HYMANS ROBERTSON

TOGETHER, STEPPING INTO THE FUTURE OF THE LGPS

16 May 2024

We held our 2024 LGPS conference at Edinburgh's Kimpton Hotel on 16 May. We were delighted to welcome over 25 LGPS funds on the day.

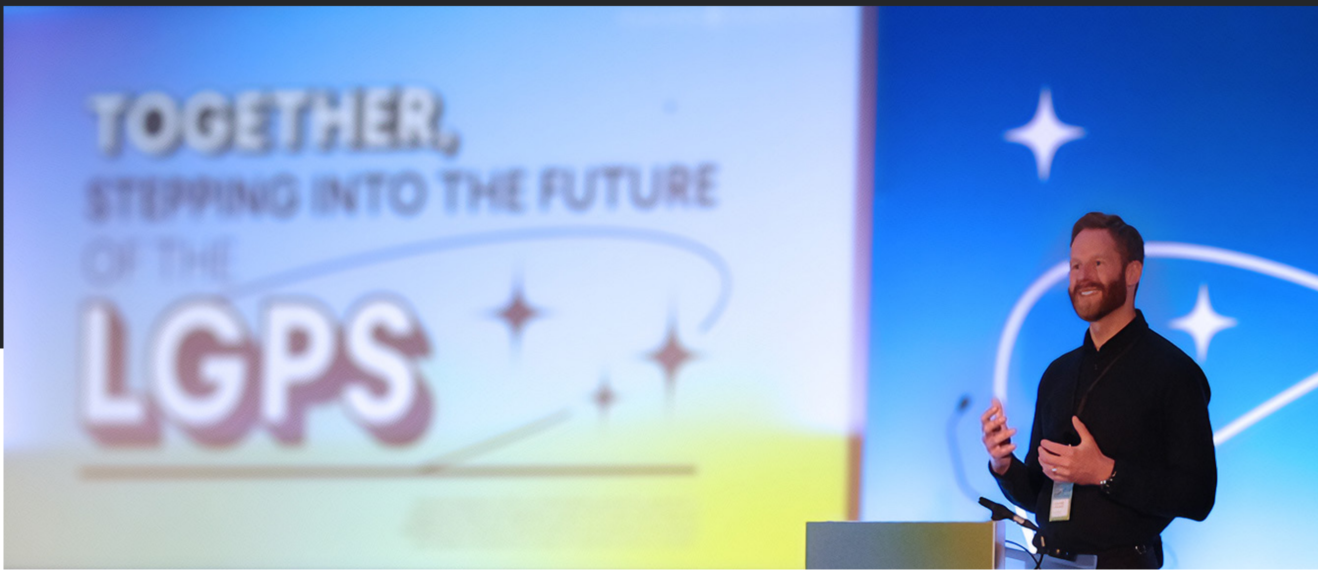
Our goal was to take a step back from today's long officer to-do lists – looking instead at the factors and trends that will shape the future of the LGPS. We focused on presenting big ideas but not necessarily big conclusions. In other words, the aim was to help funds more confidently factor in the future direction of the LGPS when planning, taking actions and making decisions in the shorter term.

We structured the day based on feedback from officers about what they wanted from an LGPS conference: fast paced, shorter sessions on broader topics, and to hear about – and from – funds that don't typically speak at conferences (the unsung heroes!). All of this in an officer-only, constructive environment where questions could be asked at any time – even the hard questions.

And because we're serious about the environment, we've offset the carbon output of delegates' travel and will also plant a tree for everyone who registered.

If you wanted to attend, but couldn't, here's an update on what you missed on the day.

– Robbie McInroy, Partner



WHAT NEXT FOR THE LGPS?

In this session, Catherine McFadyen, Jeremy Hughes (Local Government Association) and Calum Cooper looked beyond day-to-day operations to consider the macro trends and factors in an election year – and how the LGPS could evolve to face these challenges.

Central government is increasingly influencing LGPS investment policy – for example, through levelling up. But foreign policy could become a greater consideration, particularly when it comes to investing in countries that are strategic rivals to the UK. It's also important to address the gender pensions gap – possibly by promoting employer best practice. In terms of investment pools and administering authorities, Jeremy noted we still lack definitive answers on key issues, such as their optimal size.

