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London Borough of Hammersmith and Fulham Pension Fund Response

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Local Government Pension Scheme (England and Wales): Fit for the future Consultation

The London Borough of Hammersmith and Fulham Pension Fund is part of the Tri-Borough Treasury and Pensions Team alongside Westminster and the Royal Borough of Kensington and Chelsea. During 2022 the London Borough of Bexley joined as an additional partner, whereby the Tri-Borough team provides treasury and pension investment and accounting services for the borough. This collaboration of the four London boroughs allows the four London Funds to benefit from cost saving efficiencies, economies of scale, depth of knowledge and robust governance processes and best practices, with AUM totalling £6.3bn.

The Tri-Borough funds are all committed to providing excellent service to all scheme members and local residents; this includes ensuring the Fund remains fit for the future, providing value for money and effective governance, alongside generating positive excess returns. As at 30 September 2024, the total net asset value of the Hammersmith Fund was £1.374bn, with 61% of those assets pooled. Due to pooling having the potential to deliver benefits of scale and reduce costs across the LGPS, the Fund accepts the government's ambition to have all assets fully pooled by 2026. However, this should be approached with caution. Legacy assets will remain a challenge for funds to transition, particularly by the 31 March 2026 deadline and alongside the impact of transition costs. There also remain a number of issues in relation to roles and responsibilities, governance and conflict of interests, which would need further clarification.

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

To facilitate the advancement of pooling at the pace required by the central government, the LBHF Fund agrees that it is logical to establish minimum standards to ensure optimal service levels. Currently, there are disparities in the service models employed by the eight pools, so introducing guidance to align these models with each other and with best practices would be advantageous.

If Administering Authorities (AAs) can effectively delegate the implementation of investment strategies to the pools, this could lessen reliance on investment consultant advice and eliminate the need for expensive manager selection processes. However, concerns about potential conflicts of interest arise if pools promote their own fee-based products. It is therefore crucial that any legislation clearly defines the accountability and responsibilities of funds versus pool companies. Furthermore, it is essential for pool companies to maintain FCA regulation to uphold the highest standards of governance and compliance.

The LBHF Fund anticipates challenges in transitioning legacy assets to the pools within the proposed timeline. This process is likely to require substantial time and resources, incur significant transition costs, and potentially result in higher management fees due to an additional layer of oversight from the pools.

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?

The LBHF does not agree that the implementation of a fund's strategic asset allocation should be fully delegated to the pools. Autonomy for Administering Authorities (AAs) to set their own high-level investment objectives and asset allocation strategies must be preserved. AAs must retain the ability to define risk and return parameters, including the allocation between active and passive equities, which is a fundamental factor of risk management and a cornerstone of each fund's investment strategy. The suggestion that AAs may lose the ability to determine such allocations is concerning, as every LGPS fund is unique in its liability profiles, funding levels, risk appetite, membership demographics, ESG policies, and local priorities. It is essential that AAs maintain responsibility for asset allocation strategies to reflect these individual factors accurately. In addition, the fees charged in relation to active versus passive equity portfolios can be significant. For comparison, passive fees can be as low as 1 bp, with a pool oncost of 0.5 bp, compared with active funds which typically charge 40 to 70 bps, with pool oversight fees of circa. 2.5 to 3.5 bps. Given this significant disparity between fees charged and pool oncosts, there could be potential for conflict of interest from the pools based on financial incentives.

Fully delegating strategic asset allocation implementation to pools also raises significant questions about the roles of Pension Boards and Pension Committees. Currently, Pension Fund Committees hold a comprehensive mandate, including setting the Investment Strategy Statement (ISS), determining the strategic asset allocation, overseeing fund stewardship, monitoring cashflows, establishing ESG policies, implementing asset strategies, and evaluating fund performance. If these responsibilities are transferred to the pools, the relevance and function of Pension Committees would become unclear. Similarly, Pension Boards, tasked with holding Committees accountable, would face challenges in fulfilling their oversight role if key investment decisions are no longer within the Committees' purview. Therefore, the rationale and structure of governance roles under such a model require review and clarification.

