Department for Communities and Local Government

Local Government Pension Scheme: investment in partnerships

Summary of responses

March 2013
Department for Communities and Local Government

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Introduction

1. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 Regulations [the "2009 Regulations"] are designed to enable fund managers in each of the 89 locally administered pension funds in England and Wales to pursue effective investment strategies, so that local authority pension funds can deliver the returns needed to pay Scheme member pensions as well as to protect local taxpayers and employers from risks associated with meeting long term pension liabilities.

2. The 2009 Regulations set out prescribed limits on different and divergent investment products so that local authority pension funds can spread risks across a number of different types of investment. Currently, the absolute prescribed limit on investing in partnerships is set at 5% for a single partnership and overall no more than 15% of capital value in each of the funds, so as to enable these funds to take advantage of certain unregulated investment opportunities.

3. Concerns have been expressed that local authority pension funds have not been in a position to diversify their investments into vehicles established to take advantage of potential returns from investments in infrastructure opportunities.

4. In particular, it was suggested that the current absolute legal 15% limit on investing in partnerships was too low and would put some local authority pension funds at risk of exceeding this limit, thereby preventing them from pursuing infrastructure investment opportunities as well as helping the economy to grow.

5. A consultation exercise was, therefore, carried out seeking views on a number of issues which would remove this perceived barrier to extending investment options.

Consultation proposals

6. The consultation sought views on a series of options for amending the 2009 Regulations to remove the perceived barrier to funds taking up opportunities to invest in infrastructure projects by use of partnerships.

7. The Department invited respondents' views and any evidence on all aspects of the consultation and in particular to the following options and questions:

A) Increase the limit on investments in partnerships from 15% of a local authority pension fund to 30%.

Such an increase could facilitate investment in infrastructure investment vehicles along side other existing arrangements organised as limited liability partnerships. However, there would be no direction for funds to spread investment in limited liability partnerships between different classes of investment. For example, a fund could use this higher limit to increase the proportion of funds that could be invested in other investment opportunities such as private equities. In addition, any increase to the proportion of funds invested in partnerships must be considered within the increased risk potentially involved in such vehicles and the risk assessment which is already required.

B) Create a new investment class for investment in infrastructure (including via limited liability partnerships), with an appropriate investment limit of 15% of an overall fund.

Again, this approach would need to be considered in the context of increases in risk associated with investment in limited liability partnerships. However, it may help to protect against concentration of investment in a particular type of investment. In considering this option, respondents are asked in particular to offer views on how this might best be defined in regulation.

8. In the light of the options set out above, the Government would welcome views on the following questions:

    I. How best could the LGPS (Management and Investment of Funds) Regulations 2009 be amended to enable local authority pension funds to invest more easily in infrastructure vehicles?

    II. What would be the most appropriate limit on investment in partnerships contained in the LGPS (Management and Investment of Funds) Regulations 2009?

III. Should a new investment class for investment in infrastructure (including via partnerships or limited liability partnerships) be created and be inserted into the LGPS (Management and Investment of Funds) Regulations 2009? If so, what would be an appropriate limit for such a class? How might this be defined in regulation?

9. Are there other ways, not specifically raised in this consultation document that the LGPS (Management and Investment of Funds) Regulations 2009 could be amended to increase flexibility for local authority pension funds to invest in infrastructure projects?

10. Are there ways in which the regulations could be amended to facilitate investment in infrastructure specifically in the UK, where local funds believe that appropriate rates of return can be achieved?

Consultation process

11. The consultation started on 6 November 2012 and closed: 18 December 2012. The consultation document was available on the GOV.UK website and responses could be returned to the Department for Communities and Local Government by email or by post.

12. On publication, the Department drew the consultation paper to the attention of all parties with an interest in the Local Government Pension including, the Local Government Association, trades unions and key representative bodies including the National Association of Pension Funds. A full list of consultees is at Annex A.

13. The total number of responses received to consultation was 87, broken down as follows:

Councils (County, Boroughs, London Boroughs, Districts and Welsh	17
Town and Parish Councils	8
LGPS Pension Funds	28
Individuals	8
Companies	5
Unions	4
Others	17
TOTAL	**87**

14. The Department has considered the comments and evidence provided in each consultation response and, in the next section, offers a summary of the responses to the particular consultation questions.

