<u>Commentary on issued DCLG guidance on Investment Strategy Statement</u>

DCLG guidance on what the new Investment Strategy Statement ("ISS") should contain has recently been published, reflecting the revised Investment Regulations which were consulted on last autumn and are expected to become law shortly. It also covers the powers of the Secretary of State to direct an LGPS Fund's affairs if DCLG guidance, including this document, is not followed.

The guidance is broadly in line with that published at the time of the consultation. **Many of the current prescriptive investment regulations are to be abandoned in favour of a prudential approach**, which has to be welcomed. It also makes it slightly clearer what investment functions the administering authorities will remain responsible for after pooling: "policy on asset allocation, risk and diversity[1], amongst other things" is the precise wording.

The ISS will need to be a comprehensive document, covering not only investment, appetite for risk, stewardship, and ESG approach, but also compliance with the pooling criteria. I have noted the following points which may be worthy of attention:

- **The Government has softened its approach to the pooling criteria**, saying that an authority must demonstrate that it meets them, or that 'to the extent that it does not, the Government is content for it to continue.' That appears to allow a loophole on size, for example.
- **The need to take advice is stated throughout this guidance**. This can presumably be met by using either an investment consultant or an independent advisor, or by advice from the pool itself.
- The ISS will need to explain the extent to which the views of the local pension board and other interested parties are taken into account when taking investment decisions on non-financial factors. It is not clear whether 'other interested parties' includes, for example, lobby groups or petitioners.
- Policy contrary to foreign policy or UK defence policy is not allowed. From the wording of the guidance, this includes a ban on any divestment from UK defence industry, for example.

With a prudential framework, it is understandable that there is need for a safeguard in case an administering authority is failing. The guidance has included new measures to make this power usable only in an appropriate and proportionate manner. **This includes a new requirement on the Secretary of State to take into account any report by the relevant Local Pension Board** as well as the actuary**.**

The bottom line remains, however, that the Secretary of State still has the powers to direct a fund if the administering authority is found not to have followed appropriate regulations or guidance, and a future government may interpret this more harshly than the current one[2].

William Bourne 23rd September 2016

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[1] I suspect they mean diversification, not diversity here

[2] As an example, if the current economic sanctions against Russia, currently covering primary and secondary investment in selected Russian defence companies, were to be extended to cover all quoted companies, would that mandate the fund and its managers to sell Russian investments immediately, regardless of the financial impact? And would disobedience allow the Secretary of State to direct the fund?