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PPI Digest

The Chancellor's Mansion House Speech

LGPS Megafunds

What just happened? The Chancellor announced that Local Government Pension Schemes (LGPSs) investments would operate through investment pools rather than local authorities to generate megafunds which would bring a larger scale to their investment capacity. The Government intends to play a greater role in the governance of LGPSs and to mandate that 5% of LGPS funds are invested in UK assets.
It's important to note that a lot of LGPS investment is already done through pooled funds. There are currently 8 LGPS pools, and all LGPSs are a member of a pool. However, not all LGPS funds are invested through their pools, and the Government would like to see 100% of LGPS funds in pools.

The Pensions Policy Institute (PPI) statement:

100% pooling of LGPS funds will increase the investment opportunities for LGPSs. LGPSs have been working towards achieving higher levels of pooling already. However, there are some barriers to 100% pooling, at least in the short term. These schemes are often heavily invested in illiquid assets, and selling these off before their maturation could be costly for schemes and their members. LGPS schemes may also focus on investment in their local areas in order to improve local infrastructure, which would be more difficult on a 100% pooled basis. In addition, there are concerns from stakeholders that requiring schemes to invest a proportion of funds within domestic assets could result in tensions for schemes between acting in the best interests of members and supporting the UK economy. Market based risks will also arise if a large number of schemes begin competing to invest in very similar asset pools, resulting in potential scarcity. There may also need to be measures to increase the availability of high quality domestic assets for the pools to invest in.

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LGPS Megafunds continued

The proposed change will: increase investment opportunities but during the transition potentially increase member costs, raise governance conflicts and could result in market scarcity.

Adequacy: over the short term, consolidation at a fast pace could result in reduced returns on assets (if schemes have to sell off quickly) and increased costs for members (to fund the transition). Over the long term, adequacy could be aided through higher returns, unless there is too much focus on one asset type, resulting in scarcity issues.

Fairness: scheme member experiences are likely to become more homogenous if all LGPS funds are pooled and investment strategies are influenced by Government drives towards infrastructure and domestic equities.

Sustainability: the degree to which this policy impacts sustainability will depend on how it is implemented. Schemes will need to continue to be supported to invest in high quality assets which target returns and volatility management, and such UK based assets will need to be available. If schemes are required to invest in poorer quality assets in order to fulfil a Government quota, this could affect long term scheme funding levels.

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Minimum multi-employer scheme size

What just happened? The Chancellor announced that the government would be consulting on proposals to place a minimum threshold on pension default fund size. Comparisons are made to international evidence of fund size performance increasing when assets reach £25bn - £50bn. The consultation also proposes reducing the number of default funds offered by Group Personal Pension Schemes (GPPs).

The Pensions Policy Institute (PPI) statement:

If the threshold for the size of the default fund option of multi-employer DC pension scheme sizes is set at around £25bn there may be a reduction by 2030 to fewer than 30 default funds across providers. This assumes a market still skewed towards the largest providers and the continued growth of funds under management. There would also need to be a reduction in the number of customised default strategies typically offered in GPP arrangements.

Adequacy: The impact of consolidation will offer limited benefit only to the membership of smaller schemes. These members are unlikely to see a transformational change in their outcomes. So, while this is expected to have a positive impact on future adequacy, the effect will be limited.

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Fairness: Market consolidation will reduce choice for employers, particularly those who took advantage of the increased customisation available through GPP arrangements, but may improve value for money for members. The reduction in the number of providers and the tendency for members to remain in default funds will result in less variation between members as a result of the performance of their pension scheme.

Sustainability: introducing this threshold renders most multi-employer pension schemes unsustainable, although this will affect a minority of pension scheme memberships as the seven largest providers already manage 80% of DC assets. Most current providers would need to exit the market, reducing the number of providers offering multi-employer DC schemes from around 60 to potentially 20 or even fewer. This will reshape the financial products market, potentially impacting the provision of other products offered by insurers who also currently offer GPP provision.

