

To: [pensions.review@hmtreasury.gov.uk](mailto:pensions.review@hmtreasury.gov.uk)

25 September 2024

## Pensions Review September 2024

### London CIV Response

I (Dean Bowden, Chief Executive), write on behalf of London LGPS CIV Limited (London CIV) the pooling company for the 32 London Local Authorities and City of London. London CIV was established as a FCA authorised and regulated company in 2015 and now has £17.1bn assets under active management which means that after a further £14.5bn passive fund assets considered pooled are added over 60% of London LGPS assets are pooled. London CIV has 18 funds which invest in public markets and 6 in private markets. London CIV was established as a voluntary venture by its partner funds, before LGPS pooling was mandated as government policy, to take advantage of the potential opportunities afforded by pooling the pension assets of the London LGPS. Collaboration and compromise have been the key to the success of the London pooling community, especially in the last 2 years.

### Executive Summary

- London CIV was established as a voluntary venture by its partner funds to take advantage of the potential opportunities afforded by pooling the pension assets of the London LGPS.
- The LGPS pooling ecosystem has continued to evolve and the London LGPS has continued to innovate. Together we aim to develop a model that looks beyond pooling assets in public and private market funds to ensure a resilient LGPS.
- Partner funds remain responsible for their investment strategies and we are ever conscious of the tensions to be balanced in assisting funds in meeting fiduciary responsibilities and taking the opportunities to deliver a UK and “local dividend”.
- The LGPS is currently well funded, but actuarial assumptions and markets change, and investments must match local risk profiles in order to achieve a stable contribution rate that delivers the pensions that local government workers expect without impacting on the delivery of local authority services.
- The London CIV future model includes: the provision of advisory and discretionary services, asset allocation, services that provide management of hard-to pool assets such as property and enhanced reporting i.e. climate data reporting; management of passive funds; joint procurement to reduce fragmentation and waste.
- The London CIV model has provided opportunities to access a private markets range with a bias towards UK investment which includes (Renewable) Infrastructure, UK Housing, Real Estate, Nature Based Solutions and Private Debt.
- We are now working with our 32 partner funds on priorities for the next phase of our pooling programme including the remaining £9bn of liquid assets off pool. We expect to make meaningful progress by March 2025 to transition assets but a March 2026 date is more realistic for a phased programme.
- In our view the most effective LGPS model is one where each pool can evolve organically as the pooling ecosystem overall evolves. Convergence rather than forced mergers are most likely to deliver Governments desired outcomes in the most timely manner with the least friction.
- In our view decisions about investing in the UK are best made as part of investment decision-making which considers opportunities on a risk and return basis.

- As regards incentives we suggest enhanced supply and creation of credible opportunities is preferable. The proposed National Wealth Fund might be one such route.
- We expect to be held to account, to report annually, and to have comparisons made using measures applied elsewhere in the market, and indeed this happens already using the FCA's Assessment of Value and in a suite of statutory and regulatory annual reports. We already use this as the basis of dialogue with our partner funds as to where change is needed and are discussing with them how we can develop our framework about how we achieve change where fund performance is less satisfactory than we would expect.
- We recognize that there are potential concentration risks associated with LGPS pooling as with further consolidation of the DC market and expect this risk to be kept under review as part of LGPS reporting both as regards management risk and investment risk.

## The review questions

The review, which covers both the DC market and the LGPS poses a total of ten questions under three headings. Of those four are explicitly directed at the LGPS and our response focuses on these. However other questions raise relevant issues and where this is the case we have commented on the issues to be considered in relation to the LGPS. The most obvious example is question 1 in respect of the benefits of consolidation and issues in respect of concentration risk.

## Scale and consolidation

1. *What are the potential advantages, and any risks, for UK pension savers and UK economic growth from a more consolidated future DC market consisting of a higher concentration of savers and assets in schemes or providers with scale?*

We have not addressed the broader questions in respect of the DC market.

There are issues to be considered in respect of consolidation of the LGPS. Asset pooling has been advantageous in obtaining access to new investment opportunities and achieving investment at a scale which reduces the cost of investment. Collaboration through partnerships such as London CIV potentially reduces duplicate costs and the burden of administrative and consultancy fees on pension funds.

The LGPS has continued to evolve and we expect to continue to innovate, achieving benefits through convergence. Clarity about the direction of travel and respective roles of pool companies and local authority pension funds is critical for pooling to be a success. Otherwise, there is a risk that fragmentation is not addressed and the opportunity to reduce waste is missed, with time and energy diverted on legal challenge, and opportunities to achieve positive outcomes for pension scheme beneficiaries and other wider stakeholders missed.

