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Local Government Pension Scheme investments

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Summary

Although the rules of the Local Government Pension Scheme (LGPS) are set nationally, it is administered at local level by administering authorities, whose responsibilities include managing fund investments within the statutory framework. As with the trustees of pension funds in the private sector, the primary responsibilities of administering authorities are to deliver the returns needed to pay scheme members' pensions, and to protect local taxpayers and employers from high pension costs (CLG consultation, November 2012, para 1.1).

Pooling investments

In recent years, CLG has been looking at ways to achieve economies of scale in LGPS funds – with the primary aim of improving returns and reducing deficits but also to enable greater capacity for investment in infrastructure. (CLG June 2013 and CLG, May 2014).

In the summer 2015 Budget, it said it would invite local authorities to come forward with proposals to pool investments to reduce costs. It would consult on detailed criteria and backstop legislation to ensure that authorities that did not come forward with "sufficiently ambitious proposals" could be required to pool investments (para 2.19).

In October 2015, CLG launched consultation on proposals to revoke and replace the LGPS Investment Regulations for England and Wales. Proposals included the introduction of:

- Safeguards to ensure that guidance on pooling of assets is adhered to;
- Statutory guidance to assist administering authorities prepare for the new Investment Strategy Statements, including guidance on the extent to which non-financial factors should be taken into account when making investment decisions and how these should reflect UK foreign policy

Criteria published alongside the consultation, made clear the Government's expectation for ambitious proposals for pooling. In addition, it proposed issuing guidance to authorities to the effect that investment policies should not "be used to give effect to municipal foreign or munitions policies that run contrary to Government policy." The Government proposed giving the Secretary of State power to intervene where authorities did not take advantage of benefits of scale or adhere to guidance. Intervention could include: directing an authority to develop some or all of its assets in a particular way or requiring the investment functions to be exercised by the Secretary of State (November 2015 consultation, para 4.7).

In Budget 2016, the Government said it had received "ambitious proposals" from LGPS authorities to establish a "small number of British Wealth Funds" by combining assets into larger investment pools. It would work with them to establish a new LGPS infrastructure investment platform (para 1.284).

On 22 January 2018, the Government said it had received proposals from LGPS administering authorities in England and Wales to "consolidate their assets into a small number of pools to take advantage of their scale." It would work with administering authorities to establish a new LGPS infrastructure investment platform to "boost their capacity and capability to invest in infrastructure" (PQ 123038, 22 January 2018).

Guidance on preparing and maintaining an investment strategy statement published in September 2016 said that administering authorities "must commit to a suitable pool to achieve benefits of scale." The LGPS Advisory Board issued an updated statement on pool governance in November 2018.

Regulations and guidance for LGPS administering authorities

The *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016/946)* were laid before the House on 23 September and came into force on 1 November 2016. They included specific provision for administering authorities to publish an investment strategy in accordance with guidance issued by the Secretary of State and for the Secretary of State to be able to issue a direction to any authority which fails to act in accordance with statutory obligations or guidance. They apply to England and Wales only. In Scotland and Northern Ireland, investments would continue to be managed in the same way (LGPS advisory board Q&A, 2016).

In a report published on 20 October, the Secondary Legislation Scrutiny Committee noted "high levels of opposition to the proposed power of intervention" in consultation responses (House of Lords Secondary Legislation Scrutiny Committee, LGPS (Management and Investment of Funds) Regulations 2016, HL Paper 53, 20 October 2016).

A petition called for a debate on the regulations and for the Government to be made accountable for the powers of intervention. In its response, the Government said LGPS investment decisions would remain matters for local authorities and that it expected the power of intervention to be used "exceptionally when there was clear evidence that a pension fund authority was not acting reasonably and lawfully." The petition having received over 100,000 signatures, the regulations were debated on 24 October 2016 (HC Deb 24 October 2016 c1-22WH). Following an Early Day Motion 586, in the name of the Leader of the Opposition praying against them, the regulations were debated in Delegated Legislation Committee on 22 November 2016. The committee voted by 9 votes to 4 that the regulations had been considered (DLC Deb 22 November 2016 c4-10).

On 22 June 2017, the High Court ruled that part of CLG guidance on investments was unlawful because it was issued for non-pensions purposes ([2017] EWHC 1502 (Admin)]

CLG received permission to appeal the judgement (PQ 243 HL 28 June 2017). Pending the outcome, the reference to boycotts, divestment and sanctions against foreign nations has been removed from the revised guidance (July 2017, p9). The Court of Appeal allowed the Secretary of State's Appeal in June. However, the Palestine Solidarity Campaign has been given permission to appeal to the Supreme Court.

Other Library Briefing Papers of possible interest include SN-6594 Infrastructure Policy (December 2015) and CBP-7507 Local authority boycotts (March 2016).

1. Background

Of the main public service schemes, only the Local Government Pension Scheme (LGPS) operates on a funded basis. This means that contributions from employees and employers are paid into a fund which is invested, and from which pensions are paid. The other main schemes (those for civil servants, NHS, teachers, police and firefighters) operate on a Pay-As-You-Go (PAYG) basis which means that contributions paid to the sponsoring government department, which meets the cost of pensions in payment, netting off contributions received.

The LGPS is administered, managed and funded at local level.[1] The Department for Communities and Local Government (DCLG) explains that:

> The Scheme is managed through 90 administering authorities which broadly corresponding to the county councils following the 1974 local government reorganisation as well as each of the 33 London boroughs. In most cases, the administering authorities are upper tier local authorities such as county or unitary councils, but there are also some authorities established specifically to manage their pension liabilities, for example, the London Pension Fund Authority and the Environment Agency Pension Fund. The administering authorities have individual governance and working arrangements. Each has its own funding level, cash-flow and balance of active, deferred and pensioner members. Authorities take these into account when preparing their investment strategies, which are normally agreed by the councillors on each authority's pension committee. [2]

The Local Government Association (LGA) explains the roles councillors play in the process as follows:

> Councillors sitting on the Pensions Committee in each of the 8 administering authorities in England and Wales are responsible for the management and investment of Pension Funds. Thus, as well as being funded, and funded locally, the LGPS is governed, administered and invested at individual pension fund level by elected members representing the council taxpayers and others who stand behind the LGPS. This means that the decisions are taken by democratically elected local councillors working within the restraints of local authority budgets. The administration of the LGPS is a good example of democratic accountability working well.[3]

1.1 Statistics

The LGPS is one of the largest defined benefit (DB) schemes in the world and the largest in England and Wales.[4] There are 89 LGPS funds in

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1 ODPM, *Facing the future - Principles and propositions for an affordable and sustainable Local Government Pension Scheme in England and Wales*, October 2004

2 DCLG, Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. Consulation, November 2015

3 LGA, *Submission to Independent Public Service Pensions Commission*, 13 December 2010

4 LGPS Annual Report 2014, Chair's statement

England and Wales.[5] In March 2018, they had just under 5.8 million members:[6]

LGPS membership	
Thousand	
Mar-18	
Total	5,778
Active	2,001
Deferred	2,117
Pensioners	1,660

The total assets in these funds increased to £275 bn (change of 5%) during 2018.[7] Annual reports for individual LGPS funds are on the LGPS Advisory Board website.

Information about LGPS asset management and stewardship is on the website of the LGPS Scheme Advisory Board.

The LGPS in Scotland is made up of 11 funds. The Scottish Government is responsible for the regulations, which can be seen online- here. [8] As at 2013, it was valued at £24.1 bn, and is now estimated to be valued around £26bn.[9] Details of the LGPS in Scotland - including scheme membership statistics for 2011- are on the website of the Scottish Public Pensions Agency.

