Croydon Council

REPORT TO:	**PENSION COMMITTEE** **8 March 2016**
AGENDA ITEM:	7
SUBJECT:	**Consultation on Revoking and Replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009**
LEAD OFFICER:	**Richard Simpson, Assistant Chief Executive (Corporate Resources and Section 151 Officer)**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Treasury**
WARDS:	**All**

CORPORATE PRIORITY/POLICY CONTEXT:

Sound Financial Management: These regulations relate to the Pension Fund and governance arrangements for investing assets.

FINANCIAL SUMMARY: This consultation is concerned with the regulatory framework governing investment of the Pension Fund. Effective decision making is critical to the log-term affordability and sustainability of the Local Government Pension Scheme.

FORWARD PLAN KEY DECISION REFERENCE NO: N/A

1. **RECOMMENDATIONS**

1.1 The Committee is invited to note the response that has been submitted to the Department for Communities and Local Government.

2. EXECUTIVE SUMMARY

2.1 This report sets out the Council's response to the Department for Communities and Local Government's consultation. It is based on responses from the Fund's investment advisors and the Scheme Actuary.**3. DETAIL**

3.1 The existing regulatory framework governing the investment of pension fund assets is based on a schedule listing investment instruments with allowable percentages for each. This has long been considered to be an inflexible approach that poorly reflects current investment practices.

3.2 The Department for Communities and Local Government (DCLG) are consulting on changes to the regulations as well as proposing long-stop powers relating to the creation of regional Local Government Pension Scheme (LGPS) pools. The government are seeking LGPS administering authority's views on:

3.2.1. Whether the proposed revisions to the investment regulations will give authorities the flexibility to determine a suitable investment strategy that appropriately takes account of risk.

3.2.2. Whether the proposals to introduce the power of intervention as a safeguard will enable the Secretary of State to intervene, when appropriate, to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.

3.3 The consultation is set out in the form of eight questions covering the two proposals. The consultation concluded on 19 February 2016. Croydon's response has been informed by ideas shared by both the Fund's investment advisors, Aon Hewitt and the Scheme Actuary, Hymans Robertson.

3.4 The first proposal is about deregulating and adopting a local approach to investment. The consultation proposes to deregulate and simplify the regulations that have governed the management and investment of funds since 2009. Some of the existing provisions will not be carried forward into the draft 2016 Regulations in the expectation that they would be effectively maintained by general law provisions and so specific regulation is no longer needed. There are four questions covering this proposal:

3.5 **Question 1**: **Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?** The draft Regulations set out a general framework within which authorities are expected to determine, implement and govern an investment strategy, without placing any detailed restrictions on authorities. Simplification is welcome and the removal of the existing schedule of limitations on investments should make the investment process more efficient without adding any risk for pension funds.

3.6 **Question 2**: **Are there any specific issues that should be reinstated? Please explain why.** The interaction of the draft regulations and the associated guidance could potentially be interpreted as compelling authorities to follow a particular course of action. Given the power to intervene will require authorities to explain their rationale for non-compliance with any guidance, the wording as it stands shifts the balance of power too far away from authorities to determine what is, or is not, an appropriate investment strategy. It would therefore be appropriate to either reinstate the original wording or ensure that there is sufficient consultation with authorities prior to the introduction of any new guidance.

3.7 **Question 3**: **Is six months the appropriate period for the transitional arrangements to remain in place?** Six months would be more than enough time for the transitional arrangements to remain in place, if the LGPS funds in England and Wales were able to focus entirely on this matter. However, in addition to investment pooling and regulatory change, LGPS funds are required to undertake their triennial actuarial valuations as at 31 March 2016, as well as prepare and close their year-end accounts. Local Pension Boards are still bedding in, and the changes brought in by LGPS 2014 are still being felt. Further, it is usual for Pension Committees to review investment strategy in conjunction with the completion of the triennial actuarial valuation results, which provide the latest snapshot of fund liabilities and, in part, drive the contributions that are required to be paid over the next three years. The completion of an investment strategy review would help inform the preparation of an Investment Strategy Statement (ISS). Given all of the work required of administering authorities and Pension Committees noted above, it will be extremely challenging, if not impossible, for Pension Committees to complete an investment strategy review over the proposed timescale. More time will also allow a clearer link between the ISS, Funding Strategy Statement and a Fund's liabilities to be established, and thus for a more joined up and coherent approach to be taken, not least over a period where the establishment of investment pools will be gaining momentum. Therefore, 1 October (or six months after the date of the final regulations) may not provide for enough time for a current, relevant and informed ISS to be prepared. It would be beneficial to provide for a longer transitional period, not least in terms of revisiting investment strategy in light of the actuarial valuation cycle so that the new Investment Strategy Statements are fully informed; ideally this would be a twelve months period for the transitional arrangements to remain in place.

