FINANCING AND REGULATION OF 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, along with a previous Opinion of 25 March 2014, is by way of confirmation of advice previously given in consultation.

2. I have referred in the Opinion of 25 March 2014 to the legislation which governs the LGPS, in particular now the Local Government Pension Scheme Regulations 2013, and to the role of the administering authority, and I need not repeat those matters here.

3. This Opinion is concerned specifically with two issues. The first relates to the ultimate responsibility for the payment of LGPS benefits. The second concerns the relevance to the LGPS and its regulation of Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision, often known as "IORP I".

Responsibility for the payment of benefits

4. The LGPS is organised into distinct funds. Aside from employee contributions, which are made at a fixed rate (set out in r.9 of the 2013 Regulations) regardless of the state of the fund, and any positive growth achieved through investment, the fund is financed essentially by payments from the scheme employers. Principally this means contributions, set at a percentage of the pensionable earnings of active members. That

percentage will be set every 3 years by the scheme actuary by way of a rates and adjustments certificate under r.62, obviously with a view to the fund being able to meet members' entitlements under the scheme. When an employer ceases to be a scheme employer, or to have active members (which means it will cease to make contributions – see *R (South Tyneside MBC) v Lord Chancellor* [2009] ICR 1352), it must make an exit payment under r.64, to meet the anticipated cost of the benefits of its current and former employees. Where the exit payment cannot be recovered from the exiting employer, the equivalent sum must be recovered from the remaining scheme employers through revised contributions[1].

5. It follows that, for so long as there is at least one solvent employer which employs active members, the fund should in principle be able to obtain the monies that it needs. Whilst it is theoretically possible that a time might come when there were no active members[2], and thus no further ability to call for employer contributions, this is highly unlikely so long as something akin to the current legislation remains in force – since local authority employees have a right to join the LGPS, and it continues to represent an advantageous form of pension provision from the employee perspective.

6. Further, the covenant of a local authority employer is by any normal standards extremely strong. Not only do local authorities typically have very considerable turnover, assets and reserves, they are in receipt of very substantial government revenue grants, and they have tax-raising powers of their own.

---

[1] The existence of this provision renders it less necessary to consider how far the setting of ordinary employer's contributions, as adjusted, should take account of the deficit in the fund generally, as opposed to the deficit attributable to the service of members with the particular employer in question.

[2] And as I read the 2013 Regulations, the last exiting employer would only have to make an exit payment that related to its own former employees, even if that left a deficit in relation to other members (e.g. because investment performance had proved worse than had been anticipated when exit payments were made by their employers).

7. Nonetheless, it is perhaps not so obvious as it once was that all local authorities will always have the ability to pay whatever LGPS contributions are required, whenever they fall due[3]. It is notoriously the case that authorities are experiencing a period of extreme financial stringency. Concerns have been expressed as to whether some smaller authorities, and even some large ones, will continue to be able to discharge all their mandatory statutory obligations within their available resources. Additionally, there are some constraints as to the extent to which an authority may increase its council tax (if it is a billing authority – or its precept if it is a precepting authority). The nature of those constraints has varied from time to time. At the moment, Chapter 4ZA of Part I of the Local Government Finance Act 1992 means in essence that, if a proposed level of council tax is "excessive" in accordance with principles determined by the Secretary of State, it may not be implemented unless approved in a local referendum.

8. It is thus not inconceivable that some combination of increasing longevity and poor investment performance, coupled with more general adverse financial conditions for scheme employers, might push required contributions up to a level that the remaining employer or employers could not readily pay – especially if insolvency or the termination of active membership had eliminated contributions from employers other than local authorities.

9. In principle, an employer authority which could not otherwise meet its contributions would need either to reduce other expenditure, or to raise council tax or draw upon reserves, to the extent necessary to meet its obligations in that respect. However, it is at least theoretically possible to imagine some future situation in which reserves were effectively

[3] I have been asked in general terms about the status of the Environment Agency as both an administering and an employing authority under the LGPS. In general, what I say in this Opinion about local authorities would apply to the Environment Agency as well (paragraph 22 below may be an exception). If there are any specific queries that arise in relation to the Environment Agency, I shall be happy to address them further.

exhausted, discretionary expenditure had been cut to negligible levels, and the level of required contributions (including exit payments in the event of insolvency on the part of the exiting employer) had reached a point at which it exceeded anything that could be met within the limits of whatever legislation then governed council tax increases (or perhaps the limits of what the authority could in practice raise from local taxpayers regardless of the legal position). Even short of that point one can imagine that there might be limits to how far an authority's elected members would in practice be willing to cut other services or raise council tax in order to pay LGPS contributions. If this was merely a short-term issue, it would no doubt be dealt with by some sensible rescheduling of contributions, but it is possible that the problem might be more systemic than that.

