The future of investment strategy advice in the LGPS

Optimal delivery alongside an expanded pool

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Foreword

We acknowledge the government's ambitions and aspirations for the Local Government Pension Scheme (LGPS). If done in the correct way, the LGPS could access greater benefits of scale through further consolidation and greater consistency of approach.

However, there are risks to the delivery as it is currently proposed. We believe greater consideration is required to prevent unintended consequences for the LGPS and the United Kingdom (UK). Poor delivery of these important services, particularly at risk due to the short timescales, could lead to poor investment returns, higher contribution rates from participating bodies in the LGPS (directly impacting local taxpayers), and deficient local investments.

As the government acknowledges, investment strategy is by far the most financially impactful investment decision a pension committee makes. There is therefore an overwhelming desire from funds to continue setting their asset allocations (as shown by 97% of respondents to a survey by the PLSA). This is to ensure, as far as they possibly can, their own requirements and beliefs regarding pension provision are being reflected in their strategy.

The advice in setting this investment strategy is also extremely impactful. The vast majority of funds use investment consultancy services for their investment strategy reviews. These operate within an existing efficient and competitive market, with significant resources dedicated to the delivery of strong advice in a cost-effective manner. The strong returns of the LGPS over decades is testament to it.

Funds should continue to have an option of selecting their adviser. This can include the pools once they have developed sufficient expertise and services. To deliver improved consistency, advice can be limited to only the asset classes offered currently, or could reasonably be offered, by the pools. We believe this is a far better way of achieving the benefits of greater scale than removing the benefits of the current competitive market.

By forcing advice from a single provider, who then fully implements that advice and reports on performance, you remove competitively driven value for money, high service levels and innovation, whilst introducing conflicts of interest. If funds lose access to independent advice, there is an increased risk of creating a democratic deficit and weakening the connection to local accountability.

This will allow pools to focus on priority areas of the proposals to deliver on. We suggest local investment, a key priority for government, is instead prioritised. This is incredibly important both in its potential for improving local areas, and in the ability for it to do damage if not appropriately devised, alongside the need to deliver adequate returns.

> “The Board has some concerns about funds being required to (as opposed to choosing to) take investment advice from the pool. As part of a broad spectrum of advice, the pool clearly has a role, but the Board's view is that it should form part of a (limited) number of sources of advice.” - *Scheme Advisory Board response to the LGPS (England and Wales): Fit for the future consultation*

Executive Summary

This report has been co-produced between LGPS funds (from 7 of 8 LGPS pools), independent advisers, industry experts and Hymans Robertson. It is in response to the government's current "Fit for the future" consultation, which puts forward ambitious timescales for a wide range of proposals representing a fundamental change in the way LGPS funds determine how their assets are invested.

The purpose of this paper is to consider the investment strategy proposals within the consultation in more detail. It examines the current approach to funds receiving advice, the risks within the government's new proposals, and an alternative solution which we believe will deliver a better solution for funds, pools and the government. The outcome is enhanced capacity to complete the transition of assets from the funds and develop local investment capabilities, focusing on areas with the greatest impact on growing the UK economy.

Investment strategy proposals

From the option set out in the consultation proposal, there is an overwhelming expectation that LGPS funds will decide to make their own strategic asset allocation decisions (rather than delegate to the pool). A recent survey by the Pensions and Lifetime Savings Association (PLSA) found that 97% of funds expect to continue setting their own strategic asset allocation.

Attention therefore turns to how funds can or should take advice to inform their strategic asset allocation decisions.

The consultation proposals limit funds to only take their "primary" investment strategy advice from their respective pool. In other words, the proposal removes competitive procurement and the option for funds to receive independent advice from their adviser of choice. This follows from the same proposal being made in the 2023 government consultation "Next steps on LGPS investments", where government noted that the "majority" of respondents were against this idea. There remains overwhelming opposition to this proposal, for example:

- PLSA LGPS survey (31 funds) – only 23% of respondents stated they agreed with the idea of taking investment advice from pools.
- Hymans Robertson poll - only 9% supported the plans across over 80 funds polled.

Current options for receiving advice

Currently, each LGPS fund can competitively procure their own adviser for their investment strategy reviews. Around 75% of funds use their contracted investment consultancy, whilst c. 90% of other funds procure support for this project specifically. Many also use independent advisers, either instead of or alongside an investment consultancy. This is due to both the importance of the project on long-term financial outcomes, and the complexity of the work.

Investment strategy advice service

There are several important characteristics that the LGPS requires from its investment strategy review service. Key are high quality, independence, tailored advice and value for money. It is difficult to see how the pools can, currently or in the near future, meet those requirements, certainly by 2026. A competitive market for this advice drives the strong offerings used by the market today. Forcing funds to take strategic advice from an unprocured, single entity risks inefficiency and poor outcomes, particularly as pool teams are unlikely to be able to be as well-resourced and resilient as investment consultants who are able to share the costs across far larger client footprints. Many funds are particularly concerned that sourcing advice from the pool would conflict with the independence and tailoring that are so important to their financial outcomes.

Hymans Robertson provides information on the resources it takes to build and maintain an investment strategy advice service of the quality that the LGPS requires. The substantial sunk and ongoing costs, along with the expertise needed to provide and communicate complex modelling and analysis, will be difficult for the pools to replace quickly or at a similar cost. Investment consultants can spread these costs across a larger client base than the pools will ever have.

The proposal diminishes the value provided by the established, efficient, and competitive regulated advisory market.

