Bath & North East Somerset Council

Avon Pension Fund

LOCAL GOVERNMENT PENSION SCHEME

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AVON PENSION FUND

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Dear Sandra

The Local Government Pension Scheme: Investment in Partnerships

Thank you for inviting the Avon Pension Fund to respond to the above consultation. The Avon Pension Fund is part of the LGPS, administered by Bath & North East Somerset Council.

Before addressing the questions set out in the consultation paper, the Fund has a number of general comments to make arising from the paper:

- In principle the Fund supports the need to amend the limit on partnerships given that it could restrict some funds' ability to invest in infrastructure where these funds already have significant investments via partnership structures. However, rather than tinker with the investment limits on a piecemeal basis, the Fund would prefer that the DCLG adopt a holistic approach and provide a prudential framework for risk management within the LGPS Regulations (as was proposed in the 2011 consultation which the Fund supported). 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 as the investment environment evolves over time.

- The purpose of the regulations, including the investment limits, is to ensure LGPS funds manage and control investment risk. However, there is a danger that the prescriptive limits around investment structures can determine investment strategy rather than merely be the vehicle through which investment decisions are implemented.

- In addition to the investment limits, the regulations already require funds to have regard to investment risk and to take expert advice on strategic issues. We would question whether the use of limits addresses risk appropriately given the investment risks to which funds are exposed. It is inappropriate for the regulations to "direct" investment decisions by applying an investment limit on a specific asset class, and as a result assign a perceived level of "risk" to that asset class.

- One area of concern, especially if some infrastructure projects could be within the locality of a LGPS fund, is the conflict of interest inherent within LGPS governance structures (especially given they are multi-employer funds). Local politicians are responsible for the decision making with respect to the investment strategy. Those same politicians will also naturally have a strong interest in developing their local communities. Therefore the regulations should be strengthened to provide guidance of how committees and administering authorities should manage conflicts of interest. Where conflicts arise in investment decisions there should be clear guidance as to the considerations a fund must take into account when arriving at its decision.

- Although this does not fall under the "Regulations", establishing the national platform for Infrastructure investments would be an effective way of bringing the infrastructure projects and investors together. As long as this vehicle delivers the investment returns and diversification of risks required it should enable the smaller funds, in particular, to access infrastructure opportunities in a cost effective way.

Of the two proposals outlined in the consultation paper the Avon Pension Fund is supportive of Option (A) – to increase the limit on partnerships to 30%. The Fund's response to the specific questions is as follows:

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?

Local authority funds are already able to invest in infrastructure. The barrier within the regulations, is the use of partnerships as the investment vehicle, given the regulations restricts the overall allocation that can be made to partnerships. Therefore the preferred option is to increase the limit on partnerships from 15%. There is no justification for singling out infrastructure as an asset class with a specific investment limit.

Q2. What would be the most appropriate limit on investments in partnerships contained within the LGPS Regulations?

Partnerships are currently used to invest in a variety of assets including private equity and private real estate as well as infrastructure. Therefore the limit on partnerships should be adequate to accommodate all these investment options but must also be "future proof" as other assets that are not widely invested in currently (for example other "real" assets such as forestry) may lend themselves to such investment vehicles in the future.

Given the requirement for funds to take advice and have regard to investment risk and diversification, the absolute limit could be significantly higher than the current 15%. A limit of at least 30% could be appropriate.

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?

We do not support this approach as the regulations should not "direct" investment decisions. The regulations provide for LGPS committees being responsible for setting investment strategies having taken expert advice. It should be noted that funds are not necessarily adverse to infrastructure as an investment option; the availability of suitable assets and vehicles to facilitate diversified investment opportunities has been the main barrier to infrastructure investing for most funds.

In addition establishing a new class would create a major challenge to define "infrastructure investment" within the regulations and poorly defined or out-dated definitions can lead to problems over interpretation and lead to disproportionate focus on managing the investment structure rather than investment strategy. For example would "infrastructure investments" via equity or bond portfolios or pooled funds be part of this definition? If so how would that affect the other restrictions within the Regulations?

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?

For the reasons set out above, rather than amend just one investment limit in isolation, the regulations should adopt a prudential framework for the management of investment risk. This would provide flexibility within a risk framework for funds to adopt a strategic policy that supports their funding strategy having taken expert advice.

Q5. 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?

Covered in response to Q4.

We hope these comments are a useful contribution to the consultation.

Yours sincerely,

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