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Local Government Pension Scheme – Investments
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Sent via email: sandra.layne@communities.gsi.gov.uk

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28 November 2012
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This matter is being dealt with by Sean Collins
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Dear Ms Layne

Investment in Partnerships

I am writing on behalf of the Oxfordshire Pension Fund Committee who considered the above consultation document and agreed this response at their meeting of 7 December 2012.

The Committee noted that the primary driver for the consultation was to ensure all Pension Funds were in a position to properly diversify their investments and take advantage of the returns available from investments in infrastructure. In particular the consultation addressed the Investment Regulations limitation on investments in partnerships, whereby the current 15% limit was seen as a limiting factor to infrastructure investments, as partnerships were seen as the main investment vehicle for such investments.

For the Oxfordshire Pension Fund, our current investments in partnerships is less than 5% of the total fund, and therefore the current Investment Regulations are not seen as a major barrier to future investment in infrastructure. Our response below to your five specific questions needs to be seen in that context.

The Committee is currently exploring the opportunities available to invest in infrastructure. This review is in the context of the overall investment position of the Fund, the trends in the overall net cash position of our Fund, and the anticipated future streams of contribution and investment income, and pension payments. The key barrier to any investment in infrastructure will be the identification of an investment vehicle that seeks to deliver a targeted income stream at an appropriate level of risk and over an appropriate time period, and provides a better alternative to other investment vehicles that deliver similar results.

A second barrier to investment in infrastructure will be developing a fuller understanding of the various investment vehicles, and balancing the risks/returns across different infrastructure assets, different geographical areas, and different equity/debt models. Many of the new infrastructure investment vehicles do not have a track record against which future performance can be assessed (accepting the normal proviso that past performance is no guarantee of future performance).

Related to the issue of understanding the various investment vehicles available is the potential conflict of interest in investing in local infrastructure projects, and the lack of clarity over the fiduciary responsibilities of the Pension Fund Committee Members. That responsibility is seen to be to the members of the Pension Fund first and foremost, and not necessarily to the local community in Oxfordshire or indeed in the United Kingdom itself. The need to avoid challenge on delivery of the fiduciary responsibility can be seen as a barrier to targeting investment in local infrastructure programmes.

In that context, our response to your five specific questions is as follows:

1. *How best could the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 be amended to enable local authority pension funds to invest more easily in infrastructure vehicles?*

   Extend the limits on contributions to partnerships, as this is the most common vehicle type used to make infrastructure investments but is also commonly used for other alternative investments such as private equity.

2. *What would be the most appropriate limit on investments in partnerships contained within the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009?*

   Not sure what the most appropriate limit is but the 30% proposed should be adequate. Maintaining a limit at around 30% still recognises the risks involved in investing through partnership vehicles and so still acts to limit funds exposure to these risks.

   Investments in partnerships are typically used to make investments in alternative asset classes. According to the Towers Watson Global Pension Assets Study, at the end of 2011 the typical allocation to alternatives (assets other than equities, bonds and cash) in the largest seven pension fund markets was 18.5%. A report by Mercer placed UK pension fund investments in alternatives at 15% of fund assets. The 2011/12 WM annual review of Local Authority Pension Funds which covers 84 LGPS funds found that 9% of fund assets were allocated to alternatives and that there was a trend towards increasing allocations to alternatives.

   These reports suggest that at present a 30% limit should allow sufficient scope for LGPS funds to make infrastructure investments while also allowing room for individual differences between scheme investment strategies and future changes in investment preferences.

3. *Should a new investment class for investment in infrastructure (including via partnerships or limited liability partnerships) be created and be inserted into the Local Government Pension Scheme (Management and Investment of Funds Regulations 2009? If so, what*

would be an appropriate limit for such a class? How might this be best defined in regulation?

No. This may cause issues around defining what constitutes infrastructure investments. The current limits are not based on limits on individual asset classes so this would not fit with current structure of the investment limits. Having a limit on infrastructure investments alone would not make sense as why would there then not be limits for private equity etc.?

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

   Not within the boundaries set out in the consultation document (i.e. that there is a requirement for arbitrary limits in some form).

   However, it would be useful to clarify how the investment limits for partnerships in the Regulations are intended to work, and in particular how they deal with the pattern of a significant commitment at the outset of a new partnership, followed by a series of drawdowns and distributions, so that the actual investment is never equal to the full commitment. Questions include:

   - Is the test therefore made at the point of the initial commitment?
     - Or at the point of each drawdown?
   - How are undrawn commitments and expected distributions to be taken into account?
   - Can future drawdowns be made against firm commitments when appreciation of assets takes the investment above the investment limit?

5. *Are there ways in which the Regulations could be amended to facilitate investment in infrastructure specifically in the United Kingdom, where local funds believe that appropriate rates of return can be achieved?*

   Do not believe that this is necessary as the change proposed to increase the partnership limit to 30% should give funds sufficient opportunity to invest in infrastructure and then, as stated in the consultation, the fund will be free to decide what investment is best be that infrastructure in the UK or otherwise. Given the fiduciary responsibility of Pension Fund Trustees it is not clear whether targeting infrastructure investment specifically in the United Kingdom can be a legitimate objective.

We thank you for the opportunity to offer our view on the Consultation, and we hope they are useful in determining any future changes.

Yours sincerely

Sean Collins
<u>Service Manager (Pensions, Insurance and Money Management)</u>

<u>On behalf of the Oxfordshire Pension Fund Committee</u>