10. I must say that, from a political as opposed to a legal perspective (and for what my views from such a perspective may be worth), I find it well-nigh inconceivable that central government would allow matters to reach the stage of a complete collapse in local authority finances, and default upon authorities' legal obligations, without undertaking some form of intervention first. What that intervention might look like is another matter: it might involve, for example, legislation to reduce LGPS benefits rather than, or as well as, the provision of additional finance. Subject only to such constraints as might be imposed by the Insolvency Directive (see paragraph 20 below) or by the European Convention on Human Rights[4], it would be a matter for the government and (potentially) Parliament to decide how to address such a crisis.

[4] Accrued pension rights will usually amount to possessions within the meaning of Article 1 of the First Protocol to the ECHR, so that any interference with them (e.g by legislation reducing the level of benefits payable in respect of past service) would have to be justified. But financial crisis might in principle constitute such justification, although the test might well be stringently applied in such a context: see e.g. the discussion in *R (Public and Commercial Services Union) v Minister for the Civil Service* [2011] IRLR 903.

11. Nonetheless, I am asked to consider what the legal position would be in the absence of such intervention. I shall do so by reference to three questions that have been raised with me.

12. The <u>first question</u> is what the rights and duties of the administering authority are, as against an employing authority which fails to pay contributions as they fall due. In my view it is reasonably clear that the 2013 Regulations operate so as to make those contributions a statutory debt, for which the administering authority could sue in the ordinary courts[5]. I also consider that the administering authority is in principle obliged to take such steps as are open to it, including by way of litigation, in order to recover unpaid contributions. This must follow from its fiduciary and public law duties. I do not mean to suggest that the administering authority has to issue a claim form the moment that an employer fails to pay its contributions on time: there may be sensible reasons for not doing so, in particular if the default is the result of a temporary problem which will shortly be remedied. But ultimately the administering authority must behave in much the same way as any creditor in an arm's-length relationship with its debtor would behave[6].

13. I would add that under r.71 of the 2013 Regulations the administering authority is empowered to require interest to be paid on contributions that are overdue by more than a month. This is a discretionary power, so its exercise is evidently not to be automatic. Amongst other possible considerations, the reason why the contributions were paid late might well be material (e.g. if the delay resulted from administrative error, or a

[5] In *Tees Conservancy Commissioners v James* [1935] Ch 544 that was held not to be the case in relation to employee contributions, to the fund established under the Tees Conservancy Act 1907. But that was in my view the result of the fact that the Act provided for the deduction of contributions from wages, and contained no indication that they were liable to be paid in any other way. By contrast, r.67 of the 2013 Regulations imposes clear obligations upon the employer to contribute and to pay.

[6] Some mention was made in consultation of the possibility of powers being exercised by the Pensions Regulator. So far as I can see, however, the LGPS is taken outside the scope of the most obviously relevant tPR powers (e.g. under ss 38 and 43 of the Pensions Act 2004) by virtue of being prescribed by delegated legislation.

genuine issue about the amount properly due). Nonetheless, my view is that the administering authority should normally exercise the power to charge interest, certainly where the employer has simply failed to pay on time. Again, this seems to me to flow from the administering authority's fiduciary duty or similar public law duties: it should generally seek to maximise the financial resources of the fund, and it is not right that the cost of late payment (or the lost benefit of having the money for longer) should rest with the fund rather than with the defaulting employer.

14. The <u>second question</u> is what happens if the assets of the fund are insufficient to pay benefits as they fall due. Is there an "ultimate guarantor" of the benefits payable to scheme members, whether the administering authority or central government?

15. So far as the administering authority is concerned, the question is whether it would under those circumstances be under an obligation to make the payments from its own resources apart from the fund. Except perhaps in the short term, the question of whether the administering authority was obliged to pay benefit entitlements out of its own general resources should only be of practical significance if that authority had ceased itself to be an employer of active members (otherwise, the same result would simply follow indirectly, because of the increase in its contributions that would be required[7]). If the administering authority could not afford to pay its contributions as an employer, then recharacterising its obligations as ones owed in the capacity of administering authority would not help to extract money from it that it did not have.

16. But if the point was reached at which the issue did arise, my view is that the administering authority would owe no obligation to pay benefits to members otherwise than out of the assets of the fund. I say that for the following reasons:

[7] Subject to the possibility that the raising of its contributions might have to wait until the next triennial review.

