

CIPFA Pensions Network Workshop

Fiduciary Duties of Investment Intermediaries

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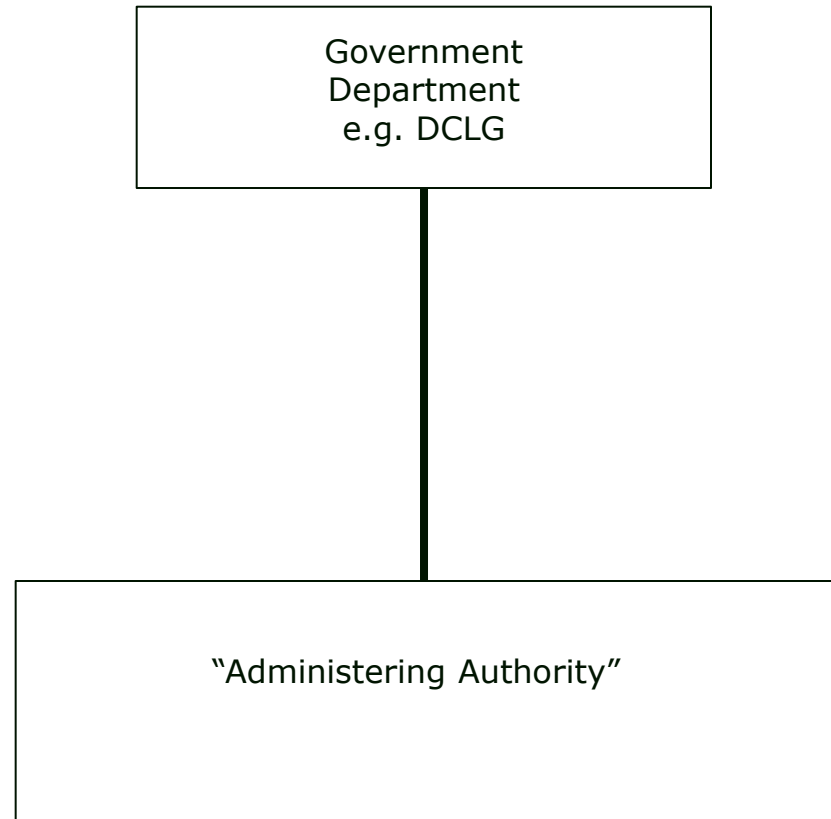
7th and 10th October 2014



Agenda

- Role of the Administering Authority
- Fiduciary Duties
- LGA Opinion
- Law Commission Report
- Impact of LGPS Reform

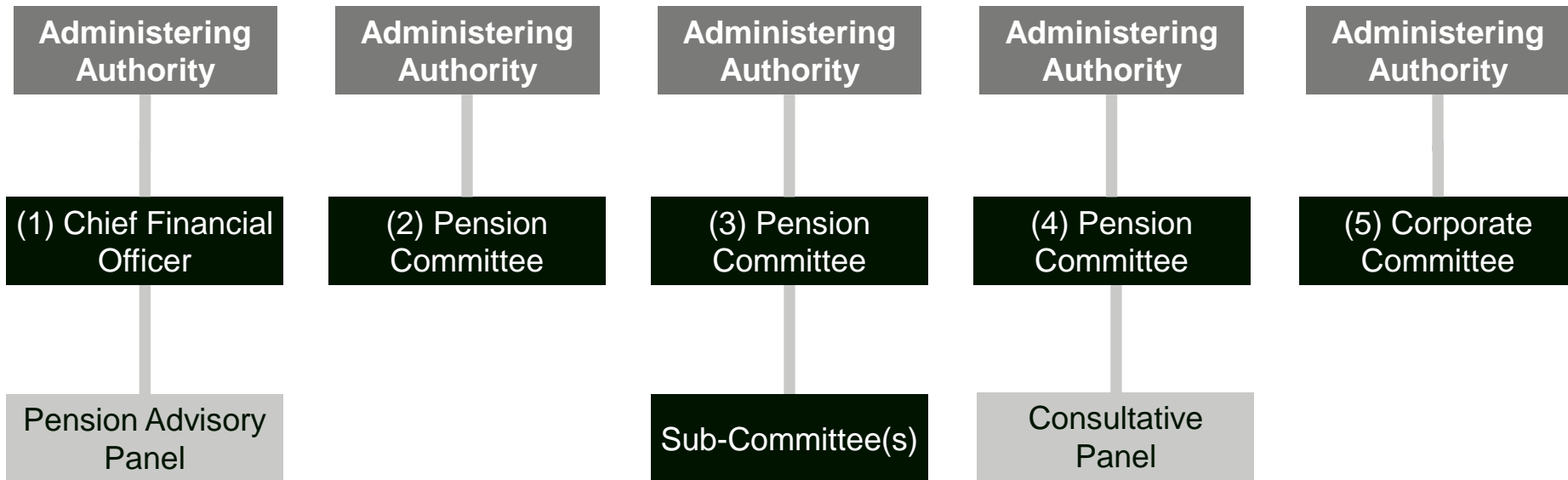
Current LGPS Governance Structure



Role of Administering Authority

- LGPS is statutory not a trust based scheme
- Administering Authority has a corporate legal identity separate to its elected members
- Responsibility for managing and administering its fund - LGPS Regulations 2013
- Responsibility for the investment of the Fund - LGPS (Management and Investment of Funds) Regulations 2009
- Power (under local government law) to delegate its functions