Furthermore, oversight of fund cashflow management must remain with fund officers to ensure timely benefit payments to members. Many funds are in a cashflow negative position and rely on frequent income distributions, asset redemptions, and cash drawdowns. Fully delegating this process to the pools could create risks, including delayed or insufficient payments to members, potentially breaching fiduciary duties.

Lastly, we foresee challenges in maintaining alignment between a fund's assets and liabilities. Strategic asset allocations must reflect the liability profiles and discount rates specific to each fund. Delegating implementation to pools introduces the risk of assets failing to align with liabilities, which could compromise pension funding outcomes.

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

The LBHF Fund does not agree that an investment strategy based on full delegation of implementation activity to pools would be sufficient to meet an Administering Authority's (AA's) fiduciary duty. Fiduciary duty requires AAs to act in the best financial interests of their members and stakeholders, and this cannot be assured without retaining significant control over key elements of the investment strategy.

AAs must retain the ability to determine their own investment objectives and strategic asset allocation to ensure alignment with the unique characteristics of each fund. Critical aspects such as risk and return settings, including the choice between active and passive management, are fundamental to managing risk and achieving funding objectives. The proposal to limit such decision-making undermines the ability of AAs to address their fiduciary responsibilities effectively.

Moreover, there is the question of whether the AA could be accountable to the local council tax payer, based on investment decisions made by pools.

4. What are your views on the strategic asset allocation template?

The LBHF Fund believes the proposed template for strategic asset allocation in the Investment Strategy Statement is too high level and restrictive, and limits the flexibility of Administering Authorities (AAs) to design effective investment strategies. In many cases, AAs use diverse investment styles within asset classes to complement each other and reduce correlations between assets. The proposed template does not account for this approach, which is integral to managing portfolio risk and optimising returns.

Moreover, the template significantly constrains funds' ability to manage risk and achieve the discount rates set by actuaries. This limitation is particularly problematic in the equities asset class, where the absence of an option to allocate between active and passive strategies restricts essential risk management and return optimisation tools.

In summary, while a standardised template could provide consistency, the proposed structure compromises the ability of funds to meet their unique investment needs and fiduciary responsibilities. A more flexible approach could better serve the diverse requirements of the LGPS.

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?

While it is acknowledged that advice from pools could potentially reduce investment consultancy fees for many funds, significant concerns remain. Firstly, not all pools currently possess the requisite knowledge and expertise to provide high-quality investment advice, raising questions about their capability to effectively support AAs in this regard.

Additionally, allowing pools to provide investment advice introduces a risk of conflict of interest, particularly if pools recommend their own strategies or products. This could reduce competition among asset managers, diminishing incentives to lower management fees and improve performance. It also limits AAs' ability to seek alternatives, particularly in cases where the performance of pool-managed assets is poor. Without a clear mechanism for holding pools to account for underperformance, the effectiveness of this model is questionable.

Another issue is the governance structure within some pools. Currently, shareholder funds in certain pools lack the authority to remove directors or senior leadership, which could hinder accountability and responsiveness. To address this, shareholder agreements may need to be reviewed and amended to ensure adequate oversight and governance.

In summary, while there are potential cost benefits, the risks of conflicts of interest, lack of expertise, diminished competition, and unclear accountability lines make it unsuitable for pools to provide investment advice. The LBHF Fund believes that independent advisors remain better positioned to offer unbiased and effective support tailored to the unique needs of each fund.

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?

The LBHF agrees that all pools should be established as FCA-authorised investment management companies and authorised to provide relevant advice. This would ensure adherence to high standards of governance, transparency, and regulation, providing greater confidence in operations and safeguarding the interests of partner Administering Authorities.

