Principles for Responsible Investment

UNEP Finance Initiative — Changing finance, financing change | United Nations Global Compact

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

MERSEYSIDE PENSION FUND

COUNTRY
UK

TYPE OF FUND/ORGANISATION
Local government pension scheme

TOTAL ASSETS
£5.6 billion (US$ 8.4 billion) as at March 2013

"To overcome the limited supply of funds that support local regeneration and enterprise development, several local government pension funds have launched the Investing for Growth initiative to kick-start the market."

INTRODUCTION

The Merseyside Pension Fund (MPF) provides pensions for local government employees in the Liverpool city region. As of March 2013, it had 123,941 members. The Fund's responsible investment policy has three components: voting; engagement with companies on environmental, social and governance (ESG) issues; and collaboration with like-minded investors. In recent years, MPF has worked actively with other local government pension schemes, UK banks and policymakers to determine whether and how such schemes can direct their capital towards regenerating areas particularly hard hit by the recession and resulting funding cuts, like Merseyside.

This case study describes the conclusions that MPF (and similar funds) came to that led them to increasing their investment in funds that support local regeneration. It is one of a series of case studies produced by the PRI Initiative's Environmental and Social Themed Investing Work Stream.

KEY POINTS

- The recession and resulting cuts in local government funding has prompted local government pension funds, like the Merseyside Pension Fund, to direct some of their capital towards funds that support local regeneration and enterprise development.
- This new form of investment can benefit the funds' sponsoring employers in several ways; it can alleviate pressure on their capital budgets, increase their tax receipts and reduce their medium to long-term costs of providing local services. Moreover, if these investments generate the expected returns, sponsors will be less likely to have to fund a scheme deficit.
- The tangible social and economic benefits delivered to scheme members include better infrastructure, community facilities, jobs and training.
- To overcome the limited supply of these types of investment vehicles, several local government pension funds have launched the Investing for Growth initiative to kick-start the market and together committed up to £250 million (US$ 400 million) of new investment.[1]

1 For more background on the 'Investing for Growth' initiative and MPF's involvement, see: www.investing4growth.co.uk; 'Local authority pension funds – Investing for growth' Smith Institute 2013 and 'Fiduciary duty and environmental and social themed investing' PRI 2013.

RATIONALE

MPF's investment strategy is to maximise returns over the medium to long term while having regard to its liability commitments. Maintaining a balanced portfolio of assets across a diversified portfolio invested in a range of stocks and sectors is of paramount importance. The Fund is committed to responsible investment, which it pursues through various responsible investment strategies including collaborating with other investors and investing in thematic funds designed to generate local social and economic redevelopment.

This new approach came about following extensive dialogue with central and local governments, and other local government pension funds through the Investing for Growth Initiative.[2] MPF came to the view that investment in local regeneration and development – as long as it meets expected risk/return requirements and due diligence standards – is entirely compatible with the Fund's fiduciary duty.

Moreover, MPF identified several additional benefits to this type of investment. The vast majority of MPF's beneficiaries live in the local area and will continue to do so when they draw their pension; many are on low incomes and have been hit hard by the recession. By investing their contributions in the development of the local area and the region, and in ways that support SMEs and create jobs, MPF can help to maintain and improve the physical surroundings and quality of life of its members, before and after they retire.

MPF also believes that over the medium to long term, investing in local economic development, service provision and local businesses creates a virtuous circle. MPF's sponsor, Liverpool City Council (LCC), is responsible for delivering local housing, education, healthcare, social services and developing and maintaining local infrastructure. Devoting some of the pension fund's capital to investment in housing development, the provision of health and social services or supporting SME growth both alleviates financial pressure on LCC and benefits it directly. For example, investing in funds that support SMEs creates employment and lowers LCC's costs of supporting the unemployed, increases the council's tax receipts and generates further economic development through a multiplier effect (i.e. as SMEs or their employees spend money with other local businesses, economic activity increases overall). If these investments are successful and generate the expected returns, MPF can achieve full funding. Money that LCC would otherwise have had to devote to supporting the Fund can be used to deliver services.

TYPE AND STRUCTURE OF INVESTMENTS

Two particular investments with Bridges Ventures, a UK private equity manager that specialises in impact investment, illustrate how MPF has begun to implement its strategy.

