

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

First Delegated Legislation Committee

LOCAL GOVERNMENT PENSION SCHEME (MANAGEMENT AND INVESTMENT OF FUNDS) REGULATIONS 2016

Tuesday 22 November 2016

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not later than

Saturday 26 November 2016

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The Committee consisted of the following Members:*Chair:* ALBERT OWEN

† Adams, Nigel (*Selby and Ainsty*) (Con)
 Austin, Ian (*Dudley North*) (Lab)
 † Cartlidge, James (*South Suffolk*) (Con)
 † Double, Steve (*St Austell and Newquay*) (Con)
 † Doyle-Price, Jackie (*Thurrock*) (Con)
 Dugher, Michael (*Barnsley East*) (Lab)
 † Foxcroft, Vicky (*Lewisham, Deptford*) (Lab)
 † Fysh, Marcus (*Yeovil*) (Con)
 † Howlett, Ben (*Bath*) (Con)
 † Huddleston, Nigel (*Mid Worcestershire*) (Con)

† Jones, Mr Marcus (*Parliamentary Under-Secretary
 of State for Communities and Local Government*)
 † Lewis, Mr Ivan (*Bury South*) (Lab)
 † Mactaggart, Fiona (*Slough*) (Lab)
 † Malthouse, Kit (*North West Hampshire*) (Con)
 † Pearce, Teresa (*Erith and Thamesmead*) (Lab)
 † Pow, Rebecca (*Taunton Deane*) (Con)

Nehal Bradley-Depani, Katy Stout, *Committee Clerks*

† **attended the Committee**

First Delegated Legislation Committee

Tuesday 22 November 2016

[ALBERT OWEN *in the Chair*]

Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

2.30 pm

Teresa Pearce (Erith and Thamesmead) (Lab): I beg to move,

That the Committee has considered the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (S.I., 2016, No. 946).

It is a pleasure to serve under your chairmanship, Mr Owen. I am pleased that we have the chance to discuss the regulations.

Some 5.4 million local government employees are members of the local government pension scheme, which covers 81 funds in England and eight in Wales. The LGPS has a market value of just over £213 billion, which makes it one of the largest funded pension schemes in the world and the largest in England and Wales. The regulations include far-reaching changes to the LGPS that give the Secretary of State new powers to intervene directly in its financial decisions.

When such significant changes are made to the pensions of so many people, parliamentary scrutiny is only right and proper. I am glad that the hon. Member for Ross, Skye and Lochaber (Ian Blackford) introduced a Westminster Hall debate on the regulations after 105,000 people signed a petition to oppose them. I am also pleased that the Leader of the Opposition tabled an early-day motion praying against the regulations and that 104 Members of Parliament signed it.

The regulations bring in a raft of changes to say how, where and why the funds of LGPS members will be invested. Some of those changes are desirable, others less so. The Opposition support the pooling of the scheme's investment assets, with the creation of up to six British wealth funds, which will create cost transparency and cost reductions. However, alongside that welcome and economically sensible policy, the Government have brought in changes that have raised deep concerns from members of the public as well as Members of this House.

The basic principle that underwrites all pension schemes is that pension funds should always be invested in the best interests of their members—that all pension schemes' investment decisions should be guided by maximising financial return and financial stability for members. That is not just a principle; it is the law. However, since the regulations took effect, the LGPS—unlike any other pension scheme in the country—may not be required to invest in its members' best interests, because the Secretary of State reserves the right to intervene in how the pension funds of local government employees are invested. If funds are invested somewhere that does not comply with current UK foreign policy or that does not meet

the requirements for infrastructure investment, the Secretary of State could intervene. Those are unprecedented powers. No other pension pot in the country is subject to such extraordinary measures: not MPs' pensions, not civil service pensions and certainly not private sector pensions.

Surely investment decisions concerning local government pensions should be taken by the expert advisers employed to do just that. The LGPS has a scheme advisory board for that purpose, which includes pension experts who trained for years in investing pension funds to maximise profits. Under the regulations, LGPS members are the only pension scheme members in the country to have the investment of their valuable pensions dictated by the political will of a Secretary of State, rather than by the financial and legal expertise of a pension scheme advisory board, or are the Government considering issuing the same rules for trust-based schemes or even for MPs' schemes? Perhaps the Minister could let the Committee know.

