

WIRRAL COUNCIL

PENSIONS COMMITTEE

25 JANUARY 2016

SUBJECT:	LGPS – INVESTMENT REGULATIONS
WARD/S AFFECTED:	NONE
REPORT OF:	STRATEGIC DIRECTOR TRANSFORMATION & RESOURCES
KEY DECISION?	NO

1.0 EXECUTIVE SUMMARY

1.1 This report provides Members with details of a consultation on proposals to revoke and replace the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 and seeks approval for the response attached. Responses are required by 19 February 2016.

2.0 BACKGROUND AND KEY ISSUES

2.1 The proposals in this consultation are the culmination of work looking into Local Government Pension Scheme investments that began in early 2013. It has been developed in response to the May 2014 consultation, *Opportunities for collaboration, cost savings and efficiencies*.

2.2 Some respondents to the May 2014 consultation also suggested that amendments were required to the investment regulations in order to facilitate greater investment in pooled vehicles. In addition, prior to that consultation, authorities and the fund management industry had called for wider reform. A small working group was established to look at whether the approach to risk management and diversification in the existing regulations was still appropriate. They recommended moving towards the “prudential person” approach that governs trust based pension schemes. The group also sought clarity as to whether certain types of investment were possible, such as the use of derivatives in risk management.

The consultation on the Investment Regulations is being undertaken in parallel with the consultation on pooling of LGPS assets.

Response to the Law Commission’s Review of Fiduciary Duty

2.3 The Kay Review on Fiduciary Duty published its final report in July 2012. In addition to making a number of recommendations to address the excessive focus on short-term performance in equity investment markets, it recommended that the Government ask the Law Commission to review the fiduciary duties of investment intermediaries amid

concerns that these common law duties were being interpreted by some pension schemes as a requirement to focus solely on short-term financial returns.

2.4 In their report, published in July 2014, the Law Commission called on the Department to review:

- Whether the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 should transpose article 18(1) of the 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.

2.5 These recommendations were supported by the Government's progress report on the implementation of the Kay Review published in October 2014 by the Department for Business Innovation and Skills.

2.6 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.

2.7 Regulation 4 of The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005 No 3378) transposed Article 18(1):

"4. (1) The trustees of a trust scheme must exercise their powers of investment, and any fund manager to whom any discretion has been delegated under section 34 of the 1995 Act (power of investment and delegation) must exercise the discretion, in accordance with the following provisions of this regulation

(2) The assets must be invested:

(a) In the best interests of members and beneficiaries; and

(b) In the case of a potential conflict of interest, in the sole interest of members and beneficiaries."

2.8 The Local Government Pension Scheme is a statutory scheme made under section 1 of the Public Service Pensions Act 2013 and previously under The Superannuation Act 1972. It is not subject to trust law and those responsible for making investment decisions in the Scheme are not therefore required to comply with Regulation 4 of the 2005 Regulations.

2.9 In a circular issued by the then Department of the Environment in 1983 (No 24), the Secretary of State took the view that administering authorities should pay due regard to the principle contained in the case of *Roberts v Hopwood* [1925] A.C. 578 p. 595:

"A body charged with the administration for definite purposes of funds contributed in whole or in part by persons other than members of that body owes, in my view, a duty to those latter persons to conduct that administration in a fairly business-like manner with reasonable care, skill and caution, and with a due and alert regard to the interest of those contributors who are not members of the body. Towards these latter persons, the body stands somewhat in the position of trustees or managers of the property of others."

- 2.10 Those in local government responsible for making investment decisions must also act in accordance with ordinary public law principles, in particular, the ordinary public law principles of reasonableness. They risk challenge if a decision they make is so unreasonable that no reasonable person acting reasonably could have made it.
- 2.11 Having considered fully the recommendation made by the Kay Review and supported by both the Law Commission and the Government, Ministers are satisfied that the Scheme is consistent with the national legislative framework governing the duties placed on those responsible for making investment decisions. The position at common law
- 2.12 Ministers do, however, propose to remove the requirement for the performance of investment managers to be reviewed once every three months from the regulations.
- 2.13 In developing these draft regulations, the Government has sought, where appropriate, to deregulate and simplify the regulations that have governed the management and investment of funds since 2009. Some of the existing provisions have not been carried forward into the draft 2016 Regulations in the expectation 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.
- 2.14 As part of this deregulation, the draft regulations also propose to remove the existing schedule of limitations on investments. Instead authorities will be expected to take a prudential approach, 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.
- 2.15 Key to this will be the investment strategy statement, which authorities will be required to prepare, having taken proper advice, and publish. The statement must 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.

