UNISON Response to Government Consultation on the Local government Pensions Scheme

January 2025

UNISON has long campaigned for improvements to the LGPS and welcomes the government's desire to make improvements. The current system needs change across all three areas identified: Pooling, local investment and governance.

The views of members whose pay and deferred pay forms the basis of the LGPS has long been sidelined and their role in governance is inadequate in most parts of the system. It is disappointing that the consultation paper has but one paragraph on this and that the overall focus seems to be mostly on pools and investments.

UNISON called for the pooling of assets into a small number of pools well before the previous government introduced the current underregulated, lightly governed, hotch potch of eight variable Pools. We acknowledge that the government's overall aim is to improve the relationship between funds and Pools and enhance governance by the former. However our reading of the consultation is that it hands much more power to the pools. Without clear regulations and guidance Pools will not necessarily do 'the right thing' and most funds will not be in a position to take control. At a minimum, governance of each pool needs to reserve to their owners, remuneration, appointment to senior executive roles and ensuring that Pools' investment products meet the fiduciary requirements of owners.

Question 1: Do you agree that all pools should be required to meet the minimum standards of pooling set out above?

Answer: we support the establishment of common standards for all pools.

We look to the Government to ensure that foreseeable costs of additional regulation and disruption are minimised.

Question 2: Do you agree that the investment strategy set by the administering authority should include high-level investment objectives, and optionally, a high-level strategic asset allocation, with all implementation activity delegated to the pool?

Answer: yes, but it should not be limited to these. It also needs to allow AAs to require passive in preference to active management for listed equity assets. Notwithstanding the plethora of evidence that passive approaches outperform in listed markets, Pools have set up active equity operations, with staffing and cost implications. AAs need to have control over this rather than such decisions being made by Pools on their behalf. That would contradict proper fiduciary practice.

Question 3: Do you agree that an investment strategy on this basis would be sufficient to meet the administering authority's fiduciary duty?

Answer:Firstly there is a need for a definition of 'fiduciary duty'. The government should ask the LGPS scheme advisory board to work with scheme stakeholders to come up with a suitable definition.

UNISON members involved in fund governance have repeatedly come up against cautious interpretation of fiduciary duty on the part of officers advising them. The Financial Markets Law Committee, at the request of the Government, advised on fiduciary duty around sustainability in the context of pension fund investment in February 2024. Its advice was that it is proper (and indeed, required by fiduciary duty) for those with fiduciary responsibility (and they made clear that this related to local authority funds as to those with a traditional Trustee structure) to consider advice but to themselves decide upon the application of that advice. In such consideration, they were entitled (rather, obliged) to consider all relevant factors, including the wishes of beneficiaries.

The FMLC confined itself to consideration of climate change - that was the question they were asked. But from our perspective, the principles set out by the FMLC are equally applicable to other non-return based considerations around investment. It is proper for Funds to consider what categories of economic activity are acceptable to them for investment. For example, a number exclude investment in gambling, tobacco or supply or manufacture of categories of weaponry. And after Russia's invasion of further areas of Ukraine in 2021, funds rapidly divested holding in Russian assets. They were right to do so even at that belated stage.

Branches which represent large numbers of Fund members have considered investment matters and adopted policies through their democratic processes in a number of areas, most notably around climate change and investment in fossil fuel exploitation, and where companies continue to contribute to violations of ILO core conventions or other violations of international law. Under Law Commission guidance, member sentiment should be properly weighed by those with fiduciary duty, and acted upon where it would not have significant impact upon investment returns. This should include the possibility of divestment, particularly where engagement over a specified period has failed. But in the views of those branches this has seldom been the case, including in the case of investments in companies which continue to take serious regulatory, legal and reputational risks.

There is clearly a risk that in future, Pools will reduce the number of investment products offered to Funds so that they cannot adequately reflect the investment strategies developed by each fund. This would frustrate the exercise of fiduciary duty by individual funds, and we look to Government in developing guidance for funds and pools to ensure this does not happen.

