DUTIES OF ADMINISTERING AUTHORITIES UNDER THE LOCAL GOVERNMENT PENSION SCHEME

OPINION

1. I am instructed to advise the Local Government Association ("the LGA"). The LGA, on behalf of its members, is concerned to understand, in certain particular respects, the nature of the duties which fall upon the administering authorities of funds established for the purposes of the Local Government Pension Scheme ("LGPS"). This Opinion is by way of confirmation of advice previously given in consultation.

2. The LGPS is a defined benefit scheme, the terms of which are prescribed by delegated legislation made under s 7 of the Superannuation Act 1972. The main current governing instruments are the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007 No 1166), and the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008 No 239). From 1 April 2014 it will be the Local Government Pension Scheme Regulations 2013 (SI 2013 No 2356 – "the 2013 Regulations"), albeit with transitional provisions to protect benefits accrued under the earlier version of the LGPS. The 2013 Regulations are designed in part to satisfy the requirements of the Public Services Pensions Act 2013 when it comes into force. Although there are important differences between the old and new schemes from a benefits perspective, I do not see any changes which would affect the issues discussed in this Opinion. Since the LGA is principally concerned with the position going forward, I shall refer below to the provisions of the 2013 Regulations. Also relevant to the question of investment of scheme funds are the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009 No 3093 – "the Investment Regulations"), which will continue in force after 1 April 2014.

3. Under r.53 of the 2013 Regulations, each of the administering authorities listed in Part 1 of Schedule 3 must maintain a pension fund for the LGPS, and the administering authority is "responsible for managing and administering the Scheme" in relation to any person for whom it is the appropriate administering authority. Under r.2(2), it is also the scheme manager (as provided for by s 4 of the 2013 Act) "responsible for the local administration of pensions and other benefits payable under these Regulations". All of the administering authorities are local authorities, save for the London Pension Funds Authority, the South Yorkshire Pension Authority, and the Environment Agency.

4. There may be, and usually will be, a number of different employers in relation to any given LGPS fund. They may be the bodies listed in Schedule 2 to the 2013 Regulations, or they may be admission bodies[1]. They are required to make the pension contributions and other payments into the fund provided for at r.67 et seq of the 2013 Regulations.

5. The first question I am asked to address in this Opinion is whether the administering authority owes fiduciary duties, and if so, to whom[2].

6. In my view the administering authority does owe fiduciary duties, both to the scheme employers, and to the scheme members. I would accept that, as the Court of Session held in relation to the similar Scottish scheme in *Re Bain* 2002 SLT 1112, there is no free-standing trust apart from the statutory scheme, and therefore that the administering authority is not a

[1] It is possible for separate admission agreement funds to be established, but I understand that this is unusual (if indeed it has occurred at all), and this Opinion is directed to the position of the ordinary fund.

[2] I am aware that there is a pending claim, due to be tried in the early part of 2015, which involves a dispute between a claimant administering authority (Wolverhampton CC) and a defendant contractor/admission body, and in which the counterclaim raises certain issues about alleged fiduciary obligations owed by the claimant to the defendant. There is some potential for any judgment that may be given in this case to affect the issues discussed in this Opinion.

trustee as such[3]. But fiduciary duties are not limited to trustees. A classic case in which fiduciary duties are held to exist is that in which one person administers the property or the financial affairs of another (see the speech of Lord Browne-Wilkinson in *White v Jones* [1995] 2 AC 207). Although not strictly speaking a trust fund, an LGPS fund is closely analogous to one. The way in which it is administered may have a significant financial impact upon employers and members.

7. That is most acutely true, and most immediately apparent, in the case of scheme employers, who are liable to have to pay for mismanagement through increased contributions. But it is also true of members. Whilst a member's statutory entitlement to his or her defined benefits subsists regardless of whether the fund is doing well or badly (and the contributions required of the member do not vary with that performance), it would be naïve to suggest that there is no scope for members to be affected by fund performance. If the fund is doing badly, and employer contributions rise as a result, it is easy to see that the various discretions for which the 2013 Regulations provide are less likely to be exercised in members' favour. Further, as a practical proposition, if the fund is running into severe financial problems and employer contributions threaten to reach unsustainable levels, legislative measures are likely to be taken to curtail benefits or raise employee contributions well before the point of exhausting the fund is reached, regardless of what the position might be if such exhaustion actually occurred[4].