LGPS funds are required to conduct a valuation every three years. The most recent was as at 31 March 2016.[10]

1.2 Investment framework

General

The Law Commission's July 2014 report on the Fiduciary Duties of Investment Intermediaries concluded that:

> […] trustees should take into account factors which are financially material to the performance of an investment. Where trustees think ethical or environmental, social or governance (ESG) issues are financially material they should take them into account.
>
> However, while the pursuit of a financial return should be the predominant concern of pension trustees, the law is sufficiently flexible to allow other, subordinate, concerns to be taken into account. We conclude that the law permits trustees to make investment decisions that are based on non-financial factors, provided that:

5 Scheme Advisory Board – 2016 LGPS actuarial valuation summary, 31 March 2016, p4
6 CLG, LGPS Funds: England and Wales 2016/17, 25 October 2017
7 LGPS Scheme Advisory Board – Scheme Annual Report 2018/highlights
8 *Scotland Act 1998,* schedule 5
9 Scottish Parliament Local Government and Regeneration Committee, Report on Pension Fund Investment in Infrastructure and City Deal Spend, 30 November 2015, para 11
10 Local Government Pension Scheme Advisory Board – 2016 valuations -summary; SPPA website/local government/valuations

- they have good reason to think that scheme members share the concern; and
- there is no risk of significant financial detriment to the fund.[11]

The Law Commission explained that in many (though not all) respects, the law of fiduciary duties is the same in Scotland.[12]

In a further report in June 2017,Pension Funds and Social Investment, the Law Commission said it had found that the law was flexible enough to allow some social investment by pension funds.[13] The barriers were mostly "structural and behavioural rather than legal or regulatory." It made recommendations to reduce these barriers.

In an interim response in December 2017, the Government said it was considering action, including plans to clarify legislation around:

- consideration of broader long-term financial risks
- pension schemes' ability to consider members' non-financial or ethical concerns
- the role of engagement alongside voting as an important aspect of stewardship of pension scheme assets.[14]

In its final response in June 2018, the Government said it would "update the law to require pension scheme trustees to consider the impacts of their investments from a changing environment, corporate governance and social trends" and "clarify regulations to strengthen trustee's stewardship duties, as the owners of the firms in which they invest."[15] In September 2018, it laid regulations before Parliament, allowing a year for trustees to familiarise themselves with the changes before they took effect. It proposed to require trustees to, by 1 October 2019:

- where they are required to produce a Statement of Investment Principles (SIP), update or prepare it to set out:

  - how they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance considerations, including climate change;

  - their policies in relation to the stewardship of investments, including engagement with investee firms and the exercise of the voting rights associated with the investment;
- in relation to relevant schemes – broadly, schemes offering money purchase benefits, subject to a few exceptions - to publish their Statement of Investment Principles on a website so that it can be found and read by both scheme members and interested members of the public, and inform

[11] Law Commission, Fiduciary Duties of Investment Intermediaries
[12] Law Commission, Fiduciary Duties of Investment Intermediaries, June 2014, Para 1.15
[13] i.e. investment for the wider social good, or for social impact
[14] DDCMS and DWP, Pension funds and social investment: interim response, Dec 2017
[15] DDCMS, DWP, Pension funds and social investment: final response, June 2018; DWP, Clarifying and strengthening trustees' investment duties – Government response, September 2018

scheme members of its availability via the annual benefit statement;

- in relation to the default arrangement, prepare or update their default strategy to set out how they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance risks, including climate change.

11.Secondly, we proposed that from 1 October 2019:

- when they next prepare or update their Statement of Investment Principles, they prepare a separate 'statement on member's views', setting out how they will take account of the views which, in their opinion, members hold, in relation to the matters covered in the Statement of Investment Principles. In addition, we proposed to require trustees of relevant schemes to publish that statement.

Finally, from 1 October 2020, we proposed to require trustees of relevant schemes which are required to produce a Statement of Investment Principles to:

- produce an implementation statement setting out how they acted on the principles they set out, and how they acted on the statement which covered how they would take account of the views which, in their opinion, members hold;
- publish that implementation statement online in the same way as the Statement of Investment Principles, and inform scheme members of its availability via the annual benefit statement.[16]

The Explanatory Memorandum to *The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 (SI 2018/998)* says:

> 7.9 The purpose of the Statement of Investment Principles (SIP) is to require trustees to set out, in writing, their strategic approach to investment. It does not determine trustees' investment duties. However, the existing requirements of the SIP are not clearly aligned with trustees' fiduciary duty. This has discouraged some trustees from considering risks and opportunities that may be financially material over the long term, and from acting as engaged asset owners, even where they have a duty to do so.
>
> 7.10 As pension schemes are often invested for many decades, it is appropriate that trustees should consider the long-term sustainability of investments and take responsibility for looking after their investments through the exercise of voting rights and other engagement activities (known collectively as stewardship). The types of engagement activities that trustees or their asset managers may consider include meeting with or writing to the firms in which they invest – either one-to-one or collectively alongside shareholders – to influence decisions. The existing requirements of the SIP have given trustees the impression these things are optional, which they are not.
>
> 7.11 The Law Commission has twice recommended that the requirements of the SIP be updated to reflect more accurately the

[16] DWP, Government response: clarifying and strengthening iinvestment duties, September 2018

> investment duties that trustees have. Updated guidance from the Pensions Regulator has not been sufficient to correct current practice by trustees. Similar recommendations have been made by the Parliamentary Environmental Audit Committee and the Green Finance Taskforce.
>
> 7.12 These amendments are not intended to encourage or support boycotts or divestment campaigns. When it comes to taking account of members' views trustees are only permitted to do this when there is a broad consensus. Where an investment issue is contested, as divestment from fossil fuels or from some regimes will generally be, the trustees should focus exclusively on financially material risks and opportunities, rather than seek to weigh up the relative strengths of views.
>
> 7.13 Regulation 4 of this instrument:
>
> • amends the requirements of the SIP so that by 1 October 2019 schemes must include in the SIP their policy in relation to:
>
> - financially material considerations such as environmental, social and governance considerations, including climate change;
>
> - the extent (if at all) to which members' views are taken into consideration; and o the stewardship of investments.
>
> • amends the requirements in relation to the default arrangement so that by 1 October 2019 schemes must set out their policy in relation to:
>
> - financially material considerations such as environmental, social and governance considerations, including climate change; and
>
> - the stewardship of investments, where the scheme has at least 100 members. [17]

The Law Commission welcomed the proposed changes to the investment regulations, which it had first considered as part of its 2014 report on Fiduciary Duties.[18]

The Pensions Regulator issued new guidance on investment governance in November 2018.

Rules specific to the LGPS

As with pension funds more generally, the primary responsibilities of LGPS funds are to deliver the returns needed to pay scheme members' pensions, and to protect local taxpayers and employers from high pension costs.[19]

In April 2014, the Local Government Association published legal advice on the fiduciary duties of LGPS administering authorities.[20] This said that the power of investment must be exercised for investment purposes and not for wider purposes. However, as long as this remained true, the

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17 Explanatory Memorandum to SI 2018/988

18 Law Commission website, Pension Funds and Social Investmentv

19 CLG, Local Government Pension Scheme: Investment in Partnerships – consultation, November 2012; Scottish Parliament Local Government and Regeneration Committee, Report on Pension Fund Investment in Infrastructure and City Deal Spend, 30 November 2015, para 15-17

20 LGPS Advisory Board, Advice on Fiduciary Duty with regard to the investment of Local Government Pension Scheme (LGPS) funds, April 2014. See http://lgpsboard.org/index.php/publications

precise choice of investment could be influenced by wider considerations:

> [Nigel Griffen QC] has now produced his advice which can be found here. His conclusions were:
>
> In managing an LGPS fund, the administering authority has both fiduciary duties and public law duties (which are in practice likely to come to much the same thing).
>
> This conclusion is clarified in the body of the opinion in paragraph 6 as follows:
>
> *In my view the administering authority does owe fiduciary duties, both to the scheme employers, and to the scheme members.*
>
> The administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the fund (balancing risk and return in the normal way).
>
> However, so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund. In taking account of any such considerations, the administering authority may not prefer its own particular interests to those of other scheme employers, and should not seek to impose its particular views where those would not be widely shared by scheme employers and members (nor may other scheme employers impose their views upon the administering authority).
>
> So for example, in our view, an administering authority may choose to take into account the public health implications of tobacco investment but only if the result of such consideration is the replacement of these investments with assets producing a similar return.
>
> Alternatively, in our view, an administering authority may take account of social housing needs but only if an investment in such stands up as an investment in its own right and can demonstrate that it is not preferring its own interests over other scheme employers in making the investment.[21]

