

1 December 2009

Addressees as below

Dear Colleague

**The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, SI 2009/3093**

1. The above regulations (“the investment regulations”) have now been made under powers contained in section 7 of the Superannuation Act 1972. They replace the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998, SI 1998/1831.
2. The new regulations come into force on 1 January 2010. But see also the relevant information below regarding each particular provision for full details about implementation.
3. The necessary statutory consultation with all Scheme stakeholders in England and Wales took place between 6 February and 3 April 2009. A summary of the responses can be viewed on the CLG website at <http://www.communities.gov.uk/localgovernment/publications/consultations>

**PART I - THE REGULATIONS**

**Regulations 3(4) and 16 - Ending Use of Fund Money by the Administering Authority**

4. As proposed in the consultation paper, the provisions in the 1998 regulations which allow such use – old regulations 3(4) and 12 - will be revoked. **Regulation 3(4)** has been amended so that, **from 1 April 2010 onwards, use of pension fund money by the administering authority**

for any purpose for which it may borrow money **will no longer count as an “investment” under regulation 3.**

5. **Regulations 3(4) and 16** therefore constitute a transitional provision covering the period between the date of the coming into force of these Regulations and 31 March 2010. Related CIPFA guidance for authorities is being prepared. This will advise on best practice if an authority does use fund money during the interim period prior to 1 April 2010.
6. Section 1 in Part 1 of the Local Government Act 2003 sets out the purposes for which a local authority may borrow, namely: “(a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs”. The practical effects of the regulatory change are therefore that the administering authority, in its capacity as a local authority, will no longer be able to use fund money for those purposes from 1 April 2010.
7. If an administering authority currently uses pension fund money, pools that used money with its own cash balances, and then invests the pooled sum on the money markets (before returning a share of the interest earned to the pension fund), the authority will have no legal power to do that under these regulations after 31 March 2010 – since the pension fund authority will have no vires under the regulations to invest fund money by allowing it to be used by the local authority.
8. The pension fund will remain able to invest its cash balances as it sees fit, provided it complies with the regulations and any other relevant legislation.

#### **Regulation 3(8) & 3(9) - Stocklending – References to COLL**

9. **Regulations 3(8) & (9)** (definition of “investment”) update references to the relevant Financial Services Authority Sourcebook, now called COLL. They adapt COLL chapter 5.4 to the LGPS context, by making the administering authority responsible for compliance with the rules and guidance specified. The full contents of COLL 5.4 can be seen at <http://fsahandbook.info/FSA/html/handbook/COLL/5/4>
10. **Regulation 3(9)(d)** includes a modification so that sub-paragraphs (1)(b)(iii) and 1(b)(iv) of paragraph COLL 5.4.4 do not apply to LGPS Funds. Those sub-paragraphs allow certain USA broker-dealers and banks to be used as counter parties. This is not considered appropriate at the present time for LGPS funds.
11. As the modifications made in regulation 3(9) are relatively complex, a **Keeling Schedule**, which shows the wording of the relevant part of the COLL Sourcebook when those modifications are applied, is attached to this letter for the information of authorities (**Annex A**). Words shown in italics in the Schedule are defined elsewhere in COLL. Further copies of this document can be obtained by emailing : [margaret.dunleavy@communities.gsi.gov.uk](mailto:margaret.dunleavy@communities.gsi.gov.uk)

## **Regulation 5 - Borrowing power**

12. **Regulation 5** gives a fund administering authority an explicit power to borrow, for up to 90 days, for the purposes of its pension fund. Borrowing in order to invest on behalf of the fund is not permitted.
13. Regulation 5 clarifies the legal position, following Part 1 of the Local Government Act 2003, which deals with the capital finance provisions of local government finance legislation and provides a borrowing power for local authorities, but only in respect of their general local authority functions.
14. **Regulation 5(2)** sets out the purposes for which the power may be used, ie for cash flow purposes - for instance to ensure that all scheme benefit payments can be made on time, or in a transition management situation when the allocation of the fund's assets is being changed. The pension fund needs to have identifiable income from which repayment of the borrowed amount and any related interest can be funded. In response to suggestions from consultees, the period for which borrowing can last is specified as 90 days - rather than 30 days as suggested in the statutory consultation.

## **Regulation 6 - Separate bank account for the pension fund**

15. This change was proposed in the statutory consultation paper. In view of the comments from consultees on a suitable and practical lead-in time, **regulation 6(1)** provides that the new requirement must be complied with **from 1 April 2011**. For the avoidance of doubt, authorities should be aware that a physically separate entity with a different bank account number is necessary in order to comply with this regulation, not just an accounting separation.
16. **Regulation 6(2)** defines "deposit-taker" for the purposes of this regulation. A provision forbidding set-off by the deposit-taker has been added at **regulation 6(3)**.
17. CIPFA will be invited to prepare guidance, for fund authorities that do not currently have a separate bank account, on best practice during the interim period before they establish a separate account.