The private-sector perspective

Calum Cooper showed the private sector DB pensions journey over last 18 years. In 2006, there were 7800 DB schemes. There are now 5000, as schemes have wound up and closed, with only 188 open to new members. Private-pension inadequacy could prove to be the biggest threat to LGPS sustainability, with private-sector savings four times less than in the public sector. But does it mean the government will intervene to either level down the public sector or level up the private sector? Time will tell.

In summary, there are many and varied challenges ahead, which makes it essential for those of us who 'know and love' the LGPS to productively engage in the debate and make our voices heard.

THE DIRECTION OF LONG-TERM LGPS FUNDING AND WHAT IT MEANS FOR TODAY

Rob Bilton presented the next session, which considered funding trends over the next 10 years. Rob set out three trends that he thinks will influence future funding decisions:

01. **Size of assets:** because LGPS funds now hold more assets than they ever have, and with values likely to rise further in the next 10 years, we're a long way from the talk of 'death spirals' in the 2010s – could the LGPS see instead a 'glorious explosion' in asset values?

02. **Impact of contributions:** as asset values have grown, contributions will become less and less effective in terms of helping to manage funding positions in future. Will contributions end up being more important for cashflow management than funding?

03. **Make-up of funds:** there are still over 10,000 schools that have not converted to academy status. For funds in England, this means an extra 10,000 employers could potentially join over the next few years. Additionally, as more employers exit, orphan liabilities could make up 10% of a typical fund's liabilities. How will funds manage this growth in employer numbers and legacy liabilities?

Rob's thoughts were followed by a panel discussion with Simon Taylor (Assistant Director of Pensions, West Midlands Pension Fund), Laura Colliss (Pension Fund Manager, North East Scotland Pension Fund) and Cory Blose (Employer Services & Communications Manager, Northamptonshire Pension Fund). Topics discussed included the importance of managing stakeholders' expectations about what 'surplus' actually means; getting the messaging right for members, councillors and government; how cash-flow management and the role of contributions will remain essential; and whether orphan liabilities are a funding opportunity or risk.

> I really enjoyed the conference and in particular the range of topics and their future looking focus. There was a lot in there to think about and it was great to hear from other funds too.
>
> It was a quality event with quality speakers.
>
> **Elaine Muir,**
> Fife Council

THE OPERATIONAL FUTURE OF THE LGPS SENIOR OFFICER ROLE

After lunch, Ian Colvin ran an interactive session about the senior officer role, which was first mooted in 2019 when the England & Wales SAB took on the Good Governance project to examine the effectiveness of LGPS governance and identify enhancements.

When asked to pick the most appropriate leadership style for this role from a list of six, 33% of delegates chose ‘participative’ (listening to everyone’s thoughts before making the final decision), with 27% picking ‘transformative’ (inspiring people and instilling passion). But the best style of management is likely to depend on context and circumstances. The key point is that leadership sets the strategy and tone. So, getting the right leaders and the right structures in place will be essential.

When asked about the biggest challenge of developing the LGPS senior officers of the future, 51% chose maintaining the pipeline of talent, with retaining people in post, acquiring the necessary skills and a lack of support and guidance listed as other challenging factors. The talent issue could be addressed by robust succession planning and by recruiting from elsewhere – for example, the private sector.

Ultimately, we must wait for the consultation on Good Governance, which we expect this year. If the role is formalised by legislation or guidance, the delegates in the room will form the first wave of senior officers.

THE FUTURE OF ESG

Susan Black chaired a panel discussion with Amy Sutherland, Neil Sellstrom (Tyne and Wear Pension Fund) and David Vallery (Lothian Pension Fund).

Amy began with a presentation on Environmental, Social and Governance (ESG), a phrase first coined in 2004 by the UN Global Compact. Twenty years later, legislation and regulation have increased, presenting a host of risks and opportunities. Over the next 20 years, Amy suggested that Hymans Robertson’s three-pillared ABC approach (Achieving net zero, Being better stewards and Creating positive impact) in combination with a focus on themes such as biodiversity, AI, modern slavery and pandemic risk will help to navigate these risks and opportunities.

The panel agreed that while the ‘S’ and the ‘G’ in ESG haven’t been forgotten, the ‘E’ (specifically, climate change) is the biggest issue and is likely to remain so in the future. It’s important, however, to try and build in the S and G, to ensure a holistic approach to long-term risk management.

To conclude, Susan asked whether in 10 years’ time ‘responsible investment’ will be simply called, ‘investment’? The panel were hopeful that the answer would be yes, especially in the UK.

