

## Fit For the Future Consultation LGPS England and Wales

### Analysis and potential implications for LGPS Scotland

The consultation forms part of the UK Government's Phase 1 Pension Reforms (Phase 2 on adequacy of Automatic enrolment has been postponed indefinitely). The consultation was launched immediately after the chancellors Mansion House speech on 14 November 2024. It set out proposals in three areas:

- Pooling
- Local Investment
- Governance (LGPS Funds and Pools)

This paper summarises the proposals and sets out the points of interest and potential implications for LGPS Scotland. It also covers items which although expected did not appear in the consultation.

### Pooling

#### Background to pooling

In November 2015 the UK government published 'Investment reform criteria and guidance for pooling' since that date seven investment pools have been created across England with a further investment pool including all of the LGPS Funds in Wales.

There are essentially three different models of pooling as follows:

- The 'build option' which is used by Borders to Coast (B2C), Brunel, LGPS Central, London CIV (LCIV) and Local Pensions Partnership Investments (LPPI). This model has at its centre an FCA regulated asset manager wholly owned by its client Funds which runs a range of investment funds via an Authorised Contractual Scheme (ACS) as well as other vehicles and arrangements for alternative assets.
- The 'procurement option' which is used by ACCESS and the Wales Pension Partnership (WPP). This model has no central asset manager but rather makes use of procured FCA regulated services to run a platform of funds and vehicles which client LGPS Funds can invest in.
- The 'alternatives first model' which is used by Northern LGPS. This model also has no central asset manager and uses specific vehicles for client funds to invest in alternative assets. Investment in listed assets is retained by the client funds.

Progress on transferring assets into pool funds and vehicles has been varied with some LGPS funds transferring nearly all of their investment to the pool while a small number have not invested or transferred anything via their pool. Overall about 50% of assets in E&W are pool managed.

A history of pooling in England and Wales can be found on the E&W SAB website

<https://lgpsboard.org/index.php/structure-reform/investment-pooling-2015>

The UK government appears to have lost patience with LGPS funds in E&W and now seeks to standardise, accelerate and broaden the scope of pooling through the proposals set out in the consultation.

## Proposals on pooling

The consultation lists a number of proposals around pooling which we understand will be set out in legislation through the upcoming Pension Schemes Bill 2025. In summary these proposals are as follows.

All LGPS pools would be required to:

- Move to the 'build model' by April 2026.
- Be the principal provider of strategic investment advice to their client LGPS Funds by April 2026.
- Develop an in-house investment capability 'over time'.
- Develop the necessary expertise and resource to provide due diligence on local investment opportunities by April 2026.
- To be able to take on the management of all LGPS Fund assets not transferred into pool funds or vehicles by April 2026.

Pools must submit their plans to achieve the above (or merge with a pool which can) by March 2025. It would appear the tight timescale is deliberate in the sense that UK government does not expect all of the pools not currently using the build model to be able to meet the April 2026 date thereby reducing the number of pools.

LGPS Funds:

- Would continue to set their investment strategy however UK government's strong preference is that the pool sets the Strategic Asset Allocation (SAS).
- Must delegate all implementation decisions including manager selection to the pools.
- May set the SAS but must do so using a limited template of asset types.
- Can only take external investment advice in exceptional circumstances (the stated aim being to end the Investment Consultant market for LGPS Funds in E&W).
- Must transfer all listed assets to pool funds or vehicles by April 2026.
- Must transfer any non-pooled alternative assets to the management of the pool by April 2026

## Learnings and implications for Scotland

LGPS Scotland did not follow E&W down the path to pooling and therefore there are no direct implications for LGPS Funds here.

However, the consultation does clarify a number of points with regard to the UK government's preferences for pooling investments namely:

- That their preferred model of pooling is one which in many ways is similar to the Fiduciary Management (FM) model in place for private sector pension schemes.
- However unlike the FM model there does not appear to be the flexibility for LGPS Funds to change to another manager nor to procure external oversight of that manager.
- They do not see the need for or value in each LGPS fund having an Investment Consultant

Therefore any developments in this area in Scotland may wish to include the model and delegations as set out in the consultation at least as a starting point.

## Local Investments

It was clear before the consultation that despite existing LGPS allocations to 'impact investment' in the UK a primary objective of the UK government was to encourage more investment in UK growth assets. The consultation sets out how it wishes LGPS Funds in E&W to meet this objective.

### Proposals on Local Investment

The consultation sets a definition of local investment as investments local to any of a pool's client LGPS Funds, or investments in their region (or in Wales, for Welsh LGPS Funds). It also invites views on other potential definitions which acknowledges that some pools and Funds have no obvious geographical boundary (e.g. B2C and the Environment Agency).

The proposals are in summary:

- LGPS Funds to set out their approach to Local investment as part of their Investment Strategy. This must include high level objectives and a target range for local investments.
- LGPS Funds to take account of local growth plans (or work with local authorities if no local growth plan is in place) when setting their objectives and targets.
- LGPS Funds to work with Combined Authorities (CA), Mayoral Combine Authorities (MCA), Combined County Authorities (CCA) or the GLA, or local authorities in other areas, with a view to identifying potential local investment opportunities for consideration by their pool.
- LGPS pools to provide due diligence on all opportunities identified and make the final decision on whether to invest. In doing so pools would be expected work closely with their client LGPS Funds CAs, MCAs or CCAs, and other relevant authorities (including the GLA in London and Corporate Joint Committees in Wales) to support local investment.
- LGPS Funds to set out the extent and impact of their local investments in their annual report.