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

The LBHF Fund agrees that, where appropriate, listed assets should be transferred to the pool companies. However, clarification is needed on the definition of "transfer" to ensure it does not require the sale of assets but rather refers to oversight by the pool. Transfers may involve significant legal and administrative costs, which may not outweigh the benefits. Furthermore, the proposed deadline of 31 March 2025 may be challenging for some funds, and an extension to 31 March 2026 would be far more practical.

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

The LBHF Fund broadly agrees, but some exclusions should apply, such as assets in runoff and small scale investments. Further clarifications also remain regarding who would handle capital calls which are often managed via online portals, as well as the treatment of direct property investments.

For illiquid assets, which are often long-dated and complex, the benefits of transferring these to the pool are unclear and could increase costs due to additional management fees, legal expenses, and transition costs. It may be more appropriate for illiquid legacy assets nearing maturity to remain under AA oversight until they fully run off. Additionally, the timeline for transferring such assets may not be feasible, so a ‘comply or explain’ approach with best efforts to meet a 31 March 2026 deadline would be more practical.

While there may be capacity for pools to manage legacy assets if common funds are established, in the case of the London CIV, transferring all illiquid assets could result in the pool overseeing over 400 mandates, the associated costs and pools’ ability to handle these numerous illiquid mandates must be carefully considered.

9. What capacity and expertise should pools develop to manage legacy assets?

The pools will need to recruit to further develop a range of skills and knowledge. This will be particularly important in the case of the London CIV which has 32 funds. LCIV will need to manage the scale and specialism needed for a large range of legacy illiquid asset class transfer.

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?

The LBHF Fund agrees that funds should aim to transition all listed assets to pooling arrangements by 31 March 2026. This timeline aligns with the overall objectives of pooling and provides a clear deadline for funds to work towards.

However, we recommend that for legacy assets, a "comply or explain" approach be adopted. This would allow flexibility where transitioning certain assets by the proposed deadline proves impractical or detrimental to fund objectives. Such an approach ensures transparency while acknowledging the complexities involved.

It is anticipated that developing the necessary skills and knowledge for managing all legacy assets within this timeframe will be a significant challenge for pools. Building expertise in handling these assets will require careful planning, recruitment, and potentially new partnerships, which may extend beyond the proposed timeline.

Additionally, we propose that an exclusions policy be introduced for illiquid assets currently in their runoff period. Oversight of these assets should remain AAs until maturity. This would minimise disruption, avoid unnecessary transaction costs, and ensure these assets continue to be managed effectively during their natural lifecycle.

In summary, while the proposed timeline is a viable target, implementing it in a pragmatic and flexible manner will be critical to its success.

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?

There is considerable scope to enhance collaboration between Local Government Pension Scheme (LGPS) pools, particularly through the sharing of specialisms and specific local expertise. Greater collaboration has the potential to broaden the investment opportunities available to LGPS funds, enabling them to leverage the unique strengths and skills developed by individual pools. Such collaboration could result in synergies, enhanced knowledge-sharing, and improved outcomes for all stakeholders.

Currently, LGPS funds are only permitted to invest within a single pool. Expanding the framework to allow cross-pool collaboration would create opportunities for funds to access a wider range of investments and specialised expertise, maximising the benefits of pooling for clients.

Each pool has developed its own areas of specialisation and strength, ranging from specific asset classes to innovative investment strategies. By working together, pools could combine these strengths to deliver greater efficiency, mitigate risks, and generate enhanced returns. A collaborative approach would also enable the sharing of knowledge and skills, fostering innovation across the LGPS ecosystem.

However, several barriers to collaboration exist. Cultural differences between pools, varying scales of operation, and challenges posed by Financial Conduct Authority (FCA) regulation could hinder efforts to work together effectively. Additionally, gaps in knowledge or misaligned objectives between pools may create further obstacles. Addressing these barriers will require a concerted effort to harmonise practices, build trust, and ensure alignment of goals and regulatory compliance.

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?