THE FUTURE OF INVESTMENT RISK MANAGEMENT: SAYING WHAT WE SEE

Most LGPS funds are in a strong funding position, and we should explore innovative ways to deal with this. Iain Campbell was faced with the intimidating task of either making investment risk management interesting or… playing a game (in this case, we played our own version of the Catchphrase gameshow – where you say what you see).

A change of scene

Why has the funding scene changed? Largely because of how gilt yields have moved since 2015. In short, after years of ultra-low or negative yields, meaning gilts were largely off the menu for many LGPS funds, the recent huge rise in yields means the next investment strategy reviews are likely to look very different to the last few.

Come full circle

In a traditional LGPS strategy, assets are divided into growth, income and protection. When it comes to de-risking your investments, you would traditionally move growth assets, like equities, into protection assets, typically gilts. This way, the overall risk is brought down, with the downside that expected returns are also reduced. The challenge is whether this will be affordable, or will it put pressure on contributions, which is difficult to get past when gilt yields are ultra-low. Otherwise, you can de-risk through diversification: this involves a wider range of investment types that behave differently to one another – things like infrastructure and private debt. This helps because you should expect higher returns from those assets compared to gilts. However, the challenge is this typically leads to a portfolio that's more complex and less liquid. Diversification as a risk management tool also leaves you when you need it most – these types of assets will also drop when equity markets plummet. Both options have their pros and cons. But with such higher yields, the traditional method of moving into gilts is potentially back on the table.

However, rather than stopping there and just moving more money into gilts, we see this strong funding position in the LGPS as a big opportunity to go…

Back to basics

You need to set a definition of investment risk. Only then can you properly manage it. It could include volatility in asset values or funding levels, and it could be over the long term or the short term. Whichever you choose will have a big impact on the right mix of assets to hold to manage those risks.

Horses for courses

And once you've set your definition, you have to find the right investments to manage the risks. But gilts aren't the only way to do this. It can be helpful to learn lessons from outside the LGPS – for example, using 'anti fragile' assets like gold, foreign currencies (particularly the Japanese yen and US dollar), US treasuries or derivatives-based strategies. Very few LGPS funds use these. But during times of market crisis – like the dotcom bubble, GFC or Covid-19 – these types of investments have performed really well. A simple basket of these has also outperformed gilts over the long term. That makes them an option for managing short-term risks without harming long-term returns.

There are even smarter ways to manage risk: you could set up a simple and easy-to-implement framework to steer your money into different assets based on what's going on in markets. That's just one option for best fitting your protection assets to the current market environment and your own definition.

To sum up

No matter which option you choose, it's important to follow three steps: review your beliefs and definition of risk, stress your fund against your chosen risks and then manage ***your*** risks.

> Exactly the conversations the LGPS (in Scotland) needs to be having – informed, thoughtful, forward-looking. Right time, right place, right people.

Richard McIndoe,
Strathclyde Pension Fund

TRANSLATING BIG TECH TRENDS INTO THE LGPS

To finish the day, Chris Varley (Partner and Head of LGPS Digital) encouraged delegates to think about long-term big-tech trends affecting not just pensions but the wider industry. He highlighted some of the challenges of working with new technology. Firstly, because it often emerges from academic research, new technology is often discussed using specialist jargon, making it less approachable. Building some basic knowledge – using less daunting sources of information like BBC Click or TED Talks – can help break down this barrier.

Secondly, technology is not inherently valuable. It only becomes valuable once a useful application is found. When considering which ideas to focus on, you could start by thinking about what's affecting your scheme, whether that's environmental or internal factors. It can also be helpful to seek third-party views.

He also suggested that controlled experimentation is a practical way to find applications without investing a lot of time and effort. A notable innovation is AI, which Chris demonstrated by building a chatbot using a generative pre-trained transformer (GPT).

The delegates' questions brought up the importance of safeguarding when using AI, with trusted sources of data being crucial – you can only rely on the results after multiple checks, testing and requirements analysis. It's important to restrict these tools to only use trusted repositories of information, rather than the internet at large, if you need specific answers to be generated.

In short, human judgment and oversight is an important part of the process.

FIND OUT MORE

If you'd like to explore any of these themes further, please get in touch with one of the sessions' presenters, or get in touch here.

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If you were unable to join us on the day, or would like to relive the highlights of the day, **watch our highlights video here.**

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