15. Some respondents offered comments on broader aspects of the Local Government (Pension and Management of Funds) Regulations which were outside the scope of this consultation exercise. These comments have informed consideration of further action to be taken once the Public Service Pensions Bill is enacted.

Summary of responses

Comments received regarding Option A:

a) A total of 51 respondents supported Option A ie increase the limit on investments in partnership from 15% of a local authority pension fund to 30%, with 15 not insupport.

b) While expressing support for this Option, respondees also went on to say that they would welcome a broader review, since they were not in favour of caps on investments as set out in the 2009 Regulations.

c) A number would have liked to have seen the limit set at 25%, but overall the principle of an increase to a 30% limit was seen as a reasonable and appropriate short term measure. They therefore welcomed the extra flexibility proposed.

d) The rest of the responses either did not have any comments or did not offer a view either way.

Comments received regarding Option B:

- A total of 13 supported Option B, ie create a new investment class for investment in infrastructure with an appropriate investment of 15% of an overall fund, with 32 not in support.
- There was a degree of nervousness about having a specific class to cover infrastructure as it might only suit some funds and could be a precursor to setting a minimum limit.
- It was also seen as not feasible on the grounds of being unable to define easily the infrastructure class, which in itself would be too prescriptive and simply add another administrative complication.
- The rest of respondees either did not have any comments/did not offer a view either way.

16. The following comments were made in relation to the five questions asked.

Q1 How best could the LGPS (Management and Investment of Funds) Regulations 2009 be amended to enable local authority pension funds to invest more easily in infrastructure vehicles?

Comments:

I. It was felt that the main barrier to investment in infrastructure is the limited type of projects which are available and suitable for pension funds. The funds would welcome any encouragement for more “investible” UK infrastructure projects, and to back this up perhaps the 2009 Regulations should be amended in a manner that protects the employer and employee contributions from high risks and large losses. Since investment in infrastructure carries a high risk, some form of Government guarantee would be needed to attract investment. Funds would also need detailed definition of the types of infrastructure vehicles and guidance on investing.

II. In a broader context respondees would rather see this question addressed as part of a comprehensive review of the investment regulations. Any review should reflect current financial markets with the need to see all limits on investment vehicle structures to be removed from the 2009 Regulations and instead require authorities to maintain a diversified investment portfolio.
Such a move towards a control basis set within a prudential risk framework would match the approach applicable to private sector trust based schemes. It could perhaps be achieved by the simple deletion of Schedule 1.

Q2 What would be the most appropriate limit on investment in partnerships contained in the LGPS (Management and Investment of Funds) Regulations 2009?

Comments:

- Although there was agreement that the 30% limit as suggested is a sensible approach, some felt this could be restricted to only 25% in order to retain some flexibility in the fund. If the 30% limit was pursued it should perhaps be accompanied by 3 provisions – standardised calculation and methodology, focus on fund appropriateness and clear sanctions for enforcement. It was also important to consider in the context of regulation 15 of the 2009 Regulations, scope for strengthening the requirement for taking professional advice to specifically require advice from an actuary, even though professional advice already covers actuarial input.

- In welcoming any increase in the limit, which enabled more flexibility, it needed to be recognised that the decision on whether to invest in a particular vehicle was a matter for the fund. In making such decisions governance arrangements should be strengthened to ensure that all investment decisions were made for the benefit of members

- In the broader context the argument was repeated that the 2009 Regulations should not have limits, as a fixed limit would actually frustrate the delivery of investment strategies. Since the responsibility for meeting the liabilities and hence managing the fund falls to the individual funds then limits should be left to individual funds to determine.

Q3 Should a new investment class for investment in infrastructure (including via partnerships or limited liability partnerships) be created and be inserted into the LGPS (Management and Investment of Funds) Regulations 2009? If so, what would be an appropriate limit for such a class? How might this be defined in regulation?