(i) There is nothing in the language of the Regulations which in terms imposes such an obligation. Given its potentially very burdensome nature[8], one would have expected any such obligation to be clearly and explicitly imposed. For the most part[9], the provisions which confer an entitlement to benefits are couched simply in the language of being entitled to payment of a pension, which leaves open the question of what person or assets that entitlement is enforceable against. Putting the point another way, they are not expressed in terms of a right to be paid monies by the administering authority, or in terms of the administering authority being under a duty to make such payments;

(ii) Rather, the role of the administering authority is said to be one of management and administration;

(iii) The whole concept of a segregated fund tends to suggest that it is from the fund that the relevant payments are to be made. This is consistent with r.4 of the Investment Regulations, which regulates the payments that may be made into or out of the fund, and with the provisions regarding employer contributions and payments, which are clearly intended to meet benefit liabilities without further payments by the administering authority (even if it is possible to conceive of circumstances in which that intention might not be fully achieved);

(iv) It is true that an LGPS fund is not a trust fund as such, so that if looked at strictly in terms of ownership there is no distinction between the assets of the fund and the other assets of the

[8] The administering authority will often also be the largest employer for its fund, but that is not invariably the case, and the liabilities attributable to other employers may certainly be very substantial.

[9] An exception is to be found in r.40 of the 2013 Regulations, which says that the administering authority "shall pay a death grant". But I do not think that this relatively peripheral case should drive the interpretation of the Regulations as a whole.

administering authority: see *Re Bain* 2002 SLT 1112[10]. But the administering authority is certainly not entitled to treat the money in the fund as if it was simply its own money (cf. *Walter v Eton RDC* [1951] 1 KB 84). Conversely, it is not in my view obliged to treat fund liabilities as if they were its own general liabilities. It is notable that there are references in the legislation to the "liabilities of the main fund" (r.54(4)(a) of the 2013 Regulations) and to the "solvency of the fund" (s 13 of the 2013 Act, and r.62(5) of the 2013 Regulations). It is possible for there to be a liability on a person to pay which is properly analysed as a liability to pay out of a particular fund: see e.g. *Salford Corporation v Lancashire CC* (1890) 25 QBD 384 at 388;

(v) Accordingly, my view is that the 2013 Regulations should be interpreted as meaning that the administering authority has to manage the fund by paying out of it the benefits to which members are entitled, but not as imposing upon the administering authority an obligation to pay those benefits by other means[11];

(vi) I would add that, if the administering authority could see that the fund would at some point in the future be exhausted, it would nonetheless in my view be obliged to keep paying benefits in full as they fell due, until there were no assets left from which to do so. I can see nothing in the statutory scheme which would allow the administering authority, for example, to pay reduced benefits with a view to being able to make payments for longer or to more members;

---

[10] 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).

[11] I note that Mr Furness QC, in the opinion referred to below, comes to what I understand to be the same conclusion at paragraph 4.

(vii) I have been asked what recourse members might have in the event of non-payment of benefits by the administering authority. If the money was in the fund to pay benefits, then the members could sue for payment. If there was no money in the fund, it may be that a member could obtain a judgment for unpaid benefits, but I would expect any such judgment to be in terms that made it clear that it was enforceable only against assets in the fund, which would mean that it could not in practical terms be enforced unless the position changed. If the administering authority was failing to take all available and sensible steps to get in to the fund monies due from employers or other debtors, then I would expect members to be able to take action to compel it to do so, whether by judicial review or otherwise.

17. For completeness, I note a point which was mentioned to me in consultation, in that there is one administering authority which is a body established for that purpose and no other, namely the South Yorkshire Pension Authority ("SYPA"), established by the Local Government Reorganisation (Pensions etc) (South Yorkshire) Order 1987 (SI 1987 No 2110)[12]. The point made to me is that SYPA has a levy-raising power, and that it was hard to see why such a power should be conferred unless it was because SYPA might have an obligation to pay benefits not limited to what could be met out of the fund (the suggestion being that other administering authorities did not need such a power because they were authorities with tax-raising powers). However, examination of article 4 of the Order shows that the expenditure of SYPA which may be recovered by this means is limited to expenditure and costs which may *not* be paid out of the fund: see article 4(3). In other words, it is talking about administrative expenditure, and not expenditure on benefits. If anything, therefore, the point supports the conclusion expressed in paragraph 16 above: apart from requiring contributions to the fund in the normal way,

[12] The position of the London Pension Funds Authority is rather different.

SYPA has no means of raising money to pay benefits, and that tends to confirm that an administering authority has no obligation to pay benefits otherwise than out of the fund.

18. Turning to central government, in my view it is not in any direct way the guarantor of, or ultimately responsible for the payment of, LGPS benefits. Neither in the 2013 Regulations, nor in the Superannuation Act 1972 under which they are made, nor in the Public Service Pension Schemes Act 2013 is any such obligation to be found. I am not aware of any statement of commitment by the government which might found a legitimate expectation in public law (and such an expectation is not in any event the same as an absolute legal obligation, departure from it also being capable of being justified by an overriding public interest).