There is also concern that the Government have not listened to the concerns that people have voiced loudly and clearly. In the consultation before the regulations were introduced, 98% of respondents rejected the proposals. Even if the Government did not listen to them, they might have listened to expert opinion in the field. That expert opinion was sought, but it appears that it was also ignored. Respected bodies, from the Local Government Association and the Law Commission to the largest public sector union in the country, have all voiced their concerns about one Department having control over how local government employees' pensions are invested.

A further criticism of the regulations is that the asset pools created will have no membership representation on the pool governance structures. It should be expected that pension scheme members have some representation in investment decisions, and they should have levers so that their voices are heard. Members of every other pension scheme in the United Kingdom have representatives on the scheme board. The asset pools will hold at least £25 billion of scheme members' pensions, yet they will have no representation in the governance of those pools. When the right hon. Member for Maidenhead (Mrs May) became the Prime Minister, she signalled a drastic shift in Government policy by speaking of putting workers on company boards; she could start here, with local government pension schemes.

The Minister will already know that it is alleged that the regulations are in breach of article 18 of the EU directive on institutions for occupational retirement provision, which states that pension funds must invest in the best interests of their members. The regulations state that LGPS funds will have to be invested in accordance with UK foreign policy. It appears that those two requirements may conflict. It is unconventional for local government employees uniquely to be subjected to such regulations, given that no other scheme is subject to them. The Law Commission has advised the Secretary of State that his Department must implement article 18 for the LGPS. The Secretary of State has admitted that there may be sufficient grounds for a legal challenge.

Whatever happens once article 50 is triggered, and whichever directives get written into UK law, it is not sensible to bring into law regulations that directly contravene European law while we are still a member of the European Union. The regulations became law on 1 November; has the Department received a legal challenge regarding

their implementation? In truth, this is a matter not of political dispute, but of law. The regulations appear to contravene the occupational retirement provision directive under EU law.

I have four questions for the Minister. I understand that he may not be able to answer them directly this afternoon, but I hope that he will commit to writing to me if that is the case. First, why did the Government not take the advice of the scheme advisory board and the Law Commission to revise the regulations and bring them into line with the directive on institutions for occupational retirement provision?

Secondly, does the Minister agree with the legal advice given by the scheme advisory board in 2014, which stated that LGPS members are not afforded the comfort of the Pension Protection Fund and that, in the event of a local authority running out of money, members of the scheme would just become ordinary creditors? Thirdly, has the Minister sent the new regulations and the new transposition table to the European Commission to ensure that the regulations do not contravene obligations under the directive? Finally, the regulations became law on 1 November; has there yet been a legal challenge regarding their implementation?

2.38 pm

The Parliamentary Under-Secretary of State for Communities and Local Government (Mr Marcus Jones): Thank you for allowing me the opportunity to respond, Mr Owen. I am grateful to the hon. Member for Erith and Thamesmead for opening the debate. This is not the first time that many of us have discussed these important issues. I shall once again attempt to tackle many of the misconceptions and reassure scheme members that their pensions are not at risk.

I reiterate that the local government pension scheme is a defined-benefit scheme, for which benefits are guaranteed by statute and are not directly affected by the investment performance of individual funds. Scheme members in different local funds, each with different asset allocations and funding strategies, receive the same level of benefits based on salary and length of scheme membership. Nevertheless, local administering authorities should seek to maximise returns from investments, thereby limiting the risk that town hall pensions would otherwise pose to council tax payers and local services. We have made it clear, on several occasions, that investment decisions must be taken in the best interests of scheme members and taxpayers.

I shall turn now to the main issues raised by the hon. Lady. The regulations are not an attempt by the Government to micromanage pension funds. Under the new investment regulations, administering authorities will be significantly more responsible and accountable for their own investment decisions. They will no longer be constrained by central prescription. We have, for example, removed the limits on the proportion of assets that can be invested in particular ways. With that extra freedom comes a requirement to act reasonably, which brings the scheme broadly into line with private sector ones in that respect and represents a landmark shift in policy.