Concerns raised by LGPS community

There are significant concerns in the LGPS community (including the LGPS Scheme Advisory Board in England and Wales) around the conflict of interests that can arise from a single entity (which funds can't leave) giving both investment strategy advice and then implementing it. The Competition and Markets Authority (CMA) review of fiduciary appointments in the private sector implemented a number of measures to protect from this, that are not addressed in the proposals.

- **Performance Reporting**: The pool controls performance reporting, which may lead to underperformance being excused without proper scrutiny, without established oversight. Whilst there are experienced and effective independent advisors in the market, many do not have the resources to provide the level of oversight to adequately due diligence and challenge it. The proposals may make it harder for funds to assess whether they received good advice which has been implemented well, or if issues need fixing.
- **Lack of Competition**: Funds would be unable to change adviser from their pool to other providers if dissatisfied with the pool's advice or performance, this reduces the incentive for pools to offer top-quality services. Whilst funds are shareholders in their pools, and able to remove underperforming staff or board members, this is far more difficult, expensive, time consuming and higher risk than simply being able to change providers.
- **Conflicting Objectives**: There's concern about the potential for government pressure on pools to prioritise political goals (e.g. investing in the UK), or de-risking, over fiduciary duties. This could impact investment decisions and reduce the pool's focus on achieving the best outcomes for funds.
- **Fees**: The structure of fees for additional services, like strategic asset allocation advice, could create conflicts of interest. For example, potentially influencing pools to favour internal management over external options. Pressure to minimise costs might also impact service quality.
- **Reduced Innovation**: There are worries that the proposed model will limit innovation and diversification within the LGPS, as the pools may be less willing to invest in new asset classes that require extra effort.
- **Pet Projects**: Concerns exist that pools may steer funds towards certain asset classes based on the personal interests of the pool, rather than what is best for the funds' investment strategies, or where the pools do not have the necessary expertise.

Additionally, whilst not a conflict-of-interest issue, funds also expressed concerns around the level of resourcing and the robustness of the service that pools will be able to offer.

An improved solution

This paper puts forward an alternative solution to obtaining investment strategy advice in the LGPS via three pillars, that we believe delivers for funds, pools and government.

1. Funds should continue to be able to procure their own investment strategy advice, including from the pools if funds so wish. This procurement can continue to be on a competitive basis, helping to achieve lower fees. This will allow funds to continue to appoint the best value-for-money provider and give pools time to develop their offering, whilst addressing the concerns of conflicts of interest.

2. Advice can be limited to the solutions of the pool, or that could be reasonably provided by the pool, including being able to invest in other pools' solutions if a fund's own pool doesn't offer a solution. This manages the risk of advice being given to invest in asset classes and solutions outside of the pool.

3. New ideas for attractive investment opportunities can continue to be raised by the adviser, to be discussed with the pools, to ensure that the LGPS investment returns continue to benefit from market innovation and diversification.

Capacity to focus on government's priority areas

This solution will provide pools with the capacity to instead focus on the primary function of day-to-day management of current assets, alongside substantial additional requirements from elsewhere in the consultation proposals. This capacity can be focussed on catalysing local investment capabilities, which is likely the most challenging of services the pools must provide, but one of high importance to UK economy. This is imperative as without the pools developing the local investment capabilities, investments will not be made. Meanwhile, an established, functioning and competitive market exists for investment strategy advice, that can continue whilst other capabilities are developed. This arrangement should be kept under review as pools develop, for example every three years under the lens of improving efficiency, good governance and better outcomes.

Summary of recommendations

1. Funds should retain the option to procure their own adviser for investment strategy on a competitive basis, this can include inviting proposals from pools (both their own and other pools).
2. To facilitate more efficiency and strategic consistency between funds, the scope of allocation advice is limited to the solutions offered by the pool (or could reasonably be offered in future).
3. New investment ideas not currently offered by the pools can continue to be put forward to funds to ensure informed decision making, robust audit trails, and to ensure that the LGPS investment returns continue to benefit from market innovation and diversification.
4. Recognising the pools' increasing remit and development plans, LGPS advice arrangements should be reviewed on a pool-by-pool basis every three years under the lens of improving efficiency, good governance and providing better outcomes.
5. Pools use the opportunity to prioritise completing the transition of assets from the funds and building local investment capabilities.

Background

On 14 November 2024, the Chancellor, Rachel Reeves, gave her first Mansion House speech. It turned out to be an eventful one for the LGPS, with a number of significant points put forward to the LGPS in a consultation launched shortly afterwards.

This consultation covers three main areas.

1. **Pooling.** By 31 March 2026, the government require all pools to be FCA regulated investment management companies. All assets be invested through the pool with implementation of investment strategies fully delegated to pools. Funds maintain the decision regarding investment strategy, but this is to be limited to either high-level investment objectives, or a high-level asset allocation. Pools will advise on the setting of these.

2. **Local investment.** Funds will be required to invest locally, setting out their approach to local investment, including a target range within their investment strategies. Funds will also be required to work with local combined authorities and mayors to achieve this investment. These investments, and their impact, will also be included in annual reports. Pools will be required to undertake the due diligence on potential investments and will decide whether to invest in each project they review.

3. **Good governance.** After four years, the government is acting on the recommendations of the Good Governance Review. This includes proposing: a requirement that committee members have the appropriate knowledge and skill, funds publish strategies on governance, training and administration (including conflicts of interest), and that a senior LGPS officer is appointed at each fund. A key inclusion is the proposal that funds will be required to participate in a biennial independent governance review to obtain assurance that they are meeting governance requirements. One new recommendation is the proposal that pension committees appoint an independent adviser to drive governance improvement, challenge and delivery. Similarly, Pool boards may also need to include representatives from their funds and improve transparency, including reporting investment performance and transaction costs.