19. It is right to mention that in *Tamlin v Hannaford* [1950] 1 KB 18, Denning LJ said in relation to a statutory corporation (the British Transport Commission) that "the taxpayer is the universal guarantor of the corporation", that its business could not otherwise continue, and that it was this guarantee which rendered shares, debentures and the like unnecessary. A local authority is also a corporation created by statute. But I do not consider that Denning LJ was laying down some sort of legal principle that the Crown was liable to secure the performance of the obligations of the BTC or any other statutory body. Rather, he was describing how things worked from a political or business perspective (in the context of holding that the BTC was nonetheless not a servant or agent of the Crown): see e.g. his comment that the taxpayer "would no doubt be <u>expected</u> to come to its rescue before the creditors stepped in" (emphasis supplied).

20. It is also true that the government would have to comply with its obligations under the Insolvency Directive (Directive 80/987/EEC), as interpreted by the European Court of Justice in C-278/05 *Robins v Secretary of State for Work and Pensions* [2007] ICR 779 and more

recently in *Hogan v Minister for Social and Family Affairs* [2013] 3 CMLR 27. Article 8 of the Directive requires member states to take the necessary measures to protect the interests of (former) employees in respect of pension rights upon employer insolvency. Since the LGPS has been excluded from eligibility for the Pension Protection Fund, the question might arise as to whether merely placing a funding obligation upon public body employers, with revenue-raising powers and not capable of becoming insolvent in a formal sense, is a sufficient "measure" for article 8 purposes. It is at any rate arguable that it is not, and that if the employing authority in fact became unable to meet its financial obligations, something more would have to be done. However, whatever exactly that "something more" might be (which is certainly not a straightforward question[13]), it is clear that it would not necessarily lead to all benefits being paid in full. *Hogan* appears to interpret the ultimate obligation as being to ensure the payment of 50% of benefits.

21. I have been asked to express a view about "the extent of the risk to members' benefits inherent in the lack of a statutory guarantee". In my view that is a political or economic question, rather than a legal one. The extent of the risk depends on the one hand upon the likelihood of it becoming impossible in practice to recover employers' contributions in sufficient sums to be able to meet benefits as they fall due, and on the other hand upon how central government would react to that situation. I have already made it clear (see paragraph 10 above) that my own view is that it is highly unlikely that central government would not intervene in some way long before the money ran out; but whether such intervention took the form of ensuring the payment of benefits by other means, or reducing benefit entitlements, or some combination of the two, one cannot say. It is perhaps worth making the point that, even if LGPS benefits were guaranteed by central government, that would not make it

[13] One possibility is that the Secretary of State might not lawfully be able to lay down principles making a particular council tax increase "excessive", if that increase was required in order to meet LGPS contributions.

100% certain that they would be paid in full: in theory at least, governments can default financially, and governments with a majority in Parliament can legislate to reduce even accrued benefit entitlements. But all this seems to me a very long way from any position that has yet been reached.

22. The third question concerns what happens if a local authority does run out of money to satisfy all its obligations as they fall due, so that it is "insolvent" in at any rate the everyday sense of the term. It is clear that local authorities in England and Wales are not subject to the insolvency jurisdiction of the courts: they cannot be wound up or undergo any similar procedure. This is in contrast to the United States, which has its Chapter 9 bankruptcy regime specifically for municipalities. Specifically, a local authority is plainly not a company registered under the Companies Acts, and nor is it an unregistered company within the meaning of s 220 of the Insolvency Act 1986, because it is neither an "association" nor a "company" – it is not formed by the coming together of members. In *Re National Union of Flint Glassworkers* [2006] BCC 828, HHJ Norris QC considered that the court had an inherent jurisdiction "to dissolve any body of any kind for which no other machinery exists for securing its proper winding up" – but even if that is true as a general proposition, it cannot apply to a body, such as a local authority, which is required to exist by virtue of statute.

23. I can see nothing in the legislation which would give any priority to payments required to meet LGPS contributions, or any special rights to an administering authority as a creditor. The only creditor of a local authority which has any such priority is a lender of money to the authority, to the extent set out in s 13 of the Local Government Act 2003. All local authority borrowing is charged on the revenues of the authority (and no other form of security for money owing is valid), and an unpaid lender may apply for the appointment of a receiver to exercise powers including

the setting of council tax. By implication, any other creditor would not be able to seek similar relief – although a refusal by an authority to set council tax at a level which would enable it to meet statutory obligations, including the obligation to make LGPS contributions, might perhaps be challenged by way of judicial review.

