

CLWYD PENSION FUND

Consultation Response

LGPS (Management and Investment of Funds) Regulations

Introduction

This is a response on behalf of the Clwyd Pension Fund (administered by Flintshire County Council) to the proposed revisions to the investment regulations which aim to:

1. Give funds the flexibility to determine a suitable investment strategy that appropriately takes account of risks.
2. Introduce the power of intervention to the Secretary of State to ensure that funds take advantage of scale by pooling and deliver investment strategies that adhere to regulation and guidance.

The comments made are by exception, on significant items only.

No legal advice has been sought by the Fund on the revised regulations.

Proposal 1

- Q1. 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?

Governance – Proper Advice

The definition of 'proper advice' para 2 (1) should be reviewed. We have officers who meet the current definition of being 'qualified by their ability in the practical experience of financial matters', to which investment decisions are delegated. However, they must still also take advice from a suitably 'qualified and authorised' person in our scheme of delegation. This gives comfort to the Committee that all investment decisions are being effectively scrutinized by a qualified investment expert. This does not prevent a fund from directly employing such a person or via a new pool but for a fund of our size employing such advice from an investment consultancy firm remains the most cost effective option.

Strengthening this requirement across the LGPS, to match private sector requirements, should also assist the Secretary of State on determinations around Proposal 2 (Q5) and also should make the requirement of intervention less likely in the first place.

In addition, the potential issues under MiFiD II of LGPS funds being classed as retail investors could be overcome as most investment managers would be willing to 'up' funds to professional status if they are receiving independent advice from qualified individuals.

Also, the definition currently only applies to 'financial matters'. This should be extended to investment, actuarial and legal matters. For example, in para 9 (3) – 'terms on which appointment is made' we would require 'proper' legal advice.

A further suggestion is that there is a requirement to measure the effectiveness of the advice provided over a suitable period of time.

Investment Strategy Statement (ISS)

There is an opportunity within the new ISS for an additional requirement for the authority to publish a Scheme of Delegation from Committee to sub committees, to officers, to advisors and also 'pools' for investment and funding decisions. Again this should assist the Secretary of State with Proposal 2 (Q5).

Para 7 (1) states 'An authority must, after taking proper advice, form an investment strategy which must be in accordance with guidance issued by Secretary of State.' This could be extended to state 'on the proper governance of a local government pension fund' or some other phrase that would equally avoid a future administration dictating strategy that suited that administration rather than ensuring the LGPS is managed in the interest of all its stakeholders.

It may also be advisable to explicitly state somewhere within these Regulations the overriding fiduciary duty to stakeholders which is discussed in paragraphs 2.12 to 2.22 of your consultation document.

Investments

Para 3 (3) After advice from our investment consultants, this definition could, they believe, restrict funds like ourselves from using 'swap' contracts to implement a Liability Driven Investment strategy as these instruments are 'Over the Counter' instruments and not traded on a recognised stock exchange. Therefore the definition needs to be amended appropriately.

Q2. ARE THERE ANY SPECIFIC ISSUES THAT SHOULD BE REINSTATED? PLEASE EXPLAIN WHY.

None.

Q3. IS SIX MONTHS THE APPROPRIATE PERIOD FOR THE TRANSITIONAL ARRANGEMENTS TO REMAIN IN PLACE?

From a practitioner view point, a 12 month transition period, which may both assist with incorporating the new pooling arrangements within our ISS and linking the completion of the ISS with the Funding Strategy Statement, would be helpful.

Q4. 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?

Given the importance of this to the Clwyd Fund, advice was sought from our investment consultant who stated:

*We **do not** believe that derivatives should be used **only** as a risk management tool. In our view, they should be used for **efficient and effective portfolio management**. In a number of cases it can be of lower cost to use derivative instruments rather than purchase physical securities.*

There are also certain asset classes where derivatives are prevalent at an underlying level (e.g. Managed Futures). We believe the inclusion of such asset classes can form an effective tool in portfolio construction and therefore would support the ability for LGPS Funds to potentially invest in them, albeit via a third party such as an asset/investment manager (and not on a direct basis).

For currency hedging for example then provided appropriate advice is taken, the direct use of derivatives should be permissible.

Therefore, the wording 'efficient and effective portfolio management' should be included in the regulations.

Proposal 2

Q5. ARE THERE ANY OTHER SOURCES OF EVIDENCE THAT THE SECRETARY OF STATE MIGHT DRAW ON TO ESTABLISH WHETHER AN INTERVENTION IS REQUIRED?

A suggestion is that as part of the annual audit by External Auditors they should be required to receive a statement from the fund's external advisors i.e. actuary and investment consultant justifying the investment and funding strategy and approach (to cover pooling) and stating where the fund has not accepted 'proper advice' provided or not followed regulations or related guidance. These statements should be published in the fund's annual report and material matters of 'non-compliance' reported by the External Auditor to the Secretary of State.

Q6. 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?

Given that this should be an exceptional circumstance and each case will be different, silence on timescales in regulation seems the most appropriate, albeit we have not taken legal advice on this point.

Q7. DOES THE PROPOSED APPROACH ALLOW THE SECRETARY OF STATE SUFFICIENT FLEXIBILITY TO ENSURE THAT HE / SHE IS ABLE TO INTRODUCE A PROPORTIONATE INTERVENTION?

There is no obvious reason why the regulation as drafted does not give sufficient flexibility to introduce proportionate intervention albeit we have not taken legal advice on this point.

Q8. 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 IT HAS NOT HAD REGARD TO BEST PRACTICE, GUIDANCE OR REGULATION?

Yes, with the caveat of changing paragraph 7 (1) as explained above, albeit no legal advice has been taken.

Finally, the Members of the Investment Regulation Review Group in Annex A should be congratulated on the draft regulation which, with some minor adjustments covered above and by others, both meet the objectives set and should re-assure stakeholders that LGPS investments across all funds are managed in a professional manner, following best practice and guidance.

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