

LGPS Reform  
Department for Communities and Local Government  
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London  
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18<sup>th</sup> February 2016

To whom it concerns

**Local Government Pension Scheme**

Please find attached to this letter the LGA's response to the consultation:-

Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

If you have any questions, please do not hesitate to contact me.

Yours sincerely



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## **About the Local Government Association**

This response is submitted by the Workforce Team of the Local Government Association (the LGA), on behalf of local authorities. The LGA is the national voice of local government. We work with councils to support, promote and improve local government. The LGA covers every part of England and Wales and includes county and district councils, metropolitan and unitary councils, London boroughs, Welsh unitary councils (via the Welsh LGA), and fire and national park authorities. The Workforce Team of the LGA offers advice on employment issues and represents local government employer interests to central government, government agencies, trades unions and European institutions.

## **Response to the Law Commission's Review of Fiduciary Duty**

1. In their report, *Fiduciary Duties of Investment Intermediaries*, published in July 2014, the Law Commission called on the DCLG to review:
  - Whether the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 should transpose article 18(1) of the European Commission's 2003 Institutions for Occupational Retirement Provision (IORP) Directive, and
  - Those aspects of Regulation 9 of the 2009 Regulations which require investment managers to be appointed on a short-term basis and reviewed every three months.
2. In response to the commission's request for review, DCLG proposes to remove the requirement to review managers on a three month basis but proposes no amendments to transpose 18(1) of the IORP.
3. Article 18(1) of the IORP Directive requires assets to be invested in the best interests of members and beneficiaries and, in the event of a conflict of interest, in

the sole interests of members and beneficiaries. For trust based pension schemes, regulation 4 of The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005 No 3378) transposed Article 18(1) in full. However DCLG maintain that as a statutory (not a trust) scheme the LGPS does not have to comply with regulation 4 and furthermore existing common legislation and case law provides sufficient protection for members with regard to the result of investment decisions on their benefits.

4. In September 2014 the LGA, on behalf of the LGPS Advisory Board, [sought the opinion](#) of Nigel Giffin QC on a number of matters including the application of article 18. Although in his view the ‘fiduciary duty and public law duties of the administering authority, ....., would in fact (and with one possible exception) impose upon it all the obligations that article 18(1) requires’, he goes on to state that ‘it would clearly be preferable if the relevant provisions of the Occupational Pension Schemes (Investment) Regulations 2005 were made to apply to the LGPS’.

## **LGA response**

- **In view of the opinion from Nigel Giffin QC, LGA would ask that DCLG reconsider their approach on this matter and amend the regulations to transpose article 18(1) directly.**
- **This could be achieved by defining explicitly the purpose for which administering authorities undertake their investments.**
- **For example, ‘Administering authorities must invest in the interests of funding member benefits’.**

## **Proposal 1: Adopting a local approach to investment**

5. The draft regulations remove provisions dealing with items such as stock lending and the number, choice and term of investment managers. Although these and

other provisions have not been carried forward into the draft 2016 Regulations, the Government's view is that they would be effectively maintained by general law provisions and so specific regulation is no longer needed. For example, those making investment decisions are still required to act prudently, and there remains a statutory requirement to take and act on proper advice.

6. Also removed are the limitations in schedule 1. Instead there is a requirement for LGPS fund authorities to take a prudential approach to investment, demonstrating that they have given consideration to the suitability of different types of investment, have ensured an appropriately diverse portfolio of assets and have ensured an appropriate approach to managing risk. A key element of such demonstration will be a new Investment Strategy Statement which should cover:

- A requirement to use a wide variety of investments.
- The authority's assessment of the suitability of particular investments and types of investments.
- The authority's approach to risk, including how it will be measured and managed.
- The authority's approach to collaborative investment, including the use of collective investment vehicles and shared services.
- The authority's environmental, social and corporate governance policy.
- The authority's policy on the exercise of rights, including voting rights, attached to its investments.

7. This statement must be published no later than six months after the regulations come into force. However as the draft regulations would also revoke the existing 2009 Regulations when they come into effect transitional arrangements are required. The transitional arrangements proposed in draft regulation 12 would mean that the following regulations in the 2009 Regulations would remain in place until the authority publishes an investment strategy or six months lapses from the date that the regulations come into effect:

- 11 (investment policy and investment of pension fund money)
  - 14 (restrictions on investments)
  - 15 (requirements for increased limits)
  - Schedule 1 (table of limits on investments)
8. Although there will not be a requirement to maintain a Statement of Investment Principles, the main elements, such as risk, diversification, corporate governance and suitability, will instead be carried forward as part of the reporting requirements of the new investment strategy

### **Questions from consultation**

- i. Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?
- ii. Are there any specific issues that should be reinstated? Please explain why?
- iii. Is six months the appropriate period for the transitional arrangements to remain in place?
- iv. Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?