## **Regulation 12(2) - Statement of Investment Principles - stock lending, risk**

18. As proposed in the statutory consultation, an administering authority must now include in its statement of investment principles (SIP) information about its policy on the lending of stocks or other securities from its pension fund, by virtue of **regulation 12(2)(h)**; and on the ways in which risks are to be measured and managed, by virtue of **regulation 12(2)(c)**.
19. The first such statement must be published by **1 July 2010** – see **regulation 12(4)**.

20. For the avoidance of doubt, regulation 12(2)(c) does not require authorities to adopt a liability driven investment strategy.

### **Regulation 12(3) – Secretary of State’s guidance on investing**

21. The equivalent provision to regulation 12(3) in the 1998 regulations – regulation 9A(3A) – required each administering authority to report on its compliance with the Myners principles, as set out for the LGPS in CIPFA Guidance Note Issue No.5<sup>1</sup>. The principles for all funded occupational schemes were significantly revised in 2008.
22. **Regulation 12(3)** now provides that authorities should report on their compliance with guidance given by the Secretary of State. Such guidance will be issued as and when necessary in the light of developments. The statutory consultation did not mention this alteration, but including this will avoid the need to amend regulation 12 whenever the guidance changes. The guidance from the Secretary of State is expected shortly. Details will follow in a separate letter.

### **Regulation 12(5) – Keeping the Statement of Investment Principles up to date**

23. Attention is drawn to an amendment to regulation 12 – subparagraph (5) concerning revisions to the Statement of Investment Principles, which was not included in the statutory consultation paper but is considered necessary. The amendment requires any material change in policy on the matters referred to in regulation 12(2 and 12(3), to be reflected in a revised published Statement within 6 months of the change.

### **Regulation 14(1) - Overriding regulations concerning Employer-Related Investments**

24. As proposed in the statutory consultation, the regulations now contain a reference to the Occupational Pension Scheme (Investment) Regulations 2005, SI 2005/3378 as amended, in order to clarify their potential relevance in relation to some LGPS fund investment decisions. The reference is in **the footnote to regulation 14(1)**.
25. Further information about the Occupational Pension Scheme provisions, including their full text, can be seen at [http://www.opsi.gov.uk/legislation/about\\_legislation.htm](http://www.opsi.gov.uk/legislation/about_legislation.htm) Any LGPS fund authority taking an investment decision on which both the LGPS and Occupational Pension Scheme investment Regulations could have a bearing, should obtain appropriate advice.

### **Minor reordering**

26. Authorities may wish to note that minor changes to the order of the regulations have been made. The regulation on the definition of “investment manager” is now **regulation 6**, rather than regulation 4 as in

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<sup>1</sup> “CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom”.

the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998, in order to be closer to the other extant provisions on investment managers. The regulation on management of the pension fund is now **regulation 4**, rather than regulation 5.

## **Future Developments**

27. The Department is grateful to consultees for their detailed and careful responses to the statutory consultation on this SI. This SI takes forward the original proposals and some suggestions consultees made that were considered to improve the regulations without changing their essential character and format.
28. However, the Department recognises that some consultees suggested more substantial changes - including the adoption of a much less prescriptive approach to prudential regulation. The intention is that consideration will be given in due course to the other suggestions consultees made and, in particular, to those made by CIPFA in its report: Local Government Pension Scheme Investment Regulations - Options for Change, January 2009. Those who responded to the statutory consultation, and all other Scheme stakeholders, will be kept informed of any future developments and included in any future consultation to which Ministers agree.
29. The remaining issues (not forming part of the investment regulations and mentioned in paragraphs 22 to 29 of the statutory consultation paper - for instance, scheme guidance on conflicts of interest), will be addressed separately in due course. All stakeholders will be kept informed of, and consulted on, any emerging proposals.
30. The Department issued an informal consultation letter on 13 May 2009 about Scheme governance. The consultation ended on 30 September 2009. Many helpful and comprehensive responses were received. The outcome of that important exercise will be published shortly on the Department's website.