Delegation of LGPS Decision Making



Advisory

Decision maker

Role of Administering Authority

- Delegation does not remove the council as the administering authority
- LGPS not a trust based scheme - often described as “quasi trustee”
- Does the administering authority owe a fiduciary duty?

Fiduciary Duties

- Confusing and inaccessible
- “legal polyfilla” - Moulds around other legal structures filling the gaps
- Sits alongside other statutory, equitable and common law duties a fiduciary owes
- Distinguishing duty of loyalty
- May be varied by contract
- May be read subject to regulatory rules



Fiduciary Duties

- Duties not limited to trustees
- Exists where one person administers the property of finances of another
- LGPS fund is analogous to a trust
- How it is administered may affect employers and members
- Fiduciary duties likely to apply to administering authorities

Fiduciary Duties

- Employers 'fund' mismanagement of a fund
- Members also directly or indirectly affected
- However public law obligations have similar effect
- *Wednesbury*-type obligations to:
 - exercise discretions rationally
 - for proper purpose
 - by reference to legally relevant considerations

LGA Opinion

- Particularly relevant to investment of LGPS funds
- Opinion commissioned by LGA on behalf of Scheme Advisory Board
- Issued March 2014
- What considerations may influence exercise of investment decisions?

LGA Opinion - Findings

- Duty to invest fund monies (Inv Reg 11)
- Must be used for that purpose and not for some other purpose
 - Not invest in social housing because of a need for more housing – if not a good and prudent investment
 - Not exclude investments e.g. on grounds of social, ethical or environmental reasons if it would have an adverse impact on returns

LGA Opinion - Findings

- Can wider considerations influence decisions?
- Yes – where no risk of material financial detriment to the fund
 - Social housing good financial investment
 - Location is immaterial
 - Could prefer local investment
- Not place own interests above other employers
- Not impose own views not shared by other employers or members

LGA Opinion - Summary

- Administering Authority has both fiduciary and public law duties (in practice same thing)
- Power of investment must be used for investment purposes
- May be influenced by wider environmental, social or governance (“ESG”) considerations
- Only where no material financial detriment to the fund

Law Commission Report

- Kay Review July 2012 – Review of UK equity market
- Uncertainty and misunderstanding of fiduciary duties by trustees and advisers – focus on short term returns
- Recommended review by Law Commission of fiduciary duties

Law Commission Report

- November 2012 – Kay Report accepted by Government
- March 2013 - Report commissioned by BIS and DWP
- July 2014 – Report published

Law Commission Report – Fiduciary Duties

- Law confusing and inaccessible
- Not advocate codifying the law
- Recommend TPR endorses LC's conclusions
- Useful guidance - distinguishes
 - Financial factors – relevant to primary investment duty to balance return vs. risk
 - Non-financial factors – ESG considerations

Law Commission Report – Fiduciary Duties

- ESG factors can be financially material
 - Risk of litigation in tobacco industry
- Non-financial factors such as ESG may be taken into account if:
 - Good reason to think members share the concern; and
 - Decision does not involve risk of significant financial detriment

Law Commission Report – LGPS

- Recognises statutory powers and duties of LGPS
- No specific duty to invest in best interests of the scheme members in Investment Regulations
- Institutions for Occupational Retirement Provision (“IORP”) Directive Article 18(1) imposes a “best interests” duty – direct application to LGPS?
- LGA opinion consistent with Commission’s views on trustees

Law Commission Report

– LGPS Recommendations

- Likely that rules similar to those that apply to trust-based schemes apply to LGPS
- Recommendation that Investment Regs are amended to introduce explicit best interests duty in accordance with Article 18(1)
- Review requirements to appoint investment managers on short term basis
 - one month notice
 - three monthly reporting requirements

Law Commission Report

– Other Recommendations

- Review of private sector Investment Regs
 - Exemptions for schemes with less than 100 members
 - Review references to social, environmental and ethical considerations in SIP
- Government to review whether trustees should state their policy on stewardship
- IGCs to statutory duty to members to act with reasonable care and skill in members' interests

