The Local Government Pension Scheme Advisory Board

Supreme Court decision on LGPS investment guidance

Summary

In a judgment handed down on 29 April 2020, the Supreme Court has ruled by a narrow majority that the Secretary of State for Housing, Communities and Local Government exceeded his powers when issuing guidance in 2016 to Local Government Pension Scheme (**LGPS**) administering authorities which purported to prohibit the adoption of investment policies that are contrary to UK foreign policy or UK defence policy.

Background

- 1 November 2016 - The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the **2016 Regulations**) come into force setting out the provisions governing the management and investment of LGPS pension funds by administering authorities. Regulation 7(1) of the 2016 Regulations provides for the formulation by administering authorities of an investment strategy statement in accordance with statutory guidance.

- 1 November 2016 - As envisaged by the 2016 Regulations, statutory "Guidance on Preparing and Maintaining an investment strategy statement" issued by the then Department for Communities and Local Government came into effect. The guidance permitted ethical and social objections to a particular investment to be taken into account. However, it expressly stated that it was "inappropriate" for administering authorities to use pension policies "to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries…other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government", and that LGPS funds "should not pursue policies that are contrary to UK foreign policy or UK defence policy". This restriction would have operated even if the proposed investment policy did not involve significant financial risk to the fund and irrespective of whether there were reasonable grounds to believe that it would be supported by members.

- June 2017 - A judicial review challenge was brought by Palestine Solidarity Campaign Ltd and a LGPS member, alleging that the Secretary of State had gone beyond the scope of the powers granted to him under the 2016 Regulations by including these passages in the guidance. The High Court agreed, finding that the powers provided by the legislation could only be exercised for pension purposes and that the Secretary of State had not acted for such a purpose when issuing the guidance.

- July 2017 – The Department reissued the guidance with the relevant passages removed.

- June 2018 - The Secretary of State appealed the decision and the Court of Appeal disagreed with the High Court allowing the appeal. The decision found that there was nothing objectionable in the Secretary of State having regard to considerations of wider public interest, including foreign policy and defence policy, in formulating such guidance. However, the Department did not revise the guidance at that point because leave to appeal the Court of Appeal decision was granted.

- April 2020 – Supreme Court decision on the appeal by the Palestine Solidarity Campaign Ltd and a LGPS member against the Court of Appeal decision was published.

Purpose of the summary

This summary seeks to clarify the direct legal impact of the Supreme Court's judgement in relation to investment guidance issued by the Secretary of State. It also includes items of interest from the

court's reasoning in reaching its judgement that may inform the thinking of both scheme stakeholders and government in the future.

The Decision and its Direct Impact

Essentially, the Supreme Court had to answer the following question: is the power granted to the Secretary of State under the 2016 Regulations wide enough to entitle him to issue guidance which effectively prohibits LGPS administering authorities from pursuing policies that are contrary to UK foreign or defence policy? If that power is not wide enough to allow the Secretary of State to issue guidance in such terms, then it was unlawful for him to do so.

By a 3-2 majority, the Supreme Court found that the Parliamentary purpose in conferring the relevant power on the Secretary of State was to enable him to provide guidance about how administering authorities should administer and manage the LGPS funds, and how, within the investment strategy, they should take ethical considerations into account.

However, the Court found that in the contested passages of the guidance, the Secretary of State had, according to Lord Wilson, incorporated something quite different: *"an attempt to enforce the government's foreign and defence policy"*.

The outcome of the decision is that the Secretary of State went beyond his powers by including the contested passages in the guidance. The reissued guidance from July 2017 (with the relevant passages removed) remains valid.

The judgement does not change the fundamental duties and responsibilities of LGPS administering authorities in relation to their investment or other powers. The administering authorities remain responsible for investment decisions.

Potential Indirect Impact of the Decision on MHCLG Guidance

Although the decision did not challenge the validity of any extant guidance (in fact comments made by the Court do not challenge the status of the investment guidance outside of the contested passages), the Court's reasoning may impact on the nature of future guidance issued by the Secretary of State.

Section 3 of the Public Service Pensions Act 2013 (the **2013 Act**) enables the responsible authority to make, subject to the Act, such regulations as they 'consider appropriate'. Schedule 3 of the Act sets out the matters for which regulations may make provision these include, at paragraph 12, the "*administration and management*" of schemes, including for the issue of guidance or directions in that regard.

The Supreme Court found that the policy of the 2013 Act, recognised in the case of the LGPS by the 2016 Regulations and indeed by most of the guidance, is for guidance to identify procedures and the strategy which administering authorities should adopt in the discharge of their functions.