Collaboration between partner funds within the same pool offers significant opportunities, particularly in areas such as administration and training, as demonstrated by existing successful arrangements.

The LBHF Fund is part of the Tri-Borough Treasury and Pensions team, alongside Westminster City Council, the Royal Borough of Kensington and Chelsea, and more recently, the London Borough of Bexley. This collaboration exemplifies how joint working arrangements can deliver cost-saving efficiencies, economies of scale, and robust governance practices. With a combined asset under management (AUM) of £6.3 billion, these funds benefit from shared resources and expertise. Key collaborative efforts include joint procurement of critical services, such as custodianship, actuaries, and investment consultants.

Additionally, the Tri-Borough team organises at least biannual training sessions for Pension Fund Committees and Boards. These sessions are open to all London officers and members, fostering knowledge-sharing and professional development across the funds.

The LBHF Fund currently retains control of its administration services, delivered by Local Pensions Partnership Administration (LPPA). This approach ensures the sensitive handling of member data and mitigates reputational risks associated with transitioning these critical functions.

Chapter 3: Local investment

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

The LBHF Fund believes that, for reporting purposes, the definition of 'local investment' should encompass the entirety of the United Kingdom. Limiting the scope of local investment solely to the geographical area in which a fund is located would significantly constrain investment opportunities. Such a narrow definition could hinder the fund's ability to access a diverse range of assets and, consequently, its capacity to generate the returns necessary to meet the discount rate.

By adopting a broader, UK-wide definition, funds would retain the flexibility to pursue investments that align with their objectives while contributing to the economic development of the country as a whole.

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?

The LBHF Fund does not agree that administering authorities should take the lead in these matters. Instead, this responsibility should rest with the investment pools, in collaboration with relevant combined authorities.

With the proposed delegation of investment strategy implementation to the pools, administering authorities would face significant challenges in directly influencing local investment decisions or integrating specific local growth plans into their strategies. In the context of London, where there are 32 individual client funds, it would be impractical for the London CIV to evaluate and implement 32 separate proposals for local investment projects. A more efficient approach would be for the pools to take on this responsibility fully, working with combined authorities and other local partners where appropriate.

However, this approach raises a potential concern: conflicts of interest could emerge between funds and combined authorities, as each may prioritise differing investment agendas. Effective collaboration and clear communication will be essential to navigate such challenges and align objectives where possible.

In summary, while the principle of supporting local growth is recognised, it is more practical and effective for pools to assume responsibility for identifying and implementing local investment opportunities, in partnership with relevant authorities, rather than requiring administering authorities to take a direct role.

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?

The LBHF Fund does not agree that administering authorities should set out specific objectives or target ranges for local investment in their investment strategy statements. Beyond establishing a high-level strategic asset allocation, the responsibility for identifying and implementing local investments should be fully delegated to the pools.

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?

The LBHF Fund agrees that pools should be required to develop the capability to conduct due diligence on local investment opportunities and to manage such investments. This would ensure a professional and consistent approach to evaluating and overseeing local investments, aligning with the broader objectives of pooling.

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?

The LBHF Fund does not agree that administering authorities should report on local investments and their impact in their annual reports. LGPS funds already face significant pressures from existing and upcoming governance reporting requirements, and additional reporting could strain resources, delay external audits, and raise challenges in measuring and standardising the impact of local investments, particularly when asset strategy implementation is fully delegated to pools.

Funds would need to consider how they report the impact of their local investments if the implementation of the asset strategies are fully delegated to pools. Funds would need to measure the impact of local investments and devise a methodology that is consistent throughout the LGPS.

Chapter 4: Governance of funds and pools

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

The LBHF Fund agrees with the overall approach to governance aligned with the SAB's Good Governance recommendations, as most funds are already adhering to the proposals outlined in the consultation. However, the framework should be broadened to ensure that investment pools are held accountable, given their critical role in implementing investment strategies. It is also important to recognise that funds will lose some autonomy over directing investments, limiting governance to oversight of the pools' actions.

