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**Wednesday, 12 October 2016**

**UNISON Local Government Pension Scheme (LGPS) Briefing**

For all service groups, regions and branches – with LGPS members in England/Wales. Scotland for information.

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**Issue:** Department for Communities and Local Government (DCLG) Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and guidance on Preparing and Maintaining an Investment Strategy Statement for the Local Government Pension Scheme.

**Introduction**

This briefing informs the union of the new LGPS regulations and guidance and the issues related to it. The regulations are instructions to the LGPS administration authorities on how to invest scheme member’s pension funds.

All other UK pension funds and EU pension investing instructions require that all investments must be made in the best interests of scheme members and that any potential conflict of interest must be resolved in their favour. The new regulations do not even mention scheme members in an affirmative manner.

The new regulations and guidance are the outcome of consultation which began back in November 2015. These accompanied guidance on the requirement for all 89 investment funds to begin a process of pooling assets into Common Investment Vehicles of CIV’s with a minimum of £25bn in value.

The Regulations come into force on 1 November 2016 but give administering authorities until 1 April 2017 to publish their first Investment Strategy Statement (ISS) in accordance with the new rules. DCLG had already, on 15 September 2016, taken the rather unusual step of publishing its statutory guidance—*before* the Regulations became law.

Effective dates aside, the legislation is all but identical to the draft version that was circulated for consultation purposes in November 2015. UNISON was successful in obtaining a debate about the changes to the LGPS discussed in this briefing after over 100,000 members signed the Parliamentary petition; we are still waiting for a date for the debate.

**Key issue:** Despite almost universal opposition by consultation respondents, over 23,000, the government has gone ahead and given itself unprecedented powers of intervention over the investment process, demanding that the fund’s investments must not breach UK foreign policy. UNISON is very concerned that the DCLG Secretary of State can direct a fund to make changes to its investment strategy, force it to invest in specific assets and transfer the investment functions of the administering authority to the secretary of state or a nominated person.

**Background**

At the end of September 2016 the DCLG published new regulations and guidance for the LGPS funds in England and Wales, following a consultation earlier this year. UNISON welcomes some aspects of the new regulations and guidance.

**Summary of the key issues**

* UK and EU pension investing law requires that all investments must be made in the best interests of scheme members and that any potential conflict of interest must be resolved in their favour.
* LGPS investment funds sole purpose is to provide benefits in retirement, they are not there to further the interests of UK government foreign policy.
* The regulations and guidance give the DCLG Secretary of State unprecedented powers to intervene in LGPS Funds investment strategies. UNISON is taking legal advice on whether such powers contravene UK and EU pension investing law which states ‘Member States shall not require institutions located in their territory to invest in particular categories of assets’.
* Such a direction would be a potential breach of the EU Directive 41/2003 Institutions for Occupational Retirement Provision. Article 18 paragraph 3 of the IORP Directive states ‘Member States shall not require institutions located in their territory to invest in particular categories of assets’.
* The regulations and guidance will force LGPS administering authorities to invest only in accordance with UK foreign policy, stating that funds “Should not pursue policies that are contrary to UK foreign policy or UK defence policy” UNISON is taking legal advice on whether such a condition on investing breaches UK and EU pension investing law.
* The guidance seeks to improve funds’ appetite for responsible investing and corporate governance activity, including engaging with company boards and exercising voting rights. UNISON supports this in so far as there must be a duty to consult scheme members on this approach.
* The guidance requires all administration authorities to report on their participation in Common Investment Vehicles (CIVs) to scale up the asset base and improve investment returns. UNISON supports this process but the government and Scheme Advisory Board must ensure that the CIV’s have scheme member representatives and that they should be nominated by trade unions that make up the Scheme Advisory Board (see our separate guidance on this issue).
* UNISON has called on the opposition parties to oppose the introduction of the new regulations

**Secretary of State Powers of Intervention**

Powers of intervention have revived concerns about the potential power of the government to direct investments made by the scheme’s 89 funds. Such a direction would be a potential breach of the EU Directive 41/2003 Institutions for Occupational Retirement Provision. Article 18 paragraph 3 of the IORP Directive states ‘Member States shall not require institutions located in their territory to invest in particular categories of assets’.

Investment strategy should be a matter for the scheme members and the LGPS funds. It is not appropriate for the government to intervene. By demanding powers of intervention the government contradicts its previous assertion that scheme members of the LGPS are protected by Common Law provisions.

**Key issue: The Occupational Pension Scheme (Investment) Regulations (OPSIR) which all other pension funds in the UK have to follow do not contain powers of intervention for the Secretary of State and UNISON questions the legal basis for this proposal.**

**General comments on the investment regulations**

UNISON, the LGPS Scheme Advisory Board (SAB) and the Law Commission have already expressed the opinion that that the government’s current investment regulations do not correctly apply the EU Directive 41/2003 Institutions for Occupational Retirement Provision (IORP). We believe that the UK government is not enforcing the statutory rights of scheme members to have LGPS pension funds invested in their best interests. The UK’s Pensions and Lifetime Savings Association previously raised similar concerns, calling for fiduciary duty to be made explicit in the LGPS investment regulations.

