whilst we agree that competition between pools may not be desirable, we would suggest that partner Funds investing directly in other pools should not always be considered to be competition. This could be viewed more as collaboration, something which we believe should be promoted to maximise efficiency. We believe Funds should be able to leverage the opportunities and expertise available efficiently and cost-effectively across the LGPS pooling community. Some pools may have products or services that are not currently available in other pools (and it may not be cost effective for each pool to develop expertise in every area).

Requiring a Fund to invest in another Pool's product via a specially created vehicle or wrapper with its own pool creates unnecessary layers of fees and complication. Pools with the requisite regulatory permissions should be able to directly allocate from a partner Fund without the need for an additional layer. If a pool does not have the requisite regulatory permissions, or chooses not to provide "managing investments" as a service outside of "AUM pooled", the Partner Funds in that pool should be free to invest in another pool's vehicle.

Pools should be actively advising funds regarding investment decisions, including investment strategies.

LPFA completely agrees that pools should be actively advising Funds on investment decisions, including investment strategies. This aspect of the reform process would be best realised through (and would be an inevitable consequence of) the wholesale adoption of completely outsourced fiduciary management with the Funds deciding on their own Strategic

Asset Allocation across broad asset classes but the decisions as to which underlying investments to make (or which external managers to hire) made exclusively by the pool.

Local Pensions Partnership Investments, the pool of which LPFA is a part, operates on this basis, which has driven significant cost savings and improved returns over time.

Pools should be equipped to implement an investment strategy as instructed by their partner fund. An investment strategy should be interpreted to mean a broad instruction regarding asset classes and level of risk. It should not include an excessive number of classes, or choice of specific assets.

LPFA would wholeheartedly agree with this aspect of the proposals. As stated above, completely delegated fiduciary management should be utilised throughout LGPS. Funds would determine their Strategic Asset Allocation based on their own circumstances and risk tolerances following advice from specialists within their pool. The only role for external advisers would be periodically to assist the Fund independently to assess the performance of their pool.

Pools should expect funds to invest via their existing sub-funds where possible. This avoids an unfavourable scenario whereby an excessive number of similar sub-funds undermine the purposes and benefits of pooling.

The proliferation of sub-funds within pools acting as a constraint on investment decision making is an issue that we have already identified in this consultation response. Many Funds continue to operate models that proliferate asset offerings, replicate processes and embed inefficiencies in pools. This approach undermines the purpose and benefits of pooling.

As previously outlined, a fiduciary management model that empowers professional decision making would build on the benefits of pooling and significantly reduce costs as it has already done at LPPI.

Pool governance structures should be equipped to take quick decisions as opportunities present themselves, within the delegated remit of the fund.

LPFA completely agrees that pool governance structures should be equipped to take quick decisions within a broad delegated remit as outlined in a Strategic Asset Allocation. LPFA believes that the most practicable and cost-effective means of creating a structure capable of taking these quick decisions would be a completely outsourced fiduciary management model.

LPFA already operates a fiduciary management model that has reaped tangible benefits in Fund performance and cost reduction. More generally, LPFA believes that there is a balance to be struck between guidance and mandatory reform. On core principles of reform such as the above, the Government should consider mandating Funds to encourage professionalisation and improve governance and reporting.

Question 4: Should guidance include a requirement for administering authorities to have a training policy for pensions committee members and to report against the policy?

LPFA agrees that pensions expertise is an important requirement for effective decision making and that there are some factors which make the acquisition and retention of this expertise within the confines of current structures harder.

There already are training plans for Pension Committee members at a localised level and a requirement to institute a more formal training policy whilst welcome, would have only a limited effect in improving expertise levels without a more extensive series of reforms designed to encourage the enhanced professionalisation of LGPS. Training policies should be published and set out the administering authority's approach to delivery, assessment and recording of training plans.

Furthermore, where authorities are delegating less to their pools, they could be required to demonstrate higher levels of training and qualification amongst their Committee Members. This should include evidence of understanding following training and would be consistent with the training requirements for pool employees within a regulated manager. This more demanding training requirement could be reduced (or eliminated) to the extent an authority operates a fiduciary management model within their pool on the basis the authority is recognising the expertise sits within the pool.

We would also welcome the recommendations of the "Good Governance Phase 3 report to SAB" being implemented sooner rather than later and support the Pensions Regulator's new General Code being mandated in those areas of applicability to LGPS officers, councillors or pool staff.