Investment regulations – E&W

Until 1 November, the main regulations governing the investment of LGPS funds in England and Wales were the *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093).*

These regulations required administering authorities to maintain a Statement of Investment Principles. Furthermore, they were required to ensure the fund remains within percentage limits on certain investments.[22] These limits can be extended provided certain conditions are met (for example, they take proper advice).[23]

[21] Ibid
[22] Regulation 14 and Schedule 1 (SI 2009/3093)
[23] Regulation 15 Tolley's looseleaf Pensions Law, section A7.32

The Department for Communities and Local Government consulted in 2012-13 on whether the Investment Regulations applying to England and Wales should be amended to increase the ability of LGPS funds to invest in 'partnerships'. The regulations set a limit on investing in partnerships of 5% for a single partnership and overall no more than 15% of the capital value of the fund. There was concern that these rules constrained the ability of LGPS funds to invest in infrastructure vehicles, which were usually organised as limited partnerships.[24] Following the consultation, the Government amended the regulations to increase the overall limit to 30%. The requirement to take proper advice and risk assessment if investing above the 5% individual limit remained.[25] Additional restrictions imposed were that:

- Investments in unit trusts, open-ended investment companies (OEIC) and life insurance unit linked funds when such vehicles are managed by the same body are subject to a limit of 35% of fund assets at the time an investment is made; and
- Unlisted investments (i.e. investments that are not listed on a regulated stock exchange) which are not caught by another limit under the regulations, are limited in aggregate to 15% of the fund at the time the investments are made.[26]

In its May 2014 report on the structure of the LGPS, Hymans Robertson recommended replacing these restrictions with a "prudential framework as used in the private sector."[27] The Coalition Government said it would consult on reforms to the investment regulations.[28] The consultation process is discussed in section 2 below.

The 2009 regulations were replaced on 1 November 2016 the *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016/946)* . The Explanatory Memorandum explains that:

> Specific provision is made for administering authorities to publish an investment strategy in accordance with guidance issued by the Secretary of State and for the Secretary of State to issue a direction to any authority which fails to act in accordance with its statutory obligations or guidance issued under Regulation 7.

Investment regulations – Scotland

For Scotland, they are the *LGPS (Management and Investment of Funds) (Scotland) Regulations 2010 (SSI 2010/233)).* The regulations were amended in 2016 to increase the proportion of funds that can invest in partnerships from a maximum of 15% to a maximum of 30%.[29]

Details of the legislative framework within which investment decisions are made are in the Scottish Public Pensions Agency's evidence to the

[24] CLG, LGPS: Investment in Partnerships. Consultation, November 2012, para 2.7
[25] Explanatory Memorandum to the *LGPS (Management and Investment of Funds) (Amendment) Regulation 2013 (SI 2013/410)*, para 7.7-8
[26] SI 2009/3093, reg 14, Schedule 1; Hymans Roberts, LGPS structure analysis, December 2013
[27] Ibid
[28] CLG, Local Government Pension Scheme: opportunities for collaboration, cost savings and efficiencies, May 2014, para 4.13
[29] LGPS (Management and Investment of Funds) (Scotland) Amendment Regulations 2016 (SSI 2016/74)

Local Government and Regeneration Committee's inquiry into Pension Fund Investment in infrastructure.

2. Proposals for reform

2.1 2013 CLG consultation on future structure

In 2013, the Department for Communities and Local Government (CLG) consulted on possible changes to the structure of local authority pension funds in England and Wales, with the main aims of dealing with deficits and improving investment returns:

> **High level objectives**
>
> 1. Dealing with deficits
> 2. Improving investment returns
>
> **Secondary objectives**
>
> 1. To reduce investment fees
> 2. To improve the flexibility of investment strategies
> 3. To provide for greater investment in infrastructure
> 4. To improve the cost effectiveness of administration
> 5. To provide access to higher quality staffing resources
> 6. To provide more in-house investment resource.[30]

Announcing the consultation, the then Local Government Minister, Brandon Lewis said a merger of funds was one possible outcome:

> I am neither ruling anything in nor ruling anything out at this stage. However, the clear message from me this morning is that I am not wedded to the existing number of 89 funds in England and Wales. If it takes a smaller number of funds to improve the efficiency and cost-effectiveness of the scheme, I shall not shy away from pursuing that goal.[31]

CLG asked Hymans Robertson to look at three options:

> **Option 1: A single asset pool**
>
> Under this option the 89 administering authorities would remain but there would be a single collective investment fund for all assets. Decision making on asset allocation and contribution strategies would remain with the 89 administering authorities. They would also continue to be responsible for their own liabilities, employer liaison and member administration.
>
> **Option 2: 5 to 10 asset pools**
>
> This option is the same as 1 except that there would be 5 to 10 collective investment funds. The 89 administering authorities would remain. Each would be responsible for decision making on asset allocation and contribution strategies and for its own liabilities, employer liaison and member administration.
>
> **Option 3: 5 to 10 merged funds**
>
> Under this option, the 89 separate LGPS funds would be replaced by 5-10 merged funds. Responsibility for assets, liabilities, deficit

[30] CLG, [Call for evidence on the future structure of the Local Government Pension Scheme, June 2013](#)

[31] Ibid, background

> management, employer liaison and member administration would all transfer to the new organisations responsible for the 5 to 10 merged funds.[32]

Organisations like UNISON have argued for LGPS fund merger on the grounds that larger funds have better gross investment returns, lower investment expenses and lower operating costs.[33]

In a Westminster Hall debate in September 2013, Mark Field MP set out some of the concerns that had been raised:

> I understand that the Government's preferred alternative is pooling, with independent funds fully merged to produce cost efficiencies and to open the possibility of investment in bulky, illiquid assets outside the scope of smaller funds. That alternative is not without risks and problems. Well-funded schemes might, in effect, be bailing out less well-funded schemes. With new bodies appointed to manage pooled funds, there would likely be less accountability and employer-employee representation. It is also a somewhat flawed assumption that larger investment funds will necessarily deliver better investment returns at a lower cost. Of course, there is a broad risk to all of us that politicians of whatever political colour might be tempted to use the large investment funds to pay for economically unsound infrastructure projects. Local council tax payers will end up footing the bill if we get that wrong.[34]

The LGA said:

> Any merger of fund assets and liabilities should reflect that level of success in the resulting scheme employer funding levels (and therefore deficit contribution rates) of the merged fund.[35]

It said there were a number of different ways in which funds could be merged. Each had its advantages and disadvantages and each with "varying levels of legal, financial and practical hurdles to be overcome for implementation."[36]

A spokesperson Hymans Robertson said there was general agreement on the need to improve efficiency through collaboration:

> While there is no evidence that bigger LGPS funds, on average, perform better than smaller funds that is not the same as saying that there is no benefit in structural reform and LGPS-wide collaboration. One thing that all stakeholders in the LGPS community can agree on is that options for improvements in investment efficiency through collaboration and reform should be pursued[37]

The issues are discussed further in:

- Michael Johnson, Local Government Pension Scheme: Opportunity Knocks, Centre for Policy Studies, November 2013;

[32] Hymans Roberts, LGPS structure analysis, December 2013
[33] UNISON submission to CLG call for evidence on the future structure of LGPS Funds, 2013
[34] HC Deb 10 September 2013 c228-35WH
[35] LGA, Response to call for evidence on the future structure of the Local Government Pension Scheme, 27 September 2013
[36] Ibid
[37] Pension savings plan at risk. Local Government Chronicle, 9 September 2013

- National Association of Pension Funds, Local Government Pension Scheme 2013: investing in a changing world, May 2013.

