London Borough of Croydon

Response to Call for Evidence (Pensions Review)

Responses can be made online or emailed to: pensions.review@hmtreasury.gov.uk

The London Borough of Croydon is the Administering Authority for one of the 87 Local Government Pension Scheme (LGPS) funds. The call for evidence covers both the LGPS and the DC market. Where we feel questions are relevant only to the DC market we have decided not to provide any response and have indicated that the question is outside the scope of our response. The London Borough of Croydon broadly supports the responses given by the London CIV and the Society of London Treasurers (SLT) and has in fact used the majority of the SLT response in formulating our own.

Scale and Consolidation

1. What are the potential advantages, and any risks, for UK pension savers and UK economic growth from a more consolidated future DC market consisting of a higher concentration of savers and assets in schemes or providers with scale?

This question specifically targets the DC market, which is outside the scope of our response.

2. What should the role of Single Employer Trusts be in a more consolidated future DC market?

This question specifically targets the DC market, which is outside the scope of our response.

3. What should the relative role of master trusts and GPPs be in the future pensions landscape? How do the roles and responsibilities of trustees and IGCs compare? Which players in a market with more scale are more likely to adopt new investment strategies that include exposure to UK productive assets? Are master trusts (with a fiduciary duty to their members) or GPPs more likely to pursue diversified portfolios and deliver both higher investment in UK productive finance assets and better saver outcomes?

This question specifically targets the DC market, which is outside the scope of our response.

4. What are the barriers to commercial or regulation-driven consolidation in the DC market, including competitive and legal factors?

This question specifically targets the DC market, which is outside the scope of our response.

5. To what extent has LGPS asset pooling been successful, including specific models of pooling, with respect to delivering improved long-term risk adjusted returns and capacity to invest in a wider range of asset classes?

The London Borough of Croydon is a member of the London CIV pool. The London CIV was established in 2015. We believe it is not possible to provide meaningful evidence to measure whether improved long-term risk adjusted returns have been achieved over the period from 2015 to date. We can measure the savings made and since its introduction, investment management fees have significantly decreased across major asset classes, particularly in private markets. The London CIV estimates almost £87 million in savings since its inception. We believe the cost savings and other benefits provided by the London CIV will lead to improved long-term risk adjusted returns.

It has taken time for the London CIV to establish itself and gain the confidence of member funds to invest. The London Borough of Croydon Fund was initially a reluctant investor, but has now committed to transferring all of its listed assets to the London CIV by 31 March 2025. This demonstrates that the success of the London CIV is now starting to emerge. Assets flowing to the London CIV have increased significantly over the last couple of years as the number of funds launched has increased.

The London CIV has launched several mandates, significantly enhancing its Partner Funds' capacity to invest in a wider range of asset classes. Examples of these include renewable infrastructure, buy-and-maintain credit, and UK-based property—all now accessible more quickly and cost-effectively than before the introduction of asset pooling.

LGPS asset pooling, however, continues to evolve, meaning the relationship between the Asset Pool and its Partner Funds remains paramount. The recent FCA regulatory permissions obtained by the London CIV provide further opportunities for the asset pool to work more closely with its Partner Funds. To support this, the London LGPS community has established a robust engagement framework, ensuring accountability as the Asset Pool's operating model develops. This strategic framework is led by Chief Finance Officers and Senior Pension Officers across the London Boroughs, backed by a strong, collaborative London pensions officer group. Several ongoing workstreams have been set up, aimed at addressing various aspects of LGPS scheme administration and investment.

Therefore, to ensure long-term success and deliver value to members and stakeholders, implementing an effective, modern governance structure should be a priority. Such a structure should provide proper oversight of the Asset Pool while maintaining local accountability. It should include representation from LGPS funds, scheme employers, and scheme members. At the same time, it should facilitate choice, allowing those with fiduciary responsibilities to fulfil their obligations to diverse stakeholders, whilst recognising that compromise will be needed to deliver an optimum pooled solution.

The ongoing collaborative efforts across the London LGPS community provide strong evidence of the potential for improved long-term, risk-adjusted returns through working together towards shared objectives.