24. So if a local authority ran out of money, the first call upon revenues in existence or capable of being raised would belong to its lenders. Thereafter all creditors, including the administering authority, would be in the same position. In the absence of an insolvency regime, it would in effect be "first come, first served" for creditors seeking to obtain and enforce judgments for monies owing, subject to such general discretionary powers as the courts have to allow particular methods of enforcement to be pursued and to stay proceedings and stay execution of judgments. As I say, however, I find it well-nigh inconceivable that central government would permit such a free for all to occur without intervening in some way.

<u>The IORP I Directive</u>

25. I now turn to the relevance of IORP I[14]. The first question is whether the Directive applies to the LGPS at all. I have been supplied with a copy of an opinion given to Unison by Mr Michael Furness QC (dated 24 May 2007), who took the view that IORP I did apply to the LGPS. I have also been supplied with a letter from the DCLG to the LGA dated 8 October 2013, which suggests that the government also considers IORP I to be

[14] On 27 March 2014 the Commission published its proposal for a new IORP II Directive, which would codify (by recasting) and amend IORP I. In broad terms, IORP II would introduce new and strengthened governance requirements. The fundamental definition contained in article 6(a), discussed in detail below, would not be changed by the draft containing the proposal. It is striking that the deletion of the word "not" in the new draft article 5 seems to convert the position into one in which it would be for member states to opt into the application of some articles to statutory schemes, which might be seen as supporting (at least once IORP II comes into force) my preferred view below that such schemes do not, if purely statutory, fall within article 6(a). However, it remains to be seen whether and in what form the proposed Directive is ultimately adopted, and the contemplated implementation deadline is not until 31 December 2016. It is not therefore of immediate legal relevance. Having said that, I shall be pleased to address any specific queries that the LGA may have about its implications.

applicable to the LGPS: "Directive 2003/41 applies to all occupational pension schemes, both trust-based and statutory." I have not found the point easy, but I have ultimately been persuaded that that view is indeed correct, for reasons which I shall seek to explain.

26. Mr Furness concluded at paragraph 9 of his opinion that IORP I could only sensibly be applied to the LGPS on a fund by fund basis, a point with which I agree. He then noted that whether the Directive did apply therefore depended upon whether each such fund was "an institution for occupational retirement provision" as defined by article 6(a). At paragraph 10 of his opinion, he helpfully set out the five different components of the definition.

27. Taking the first four of those components in turn:

    (i) I agree with Mr Furness that an LGPS fund is an "institution", essentially for the reasons that he gives;

    (ii) I agree that it clearly operates on a funded basis;

    (iii) I agree that it is established separately from any sponsoring undertaking, again for the reasons that Mr Furness gives (which match the analysis of the role of the administering authority set out earlier in this Opinion);

    (iv) Plainly the LGPS is established for the purposes of providing retirement benefits.

28. However, I have greater difficulty with the fifth and final component of the definition, namely whether the LGPS fund is established in the context of an occupational activity "on the basis of an agreement or contract agreed individually or collectively between the employer(s) and the employee(s)

or their respective representatives[15]." The problem is not with the context of an occupational activity, which evidently exists, but rather with the requirement that the fund be established on the basis of a collective agreement or contract between employers and employees.

29. Mr Furness says in a single sentence at the end of his paragraph 11 that this requirement is "clearly satisfied", without elaborating further[16]. But for my part I have not found it so straightforward to see where the necessary collective agreement or contract is to be found. Individual contracts of employment may well in practice refer to the employee's right to belong to the LGPS, but they need not do so, since that right is statutory and not contractual in nature (and remains so whether it is referred to in the contract of employment or not). Certainly the individual contract of employment is not the basis upon which the LGPS, or any particular LGPS fund, is established or upon which LGPS benefits are provided. Nor am I aware of any pertinent collective agreement. Rather, the LGPS and its individual funds are, as it seems to me, established on a purely statutory basis. A statute is not the same as a collective agreement or a contract.

30. On the other hand, article 5 of the Directive says that member states may choose not to apply articles 9 to 17 to institutions where occupational retirement provision "is made under statute, pursuant to legislation, and is guaranteed by a public authority". If statutory schemes fall entirely outside the Directive in any event, then it is hard to see what purpose that option serves.

31. It is not easy to find a convincing reconciliation between article 5 and article 6(a). In the end, what has persuaded me to agree with Mr

---

[15] The alternative limb concerned with self-employed persons can be ignored for present purposes.

[16] Although he may have regarded the point as flowing from what he had earlier said, in his paragraph 8, about article 5 of the Directive.

Furness's view is the explanatory memorandum, prepared by the Commission, which accompanied its original proposal for the Directive[17]. In the draft text which accompanied the proposal, the article 6(a) definition was in similar though not identical terms to its final wording.

