By email to LGPensions@communities.gov.uk

16 January 2025

**Local Government Pension Scheme (England and Wales): Fit for the future**

1. ShareAction is a UK registered charity that works to build a financial system that serves our planet and its people. ShareAction works to define the highest standards for responsible investment, mobilising investors to take action to improve labour standards, tackle climate change and the biodiversity crisis, and address global health issues. We have strong relationships with financial regulators, government departments, investors and asset owners including UK defined contribution pension schemes. ShareAction was previously called Fair Pensions and we have called for fiduciary duty reform and pensions reform generally for over 10 years.

2. We write in response to the above consultation published on 14 November 2024. Our response to this consultation relates solely to **urging the regulation of investment consultants as part of the review of the Local Government Pensions Scheme (LGPS).**

3. The government is consulting on delivering a major consolidation of Local Government Pension Schemes. Proposed changes to LGPS arrangements will lead to a smaller number of bigger funds which will be regulated by the FCA but which will still be obtaining advice from investment consultants who might not be regulated.

4. The current LGPS consultation includes the following proposals for administering authorities (AAs) and pools:
    a. AAs would remain responsible for setting an investment strategy for their fund, and would be required to fully delegate the implementation of that strategy to the pool.
    b. AAs would be required to take principal advice on their investment strategy from the pool.
    c. Pools would be required to be established as investment management companies authorised and regulated by the FCA, with the expertise and capacity to implement investment strategies.

5. The LGPS consultation notes that currently, 5 of the 8 pools are established as FCA authorised investment management companies. The government proposes that all pools should be established as investment management companies and all such companies would require FCA authorisation. The consultation states that not all pools have the existing capability to provide advice to the AAs; full advisory capability, or the means to share advisory capability across pools, would need to be developed over time and that in the meantime, the government expects that pools would seek to procure advice on behalf of their partner funds. It seems reasonable to suppose that such advice would be sought from investment consultants which then makes it surprising to require pools to become authorised and regulated by the FCA without also requiring the firms who advise the pools on their investments to also be authorised and regulated by the FCA.

6. Last year, ShareAction wrote to HM Treasury urging the regulation of investment consultants. We noted that on numerous occasions over the last ten years the Financial Conduct Authority, the Competition and Markets Authority, parliamentary committees and other interested parties have called for investment consultants to be brought within the FCA's regulatory perimeter. Please see the following link for the full text of our letter to HM Treasury. https://shareaction.org/policies/hm-treasury-should-expedite-the-regulation-of-investment-consultants

**There are several reasons why we consider that the regulation of investment consultants is needed and why this should happen as part of the current pensions review**

7. The FCA currently regulates some, but not all, investment consultancy services. Investment consultancy services which are not regulated activities include advice on investment strategies, manager selection and asset allocation, and advice on the suitability of a fiduciary management service or provider. The unregulated activities of investment consultants significantly influence the investment decisions taken by UK pension schemes and will have a significant impact on pension scheme outcomes.

8. Advice on strategic asset allocation is one of the most important aspects of investment consultancy advice:
    a. Strategic asset allocation determines the assets within a pension scheme portfolio;
    b. Strategic asset allocation is a key determinant of the likely returns of the pension scheme; and
    c. Strategic asset allocation can also influence markets in general (for example, the widespread adoption of the LDI approach).

9. Given the general importance of strategic asset allocation advice it seems illogical and unjustifiable that this is one of the services that is not regulated. Furthermore, given the government's current focus on expanding asset allocation and encouraging pension investment into UK assets, the issue of strategic asset allocation will become increasingly important.

10. The investment consultancy market is relatively concentrated and the market power of certain players will be further increased following recent acquisitions, including the acquisition of Cardano by Mercer.

11. There are concerns about potential conflicts of interest within the sector:
    a. There is a potential conflict of interest when investment consultants are both assessors of asset managers and also seeking to provide services as the fiduciary manager of assets themselves.
    b. There is also a potential conflict of interest where investment consultants offer their own Master Trusts. As an illustrative example, Mercer is one of the biggest investment consultants in the UK and it provides advice to a large number of UK pension schemes but it also runs its own DC Master Trust and its own DB Master Trust.

12. There can be significant variation in performance across pension providers and these significant divergences in returns would mean substantial differentials in outcomes when compounded over a pension saver's lifetime. Investment consultants' recommendations will have a big impact on member outcomes given this wide variety of performance, so it is important that these decisions - which are rarely revisited and never reversed - are conflict-free.

13. Advice on systemic risks should be, but may not always be, appropriately included in advice from investment consultants. The regulation of such advice would enable parameters to be developed and assessed to ensure the provision of suitable advice on systemic risks.

14. The investment consultancy industry has faced criticism for the use of economic scenario models which significantly underestimate both the scale of future climate-related damages and the near-term risks of such damages occurring due to the failure to include climate tipping points in their models, which may result in incorrect investment advice. The Institute and Faculty of Actuaries has stated that many climate-scenario models in financial services are significantly underestimating climate risk, in particular because the real world impacts of climate change, such as the impact of tipping points, are largely excluded. There is also concern about the use by investment consultants of Integrated Assessment Models which have been criticised for their flawed analysis of the impact of climate change on investment returns and the inaccuracy of their forecasts. We would encourage the government to consider an inquiry or evidence session to examine the extent of the use of inaccurate climate scenario models and the erroneous investment advice which may result.

15. We would also suggest that regulation of investment consultants should support the government's broader objectives and ambitions:
    a. Regulation of consultants should support the government's objectives around scheme consolidation, given that consultants do not have much of an incentive to be helpful in this regard (more schemes means more clients for consultants).
    b. Regulation of consultants should help the government's ambition to secure better long term outcomes for UK savers by enabling more consistent and high quality advice through regulatory supervision of that advice.
    c. Regulation of consultants should help the government's objective of mobilising private capital for low carbon transition by enabling more consistent and high quality climate modelling to underpin the advice received by schemes.
    d. Regulation of consultants should support the government's objective of seeing more UK pension capital allocated to UK productive assets.

16. In relation to productive asset allocation, consultants' influence over strategic asset allocation by UK pensions schemes is highly relevant. It is also reasonable to consider that consultants' advice has driven pension capital out of UK assets over the last decade. We therefore consider that regulation and oversight of the strategic asset allocation advice provided by investment consultants should assist in enabling more productive asset allocation and the regulation of strategic asset allocation would give comfort to schemes to invest in a wider range of assets in the UK. In particular, private equity and other longer-term investments tend to be more risky and have a more uncertain and potentially a more volatile profile. Such assets will certainly have a different risk-return profile to the investments normally made by the majority of pension schemes. Regulation and oversight of advice on strategic asset allocation should help mitigate

some of these risks and encourage pension schemes to have more confidence in investing in a broader range of assets.

17. Regarding the type of regulation that would be effective, this should be determined by HMT and the FCA. However we would think that the following approach would be reasonable:
    Step 1: Add regulated activities and include all those not currently regulated at all.
      Step 2: Once all firms are regulated, the FCA would need to assess conduct and advice provided e.g. look at whether investment consultants are actually providing bespoke advice to that client and potential conflicts of interest.
      Step 3: Implement specific rules in the FCA Handbook based on what is going wrong or not working well.

18. Once investment consultants have been brought into regulation, regulators could then proceed to conduct more detailed assessments of the reasonableness of the methodologies adopted by investment consultants. Such an assessment would assist the regulator in determining whether investment consultants are advising on overall value rather than cost or other metrics.

19. It would be worth including in legislation the ability/requirement for the FCA to put requirements on investment consultants to consider environmental and/or wider sustainability issues when giving advice.

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