

WIRRAL COUNCIL

PENSIONS COMMITTEE

6 APRIL 2009

REPORT OF THE DIRECTOR OF FINANCE

INVESTMENT REGULATIONS CONSULTATION

1. EXECUTIVE SUMMARY

- 1.1. The Department for Communities and Local Government (DCLG) published draft regulations on 6 February 2009 to consolidate the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (“the investment regulations”) SI 1998/1831, and to make various amendments. A consultation exercise was open until 3 April 2009.
- 1.2 This report outlines the scope of the proposals, details the proposed regulations, the key proposals, and the response. Members are requested to agree the response.

2. SCOPE OF PROPOSALS

- 2.1 This consultation exercise is primarily a consolidation of the 1998 regulations, as amended, but does include several proposals on separate bank accounts, borrowing, and employer-related loans, which the DCLG decided should be taken forward for consideration by interested parties

3. THE PROPOSED REGULATIONS

- 3.1 The intention is for the Regulations to come into effect later in 2009. **Regulations 11 to 14 of the LGPS (Miscellaneous) Regulations 2008**, SI 2008/2425, made minor amendments to the investment regulations, to update references they contain to the other regulations for the Scheme. The draft investment regulations now reflect those earlier changes.

4. **KEY PROPOSALS**

Separate bank account for the pension fund - regulation 6

- 4.1 The intention of this amendment is to improve the transparency of cash transactions between pension funds and general local authority accounts, and follows long-standing Audit Commission best practice. Many administering authorities including Wirral already have a separate bank account and the only significant concern expressed by those who do not is that the amending regulations must allow sufficient lead-in time to enable authorities to introduce new arrangements without any detriment to their investment strategies. In addition to any general comments about this proposal, consultees were also invited to comment on what would be a suitable and practical lead-in time before any change took effect.
- 4.2 Wirral already operates separate bank accounts and therefore supports this amendment.

Temporary borrowing power- regulation 15

- 4.3 Regulation 15 proposes that the Administering Authority should have an explicit, but limited, power to borrow for the purposes of its pension fund. Borrowing in order to invest on behalf of the pension fund would not be allowed.
- 4.4 It is understood that there can be occasions where limited short-term borrowing does, unexpectedly, prove to be necessary for cash flow purposes - for instance as a part of transition management when the allocation of fund assets is being changed, or to ensure that all scheme benefit payments can be made on time. The pension fund needs to have identifiable known income it will receive shortly, with which repayment of the amount borrowed can be funded. The cost of the relevant loan repayments, and any interest payable, would be chargeable to the pension fund.
- 4.5 The amendment will therefore clarify the legal position of Part 1 of the Local Government Act 2003 which deals with the capital finance provisions of local government finance legislation and which provides a borrowing power for local authorities, but only in respect of their general local authority functions. The draft provision was recommended by CIPFA in July 2008 after its initial review of the extant regulations.
- 4.6 Merseyside Pension Fund supports the clarification provision of this proposed amendment.

Statement of Investment Principles (SIP): stock lending - regulation 11(2)(h)

- 4.7 Draft regulation **11(2)(h)** extends the existing regulation on this subject to require the statement of investment principles (SIP) to include information about the policy on the lending of stocks or other securities from the pension fund.

Stocklending – References to COLL

- 4.8 Draft regulation **3(7) & (8)** (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>
- 4.9 The DCLG does not think that regulation **3(8)** needs to include a reference to COLL 5.4.8G. It is only guidance, and the overall provisions of the LGPS investment regulations cover relevant points already. That approach can be reviewed, however, if consultees consider that a reference is necessary. Were a reference to 5.4.8G to be added to regulation 3(8), it would have to include appropriate modifications.
- 4.10 Consultees should note, and may have comments regarding, ways in which COLL chapter 5.4 is different from the equivalent section of the previous Sourcebook. Namely:
- Counterparties may now include certain USA broker-dealers and banks. The DCLG is minded to provide a modification in regulation 3(8) of the new investment regulations, so that COLL 5.4.4(1)(b) (iii) and (iv) would not in fact apply to LGPS Funds.
 - The difference in arrangements for stock lending transactions made through the Euroclear Programme are mentioned at 5.4.4(3)
 - Although as explained above this is unlikely to be relevant, 5.4.8(2) has guidance on how cash collateral can be reinvested.
- 4.11 These changes were explained in an FSA Quarterly Consultation which can be found on their website - FSA 06/18, (No.10) October 2006, paragraphs 6.28 to 6.41.

- 4.12 Merseyside Pension Fund supports the adaptation of COLL chapter 5.4 to the LGPS context. However, we do not entirely agree that reg 3(8) does not need to include reference to COLL 5.4.8G. Although this is only guidance, there has been some considerable doubt among parties - including auditors, regulators and practitioners - as to how cash collateral may be reinvested. The introduction of the guidance in 5.4.8(G) was made by the FSA after collaboration with industry participants. Prior to this there was no guidance as to how cash could be invested. It was therefore considered beneficial to have some opinion on this subject and the best reference was to follow the approved collateral items. If this reference were to be omitted and cash collateral be permitted, then alternative guidance should be provided.