Investment strategy advice

A number of the proposals have proven to be controversial within the LGPS. Perhaps most so is the push for funds to take their “primary” investment strategy advice from their pools. This represents a significant change from current practice – a poll run by Hymans Robertson showed 91% of over 80 funds did not want to source this service from their pool.

Not all LGPS funds employ investment consultants on a permanent basis, but 76 do across the UK, whilst the vast majority who don’t, use them for specific projects. Many also use independent advisers to contribute to the robustness of the advice. The most common of these projects is a review of the investment strategy, typically alongside the triennial actuarial valuation review.

The current approach

The current approach within the LGPS is to use the new funding position and future cashflows coming from the triennial actuarial valuation as a point to test whether the current investment strategy remains suitable, or if there are better options. The actuarial valuation acts as an important health check for a fund and gives the pensions committee the opportunity to review and test their beliefs on important issues like risk and contribution affordability. These important factors have a significant impact on the optimal investment strategy for a fund, and it is therefore important to reflect any changes to them in the investment strategy. This process is typically conducted in tandem by the fund's appointed actuary and investment consultant, with input from independent advisers, with the latter providing important input from an investment perspective.

Within the investment strategy review, once appropriate training has been undertaken and beliefs have been agreed with the respective Pension Committee, the majority of funds will work with an investment consultant who will recommend a number of high-level asset allocations that will be tested against the current investment strategy, challenged, debated and the most appropriate strategy agreed that meets the fund's objectives. These alternatives will be based on the outcomes of the actuarial valuation process, the pension committee's investment beliefs, the latest market conditions and long-term outlook, and the committee's climate ambitions. These will typically look at the expected impact of increasing risk and decreasing risk, typically with some alternative combinations of asset classes to achieve those. Key to all of this is ensuring the alternative investment strategies will be implementable and workable once in place, for example from a liquidity perspective.

From there, modelling is undertaken to test how the various investment strategies will perform in a wide range of market and economic scenarios, ranging from the very good to the very bad. This modelling is run by complex systems using a range of inputs, heavily based on significant levels of research, such as the expected returns and volatility of the different asset classes, as well as how correlated their returns are in different scenarios, and the potential impacts of climate change on future outcomes.

From this modelling, the investment strategies will then be measured against metrics such as the likelihood of that investment strategy achieving full funding over the long-term, as well as a downside risk metrics, such as how far the funding level could fall in particularly bad scenarios, or the likelihood employer contributions would have to increase. The alternative strategies will then be compared based on these metrics, with further scrutiny and debate, to find the optimal future asset allocation.

Once all is agreed, a final recommendation will then be put to the pensions committee for approval.

Government's proposal

The proposal from government is that the pools now replace the role provided by investment consultants and independent advisers in providing investment strategy advice. For seven of the eight pools, this is an entirely new service. It is proposed that funds work with their pools to set high-level investment strategy objectives, such as target levels of return and risk, investment preferences and constraints and responsible investment issues.

Under this approach, the pools would then be delegated the full implementation of those high-level investment objectives, including the strategic asset allocation. Table 1 provides a diagram summarising this.

Table 1: The roles and responsibilities of the Administering Authority versus the pool

	Task	Impact on overall investment outcome of the fund	AA Role	Pool role	Definitions
Strategy	Investment objectives	High	Decide	Advise	Return objectives, risk tolerances, investment preferences, constraints and limitations, and the approaches to local investment and responsible investment.
	Strategic asset allocation		Decide (optional)	Advise/ Decide	Long-term, stable allocation based on overall investment objectives and risk tolerance
Implementation	Tactical asset allocation		Monitor	Decide	Adjustments to the asset mix, such as in respect of geographic allocation, consistent with the asset allocation strategy.
	Investment manager selection		Monitor	Decide	Appointment of external (or in-house) managers of specific investment mandates
	Stock selection		Monitor	Decide	Choosing individual investment opportunities based on detailed analysis of the opportunity
	Investment stewardship		Monitor	Decide	Engagement with the invested companies in line with Investment Objectives.
	Cashflow management	Low	Monitor	Decide	Management of the disinvestment (or investment of contributions) in collaboration with administrators and Fund Actuary

Source: Ministry of Housing, Communities & Local Government

Alternatively, if they wish to, funds can instead provide a high-level strategic asset allocation, based on and limited to a template table provided by government. This is included below in table 2.

Table 2: Template for strategic asset allocation

Asset class	Strategic asset allocation (%)	Tolerance range (±%)
Listed equity		
Private equity		
Private credit		
Property / Real estate		
Infrastructure		
Other alternatives		
Credit (i)		
UK Government bonds		
Cash (ii)		

Source: Ministry of Housing, Communities & Local Government

This point raises a question of whether funds take the decision over investment strategy themselves, or delegate it to the pools simply based on their high-level investment objectives. In either case, it is proposed that the pool will advise on the setting of these; however, only opting to set the high-level investment objectives is an additional, and significant, level of delegation to the pools.

It goes without saying that, whether providing advice on the setting of high-level investment objectives or strategic asset allocation, this is a monumental shift in the role of the pool, and something that will take considerable work to build and manage. However, before assessing this, we examine what it is that the LGPS needs from an investment advisory service.

Canadian model - Strategic Asset Allocation Advice
(Research bullets provided by the Pension Policy Institute – 'PPI, 2025')

In August 2024, Chancellor Rachel Reeves met with representatives from the "Maple 8" funds and expressed a desire to learn from the Canadian model.