However, scale brings concentration risk and it is important to be able to invest in quality assets. We therefore expect to see ongoing monitoring of concentration risk, which might potentially be undertaken as part of LGPS scheme wide reporting on a regular basis. This should consider both investment risk and also management risk. This is a matter of managing risk rather than an argument against further LGPS pooling. It is a reason why convergence rather than merger is to be preferred. It allows change to take place in an organic managed way built on partnership rather than a forced way which could result in unintended consequences and outcomes.

2. *What should the role of Single Employer Trusts be in a more consolidated future DC market?*

This question is directed at DC schemes and a response has therefore not been made.

3. *What should the relative role of master trusts and GPPs be in the future pensions landscape? How do the roles and responsibilities of trustees and IGCs compare? Which players in a market with more scale are more likely to*

*adopt new investment strategies that include exposure to UK productive assets? Are master trusts (with a fiduciary duty to their members) or GPPs more likely to pursue diversified portfolios and deliver both higher investment in UK productive finance assets and better saver outcomes?*

This question is directed at DC schemes and the role of master trusts and GPPs and a response has therefore not been made. We have not sought to apply the issues to the LGPS context.

4. *What are the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors?*

This question is directed at DC schemes and a response has therefore not been made. We have not sought to apply the issues to the LGPS context.

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

The real test of the LGPS pooling is whether it delivers long term value and on its original aims, bearing in mind that we are only 10 years into a 15 year programme with most funds launched in the last five years. Reviewing each of the aims for London CIV specifically;

- i) **Economies of scale** can be measured in several ways. Using the Annual Reports net savings measure based on CIPFA guidance London CIV has delivered £86m of savings to partner funds since inception. Pools also add additional value e.g. services that third parties would usually have charged for e.g. climate reporting service, training, and a greater stewardship and engagement “reach”.
- ii) **Access to asset classes** The London CIV model provides access to a diverse range of private markets solutions many with a UK investment bias for example (Renewable) Infrastructure, UK Housing, Real Estate, Nature Based Solutions and Private Debt. London CIV also offers public markets solutions to meet specific investment requirements, e.g. Paris aligned equity exposure and fixed interest solutions that help match liabilities.
- iii) **London CIV’s governance model** is designed to ensure high engagement with partner funds whilst making use of an FCA authorised and regulated company to ensure that investments are managed using professional expertise, with greater oversight of any third party investment managers used. Partner funds are both shareholders and clients and the reserve powers in the shareholder agreement ensure partner funds have a say in the strategic plan and financial strategy for the company. The model also ensures the involvement and engagement with stakeholders including Trade Unions (representing beneficiaries), Leaders of Local Authorities, Pension Investment Committee Chairs, S151 and Pension Officers.
- iv) The LGPS scheme is a **long term investor**, and pools are relatively young. London CIV has been adding to its portfolio of funds over ten years in response to partner fund demand so as yet it is difficult to assess the long term risk adjusted return point in a meaningful way.

Looking forward:

- The London CIV future model includes: provision of advisory and discretionary services, asset allocation, management of hard-to pool assets such as property and enhanced reporting; management of passive funds; joint procurement to reduce fragmentation and waste. We are working with our partner funds on the next phase of our pooling programme including the £9bn of liquid assets held outside of the pool. We expect a March 2026 date to be more realistic than 2025 for migration of these assets into the pool.
- Partner funds retain responsibility for investment strategies and we are ever conscious of balancing the tensions in assisting funds to meet fiduciary responsibilities and taking opportunities to deliver a UK and “local dividend”.

- Local authority pension funds have a duty to pay good pensions to local authority workers. The LGPS is currently well funded through good investment management focused on that goal. Actuarial assumptions and the market change, and achieving a stable contribution rate is important to ensure local authority employers can deliver services to residents

## Costs vs Value

*1. What are the respective roles and relative influence of employers, advisers, trustees/IGCs and pension providers in setting costs in the workplace DC market, and the impact of intense price competition on asset allocation?*

This question is directed at DC schemes.

As regards LGPS schemes our goal has been to reduce the fees paid to investment managers and at the same time deliver added value. Added scale has provided an opportunity to negotiate on fees and we believe that greater asset pooling increases the opportunity to do so.

We expect that as the pooling LGPS ecosystem develops advisers will play a key role in supporting partner funds in overseeing the activity of the pools and would hope that this includes dialogue on the insight to reduce costs in a transparent way which truly recognises the role of pools as a shared service supporting the administering authorities.

We expect to be held to account, to report annually, and to have comparisons made using measures applied elsewhere in the market. Indeed, this happens already using the FCA's Assessment of Value and in a suite of statutory and regulatory annual reports. We use this as the basis of dialogue with our partner funds as to where change is needed. Additionally, we are discussing how we can develop our framework about how we achieve change where fund performance is less satisfactory than we would expect.