2.2 2014 CLG consultation on collaboration

In May 2014, CLG announced that it had decided not to pursue the idea of fund mergers but would consult further on establishing "common investment vehicles". Although a few respondents had argued for merger as the best option, they had been more commonly mentioned in the context of their drawbacks:

> Mergers are likely to have very high transition costs with further cost benefit analysis needed to understand exactly how much.
>
> Mergers will require substantial resources and time to implement effectively.
>
> There are potential risks to the Scheme and market of concentrating the fund too heavily and moving such large amounts of assets.
>
> Many underlined the difficulty of cross subsidising weaker funds and how to merge them with better performing ones.
>
> Roughly 15 respondents noted that merging funds would not tackle deficits.
>
> 23 respondents, mainly from the private sector, raised the issue of constrained capacity if funds were merged. Two investment firms cited examples of their own policy of closing investment strategies before they get too large to manage effectively.[38]

Many had argued that the benefits of a merger might be achieved more quickly, simply and economically through common investment vehicles. Key arguments included:

> Common investment vehicles should deliver most of the cost reduction benefits of mergers but they can be realised more quickly; not least because setting up the vehicles does not require primary legislation.
>
> Common investment vehicles can harness economies of scale in the same way as mergers, for example through increased bargaining power on fees.
>
> This approach would allow authorities to maintain the direct link to accountable, elected councillors, seen as fundamental by most respondents.
>
> Others noted how this option still allows for different deficit positions and recovery periods; so that each fund can take into account the profile of their liabilities when determining their funding strategy.[39]

A further consultation, launched in May 2014, on opportunities for collaboration, cost savings and efficiencies. This asked for views on the specific type of common investment vehicle (CIV) to be used. It anticipated that the following principles might underpin the design:

- Pooling of assets, possibly on a unitised or share basis;

[38] CLG, Call for evidence on the future structure of the Local Government Pension Scheme - Government response to the call for evidence, May 2014, para 2.29
[39] Ibid

- Safeguards for individual funds, for example through Financial Conduct Authority authorisation;
- Governance arrangements considered as part of wider governance reforms arising from 2013 *Public Service Pensions Act*;
- Strategic asset allocation remains with individual funds; and
- An option for other funded public service pension schemes to participate in the common investment vehicles if they wish.[40]

The proposal was not to pursue fund mergers at that time.

The consultation also asked for comment on a proposal to move to passive fund management of all listed assets accessed through a common investment vehicle.[41]

A PQ answer in December 2014 said:

> The consultation *Opportunities for collaboration, cost savings and efficiencies* set out how the Local Government Pension Scheme could deliver annual savings of £660 million by reforming the way the funds make their investments. Advice commissioned by the Minister for the Cabinet Office and the Minister for Local Government using the Contestable Policy Fund was used to inform the consultation. Of the £660 million savings identified, the analysis showed that £420 million could be found by using passive, rather than active management of listed assets such as bonds and equities.[42]

The Government's response to the consultation was published in November 2015. [43]

2.3 Summer 2015 Budget

In the Summer 2015 Budget, the UK Government announced that it would work to ensure that that LGPS investments were 'pooled' to reduce costs. A consultation would be published later in the year:

> **2.19 Local Government Pension Scheme pooled investments** – The government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments.[44]

The National Association of Pension Funds responded that:

> The NAPF and its LGPS member funds will engage constructively with the Government on this initiative; but it's clear that pooled investments will work most effectively where they arise out of

[40] CLG, Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies, May 2014, para 4.14
[41] Ibid para 3.3
[42] PQH L3480 16 December 2014
[43] DCLG, Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies. Consultation response, November 2015, para 2.2-3
[44] HM Treasury, Summer 2015 Budget, July 2015

> natural collaboration between funds rather than where funds are forced to invest together.[45]

The LGA said would comment on the proposals when put forward and "work with the government to ensure the best result for administering authorities and local taxpayers."[46]

An article in the Local Government Chronicle (LGC) on 13 July 2015 said senior LGPS figures were arguing for a flexible approach. The requirements to pool assets should "not be too prescriptive."[47] On 28 August, it said the LGA had been told that all funds would be required to invest in pooled vehicles of around £30bn.[48] Analysis of up-and-running projects published in September found that there were different structures that could help meet the Treasury's demands. These included:

- The London Collective Investment Vehicle (an investment platform through which London funds could buy investment firms' services at a lower cost);
- Joint vehicles, such as those created by the London Pension Fund Authority with the Greater Manchester Pension Fund and Lancashire.
- Delegating decisions to a "joint section 101 committee" – where funds collaborated by delegating investment decisions.[49]

2.4 2015 Conservative Party conference

In his speech to the Conservative Party Conference in October 2015, Chancellor of the Exchequer George Osborne announced the intention to work with councils to create half a dozen British Wealth Funds able to invest in infrastructure:

> At the moment, we have 89 different local government pension funds with 89 sets of fees and costs.
>
> It's expensive and they invest little or nothing in our infrastructure.
>
> So I can tell you today we're going to work with councils to create instead half a dozen British Wealth Funds spread across the country.
>
> It will save hundreds of millions in costs, and crucially they'll invest billions in the infrastructure of their regions.[50]

The *Financial Times* reported on 1 November 2015 that central government and local authorities were consulting on how this would work. More detailed proposals are expected to be published before the

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[45] NAPF comments on 2015 Summer Budget, 8 July 2015
[46] LGA, July Budget 2015, On the Day Briefing, 8 July 2015
[47] 'Senior pensions figures urge flexible approach for reform, Local Government Chronicle (LGC), 13 July 2015
[48] 'Council pension funds must invest in pooled vehicles of c£30bn', :LGC 28 August 2015
[49] 'Pension fund collaboration projects gear up for a new era of reform', LGC, 17 September 2015; 'Collaborators to expand as Treasury demands £30bn investment pools', LGC, 17 September 2015; ''Loose partnerships' of pension funds will not satisfy government', LPFA warns, LGC, 22 September 2015
[50] George Osborne's speech to Conservative Party Conference 5 October 2015

end of this year, although it was recognised that "asset pooling could take years to achieve to help local authorities avoid exit fees or other penalties for leaving their illiquid investments."[51]

The announcement was met by caution by LGPS stakeholders. Jeff Houston, head of pensions at the LGA, said pooling investments might provide access to opportunities not available to individual funds. However, the test must always be whether the investment was a good one or not.[52] Brian Strutton of the GMB suggested the Government would need to underwrite returns to make a difference:

> Combining council workers' pension funds will not lead to more investment in UK infrastructure unless the government underwrites the rate of return available…The only reason more of the LGPS assets are not invested in infrastructure is because the risk outweighs the returns.

Rob Whiteman, Chief Executive of the Chartered Institute of Public Finance and Accountancy (CIPFA), said LGPS investment returns must not be compromised by thoughts of compulsory investment in local or regional investment in infrastructure from which the returns may be much less certain.[53]

2.5 2015 consultation on regulations

On 25 November 2015, DCLG published its response to the May 2014 consultation (Opportunities for collaboration, cost savings and efficiencies). It said responsibility for asset allocation would stay with the 90 administering authorities and that savings could be delivered through the use of asset pooling and, in particular, collective investment vehicles. Drawing on discussions with local government and the fund management industry over the summer, the Government prepared criteria against which the authorities' proposals for pooling would be assessed. Authorities were asked to develop proposals for pooling assets.[54] Investment reform criteria and guidance for the LGPS on pooling assets were also published. At the same time, a consultation on proposals to revoke and replace the Investment Regulations proposed two areas of reform:

> 1. A package of reforms that propose to remove some of the existing prescribed means of securing a diversified investment strategy and instead place the onus on authorities to determine the balance of their investments and take account of risk.
>
> 2. The introduction of safeguards to ensure that the more flexible legislation proposed is used appropriately and that the guidance on pooling assets is adhered to. This includes a suggested power

[51] 'UK local pension spend £240m more on investment', *Financial Times*, I November 2015 (£)
[52] LGA: Treasury cannot force pension funds to invest in infrastructure, Local Government Chronicle, 5 October 2015
[53] Ibid
[54] CLG, Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies. Consultation response, November 2015

> to allow the Secretary of State to intervene in the investment function of an administering authority when necessary.[55]

In more detail, regarding the proposal to adopt a local approach to investment, the Government proposed removing the existing schedule of limitation on investments and instead to require authorities to take a prudential approach. Key to this would be the investment strategy statement authorities would be required to prepare, covering:

- 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.[56]