As we have stated before in our response to question one, we believe there are significant benefits to be gained from professionalisation. Having Funds run by a professional Board made up of individuals with relevant specialist skills (such as pensions administration, investment, ESG expertise, etc) with the time and inclination to devote to rigorous scrutiny of these areas would make for better decision making. Such a Board would also typically experience a lower level of turnover in membership than pension committees.

As LGPS is a national scheme, the Government should assess, as it seeks to drive forward pooling and consolidation, whether local accountability as it is currently exercised within the system is a barrier to improvements.

The Government is right to champion greater expertise within LGPS as a guiding principle in order to deliver improved returns. Introducing professional Boards and more strategic oversight from Administering Authorities would contribute to the progress of reforms.

Question 5: Do you agree with the proposals regarding reporting? Should there be an additional requirement for funds to report net returns for each asset class against a consistent benchmark, and if so, how should this requirement operate?

Yes, LPFA believes in strengthening the governance of LGPS schemes through enhanced transparency measures such as scheme annual reports.

The utility of this benchmarking would be enhanced under a completely outsourced fiduciary management model. In such a system, with Funds setting allocations across broad asset categories, comparisons would provide meaningful insight to Administering Authorities.

Under the current system comparisons would have to be made across a significantly high number of overlapping asset categories existing within the sub-funds that make up pools, complicating the picture and undermining good governance.

We would caution however that an emphasis on metrics such as net returns could lead to inaccurate comparisons between schemes with differing objectives and risk profiles. Different Funds can have different funding requirements and therefore can seek different returns. It could also encourage focus on more short-term metrics whereas the LGPS Funds are open and are thus long-term investors. This could distort decision making in ways that would run counter to the objectives of reducing costs and delivering improved long-term returns.

Further areas of concern on a drive to a uniform benchmarking would include the possibility of herding and short-term behavior where Funds seek to minimise tracking error with respect to the uniform benchmark. This is especially the case if the benchmark is peer-based and based on one-year returns. This is what we currently see in other countries such as Australia and Chile.

For private assets, benchmarking is extremely difficult, and it is not clear that any body (whether government based or not) will be able to draw meaningful comparisons from such an exercise.

It may conflict with funds' additional mandates, such as the drive to net-zero. For example, a fund going green in the interests of producing enhanced long-term returns may face tracking error relative to the uniform benchmark in the short-term and therefore be penalised in years where returns of green stocks are lower.

Perhaps most importantly, an asset-specific uniform benchmark doesn't take into account a Fund's overall situation. Some Funds might choose to invest heavily in a particular investment because of its strategic properties at the total Fund level. Even if that investment underperforms the asset-specific benchmark, it might still be valuable for the Fund.

We would be supportive if there is appetite for benchmarking to assess the performance of every Fund, and here it may be more appropriate to develop a benchmark at the total Fund level, instead of the asset class level. This would be much easier to achieve if each pool operated under an outsourced fiduciary management model.

Consistent with LGPS being a long-term investor, any benchmark should be taken over an extended period of time (e.g., 5-year rolling period) in order to encourage long-term investing and allow for short-term fluctuations.

Finally, a benchmark could be made more Fund-specific, so that it is adapted to the Fund's asset-liability profile. A more mature Fund does not have the same risk tolerance as other more immature Funds so its benchmark shouldn't necessarily be the same.

There are several examples of how Funds around the world (e.g., CPP, PSP, NZSF, NBIM) have adopted an interesting path where they have both a reference portfolio and a policy portfolio. We welcome organisations such as CEM working to establish consistent conditions for LGPS reporting and benchmark and the Government should encourage more support for consistent benchmarking.

Overall benchmarking would be useful for introducing greater consistency and transparency in decision making, contributing to an improvement in the quality of governance in the LGPS sector, however the benchmark needs to take into account Fund specific criteria.

Question 6: Do you agree with the proposals for the Scheme Annual Report?

Yes, assuming information is standardised, and Funds are reporting consistent data. We believe this will require SAB to set out detailed requirements for how to categorise and calculate the data. However, without structural changes to address the multiplicity of entities involved in the reporting process, the value of the Scheme Annual Report in enhancing transparency and accountability as part of improved governance will be limited.

Chapter 3: LGPS investments and levelling up

Question 7: Do you agree with the proposed definition of levelling up investments?