Comments:

I. The point was made that if the 2009 Regulations were amended to introduce a new investment class then it should have a limit of 15% of the whole fund. as it would be hard to define. Some merit was seen in a new investment class if it included all forms of infrastructure investment and if the partnership limit was overlapping or reduced because infrastructure was taken out of it

II. But there was much greater rejection of this proposals on the grounds it would add complexity, it may restrict investment in new developments, issues around how one defines "infrastructure investments" would need to be resolved and not all pension funds are suited to the infrastructure asset class.
The other point being made was that this was simply not need as currently funds have not over invested in infrastructure within the current limits.

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Q4 Are there other ways, not specifically raised in this consultation document that the LGPS (Management and Investment of Funds) Regulations 2009 could be amended to increase flexibility for local authority pension funds to invest in infrastructure projects?

Comments:

- The response here took the broader perspective and argued that a rewrite of the regulations, which takes account of the changed investment landscape is needed. Any new regulations should Remove Schedule 1 limits and move toward the model used by private sector tryst based occupational pension funds. This would require the regulations to be set within a prudential risk framework where absolute prescribed investment limits are abandoned. Investment decisions would flow from the other issues facing the fund so that asset classes reflected assumptions, risks, cash-flows and other broader demographic matters.

- LGPS funds would benefit from guidance on how to evaluate investment opportunities, and in the context of infrastructure this may involve having a form of guarantee – needed to attract investment - or taxpayers could be exposed to risk.

- DCLG was also encouraged to implement the actions suggested in a report called "Investing for Growth".

Q5 Are there ways in which the regulations could be amended to facilitate investment in infrastructure specifically in the UK, where local funds believe that appropriate rates of return can be achieved?

Comments:

I. It was recognised that limits could be introduced to ensure that a proportion of investment was made in the UK, however, funds should decide where to maximise their returns.

II. So, although the principle of amending the 2009 Regulations to allow funds greater flexibility was supported – it was not felt that this flexibility should be restricted to the UK and any regulation changes should not favour investment in any particular geographic area. The point was made that investment in UK infrastructure would restrict diversification, limit the funds ability to invest globally and the regulations should not favour UK infrastructure over infrastructure from other parts of the world or other asset classes in particular if this jeopardised absolute returns.

III. Instead consideration should be given to the removal of obstructive and unnecessary limitations in the 2009 Regulations in order to aid funds with a holistic approach introduced to the regulations whereby prudential risk management is delegated to funds.

IV. The issue of how to manage conflicts of interest – if say, an administering authority wished to invest in its own PFI scheme – was recognised, with the establishment of a national platform for infrastructure investment perhaps a better means of resolving this type of problem.

V. Respondees felt there needs to be a permanent set of guidelines and if funds invest in infrastructure, there needs to be a guaranteed minimum rate of return with any loss underwritten by a public sector guarantee.

VI. The Government should also consider the funding of an independent agency to monitor/assess the financial, economic, social and environmental value of UK infrastructure projects.

Other comments

17. Further to responding to the options and specific questions, respondees also made the following points.

- It was not felt that the 2009 Regulations did in fact establish a barrier to funds investing in infrastructure projects. Further the point was made that the extension of the limits on partnership investment would not increase UK infrastructure investment.

- Indeed the points were made that an initiative to promote local infrastructure conflicted with the pension fund obligation to maximise returns and it is not part of a fund's fiduciary responsibilities to promote economic growth in the UK.

- Moving forward the proposals to introduce cost sharing mechanism as part of the benefit and contribution structure would mean that members of the scheme would be more exposed to investment risk. It is also important that proper training is given for those considering future investing in infrastructure.

18. In view of the fact that some 80% of those responding to the two main options supported Option A, together with the positive answers to Question 1, the Minister decided to move speedily to remove the perceived barrier. This provides local decision makers with the option to take advantage of alternative investment opportunities, and removes a potential restraint to investing in a growing economy. Since the Public Service Pension Bill when enacted will oblige more action on Scheme governance it was felt that many of the valid and helpful comments on the future structure of the 2009 Regulations could be considered further and appropriate action taken at that point in time.

Conclusion

19. Government policy in relation to pension schemes is to ensure that local authority pension funds are in a position to pay the pensions to which members have contributed whilst at the same time protect the local council taxpayers, local services and ensure that there are no conflicts of interest.