Transitional arrangements

- 2.16 Draft regulation seven proposes to require authorities to publish an investment strategy statement no later than six months after the regulations come into force (this is currently drafted as 1 October 2016, in case the draft regulations come into effect on 1 April 2016). However, the draft regulations would also revoke the existing 2009 Regulations when they come into effect. Transitional arrangements are therefore required to ensure

that an authority's investments and investment strategy are regulated between the draft regulations coming into effect and the publication of an authority's new investment strategy statement. 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)

2.17 It is not proposed to carry forward the existing requirement under regulation 12 of the 2009 Regulations to maintain a Statement of Investment Principles. However, 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 statement.

Non-financial factors

2.18 The Secretary of State has made clear 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.

The draft replacement Regulations include provision for administering authorities to publish their policies on the extent to which environmental, social and corporate governance matters are taken into account in the selection, retention and realisation of investments. Guidance on how these policies should reflect foreign policy and related issues will be published ahead of the new Regulations coming into force.

2.19 Questions from DCLG:

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?

Are there any specific issues that should be reinstated? Please explain why.

Is six months the appropriate period for the transitional arrangements to remain in place?

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?

Introducing a safeguard: Secretary of State power of intervention

2.20 The first part of this consultation lifts some of the existing restrictions on administering authorities' investments in order to make it easier for them to pool their investments and access the benefits of scale. To ensure that this new flexibility is used appropriately, the consultation also proposes to introduce a power to intervene in the investment function

of an administering authority if the Secretary of State believes that it has not had regard to guidance and regulations. The consultation sets out the evidence that the Secretary of State may draw on before deciding to intervene, and makes clear that any direction will need to be proportionate. The power proposed in this consultation is intended to allow the Secretary of State to act if best practice or regulation is being ignored, which will help to ensure that authorities continue to pursue more efficient means of investment.

2.21 Draft regulation 8 sets out the process for intervention under the following sections:

- Determining to intervene
- The process of intervention
- Review

2.22 At the time of writing this report, officers had not completed a response to the consultation as, shortly, they are due to meet with other funds to discuss the potential effects and implications. At this stage, there are no particular concerns although the Secretary of State's powers of intervention are a new development.

3.0 RELEVANT RISKS

3.1 The Investment Regulations are central to the management of LGPS assets and it is important that they are fit for purpose and that the Fund is compliant with them.

4.0 OTHER OPTIONS CONSIDERED

4.1 All appropriate options remain under consideration.

5.0 CONSULTATION

5.1 The consultation is being undertaken by DCLG

6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS

6.1 N/A

7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 There are none arising from this report.

8.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

8.1 The new investment regulations will require officers to undertake additional work in order to ensure arrangements at the fund remain appropriate but this should be accommodated within existing resources.

9.0 LEGAL IMPLICATIONS

9.1 There are none arising from this report

10.0 EQUALITIES IMPLICATIONS

10.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

(b) No because there is no relevance to equality.

11.0 CARBON REDUCTION AND ENVIRONMENTAL IMPLICATIONS

11.1 There are no carbon usage implications, nor any other relevant environmental issues arising from this report.

12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising from this report.

13.0 RECOMMENDATION/S

13.1 That Members note the report and agree that a response to the consultation is made by officers with the approval of the Chair.

14.0 REASON/S FOR RECOMMENDATION/S

14.1 It is important that Members are informed of potential changes to the legislative framework of the LGPS.

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APPENDICES None

BACKGROUND PAPERS/REFERENCE MATERIAL

Local government pension scheme: investment regulations' Investment Reform

BRIEFING NOTES HISTORY

Briefing Note	Date

SUBJECT HISTORY (last 3 years)

Council Meeting	Date