The paper sets out a schematic representation of Pool and AA responsibilities in paragraph 32. In all areas of operational activity the AA is said to have a monitoring role but has little power to do anything if it is unhappy with the result of this monitoring. Regulations need to be strengthened to ensure that funds have more powers than just monitoring, including allowing them to move assets from one pool to another. The governance proposals need to give the owners of the Pools meaningful control over them so they have the requisite tools to exercise fiduciary control, especially in difficult circumstances. There needs to be a model for dealing with an underperforming pool; for enabling movement between pools; and for enabling pools to realise fully the benefits of scale through potentially specialising in particular types of investment and allowing members to invest with another pool where that had the relevant expertise.

Question 4: What are your views on the proposed template for strategic asset allocation in the investment strategy statement?

Answer: We do not see the value in Government prescribing the template for asset allocation. This is an unnecessary requirement and will prevent pools and funds coming up with formats for the expression of investment strategy that best enable it to be delivered, in the context of the relationship between individual pool and its owners. If the Government did proceed with this requirement, the template needs to be expanded to give Funds as asset owners appropriate control over investment allocation, at the strategic level. It needs for example to also include provision for funds to specify passive investment of the funds they own, in liquid investment categories, if that is their wish. AAs should be able to set geographical parameters (for example, requiring a certain level of equity investment to be in the UK, which would be supportive of future UK economic growth).

Question 5: Do you agree that the pool should provide investment advice on the investment strategies of its partner AAs? Do you see that further advice or input would be necessary to be able to consider advice provided by the pool – if so, what form do you envisage this taking?

Answer: This proposal would mean a significant potential conflict of interest if investment managers advise on and execute investment strategy. Funds need to have access to alternative independent advice. The proposals would institute an investment manager that cannot be sacked.

Question 6: Do you agree that all pools should be established as investment management companies authorised by the FCA, and authorised to provide relevant advice?

Answer: There is certainly a need for greater regulation and consistency of governance cross pools. We note that the performance of the FCA has been criticised by the APPG for Investment Fraud, and others, so we would expect that the government has reviewed the FCA to see if it is confident that the body is fit for this purpose. We expect that the Government will have cost/benefit-analysed this proposal and that the very substantial costs and opportunity cost in terms of senior management time and attention associated with setting up the structures required for FCA authorisation, for those Pools not currently authorised, are exceeded by tangible, costed benefits. We also have concerns that going through the process of FCA approval will solidify in place the existing architecture of 8 Pools with existing geographies. We do not think this the optimal structure, and it may be that a solution involving Pool consolidation before such expenses are incurred would be preferable.

Question 7: Do you agree that administering authorities should be required to transfer all listed assets into pooled vehicles managed by their pool company?

Answer: If our other points are taken on board then yes over time, but too tight and strict guidance could have an adverse impact on current investments. This could require quick liquidation of all existing untransferred assets, including where these are currently managed passively with very low management costs, which the pools cannot rival. It is for this reason that many of the assets held by the owners of Borders to Coast have not been transferred. Requiring these to be quickly liquidated and transferred would be expense for no purpose.

This proposal would “bake-in” the existing pattens of pool membership, in a way that may impede effective and efficient management of assets in future. Pools have the geographical configuration they do as a result of historical accidents – and they do not all have geographical coherence or represent (in most cases) sensible aggregations of economic activity (Brunel and the Welsh Pensions Partnership are exceptions). We recognise that the Government in its previous consultation response indicated that it did not consider this something it wished to address. But there are clear risks in establishing structures which would not enable future consolidated arrangements for pension funds except where these also matched Pool geographical boundaries.

Question 8: Do you agree that administering authorities should be required to transfer legacy illiquid investments to the management of the pool?

Answer: See answer to Q.7, this should take place if, where and when the Pool is better placed to manage such assets. In many cases the most efficient solution will be to allow the normal asset lifetime to play out, not require transfer or liquidation to a timetable which does not make financial sense.

Question 9: What capacity and expertise would the pools need to develop to take on management of legacy assets of the partner funds and when could this be delivered?

Answer: this would vary from fund to fund. We agree that Pools need to build in-house capacity and these need to be expert before further asset transfers.