Bridges Ventures Sustainable Growth Fund III: In 2013, MPF made a £7.5 million (US$ 11.97 million) investment from its alternatives allocation to this fund, the third in Bridges' suite of impact investment funds. The fund provides growth capital for SMEs that create positive social, economic and/or environmental impacts through the products they sell or through the economic growth they generate in underserved areas. Companies must operate within three sectors (health and well-being, education and skills, or the environment) to be selected for investment or must be located within the 25% most deprived local authorities in the UK. This fund is expected to deliver a double digit IRR, in line with MFP's usual return expectations from private equity. Bridges reports annually to investors on the positive social, economic and environmental impacts generated by the Fund and how ESG risks have been managed. This investment enables MFP both to support SME development and profit from it.

Bridges Ventures Care Places Fund: In 2011, MPF invested £1 million (US$ 1.6 million) from its £180 million property allocation in the Bridges Ventures CarePlaces Fund.[3] It is expected to yield around 6% per year. The CarePlaces Fund is a partnership between Bridges and Castleoak, a property developer that exclusively builds high-quality care homes for the elderly in the UK. The homes are pre-let to carefully selected companies with an exemplary record in running such facilities. This fund enables MPF to seize a unique investment opportunity that it cannot access directly. Moreover, the fund's narrow focus on one property type enables MPF to diversify its sources of return and spread its risk within its property allocation.

APPROACH

As with other local government pension schemes, elected members from the Liverpool city region set the fund's investment strategy and framework. Investment decision-making is fully delegated to MPF officers; it has complete discretion over fund choice.

2 ibid
3 The Care Places Fund was called the UK Healthcare Property Fund. The name was changed in December 2011 to reflect the complete focus on investing in properties in the care sector.

As a relatively small organisation, MPF does not have a single staff member whose only role is to implement its responsible investment policies. Rather, one officer has responsibility for guiding and overseeing implementation of the responsible investment policy, among other roles. This is achieved through a series of investment philosophy papers for each asset class that articulate how ESG and responsible investment concepts should be considered when making investment decisions. They are not intended to ensure that MPF has 'ticked the responsible investment box' but instead to encourage the investment team to actively consider the relevance of ESG issues to each investment and ensure they have been appropriately factored in. These papers are referred to in the investment case papers presented for all new investments.

The Fund has not set a formal target for this form of thematic investment – though it has pledged an initial £25 million through the 'Investing for Growth' Initiative. The two Bridges funds profiled are not grouped as a particular form of investment, but sit alongside other investments with the relevant allocation (to private equity, property etc.). Similarly, when MPF reports fund performance to its Trustees, it does so within the relevant asset class section, not under a 'thematic investment' heading. Moreover, MPF does not apply any different or additional tools or practices to select these types of thematic funds; it uses its standard due diligence processes to identify and select managers. However, MPF looks for a clear articulation of the particular economic, environmental or social impacts a fund of this type intends to generate, requires evidence that they can do so and reviews managers' reports to track delivery of the intended impacts.

CHALLENGES

Insufficient investment opportunities of sufficient scale and impact: There are relatively few funds with the focus that MPF and its peers are seeking in the UK at present. This limits MPF's ability to invest as much as it would like, and means that the economic, social and environmental impacts achieved are not as great as they could be. MPF has addressed this challenge by starting to make the types of investments profiled and signalling its demand for more opportunities of a larger size – in part through the Investing for Growth Initiative and in part by actively communicating to the market its interest in increasing this type of allocation.

Driving uptake of innovative social finance vehicles across the local government sector: Understanding of how ESG issues relate to mainstream investment is still limited among trustees and beneficiaries in this sector. Understanding of innovative forms of finance of great relevance to local governments and their pension funds is more limited still. These include environmental and social themed investments, social impact bonds and other emerging forms of social enterprise finance. 'Early adopters' like MPF can play an important role in raising understanding and increasing demand and uptake of these products by sharing their expertise with trustees and other funds, and their local government colleagues who commission services or are responsible for local infrastructure development.

Lack of policy clarity: Many types of environmental and social investment rely in part on government regulation and policy, and in some cases, financial support or risk sharing. A lack of clarity around environmental and social policy can inhibit investors' appetite for investing in environmental and social themed funds. MPF addresses this challenge by collaborating with other investors through bodies such as the Institutional Investors' Group on Climate Change (IIGCC) to communicate its concerns, and press for clarity and long-term policy certainty.