32. Paragraph 1.3(c) of the explanatory memorandum, headed "Establishing a coherent scope", states very clearly that the Directive covers all IORPs which operate on a funded basis and are outside the social security systems, and says: "Briefly, any institution that receives contributions and invests them with the sole purpose of paying out retirement benefits is considered to be an IORP." Paragraph 1.1(a) also makes it clear that, in general, a pension scheme which is not a social security scheme or an individual scheme (i.e. a product taken out with a life assurance company) is an "occupational scheme", and that there is an IORP when, as is generally the case, an occupational scheme involves employer and employees paying into a savings scheme (either within the company itself or using a separate financial institution), out of which retirement benefits will be paid to those same employees. In the light of these statements as to the scheme and scope of the legislation, which clearly constitute a significant part of the backdrop to the passing of the Directive, it is very hard to contend that schemes which were purely statutory in origin were not intended to be covered, assuming that they did not amount to social security schemes within the meaning of Regulation 1408/71 (and I cannot see that the LGPS falls into that category). The first comment on article 6 in the explanatory memorandum says simply that the Directive "is intended to apply to employment-related institutions for pension provision that operate on a funded basis", and it refers to the notion of the IORP having been chosen because it is generic enough to cater for the diversity of institutions operating in the EU. The following comment on article 5 should also be noted:

[17] I am indebted to Mr Ivan Walker, the solicitor advising Unison, for drawing attention to the relevance of this text.

> "In some Member States, occupational retirement provision can be operated by institutions which are covered by a public authority with revenue raising powers. Such a cover is deemed to be sufficient for the protection of members and beneficiaries."

33. The conclusion must, I think, be that, on a true reading, article 6(a) requires only that the occupational activity (and not the pension arrangements themselves) need be based upon a contract of employment or collective agreement. Although that is not the most natural reading of the text, the combined effect of the explanatory memorandum, and the fact that it makes sense of article 5, in the end persuades me that it must be correct.

34. I now turn to consider the effect of the Directive upon LGPS. As already noted, article 5 permits member states not to apply articles 9 to 17 of IORP I to cases where provision is made under statute and guaranteed by a public authority. Although there is no guarantee in the conventional domestic law sense in the case of the LGPS, I think (in common, as I understand it, with Mr Furness) that the obligations of the employing authorities are sufficient to engage this dispensation here. However, I have not been asked to advise on the question of whether the United Kingdom has effectively exercised its option, or on the implications for the LGPS if articles 9 to 17 are applicable. The two articles about which I have been asked to advise are article 8 and article 18, neither of which is capable of being disapplied under article 5.

35. Article 8 requires member states:

> "to ensure that there is a legal separation between a sponsoring undertaking and an institution for occupational retirement provision in order that the assets of the institution are safeguarded in the interests of members and beneficiaries in the event of bankruptcy of the sponsoring undertaking."

36. Clearly, an LGPS fund does not itself have legal personality. Its assets belong to the administering authority, and that authority will also (normally) be a sponsoring undertaking, i.e. an employing authority. However, having regard to the stated purpose of article 8, this should not be seen as objectionable in itself. It should in my view be sufficient compliance with article 8 if there is some legal bar to the assets of the pension institution (i.e. the fund assets) being taken by the employer's other creditors. This is also the view taken in the helpful commentary on IORP I prepared for the European Federation for Retirement Provision by Mr Simon Arnot of Steptoe & Johnson LLP, where he speaks of the concept of a "privileged category of asset".

37. It has been pointed out to me that in some places the Directive refers specifically to ring-fencing as a concept, which on a purely linguistic approach might be thought to suggest that, where the term "separation" is used, something more is required. But what is required by article 8 is "legal separation", which does not necessarily mean complete separation for all purposes, as opposed to a separation of a particular kind which the law will recognise. The meaning must ultimately depend upon the context, and to my mind the key point here is that article 8 itself specifically identifies the purpose for which the separation is required, i.e. that the relevant assets should be safeguarded if the sponsoring undertaking becomes insolvent. That purpose is fulfilled if one takes the approach suggested in paragraph 36 above. Again, I acknowledge that recital 8 to the Directive refers to institutions which are "completely separated" from any sponsoring undertaking, but I regard that as a shorthand for the effect that the Directive's specific provisions have, and in any event not as a point which is sufficient to outweigh the strong indication to be found in article 8 itself.