Question 10: Do you have views on the indicative timeline for implementation, with pools adopting the proposed characteristics and pooling being complete by March 2026?

Answer: this is much too tight and will mean the liquidation of assets in a way, cost and at a pace that may not secure best value for members. Best value not an artificial deadline should dictate the pace of transactions. And a requirement for quick certification of compliance by the FCA will be a very considerable drain on resources and senior management time in administering authorities of those funds which are not now FCA registered. We know, for example, that there are weekly meetings of Section 151 officers diarised by one group of Pool owners. The opportunity costs incurred are very significant, at a time when there are many other pressures on Council resources.

Other developments

Question 11: What scope is there to increase collaboration between pools, including the sharing of specialisms or specific local expertise? Are there any barriers to such collaboration?

Answer: the government should move to consolidate pools and encourage collaboration in any continuing to exist, while ensuring that the specific capabilities and ability to support Welsh economic development embodied by the Welsh Pensions Partnership is supported. It would also make sense for Pools to develop specialisms and market them to Funds, rather than every Pool develop a comprehensive slate of investment capability; that would promote efficiency and mean that genuine strengths could be built up, meeting the needs of the particular places served by particular pools, and enabling a broader spread of investment by Funds.

Question 12: What potential is there for collaboration between partner funds in the same pool on issues such as administration and training? Are there other areas where greater collaboration could be beneficial?

Answer: there is clearly great potential. Some is already realised through networks of collaboration. We have real concerns about the capability of many authorities in the economic development space as this capability has reduced in recent years given constraints on local authority revenues. There would be scope for those still strong in this area to support weaker authorities to develop.

Future systems and guidance need to ensure that there is no obstacle to cooperation between Funds which are members of different pools.

Reducing the number of funds could allow for considerable cost savings on admin and investment management fees. But larger authorities would still need to be able to deliver excellent administration to scheme members. Where funds themselves identify the potential for joint working – as in the tri-borough arrangements in West-Central London – efficiencies can be achieved without reductions in service levels. But the circumstances in which such savings can be achieved will be specific to the circumstances of individual funds.

Administering authorities should also be separated from local authorities. A model is the South Yorkshire Pension Fund. Current legislation allows such entities to be established as combined authorities. The extant system means that local councillors and their interests can dominate political and investment decisions on the pensions committee, and means that where there are significant shifts in local political power there is great volatility on fund committees. Too often the views of other employers, and members, are not heard or acted upon.

This would also ensure that structures for Fund administration were robust to changes in local government organisation. We can expect a variety of different configurations to arise from the present consideration of optimal structure and these may not match existing structures. Whatever the outcomes, there needs to be continuing robust, effective governance structures for Pension Funds.

Chapter 3: Local investment

Proposals

Question 13: What are your views on the appropriate definition of ‘local investment’ for reporting purposes ?

We acknowledge the Government’s priority growth mission. We share the ambition to grow the economy and recognise that the LGPS has a significant role to play. Members are supportive of investment which will improve economic conditions in their local areas; pension fund money belongs to them, and other things being equal, investment with tangible impact on the places where they live is valued by them (in a way which it is unlikely to be valued by Pool companies with no particular geographical focus). We also welcome the proposals for local authorities to work closely with each other and with local stakeholders to generate investable propositions.

On the definition of local investment as being located in any geography involved in a pool, we wonder whether the proposed definition might mean geographically spread pools would invest in only a proportion of their geography, while claiming to have carried out local investment. We believe a definition which would ensure broader investment across a Pool area would resonate better with LGPS members. They want to see that their pay and deferred pay supports economic development close to where they live.

Question 14: Do you agree that administering authorities should work with their Combined Authority, Mayoral Combined Authority, Combined County Authority, Corporate Joint Committee or with local authorities in areas where these do not exist, to identify suitable local investment opportunities, and to have regard to local growth plans and local growth priorities in setting their investment strategy? How would you envisage your pool would seek to achieve this?