8. I should say, however, that I rather doubt that the existence of fiduciary duties will in this context make very much difference to what the position

[3] The judgment in the earlier Scottish case of *Martin v City of Edinburgh DC* 1988 SLT 329 proceeds on the basis that the LGPS fund is a trust fund, but it seems to me that this is clearly incorrect (and the point does not appear to have been argued).

[4] That is one of the issues to be addressed in further written advice. For present purposes it suffices to say that, whilst I think it unlikely as a matter of political reality that matters would ever be allowed to reach the stage of exhaustion of the fund, there is at any rate a theoretical potential for members' interests to be prejudiced in that scenario.

would be if analysed simply in terms of the obligations imposed upon the administering authority as a matter of public law – notably, the normal *Wednesbury*-type obligations to exercise discretionary powers rationally, for a proper purpose and by reference only to legally relevant considerations. It is well established that the nature and content of a fiduciary duty will vary according to the circumstances of the case and the precise nature of the relationship between the parties: the classic analysis is that of Millett LJ, as he then was, in *Bristol & West Building Society v Mothew* [1998] Ch 1. There is an analogy to be drawn with the recent decision of the Court of Appeal in *Charles Terence Estates Ltd v Cornwall Council* [2013] LGR 97, where the court acknowledged the line of authority which stated that local authorities owe a fiduciary duty to local taxpayers, but nonetheless treated the content of that duty in a manner which was for practical purposes indistinguishable from *Wednesbury* unreasonableness. The defendant authority's contention in *Charles Terence* was that it was free of any obligation to make further payments under certain leases concluded by its predecessors, because those leases were void, having been entered into in breach of fiduciary duty. The alleged breach of fiduciary duty consisted of a failure to have regard to market rents when the leases were concluded. At paragraph 20, Maurice Kay LJ said that the facts, taken at their highest, established significantly less culpability than in cases where breach of fiduciary duty arguments had succeeded. Those had been cases of "eccentric principles" or "flagrant violation" or the making of a gift or present of public money, or of the doubling of ratepayers' financial burden. It was pointed out that it was wrong to seek to justify excessive judicial intervention "by adopting an expansive approach to *vires* and fiduciary duty". Caselaw about *Wednesbury* unreasonableness in the balancing of different interests was said to "resonate" in the context of fiduciary duty arguments as well. In *R (Nash) v Barnet LBC* [2013] EWHC 1067 (Admin) the language of "reckless disregard" of proper financial principles was used to indicate what was necessary to make good a claim of breach of fiduciary duty.

9. One potential difference is that a breach of fiduciary duty is capable of sounding in damages (or at any rate an obligation to pay compensation in equity), whereas a breach of public law, as such, is not. Equitable compensation was described in *Target Holdings Ltd v Redferns* [1996] 1 AC 421 as being designed "to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach." But it is to be noted that acting negligently but in good faith is not a breach of fiduciary duty: see e.g. *Royal Bank of Scotland plc v Chandra* [2011] EWCA Civ 192. It is not necessary for the purposes of this Opinion to consider whether an administering authority owes a duty of care in negligence to scheme employers[5], although in view of the fact that the authority's role is imposed upon it by statute and without any element of profit, this seems to me unlikely.

10. The next issue I am asked to address is how an administering authority may approach the discharge of its functions, and in particular, what considerations may legitimately influence the exercise of investment decisions.