38. Another point that has been raised is that the absence of separate legal personality as between an authority in its capacity as administering

authority, and that authority in its capacity as employer and more generally, is that the administering authority might not be able to sue itself for unpaid contributions. However, I am not persuaded that this is so significant an issue as to drive a different interpretation of article 8. Even if it is correct to say that the authority acting in one capacity could not sue itself in some other capacity (and I do not think this is by any means beyond argument), and even if one disregards the scope which might exist to develop the law concerning derivative actions so as to address such a situation, it seems to me clear that in such a situation an interested party such as a scheme member would be able to seek judicial review to compel the authority to pay its contributions or fulfil its other obligations as employer.

39. If a bar or privileged category of assets, as described in paragraph 36 above, is sufficient to satisfy article 8, then in my view it exists here, even though an LGPS fund is not held by the administering authority on trust as such. It would be surprising, given the whole nature of the fund as already discussed above, if its assets were generally available to the creditors of the administering authority, and in my opinion such a result is avoided by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009 No 3093 as amended - "the Investment Regulations"). In particular, r.4(1) of the Investment Regulations governs the sums that the administering authority may pay from the fund. For this purpose, it specifies only the administrative costs identified in r.4(5), although it is obviously also permissible to make the payments of benefits themselves, as required by the 2013 Regulations (and see r.5 on permissible borrowing). Unsurprisingly, the administering authority is not permitted to make payments from the fund to its creditors generally. It must follow that the creditors themselves cannot enforce against the fund assets[18]. I would certainly agree that it would be preferable if the legislation stated this explicitly. Nonetheless, I do not

[18] See also r.6(3) preventing the exercise of rights of set-off in respect of bank accounts.

think there is much doubt about the point: and if there otherwise was, then it would be necessary (on familiar *Marleasing* principles) to interpret the relevant provisions so as to achieve the result required by article 8 of IORP I, assuming that it does indeed apply.

40. I have been asked to comment upon how my view about the privileged status of the fund assets sits with two particular statutory provisions, namely ss 13(3) and 17(1)(b) of the Local Government Act 2003. As to s 13(3), the query raised is whether income of the fund would not count as a "revenue" of the administering authority, so that all that authority's borrowing (in whatever capacity) would be charged upon it (see paragraphs 23-24 above), as well as on all the authority's other revenues. It is indeed my view that such income would fall outside s 13(3), because it would not be treated as a revenue "of" the authority in view of the specific purpose for which it is required to be applied. Again, a *Marleasing* approach would resolve any doubt that might otherwise exist. As for s 17(1)(b), that merely provides that any temporary use by a local authority of money forming part of an external fund is to be treated as borrowing by the authority for the purposes of the capital finance regime in the 2003 Act. Although the LGPS fund is one kind of external fund, amongst others, this provision does not create or imply the existence of any power in the administering authority to make use of it for non-LGPS purposes[19]. It simply regulates one aspect of the consequences in a case in which such use is permissible and occurs.

41. I have referred in paragraph 17 above to the fact that there does exist one case, South Yorkshire, in which the administering authority is not an employing authority and has no other functions than the administration of its LGPS fund. It may be useful to record for completeness that no

[19] The position might well have been different before 1 April 2010, because the use of fund money for any purpose for which the administering authority could borrow money then counted as an investment: see rr. 3(4) and 16 of the Investment Regulations. The absence of any provision similar to r.16 in relation to post-April 2010 use of fund monies reinforces the view that I have expressed.

possible issue about compliance with article 8 could arise if that model was adopted for the LGPS generally.

42. Turning to article 18, which I have been asked to address since the initial consultation, this is headed "Investment rules" and contains a number of different provisions about the requirements which member states must or must not impose upon institutions located in their territories. These may be summarised as follows:

(i) There must be a requirement to invest in accordance with the "prudent person" rule, and in particular in accordance with the six rules set out in sub-paragraphs (a) to (f) of article 18(1);

(ii) The institution may not borrow (other than temporarily, for liquidity purposes) or act as a guarantor on behalf of third parties – article 18(2);

(iii) Article 18(3) provides that member states "shall not require institutions . . . to invest in particular categories of assets";

(iv) Investment decisions must not be made subject to prior approval (sc. by other state authorities) or systematic notification requirements – article 18(4);

(v) Articles 18(5) and (6) permit member states to lay down detailed investment rules, including quantitative rules, for institutions generally or particular institutions, which are prudentially justified, subject to certain specific restrictions on what prohibitions may be imposed;

(vi) Article 18(7) is concerned with cross-border activity, i.e. where the institution is located in one state and the sponsoring undertaking in another. I should not have thought that this was any of real relevance to LGPS[20], so I shall leave it aside unless asked to consider it further.

43. I am not aware of any requirements which might be said to infringe article 18(3) or article 18(4). So far as article 18(2) is concerned, r.5 of the Investment Regulations appears to meet the requirement for a restriction on borrowing. There is no specific prohibition on the giving of guarantees[21], but if my views about the permissible use of fund monies as set out above are correct, it is hard to imagine in what circumstances a guarantee that could be called against fund monies could lawfully be given.