Merseyside Pension Fund would also recommend that regulation 3(8) is not modified. Although it would not benefit at present, Merseyside Pension Fund sees no reason for DCLG to retain the exclusion of certain USA broker-dealers and banks as other corporate pension schemes do not have this restriction.

The SIP and risk - regulation 11(2)(c)

- 4.13 The Funding Strategy Statement already provides some related information on investment strategy and managing financial risks. Draft regulation 11(2)(c) proposes to extend the existing requirement for the statement of investment principles to cover the policy on risk, by adding the words “including the ways in which risks are to be measured and managed”. The amendment reflects a similar requirement on private sector pension schemes.

- 4.14 Merseyside Pension Fund supports the proposed amendment.

Reference to overriding regulations concerning employer-related investments - regulation 13(1)

- 4.15 The Explanatory Note to the existing regulations does mention that overriding regulations exist, the latest version being the Occupational Pension Scheme (Investment) Regulations 2005, SI 2005/3378 (“OPSIR”), but there is currently no reference to these in the body of the LGPS investment regulations.

To clarify the situation, draft regulation 13(1) contains a reference to the relevant provisions of OPSIR.

Further information about OPSIR is at **Annex B**. The full text can be seen at http://www.opsi.gov.uk/legislation/about_legislation.htm

4.16 Merseyside Pension Fund supports the proposed amendment.

Use of Fund Money by the Administering Authority - Revocation of existing regulations 3(4) and 12

4.17 A provision of this kind has featured in the relevant Superannuation Act or scheme regulations since 1937 (with changes to details as time went on), and is subject to the prudential requirements and limits in the current regulations as a whole.

4.18 Although it is perhaps arguable that such use represents a safe investment, with the daily interest rate payable being prescribed, after many changes over the years in the wider pensions world it has come to be seen by some commentators as being out of step to allow Administering Authorities to use pension fund money in this way. There is no obvious reason why the Administering Authority should be able to do so when other participating employers cannot. The DCLG has therefore concluded that when the 1998 regulations are revoked, existing regulations 3(4) and 12 will not be replicated in the new provisions.

4.19 A transitional provision is proposed at draft **regulation 16**. This is only intended to be used where appropriate and to enable such arrangements to be unwound in an orderly manner without detriment to the pension fund.

4.20 Merseyside Pension Fund supports the proposed amendment.

Other Issues - duty of care, governance

4.21 Regulation 4 of The Occupational Pension Schemes (Investment) Regulations 2005, which applies only to private sector schemes, imposes the following requirements:

“Investment by trustees

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(a) (power of investment and delegation) must exercise the discretion, in accordance with the following provisions of this regulation.

(2)

(3) The powers of investment, or the discretion, must be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole.”

The provision usefully summarises the fiduciary duty of private sector pension fund trustees, and the investment outcomes which the prudential investment provisions of such regulations would be seeking to achieve.

- 4.22 In 2008, the CIPFA Pensions Panel review of the LGPS investment regulations proposed, amongst other things, the following definition of “investments”:

“The assets of the pension fund must be invested in such a way as to ensure the security, quality, liquidity and profitability of the portfolio as a whole and, in doing so, take the appropriate market, risk and investment advice. In the event of a potential conflict of stakeholder interests, investments must be made in the sole financial interests of the fund.”

- 4.23 The DCLG has tended to take action to ensure that the LGPS reflects private sector best practice and sustains its position as an exemplar occupational scheme. On this basis, consultees were invited to consider whether a provision of this kind is desirable or necessary to clarify the duty of care owed by those responsible for investment decisions within the LGPS.

Consultees were invited to comment on the merits of this proposal; and, in particular, whether the approach taken by the 2005 regulations mentioned above, or the wording above suggested by CIPFA, is appropriate in the LGPS context. The CIPFA report was published on 28 January 2009.

- 4.24 Merseyside Pension Fund supports the proposed amendment.
- 4.25 The response submitted by the close of consultation on 3 April 2009 is attached as Appendix 2.

5. FINANCIAL AND STAFFING IMPLICATIONS

- 5.1 There are none arising directly from this report.

6. COMMUNITY SAFETY IMPLICATIONS

- 6.1. There are no specific implications arising from this report.

7. LOCAL MEMBER SUPPORT IMPLICATIONS

- 7.1. There are no specific implications for any Member or Ward.

8. LOCAL AGENDA 21 IMPLICATIONS

- 8.1. None.

9. **PLANNING IMPLICATIONS**

9.1 There are no specific implications arising from this report.

10 **BACKGROUND PAPERS**

10.1 The Local Government Pension Scheme (Management and Investment of Funds) (Consolidated and Amendment) Regulations 2009 – DCLG February 2009.

10.2 LGPS Investment Regulations Options for Change – CIPFA November 2008.

11. **RECOMMENDATION**

11.1. That Members agree the response to the proposed amendments to the investment regulations.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/73/09