Answer: We welcome proposals to involve Local authorities, in a new devolved environment, in development of opportunities. However we query whether this is a very complicated formulation and might create burdens upon authorities. It could privilege investment targets identified by the sub-national authority identified above equally or more worthy investments with local impact, but which were identified through another process. For example, through the work of housing associations, universities, local enterprise support organisations, and others. Sub-national entities vary wildly in their capability to identify and develop viable investable propositions, and there is an absence of strategic oversight given the very variable performance and capability of local enterprise partnerships.

We do think that it is important that Funds are the strategic drivers. We believe that currently some Pools have designed investments and then offered them to Funds, rather than Funds identifying their needs and requiring Pools to respond to those requests. We think it is important that either in regulation or guidance it is made clear that funds are in the driving seat.

We also see a key role for other publicly funded economic actors in generating investable opportunities. These should include, but not be limited to, GB Energy, the British Business Bank and Homes England. We would see that each of these, and others with broad national coverage, should be looking to develop projects which meet the investment needs of LGPS pension funds, with a focus on ensuring a good geographical spread of investable projects.

Question 15: Do you agree that administering authorities should set out their objectives on local investment, including a target range in their investment strategy statement?

Answer: yes. See above. It is very important that Funds are in control. They retain fiduciary duty under the proposals and this requires them to continue to set out locational, risk-reward and other criteria against which their pool must deliver. We also see that Teckal-compliance requires the effective control of the Pool by its owners, and for Pools to have as their principle focus delivery against the requirements owners specify.

In agreeing that there should be a requirement to set out a target range for local investment, we are mindful of arguments put by other stakeholders around the risk of distorting activity by a target-setting process, and in particular around two points:

- A local investment target is not included in the proposed template, with which it is anyway an uneasy match; local investment might be across different template categories: eg listed equity, lending whether on a corporate or project basis; part-ownership of projects bult by unlisted vehicles, etc,
- There needs to be clarity over what is meant by “local investment”. We see this as investment with local impact, rather than just investment which leads to spending in a particular place.

Our view is that this is an area where further thinking around what target guidance or assessment should look like is necessary.

Question 16: Do you agree that pools should be required to develop the capability to carry out due diligence on local investment opportunities and to manage such investments?

Answer: yes, and they must ensure that this enables support for projects at a scale which will enable local economic development and backing for appropriate projects. This is likely to include investments which are much smaller than Pools would generally consider for other categories of investment. For example, if supporting scale-up investment funds in a particular city, county or administering Authority area, or supporting a programme for University spin-outs from a particular institution, the likelihood would be that this would involve the commitment of single units or tens of millions in investment, rather than what Pools would generally considerable efficient scale investment.

In answering this question we identify a concern that Pools are likely to be so remote from the areas supplying their funding that they under-value investment which would benefit those places, on the basis that it is more resource-intensive and expensive than other types of investment. This underlines our view that Funds need to retain ultimate control if the objective of delivering local economic development is to be delivered.

While Pools should develop capacity for investment appraisal, clearly as Funds retain fiduciary responsibility the yes/no decision should remain with the Fund.

Question 17: Do you agree that administering authorities should report on their local investments and their impact in their annual reports? What should be included in this reporting?

Answer: We agree that AAs should assess and publish information on their local impact, provided that sensible metrics that did not distort investment decision-making or create excessive burdens can be developed. We would see that this needs to be done in a common way across the network of funds with common metrics employed. It would be sensible for a working group of experts in this area to develop proposals. We are not sure that the Annual Report is necessarily the proper place for this reporting. Annual reports are already unwieldy and little read locally; imposing a burden for something which communities would not find useful would not be worthwhile. That said, it is very important that stakeholders be able to compare and contrast the effectiveness of approach of different Funds, so this information must be published, and in the most usable form for this purpose.

Chapter 4: Governance of funds and pools

Fund governance

Question 18: Do you agree with the overall approach to governance, which builds on the SAB's Good Governance recommendations?

Answer: yes. UNISON supported the SAB's recommendations in responding to the original consultation and are pleased there is finally impetus behind implementation. However, a key recommendation is missing: The LGPS SAB recommendations said: *C.1 Each fund must produce and publish a policy on the representation of scheme members and non-administering authority employers on its committees, explaining its approach to voting rights for each party. This is not mentioned in the Consultation document but is a key element of improving governance and responsiveness to scheme members.

