Merseyside Pension Fund

Incorporating impact into their portfolio

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Key points

- Merseyside Pension Fund (MPF) first explored social impact investing through a collaboration with other local authority pension funds called Investing for Growth.
- Since the Investing for Growth collaboration, Merseyside Pension Fund has gone on to make a number of "impact investments" across different asset allocations and is currently developing an investment allocation to their local area which will encompass impact investments.

MPF quotes

"There is a decent investment case to be made for impact if you are seeking diversification in your overall fund, particularly in a low yield/low return environment and when responsible investment is fundamental to your strategy."

"Social impact or thematic investing may provide access to diverse opportunities, uncorrelated to other assets, and can deliver acceptable risk-adjusted returns."

Introduction

Merseyside Pension Fund provides pensions for local authority employees in the Merseyside Region. As at 31st March 2017, it has 131,000 members and £8.3 billion assets under management. MPF was a member of the Investing for Growth initiative, a collaboration of a number of Local Authority Pension Fund Forum (LAPFF) members that sought to find ways of directing capital towards supporting local social problems, particularly in light of the changing landscape of public services commissioning and delivery. This case study demonstrates an example of a LGPS's approach to incorporating impact into its pension fund and how that is evolving into investing locally for impact, whilst remaining fully aligned to its fiduciary duties. As a result of positive experience with past impact investments, MPF is open to exploring opportunities to collaborate and co-invest with others into impactful opportunities.

What investments were made?

Since it started impact investing in 2012, MPF has committed £50m to impact investments to date, across 7 investments, primarily within private equity and property allocations. These are illiquid investments at a relatively early stage of their life-span, but the early indications are that they are on-track to achieving their targeted returns.

One investment was the Bridges Fund Management Social Impact Bond (SIB) Fund into which they invested £1m in 2015. While the Bridges SIB fund is a generalist SIB fund, one of the fund investments was investing into a recommissioned outcomes contract aimed at preventing 14-19 year-olds in the Merseyside region from becoming NEET, i.e. a young person who is not in education, employment or training.

A previous programme (delivered by Career Connect, a Liverpool-based charity) was so successful – delivering over £9m worth of positive outcomes to the Department of Work & Pensions at a cost of just £4.5m – that it became one of the first SIBs in the world to repay investors in full and ahead of schedule. It provided evidence for a totally new way for the Government to tackle this issue.

The Bridges SIB Fund is the lead investor in its successor programme 'Unlocking Potential', also delivered by Career Connect and co-commissioned by DWP Innovation Fund alongside the five local authorities across Merseyside (all 'schedule employers' in Merseyside Pension Fund):

- Provide coaching and support to disadvantaged 14-17 year-olds in Greater Merseyside region who are at risk of becoming NEET (4040 in target cohort).
- Participants improve attendance at school, improve attainment and/or enter sustained employment
- Unlocking Potential delivered from March 2015 to April 2018 and is currently delivered in over 100 schools and colleges by specialist resilience coaches.
- Unlocking Potential project receives staged payments linked to achievement of these outcomes (e.g. improved attendance, educational qualifications attained etc).
- Bridges SIB Fund has claim on these cash-flows as lead investor.
- Reduced DWP spending in the long-term through welfare savings as a result of improved health and employment outcomes of the cohort; savings achieved pays for the programme.
- Local commissioners only pay for achieved outcomes, which align with locally determined priority objectives.

How did these investments come about?

MPF and other LAPFF members collaborated on the Investing for Growth initiative. This resulted in six LAPFs making available £250m to allocate to impact investments which met a series of predefined objectives. It was through this that Merseyside invested in the Bridges Fund Management Social Impact Bond fund – this was the first investment where the social impact objectives were explicitly prioritised alongside the financial objectives. Since this collaboration, MPF has gone on to make other impact investments including Bridges Evergreen Holdings, a permanent capital vehicle for mission led businesses, along with private equity funds that incorporate an impact lens such as Palatine Impact Investment fund.