Law Commission Report

– Other Recommendations

- Government to review in 2017 if default fund cap has incentivised trading over long term investment
- Government to consider extending S138D of FSMA to give greater rights to sue intermediaries for breaches of FCA rules

Law Commission Report

– Rest of the Investment Chain

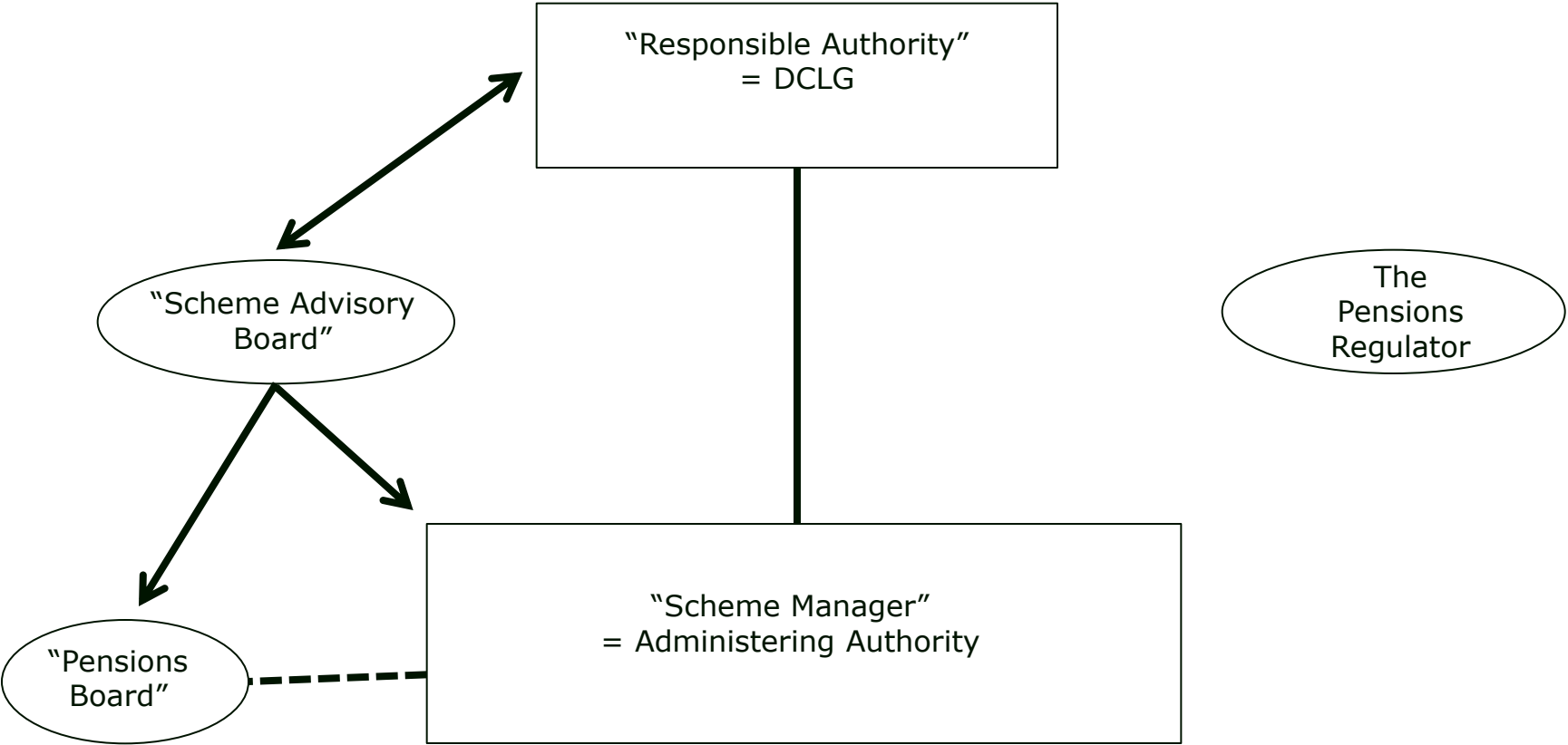
- No recommendation to review regulation of investments consultants but Government to actively monitor this area
- Stock lending fees to be reviewed in 2017 – review risks, disclosure and requirements for transparency and controls
- Government to review system of intermediated shareholdings

Law Commission Report

– Summary

- Published July 2014
- Await Government's response
- Specific issue for LGPS – impact in practice?
- Likely amendments to Investment Regulations
- Many wider issues too
- Greater practical clarity on fiduciary duties

Impact of New LGPS Governance?



New LGPS Governance

- Administering Authority must establish Local Pension Board for each LGPS fund by 1 April 2015
- To assist Administering Authority in securing compliance with LGPS regulations and Regulator requirements
- Not change role of the Administering Authority
- Remains decision maker and subject to fiduciary duties
- Local Pension Board non-decision making role

Any questions?





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