Question 19: Do you agree that administering authorities should be required to prepare and publish a governance and training strategy, including a conflict of interest policy?

Answer: yes. The conflict of interest policy will be particularly important in future with the aspiration for higher levels of investment with local impact.

Question 20: Do you agree with the proposals regarding the appointment of a senior LGPS officer?

Answer: Yes. We strongly support the requirement for senior dedicated management resource. We believe that this would be best addressed by separation of pension funds from administering authorities, but if the Government is not minded to do this, ensuring a competent person with pensions expertise leads Fund administrations is an appropriate step.

Question 21: Do you agree that administering authorities should be required to prepare and publish an administration strategy?

Answer: Yes.

Question 22: Do you agree with the proposal to change the way in which strategies on governance and training, funding, administration and investments are published?

Answer: agree on improving the readability of the annual report through concentrating that on those matters of most interest to members. It is important that transparency is achieved on the other strategies, which still need to be published and made available for reference by any member of the fund.

Question 23: Do you agree with the proposals regarding biennial independent governance reviews? What are your views on the format and assessment criteria?

Answer: this is potentially a burdensome and expensive process with little particular obvious benefit. We do not understand what problem is being addressed here. The suggested frequency will ensure that every fund is either undergoing, implementing or preparing for a review at all times. We suggest a review of the expected cost and benefit before this is taken forward, and do not see the case for such frequent review, except where clear concerns are identified in the initial assessment. We also wonder who Government envisages carrying out such reviews? We see that there are likely to be a limited number of people with the specialist skills and experience required, most of whom will be working for LGPS funds currently. The sector needs these people working in it, not assessing it.

Question 24: Do you agree with the proposal to require pension committee members to have appropriate knowledge and understanding?

Answer: yes. It has always been anomalous that Board members have training requirements which enable confidence in their ability to understand the matters on which they advise, but Committee members who have to decide have not been required to prove their expertise and understanding.

Question 25: Do you agree with the proposal to require AAs to set out in their governance and training strategy how they will ensure that the new requirements on knowledge and understanding are met?

Answer: yes.

Question 26: What are your views on whether to require administering authorities to appoint an independent person as adviser or member of the pension committee, or other ways to achieve the aim?

Answer: this is an unnecessarily prescriptive and burdensome requirement. Where an authority has sufficient expertise available in-house, it is not necessary for another person to be added to the payroll, whose costs are paid out of scheme assets.

Pool governance

Question 27: Do you agree that pool company boards should include one or two shareholder representatives?

Answer: We think that such a limited amount of shareholder representation would mean that owners could not actually control the entity they own. In our view the Pool company Board should have a majority of representatives of their shareholders, who are their owners. It might be that this could be better achieved through having an operational board meeting FCA requirements, which reports to a supervisory board, made up of representatives of the Pool's owning authorities. Executive from the Pool might serve on that, though in our view it would be better for all directors to represent the interest of owners. It would be responsible for decisions on appointment of the most senior officers of the Pool, including its board, for policy on renumeration, and for ensuring that in investment practice, the Pool delivers against the requirements and to the strategies specified by its owners. And for such other matters as the owners of the Pool decide.

Question 28: What are your views on the best way to ensure that members' views and interests are taken into account by the pools?

Answer: This is best secured by ensuring meaningful members representation, in voting capacity, on the supervisory board of the Pool. We do not see why

Pool Board arrangements should be any different from those applying to all other DB pension schemes: member representatives totalling at least a third of the membership of the board. These individuals should be trade-union nominated, which ensures the selection of people who are part of an organisation with other scheme members..

Question 29: Do you agree that pools should report consistently and with greater transparency including on performance and costs? What metrics do you think would be beneficial to include in this reporting?

Answer: Yes. The metrics should include total return broken down by investment category, comparison of returns against common benchmarks, costs compared to relevant comparators in similar funds. Reports for each Pool should be prepared and published on a common, comparable basis, and be published at the same time.

January 2025
A.dobbie@unison.co.uk