It is important to remember that the primary purpose of any pension scheme (including the LGPS) is to ensure that its members receive the pensions for which they have worked and which they deserve. This must be the criteria against which those charged with governing each Fund should make decisions. We do not believe, therefore, that any investment decisions should be mandated to reflect political policies, objectives, priorities or views, whether international, national or local.

Ultimately, “levelling-up” is a government initiative and, regardless of how worthy, should not in itself be a measure against which LGPS investments should be determined. We believe that good governance and effective and professional management of Funds, pools and ultimately the LGPS will produce the strong investment decision making and effectively diversified strategies the Government is aiming to achieve.

Given the above, we do not have any additional comments to make on the definition, other than to note that amongst Funds where such an approach as we have outlined is already taken, a significant level of investments already meet the proposed definition. For example, investment in Infrastructure - as an asset class - is already seen by LGPS Funds as attractive and most Funds already have a substantial allocation to it. LPFA is particularly interested in it as shown by its investments (via LPPI) in GLIL and the London Fund, which both contain assets that meet the Government’s levelling up definition. As at 31 March 2023, 12% of LPFA’s approximately £7.7 billion was invested in Infrastructure.

Nonetheless, the criteria which must be adopted is firstly that any investment (regardless of asset class) must produce appropriate risk adjusted returns for the Fund in the interests of the provision of members’ pensions. If that investment also helps the UK, then that is a significant added advantage.

To that end, the Government could encourage LGPS Funds to provide investment for much needed capital infrastructure such as new schools, care facilities or hospitals. One possibility would be via an adapted (and lower cost) “PFI type” arrangement with LGPS Funds. Although this would involve detailed consideration, at a high-level this might involve the LGPS constructing and owning the relevant buildings which they would then lease on long-term contracts to local authorities/health trusts, etc. (underpinned by a government guarantee) which would operate and bear the cost of running the buildings. If held as part of an allocation to the infrastructure asset class (within a balanced portfolio) by a Fund, the required return to the Fund in these circumstances might be a form of “fixed interest” return and the resulting overall cost would very likely be less than private sector solutions currently available.

Question 8: Do you agree that funds should be able to invest through their own pool in another pool’s investment vehicle?

Yes, Funds should be able to invest through their own pool in another pool’s investment vehicle and we also believe that there are circumstances where funds should be able to invest directly into another pool’s investment vehicle. However, we do not believe that this alone will improve returns without further moves towards fiduciary management and away from the traditional shareholder model required to maximise the benefits of pooling.

Funds should be actively encouraged to ensure that pools are delivering good performance and collaborating effectively. In order to implement this, the Government will also need to encourage effective delegation and professionalisation of the LGPS sector.

Under the current system, Funds are generally unprepared to invest in investment vehicles unless they are shareholders. This acts as a brake on collaboration with Funds neglecting investment opportunities that could deliver better value for money or returns. Although each pool has attempted to address this, it remains a challenge and barrier to progress. In response, there are a range of interventions that can potentially support and expand the ability to invest. This includes investment in internal asset management capability as the Government has identified.

Investing in internal asset management capability as we have done at LPPI would also be beneficial for enhancing the ability to capitalise on investment opportunities. The LPPI model, with nearly half of the book internally managed, supports cost savings and improves performance.

The more widespread use of appropriately crafted client service agreements to replace automatic shareholder participation by each Administering Authority in its pool would allow Funds to maximise returns and reduce costs without compromising the overall quality of oversight. This approach would also allow individual Funds to move more easily between pools or access alternative investment offerings.

Simplified governance structures would also enable Funds to collaborate with a range of pools while continuing to support their own pools.

Question 9: Do you agree with the proposed requirements for the levelling up plan to be published by funds?

Reporting exposure against appropriately defined levelling up investments is not problematic, and government can legitimately express their own desire to see 5% invested and to require Funds to report transparently where they are against this objective.

However, this is different from requiring Funds to have a plan to invest 5%. As indicated in our response to Question 7, we do not consider “levelling-up” in itself to be an appropriate target or measure for LGPS.

LPFA is in favour of improving governance in the LGPS sector through a greater emphasis on transparency and accountability. Improved reporting has historically supported pools to deliver objectives or asset allocation targets.

Whilst we agree that investments that support levelling up may form part of a well-diversified portfolio, we believe that imposing a requirement for a plan to invest up to 5% may be problematic from a fiduciary duty perspective unless plans are heavily caveated in that regard – in which case these plans will be of limited value.