As discussed in section 3.2 below, the Government would issue guidance making it clear to authorities that they should not pursue policies which run contrary to UK foreign policy.[57] The consultation also proposed to give the Secretary of State the power to intervene where an authority had "failed to have regard to the regulations governing their investments or guidance issued under draft regulation 7(1)."[58]

There are also plans to review the continued relevance of the restrictions in the investment regulations applying to LGPS funds in Scotland.[59]

2.6 Budget 2016

In Budget 2016, the Government said it had received proposals from local authorities to establish a small number of British Wealth Funds by combining assets:

> 1.284 The government has received ambitious proposals from Local Government Pension Scheme administering authorities t**o establish a small number of British Wealth Funds across the country by combining their assets into much larger investment pools.** These pools will deliver annual savings of at least £200-300 million, and we will work with administering authorities to establish a new Local Government Pension Scheme

55 DCLG, Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 Consultation, November 2015
56 Ibid, para 3.4
57 Ibid para 3.8
58 Ibid para 4.4; Draft regulation 7(1) requires an authority 'after taking proper advice' to 'formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State'
59 SPPA evidence to Local Government and Regeneration Committee of the Scottish Parliament, April 2015

> infrastructure investment platform, in line with their proposals, to boost infrastructure investment.[60]

It would work with them to deliver "much larger investment pools by 2018."[61]

There is information about the plans for investment pooling on the LGPS Scheme Advisory Board (SAB) website. For example, eight pools have submitted detailed proposals to Government.

The SAB issued a statement on pool governance in March 2017, which it revised in November 2018 to place more emphasis on the importance of engaging with member representatives:

> At its meeting on the 16th February 2018, the Board agreed to review the wording of the policy statement on pool governance published here on the 23rd March 2017. The following statement was subsequently agreed (revised text shown in bold) –
>
> *"The Board recognises that it is for scheme managers within each pool to develop appropriate governance to assure all stakeholders of the transparent and effective implementation of strategy. In this respect the Board notes the comments made by the then Local Government minister Marcus Jones MP on this matter in the Westminster Hall debate on 24th October 2016.*
>
> *The board recognises that strategic decisions on asset allocations and responsible investment will remain at the local level and therefore the involvement via local pension boards of those employers beyond the scheme manager along with member representatives in those areas would continue. However, the Board **would expect that** scheme managers involve those same employers and member representatives in assisting with the assurance of transparent reporting from pools and ensuring the effective implementation of strategies by pools. Such involvement should include the consideration of provision of direct representation on oversight structures. **In line with the UK Corporate Governance Code principle of 'comply or explain', any pool making a decision to exclude member representatives from their formal oversight structures should publish this decision and formally report the reasons to the local pension boards which the pool serves."***[62]

On 22 January 2018, the Government said it had received proposals from LGPS administering authorities in England and Wales to "consolidate their assets into a small number of pools to take advantage of their scale." It would work with administering authorities to establish a new LGPS infrastructure investment platform to "boost their capacity and capability to invest in infrastructure."[63]

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60 HM Treasury, Budget 2016, HC 901, March 2016,
61 Ibid, para 2.14
62 See SAB website – investment pooling – statement on pool governance (March 2017) and Updated statement on pool governance (November 2018) 7
63 PQ 123038, 22 January 2018

2.7 The 2016 regulations

The *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016/946)* were laid before the House on 23 September, to come into force on 1 November 2016. They apply to England and Wales only.

The regulations include specific provision to publish an investment strategy in accordance with guidance issued by the Secretary of State and for the Secretary of State to issue a direction to any authority which fails to act in accordance with its statutory obligation or guidance issued under regulation 7.[64]

Regarding the investment strategy statement, the Explanatory Memorandum states:

> The statement must demonstrate that investments will be suitably diversified and should outline the administering authority's maximum allocations for different asset classes, as well as their approach to risk and responsible investing. Separate guidance from the Secretary of State will clarify how the Government's announcement on boycotts, sanctions and divestments should be taken into account when investment decisions are taken.[65]

Regarding the power of intervention in regulation 8, the Explanatory Memorandum states:

> 7.10 Regulation 8 provides the Secretary of State with the power to intervene in the investment function of an administering authority if he is satisfied that the authority is failing to act in accordance with the regulations and guidance. The regulation also enables the Secretary of State to initiate enquiries if an intervention is warranted and must consult the authority concerned. The Secretary of State can intervene by directing the authority to undertake a broad range of actions to remedy the situation.

The guidance on preparing and maintaining an investment strategy statement was published on 15 September 2016. It states that administering authorities "must commit to a suitable pool to achieve benefits of scale":

> **Regulation 7(2)(d) - The approach to pooling investments, including the use of collective investment vehicles and shared services**
>
> All authorities must commit to a suitable pool to achieve benefits of scale. Administering authorities must confirm their chosen investment pool meets the investment reform and criteria published in November 2015, or to the extent that it does not, that Government is content for it to continue. Any change which results in failure to meet the criteria must be reported by the administering authority, and/or pool, to the Secretary of State and the Scheme Advisory Board. Administering authorities should set out their approach to pooling and the proportion of assets that will be invested through the pool. This must include the structure and governance arrangements and the mechanisms by which the authority can hold the pool to account. Where services are shared or jointly procured, the administering authority must set out the

64 EM for SI 2016/946
65 Ibid para 7.9

> rationale underpinning this and the cost benefit of this, as opposed to pooling. Administering authorities must provide a summary of assets to be held outside of the pool, and how this demonstrates value for money. The progress of asset transfers to the pool must be reported annually against implementation plans and submitted to the Scheme Advisory Board. Where it is possible that an asset could be pooled in the future, authorities must set a date for review and criteria that need to be met before the asset will be pooled.[66]

Concerns

UNISON argues that "investment decisions should be made by the funds and their members, not ministers."[67] It broadly supports the pooling process but was concerned that the regulations provide for "unprecedented powers of intervention."[68]

In its response to the draft regulations, the LGA expressed concern that the extent of the powers for the Secretary of State to intervene were too broad:

> The extent of the powers given to the SoS are very broad and therefore provide more than sufficient flexibility. LGA's concern is that regulation 8(2)(a) ('that the authority make such changes to its investment strategy under regulation 7 as the Secretary of State considers appropriate, within a period of time specified in the direction') is too broad. Use of this regulation could put the SoS in a position of personally directing the strategic investment decisions (including the allocation of assets) for a particular LGPS fund. This could potentially open the SoS to challenge under EU restrictions on government intervention in pension fund investment, particularly if such directions proved to be ineffective.[69]

The Pensions and Lifetime Savings Association said:

> We agree with the Governments proposals for pooling and the need to ensure that fund are committed to delivering these pools. However, there is a risk that such broad powers, combined with a lack of an explicit fiduciary duty, could ultimately be used by a future government to direct what funds invest in, with limited regard to the impact to the payment of member benefits and the costs to employers and members. It would be reassuring for funds if there were greater checks and balances included in the regulations.[70]

In its response to the consultation, the Government said that:

> A significant majority of respondents claimed that granting the Secretary of State a power of intervention on investment functions would undermine the UK Government's stated commitment to transfer power to local government and would represent a serious attack on local democracy.