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

We believe that the Government's role should be to create opportunities to invest and consider the balance between encouraging foreign investment and providing opportunities for investment by UK pension funds. It is our understanding that this idea lay behind the creation of a National Wealth Fund.

The decision to invest must always be taken on its own merits in the interests of the fund.

## Investing in the UK

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

The primary focus of any investment should be the net return it is contributing to the portfolio, given the level of risk that is being taken, any shift to this lens away from a pure cost focus, is therefore appropriate.

The impact of consolidation and a focus on net return needs to be considered on an individual asset class level. Pipelines and the opportunity to invest are imperative. Taking broad classes in turn:

- Listed equity: Firstly large cap equity is not necessarily beneficial to UK growth. 80% of revenue for the FTSE100 is internationally derived. To get benefit for UK means moving down the cap scale, where large scale investment can actually be a detractor i.e. through moving markets and artificially inflating prices.

- Illiquid assets: scale does lead to a greater ability to access opportunities and drive down costs. This is clearly the area that consolidation of pension scheme assets can have the biggest impact in. There is demand for UK assets in this area, but the supply of credible, investable opportunities needs to increase.

In our view decisions about investing in the UK are best made as part of investment decision-making which considers opportunities on a risk basis and this includes place based criteria. Investment in our private markets portfolio has a strong UK bias and went up by nearly a third in 2023/24. This is demonstrative of the government's belief that pooling LGPS assets increases our ability to invest further in the UK.

The UK Housing Fund and Real Estate Long Income (RELI) Funds are 100% invested in the UK. The Renewable Infrastructure Fund is 42% and the Infrastructure Fund 35% invested in the UK. London CIV also has experience of establishing The London Fund.

The current system means that multiple parties influence decision-making and derive income from providing services. This leads to inconsistency of advice and investment solutions across the LGPS, and duplicative activity, all of which contributes to fragmentation and waste.

The enhanced service model now offered from London CIV, designed in collaboration with partner funds, includes the provision of investment strategy advice, asset allocation and reporting to pension committees, is designed to reduce this fragmentation and inconsistency. We believe it is possible to offer the choice partner funds require within this framework.

Greater consistency, whilst respecting the fiduciary obligation of and decision-making authority of partner funds, would lead to increased consolidation through convergence on an organic basis.

In order to achieve the benefits of collaboration we believe that Government must set out the roles and responsibilities of the different parties in the LGPS environment with greater clarity.

2. *What are the main factors behind changing patterns of UK pension fund investment in UK asset classes (including UK-listed equities), such as past and predicted asset price performance and cost factors?*

At a very high level, provided below are the patterns of UK pension fund investment we have observed, which we suggest should be considered in developing policy, in particular if the desired outcome is to achieve UK investment:

- UK listed tends to equate to alignment to global indices
- Similarly passive fund investments (at lower cost) tend to imply a move away from UK investments. A focus on cost alone has driven much investment into this area.
- UK Fixed Income investments remain predominately in sterling to avoid currency risk
- Infrastructure investment is predominately UK based when the LGPS is considered.

In other words the greatest focus in terms of creating new opportunities for UK investment in respect of the LGPS is likely to be private market investment. This is London CIV's recent experience and investment in our private markets portfolio which has a strong UK bias went up by nearly a third in 2023/24.

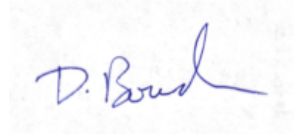
3. *Is there a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC and LGPS funds to UK assets or particular UK asset classes, taking into account the priorities of the review to improve saver outcomes and boost UK growth? In addition, for the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

In our view incentives are preferable to requirements which potentially lead to poor outcomes. Incentives which take the form of opportunities are the best answer. The incentive to invest should be returns and no further incentive should be necessary. The return should “make the case”.

As we explain in our answer to question 1 in this section the LGPS is already making a significant investment in the UK through private market investments based on investment criteria. We report on this in our Annual Report, and partner funds report on this as part of LGPS reporting, which serves to ensure ongoing dialogue on this important issue. The potential to deliver a “local dividend” is one which elected members in particular continue to debate in addition to place based investment as part of investment strategies.

The LGPS is currently a fully funded scheme and we suggest that it would not be advisable for the government to create a requirement to invest in the UK since this would imply an obligation on the government to underwrite the potential liability that rests on fiduciaries which would add complexity to the management of the scheme (and the legislation).

Yours sincerely

A handwritten signature in blue ink, appearing to read "D. Bowden", is centered on a light-colored rectangular background.

Dean Bowden

Chief Executive, London CIV