### **LGA response**

- i. **Although the LGA does not intend to comment in detail on the draft investment regulations (such comments will come better from those**

**directly involved in investment matters at local funds) it welcomes the move to a more flexible framework for funds, while ensuring they demonstrate appropriate levels of prudence and risk management.**

**LGA would wish to ensure that the regulations include all LGPS funds (for example the closed Environment Agency Fund) and ask that DCLG clarify that this is the case and are satisfied that the regulations as drafted (particularly regulation 4) provide for such coverage.**

**ii. None**

**iii. Yes**

**iv. No comment – leave to funds to make comments on this question**

## **Non-financial factors**

9. The consultation document makes reference to forthcoming guidance to reinforce the Government's view that using pensions and procurement policies to pursue boycotts, divestments and sanctions against foreign nations and the UK defence industry are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

## **LGA response**

- **LGA is concerned that such guidance should not impair the ability of LGPS pension funds to pursue ESG policies appropriate to meeting their duty to maximise returns and would seek assurances from Government that this will not be the effect of such guidance.**

## **Proposal 2: Introducing a safeguard - Secretary of State (SoS) power of intervention**

10. The power of intervention in the draft regulations consists of the following elements.

### **Determining to intervene**

11. The Secretary of State may determine an intervention is necessary if the administering authority has failed to have regard to the regulations governing their investments or guidance issued under draft regulation 7(1). Examples of evidence of such failure may include not complying with best practice (e.g. by not giving due regard to advice from the Scheme Advisory Board), not investing via an asset pool that meets the requirements of relevant guidance or not carrying out another pension related activity effectively (e.g. an unsatisfactory 'section 13 report').

12. The SoS can provide for further investigations to be made and more evidence gathered prior to any decision to intervene being taken.

### **The process of intervention**

13. The power to intervene is broad and includes a provision for the SoS to seek external advice when determining what that intervention should be. However it could include:

- Requiring an administering authority to develop a new investment strategy statement that follows guidance published under draft regulation 7(1).
- Directing an administering authority to invest all or a portion of its assets in a particular way that more closely adheres to the criteria and guidance, for instance through a pooled vehicle.

- Requiring that the investment functions of the administering authority are exercised by the Secretary of State or his nominee.
- Directing the implementation of the investment strategy of the administering authority to be undertaken by another body.

14. Before any intervention, the LGPS fund would be presented with the evidence, notified of the action and timing and given the opportunity to respond.

### **Review**

15. Draft regulations provide for any action taken to be subject to review and for the fund to be clear what is required to end the intervention.

### **Questions from consultation**

- v. Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?
- vi. Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?
- vii. Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?

### **LGA response**

- v. **Other sources of evidence should include the Key Performance Indicators developed by the Scheme Advisory Board. More importantly, whatever the source of evidence, the LGPS fund authority should have ample opportunity**



to explain, clarify or challenge the evidence before any intervention takes place.

In this respect the authority should have access to any and all base data from which such evidence has been derived. Furthermore authorities should be given an explicit power to appoint experts to assess the evidence (including the base data) in order to provide an effective challenge.

- vi. LGA would wish to see a minimum time period set for the consideration and examination of evidence prior to any intervention (six months?) and would therefore wish to see regulation 8(3) amended to provide for this.

The assessment of the evidence by the SoS should be based on a 'presumption of innocence' and as such LGA would wish to see regulation 8(1) strengthened to ensure that the SoS is not only 'satisfied' but 'satisfied beyond reasonable doubt' of the authority's failure to have regard to guidance.

Although the consultation document refers to a review period there is no direct reference to such a period in the draft regulations. LGA would therefore wish to see a right for the authority to request a review included in regulations with for a set timescale for the SoS to respond to such.

- vii. The extent of the powers given to the SoS are very broad and therefore provide more than sufficient flexibility. LGA's concern is that regulation 8(2)(a) (*'that the authority make such changes to its investment strategy under regulation 7 as the Secretary of State considers appropriate, within a period of time specified in the direction'*) is too broad. Use of this regulation could put the SoS in a position of personally directing the strategic investment decisions (including the allocation of assets) for a particular

**LGPS fund. This could potentially open the SoS to challenge under EU restrictions on government intervention in pension fund investment, particularly if such directions proved to be ineffective.**

**In order to avoid the potential for challenge it would perhaps be better to limit the direct powers of intervention to determining the manner of investment as in regulation 8(2)(b) (*‘that the authority invest such assets or descriptions of assets as are specified in the direction in such manner as is specified in the direction’*) while leaving wider intervention to take place through a third party. The powers set out under regulation 8(2)(c) could therefore be limited to a person nominated by the SoS to provide for such a situation.**

**A further means of minimising any risk of challenge would be to ensure that both Houses are aware of and comfortable with these proposals by passing these regulations through the positive procedure.**