

West Yorkshire Pension Fund (WYPF) Response to the consultation on revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

Executive Summary

This is the response of WYPF to the Department for Communities and Local Government (DCLG) consultation on Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The proposed new regulations, in summary, make three changes:-

- The introduction of an Investment Strategy and the removal of the prudential limits.
- The requirement for funds to pool their assets.
- The power for the Secretary of State to intervene where an Investment Strategy is deemed not acceptable, a fund does not make satisfactory pooling arrangements, or a fund does not make suitable arrangements to make investments determined by the Secretary of State. Only infrastructure investments are specifically mentioned in the consultation.

General Comments

WYPF welcomes the revision of the investment regulations, and the widening of local discretion and accountability that comes with the removal of the schedule of limits from the regulations.

WYPF is, however, concerned that introducing a power of direction for the Secretary of State is completely contrary to the principle behind the changes to the regulations, increasing local discretion and accountability. WYPF is therefore of the view that all matters where any direction or intervention may be required it should be guided by the national Scheme Advisory Board (SAB), which has been established by the Secretary of State under the Pensions Act 2013 to advise the Secretary of State, and individual funds, and produce guidance on best practice. The SAB membership is determined by the Secretary of State, and contains the knowledge and expertise that would be required in the event that a fund requires assistance in fully complying with the regulations.

Response to Consultation Questions

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?

WYPF welcomes the widening of local discretion and accountability that comes with the removal of the schedule of limits from the regulations, and the move towards the private sector 'prudent man' approach.

Whether the proposed deregulation will achieve the intended policy aim is somewhat difficult to judge, as the regulations are being considered in isolation, as the guidance to be issued by the Secretary of State could have a significant impact on the proposed freedoms.

Draft regulation 7(4) is prescriptive, and is contrary to the principle of deregulation, and the administering authority being given the power to develop a prudent investment policy having taken proper advice

An Investment Strategy (IS) should be relatively straightforward to develop, as funds already have a Statement of Investment Principles, which covers many of the requirements of the IS.

It is unclear why it is necessary for the Secretary of State to introduce a power of direction in revised regulations where the stated policy objective is reduced regulation. The Secretary of State has established the SAB in accordance with the Pensions Act 2013 to advise the Secretary of State and individual funds, and develop guidance and encourage best practice. Any intervention, which should stop short of direction which would in effect mean the Secretary of State would be taking responsibility for the result, which, ultimately, is the meeting of the liabilities of the fund. WYPF would therefore not support intervention without evidence that the SAB had failed to perform its role in relation to promoting best practice in complying with regulations.

Assuming that the power of direction is included in the final regulation, with all the risks to the Secretary of State making directions would bring, the circumstances in which the power may be exercised must be much more clearly defined in the regulations, and they should specify whose judgement he will rely on when, for example he rejects an IS which has been developed by a fund after taking proper advice.

Greater clarity in the regulations as to how any direction is to be implemented is required, as it would not be appropriate for the Secretary to State to control his own actions by guidance. For example, would there be a role for the SAB, DCLG staff, elected members or officers from another administering authority?

WYPF takes the view that if the guidance yet to be produced is clear then there will be little need for the power of direction, as there are sufficient extant remedies available to the Secretary of State and other interested parties, for example, the Local Pension Board (LPB) and the SAB.

2. **Are there any specific issues that should be reinstated? Please explain why.**

No.

3. **Is six months the appropriate period for the transitional arrangements to remain in place?**

With the advent of pooling 6 months is likely to prove to be too soon, and as 2016 is a valuation year funds will already be consulting on their Funding Strategy Statement (FSS) later in the year. As these two documents are interdependent, and both require consultation, it would make administrative sense if the IS and FSS were prepared simultaneously. Transitional arrangements should apply until the date of approval of the next FSS, and terminate for each fund on the date of the approval of its ISS.

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?**

Derivatives are currently used for more than just risk management, for example financial futures may be used to implement asset allocation decisions in a timely manner, giving immediate market exposure while allowing time for considered stock selection.

Although the use of derivatives is wider than risk management or portfolio hedging, there is no doubt that their use must be understood and controlled by the pensions committee members.

Therefore it would be sensible if the regulations specified that derivatives and other complex financial products may only be used where pension committee members have received appropriate technical training, can demonstrate an understanding of the products to be used, have received a report which shows the worst outcome for the fund, and have discussed this with an independent advisor.

This also begs the question why the regulations do not require pensions committee members to have the appropriate knowledge and skill to exercise their responsibilities prudently and effectively, particularly as members of the LPB, which only has the power to scrutinise decisions of the pensions committee, are specifically required to have or obtain appropriate knowledge. The large, well governed funds already have a knowledge and skills framework in place, and making this a requirement would improve governance across the LGPS, and fits well with the policy objective of greater local discretion. This period of significant change would be a good moment for such a change.

5. **Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?**

As Regulation 8(4) is widely drafted the sources of evidence to be consulted could be developed in the guidance to be produced. However, the one obvious source of evidence that should be consulted in all cases before an intervention should be the

external auditor, as an independent person familiar with the relevant fund and the regulations and guidance applicable.

- 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?**

The regulation allows sufficient scope to present evidence, but as no time is prescribed, and investment management is a long term business, evidenced by the removal of the requirement for a review of investment managers every three months, it is not possible to conclude that sufficient time is allowed. The regulations should specify a minimum period of at least 180 days, which would allow the fund adequate time to gather, prepare and submit evidence, and for the Local Pension Board to consider the evidence before it is submitted to the Secretary of State.

- 7. Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?**

The Regulation provides the Secretary of State with almost unlimited flexibility to intervene. It is more relevant to consider whether the scope for intervention or direction is too wide, particularly as the intervention can include instruction in relation to the exercise of its (the administering authority) functions under the regulations (Regulation 8(2)(d)) which may have direct financial implications (cost) for the fund concerned. This clearly steps beyond the line of maintaining clear accountability to the local Council Tax Payers.

- 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?**

Without any restrictions in the regulations it cannot be certain that any intervention by the Secretary of State would be proportionate. The regulations should specify that any intervention would be based on advice to the Secretary of State from the national Scheme Advisory Board, which has been established by the Secretary of State in accordance with the Pensions Act 2013 for exactly this purpose.