The power of intervention has been included in the regulations as a backstop power—I reiterate that that is what it is—to protect about £200 billion of assets and 5 million members in the LGPS in the rare circumstances

in which it might be necessary to do so. The regulations include a number of safeguards in the exercise of the power, including full consultation with the relevant authority, to ensure that the power is used appropriately and proportionately. Furthermore, the Government's response to the consultation on the regulations made it clear that the power would be used only where there was clear evidence that an authority was failing to act in accordance with the regulations or guidance.

Let me underline the fact that I respect and understand the strength of feeling expressed by many of the people who responded to the consultation and those who signed the petition that was discussed by hon. Members last month, as mentioned by the hon. Lady. The proper conduct of pensions and pension investments is an important issue that should be of deep concern to us all. That is why, through the regulations, authorities will be required to publish, in their new investment strategy statement, their policies on the types of investment made. Scheme members and taxpayers will be able to scrutinise those statements and hold administering authorities to account.

The hon. Lady mentioned the participation of representatives from individual schemes in relation to pooling, and I hope that I can reassure her by saying that individual schemes will still set their own investment strategy, which will be followed within the pooling structure by the professional investment managers that the pools employ.

Some concern has been directed towards the Government's position on local authority boycotts, divestments and sanctions against foreign nations and the UK defence industry. The investment regulations and guidance allow authorities to take into account non-financial factors, such as social, environmental and corporate governance considerations, when making investment decisions. In doing so, they must still take proper advice, act lawfully and take decisions that are in the best interest of scheme members and taxpayers. The hon. Lady said that that was paramount in relation to investments made by the schemes, and I completely agree. However, authorities must also act in a way that is consistent with UK foreign and defence policy. Such matters are properly addressed by national, not local, Government.

I would like now to take head on the case of Israel and the Occupied Palestinian Territories, which has been raised a number of times in debates over the past months and has clearly been at the forefront of many hon. Members' minds. The UK has a clear position on Israeli settlements in the occupied territories. Settlements are illegal under international law, constitute an obstacle to peace and take us further away from the two-state solution to the Israel-Palestine conflict. The Government recognise that there may be legal and economic risks to investment in the Occupied Palestinian Territories, stemming from the fact that Israeli settlements are built on occupied land and are not recognised as a legitimate part of Israel's territory. The new rules expressly permit administering authorities to take those risks into account when making investment decisions, alongside the non-financial factors that I mentioned earlier, such as social, environmental or corporate governance considerations.

It is important that administering authorities act in line with UK foreign policy. They should only pursue boycotts, divestments and sanctions where formal legal sanctions, embargoes and restrictions have been put in

[Mr Marcus Jones]

place by the UK Government, with whom policy responsibility for such matters should lie. Our guidance on this is no different from that on public sector procurement, which is in turn firmly based on the position in international law.

Another concern that has been raised—I think that the hon. Lady alluded to it—relates to a misconception that the Government intend to use the regulations to compel authorities to gamble scheme members' money away on infrastructure projects. I make no apology whatever for the fact that the statutory guidance that accompanies the regulations makes it clear that authorities should be ambitious in developing their proposals on infrastructure investment, an increasingly important area that is seen as a suitable option for large pension funds with a longer-term liability. Figures published by the LGPS advisory board in 2013 show that only £550 million—0.3% of the scheme's total assets at the time, which were £180 billion—was invested in infrastructure. That falls some way behind other large pension funds that have elected to invest 10% or 15% in the area.

Investing in large-scale infrastructure projects can offer a useful match to the long-term liabilities held by pension funds. Other countries are well ahead of us in their thinking on infrastructure, and it is time we stepped up to the challenge. However, there is no compulsion on a fund to make a certain level of infrastructure investment; that decision is based purely on the fund's circumstances and situation. The fund's overriding objectives must be to get best value and to follow the fiduciary duty that it owes to scheme members.

The allegation that the hon. Lady raised—I think that she acknowledged that it was just an allegation—that the regulations may be unlawful under EU law has been looked at carefully. Our situation is different, because the funds in these pension schemes are not related to the employer involved; they are stand-alone funds. Although they are badged as a local area's pension scheme, those funds are in a secure place where the employers and local authorities cannot access them—there are different rules on how they can be accessed. The legislation to which the hon. Lady refers exists to protect scheme members in pension funds to which the employer has access.

