

**EXPLANATORY MEMORANDUM TO**  
**THE LOCAL GOVERNMENT PENSION SCHEME (MANAGEMENT AND**  
**INVESTMENT OF FUNDS) REGULATIONS 2009**

**2009 No. 3093**

1. This explanatory memorandum has been prepared by the Department for Communities and Local Government and is laid before Parliament by Command of Her Majesty.

2. **Purpose of the instrument**

2.1 This instrument is primarily a consolidation of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (S.I. 1998/1831) (“the 1998 Regulations”) with the numerous instruments which have amended them since they were made. The opportunity has also been taken to update the 1998 Regulations and to make a small number of more substantive changes which are detailed below.

2.2 These Regulations set out the arrangements which apply to the management and investment of funds arising in relation to a pension fund maintained under the Local Government Pension Scheme (Administration) Regulations 2008 (S.I. 2008/239) (a “pension fund”). Such a fund constitutes the occupational pension scheme for local government employees, other than teachers, police officers and firefighters.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

An undertaking to review and consolidate the 1998 Regulations was given in the Explanatory Memorandum to the Local Government Pension Scheme (Miscellaneous) Regulations 2008 (S.I. 2008/2425).

4. **Legislative Context**

4.1 These Regulations are made under section 7 of, and Schedule 3 to, the Superannuation Act 1972.

5. **Territorial Extent and Application**

This instrument applies to England and Wales.

6. **European Convention on Human Rights**

As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

## **7. Policy background**

7.1 These Regulations are primarily a good housekeeping measure. The existing equivalent regulations, the 1998 Regulations, were made over 10 years ago, have been subject to numerous amendments since, and users have asked for them to be updated and (where appropriate) clarified.

7.2 But the opportunity has also been taken to make three more substantive changes. These were suggested or supported by various fund interests, chiefly the Chartered Institute of Public Finance Accountancy (CIPFA), the professional body for senior fund administering authority officers which recently reviewed the 1998 Regulations, and by trade unions representing scheme members.

7.3 Firstly, new regulation 3(4) will revoke a longstanding provision – regulation 3(4) - which allows an administering authority to use money from its pension fund for any purpose for which it has a statutory right to borrow. An authority's statutory right to borrow is defined in section 1 of the Local Government Act 2003. This allows a local authority to borrow money for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs, subject to limits set out in Part 1 of that Act.

7.4 A pension fund will often hold a small percentage of its assets in cash. Where such a cash balance is available for short-term investment and is used by the administering authority under regulation 3(4), the authority may in some cases then pool the pension fund cash with its own cash and invest both together on the money markets, in a way that accords with the authority's treasury management strategy.

7.5 Such use under regulation 3(4) of the 1998 Regulations has been subject to the prudential investment requirements that apply under both the new and the 1998 Regulations, and the administering authority must, by virtue of regulation 16 (regulation 12 of the 1998 Regulations) pay the pension fund a specified minimum rate of interest. However, such use is unconventional when compared with the provisions of current legislation in relation to occupational pensions, as a fund administering authority is one of the employers participating in the pension fund.

7.6 Accordingly, new regulation 3(4) now provides that from 1st April 2010 such use will no longer count as an investment for the purposes of these Regulations.

7.7 Secondly, regulation 5 gives administering authorities a limited power to borrow on behalf of the pension fund for up to 90 days. The power cannot be used to invest, but only for cash flow management in specified circumstances which should in practice be exceptional, i.e. to ensure that

benefits are paid on time, and in transition management situations when the allocation of a pension fund's assets is being changed. Money can only be borrowed for the purposes mentioned in regulation 5(2) if, at the time of borrowing, the administering authority reasonably believes that the sum borrowed, and any interest charged as a result, can be repaid out of the pension fund within 90 days of the date when the money is borrowed. For example, the authority may be expecting to receive income from contributions, or capital from the planned sale of fund investments. Pension fund management arrangements presume no borrowing normally. But occasionally unexpected pressures can occur and, in these circumstances, the power would enable administering authorities to avoid becoming forced sellers of fund assets at the wrong time in the market cycle because of a need for cash flow.

7.8 This regulation will clarify the legal position following the coming into force of Part 1 of the Local Government Act 2003, which deals with the capital finance provisions of local government finance and provides a borrowing power for local authorities, but only in respect of their general local authority functions. HM Treasury have been consulted and have no objections to the change. Private sector pension schemes have a similar limited borrowing power under the Occupational Pension Scheme (Investments) Regulations 2005 (S.I. 2005/ 3378).

7.9 Thirdly, regulation 6 introduces a new requirement for each pension fund to have, by 1 April 2011, a bank account which is separate from any which the administering authority has in its capacity as a local authority. This change is being adopted because it will enable pension fund monies to be clearly ring-fenced from other monies of the local authority, and thus reflects a longstanding Audit Commission view on best practice. Some pension funds already have a separate bank account, but this change will ensure consistency across all 89 administering authorities in England and Wales.

7.10 Other minor amendments are as follows-

(a) Regulation 12(2)(c) and 12(2)(h) specify additional content for an administering authority's statement of investment principles. A statement must already set out the principles governing the authority's investment strategy, covering the types of investment to be held, the balance between them, and risk. For transparency and as good practice, an administering authority must now also include information on any stock lending activity it undertakes (likely to be relevant in practice for a minority of authorities), and on the ways in which risk is measured and managed. (A similar requirement on risk applies to private sector occupational schemes under pension legislation.) An administering authority may well include all of this information in its statement already, but it is considered useful to confirm what is expected. Regulation 12(4) requires the first such statement to be published no later than 1 July 2010. Regulation 12(5) makes clear that the revision of a statement (following any material change in the authority's policy on the matters mentioned in regulation 12(2) and 12(3)) must be completed within 6 months of the date of the change.

