Division(s): N/A

PENSION FUND COMMITTEE – 25 JUNE 2010

INVESTMENT AND REPRESENTATION

Report by County Solicitor and Head of Legal & Democratic Services

Introduction

1. As a statutory public service scheme, the Local Government Pension Scheme has a different legal status compared with trust based schemes in the private sector. Matters of governance in the LGPS therefore need to be considered on their own merits and with a proper regard to the legal status of the scheme. This includes how and where it fits in with local democratic process through local government law and locally Elected Members who have a fiduciary duty to the fund, scheme members and local council taxpayers. The Elected Members retain overall responsibility for the management of the fund and its investment strategy, and individual decisions about investments.

2. The County Solicitor provided a detailed summary of the duties and responsibilities of the Pension Fund Committee Members in May 2008 and February 2009. This report updates those reports to take into account changes in the law and recent statutory guidance issued by the Department for Communities and Local Government.

3. Local Government Pension Schemes are administered under the Superannuation Act 1972, and subsequent regulations. Section 7 of the 1972 Act empowers the Secretary of State to make regulations for the provision of pensions for people employed in local government, and the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) ("the 2008 Regulations") contain detailed provisions for the administration of Pension Funds by "administering authorities". The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the 2009 Regulations) impose specific duties on administering authorities as to the investment of the assets of the fund which is their responsibility. In addition to statutory obligations, the general law relating to Trusts and Trustees will also apply, subject to any contrary provision in the Regulations themselves.

4. The Pensions Ombudsman has specifically stated that the term "Trustee" is frequently used as a matter of convenience for those with the responsibility for administering the Scheme. Members of the Pension Fund Committee are not Trustees in the traditional sense of the word because the LGPS is a statutory scheme but nevertheless the term aptly describes the duties that apply to Council Members in the administration of the Scheme. (Hadley v Orkney Islands Council: Pensions Ombudsman determination)

The Management & Investment of Funds

5. Regulation 11 the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, requires the administering authority to invest fund monies which are not needed immediately and power is included to vary the pension fund investments. The 2009 Regulations contain a requirement for an investment policy to be formulated with a view:

    (a) to the advisability of investing fund money in a wide variety of investments; and

    (b) to the suitability of particular investments and types of investments.

    The authority must obtain proper advice at reasonable intervals about its investments and must consider such advice in taking any steps in relation to its investments.

6. Regulation 8 expressly authorises administering authorities to appoint one or more investment managers to manage and invest the fund for them, provided that the appointment satisfies various conditions. Regulations 9 and 10 impose requirements for the appointment of the investment manager and for conducting performance reviews.

7. As already stated, administering authorities are required to invest pension fund monies not for the time being required for the payment of benefits. Limitations are imposed, however, to restrict the proportion of the fund's investments which may be placed in any category.

Statement of Investment Principles (SIP)

8. In accordance with regulation 12 of the 2009 Regulations, an administering authority must, after consultation with such persons as it considers appropriate, prepare, maintain and publish a written statement of the principles governing its decisions about the investment of fund money. The statement must cover its policy on—

    (a) the types of investment to be held;

    (b) the balance between different types of investments;

    (c) risk, including the ways in which risks are to be measured and managed;

    (d) the expected return on investments;

    (e) the realisation of investments;

    (f) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments;

(g) the exercise of the rights (including voting rights) attaching to investments, if the authority has any such policy; and

(h) stock lending.

9. The SIP must also state the extent to which the authority's policy complies with guidance given by the Secretary of State. As from 1 January 2010, the relevant guidance is '*Investment Decision-Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles*' published by the Chartered Institute of Public Finance and Accountancy (CIPFA). The guidance sets out, in a way that is appropriate for the Local Government Pension Scheme Funds, the six revised principles on investment decision-making for occupational pension schemes that were agreed in 2009 by the Investment Governance Group's Local Government Pension Scheme (LGPS) sub-committee.

10. Elsewhere on this agenda, the Pension Fund Committee is asked to review its compliance with the new statutory guidance and to include the extent of its compliance in the Oxfordshire Pension Fund Statement of Investment Principles, which is also reviewed elsewhere on this agenda.

Governance Compliance Statements (GCS)

11. The Governance Compliance Statement should fully describe and explain the authority's arrangements for the delegation of their functions, the frequency of Committee Meetings, Terms of Reference and operational procedures of such delegations and the extent of scheme member representation on Committees. With effect from 1 April 2008, regulation 31 of the 2008 Regulations sets out the responsibility of administering authorities to keep the GCS under review and, where necessary, revise their governance compliance statements.