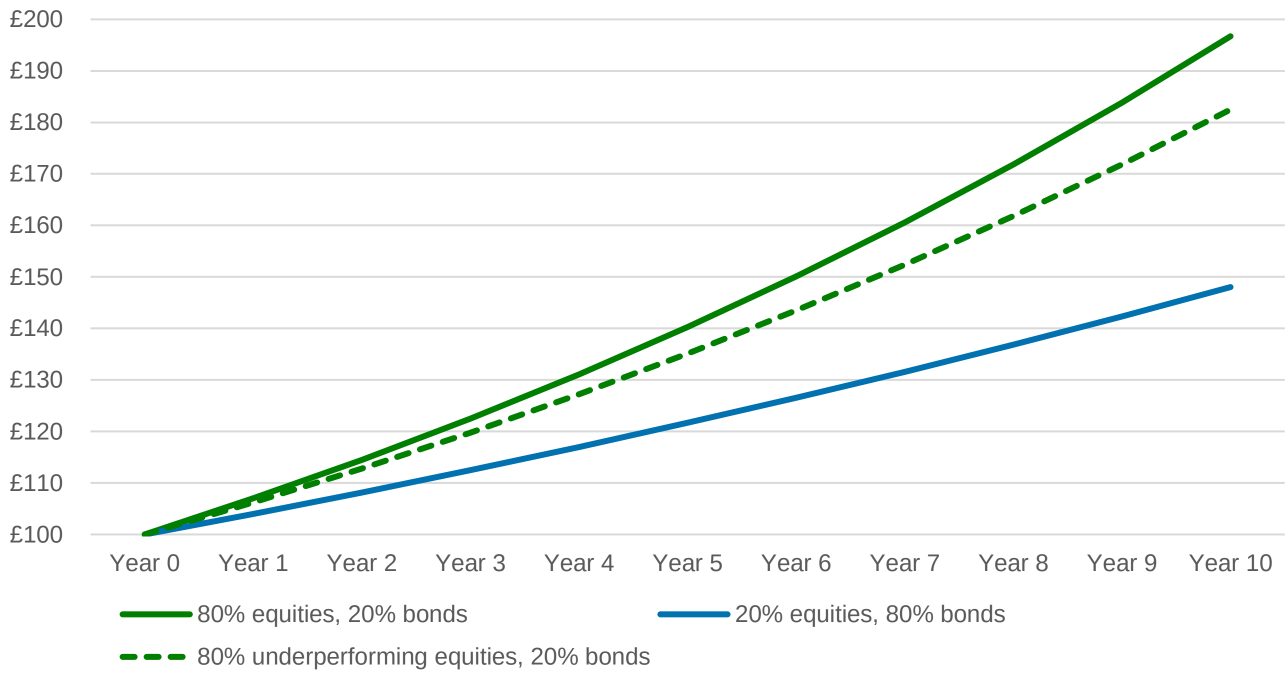
- Maple 8 funds are capable of making strategic asset allocation decisions in-house. The government's proposals would require the LGPS pools to develop the capability to advise funds on strategic asset allocation, although they do not have this yet.
- The Canadian funds in-house capabilities have been built over decades.
- The distinctions and interactions between the Canadian equivalents of LGPS Funds and pools vary in different provinces, but where parallels can be drawn, there are no restrictions on pool members option to seek advice or invest outside of pools.

However, there is some evidence of dissatisfaction from pool members around a "one-size fits all" approach.

What do funds need from SAA advice?

The decision regarding investment strategy is often acknowledged as the most financially important decision an investor can make over the long-term. Far more important than the implementation decisions, such as manager selection. A study as far back as 1986 found investment strategy was responsible for 93.6% of returns (Gary P. Brinson, 1986).

It makes sense. The proportion of your assets you invest in equities, earning c. 8% p.a., is far more impactful than the decision of which active manager to pick who will likely give you +/-1% p.a. around that market return. The analysis below shows the difference between the return on investing 80% in equities and 20% in bonds (solid blue line) versus 20% in equities and 80% in bonds (orange line). The higher equity allocation strategy returns double the lower equity allocation strategy. The dashed blue line then shows the impact of an 80% equity, 20% bond strategy where an active equity manager underperforms by 1% p.a. The return impact is far smaller. That said, there are of course times when extreme outcomes of implementation, i.e. very good or very bad, can outweigh strategy.



So, what do funds need their investment strategy advice service to be?

High quality

Given the financial impact of this advice, it is incredibly important that it is done well. In the next section we will go into what is required to provide a strong investment strategy advice service but, as demonstrated by the long-term financial impact, such important investment decisions need to be based on extremely strong research and rigorous systems and processes. The 2016 regulations state funds must take “proper advice”, defined as "the advice of a person whom the authority reasonably considers to be qualified by their ability in and practical experience of financial matters". Finally, it also needs to evolve over time, reflecting the latest conditions, thinking and opportunities.

Independent

It is important that this advice is independent. We cover this in more detail further on, but the advice cannot be biased in any way and must only reflect the best interests of the funds. There must be a strong degree of trust that any recommendations are not being made based on incompatible aims between the adviser and the fund. Finally, independent providers of this advice can help to prevent the problems of “group-think”, leading to a reduction in diversification across strategies.

Implementable

The advice needs to be implementable. For example, it is no good telling a fund that the analysis shows everything looking great from a risk and return perspective if they were to invest everything in private markets. It would be near impossible to deploy such sums into those markets, and would then mean they would not be able to access the cash required to pay member pensions.

