

Pension Fund Committee

15 December 2015



Local Government Pension Scheme Investment Regulations

Report of Don McLure, Corporate Director Resources

Purpose of the report

- 1 To provide Members with information on the Government's consultation on the revocation and replacement of the Local Government Pension Scheme (Investment and Management of Funds) Regulations 2009 (the 2009 Investment Regulations).

Background

- 2 The 2009 Investment Regulations detail the ways that the administering authorities for Local Government Pension Scheme (LGPS) funds must manage and invest those funds. The regulations are detailed and prescriptive, for example setting out how and under what terms investment managers should be appointed and their performance monitored, as well as listing types of permissible investments and limits on what proportions of a fund can be allocated to particular assets or asset classes.
- 3 As part of its Autumn Statement on 25 November 2015, the Government published a consultation document setting out proposals to revoke and replace the 2009 Investment Regulations with the draft Local Government Pension Scheme (Investment and Management of Funds) Regulations 2016 (the 2016 Investment Regulations). A copy of the consultation document and draft regulations are enclosed at Appendix A.
- 4 The two stated proposals of the consultation are
 - Deregulating and adopting a local approach to investment – mainly to allow LGPS Funds to pool their investments and access the benefits of economies of scale; and
 - Introducing a safeguard – Secretary of State power of intervention – partly to ensure all LGPS Funds will comply with the pooling requirement.

More detail on these proposals is set out below.

Proposal 1: Adopting a local approach to investment

- 5 Much of the detailed regulation on the types of assets that can be invested in and the proportions of investment has been removed from the draft 2016 Investment Regulations. The overall approach is to move towards a more "prudent person" approach which will align the LGPS with other major funded

pension schemes, and to move away from detailed prescription on asset classes and proportions that can be invested in them.

6 Some of the regulations that will be removed under the proposals include:

- Reference to stock-lending – on the basis that no specific reference is needed if stock-lending falls within the ordinary meaning of an “investment”;
- The requirement for funds to be managed by “an adequate number” of investment managers – on the basis that administering authorities should be responsible for managing their own affairs and making these types of decisions based on prudent and proper advice;
- Conditions relating to the appointment of investment managers. The proposal is that these issues should be governed by the contracts under which the investment managers are appointed;
- The requirement for administering authorities to state the extent to which they comply with the ‘Myners principles’ on investment decision making. Authorities will still need to have regard to these principles but will no longer need to report against them.

7 The requirement to publish a Statement of Investment Principles will be replaced by a requirement to prepare, having taken proper advice, and publish an Investment Strategy Statement, which will 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.

8 The consultation also includes a section on “non-financial factors” and how issues such as environmental, social and corporate governance factors should or should not be taken into account when making investment decisions. This section includes reference to clarification from the Secretary of State 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 but in place by the Government.”* Further reference is made to the importance of ensuring the predominant concern of administering authorities when formulating a policy on environmental, social and corporate governance issues should be the pursuit of a financial return on investments, and that administering authorities should not pursue policies that *“run contrary to UK foreign policy”*.

Proposal 2: Introducing a safeguard – Secretary of State Power of Intervention

9 The draft regulations give the Secretary of State the power to intervene in the investment function of an administering authority if the Secretary of State

determines that the administering authority has failed to have regard to the investment regulations or statutory guidance issued under the regulations.

10 Examples are given of where such an intervention could be necessary, including:

- Where an authority ignores information on best practice, such as advice provided by the scheme advisory board to local pension boards;
- Where an authority fails to follow statutory investment guidance, for example, by not participating in a large asset pool with other Funds as described in the draft guidance;
- Where there is evidence that an authority is carrying out a pension-related function poorly, such as failing to carry out an actuarial valuation in accordance with the regulations.

The sort of interventions that the Secretary of State could impose include:

- Requiring and administering authority to develop a new investment strategy that is compliant with the regulations;
- Directing an administering authority to invest some or all of its assets in a way that more closely matches the guidance – for example through a pooled vehicle;
- Requiring that the investment function of the administering authority are exercised by the Secretary of State or his nominee.

11 The consultation document outlines a process covering implementation of any intervention including details of notification, monitoring and review.

12 Consultation responses are requested by 19 February 2016.

Recommendation

13 Members are asked to agree that the Corporate Director Resources in consultation with the Chairman and Vice Chairman responds to the consultation after taking advice from the investment advisors.

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