Q&A for LGPS employers
Investment reform

At the Summer Budget 2015 it was announced that the Government will work with Local Government Pension Scheme (LGPS) administering authorities to reform how LGPS investments are managed.

The LGPS is one of the largest public sector pension schemes in the UK. In England and Wales the LGPS is currently organised as 91 local pension funds, each with an administering authority responsible for the management of its assets and liabilities and the administration and payment of pensions to its local members.

The Government want the 91 LGPS pension funds to pool their assets into around six investment pools, each with assets of at least £25bn. It is hoped that this will drive down investment costs and develop the capacity and capability of the LGPS to become world leaders in infrastructure investment, thereby helping to drive growth in the UK economy.

LGPS pension funds in Scotland and Northern Ireland are not affected by the proposals, and their investments will continue to be managed in the same way that they are now.

The expectation is that the new investment pools will begin to be used for collective investment from April 2018 onwards.

The following questions and answers aim to help employers understand the changes:

Q1: Why is this happening?

A1: Across the LGPS in England and Wales the scheme holds £217bn of assets (2014/15 figure). These assets are currently held in 91 local pension funds and are used to pay the pensions of former members of the scheme and their dependants. The LGPS is one of the largest funded pension schemes in Europe.

The Government commissioned research which indicates that significant savings can be delivered by the creation of around six investment pools, each with assets of at least £25bn. Each LGPS administering authority will be obliged to join, or help create, an investment pool with other LGPS administering authorities. Savings will be achieved through economies of scale and increased bargaining power; investment costs will be reduced along with other costs for all types of investment used in the pool.

The Government is also keen for the LGPS to have the capacity and capability to be able to invest in infrastructure e.g. railway, road or other transport facilities or housing supply. Currently only a very small proportion of LGPS assets are invested in infrastructure. Investment in infrastructure is increasingly seen as a suitable option for pension funds as the investment is typically long term and can match the long term liabilities held by pension funds.

It is hoped that the development of investment pools will make it easier for LGPS funds to invest in infrastructure due to increased scale.

Q2: Will the changes affect my employer contribution rate?

A2: Not directly. As an employer you pay the balance of the cost of providing member benefits, after taking into account investment returns and employee contributions. Every three years, a qualified actuary calculates how much you should contribute to the scheme.

If the anticipated reduction to investment costs are realised and the current overall investment performance is maintained it is possible that this could impact positively on employer contribution rates. However, it is important to remember that other factors, such as changes to life expectancy, the profile of your workforce and the length of deficit recovery periods are the main drivers of your organisation's contribution rate.

In addition, it is expected that the anticipated cost savings will not materialise for a number of years due to the costs that will be incurred in implementing and moving assets into investment pools.

To ensure the long term sustainability of the scheme a cost management process is now in place in the LGPS in England and Wales for member benefits being built up from 1 April 2014 onwards. This will monitor the cost of the scheme to ensure it stays within agreed parameters as set by the Scheme Advisory Board and HM

Treasury. Should costs increase outside those parameters future changes to the scheme design may be required. Further information about the cost management process is available on the Scheme Advisory Board website - http://www.lgpsboard.org/images/PDF/Publications/CostControlMembsEmpsv2FINAL.pdf.

Q3: Who is responsible for deciding how a fund invests its assets and will this change?

A3: Each LGPS administering authority has a Pensions Committee which is made up of elected Councillors. The Pensions Committee decides how the assets for that fund are to be invested in line with the administering authority's investment strategy and agreed approaches to risk, diversification and corporate governance.

This will not change when assets are invested via the new investment pools from April 2018. Each administering authority will continue to determine its asset allocation meaning that democratic accountability will still be maintained.

Q4: Will the administration of the LGPS also be changing?

A4: No, the Government is only requiring LGPS administering authorities to pool the investment of their assets. There is no requirement for any change to the administration of the LGPS.

The LGPS administering authority that administers the scheme for your employees and ex-employees will not change as a result of these changes.

Q5: What is the timetable for investment reform?

A5: Administering authorities are required to submit their final proposals for investment pooling to Government by 15th July 2016. The final proposals are expected to confirm each authority's commitment to pooling and provide detail on how the arrangements they have made with other authorities will meet the criteria published by Government in November 2015.

The proposals, if assessed as meeting the criteria, will be taken forward with a view to the investment pools becoming operative from April 2018. Assets will start to be moved into investment pools from April 2018 with illiquid assets, such as property, taking longer to transition than others.

The Government is planning to introduce legislation to allow the Secretary of State to intervene in the investment function of an administering authority where it has not had sufficient regard to government guidance on pooling.

Q6: Where I can find out more information?

A6: Further information about investment reform is available on the LGPS Scheme Advisory Board website - www.lgpsboard.org/index.php/structure-reform/investment-pooling-2015.

If you wish to find out how the LGPS administering authority that administers the scheme for your employees and ex-employees plans to comply with the investment reform criteria you should contact them directly.