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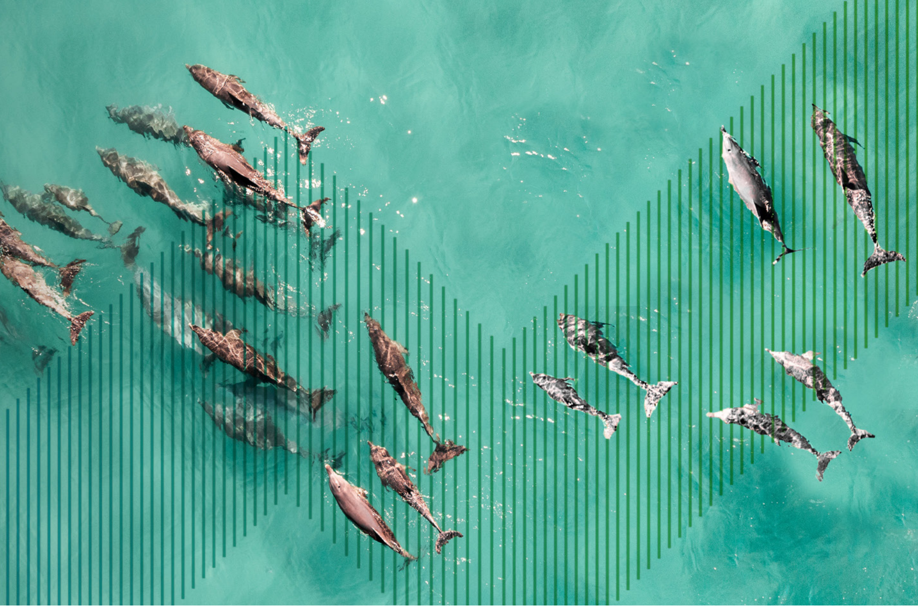
Preparing for pooling

August 2024



- The required reporting for the 31 March 2025 pooling deadline is a fantastic opportunity for funds to demonstrate the great work they have completed so far on pooling their assets.
- In order to adequately demonstrate this to government, plenty of planning and actions are required now, such as considering your pooling plans for specific assets and sternly testing your justification for any assets where there is no plan.
- It's also important to remember that assets under management is not the only measure of success for pooling – the development of the operations and oversight of the pools, as well as building partner fund confidence, are important too.

With the 31 March 2025 deadline to pool assets (or explain why you haven't) fast approaching, LGPS funds in England and Wales must consider their position. The new government has confirmed the deadline stands, with the threat of mandatory intervention hanging over funds. But this required reporting is a great opportunity for funds to demonstrate both their progress and their plans, as well as to fully justify any decisions to not pool.

This short note sets out the steps funds need to take to prepare for the reporting. These actions also serve as a useful way to challenge yourselves on whether you could pool more.

But first, what do we mean by "pooled"?

First up, it would be very helpful for government to provide some clarifications. The first is what is classed as "pooled". After last year's consultation on LGPS investments (click here for more detail), government had promised guidance to provide clarity on this question. However, given the change in government, the status of this guidance is unclear.

We can safely assume that assets invested in funds managed by the pools, particularly where they're selecting the underlying managers or picking the stocks directly, will fall under the definition of pooling. This is what the government termed "pool ownership" in their consultation.

However, there are a range of investments that are "overseen" by pools, which may or may not pass as pooled. Clear guidance on what level of oversight is classed as pooling, or what government terms as "under pool management", would be extremely helpful for funds' planning.

It might be naive to assume the new government will have all of the answers straight away. It's more likely that the first round of reporting will help government to shape its views on pooling and refine its expectations.

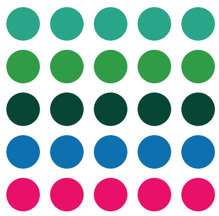
The second clarification would be whether the deadline applies to all assets or only listed assets, as the word "listed" disappeared from the government's conclusion of its consultation, only to reappear in the former minister's letter to funds in May.

In reality, it would be wise to focus on the spirit of the requirement – pooling all that you can. Assets that you can't pool will be those where your money is locked up, such as closed-ended private markets funds, or perhaps where the costs outweigh the savings. However, there have been hints from government that the success of pools as a whole is its priority, rather than cost savings at an individual fund level.

Fail to prepare...

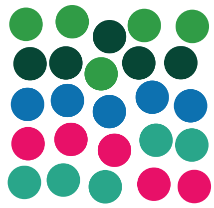
All that said, the first step for any fund will be to look across your portfolio and split the assets into three categories:

1.