Understandable

Similarly, it needs to be understandable. If pension committees can’t decipher the recommendations, or the reasons behind them, they will struggle to discuss and challenge the advice and make these decisions. This is achieved through skilled translation of very complex concepts and processes into terms and concepts that are relatable and easy to comprehend. This is not only through words, but the use of clear metrics, charts and diagrams. These often need to change for each review to reflect the current situation, for example a range of new analysis and metrics are required for this review to help funds to understand the best approach to managing the strong surpluses many funds in the LGPS have built up. To develop this takes years of institutional and personal experience.

Tailored

In addition to this, it needs to be tailored to each fund, reflecting their specific needs and objectives. There cannot be a single off-the-shelf model or approach applied to all funds, regardless of their beliefs, current position, priorities and aims. There must be scope to customise advice to the idiosyncrasies of each fund so that the review and outcomes are suited to their individual requirements. These include issues such as funds that are meaningfully cashflow negative and those with large employers with an extremely low tolerance to the risk of contribution rates needing to increase. As soon as this is scaled back and generalised, outcomes will worsen.

Value for money

Finally, it needs to be as low cost as possible, whilst remaining high quality. Local government are, of course, cost sensitive and need high quality services delivered as efficiently as possible. We’ll see in the next section the costs to build and manage a strategic oversight service. A key way to provide something high quality at low cost is through economies of scale, i.e. providing the same service across many buyers, so they share the fixed costs. This is something investment consultants are able to do. For example, Hymans Robertson costs are shared across not only the 30+ LGPS funds which they provide reviews for every 3 years, but also clients within their wider business. This required economies of scale is accessible by investment consultants providing services to the LGPS. Similarly, competition is a strong force for driving costs down, quality up and ensuring innovation continues.

What does it take to build an investment strategy advisory service?

Case study – Hymans Robertson's investment advisory service

Hymans Roberston has been providing advice to the LGPS, and its predecessors, for over 100 years. Over this time, it has evolved the services that it provides to meet the needs of LGPS stakeholders. A key part of the investment services provided is the ability to deliver market leading strategic asset allocation advice services. It should be noted that there is a spectrum of advice services that can be offered, ranging from options-based advice, more directed consulting focussed on specific solutions, to full fiduciary advice services which incorporate both strategic decisions as well as implementation. Regardless of the model, outlined below are some of the key requirements to be able to deliver the strategic element of the advice, which as outlined in the prior section, has the biggest impact on long term outcomes.

Market dynamics, assets and liabilities

Firstly, to be able to provide advice on strategic asset allocation, this needs to be built on a strong foundation of knowledge and understanding of market dynamics, financial assets and how they are expected to perform and interact in different economic conditions. This is the bedrock for providing strategic allocation advice, but this knowledge alone needs to be supported and focussed in a range of ways so this can be delivered effectively as we outline below.

As a funded pension scheme, when considering strategic allocation, it is also vital to understand LGPS liabilities to ensure the assets can achieve the primary objective of supporting the payment of pension benefits when they fall due as well as supporting locally determined funding strategies. For example, this includes modelling and factoring into advice the complexities of new staff joining the scheme.

Financial modelling and risk analytics

A key element required to support strategic asset allocation advice is the ability to provide modelling and risk analytics that allows advice to be thoroughly tested and evaluated. It's also key in aiding knowledge and understanding of potential investment outcomes and associated risks. To be able to deliver this requires:

- Economic scenario modelling – an approach to modelling the returns, volatilities and correlations of a range of investable asset classes. Hymans Robertson maintain an Economic Scenario Service (ESS) as the engine behind our modelling capabilities. They invest £800k p.a. in their ESS team to produce these as well as providing wider modelling services (climate scenarios etc).
- Strategy and risk modelling – the output from the economic models then needs to be incorporated in financial modelling that allows funds to test investment options and outcomes through process like asset liability modelling (ALMs). On an annual basis Hymans Robertson spend c. £1m in the Strategy and Risk development team maintaining these systems. In addition, they spend a further £800k pa on a modelling team which importantly ensures that the output from the modelling is engaging and helps effective decision making.
- Research and market data – another key input to strategic advice and supporting modelling is the research and market data that feeds into the systems and helps develop the views and frameworks for the strategic advice. Hymans Robertson spend around £3m pa on research and market data.

There are therefore significant cost and resource requirements in being able to build out the capability to provide or support strategic asset allocation advice. There are options to instead buy in off-the-shelf SAA systems, but these can come with some limitations and additional costs.

Licensing a 3rd party SAA system doesn't remove underlying complexity (market data, research views, modelling expertise), but outsources this to the system provider and limits flexibility. In turn, this increases the governance burden on the pools and funds to understand the mechanics of the system, so that it can be applied appropriately in the context of the material decisions taken from it. Two specific limitations are:

a. The system will embed assumptions on the risk and return profile of asset classes. Relying on this system without coupling this with research expertise, and fund / pool context awareness, increases the possibility of an over-reliance on modelling, or a misapplication of the results.

b. These systems will often exclude important details for the LGPS, such as an allowance for new entrants and bespoke employer contribution strategies. If the SAA decision making is to be taken in the context of long-term sustainability of funds, these are important dynamics to capture appropriately.

Consulting knowledge and communication skills

For strategic advice to be effective it also needs to be delivered and communicated clearly and concisely and importantly with a strong understanding of the needs and objectives of the fund it is being delivered to. This requires individuals that understand the needs of the LGPS and the options that will deliver the best investment outcomes. The market for consultants with the knowledge and skills required is highly competitive and can be challenging to attract and retain the right people.