LPFA would caution that any future mandating of investment in line with the levelling-up objectives may complicate the primary aim of the LGPS in delivering pensions to its members. As stated previously, we believe that other structural reform will naturally encourage investments in these areas, as it has done within the LPPI Pool.

Question 10: Do you agree with the proposed reporting requirements on levelling up investments?

For the reasons given in response to questions 7 and 9, we would not support this proposal. However, we are supportive of the Government developing proposals to encourage LGPS Funds to invest even further into UK Infrastructure assets producing appropriate risk adjusted returns.

Question 11: Do you agree that funds should have an ambition to invest 10% of their funds into private equity as part of a diversified but ambitious investment portfolio? Are there barriers to investments in growth equity and venture capital for the LGPS which could be removed?

As outlined in previous responses, we do not support the mandating of specific asset allocation to pools. Government mandating of asset allocation could lead to the superseding of a Fund's primary purpose to deliver returns for members as well as being subject to short term political objectives. We believe that professionalisation and outsourced fiduciary management is a more productive route to building well-balanced, diversified portfolios that optimise savings and returns.

One significant barrier to greater allocations to growth equity and venture capital is the inconsistency of the investment horizon for such investments and the frequency of valuation for LGPS Funds. Three years is a relatively short period to assess any investment, and this is especially true for these early-stage private market categories. If Funds are concerned about short term mark to market requirements for assets which will likely require time to mature, they will be less likely to hold these assets. As previously referenced in our response, we would suggest Government seek wider views on the merits and challenges of extending valuation requirements for the LGPS.

As can be seen from LPFA, with our outsourced fiduciary management model, we currently invest across a diverse range of assets, including private equity. Around 8% of LPFA assets is currently invested in private equity.

Risks related to Private Equity target

LPFA also believes it is worth highlighting some specific aspects of private equity as an asset class that would impact on its mandated use within a balanced investment strategy.

- It is a broad asset class and by definition, excludes other forms of return-driving private asset classes such as private credit.
- True venture capital (i.e., investment in start-ups) is unlikely to be an appropriate investment for most LGPS Funds.
- A significant number of LGPS schemes are cash flow negative, and thus have a focus on assets which produce regular cash. However, private equity is an illiquid strategy and mandated investment could require more liquidation of assets to meet short term liabilities. This issue could potentially impact on the ability of certain Funds to meet their primary purpose which is to pay pensions to members. If the government is interested in encouraging investment in this area, it could consider incentivising this activity by other means such as introducing a mechanism to share in any reward or limiting any loss arising from such investments. In any event, any investment decisions will always be made in the context of the specific circumstances of the LGPS Fund.

We believe that once all schemes have professionalised their approach to investing, the pursuit of diversification would naturally lead to the allocations/investments outlined in the question.

Question 12: Do you agree that LGPS should be supported to collaborate with the British Business Bank and to capitalise on the Bank's expertise?

LPFA and LPPI have already met with the British Business Bank on a number of occasions to discuss collaboration and we respect its work in supporting investment into UK venture capital. We welcome the opportunity to continue to collaborate and explore the options for the LPPI to invest in venture capital without significant additional cost or risk.

Chapter 5: Improving the provision of investment consultancy services to the LGPS

Question 13: Do you agree with the proposed implementation of the Order through amendments to the 2016 Regulations and guidance?

LPFA agrees with the Government that implementing the Order through amendments to the 2016 Regulations and Guidance would improve the provision of investment consultancy services in isolation, as it does in the private sector.

However, we hold the view that the pre-existing supervisory arrangements placed on funds under SAA already effectively supervise these commissioning arrangements.

This duplication could be avoided if funds were to fully delegate the responsibility for day-to-day investment decision making to the pool. If the Government was to proceed with implementing the Order through amendments to the 2016 Regulations and guidance without introducing outsourced fiduciary management then it could potentially lead to each Fund setting opposing objectives to the pools.

Chapter 6: Updating the LGPS definition of investments

Question 14: Do you agree with the proposed amendment to the definition of investments?

We have no objections or more detailed comments on the proposed amendment.

Chapter 7: Public sector equality duty

Question 15: Do you consider that there are any particular groups with protected characteristics who would either benefit or be disadvantaged by any of the proposals? If so, please provide relevant data or evidence.

No.