11. The practical context is that the way in which superannuation fund monies are invested is capable of having an impact upon matters with which administering authorities are legitimately concerned in the context of their broader local government responsibilities. Such an impact might be positive or negative. For example:

    (i) Looked at positively, the investment of fund monies might enable or sustain some project or activity which is of benefit to the authority's area. That might be an infrastructure project, it might

[5] I cannot imagine that any such duty is owed to individual scheme members, at least in relation to the general administration of the fund.

be the provision of social housing, or it might be an undertaking offering local employment[6];

(ii) Looked at negatively, there might be certain investments which were thought[7] to be harmful to the broader interests of the authority's area or in its inhabitants – such as their health (e.g. equity holdings in manufacturers of alcohol or tobacco), or their environment (e.g. oil companies engaged in fracking). There might be other cases in which a particular investment was regarded by the administering authority as ethically objectionable (e.g. in a company alleged to be engaged in aggressive tax avoidance, or to be sourcing supplies from factories with inadequate labour conditions).

12. How far can any such considerations legitimately influence the investment decisions of the administering authority (or the instructions which it gives to appointed investment managers)? I shall assume for present purposes that any investment decisions taken would be consistent with the investment policy formulated by the administering authority under r.11 of the Investment Regulations.

13. It seems to me that there are two relevant points to make. The first point is that the power (in fact the duty) to invest fund monies under r.11 is a power of investment. Therefore it must be exercised, when it comes to the discretion to choose one investment rather than another, for investment purposes, and not for some other purpose. This must be right

[6] Some of these possibilities might, in addition to the issues upon which I have been asked to advise, raise questions of state aid. However, there would not normally be unlawful state aid if the so-called market economy investor principle was satisfied i.e. if the public body in question has acted in a way that a private commercial investor would act in a market economy. As will be apparent from the analysis below, if that test was not passed, it is unlikely that the investment would in any case be a proper one for the administering authority to make.

[7] Obviously these are issues upon which views would differ, but an opinion that the activities I mention are harmful in nature would be unlikely to be one which was *Wednesbury* unreasonable in itself.

as a matter of principle, again regardless of whether the situation is analysed in terms of fiduciary duty or in terms of public law principles (or in terms of r.11(2) of the Investment Regulations, which requires a policy to be formulated with a view to suitability and to a wide variety of investments). The same point about purpose was made in *Harries v Church Commissioners for England* [1992] 1 WLR 1241, a case of a statutory obligation to hold and invest assets for certain charitable purposes.

14. It therefore follows that it would be impermissible, for example, for the administering authority to invest fund monies in the local football club, because it was thought important to the area to keep the club afloat, in circumstances in which that was not likely to be a good or prudent investment (as compared with other investments that might be made). Similarly, it would not be permissible to invest in social housing just because there was a need for more such housing, if that was not a good and prudent investment. Nor would it be permissible to exclude from the fund investments to which objection was taken on the sorts of grounds set out in paragraph 11(ii) above, if that was likely to have an adverse impact upon the returns achieved or to lead to the fund being exposed to an unduly narrow and undiversified investment portfolio.

15. The harder question is how far such broader considerations may influence an investment decision where such adverse consequences would not follow. This has been much debated since *Harries* and the earlier decision in *Cowan v Scargill* [1985] Ch 270[8]. Leaving aside the case (irrelevant for LGPS purposes) where all the beneficiaries share a particular ethical position, *Cowan* seems to contemplate that such considerations could only be relevant on a strict "tie break" basis, i.e. where there is absolutely nothing else to choose between two possible investments. However,

[8] Again, *Martin* (see footnote 3 above) is a decision in the specific context of the LGPS, and relating to South African disinvestment, but the judgment is difficult to follow. The council's decision was struck down primarily on the basis that it had been approached in the wrong way.

although the judge in *Harries* said that his conclusions were consistent with *Cowan*, I read the judgment as going a little further, so as to permit wider considerations to be taken into account where to do so would not risk significant financial detriment to the fund.

16. That would in any event be my view of the position in relation to the LGPS. I think that is consistent with r.12(2)(f) of the Investment Regulations, which requires the investment policy to state how far social, environmental or ethical considerations are taken into account. That would be an implausible provision if such considerations were invariably or almost invariably impermissible ones to take into account, and what is a proper consideration must be determined in the light of the statutory scheme as a whole.

17. It therefore follows that the administering authority can in principle have regard to wider considerations where that does not run the risk of material financial detriment to the fund. So, for example, if social housing was a good investment financially, and the precise location was immaterial[9], the authority for the Greater Manchester Pension Fund could in my view choose to invest in social housing in Greater Manchester rather than in Cornwall. Likewise, if tobacco investments were seen as deleterious to the health of the population, they could be avoided if but only if that did not endanger the diversity of investments or the returns likely to be achieved.