No reallocation of assets was required for these impact investments as they were either incorporated within the existing asset allocation or within special opportunities allocation. MPF is now exploring a locally-focused investment allocation where impact co-investment is most likely to play a role. Although Merseyside occasionally employ consultants to assist with specific project, the impact investments they have made to date have not involved consultants and it is their in-house investment professionals that have really led the investment efforts.

Why were these investments made?

Aside from the investment return and diversification considerations, MPF's sponsors were attracted by these impact investments primarily because of the potential to create systemic change in the way capital could be channeled for social impact. In the case of the Bridges SIB Fund investment, MPF was interested in exploring how local authorities could be commissioning their services in a different way and how supportive investment to this sector could yield wider benefits to its sponsoring employers. Undoubtedly, being connected to the local authorities meant they understood how outcomes contracts work and made them a more informed investor in this emerging area. This investment was deemed to fit better with the changing landscape of the public services sector, where longer term horizons, innovation and more financially sustainable charities and social enterprises would help transform the way public services are commissioned and create systemic change.

The impact investments were deemed to fit well with the funds' investment strategy which states:

> *MPF regards social impact investing as entirely compatible with investing responsibly and considers such opportunities on a prudent basis (or as a 'finance-first' investor).*

How are the investments managed and monitored?

Which portfolio are they allocated to?

The impact investments Merseyside has made are situated across asset allocations, primarily within the illiquid portion of the portfolio, but including private equity, property and special opportunities. This reflects the range of impact opportunities accessed and the varying risk and return characteristics of the investments selected.

How is performance monitored?

In the case of the Bridges SIB Fund, it is the impact performance (measured by outcomes achieved) that directly determines the financial performance of the investment. The financial performance of impact investments is monitored in the same way as the other investments. In addition to this, the social impact performance is tracked and reported on (both at fund level and at the level of individual investments). This is particularly important to MPF because part of the initial motivation to invest with impact was to build the market and create systemic change (for example, the impact scorecard for Unlocking Potential periodically reports the number of participants enrolled on the programme, the number of positive outcomes they achieve and the value to DWP of those outcomes). The social outcomes are compared to set objectives and presented as a fully integrated part of the reporting that is monitored by MPF's investment team.

Lessons learnt

Language: Initially MPF was less confident navigating the language and terminology used in the social impact investment space. They gained comfort and confidence in this by having developed a relationship with Bridges Fund Management through a prior investment into a sustainable property fund. This confidence led to the first impact investment being made, which catalyzed several more. Having now developed the language to support conversations around outputs, outcomes, impacts and payment by results, they feel well equipped to discuss future opportunities in this space. In addition, they have become more familiar with pressing issues from their local areas, enabling them to invest in those opportunities most likely to bring about systemic change. Greater fluency in the language of impact and social investment is expected to improve mutually beneficial knowledge-sharing between MPF and its local authority sponsors.

Successes

- **Diversification:** Impact investments have offered reasonable risk-adjusted returns to other holdings, and provided diversification particularly in a low yield and low return environment
- **Systemic change:** The investments, though ongoing, have to date delivered on the tangible, quantitative outcomes that formed part of the initial proposition. For example, the SIB increased the number of young people moving into education or employment and has demonstrated more innovative ways of supporting communities and enterprises in the Merseyside region.

Further developments

Following the positive outlook of the current investments, Merseyside are at the early stages of developing a new portfolio of local impact investments. This vehicle will enable them to find attractive investments which have a footprint in Merseyside region and will make more easily make co-investments.

Further information

MPF Responsible Investment: https://mpfmembers.org.uk/content/responsible-investment

About Pensions for Purpose

Pensions for Purpose is an online collaborative initiative to raise awareness of impact investment amongst pension funds. Our members consist of Influencers (eg. impact managers, trade bodies and consultants) who want to promote the understanding of, and discussion around, impact investment, and Affiliates (eg. asset owners, government bodies, independent advisers and journalists) who want to deepen their knowledge of this important topic. Affiliates are able to register for free, which allows them to access additional, Affiliate-only material and to receive monthly updates of new content posted on the platform. For more information see https://www.pensionsforpurpose.com/.