

Investment, Governance and Engagement Committee

19th December 2018

Item 10 – Paper C

IORP Directive II

Background

1.1 At its meeting on the 5th February 2018, the committee was advised that there had been no further action since the last meeting with DWP and MHCLG officials. This paper updates the committee on developments since then

1.2 By way of background, IORP II Directive, first published in 2016, must be transposed by member states by the 13th January 2019, that is, before the date the UK is due to leave the European Union under Article 50. The UK government therefore has a duty to transpose the Directive into the national legal framework governing occupational pension schemes.

1.3 The IORP II Directive builds on IORP Directive 2003/41 that successive governments failed to apply to the LGPS, either wholly or partly, on the basis that it is a public service pension scheme underwritten by a government guarantee. The scheme advisory board and investment, governance and engagement committees have consistently argued, based on a legal opinion from Nigel Giffen QC, that no such guarantee exists on any statutory basis and that the various protections afforded by the IORP Directives to scheme members should therefore apply to the LGPS.

1.4 In 2013, the Board sought a further opinion from the then Department for Communities and Local Government. In their response, the Department maintained their long standing view that the scheme was consistent with the national legislation introduced by the UK government to transpose the IORP Directive.

1.5 On the 16th August 2018, the Secretariat sought a view from the Department for Work and Pensions on how the government was intending to transpose IORP II into national legislation and how it would be applied to the LGPS. The reply was non-committal on its application to the LGPS but the following general points were made :-

“Until the UK exits the EU, it will retain its rights and will continue to fulfil its obligations as an EU member state. This includes the transposition of EU Directives such as IORP II

IORP II largely supports the UK’s direction of travel on pension’s policy which means that the UK has already achieved transposition of most of

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the directive in its current regulatory framework. The UK will therefore be able to transpose IORP II without extensive new legislation.

The UK Government is responsible for the transposition of IORP II. Pension schemes must continue to comply with the UK's regulatory requirements. This means that pension schemes do not have to refer to the text of IORP II and seek to comply with it directly.

Pension schemes will not be expected to action any changes by January 2019. Any changes made to the rules for pension schemes will be implemented within a feasible timescale for schemes. We will include phasing or implementation periods for schemes which will allow sufficient time for familiarisation and planning.

The directive is being transposed in a minimal impact way that will be proportionate to the particular risk profile and complexity of different schemes.

Government also intends to continue to exempt the smallest schemes from these requirements. We do not intend to make changes to the aspects of the directive that do not currently apply to certain types or sizes of pension schemes."

1.6 On the 18th October 2018, Alex Cunningham MP tabled the following question :-

"To ask the Secretary of State for Housing, Communities and Local Government, with reference to the recent Court of Appeal judgement in the case of the Palestine Solidarity Campaign and Jacqueline Lewis against the Secretary of State for Communities and Local Government, whether the new Institutions for Occupational Retirement Provision Directive will be applied to the local government pension scheme in January 2019."

Rishi Sunak MP replied :-

"Following the Government's success at the Court of Appeal, pending the conclusion of any further legal proceedings, I intend to reinstate the guidance provided to Local Government Pension Scheme administering authorities requiring that they should not pursue investment policies that are contrary to UK foreign policy or UK defence policy.

Separately, the Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORP II) is due to

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be implemented by 13 January 2019. We do not feel it is necessary to change the rules of the Local Government Pension Scheme to give effect to it as we consider that its investment rules and governance requirements already comply with the Directive's objectives."

Consideration

2.1 There are a number of Articles of the IORP II Directive that have a direct bearing on the LGPS including :-

Article 5 - guarantee

The scheme's wholesale exemption from IORP 2003/41 was based on the government's view that the guarantee of the pensions promise offered by a public service pension scheme like the LGPS offers the same level of protection as that provided by Article 5.

However, in a legal opinion at <http://www.lgpsboard.org/index.php/board-publications/legal-opinions>, Nigel Giffen QC concluded that although the generally accepted position in the LGPS was that an administering authority is required to meet benefit payments on a statutory basis regardless of the circumstances of the fund it operates, this was not reflected in the regulations resulting in a potential (if extremely unlikely given the strength of local government finance requirements) circumstance of there being an uncertainty around benefit payments should the funds be unable to meet them.

Recommendation – that the Board opens discussions with MHCLG to introduce into the scheme's regulations a provision that scheme members' benefits are guaranteed on a statutory basis

Article 8 - separation

Article 8 requires separation of the IORP (administering authority) from its sponsored undertakings (scheme employers) to ensure that scheme members' benefits can continue to be paid in cases where the sponsored undertakings are declared either bankrupt or insolvent.

Following the government's decision not to apply Article 8 to the LGPS, the Board agreed to examine a number of options for separating the dual function of a local authority as both administering authority and scheme employer and to resolve the inherent conflict of interest arising from that dual role.

In May 2018, the Board circulated a bidding document for a project to examine options for change with regard to the separation of LGPS pension funds and their host authorities. Three bids were received.

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In October 2018 the Board agreed to delegate authority for making the final decision to the Chair and Vice-Chair and to give Board members the opportunity to comment on the bid responses. Later in December 2018, the three bid teams attended a panel interview with the Chair, Vice Chair and practitioner representative. At the time of writing, no final decision has been taken by the Chair and Vice-Chair on the successful bid team.

Recommendation – that the committee notes progress and that the Secretariat will keep the committee fully informed of developments as the project continues.

Article 19 (1) - investment in interest of members and beneficiaries

Article 19(1) provides that assets shall be invested in the best interests of members and beneficiaries and where there is a potential conflict of interest, solely in the best interests of scheme members and beneficiaries.

The government of the day carried forward this provision into the Occupational Pension Scheme (Investment) Regulations 2005 for schemes based on trust law but did not extend the requirement to statutory schemes like the LGPS.

In statutory guidance published in July 2017 by MHCLG, reference is made to “the duty of elected members under general law principles to make investment decisions in the best long term interests of scheme beneficiaries and taxpayers”. The guidance also makes reference to the interest of scheme members in the context of policies on diversification, risk, type of investments and how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments.

Regulation 7(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 requires administering authorities to act in accordance with this guidance when formulating their investment strategy statements.

Recommendation – that the Board opens discussions with MHCLG to align the above provisions in statutory guidance more closely with Article 19(1) and to consider amending the investment regulations 2016 to include an umbrella provision on best interest.

Article 19 (4) - member states shall not require investment in a particular categories of assets

In the light of concerns raised about potential intervention by government in the type of investments made by administering authorities, the Board’s legal adviser has confirmed that in their view, Article 19(4) is not one which requires

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transposition, as such, in the sense that it is a negative obligation on Member States, that is, “Member States shall not require institutions located in their territory to invest in particular categories of assets”.

“Furthermore, the UK Government has complied by not imposing any such requirements on UK schemes: it doesn’t have to (and arguably, given the UK constitutional doctrine of Parliamentary sovereignty, legally couldn’t) pass a law saying that Parliament must not pass any laws requiring UK schemes to invest in particular categories of assets.”

This may help to explain why the government’s position of encouraging rather than requiring administering authorities to invest in UK infrastructure.

Recommendation – that the Board seeks confirmation from MHCLG that their view on Article 19(4) concurs with that given by the Board’s legal adviser.