12. The GCS must also state the extent to which the authority's policy, as set out in that statement, complies with statutory guidance entitled 'Local Government Pension Scheme Governance Compliance Statements Statutory Guidance – November 2008'. The statutory guidance identifies 9 principles for the governance of scheme funds. In 2007 CIPFA published "Delivering Good Governance in Local Government: Framework" which identifies 6 Framework principles. The Framework is regarded as "proper practice" in local government. CIPFA has recently published 'Delivering Good Governance in Local Government Pension Funds' (2009), which seeks to set the statutory guidance in the context of the Framework. There is a clear linkage between the two sets of principles therefore, it is important that administering authorities have regard to both statutory guidance and CIPFA guidance when considering their GCS.

13. On 24 February 2006 The Pension Fund Committee formally approved a GCS under the Local Government Pension Scheme (Amendment) (No 2) Regulations 2005. The Statement was reviewed in May 2008. The Pension Fund Committee needs to review the Statement in light of the 2009 CIPFA Guidance and this is considered elsewhere on the agenda. The extent of its

compliance with statutory guidance should then be contained in the revised Oxfordshire Pension Fund Statement of Investment Principles.

The General Law Relating to Trustees

14. The word “trustee” is often used in a very general sense to mean somebody who acts on behalf of other people but in pensions law it has a more specific meaning. Most occupational pension schemes, primarily in the private sector, are established under trust law. Under a trust, named people (trustees) hold property on behalf of other people (beneficiaries). Trustees owe a duty of care to their beneficiaries and are required to act in their best interests, particularly in terms of their investment decisions. Although those entrusted to make statutory decisions under the LGPS are, in many ways, required to act in the same way as trustees in terms of their duty of care, they are subject to a different legal framework, which derives from public law. In particular, local authority members are subject to all the normal duties and responsibilities that come with their office. However, they are not trustees in the strict legal sense of that word.

15. The duties of trustees generally are based on case law and statute. Much of the case law over the years has been concerned with disputes in connection with private and family trusts and wills, as well as charities and there have been surprisingly few cases dealing with pension funds specifically. Whilst amendments to the Superannuation Regulations have removed many of the former restrictions on how investments were to be made, the general legal principles have remained largely unchanged over the years. The Court of Appeal in Roberts v. Hopwood (1925) said:

"*A body charged with the administration for definite purposes of funds contributed in whole or part by persons other than the members of the body owes, in my view, a duty to those latter persons to conduct that administration in a fairly business-like manner with reasonable care, skill and caution, and with a due and alert regard to the interest of those contributors who are not members of the body. Towards these latter persons the body stands somewhat in the position of Trustees or managers of the property of others*."

The Fiduciary Duty

16. Trustees of private sector schemes ensure better scheme security, prevent employer-led actions, which could undermine a scheme’s solvency and seek to ensure that investment and other decisions are both prudent and fair. While the public law framework applying to LGPS schemes will require similar standards of behaviour and practice by members of pension committees, who in this respect also fulfil a fiduciary role, a key distinction to be made is that LGPS benefits are established and paid under statute.

17. On the one hand, Elected Members have legal responsibilities for the prudent and effective stewardship of LGPS funds and in more general terms, have a clear fiduciary duty in the performance of their functions. However, it is equally clear that the beneficiaries of the scheme have an interest in the beneficial

title to the assets and the legal right to require that the assets are held and managed on their behalf in accordance with the governing legal instrument, in this case, the LGPS regulations. In this respect, elected councillors have a duty of care that goes beyond the strict fiduciary duty to employers and tax payers.

18. The Audit Commission have special powers to inspect and to protect the interests of council taxpayers to ensure that the Local Authority has acted lawfully in its financial transactions. Elected Members are no longer susceptible to surcharge for negligence or misconduct which has now been replaced by the concept of wilful misconduct. Wilful misconduct was defined as "deliberately doing something which is wrong, knowing it to be wrong, or with reckless indifference as to whether it is wrong or not" (Graham v Teesdale (1981)) 81 LFR 117. It is generally held that wrongful omissions fall within the same category as wrongful acts.