18. Nothing I have said above, is in my view, affected by authorities' duties under the s 2B of the National Health Service Act 2006, or under s 149 of the Equality Act 2010. The duty under the former is only to take steps that an authority considers appropriate for improving health. It cannot be appropriate to exercise an investment power in a manner not consistent with the principles above. The administering authority *could* also lawfully decide that it was inappropriate, in that capacity, for it to try to make

[9] Perhaps not a plausible assumption in reality, but useful for illustrative purposes.

difficult judgments about the health implications of investments. The s 149 duty is to have "due regard" to equalities considerations, which again does not require an investment power to be exercised in a way inappropriate from an investment perspective (cf. *R (Lewisham LBC v Assessment and Qualifications Alliance* [2013] EWHC 211 (Admin) at paragraphs 145 to 148). At most, the administering authority might be obliged to have regard to health or equalities implications in cases where it was apparent that there were significant relevant implications of choosing one investment rather than another, and that choice was entirely neutral from an investment perspective: I would expect such situations to be rare, and it would be for the administering authority to judge whether (for example) the choice really was neutral in investment terms.

19. The second point is that, even where it is permissible to have regard to wider considerations when choosing between investments, it still cannot be legitimate for the administering authority to place its own wider interests (whether those of the authority itself, or those of its own area or inhabitants) above those of the other scheme employers, assuming that the administering authority is not itself the sole employer[10]. This is simply an application of the principle that at the core of a fiduciary relationship is a duty of loyalty. The fiduciary cannot, when acting as such, prefer his own interests to those of the party to whom the fiduciary duty is owed, and cannot use his position for his own profit (or not without informed consent). I have no doubt that the same result follows from public law principles of improper purpose and irrelevant considerations.

20. What this means in practical terms is that the administering authority, when acting as such, must be blind to its own wider interests insofar as they may diverge from or conflict with those of the other parties interested in the fund. So it would not be permissible to invest in, say, a

[10] It is unlikely that, so far as this aspect of the discussion goes, there would be conflicting interests as between scheme members and the administering authority.

social housing project in the administering authority's own area, rather than one in the area of another employing authority within the fund, because of that location[11].

21. I think it also follows that the administering authority should not impose its own view on, for example, the desirability of investing in oil companies, if that would differ from views likely to be generally held by other scheme employers and scheme members. For completeness I add that it is equally not open to employing authorities to impose their own views of such matters upon the administering authority. There is no mechanism by which they could seek to do so: investment decisions are for the administering authority to take. Save perhaps in the rare cases mentioned at the end of paragraph 18 above, the administering authority is in my view under no legal *obligation* to consider investment decisions from any perspective other than the maximisation of returns, whatever precise scope there may be for it to take account of wider matters if it chooses to do so.

CONCLUSIONS

22. In managing an LGPS fund, the administering authority has both fiduciary duties and public law duties (which are in practice likely to come to much the same thing).

23. The administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the fund (balancing risk and return in the normal way).

[11] Obviously the location would not preclude the investment if that project was chosen simply because it was the best investment proposition.

24. However, so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund. In taking account of any such considerations, the administering authority may not prefer its own particular interests to those of other scheme employers, and should not seek to impose its particular views where those would not be widely shared by scheme employers and members (nor may other scheme employers impose their views upon the administering authority).

25. I shall be pleased to give my Instructing Solicitor any further advice which may be required.

NIGEL GIFFIN QC

11KBW

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11 King's Bench Walk
Temple
London EC4Y 7EQ

IN THE MATTER OF
THE LOCAL GOVERNMENT
ASSOCIATION

AND IN THE MATTER OF
ADMINISTERING AUTHORITIES
UNDER THE LOCAL GOVERNMENT
PENSION SCHEME

OPINION

Thelma Stober
Corporate Legal Adviser
Local Government Association
Local Government House
Smith Square
London SW1P 3HZ