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The Chancellor's Mansion House Speech

Local investment of council pension funds

What just happened? The Chancellor that each Administering Authority in the LGPS will be required to specify a target for the pool's investment in their local economy. There is an anchoring figure of 5%, which would represent £20bn of LGPS funds.

The Pensions Policy Institute (PPI) statement:

The proposed change should have no impact upon member outcomes as their benefits will be protected by the strength of their employers' covenants. Changes to the investment may impact the funding of schemes which would be balanced by the employers' liability. In theory if these investment opportunities exist and represent better value for the scheme than existing investments the scheme would already have made the investment:

Adequacy: the investment strategy will have no impact upon members' retained rights. If the expected future investment return of the fund is altered this may be reflected in contribution rates (if expected returns are reduced then contributions for future benefits, from employers and employees, will need to be increased).

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Local investment of council pension funds continued

Fairness: this will reduce the autonomy of trustees and restrict their capacity to set an investment strategy in the best interests of the scheme. If there is mandated investment to a certain level and there are insufficient high quality investment opportunities this will reduce the value for money of the scheme.

Sustainability: if the scheme is mandated to invest in poorer quality assets the future sustainability of the scheme may be challenged. For accrued benefits the employer may need to make deficit reduction contributions, and for future benefit entitlement either contributions would need to be increased or benefits accrual rates reduced. Any additional contributions made by the employer – mainly local authorities – might lead to high funding from taxpayers.

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The Extra Facts

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LGPS megafunds

	Where we stood	What has changed
What is this policy and how does it operate?	We currently have 8 LGPS pools, with around 39% of 86 local authority scheme assets invested through these (2022).	All LGPS assets to be invested through 8 pooled funds.
Who is impacted?	LGPSs are currently exploring options for further pooling with minimum impact to member charges and preservation of investment objectives.	LGPSs will be required to delegate the management of all their assets to the asset pool, this could impact member costs and investment returns depending on management and timetable.
When does the change come into effect?		This will be subject to consultation.
What is the likely behavioural response to the policy?	Schemes currently invest I best interests of members with a focus on local communities.	LGPSs may feel conflicted between member interests and Government pressure.

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The Extra Facts

Minimum multi-employer scheme size

	Where we stood	What has changed
What is this policy and how does it operate?	There is an estimated £600bn in institutional / workplace DC pension schemes.[1] The seven biggest providers manage nearly 80% of DC assets. [2] The other 20% is spread between smaller providers.	Driving consolidation in the system can have positive impacts on VfM, but after reaching a size of around £0.5bn any further gains are marginal. The experience in the Netherlands suggests that while a small positive impact on VfM can be seen from the lower cost and higher returns of larger funds, the effect is low order. Once a scale of £0.5bn is reached, the impact of scale on reduced charges is negligible. This conclusion is supported by the US experience, where biggest VfM gains are available to smallest schemes and that significant reductions in charges level off around $500m. A reliance on scale effects to make substantial improvement in outcomes, at least for those on low to median incomes, may be misplaced as the impact on VfM is marginal.[3]
Who is impacted?	Membership of multi-employer workplace DC schemes has been driven by automatic enrolment. 11.1 million people had been automatically enrolled by June 2024.[4] There are currently around 60 different multi-employer schemes, each investing savers' money into one or more funds.[5]	Members and providers of small multi-employer schemes. With a target default fund size of at least £25bn this would leave space for no more than 24 multi-employer pension schemes / providers in the UK. Detail would be subject to consultation, however, there would almost certainly result in a reduction in the number of schemes and customisation of default funds.