## **Queries**

31. Any queries about this statutory instrument and any other related matter can be made to Margaret Dunleavy, Workforce Pay and Pensions Division, Department for Communities and Local Government – telephone 0303 444 2183. Electronic queries can be sent to [margaret.dunleavy@communities.gsi.gov.uk](mailto:margaret.dunleavy@communities.gsi.gov.uk)

Yours faithfully,

**Robert Holloway**

## List of Addressees

### The Chief Executive of:

County Councils (England)  
District Councils (England)  
Metropolitan Borough Councils (England)  
Unitary Councils (England)  
County and County Borough Councils in Wales  
London Borough Councils  
South Yorkshire Pension Authority  
Tameside Metropolitan Borough Council  
Wirral Metropolitan Borough Council  
Bradford Metropolitan City Council  
South Tyneside Metropolitan Borough Council  
Wolverhampton Metropolitan Borough Council  
London Pension Fund Authority  
Environment Agency

Town Clerk, City of London Corporation  
Clerk, South Yorkshire PTA  
Clerk, West Midlands PTA

Fire and Rescue Authorities in England and Wales  
Police Authorities in England and Wales  
Audit Commission  
National Probation Service for England and Wales  
Homes and Communities Agency

Local Government Association (LGA)  
Local Government Employers (LGE)  
LGPC  
Association of Colleges

ALACE  
PPMA  
SOLACE  
CIPFA

Association of Consulting Actuaries  
Association of District Treasurers  
Society of County Treasurers  
Society of Welsh Treasurers  
Society of Metropolitan Treasurers  
Society of London Treasurers

NALC  
Society of Local Council Clerks

Trades Union Congress	UCATT
UNISON	GMB
NAEIA	NAPO
UNITE	

GAD  
SPPA  
HMT  
HMRC

DOE (NI)  
DWP

Financial Services Authority (FSA)  
Investment Management Association (IMA)  
Association of British Insurers (ABI)  
National Association of Pension Funds (NAPF)  
London Investment Banking Association (LIBA)  
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Hymans  
Mercer  
Hewitt  
Barnett Waddingham  
Linklaters  
Pinsent Masons  
Eversheds

## Annex A

### Regulation 3(8) and 3(9) of the LGPS (Management and Investment of Funds) Regulations 2009

#### KEELING SCHEDULE VERSION – COLL5.4.4 & 5.4.6

##### Stock lending: requirements

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###### COLL 5.4.4

(1) The administering authority may enter into a *stock lending* arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992 (without extension by section 263C), but only if:

(a) all the terms of the agreement under which *securities* are to be reacquired by the administering authority, are in a form which is acceptable to the administering authority and are in accordance with good market practice;

(b) the counterparty is

(i) an *authorised person*; or

(ii) a *person* authorised by a *Home State regulator*;

(c) *collateral* is obtained to secure the obligation of the counterparty under the terms referred to in (a) and the *collateral* is:

(i) acceptable to the administering authority

(ii) adequate; and

(iii) sufficiently immediate.

(2) The counterparty for the purpose of (1) is the *person* who is obliged under the agreement referred to in (1)(a) to transfer to the administering authority the *securities* transferred by the administering authority under the *stock lending* arrangement or *securities* of the same kind.

(3) (1)(c) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme.

##### Treatment of collateral

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###### COLL 5.4.6

(1) *Collateral* is adequate for the purposes of this section only if it is:

(a) transferred to the administering authority or its agent;

(b) at least equal in value, at the time of the transfer to the administering authority, to the value of the *securities* transferred by the administering authority; and

(c) in the form of one or more of:



- (i) cash; or
- (ii) [deleted]
- (iii) a certificate of *deposit*; or
- (iv) a letter of *credit*; or
- (v) a *readily realisable security*; or
- (vi) *commercial paper* with no embedded *derivative* content; or
- (vii) a *qualifying money market fund*.

(2) *Collateral* is sufficiently immediate for the purposes of this section if:

(a) it is transferred before or at the time of the transfer of the *securities* by the administering authority or

(b) the administering authority takes reasonable care to determine at the time referred to in (a) that it will be transferred at the latest by the close of business on the *day* of the transfer.

(3) The administering authority must ensure that the value of the *collateral* at all times is at least equal to the value of the *securities* transferred by the administering authority.

(4) The duty in (3) may be regarded as satisfied in respect of *collateral* the validity of which is about to expire or has expired where the administering authority takes reasonable care to determine that sufficient *collateral* will again be transferred at the latest by the close of business on the *day* of expiry.

(5) Any agreement for transfer at a future date of *securities* or of *collateral* (or of the equivalent of either) under this section may be regarded, for the purposes of valuation, as an unconditional agreement for the *sale* or transfer of property, whether or not the property is part of the property of the pension fund.

(6) *Collateral* transferred to the administering authority is part of the fund money for the purposes of the *rules* in this sourcebook, except in the following respects:

(a) it does not fall to be included in any valuation, because it is offset under (5) by an obligation to transfer; and

(b) it does not count as fund money for any purpose other than this section.

(7) Paragraph (5) and (6)(a) do not apply to any valuation of *collateral* itself for the purposes of this section.