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?

The LBHF Fund agrees with this initiative. Many funds already publish strategies and policies of this nature.

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

The LBHF Fund agrees with the proposals for appointing a senior LGPS officer, but greater clarity is needed on "senior" with a suggestion to use "practitioner" instead. The specific designation should depend on the authority's internal structure, such as Director, Assistant Director, or Head of Service.

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

The LBHF Fund agrees and already publishes an administration strategy.

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?

The LBHF Fund agrees with the proposal to change how strategies on governance, training, funding, administration, and investments are published. A more streamlined and transparent approach will improve accessibility and promote consistency across funds, as well as reducing the complexity of the annual reports.

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

The LBHF Fund agrees with the proposals for independent governance reviews, as they can enhance oversight and accountability. However, conducting these reviews on a triennial basis would be more appropriate, aligning them with the actuarial valuation process of the LGPS. This alignment would streamline resource use and ensure the reviews remain relevant to the fund's broader planning cycle.

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

The LBHF Fund agrees that it is essential for pension committee members to have the necessary knowledge and skills to make informed strategic investment decisions, supported by a mandatory training framework. Introducing legislation to enforce this requirement would significantly enhance the expertise and effectiveness of pension fund committees.

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?

The LBHF Fund agrees with the proposal to require administering authorities to outline in their governance and training strategy how they will meet the new knowledge and understanding requirements. This aligns with practices already followed by most LGPS funds, ensuring consistency and reinforcing existing good governance standards.

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?

The LBHF Fund supports the requirement for administering authorities to appoint an independent adviser or member of the pension committee, as this is crucial for holding investment pools accountable for implementing strategies. Independent advisors also provide necessary guidance and training to committee members, ensuring they can effectively set high-level investment strategies. Additionally, retaining the ability to procure external investment advice is essential to maintain independence, avoid conflicts of interest, and comply with Competitions Market Authority (CMA) regulations.

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

The LBHF Fund agrees that pool company boards should include one or two shareholder representatives to ensure sufficient representation and accountability to partner funds. To strengthen this accountability, shareholder agreements may need to be reviewed and amended to grant funds the ability to remove directors or senior leadership when necessary.

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

The LBHF don Borough of Hammersmith and Fulham Fund believes the most effective way to ensure members' views and interests are considered by the pools is to provide shareholders with representation on the pool board, including full voting powers. Additionally, administering authorities should have the ability to influence decisions at the board level, reflecting their reduced power to directly direct investments.

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?

The LBHF on Borough of Hammersmith and Fulham Fund agrees that pools should report consistently and with greater transparency, including on performance and costs. Currently, there is noticeable inconsistency in reporting practices across pools, making it challenging to compare performance and assess service levels effectively. Establishing minimum standards for reporting would address this disparity and create a more equitable and transparent framework for Local Government Pension Scheme (LGPS) funds nationwide.

Enhanced reporting could include a comprehensive breakdown of pool costs, such as management fees, transition and transaction costs, as well as the specific costs and savings associated with each LGPS fund. The full integration of the Scheme Advisory Board (SAB) cost transparency template would further promote consistency, particularly in relation to private market assets, where standardisation is often lacking. Additionally, the inclusion of benchmarked performance metrics for all assets and their underlying managers would provide valuable insights for partner funds, aiding in their decision-making and reporting processes.

With improved and standardised reporting from pools, LGPS funds would be better equipped to meet their own reporting requirements, particularly as part of their annual report and accounts. This increased level of transparency would not only enhance accountability but also support funds in achieving their long-term investment objectives.

Chapter 5: Equality impacts

Question 30: 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.

The Fund is conscious that regulations should not be too prescriptive as to exclude any individuals. In addition, appropriate reporting should be designed in such a way in that they will be accessible for all users: this follows accessibility regulations in Public Sector Bodies (Websites and Mobile Applications) (No. 2) which came into force during September 2018.