(b) Regulation 12(3) provides that administering authorities are to have regard to guidance given by the Secretary of State on investment decision-making and to state in their statement of investment principles how far they comply with that guidance. This replaces the requirement to have regard to guidance issued by CIPFA and enables the Department to be more responsive to changes in circumstances. The new guidance will be issued to administering authorities before the regulation comes into force.

(c) The footnote to regulation 14(1) makes clearer the potential relevance of the employer-related investment provisions of occupational pension legislation to some investment decisions facing fund administering authorities.

(d) In regulation 4(5) an outdated reference to Free Standing Additional Voluntary Contributions has been removed.

## **8. Consultation outcome**

8.1 A statutory consultation on draft Regulations, as required by the Superannuation Act 1972, took place between 6 February and 3 April 2009. Forty nine responses commenting on the proposals were received. These comprised 36 from fund administering authorities, 5 from trade unions representing pension fund members, one from the Financial Services Authority, and seven others from various interests - professional organisations for officers involved in the management and investment of the pension funds, pension fund actuaries, and the investment industry.

8.2 This was considered a sufficient consultation period because stakeholders were aware for some time beforehand (through normal communications channels) that changes were under consideration, CIPFA helped to generate proposals following its extensive consultation with stakeholders (including administering authorities), and the proposals do not affect pension scheme members' benefits. The consultation concerned investment matters, and consultees were practitioners and stakeholders with relevant fund management and financial understanding/experience. The number and range of responses received suggests that consultees found the consultation period adequate and effective. Various responses on specific parts of the draft were dealt with as detailed below.

8.3 **Regulation 3(4)** - of the 41 responses which commented on the proposal to end the ability of a fund administering authority to use pension fund money for any purpose for which it can borrow money (in its capacity as a local authority), 49% (20 responses) were in favour, and 51% (21 responses) were opposed. Most administering authorities that commented (68%) were opposed to the change on the grounds that it would increase pension fund administration costs, investing with the authority was safe, and pooling cash balances for investment was efficient in terms optimising deal size. In response to some of their concerns, the implementation date for the change will be 1st April 2010. All other interests that commented supported the proposal.

8.4 **Regulation 5** - of the 43 responses which commented on the proposal to provide a power for pension funds to undertake temporary borrowing, 93 % (40 responses) were in favour and 7% (3 administering authorities) opposed it. Those in favour included 20 fund administering authorities, trade unions and other interests. Apparently few administering authorities expect to use the power, but they still consider it a necessary clarification, especially given the other changes in the Regulations (separate bank accounts, the ending of use).

8.5 **Regulation 6** - on the proposal for a separate bank account, 62% of the 42 responses which commented on this (26 responses) supported it, and 38% (16 responses) were opposed. Amongst fund administering authorities, a small majority were in favour (17 to 15). The proposal was supported by the trade unions and other interests. Critical authorities thought the requirement unnecessary, and were concerned about extra work and costs. However, the Department considers that it will provide added transparency, and a clearer audit and accountancy trail of pension fund transactions. Reflecting administering authorities' concerns that there should be an adequate lead-in time to prepare for the change, it will come into force on 1st April 2011.

8.6 **Regulation 12** - fewer responses commented on the proposals for extra content in an administering authority's statement of investment principles. These were supported by all interests. Of the 29 responses which commented on the proposal to require information on stock lending, 28 (97%) supported it, and one (3%) had reservations. All of the 28 responses that commented on the other proposal (to include information about how risk is measured and managed) were in favour.

8.7 18 responses, comprising that from CIPFA, 12 LGPS \ fund administering authorities and 5 other respondents, proposed more significant changes to the 1998 Regulations and recommended a different less prescriptive approach. CLG recognises these consultees will be disappointed by the changes in these Regulations. But recent and current financial and market conditions are not considered a suitable background against which to embark on a loosening of the prudential regulation of investment by a public service pension scheme. CLG does not rule out a further review of these Regulations in the future when conditions have improved, at which point consultees' suggestions would be considered afresh. Those who responded to the consultation, and all Scheme stakeholders, will be kept informed of any future proposals and included in any relevant consultation.

8.8 Branches and members of one local authority trade union sent in 111 identical campaign letters about how the pension scheme's investment decision-making arrangements relate to European legislation. These responses did not comment on the draft regulations, apart from supporting the idea that each pension fund should have a separate bank account. On 13 May 2009, CLG began a consultation with all scheme stakeholders, which invited suggestions on improving or developing the scheme's governance arrangements. That consultation ran until 30 September 2009.

## 9. Guidance

Given the background to these Regulations, it is not considered necessary to issue any guidance to accompany them.

**10. Impact**

10.1 An impact assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

10.2 The impact on the public sector is considered minimal.

**11. Regulating small business**

The legislation does not apply to small business as the Regulations deal specifically with the administration of a public service pension scheme.

**12. Monitoring and review**

The Regulations do not require a specific review after implementation. But this would necessarily be part of any further review of the regulations as mentioned in paragraph 8.7 above.

**13. Contact**

Robert Holloway at the Department for Communities and Local Government  
Tel: 0303 444 2182 or email: [robert.holloway@communities.gsi.gov.uk](mailto:robert.holloway@communities.gsi.gov.uk) can answer any queries regarding the instrument.