However, Lord Carnwath states that the scope of statutory guidance does not necessarily have to be *"confined to purely procedural or operational matters"*. For example, there is no reason *"why the guidance should not extend to guidance on the formulation of the investment strategy, including the social and other matters appropriate to be taken into account."*

Whilst the Secretary of State had the power, through guidance, to direct how administering authorities should approach the making of investment decisions by reference to non-financial considerations, the Secretary of State did not have the power to *"direct (in this case for entirely extraneous reasons) what investments they should not make" (Lord Wilson).* In doing so, the Secretary of State went beyond his powers.

The Supreme Court's comments could have wider implications for MHCLG should it wish to consider using statutory guidance to mandate how LGPS administering authorities should act in the future. Although the actual impact of these comments will vary from case to case such action may in future require changes to the relevant regulations governing the LGPS.

Other Points of Interest in the Decision

Investment Issues

Following the Supreme Court's decision, it is now clear that current legislation does not permit the Secretary of State to impose the government's view on foreign and defence policy on LGPS administering authorities.

Whilst the Board has not been made aware whether any LGPS funds are in fact actively seeking to formulate ESG policies which would run counter to UK government policy in these areas, we now have certainty that, subject to compliance with the reminder of the guidance, it would be lawful for them to do so.

None of the judges take issue with the section of the guidance dealing with the extent that administering authorities can take social, environmental and corporate government factors into account when making investment decisions. Lord Wilson specifically notes that there is general acceptance that the criteria proposed by the Law Commission are lawful and appropriate and that administering authorities may take non-financial considerations into account where this would *"not involve a risk of significant financial detriment"* and where the administering authority has *"good reason to think that scheme members would share the concern."*

Fundamentally, the decision does not change the role or duties of administering authorities in relation to their investment or other powers and confirms that the administering authority remains responsible for investment decisions.

Status of Administering Authorities

The judgment confirms that a local authority, when acting in its role as an administering authority of an LGPS fund, should not be viewed as part of the machinery of the state, acting on behalf of the UK central government.

There is express endorsement by Lord Wilson of the view that administering authorities have duties which are "*similar to those of trustees*" and, of Lord Carnwath, that they are "*quasi-trustees*" of their funds. References to quasi-trustees would appear to be taken straight from statements in the Law Commission report that "*in practice administering authorities consider themselves to be quasi-trustees*". The Law Commission report does not go further than this, other than quoting some LGPS fund materials to support the statement.

However, the term "quasi trustee" has no clear legal definition in pension legislation (public or private) and therefore we should be careful not to read too much into this statement with regard to the legal status of administering authorities other than they have duties which are similar to trustees.

Importantly, the judgment does not suggest that administering authorities are actual trustees and does make it clear that the LGPS is a statutory occupational pension scheme[1] not a trust-based pension scheme.

Are LGPS Funds Public Money?

In pursuing an argument that administering authorities were part of the machinery of state, MHCLG also argued that LGPS funds are "*public money*". What MHCLG appear to have argued is that because LGPS funds are ultimately funded by the taxpayer, they are effectively the government's money and therefore the government has the power to direct how those funds should be used via guidance.

Lord Wilson rejected this argument, quoting Sir Nicolas Browne-Wilkinson VC from the Imperial Tobacco case[2], making the point that contributions are paid by both employees and employers and that employer contributions are made in consideration of the work done by their employees and so represent another element of the employees' overall remuneration.

Lord Wilson came to the conclusion that LGPS funds should rather be viewed as representing employees' money rather than public money.

This comment may be at risk of being taken out of context and should not be interpreted as meaning that LGPS funds are owned or controlled by the members. It is clear elsewhere in the judgement that the LGPS is a statutory pension scheme and that the primary responsibility for delivering the functions of the LGPS rests with its administering authority.

There is no suggestion that the assets of an LGPS fund legally vest in anybody but the administering authority. We do not believe that Lord Wilson was making such a suggestion. In fact, Lord Carnwath specifically states that, "*responsibility for investment decisions thus rests with the administering authorities*".

Conclusion

Although the judgement was primarily concerned with the exercise of the Secretary of State's powers, comments made by Lord Wilson and Lord Carnwath may be viewed as providing support for ensuring that, when taking non-financial considerations into account in relation to investment decisions, members' views should be effectively communicated to, and considered by, administering authorities as an intrinsic part of their investment decision making processes.

Otherwise, the judgement does not change the fundamental role or duties of LGPS administering authorities in relation to their investment or other powers and confirms that administering authorities remain responsible for the investment decisions of their respective funds.

8th June 2020

1 Paragraph 4 of the judgement.
2 Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd [1991] 1 WLR 589, 597