Capital markets capabilities

Strategic asset allocation advice should not be purely model driven or take place in a vacuum. Advice should always take into account current market conditions, drivers of risk and returns and relative valuations. Having a capital market service helps to inform and shape investment advice and aid practical implementation. This is another area requiring specialist expertise as well as access to research and market data.

Regulatory and compliance requirements

There should be suitable measures put in place to ensure the provider of any investment services is properly regulated and authorised to deliver those services. We believe this is particularly important for the provision of strategic allocation advice given the impact on long term outcomes.

There are minimum threshold conditions that a firm must meet to become a regulated firm and to obtain, and retain, the relevant Part 4A permissions that are required to carry out the appropriate regulated activities. These threshold conditions include, but are not limited to:

- Appropriate resources - you must have sufficient and suitable financial and non-financial resources in place in relation to the business activities carried out, or to be carried out, e.g. employees with the appropriate knowledge and training to deliver advice, appropriate systems and controls in place.
- Suitability - you must satisfy to the Financial Conduct Authority (FCA) that your firm is fit and proper, which includes its connection with any person, the nature of the regulated activity the firm wishes to carry out, and ensuring the firm's affairs are conducted soundly and prudently. The FCA will consider how a firm conducts its business and whether it can demonstrate the appropriate skill, care and diligence in its work.
- Business model - a firm must be able to demonstrate and put forward an appropriate, viable and sustainable business model, given the nature and scale of the business they intend to carry out, e.g. appropriate mandatory policies and training in place, an appropriate Senior Managers and Certification Regime (SMCR) framework in place, governance arrangements within the firm.

The timeframe for becoming an FCA-regulated can take anywhere between 6 and 12 months, depending on the completeness of your initial application. Each application will vary from firm to firm and there may be other aspects of the application process that are not covered here.

Sourcing advice from pools

High-level investment objectives or strategic asset allocation

It is first worth discussing the proposals put forward by government on funds either setting high-level investment objectives for their pools or providing them with a strategic asset allocation.

The key difference between the two is an increasing level of delegation to the pool. Simply setting high-level investment objectives gives the pool free reign to go away and implement whichever strategic asset allocation and implementation they see as best to achieve those objectives. This is akin to a fiduciary mandate in private sector schemes, where high-level aims such as achieving full funding by a certain date are set, with the implementation to achieve that then delegated to the fiduciary manager. By the funds setting the strategic asset allocation, they maintain a higher level of control and local accountability.

Currently, funds set those high-level investment objectives and then work to convert those into a strategic asset allocation aligned to meet those objectives. Giving up strategic asset allocation decisions has not been done within the LGPS. Some might argue it is because it has not been available before these pooling proposals, but it has always been possible for a fund to select a single manager to run a balanced mandate or bespoke portfolio especially for them, based only on high-level investment objectives. Why has this route never been used? Because, as noted earlier, investment strategy is by the most important decision in relation to the affordability and stability of contributions. This means funds have wanted to ensure that their local circumstances, requirements and beliefs are fully integrated. This would be extremely challenging for any third-party to achieve.

We do not believe funds should go as far as to give up the strategic asset allocation decision. Whilst there are significant concerns with the proposed asset allocation template provided by government, compared to the option of simply providing the pool with high-level investment objectives, funds setting their own strategic asset allocation provides significantly greater autonomy for a fund to implement its objectives, beliefs, preferences and constraints. It also prevents the delegation of the most important financial decision a committee can make from to a provider who has not performed this role before. We strongly believe the option to set strategic asset allocation should continue to be available for funds for the long-term.

Why is this approach being proposed?

There appears to be a number of drivers behind government's desire to make the pools the source of investment strategy advice.

Government state this is a desire to prevent 'duplication and inefficiency across a pool'. They wish to see greater consistency across LGPS investment strategies. However, total LGPS investment consultancy fees to English and Welsh funds are estimated to be around £10-12m per annum for a scheme holding £392bn in assets, or 0.003% of assets per year, with the investment strategy review fees making up a smaller share of that. It is therefore unlikely that any meaningful savings can be achieved here, particularly when the pools will likely incur significant costs in the setup and maintenance of this service. In our view, the quality and independence of the advice an administering authority receives should be the primary factor in determining how investment advice is procured. Given the importance of the strategic asset allocation decisions funds take, we question whether the risk to the broader investment performance of the LGPS, as set against these costs, is proportionate.

There also appears to be a belief that investment consultants deliberately stand in the way of pooling, due to financial drivers. A narrative has emerged suggesting that investment consultants are overly picky or inflexible on the solutions designed by pools, in order to prevent funds from investing. Whilst there could be examples of this over the last 8 years, the reality is that these new pools, launching funds for the first time, have not always designed market-leading solutions. Investment consultants have gone from helping funds to find the best managers in the world to assessing whether pool solutions meet minimum standards to invest, given they have no track record and are being managed by entirely new teams and businesses. This perspective is reinforced by the fact 73% of assets are currently under pool management.

Through the build stages of pools, there is evidence that investment consultants have helped to improve the design of these solutions and given funds confidence that it is appropriate to invest, using their knowledge and experience of reviewing thousands of investment funds, to offer ideas for enhancements, both protecting funds and helping pools to achieve success.

Why might pools not be the best source of investment strategy advice?

As covered in the previous section, setting up and then managing an investment strategy advisory service is a monumental task with significant cost. It will be a huge distraction for pools to pull together a service offering in time for the 2028 actuarial valuations, particularly for the funds that like to do this work in advance of the valuation. Given there is already a well-developed, functioning and competitive open market for these services, it is unclear why this is a priority for pools to be spending their time, particularly in the short- to medium-term.

