Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**14 DECEMBER 2012**
TITLE:	**LGPS INVESTMENT LIMITS – INVESTMENT IN PARTNERSHIPS**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – LGPS Investment Limits Appendix 2 – DCLG Consultation Appendix 3 – Draft response	

1. THE ISSUE

1.1. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the "Regulations") impose certain prudential limits on the way in which money which can be invested. In principle, these are designed to manage risk, mainly through diversification. There is a two tier system of investment limits. The first tier is the "normal" limit; the second consists of a set of higher limits which can be utilised subject approval by a Fund's Committee.

1.2. The Department for Communities and Local Government (DCLG) is seeking views on whether any amendment should be made to these limits to enable funds to invest in infrastructure (where most investment vehicles will be via a partnership structure).

1.3. The Avon Pension Fund's draft response is set out in Appendix 3.

2. RECOMMENDATION

The Avon Pension Fund Committee is asked to approve:

2.1. The response to the DCLG consultation.

3. FINANCIAL IMPLICATIONS

3.1. There are no financial considerations to consider.

4. THE REPORT

4.1. The Local Government Pension Scheme Regulations sets out prudential limits for investments. In principle, these are designed to ensure diversification and reduce risk within the Fund. There is a "normal" limit for each category and a "higher" limit that a Fund can elect to use, only if it has taken proper advice regarding the suitability of the type of investment within the investment strategy.

4.2. The Fund complies with the normal limits except for its investments in single partnerships (approved by Committee December 2008 to accommodate the investments managed by Partners) and in Life Funds (approved by Committee March 2006 to accommodate the investments managed by Blackrock) where the higher limits apply. The limits adopted by the Fund are set out in the Statement of Investment Principles.

4.3. The current regulatory limits (normal and higher) are set out in Appendix 1.

4.4. The DCLG is consulting whether the existing limit on partnerships is a barrier to funds investing in infrastructure. Partnership structures are already used for investments in other asset classes including private equity and private real estate in addition to infrastructure. Thus some funds may be approaching the 15% limit prior to any allocation to infrastructure, which could limit overall investment in infrastructure. However, the main barrier to investing in infrastructure is the availability of suitable assets and investment vehicles to facilitate diversified investment opportunities given the size of individual pension funds in the UK.

4.5. The Fund supports amending the limit on partnerships given that it could restrict the ability of funds to invest in infrastructure. However, the Fund would prefer that the DCLG adopt a holistic approach and provide a prudential framework for risk management (as was proposed in the 2011 consultation to which the DCLG never responded) rather than tinker with the investment limits on a piecemeal basis. Adopting a prudential risk framework would put the investment regulations for the LGPS on a similar framework to that applying to UK private sector schemes. This approach would not set prescriptive limits and therefore the guidelines would not have to be revised or tinkered with as the investment environment evolves.

4.6. The DCLG consultation (see Appendix 2) puts forward two options for change:

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

(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.

4.7. The Fund's draft response to the consultation questions (see Appendix 3) favours option (A) for the following reasons:

4.7.1. It is not optimal for regulations to place a limit on any category of asset class and in this respect it is not appropriate to single out infrastructure, given the barrier to investing is not the asset class itself but the investment structure through which such investments could be made i.e. the 15% limit on partnerships.

4.7.2. Partnerships are a vehicle through which investments can be made and can be used to invest in various assets, not just infrastructure. Option (A) allows flexibility for funds to reflect their investment strategy through the most appropriate investment structure at any point in time.

4.7.3. It could be difficult to clearly define “infrastructure” within the Regulations and poor or out-dated definitions can lead to disproportionate resources being used to manage the investment structure rather than the investment strategy. For example, residential housing for rent or care homes, could be considered property rather than infrastructure and invested via a property mandate (where the appropriate investment structure for such investments may be pooled property funds rather than partnerships).

4.7.4. Option (B) puts forward an “appropriate” limit of 15% for infrastructure. There is no justification as why 15% is deemed appropriate. There could be the case that having taken expert advice an allocation above 15% could be “appropriate” for some funds in relation to their funding strategy; this proposal could prevent funds from making such decisions. There is then the issue of definition discussed previously.

4.7.5. The Regulations and other Codes of Practice (such as the Myners Principles) require all LGPS funds to take expert advice before strategic asset allocation and investment management selection decisions are made. Therefore limits that provide maximum flexibility and minimum prescription are in line with the Regulations and Codes currently in place. In addition, all funds are required to set out their strategic policy in their Statement of Investment Principles including the managing the risks arising from asset allocation.

4.8. Investment in infrastructure, given that some projects could be within the locality of a LGPS fund, brings to the fore the issue of conflicts of interest inherent within LGPS governance structures. Therefore, the response highlights the need to strengthen the Regulations with regard to managing conflicts of interest by providing guidance as to the considerations LGPS funds must take when arriving at investment decisions.

5. RISK MANAGEMENT

5.1. The key risk to the Fund is that the investments fail to generate the returns required to meet the Fund’s future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund, the investment management structure and through the selection process followed before managers are appointed.

6. EQUALITIES

6.1. An Equalities Impact Assessment has not been completed given the technical nature of issue under consideration.

7. CONSULTATION

7.1. None appropriate.

8. ISSUES TO CONSIDER IN REACHING THE DECISION

8.1. The issues to consider are contained in the report.

9. ADVICE SOUGHT

9.1. The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

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Background papers	
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