Teresa Pearce: Is the Minister saying that he is under no obligation to send these new regulations to the European Commission?

Mr Jones: We do not believe that the regulations have to be put to the European Commission. As I said, we are putting them in place to give authorities the freedom to invest in any asset class that they think is best, without being constrained by the limits on certain asset classes that were applied under the previous rules. As I have said several times during the debate, we have given repeated assurances that we will not force funds to invest in infrastructure or particular types of infrastructure projects. To protect members and taxpayers, we have set a broad framework for investment decisions in the regulations and guidance and provided the backstop power of intervention that I mentioned.

In addition, the benefits are guaranteed by statute, irrespective of a fund's investment performance. The assets are separated from those of the sponsoring employer,

as I said, which protects the members if the employer fails financially. We are absolutely of the opinion that these extensive protections explain why the LGPS is largely exempt from the directive. The directive increases security for members and safeguards assets from insolvent employers in schemes without such safeguards. In this case, we certainly do not believe the directive applies.

On giving that response, and because of the couple of things I will reply to the hon. Lady on in writing, I will delay the Committee no more.

2.51 pm

Teresa Pearce: I thank the Minister for his comprehensive response. Although I understand that these are DB schemes, my understanding is that they do not enjoy the comfort of the Pension Protection Fund. Therefore, if the scheme runs out of money for some reason, future pensioners will not be safeguarded and will become creditors to the scheme as anybody else would. For that reason, although it is a DB scheme, I do not think that it gives as much comfort as some other DB schemes. That is still a point over which we have some concern.

The other issue that concerns me is that the Minister seemed to intimate that this new power would be scarcely used, which makes me wonder why we need the regulations. He said that, if it was used, it would be in consultation with the local council concerned. If such a move was made by the Secretary of State—interfering in a pension scheme is quite an unusual thing to do—I would like the Minister to make a statement to the House about why that was necessary. Although there is some comfort in some of what the Minister said, we are not fully satisfied.

Mr Jones: If I may, I will pick up on a couple of points. As I said at the outset of the debate, scheme members—the people working in local government and the various other areas that form part of the local government scheme—can rest assured because their pension benefits under the scheme are protected by statute, irrespective of which pension fund their scheme is invested in and regardless of the investment strategy and the returns that the fund has made.

On the backstop provision, the Government have made it absolutely clear that that is to be a backstop power. I would liken it to the current best value provisions that allow the Government to intervene in a local authority should it not be delivering best value for the residents it serves. The hon. Lady will know that the Government have only intervened, in a statutory sense, in five local authorities over the past 15 years or so. It is important to point out that that is an example of a backstop provision. The intention is to use this backstop provision sparingly and only when it is necessary to step in to protect the interests of both the scheme members and the local taxpayers, who might have to step in and bail out the LGPS if the investments are not made in a way that provides the best return from those funds.

The Chair: That was a very helpful but lengthy intervention.

Teresa Pearce: I thank the Minister for his further confirmation that the power will be used sparingly, but one wonders why it is needed in the first place, since we

have people administering pensions whose sole duty is to do what he describes. It is slightly different from the best value provisions.

Mr Jones: Unlike in the 2009 regulations, we are not prescribing the size of investments in particular asset classes and so on. Each individual fund therefore has far more freedom in how it makes investments, but because of that freedom, a backstop position is required, so that the Government can, if necessary, intervene when an administering authority does not deliver on its obligations.

Teresa Pearce: I thank the Minister for his very thorough responses, but I still have so many concerns that I feel we cannot support the regulations. We wish the Committee to divide on the motion.

Question put.

The Committee divided: Ayes 9, Noes 4.
Division No. 1]

AYES

Adams, Nigel
Cartlidge, James
Double, Steve
Doyle-Price, Jackie
Fysh, Marcus

Howlett, Ben
Huddleston, Nigel
Jones, Mr Marcus
Pow, Rebecca

NOES

Foxcroft, Vicky
Lewis, Mr Ivan

Mactaggart, rh Fiona
Pearce, Teresa

Question accordingly agreed to.

2.58 pm

Committee rose.