However, it argued its approach was appropriate:

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66 CLG, LGPS guidance on preparing and maintaining an investment strategy statement, 15 September 2016
67 20,000 people call on MPs to debate LGPS plans, UNISON website, January 2016
68 UNISON, LGPS funds guide, September 2016
69 LGA response to draft LGPS investment regulations
70 PLSA response to LGPS investment regulations, February 2016

> This is not the case. One of the main aims of the proposal is to deregulate and transfer investment decisions and their consideration more fully to administering authorities within a new prudential framework. Administering authorities will continue to be responsible for setting their policy on asset allocation, risk and diversity. However, given the very large sums of public money at stake, we believe that it is entirely appropriate for the Secretary of State to be able to intervene where concerns have been raised, having taken account of all available evidence.
>
> In the case of the new pooling arrangements, the view is taken that it is appropriate for the Secretary of State to be able to intervene in circumstances where administering authorities are failing to comply with the criteria and guidance on the new pooling arrangements. This power would only be used where there is clear evidence that an authority is failing to comply with regulations, guidance or best practice.[71]

Secondary Legislation Scrutiny Committee

In a report published on 20 October, the House of Lords Secondary Legislation Scrutiny Committee drew the attention of the House to these regulations on the ground that they gave rise to issues of public policy likely to be of interest. This was because significant numbers of consultation respondents considered the power of intervention to be incompatible with the independence of funds:

> Consultation by the Department for Communities and Local Government (DCLG) has shown high levels of opposition to the proposed power of intervention. In particular, 50 of 66 responses to the relevant consultation question did not agree that the proposed power met the objectives of the policy. While DCLG describes the power to intervene as a fall-back to protect public funds, likely to be used only rarely, significant numbers of consultation respondents consider that such a power is incompatible with the independence of the funds.[72]

In more detail, around three-quarters (76%) of respondents considered the proposed intervention power too broad and did not think it met the policy objective of allowing the Secretary of State to make a proportionate intervention:

> 7. In September 2015, DCG published a summary of responses to the 2015-16 consultation. This explains that there were 64 specific response to a consultation question on whether the proposed approach allowed the Secretary of State sufficient flexibility to ensure that he was able to introduce a proportionate intervention. 15 responses (24%) agreed that it did; 49 (76%) disagreed, commenting for example that the proposed intervention power was too broad, or that the power should only apply to the pooling arrangements. Noting the disagreement by a significant number of respondents, DCLG states in the summary that it remains “of the view that appropriate checks and balances are required in a framework that will significantly deregulate administering authorities’ investment functions, particularly given the very large sums of public money involved”. We obtained more

71 CLG, response to consultation on the draft regulations, 27 September 2016; PQ 47874 12 October 2016

72 House of Lords Secondary Legislation Scrutiny Committee, LGPS (Management and Investment of Funds) Regulations 2016, HL Paper 53, 20 October 2016

> information about these responses from DCLG, and we are publishing that information as Appendix 1.
>
> 8. The September 2016 summary also states that there were 66 responses to a question on whether the proposed power of intervention met the objectives of the policy, namely to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it had not had regard to best practice. 16 responses (24%) agreed that it would meet the policy objectives. 50 responses (76%) did not agree. Of these, 30 objected to the proposals in broad terms; 18 said that more clarification in guidance was necessary; and two suggested that the intervention power should only be considered on the recommendation of the scheme advisory board. DCLG refers back to its earlier response on the issue of the breadth of the power of intervention; and, noting that the Regulations in any case include provision for a report from the board to be taken into account by the Secretary of State before a direction is issued, it concludes that there would be no advantage in making further changes.[73]

As regards pooling, the Government told the Committee that "in practice, good progress is being made towards pooling and the Secretary of State currently has no intention of intervening".[74]

Debates on the regulations

A petition on the regulations (which got over 105,771 signatures) was debated on 24 October 2016.[75] It had called for a debate in Parliament on the regulations and that government should have been made accountable for the powers of intervention:

> 5 million people rely on the LGPS to pay their pensions. Government wants powers over LGPS investment funds, but they could gamble away members' money on infrastructure projects. This is not allowed in any other UK scheme, including the MPs'. The LGPS must be invested in members' best interests. Parliament must debate this issue and make the government accountable for these powers of intervention as any such direction may breach the law. Specifically Article 18 paragraph 3 of the EU Directive 41/2003 Institutions for Occupational Retire Provision: "Member States shall not require institutions located in their territory to invest in particular categories of assets.[76]

The Government responded that LGPS investment decisions would remain matters for local authorities and that it expected the intervention power to be used "exceptionally when there was clear evidence that a pension fund authority was not acting reasonably and lawfully."[77]

Introducing the debate on the regulations on 24 October, Ian Blackford, SNP Pensions spokesperson and member of the Petitions Committee, expressed concern about the powers of intervention.[78] He was supported by Jack Dromey, chair of the local government unions, who said:

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73 House of Lords Secondary Legislation Scrutiny Committee, LGPS (Management and Investment of Funds) Regulations 2016, HL Paper 53, 20 October 2016
74 Ibid, Appendix 1
75 HC Deb 24 October 2016 c1-22
76 Debate in the House the local Government Pension Scheme Investment Regulations
77 Ibid
78 HC Deb 24 October 2016 c1

> It is absolutely right, commensurate with what we always sought to do through the scheme, that we have ethical investment, that we encourage infrastructure investment and that we look at sensible pooling arrangements. However, the first obligation of a pension scheme is to its members, to deliver to those loyal, long-serving public servants the best possible retirement.[79]

Local Government Minister, Marcus Jones responded that:

> I have been absolutely clear throughout that investment decisions are for administering authorities and that that will remain the case. There is no question, nor has there ever been, of the Government directing funds to invest in a particular way—for example, in infrastructure projects. […] The power of intervention has been included in the new regulations as a backstop in the rare circumstances in which it may be necessary to protect the around £200 billion of assets and 5 million members of the local government pension scheme. The regulations include several safeguards to ensure that that power is used appropriately and proportionately, including full consultation with the relevant authority. The Government's response to the consultation made it clear that that power would be used only on clear evidence that an authority was failing to act in accordance with the regulations or guidance.[80]

Early Day Motion 586 in the name of the Leader of the Opposition, praying against the regulations, led them to be debated by a Delegated Legislation Committee on 22 November 2016.

Opening the debate, Shadow Local Government Minister Teresa Pearce said the regulations brought in changes that had raised deep concerns, relating to the Secretary of State's powers of intervention, which she described as "unprecedented":

> The basic principle that underwrites all pension schemes is that pension funds should always be invested in the best interests of their members—that all pension schemes' investment decisions should be guided by maximising financial return and financial stability for members. That is not just a principle; it is the law. However, since the regulations took effect, the LGPS—unlike any other pension scheme in the country—may not be required to invest in its members' best interests, because the Secretary of State reserves the right to intervene in how the pension funds of local government employees are invested. If funds are invested somewhere that does not comply with current UK foreign policy or that does not meet the requirements for infrastructure investment, the Secretary of State could intervene. Those are unprecedented powers. No other pension pot in the country is subject to such extraordinary measures: not MPs' pensions, not civil service pensions and certainly not private sector pensions.[81]

A further concern was that asset pools created were to have no membership representation on the pool governance structures. It had also been alleged that the regulations were in breach of article 18 of the EU direction of institutions for occupational retirement provision (IORP).[82]

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79 Ibid c3-4
80 Ibid c17
81 PBC Deb 22 November 2016 c4
82 Ibid

Responding Local Government Minister Marcus Jones argued that the power of intervention had been included in the regulations as a 'backstop power' and included a safeguards:

> The intention is to use this backstop provision sparingly and only when it is necessary to step in to protect the interests of both the scheme members and the local taxpayers, who might have to step in and bail out the LGPS if the investments are not made in a way that provides the best return from those funds.[83]

As regards any requirement on funds to invest in infrastructure, he said:

> I make no apology whatever for the fact that the statutory guidance that accompanies the regulations makes it clear that authorities should be ambitious in developing their proposals on infrastructure investment, an increasingly important area that is seen as a suitable option for large pension funds with a longer-term liability.[…]However, there is no compulsion on a fund to make a certain level of infrastructure investment; that decision is based purely on the fund's circumstances and situation. The fund's overriding objectives must be to get best value and to follow the fiduciary duty that it owes to scheme members.[84]

He did not think the IORP Directive applied in this case:

> To protect members and taxpayers, we have set a broad framework for investment decisions in the regulations and guidance and provided the backstop power of intervention that I mentioned. In addition, the benefits are guaranteed by statute, irrespective of a fund's investment performance. The assets are separated from those of the sponsoring employer, as I said, which protects the members if the employer fails financially. We are absolutely of the opinion that these extensive protections explain why the LGPS is largely exempt from the directive. The directive increases security for members and safeguards assets from insolvent employers in schemes without such safeguards. In this case, we certainly do not believe the directive applies.[85]

Explaining that she still had so many concerns that she could not support the regulations, Ms Pearce pushed the motion to a vote. The committee voted by nine votes to four to accept that the regulations had been considered.[86]