20. The Government balances this approach with the view that there should not be unnecessary barriers which prevent these pension funds from alternative investment opportunities which would assist in regeneration of local authorities and take a role in stimulating economic growth.

21. The Government has also concluded that these two objectives can be met, in the short term by increasing the current limit on investments in partnerships.

22. The Government is mindful of the need to continue improving the efficiency and transparency of the governance processes of the individual pension funds, and will consider further action to follow up the broader comments raised during this exercise as part of the wider governance issues which will follow from the enactment of the Public Services Pension Bill later this year.

23. No amending statutory instrument was included as part of the consultation but since the required changes were so straightforward the necessary amendment to the Regulations can be completed without the need for further consultation.

Annex A
List of consultees and respondents

The following were sent copies of the consultation document, as well as the document being posted on the Department's website

The Welsh Assembly
The Chief Executives of:
Town Clerk, City of London Corporation
Clerk, South Yorkshire PTA
Clerk, West Midlands PTA
Fire and Rescue Authorities in England and Wales
Police Authorities in England and Wales
National Probation Service for England and Wales
Local Government Association (LGA)
Employers' Organisation
LGPC
ALACE
PPMA
SOLACE
CIPFA
ALAMA
Association of Colleges
Association of Consulting Actuaries
Association of District Treasurers
Society of County Treasurers
Society of Welsh Treasurers
Society of Metropolitan Treasurers
Society of London Treasurers
Association of Educational Psychologists
NAPF
NALC

The total number of responses received to the consultation was 87

By breakdown:

Councils (County, Boroughs, London Boroughs, Districts and Welsh, 17

Carmarthenshire County Council, Charnwood Borough Council, Cheshire East Council; East Sussex County Council, Lancashire County Council, Northumberland County Council, North West Leicestershire District Council

London Boroughs 8

Brent, Hackney, Islington, Lewisham, Newham; Richmond Upon Thames Wandsworth and a single response on behalf of Royal Borough of Kensington and Chelsea, City of Westminster and London Borough of Hammersmith and Fulham

Town and Parish Councils, 8

Abergele Town Council, Bridlington Town Council, Leighton-Linsade Town Council ,Llanelli Town Council, Mold Town Council, Witham Town Council, Stanway Parish Council, Stanwick Parish Council

LGPS Pension Funds, 28

Bedfordshire Pension Fund, Royal County of Berkshire Pension Fund, Bexley Pension Fund, Cambridgeshire Pension Fund Board, Cheshire Pension Fund, Clwyd Pension Fund, Durham, East Riding Pension Fund, Environment Agency Pension Fund, Gloucestershire, Greater Gwent (Torfaen) Pension Fund, Greater Manchester Pension Fund, Hampshire County Council Pension Fund, Kent County Council Superannuation Fund, Leicestershire County Council Pension Fund, Lincolnshire County Council, London Borough of Camden Pension Fund, Merseyside Pension Fund, Norfolk Pension Fund, Northamptonshire Pension Fund Board, Northumberland County Council, Oxfordshire, Staffordshire Pensions Committee, South Tyneside Council Pensions Committee, Suffolk County Council Pension Fund Committee, West Midlands Pension Fund, Wiltshire Pension Fund, West Sussex Pension Fund, West Yorkshire Pension Fund

Individuals, 8

Cedric Knipe Danni Czaczkes John Cawdell Pauline Smith Mark Henesy Carl Westby Debbie Langton Becky Forreste

Companies, 5
KTI Energy Ltd, Equitix Fund Managers, Hymans Robertson LLP, JLT Investment, Consulting Mercer Ltd

Unions, 4

GMB, TUC, Unison, UNITE

Others, 17

Coombe Girls's School, The Society of Local Councils Clerks (SLCC) Chartered Institute of Public Finance Associations (CIPFA), LPFA, South Yorkshire Integrated Transport Authority, Chartered Institute of Housing Association of Schools and Colleges (ASCL), South Yorkshire Pensions Authority (linked to South Yorkshire Integrated Transport Authority), Local Authority Pension Fund Forum, East Sussex Fire & Rescue Service, Northern Trust, Office of the Police and Crime Commissioner, National Housing Federation, SPC, NAPF, Wulvern Housing, Local Government Association

TOTAL, 87