3.8 **Question 4**: **Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?** Any legislative restriction on the use of derivatives will potentially reduce the flexibility of the LGPS in England and Wales to adapt to changing circumstances and it is unclear how the Pension Committees and investment pools should demonstrate that any derivative use is purely for the purposes of risk management. Therefore there should not be explicit restrictions on the use of derivatives in the regulations.

3.9 The second proposal relates to the Secretary of State's power of intervention.

3.10 **Question 5**: **Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?** The draft regulations already provide unlimited scope for the Secretary of State to consider potential sources of evidence as to whether an intervention is required. Croydon would prefer evidential sources to be clearly specified, and indeed clearer guidance on what might constitute a reason for intervention. Similarly, as guidance is to be kept under review and will be revised as circumstances change and authorities' investment pools evolve, there is a considerable degree of uncertainty as to what might trigger the Secretary of State to commence an intervention in the future.

3.11 **Question 6**: **Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?** There is provision for the administering authority to be given time to consider the Secretary of State's proposal and present its argument for any changes that it thinks should be made. However, there do not appear to be any inbuilt safeguards for administering authorities in terms of a minimum time within which it is able to prepare a response. Similarly, it is likely that the costs of any third party support will be met from the fund, as it seems will any resulting costs, charges and expenses incurred in administering the fund if an intervention is ultimately issued. This would not seem to be the best use of a fund's assets, particularly if the fund is in a situation where the Secretary of State believes that an intervention is justified, and will undoubtedly have an adverse impact on the various employers within the fund, given the collective and shared interest that all participating employers have with the administering authority in the success of the fund. Therefore, Croydon believes that it would be in the interests of all stakeholders in LGPS funds if greater engagement and discussion could be entered into as soon as a potential issue is identified.

3.12 **Question 7**: **Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?** The draft regulations give the Secretary of State powers to direct an authority to make changes to the investment strategy or to invest in particular asset classes. This is inconsistent with the framework within which an authority is expected to take responsibility for framing an appropriate investment strategy. It is appropriate that the Secretary of State has the power to hold an authority to account for the investment strategy in place. However, any intervention concerning investment strategy should be framed by challenging the appropriateness of a strategy with reference to the authority's own risk objectives. Whilst this retains the requirements for each authority to reflect the necessary legislation and guidance, the circumstances within which the Secretary of State will determine an intervention will otherwise be applied on a relative, rather than an absolute basis.

3.13 **Question 8**: **Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?** The proposals do broadly meet the objectives of the Government's stated policy. However, whilst an improved capacity and capability to invest in infrastructure can be achieved, the underlying infrastructure market dynamics will play a part in determining whether this asset class offers an appropriate risk adjusted return and therefore represents an attractive investment at any given time. It is unclear whether intervention means the Secretary of State, or the Secretary of State's nominee, will take over the fiduciary responsibility of the local Pension Committee. Clarification in this respect would be helpful, but in any event it is assumed that the overriding principle to invest in the best interests of the pension fund members will remain.

3.14 Appended to this report are the draft regulations and the DCLG consultation. The Committee is asked to note this response and the overall effect of the government's proposal.

4 FINANCIAL CONSIDERATIONS

4.1 There are no direct financial consequences for these proposals from the DCLG however any changes to the governance of the Pension Fund could have a profound impact on the cost of the LGPS to the Council.

5. OTHER CONSIDERATIONS

5.1 Other than the considerations referred to above, there are no customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report.

6. COMMENTS OF THE SOLICITOR TO THE COUNCIL

6.1 The Council Solicitor comments that the current framework governing the investment of local government pension fund assets is set out under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. There are no additional legal implications arising from this repost.

(Approved by: Gabriel MacGregor, Head of Corporate Law on behalf of the Council Solicitor and Monitoring Officer)

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APPENDICES:

Appendix A:
Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, Consultation by DCLG, November 2015

Appendix B:
Draft Regulations

BACKGROUND DOCUMENTS:

None
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