Legal challenge

On 22 June 2017, Sir Ross Cranston issued judgment that part of the guidance on investments was unlawful on grounds that they were not issued for pensions purposes:

> […] it is clear from the Secretary of State's own evidence that the parts of the guidance the claimants challenge were not issued in the interests of the proper administration and management of the local government pension scheme from a pensions perspective, but are a reflection of broader political considerations, including a desire to advance UK foreign and defence policy, to protect UK defence industries and to ensure community cohesion.[87]

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83 Ibid c8
84 Ibid c7
85 Ibid c7-8
86 Ibid c10
87 R v Palestine Solidarity Campaign Ltd and Jacqueline Lewis and Secretary of State for Communities and Local Government [2017] 1502 ECHW (admin), 22 June 2017

The Secretary of State had not justified singling out certain types of non-financial considerations that could not be taken into account in investment decisions:

> 30. The Secretary of State attempted to meet the point with the argument that these foreign/defence affairs purposes are pension purposes since non-financial purposes, not connected with prudential management, can be pension purposes. Certainly the general law recognises that non-financial factors can be pension purposes, so long as there is no risk of significant financial detriment from taking investment decisions with such factors into account […]
>
> 31. So, too, with regulation 7(2)(e) of the 2016 Regulations and that part of the guidance stating that non-financial considerations can be taken into account provided that doing so would not involve significant risk of financial detriment and where there is good reason to think that scheme members would support the decision. There can be no objection to this part of the guidance: it is issued for pension purposes by imposing a base-line of risk and taking into account the role the legislative design gives local government pension scheme members through local pension boards and otherwise.
>
> 32. But the flaw in the Secretary of State's approach is that the guidance has singled out certain types of non-financial factors, concerned with foreign/defence and the other matters to which reference has been made, and stated that administering authorities cannot base investment decisions upon them. In doing this I cannot see how the Secretary of State has acted for a pensions' purpose. Under the guidance, these factors cannot be taken into account even if there is no significant risk of causing financial detriment to the scheme and there is no good reason to think that scheme members would object. Yet the same decision would be permissible if the non-financial factors taken into account concerned other matters, for example, public health, the environment, or treatment of the workforce. In my judgment the Secretary of State has not justified the distinction drawn between these and other non-financial cases by reference to a pensions' purpose. In issuing the challenged part of the guidance he has acted for an unauthorised purpose and therefore unlawfully.

CLG received permission to appeal the judgement.[88] Pending the outcome, the reference to boycotts, divestment and sanctions against foreign nations has been removed from the revised guidance.[89]. The Court of Appeal allowed the Secretary of State's Appeal in June 2018. However, in January 2019, the Palestine Solidarity Campaign said it had been given permission to appeal to the Supreme Court and that it was likely that a hearing would take place in the second half of 2019.[90]

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88 PQ 243 HL 28 June 2017

89 Local government pension scheme: guidance on preparing and maintaining an investment strategy statement, July 2017, p9

90 Palestine Solidarity Campaign wins right to go to Supreme Court, 9 January 2019

2.8 Guidance from the Scheme Advisory Board

In November 2018, Local Government Pension Scheme Advisory Board issued a revised statement emphasising the important of reporting and oversight arrangements:

> The Board recognises that it is for scheme managers within each pool to develop appropriate governance to assure all stakeholders of the transparent and effective implementation of strategy. In this respect the Board notes the comments made by the then Local Government minister Marcus Jones MP on this matter in the Westminster Hall debate on*24th October 2016.*
>
> The board recognises that strategic decisions on asset allocations and responsible investment will remain at the local level and therefore the involvement via local pension boards of those employers beyond the scheme manager along with member representatives in those areas would continue. However, the Board ***would expect that*** scheme managers involve those same employers and member representatives in assisting with the assurance of transparent reporting from pools and ensuring the effective implementation of strategies by pools. Such involvement should include the consideration of provision of direct representation on oversight structures. ***In line with the UK Corporate Governance Code principle of 'comply or explain', any pool making a decision to exclude member representatives from their formal oversight structures should publish this decision and formally report the reasons to the local pension boards which the pool serves.***[91]

[91] LGPS Advisory Board, statement on scheme governance, November 2018

3. Issues

3.1 Investment in infrastructure

England and Wales

As discussed in section 1.2 above, there are constraints on the extent to which LGPS funds to invest in infrastructure. Their primary responsibilities are to deliver the returns needed to pay scheme members' pensions, and to protect local taxpayers and employers from high pension costs.[92] Furthermore, current the Investment Regulations place certain limits on the investments that can be made - although the Government is currently consulting on reforms (see section 2.6 above).

The debate on how LGPS investment in infrastructure could be increased has continued. The think tank Localis produced a report in March 2012 arguing that local authorities should be prepared to see an additional 8.5% of LGPS monies invested in domestic infrastructure.[93]

The Smith Institute published a report in September 2012 looking at how local authority pension funds could do more to "invest for wider economic and social benefit."[94] It said that trustees were showing growing interest in and action towards developing new and alternative sources of investment. The main reasons cited for not investing in infrastructure were fiduciary responsibilities and "finance first":

> The question of social return cannot intrude on return or fiduciary responsibilities. No funds said they would be prepared to accept lower returns in exchange for achieving social benefit.[95]

Key barriers included:

> […] managing reputational risks associated with new investments and potential conflicts of interest, especially where local infrastructure schemes were concerned.[96]

The report made five key recommendations, including:

- Better information and clearer guidance;
- The development of demonstrable case studies and training on matching impact investment with fiduciary duties'
- Adjustments to the LGPS (Management and Investment of Fund) Regulations to enhance potential for flexibility'
- Creating an enabling platform – a clearing house that would gather data from a wide range of projects around the UK and support transparent valuation and consistent financial reporting standards;
- Establish a new pooled vehicle, with a view to "inviting local authorities/public-sector bodies to put forward bids for the

[92] CLG, Local Government Pension Scheme: Investment in Partnerships – consultation, November 2012
[93] Credit Where Credit's Due – Investing in local infrastructure to get Britain growing, Localis, March 2012
[94] Smith Institute, Local authority pension funds: investing for growth, September 2012
[95] Ibid, Executive Summary
[96] Ibid

> investment, including the leverage of other sources of public and private investment."[97]

Pensions Infrastructure Platform

For more detail, see Library Briefing Paper SN06620

In May 2013, the National Association of Pension Funds (NAPF) said LGPS funds were expecting a continuation of the trend away from equities towards 'other' assets such as property and infrastructure. It hoped the Pensions Infrastructure Platform would facilitate this:

> The NAPF has been told by our LGPS members that they want to invest more in infrastructure, but to do so the terms need to be right and give pension funds what they want. In response to the lack of opportunities for pension funds to access infrastructure as an asset class, the NAPF has been facilitating the development of the Pensions Infrastructure Platform (PIP). The PIP will be a new infrastructure fund 'for pension funds, by pension funds'. With a target size of £2bn, the PIP is expected to invest in core infrastructure assets. It is seeking returns of RPI+ 2% to 5% with appropriate remuneration packages for the PIP's investment managers and low leverage.[98]

Details of the activities of the Greater Manchester Pension Fund (GMPF) in this area are in its evidence to the Local Government and Regeneration Committee of the Scottish parliament.

The Department for Communities and Local Government ran a consultation on statutory guidance on asset pooling in the first quarter of 2019.[99]

How pooling assets could help increase investment in infrastructure

A briefing by the LGPS advisory board explains:

> The Government commissioned research which indicates that significant savings can be delivered by the creation of around six investment pools, each with assets of at least £25bn. Each LGPS administering authority will be obliged to join, or help create, an investment pool with other LGPS administering authorities. Savings will be achieved through economies of scale and increased bargaining power; investment costs will be reduced along with other costs for all types of investment used in the pool.
>
> The Government would also like the LGPS to have the capacity and capability to be able to invest in infrastructure e.g. railway, road or other transport facilities or housing supply. Currently only a very small proportion of LGPS assets are invested in infrastructure, it is hoped that the creation of investment pools will make it easier for LGPS funds to invest in infrastructure due to their increased scale. (Q&A for LGPS members – investment reform).