This issue is even more important now that the government has announced that LGPS funds are to be required to pooling LGPS fund assets into a small number of ‘British Wealth Funds, each over £25bn in size. Unfortunately these plans do not require that these giant funds must invest in the interests of scheme members. Article 18 of IORP is clear on this:

**Commentary on the regulations and guidance**

UNISON welcomes some of the developments in the regulations and guidance. We support the requirement for the LGPS to have a policy on environmental, social and governance (ESG) factors and stewardship, as well as the new provision that the pension funds must explain their approach to social investment and the extent to which non-financial factors are considered in their investment process and consult scheme members.

**What is the guidance attached with the regulations for?**

The guidance has been issued to assist administering authorities in the formulation, publication and maintenance of their Investment Strategy Statement (ISS). The ISS will be a requirement of Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016; these regulations have yet to be issued.

The ISS will replace the Funding Strategy Statement currently required to be produced by all LGPS funds. The first of such statements must be produced by April 1st 2017, then kept under review and revised from time to time and at least every three years.

**The Investment Strategy Statement required by Regulation 7 must include:-**

a) A requirement to invest money in a wide variety of investments;

b) The authority’s assessment of the suitability of particular investments and types of investments;

c) The authority’s approach to risk, including the ways in which risks are to be measured and managed;

d) The authority’s approach to pooling investments, including the use of collective investment vehicles and shared services;

e) The authority’s policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and

f) The authority’s policy on the exercise of rights (including voting rights) attaching to investments.

**Directions by the Secretary of State**

Regulation 8 of the new investment regulations enables the Secretary of State to issue a Direction if he is satisfied that an administering authority is failing to act in accordance with the guidance. In the view of the government where there is evidence to suggest that an authority is acting unreasonably, it may be appropriate for the Secretary of State to consider intervention, but only where this is justified and where the relevant parties have been consulted.

The power of Direction can be used in all or any of the following ways:-

a) To require an administering authority to make changes to its investment strategy in a given timescale;

b) To require an administering authority to invest assets as specified in the Direction;

c) To transfer the investment functions of an administering authority to the Secretary of State or a person nominated by the Secretary of State; and

d) To require an administering authority to comply with any instructions from either the Secretary of State or the appointed person in circumstances when the investment function has been transferred.

**Key issue: Controversially the Government has made clear in its guidance 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.**

Under UK and EU law the principles of a fiduciary duty of the investing pension fund must be and only be to scheme members. This attempt to impose UK foreign policy upon the LGPS funds breaks that consideration of scheme members’ interests being paramount.

**Regulation 7(2)(d) - The approach to pooling investments, including the use of collective investment vehicles and shared services**

All administering authorities must now 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. 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.

UNISON supports the creation of collective investment vehicles as proposed by the government in November 2015. We believe that increased scale and cost transparency in the investment process will deliver increased investment returns. However, we believe that these pools must ensure that they have scheme member representatives and that they should be nominated by trade unions that make up the Scheme Advisory Board.

**Investment Regulation 7(2)(e) - How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments**

The law is clear that pension funds 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. UNISON supports this position.

UNISON also supports funds taking 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.

In formulating and maintaining their policy on social, environmental and corporate governance factors, an administering authority will now have to:

* Must take proper advice
* Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors
* Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments
* Should not pursue policies that are contrary to UK foreign policy or UK defence policy
* Should explain their approach to social investments

**Investment Regulation 7(2)(f) - The exercise of rights (including voting rights) attaching to investments**

The government starts this section with the sentence “The long-term investment interests of administering authorities are enhanced by the highest standards of corporate governance and corporate responsibility amongst the companies in which they invest. Poor governance can negatively impact shareholder value”.

In the context of pension fund investing LGPS Administering Authorities are not capable legally of having interests, only individuals can. Scheme members are the only group whose interests must be of interest in the investing process. We agree however that their interests are enhanced with the highest standards of corporate governance. Regulation 7(2)(f) now requires every administering authority to formulate a policy that reflects their stewardship responsibilities.

In formulating their policy on the exercise of rights, administering authorities:-

* Must give reasons in their Investment Strategy Statement for not adopting a policy of exercising rights, including voting rights, attaching to investments
* Should, where appropriate, explain their policy on stewardship with reference to the Stewardship Code
* Should strongly encourage their fund managers, if any, to vote their company shares in line with their policy under Regulation 7(2)(f)
* May wish to appoint an independent proxy voting agent to exercise their proxy voting and monitor the voting activity of the managers, if any, and for reports on voting activity to be submitted annually to the administering authority
* Should publish a report of voting activity as part of their pension fund annual report under Regulation 57 of the 2013 Regulations

**UNISON will be demanding that this policy position must be subject to wide ranging and meaningful consultation with scheme members.**