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Minimum multi-employer scheme size

	Where we stood	What has changed
When does the change come into effect?	From 2012 when automatic enrolment was introduced.	To be introduced over time with a target of 2030 as this would be a significant market disruption.
How much money is at stake?	The conclusion that consolidating all smaller and medium-sized Dutch funds would result in cost savings of only a 1.4% (€36m or £31m) for these funds underlines the moderate cost impact of further consolidation in the Netherlands.	PPI modelling of the impact from this scale effect suggests this is unlikely to be transformational for most members.[6]

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The Extra Facts

Local investment of council pension funds

	Where we stood	What has changed
What is this policy and how does it operate?	LGPS have funds with a market value of £391.5bn.[7] It is not possible to determine how much is currently invested in their local economy.	5% of funds are to be invested in their local economy, representing nearly £20bn.
Who is impacted?	Pension boards need to ensure at valuation that their assets are adequate to meet the scheme's liabilities. The valuation of future liabilities depends upon the expected investment return on assets.	A change to the expected investment return will impact the valuation of the liabilities. If the expected return is reduced the discount rate will be reduced. This increases the value of the liabilities and would push the scheme towards deficit. An increase in expected rates of asset returns would push the scheme towards surplus. Schemes that are pushed into deficit will need to raise funds, while those in surplus may be able to redistribute this surplus. The balance of this will need to be met by employers. Any additional contributions made by the employer – mainly local authorities – might lead to high funding from taxpayers.
What is the likely behavioural response to the policy?	Investment strategies are determined in the pooled funds by the pension scheme boards. They are responsible, with advice, to determine an investment strategy that best meets the schemes needs to match its future liabilities.	Pension boards will not be able to set an investment strategy purely in the best interests of the scheme. They will need to make investments that are not currently made. The reason they may not make these investments includes: the investments may be prohibitively complex; do not represent value for money; or do not otherwise best meet the needs of the scheme.

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The Extra Facts

Local investment of council pension funds Continued

	Where we stood	What has changed
Where does this redistribute money from and to?	There is currently no specific geographic bound on investments, and are instead assessed on their ability to meet future liabilities.	This is likely to increase local investment which has not been able to compete with other investment opportunities.
How much money is at stake?	Productive assets: Public Sector DB Using FSPS data on geographic distribution, we estimate that: ❑ £14bn is invested in UK corporate bonds; ❑ £65bn is invested in listed UK equities; ❑ £36bn is invested in UK property; and ❑ £36bn invested in UK private equity and alternatives Totalling £150bn and representing 5% of UK pension assets (£3 trillion) In addition, approximately £42bn is invested in UK Government bonds representing a further 1% of UK pension sector assets invested in the UK.[8]	5% of the current fund value represents investments worth £20bn. Reallocation to local investment would result in a disinvestment in other assets.

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2	Corporate Adviser (2024) Master Trust and GPP Defaults Report
3	Hurman at al. PPI (2021) What can other countries teach the UK about measuring Value for Money in pension schemes?
4	Okello, S. (2024) The DC Future Book 2024
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6	Hurman at al. PPI (2021) What can other countries teach the UK about measuring Value for Money in pension schemes?
7	Ministry of Housing, Communities & Local Government (2024) Local government pension scheme funds for England and Wales: 2023 to 2024.
8	Wells, J. (2024) Pension scheme assets – how they are invested and how and why they change over time.

Further Reading

PPI 2021: What can other countries teach the UK about measuring Value for Money in pension schemes?

PPI 2024: The DC Future Book in association with Columbia Threadneedle Investments

PPI 2024: Pension scheme assets – how they are invested and how and why they change over time

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For further information or comment please contact…

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About the Pensions Policy Institute: We have been at the forefront of shaping evidence-based policy for over 20 years.

The Pensions Policy Institute (PPI), established in 2001, is a not-for-profit educational research organisation. We are devoted to improving retirement outcomes. We do this by being part of the policy debate and driving industry conversations through facts and evidence.

Our **INDEPENDENCE** sets us apart – we do not lobby for any particular policy, cause or political party. **We focus on the facts and evidence.**
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