19. Elected Members who are also Trustees of a pension scheme retain this responsibility not to engage in "wilful misconduct" and have the additional responsibility to have regard to their statutory obligation under the Superannuation Regulations and the obligations outlined in the case law above i.e. a duty to conduct the administration of the pension scheme in a fair business like manner with reasonable care, skill and caution and with a due and alert regard to the interest of others. These obligations are therefore higher than simply weighing up decisions and coming to a reasonable conclusion. There is an implicit expectation that proper care and skill will be applied in making decisions relating to the pension scheme. This is reinforced by the obligations to take proper advice at reasonable intervals and in addition to have regard to the investment principles as specified by CIPFA.

20. In addition the Pensions Ombudsman will investigate complaints of maladministration that has caused injustice to a party. Maladministration is defined as involving "bias, neglect, inattention, delay, incompetence, ineptitude, perversity, turpitude, arbitrariness and so on". The injustice does not only mean financial loss but it may include such things as distress, delay or inconvenience.

Elected Members' Liability

21. Elected and co-opted Members are covered by an insurance policy arranged by Oxfordshire County Council whereby they are indemnified against their legal liability for financial loss occasioned by any negligent act or accidental error or omission on the part of the Council, its employees or Members committed in good faith. The indemnity is up to £5,000,000.

22. In many cases, failure to comply with the statutory provisions can result in a fine being levied against an individual or against the Authority and where appropriate, criminal breaches of the provisions could result in prosecution.

Professional Advice & Training

23. In the discharge of their responsibility, Elected Members are under a statutory obligation to obtain "proper advice" at reasonable intervals about investments. They are also required to seek proper advice about appointments of investment managers and their performance reviews (the 2009 Regulations). "Proper advice", means the advice of a person whom the authority reasonably believes to be qualified by their ability in and practical experience of financial matters (including any such person who is an officer of the administering authority).

24. It is also important that Elected Members have sufficient expertise to be able to evaluate critically any advice they receive. In 2001, the Government accepted the ten investment principles recommended by Paul Myners in his report, "Institutional Investment in the UK". The first of those principles, Effective Decision Making", states:

> "*decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. When Trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take… Trustees should assess whether they have the right set of skills, both individually and collectively, and the right structures and processes to carry out their role effectively*."

25. Members of the Pension Fund Committee are expected to exercise due diligence, skill and expertise. Members may at some point be required to demonstrate how they have acquired sufficient skill and expertise and how they have kept up to date with developments in superannuation matters. Participation in relevant and approved training courses will be the most obvious and effective way of demonstrating necessary knowledge and understanding in order for members to carry out their duties and evaluate critically any advice they receive.

26. Democratic Services organise general training for all County Council Members. In addition, the Pension Fund Committee agrees a more specific member training programme and budget each year in February to take effect for the following financial year. This training is organised by the Finance and Procurement Service. There are a number of external member training courses and conferences held throughout the year and members are encouraged to attend these. Internal training courses have also been introduced and these are normally held immediately before Pension Fund Committee meetings. In addition to training courses, officers regularly send out newsletters, which include training articles or newspaper cuttings of topical interest.

Existing Regulations on Membership

27. Under Section 102 of the Local Government Act 1972, it is for the appointing Council to decide upon the number of Members of the Committee and their

terms of office. They may include Committee Members who are not Members of the appointing Council and such Members may be given voting rights by virtue of Section 13 of the Local Government and Housing Act 1989. It is, therefore, open to the Pension Fund Committee to include representatives as voting Members on the Committee providing they are eligible to be Committee Members.

28. In addition to the County Councilor membership on the Committee, there are two co-opted members with full voting rights nominated by the Oxfordshire district councils.

Beneficiaries' Observer

29. In 1986 the Finance & General Purposes Sub-Committee agreed to invite a representative of the beneficiaries to attend and speak but not vote at meetings of the then Investment Sub-Committee. Since then, a beneficiaries observer has attended meetings of the Pension Fund Committee and its predecessors in this capacity. The beneficiaries observer represents the present contributors, pensioners and deferred beneficiaries. The reason the observer does not have voting rights is because, if they had such rights, it would preclude County Council employees from undertaking the role.

RECOMMENDATION

30. **The Committee is RECOMMENDED:**

(a) to continue to act within its agreed Statement of Investment Principles in the best interests of the Scheme; and

(b) to continue to act within its agreed Governance Compliance Statement in the best interests of the Scheme.

P G CLARK
County Solicitor and Head of Legal & Democratic Services

Background Papers Nil

Contact Officer: Peter Clark, County Solicitor and Head of Legal & Democratic Services Tel: (01865) 323907

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