But there are further challenges to get over. The challenge heard most from funds is that they view receiving investment strategy advice from the entity that then implements it for them (and which they can’t leave) has significant conflicts of interest red flags. The most common issues mentioned are:

- **Reporting of performance** – in managing all of a fund’s assets, the pool will also become the reporter of that performance and whether they have done a good job of both the advice and the implementation. Whilst it is highly unlikely that any of this would be misreported or deliberately manipulated, the messaging around the performance will be owned by the pools. For example, excuses could be given for underperformance which funds are then under-equipped to truly test or challenge. A thorough test of the performance of such a complex appointment takes a significant amount of work, and independent advisers may not have access to the resources required to undertake this.
- **Lack of competition** – another key concern regularly mentioned to us is funds’ inability to move their investments to another provider. If they are unhappy with their pool, they have no options. Could this lead to a lack of motivation to provide a best-in-class service for their funds? Open market competition, including the ability to terminate mandates and move elsewhere, helps to reduce fees, drive innovation and improves client service. Furthermore, in the 2023 consultation on LGPS investments, government had proposed amending regulations to enforce the setting of, and monitoring against, targets for investment advisers. This no longer appears to be proposed for the pools.
- **Conflicting objectives** – it is not clear how much more influence government may have over the pools, both in the advice they give and the implementation. This is something funds should be conscious of. Government may be able to exert pressure on pools to help them achieve their policy aims, such as investing in the UK, or to de-risk to help manage government’s ability to borrow, with the LGPS now included in government’s fiscal measure, over focussing solely on the best investments for each fund and their overarching fiduciary duties. Similarly, there could be pressure for more consistent investment strategies across funds. This could be implicit, just by the government having the ability to decide it would like greater scale/a smaller number of pools, or explicit, with government having direct responsibility for those pools. As recently as November 2024, the directors of the board of AIMCo, one of the Canadian pension funds, were fired by the government of Alberta, along with the CEO, blaming underperformance

and rising costs (despite outperforming their benchmark and the increased costs being largely due to higher performance fees). An ex-prime minister has since been appointed as the chairman. This is despite a founding principle of the Canadian pensions model being independence and separation from government. Given the creation of the pools, and this sudden expansion of focus beyond fiduciary duty to achieving wider aims (like UK economic growth), there should be more independent advice to manage conflicts of interest and improve accountability and governance, not less.

> “
> *The Board is also concerned from a governance perspective about perceived, if not actual, conflicts of interest which arise where the pool is the fund’s principal, and possibly only, source of investment advice.”*-
> Scheme Advisory Board response to the LGPS (England and Wales): Fit for the future consultation

- **Fees** – it is not clear how pools meet the costs of providing additional services including SAA advice. Poorly considered fee structures could lead to a range of issues. Depending on how fees are structured, might this influence the advice that is given to funds? For example, might internally managed funds, where the majority of the fees are paid to the pool, rather than external managers, be recommended over externally managed? In addition, what pressure will exist to keep fees as low as possible?
- **Reduced innovation** – many funds informed us that they are concerned current proposals would lead to their investment universe reducing, and a key input into the advice they receive will be the pools’ desires to manage their own workloads. Furthermore, more generalised advice, leading to increasingly common investment strategies across funds, will reduce diversification across the LGPS. Whilst investment consultants can sometimes be accused of overcomplicating investment strategy advice to create additional work, significant innovation is driven from this process. This has led to some leading funds testing new asset classes, such as the recent push into natural capital strategies, giving comfort to wider funds and helping that to then spread throughout the LGPS and create enough demand for pools to then offer solutions. However, under the proposed approach, if funds would benefit from an allocation to new asset class, but it would create a lot of work for the pool to invest in it, will it be recommended? Will this stifle idea generation and innovation within the LGPS?
- **Pet projects** – some funds also mentioned a concern that assets may be steered into asset classes due to influential pool staff having an interest in it, rather than it being clearly beneficial for funds’ investment strategies.

Additionally, whilst not a conflict of interest issue, funds also expressed concerns around the level of resourcing and the robustness of the service that pools will be able to offer. The current use of investment consultants sees the LGPS able to benefit from established and robust processes whilst the sharing the costs of this with the large client bases of these firms. This will not be possible with a fully inhouse service from pools. This will either lead to higher costs or less robust advice.

We believe there is an alternative approach that helps to address both the government’s concerns over the current approach and funds’ challenges to the government’s proposal.

A new approach

It is clear from the consultation that government sees an issue in investment strategy advice being provided by entities separate to the pools, such as investment consultants and independent advisers. It is apparent that they believe this degree of separation leads to challenges from differing views and opinions as well as a perception of conflicting aims.

Challenges raised include investment advisers recommending investment types not currently available through the pool. It could well be argued that this is helping to innovate, that new investment opportunities with strong long-term benefits for the LGPS should be put forward to funds to consider, leading to the pools then developing cost-effective solutions in that space. It sometimes requires funds to be front runners and put their money into funds to help create established solutions that funds would be happy to invest in. However, where this has led to funds making allocations outside of the pool without clear reason, this has not been helpful for pooling.

Another challenge has been investment advisers overly scrutinising the solutions provided by pools or being inflexible in their preferred approach. Overall, however, evidence suggests that the review process has been positive for pooling outcomes. Consultants have applied their knowledge of the fund management industry and experience in reviewing investment solutions, helping funds identify strengths and areas for improvement. This has often led to enhanced offerings from pools and increased confidence among funds when investing, despite the lack of track record, smaller management teams, and ongoing development. However, when investment consultants have been overly critical or rigid, leading to investments outside the pool or multiple versions of a solution, it has hindered the pooling process.