The Findings of Project Pool, produced by a group of local authorities, said pooling had the advantage of achieving cost savings and other scale benefits, including a 'governance dividend'. These objectives could best be met by establishing multi-asset pools:

[97] Ibid
[98] NAPF, Local Government Pension Scheme 2013: investing in a changing world, May 2013, Executive Summary and p23
[99] LGPS Scheme Advisory Board website

For most assets currently held, namely actively-managed listed equities and bonds, these pools will be of sufficient size to deliver the majority of scale benefits (including cost savings and employing enough managers for diversification but few enough to avoid index returns) while still being of a size that individual funds can participate meaningfully in the pool's governance.

Investment in infrastructure could be facilitated by making suitable investment vehicles available to these multi-asset pools:

LGPS wide investment vehicles available to all pools ("MAPs Plus"): For a number of asset types, greater benefits may be available by LGPS-wide collaboration. For example, an infrastructure investment platform or a national procurement framework of passive investment managers could be set up alongside the MAPs and be accessible to all of them. […]

Access to infrastructure: The infrastructure assets that historically have been most attractive to pension funds like the LGPS are established projects delivering steady income streams that rise with price inflation (since pension payments from the fund increase with inflation). There has also been some demand for some higher risk-return assets, but allocations will likely be lower. Improved access and lower cost is most likely to be achieved through a national platform accessible to all of the Multi-asset Pools (MAPs). [Findings of Project POOL, Summary report, January 2016]

In Budget 2016, the Government said it would work to establish a new LGPS infrastructure investment platform:

1.284 The government has received ambitious proposals from Local Government Pension Scheme administering authorities to establish a small number of British Wealth Funds across the country by combining their assets into much larger investment pools. These pools will deliver annual savings of at least £200-300 million, and we will work with administering authorities to establish a new Local Government Pension Scheme infrastructure investment platform, in line with their proposals, to boost infrastructure investment.

The 2016 regulations include provision to require administering authorities to publish an investment strategy statement, which must be in accordance with guidance issued by the Secretary of State. The investment strategy statement must include the authorities approach to pooling investments. They also gave the Secretary of State power to intervene if satisfied the authority is failing to act in accordance with regulations and guidance.[100] The regulations are discussed in more detail in section 2.7 above.

Scotland

The Local Government and Regeneration Committee of the Scottish Parliament recently produced a report on the use of LGPS funds to invest in capital infrastructure investments. It favoured informal collaborations over formal pooling arrangements. It recommended that:

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100 SI 2016/946, reg 7 and 8; CLG, LGPS: guidance on preparing and maintaining an investment strategy statement, 15 September 2016

> […] Local Government Pension Funds should invest more capital in local projects such as affordable housing. The Committee found there is untapped potential for Pension Funds to support communities and generate income. A lack of expertise in infrastructure investment means too few Pension Funds are grasping the opportunity to invest to achieve local social or economic impact.[101]

Evidence to the Committee from the Scottish Public Pensions Agency emphasises that funds had a fiduciary duty to act with the interests of scheme members as paramount and that the Scottish Government "does not influence LGPS funds investment priorities and cannot require scheme managers to invest in infrastructure."[102]

3.2 Boycotts, sanctions and divestments

England and Wales

As discussed in section 1.2 above, LGA guidance for administering authorities explained that "the precise choice of investment may be influenced by wider social ethical or environmental considerations, so long as that does not risk material financial detriment to the fund."[103] In addition, the Law Commission concluded that trustees could make investment decisions that are based on non-financial factors, provided that they had good reason to think that scheme members shared the concern and there was "no risk of significant financial detriment to the fund."[104]

However, the Government has said it takes the view that it is inappropriate to use pensions to pursue "boycotts, divestments and sanctions against foreign nations and the UK defence industry". It has therefore issued a consultation on draft regulations requiring administering authorities to publish an investment strategy statement, which must be made in accordance with guidance from the Secretary of State. In advance of the regulations coming into force, the Government is to publish guidance explaining how investment policies should "reflect foreign policy and related issues":

> 3.7 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 Secretary of State has said, "Divisive policies undermine good community relations, and harm the economic security of families by pushing up council tax. We need to challenge and prevent the politics of division."
>
> 3.8 The *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009* already require

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101 Scottish Parliament Local Government and Regeneration Committee, Report on Pension Fund Investment in Infrastructure and City Deal Spend, 30 November 2015

102 SPPA evidence to the Scottish Parliament Local Government and Regeneration Committee, April 2015

103 Investment in local infrastructure projects vital, says Committee, 30 November 2015 LGPS Advisory Board, Advice on Fiduciary Duty with regard to the investment of Local Government Pension Scheme (LGPS) funds, April 2014.

104 Law Commission, Fiduciary Duties of Investment Intermediaries

> administering authorities to publish and follow a statement of investment principles, which must comply with guidance issued by the Secretary of State. 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. This will make clear to authorities that in formulating these policies their predominant concern should be the pursuit of a financial return on their investments, including over the longer term, and that, reflecting the position set out in the paragraph above, they should not pursue policies which run contrary to UK foreign policy.[105]

There is also provision for the Secretary of State to intervene if satisfied that an administering authority is failing to have regard to regulation and guidance.[106]

This broad approach is echoed in the CLG guidance published on 15 September, although it also states that investment policies should not run contrary to UK foreign policy:

> The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise. However, the Government has made clear that using pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government. Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.
>
> Investments that deliver social impact as well as a financial return are often described as "social investments". In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with the prudent approach. In other cases, some part of the financial return may be forgone in order to generate the social impact. These investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund.[107]

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105 Department for Communities and Local Government, Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, Consultation. November 2015; See also, DCLG, Local Government Pension Scheme: Investment Reform Criteria and Guidance, para 3.38

106 Ibid

107 CLG, LGPS guidance on preparing and maintaining an investment strategy statement, 15 September 2016

War on Want expressed concern. It expected the guidance to clarify how investment plans should comply with the statement:

> The government clearly intends to deter local councils from taking divestment action. However, where this intimidation fails, central government will still have the final say through the 'power of intervention' (see question 2).[108]

The Government's response to the consultation said:

> The majority of respondents also expressed concern about the way in which the policy on compliance with UK foreign policy is to be taken forward in the guidance to be published under draft Regulation 7(1). However, the Government remains committed to the policy set out in November's consultation paper that administering authorities should not pursue investment policies against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.[109]

Regulation 7 of the *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016* requires local authorities to produce an investment strategy statement including the authority's policy on how social, ethical and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments. Regulation 8 gives the Secretary of State power to intervene if the authority is failing to act in accordance with regulations and guidance. For more detail, see section 2.7 above.

Scotland

A recent report by the Local Government and Regeneration Committee of the Scottish Parliament explained that pension committees had a duty to treat the interests of members as paramount:

> 15. The sole purpose of the LGPS is to meet pension liabilities when they fall due. Thus, the pension committees have a legal and fiduciary duty to treat the interests of scheme members as paramount. To comply, investments made on behalf of scheme members are geared towards securing the best rate of return subject to any investment restrictions agreed for the scheme (e.g. ethical, social or environmental reasons.)[110]

On investments in industries such as fossil fuel, arms and tobacco, funds should be guided by consultation with members:

> 43. While considering rates of return, it would be remiss of us not to consider investments in certain industries, for example, fossil fuels, arms and tobacco. These might provide a high rate of return but we question whether local government pension funds should be investing in such industries given social, environmental and ethical considerations. We note Strathclyde Pension Fund's view these industries would be less responsible if public pensions did not invest and also that collective action by investors can have a

108 War on Want – protect local democracy Q and A
109 CLG, LGPS Revoking and replacing the LGPS (Management and Investment of Funds) Regulations 2009. Government response to consultation, September 2016
110 Local Government and Regeneration Committee, Pension Fund Investment in Infrastructure and City Deal Spend, 30 November 2015

greater influence on the industry. We consider funds should be guided by consultation with their members on this issue.[111]

[111] Ibid

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