Costs vs Value

1. What are the respective roles and relative influence of employers, advisers, trustees/IGCs and pension providers in setting costs in the workplace DC market, and the impact of intense price competition on asset allocation?

This question specifically targets the DC market, which is outside the scope of our response.

2. Is there a case for Government interventions, aimed at employers or other participants in the market, designed to encourage pension schemes to increase their investment budgets in order to seek higher investment returns from a wider range of asset classes?

We believe that there should be a focus on ensuring investment decisions are being made by informed and appropriately knowledgeable investors (by setting minimum training requirements etc) to meet the required returns. We do not believe that funds should be encouraged to seek higher investment returns as this could have the opposite effect due to funds taking on too much risk. Over the last ten years LGPS funds have been successful in

increasing funding levels by focusing on long term planning and good risk adjusted returns. This has resulted in lower employer contributions. After the 2022 valuation the average employer contribution rate for the LGPS was 20.8% compared to unfunded schemes where employer contribution rates have increased. The Teacher Pension Scheme employer contribution rate is now 28.68% and NHS 23.7%. This demonstrates that the LGPS is currently being well managed and has ultimately led to savings for the tax payer through lower employer contribution rates. Funds should be able to reduce their appetite for risk rather than being encouraged to essentially gamble with employer contributions, risk eroding funding and consequentially requiring higher and higher contributions, which could then place a financial strain upon employers. We believe that it would be better if the Government intervened by underwriting such investments, so that a satisfactory minimum return could be achieved that could lead to incentivising investments in a broader range of assets.

Investing in the UK

1. What is the potential for a more consolidated LGPS and workplace DC market, combined with an increased focus on net investment returns (rather than costs), to increase net investment in UK asset classes such as unlisted and listed equity and infrastructure, and the potential impacts of such an increase on UK growth?

The London Borough of Croydon has always focussed on net investment returns rather than costs when making its investment decisions. We believe that diversification is one of the best ways to manage risk associated with investment returns. Diversification can be achieved investing in a wide range of asset classes and investing different countries. Croydon has 31% of its assets invested in the UK and the UK makes up about 3.5% of global markets. Therefore it could be seen that our Fund is already heavily invested in the UK.

There is limited evidence to suggest that consolidation, whether by reducing the number of LGPS funds, Asset Pools, or both, will result in increased net investment in UK asset classes such as unlisted and listed equity and infrastructure, nor also on returns net of fees.

LGPS funds have distinct characteristics, including liability profiles, risk appetites, cash flow requirements, and other key objectives. Any attempt to further consolidate pensions across the LGPS could involve significant operational risks, risks that could substantially impact scheme members and their employers adversely. For example, a fund with a 85% funding level and another with 115% will likely have different outlooks and furthermore, the issue around local accountability (and employer contributions) becomes blurred.

Croydon supports increased collaboration across the scheme, both at LGPS fund and Asset Pool levels as we believe itis likely to be more effective and quicker, providing the potential for meaningful impact on UK growth. This collaboration extends to the widespread use of shared services in the LGPS across fund administration and investment management. However, there are additional areas which we are working on with regards to further integration to deliver better value which include better use of shared services (e.g. accountancy) and joint procurement, including advisors.

Several London LGPS funds have recently accessed UK-based investments, such as infrastructure and place-based investing, through the London CIV. In many instances, it is the Partner Funds themselves that have spearheaded these initiatives, with the Asset Pool implementing them based on investor demand. This clearly demonstrates the existing appetite for UK investments, provided the investment case is compelling.

Therefore, it is important to recognise that the primary factors influencing investment decisions in UK-based asset classes are not linked to the size of individual LGPS Funds or Pools. Rather, these decisions stem from strategic asset allocation decisions made at the fund level to safeguard scheme member pensions. This is in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, which requires all Administering Authorities to consider expected investment returns and diversification when setting their strategic asset allocation in their Investment Strategy Statements.

Clarity on this matter is urgently needed. This includes a clearer definition of what a "more consolidated LGPS" might entail, as well as the proposed approach to achieving such consolidation. Furthermore, there needs to be greater clarity on how fiduciary duty aligns—or potentially conflicts with—the aims of increased investment in UK assets.