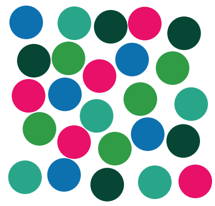
Those already pooled, either directly or through pool oversight

2.



Those not yet pooled, but with a plan to

3.



Those not pooled, with no plan to

These will form the basis of your reporting.

Category 1 – Assets already pooled

For the assets within the pool's funds, where they're selecting the managers or picking the stocks, this means job done.

For those assets under pool oversight/management, further information on the nature of the arrangement will be required. Here, you should make sure you're clear on the nature of the oversight arrangement, so that you can clearly articulate it in your report and explain the benefits it brings to your governance arrangements. It would be beneficial to ensure you are joined up with your partner funds too, to avoid conflicting reporting being provided.

Category 2 – Assets not yet pooled, but with a plan to

For these assets, it's best to have as clear a plan as possible. Why are they not yet pooled? Are you waiting for the pool to develop solutions? What are the expected timescales for this? Which of your assets do you expect to move into the new solutions? How do you expect your proportion of pooled assets to increase year by year? Answering these questions will also help you show to government the work you're doing to get your assets into the pool.

Category 3 – Assets not pooled, with no plan to

This is where most thought and preparation is needed, and where pressure is likely to be applied to funds.

As noted earlier, some assets can't be pooled, as they're locked into closed-ended funds with a defined lifetime. Here, it will be helpful to point to a plan for how the assets will be pooled once they're returned.

For those where it's not possible to achieve fee savings by pooling, either because the upfront transaction costs are too large or the pool has not achieved lower fees than your fund has, this will most likely need to be evidenced. And, as mentioned earlier, government may express a preference for your fund to pool regardless of the cost implications.

Government may look kindlier on assets outside the pool that have local impact or support the UK, as this is another area in which it's keen to see greater investment from the LGPS. For funds that have a desire to invest in their local area, their pool may not be the greatest implementation route, as other partner funds are less likely to want to also invest. Similarly, funds with specific impact aims may find that a pool solution, built for all partner funds' requirements, doesn't meet their needs. That said, government has made it clear that it would like to see the pools used as far as possible here.

Similarly, funds with particularly ambitious responsible investment aims, such as earlier net-zero targets, may not be able to achieve them through their pool's solutions if they aren't aligned to these aims. Again, government may accept this reason, given its interest in pension funds helping to tackle climate change. In both this case and for local investment, funds should, at the very least, be able to demonstrate that they've fully explored the ability to implement through their pool.

When assets haven't been pooled because the pool doesn't offer a solution in an asset class, and has no plans to do so, you'll need to justify the importance of that asset class to your fund. This will need to include information such as the role it serves in your portfolio – for example, diversification or income generation – and the clear benefits it achieves, evidencing this where you can. It will help if this is a large strategic allocation, rather than a small holding that will have a limited impact on your fund as a whole. You'll also need to demonstrate that no other pool solutions can perform a similar role in your portfolio.

The sternest test from government will most likely come if your pool does offer a solution, but you choose to continue investing outside. If you can't point to either assets being locked up or cheaper fees, then you can expect a strong test of your justification. If you haven't pooled because you don't have confidence in the pool's solution, you must be able to articulate and evidence why. Similarly, if you prefer a solution outside the pool, you must, again, be able to clearly explain why you believe it's better and will lead to improved outcomes. As far as possible, these need to be forward-looking – historical performance comparisons are unlikely to pass muster here. If you're invested in both your pool's offering and an external solution for diversification purposes, the diversification benefits will, again, need to be proven.

Demonstrating good behaviour

We must also remember that, this early in the life of the pools, the level of assets they're managing isn't the only measure of success. Building up working relationships, operating processes and oversight arrangements are all important steps towards making your pool work. Creating the confidence to invest larger shares of their assets is the key measure of success at this stage. Your fund's progress here should also be included in your reports.

Pooling is coming

The new government has made it very clear that pooling is the future for the LGPS. The upcoming reporting deadline, therefore, provides a fantastic opportunity for funds to demonstrate the great progress they've already made. While pooling progress is often described as slow in the press, huge strides have been made in just a few years, creating multi-billion-pound investment pools.

However, government must remember that these pools are still relatively new, and assets under management isn't the only measure of progress. For many pools, building up the confidence of their partner funds and improving the working practices with them has been the major progress, after which assets will naturally follow.

We believe funds should use the upcoming deadline and reporting to clearly show their progress on pooling. Not only the assets you have and plan to pool, but also the ways in which you've worked to build the pool, improve its operations and gain the confidence to invest. This reporting will be incredibly important to prevent mandated pooling.

If you would like to discuss anything further, please get in touch with your usual Hymans Robertson consultant.

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