### Fiduciary Duty

In the consultation the UK Government states that it is satisfied that the proposals on pooling enable LGPS Funds to continue to meet their fiduciary responsibilities. There is no further detail provided to back up this statement which should be considered in the light of:

- The lack of clear legislation in this area
- The differing views on the extent of fiduciary duty on LGPS Funds
- Further KC advice received by the E&W SAB

### Learnings and implications for Scotland

It seems clear from correspondence with the Board in 2024 that the Scottish Government is interested in exploring ways in which LGPS Funds could invest more in local opportunities while continuing to meet their fiduciary responsibilities.

The proposals for E&W do not set any mandatory directives with regard to the type or amount of local investment LGPS Funds should include in their portfolios. A similar approach could potentially be followed in Scotland taking into account the proposals in the consultation which set out:

- A definition of local investment which if transposed would include any LGPS fund area or the whole of Scotland
- A model for the setting of strategy and targets which could be replicated for Scottish LGPS Funds
- A framework for the development and sourcing of investment opportunities through local and regional government. Although Scotland does not operate a CA, MCA, CCA regime there are potentially regional organisations which could participate such as Scottish Enterprise and EDAS
- The framework for due diligence and decisions. The major element in the E&W proposals which is not directly replicated in Scotland is an investment vehicle (the pool) capable of performing significant amounts of due diligence, making informed investment decisions and implementing those decisions at a multi LGPS Fund and/or national level.

## Governance

The consultation sets out a range of proposals in the area of governance for both LGPS Funds and Pools. The origin of many of the Fund proposals are the E&W Good Governance recommendations from 2021. More details on this project and the recommendations made by it can be found at <https://lgpsboard.org/index.php/projects/good-governance>.

### Proposals on Fund Governance

The proposals for LGPS Funds cover a range of areas of governance and will we understand be contained in guidance as well as or instead of regulation. T

The proposals are that LGPS Funds

- Appoint/nominate a single LGPS senior officer to have delegated responsibility for the management and administration of the Fund as their primary role and in particular ensure that the LGPS function has sufficient resourcing to meet its duties.
- Participate in biennial governance reviews including producing, if necessary, a plan to address issues identified as requiring improvement. The review is to be carried out by a independent experts with a good knowledge of the LGPS. A 'Peer Support' regime is to be developed by the E&W SAB to support funds.
- Prepare and publish a governance and training strategy (replacing the governance compliance statement), including a conflicts of interest policy, and a pensions administration strategy (currently not mandatory).
- Reduce the size and complexity of Fund annual reports by MHCLG removing the requirement to include a number of the policies within it.
- Must ensure that that committee members, the senior officer and officers should have the appropriate level of knowledge and understanding for their roles, and that the requirements for pension committee members and local pension board members should be aligned.

There is also one further proposal which was not included in the E&W Good Governance recommendations – that LGPS Funds:

- Should appoint a suitably experienced and qualified independent advisor/committee member to provide expertise and continuity. It should be noted that this role is envisaged to be wider than that

performed by the independent investment advisor used by many LGPS Funds in E&W and more akin to a professional trustee in the private sector.

## Proposals on Pool Governance

Both the consultation and subsequent discussions with UK Government officials make clear that the governance model for LGPS pools is heavily reliant on LGPS Funds taking an active role as a shareholder of their pool. The view from UK Government is that LGPS Funds will not need to change their pool (i.e. move from one pool to another if they are unhappy) as they can change their pool (i.e. use their shareholder power to change the direction, management or board of their pool).

The proposals included in the consultation are:

- Pool boards to include at least one shareholder representative
- A requirement for pools to publish investment performance and transactions costs.

The consultation also asks for views on how best the voices of scheme members can be heard within pool governance structures.

## Learnings and implications for Scotland

Taking the pool governance proposals first. There are no direct implications for Scotland as there are no pools, but as with the pooling proposals set out at the start of this paper, the proposals provide a good understanding of UK Government's preferences in this area. However it should be noted that a significant number of (public) responses (including Barnett Waddingham's) seek to make the case that the proposals do not go far enough and further oversight of pools beyond that envisaged in the consultation will be necessary.

The governance proposals for E&W Funds seem to have, in the main, met with a broad welcome in that they are based on the SAB Good Governance recommendations from 2021 which at the time garnered broad support.

There are a few areas of the proposals which have been questioned in public responses and would benefit from further clarity before any consideration could be given to their adoption in any form in Scotland:

- Guidance by CIPFA on the proper relationship between the Senior LGPS Officer and the Section 151 (Section 95 in Scotland) Officer.
- Clarity on what happens should an LGPS 'fail' the independent review
- Guidance on the recruitment and appointment process for the independent advisor.

## Expected items not in the consultation

### Member representation

The E&W Good Governance recommendations included a requirement for LGPS Funds to set out their policies on scheme member representation, including on pool governance structures. The consultation is silent on scheme member representation at the Fund level and contains only a request for views on hearing the member voice at the pool level.

Given the expected closer relationship between the new UK Government and Trade Unions this was a surprising omission.

## Fund Mergers

There was a significant amount of trailing of the mansion house speech in the press prior to the publication of the consultation. Headlines such as the creation of Canadian style superfunds were prevalent and there was a significant number of statements around the inefficiency of 86 funds in E&W.

In the event the consultation does not mention fund mergers in any form mandatory or otherwise. We understand this was in recognition that forcing such mergers could delay the implementation of local investment. From further discussions with UK government it has however been made clear that fund mergers are definitely not off the agenda and that 86 funds are still too many.

We understand the UK Government is continuing to consider its options in this area including mandation and/or the encouragement of the use of existing Combined Suthority legislation to voluntarily merge funds into a smaller number of South Yorkshire Pension Fund style single purpose pension authorities.

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