2. What are the main factors behind changing patterns of UK pension fund investment in UK asset classes (including UK-listed equities), such as past and predicted asset price performance and cost factors?

As global investors with the primary objective of safeguarding member pensions, LGPS funds have the ability and willingness to invest in countries offering attractive risk-adjusted returns, including the UK. It is estimated that the average London LGPS fund has approximately one-third of its assets invested within the UK across various asset classes, including UK property, UK listed equities, and UK government gilts. Like other London LGPS funds, the London Borough of Croydon Pension Fund has 31% of its assets invested within the UK.

The London Borough of Croydon Pension Fund is similar to other LGPS funds which have traditionally maintained substantial allocations to UK Property. In recent years, they have expanded beyond traditional "core and core plus" property funds, venturing into residential housing and student accommodation. These sectors have become attractive due to favourable supply/demand dynamics and their ability to generate stable income—an important factor for LGPS funds as they mature. Furthermore, these place-based investments often provide positive environmental and social benefits, increasing their overall attractiveness to investors.

However, several factors have negatively impacted the relative attractiveness of UK listed and unlisted equity. For example, as of 31 August 2024, UK listed companies comprised only 3.43% of the MSCI ACWI Index, with most of the largest UK companies earning the majority of their revenues from outside the UK. Therefore, significant allocations to UK listed equities would not align with the investment diversification principle, which is rightly emphasised in the Statutory Guidance on Investment Strategy published in July 2017.

UK listed equity returns have consistently underperformed global financial markets, particularly the US. The FTSE 250 index, which reflects the real strength of the UK economy, has significantly lagged the MSCI ACWI index over the past five years, remaining essentially flat during this period. This stark contrast has led to a considerable shift away from UK listed equities. In addition to this, purchasing UK listed equities often incurs higher transactions costs which further deters investment capital.

In recent years, many LGPS Funds have either set or seriously considered adopting net zero ambitions and decarbonisation targets. UK listed equities have a lower representation of information technology companies and a higher allocation to legacy industries with greater

carbon intensity. Consequently, global stocks currently offer both higher expected returns and better alignment with ESG objectives.

If the government were to prioritise enhancing the UK's global competitiveness in business, emerging industries and technology, by addressing these issues, the relative attractiveness of UK listed equities should improve and likely lead to increased allocations to UK assets over time.

3. Is there a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC and LGPS funds to UK assets or particular UK asset classes, taking into account the priorities of the review to improve saver outcomes and boost UK growth? In addition, for the LGPS, there are options to support and incentivise investment in local communities contributing to local and regional growth. What are the options for those incentives and requirements and what are their relative merits and predicted effectiveness?

There is a case for establishing additional incentives to attract more LGPS funds to invest in UK asset classes. Such incentives could include government-funded financial and risk management measures, such as tax breaks or guarantees of minimum or fixed returns (the latter may be more palatable, as the government could benefit from any excess return, which could then be re-invested to further stimulate UK growth). These measures would enhance the attractiveness of UK investments for LGPS funds while ensuring they meet their objectives.

However, these should only be incentives that LGPS funds can voluntarily use if they align with the funds' best interests and investment objectives. In considering any requirements aimed at encouraging raising allocations to UK assets, any such effort would likely conflict with and complicate the fiduciary duty of those responsible for governing LGPS schemes.

LGPS scheme liabilities currently rest with the relevant employers. Therefore, any directives regarding portfolio allocation must carefully consider this fact. Individual LGPS funds are required consider these liabilities when making investment decisions, focusing on risk-adjusted returns rather than externally imposed targets or aspirations.

While UK growth benefits the wider economy, its delivery should primarily be a government responsibility, not that of employers and pension savers. Directing investment into specific asset classes could potentially lead to increased employer pension contributions or reduced pension pots–outcomes that would likely hinder rather than enhance UK growth.

All of this is under the current framework – if the government were minded for a solution which provided a total return to the overall public sector (the wider taxpayer), allowing other tangible benefits to be realised and socio economic or non tangible returns to be factored in, a complete overhaul of the legislative and accountability framework would be required. These would necessitate certain prescribed underwritings and guarantees to ensure that pensions remain payable.