Many of these challenges would fall away as pools complete the build stage. However, there is a far easier fix for these issues than forcing funds to take this advice from their pools. One that is likely more palatable to funds given the issues noted in the previous section and continues to add value and improve outcomes.

Our proposal

We propose that better outcomes would be achieved by instead working within the current structure, altered to work within the parameters set out within the consultation and address the government's concerns with the current approach.

We propose that the service operates as follows:

1. Funds can select who they receive investment advice from. This may be from investment consultants and independent advisers, benefiting from the established processes and systems already developed in place, or from their pools to help them build their capabilities. Funds being able to procure their own adviser, rather than by the pools, ensures the advisers are motivated to serve the best interests of the funds, rather than the pools.
2. The investment strategy advice is limited to that which is clearly implementable by the pools. This includes being able to invest in other pools' solutions where a fund's own pool does not offer one. This means recommendations to invest in asset classes not currently offered by the pools, or that could not realistically be offered in future, e.g. due to a lack of interest across other partner funds, would not be permitted in the advice. This prevents the issues of funds making investments outside of their pool, or pressure being placed on pools to provide niche solutions for only a single investor or small level of assets. Where not appointed as the primary provider of advice, pools should be a key participant in the investment strategy advice process, providing input into the advice from an implementation perspective.

3. As part of this process, advisers could put forward new investment ideas they believe to be clearly beneficial for funds to invest in that are not yet offered by the pool. This will not be a recommendation to invest in the opportunity regardless of a pool offering, but help to provide new ideas to funds and pools, that pools could then explore investing in.

Clear and compelling benefits for funds, pools and government

This method has a significant number of key benefits compared to the approach proposed by government.

Independent Advice: the solution provides independent advice, addressing the concerns around the advice being forced to be taken from the pools.

Expertise and Choice in Advice: the advice can continue to be based on the strong and well-developed expertise, experience and tools that investment consultants already possess. If funds would like to take their advice from the pools from day one, that is their choice. However, those that wish to wait until the pool has built up the expertise, experience and resources can continue to use investment consultants. Given the importance of this advice, with it being the most financially impactful decision a pensions committee can make, it is imperative that this choice is given. It also allows for continued idea generation and innovation within the LGPS.

Cost-Effective and Aligned Interests: the options for funds to procure their own investment adviser provides the benefits of continuing to achieve the lower fees currently provided by competitive procurement exercises, and clarity that the investment consultant is there to serve the funds' best interests, rather than the pools'.

Addressing the Advisor-Implementor Disconnect: the solution addresses the concerns stemming from the disconnect between the adviser and implementor. With advice being limited to only asset classes implementable through the pool, this prevents recommendations being given for assets to be invested outside of the pools, or becoming to excessively detailed and onerous for the pools to implement. As part of this process, new investment ideas can continue to be raised, such as attractive asset classes that the pool could invest in, to ensure new ideas and innovation continue to be delivered for funds.

Focus on Core and Impactful Responsibilities: the solution would allow the pools to focus their efforts elsewhere within this monumental expansion of their roles. This would remove one distraction from their day job of managing the assets to achieve the target levels of risk and return. It would allow them to instead focus on the taking on of the significant levels of assets that will now need to be passed to them, building their ability to take full discretion on the management of those assets within the set investment strategies, overseeing a large set of illiquid assets currently held by their funds and, perhaps most importantly, building local investment capabilities. A single one of these roles is a significant task, so removing one will certainly help the load.

Focus on local

It is known that the government's main ambition throughout this review is to increase investment into the UK. For the LGPS, this has taken the form of investing locally. Under the proposals, funds must work with local entities such as constituent authorities to source local investment needs and opportunities. These will then be passed to the pools to undertake investment due diligence and make the final decision on whether to invest.

This is a challenging task under any timescale. Assessing the investment prospects of local investment projects, such as housing developments or small-scale infrastructure projects, is a very different skillset to the fund manager selection undertaken by most pools so far. Perhaps more importantly, given the nature of these projects, there is a significant requirement to assess the impact these investments will have on the local area, including if they are mismanaged. Again, this is not easy to do. Adding to the challenge is that other than the work done by Greater Manchester, where they invest in this manner, there is no clear precedent of investing at such large scale to quickly leverage and learn from. There is not clear model or service for pools to buy in, so it must be built, but there is not a large number of experienced professionals in the market for pools to hire.

But the importance of these investments, and the suitable and responsible management of them, is of upmost importance to funds. The risks of having a negative impact on a local area, including the reputational risks, are significant and have often been a key reason for funds not to invest locally. It is therefore imperative that the pools are able to focus on building the appropriate resources and abilities to manage these assets appropriately.

Given the importance of this local investment to government also, it makes sense for government to allow the pools to prioritise building these capabilities over providing other services, such as building investment advisory funds (largely from scratch in 7 of the 8 pools). Importantly for government, given the lack of local investment market currently, if LGPS funds and pools do not build these capabilities, the investments will not be made and produce poor outcomes for the LGPS, local communities and UK economic growth. Conversely, services like strategic asset allocation already have a strong, developed, competitive and cost-efficient market that can continue to be used.

Ensuring the solution remains optimal

Recognising the pools increasing remit and development plans, LGPS strategic asset allocation advice arrangements should be kept under review. For example, as pools complete the asset transition, build out local investment capabilities, and establish and test oversight to the satisfaction of funds.

At which point it may make sense for pools to consider building out advisory functions. We would suggest the arrangements could be reviewed on a pool-by-pool basis every three years under the lens of improving efficiency, good governance and providing better outcomes.