44. So far as article 18(1) is concerned, sub-paragraphs (c), (d) and (f) are concerned with particular types of investment, and may conveniently be considered in conjunction with article 18(5). The opening words of article 18(1) call for prudent investment, and sub-paragraphs (a), (b) and (e) call for: investment in the best interests of members and beneficiaries (and in their sole interest if there is a potential conflict of interest with the manager of the portfolio); investment in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole; the investment of assets to cover the technical provisions (i.e. the financial commitments of the scheme as explained in article 15) in a manner appropriate to the nature and duration of the expected future retirement benefits; and proper diversification and the avoidance of excessive risk concentration.

[20] Some LGPS funds may have non-UK sponsoring undertakings, for example as a result of admission agreements with non-UK companies, but it would not appear that the sort of restrictions contemplated by article 18(7) are in play here (they would really be relevant if UK employment law sought to impose restrictions on the investment of pension schemes located elsewhere to which UK employees might belong). I have not been asked to advise about article 20, which deals with cross-border activities (and which is addressed in domestic law by Part 7 of the Pensions Act 2004).

[21] Cf. r.5 of the Occupational Pension Schemes (Investment) Regulations 2005, discussed below, which does impose such a prohibition expressly in relation to trust schemes.

45. There is, so far as I can see, no legislative provision relating specifically to the LGPS which imposes these requirements, although it is apparent that there a variety of requirements (e.g. for the publication of a statement of investment principles) which will tend to assist in their achievement. There is r.11(2) of the Investment Regulations, which deals with diversification and suitability of investments, but this falls some way short of the full range of article 18(1) requirements.

46. So far as pension schemes more generally are concerned, the requirements of article 18 are addressed by the Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005 No 3378), in particular by r.4. But that provision applies to the trustees of a trust scheme as defined by s 124(1) of the Pensions Act 1995, and the LGPS is not such a scheme.

47. In my view the fiduciary duty and public law duties of the administering authority, as discussed in my Opinion of 25 March 2014, would in fact (and with one possible exception) impose upon it all the obligations that article 18(1) requires. If that is right, does it matter that there is no express legislative implementation of article 18(1) in relation to the LGPS? The position concerning implementation requirements has recently been summarised by the CJEU in C-530/11 *Commission v UK* (13 February 2014) at paragraphs 33-36. Enactment in express and specific provisions is not necessarily required – a "general legal context" may be sufficient if it ensures full application of the directive in a sufficiently clear and precise manner. Individuals for whom the directive is designed to create rights must be put in a position to know the full extent of their rights and to rely on them before national courts. My view is that the existence of the general duties to which I have referred probably would suffice to meet this test, but there is room for argument about that, and I should have thought that it would clearly be preferable if the relevant provisions of the

Occupational Pension Schemes (Investment) Regulations 2005 were made to apply to the LGPS.

48. The possible exception to which I have referred is the requirement that investment decisions are to be made in the sole interest of members and beneficiaries in the case of a potential conflict of interest. In the opinion which I have already mentioned, Mr Furness took the view that there was such a potential conflict between the interests of the administering authority in its capacity as employer, and the interests of the members. He identified the issues which might typically arise as being those concerning the employer's potential desire to adopt a more aggressive than prudent investment policy in order to minimise contributions, and those concerning possible investment in the employer. He also took the view that merely imposing a legislative requirement to act in the sole interests of members and beneficiaries would not be enough, and that compliance with the Directive required administration to be put into the hands of a body which was distinct from any LGPS employer.

49. I do not agree with the second stage of this analysis. The nature of the member state's obligation under article 18(1) is to impose a requirement on the institution. If the state does precisely that, I do not see how it can be said that the Directive requires it to go further. Of course it is a general principle of EU law that rights and remedies must be ones which are effective, but I do not see why an enforceable legal duty to act in a particular way should not be effective. Mr Furness's approach reads article 18(1) as if it imposed a duty to prevent any potential conflict of interest even arising, which is not what it says. The fact that UK pensions legislation has gone further in relation to private sector schemes does not seem to me to point to a different conclusion. One can well see as a matter of policy why a different approach might be taken in that context, than where the employer is a public body, subject to a variety of transparency requirements, and where (not least because of its tax-raising

powers, and because employer-related investment is not really a serious issue) the potential for conflict is in any event substantially less – although I would be disposed to agree that there is still some limited potential for conflict present.

50. Is this potential conflict sufficiently addressed, despite the absence of an express legislative requirement equivalent to r.4(2)(b) of the Occupational Pension Schemes (Investment) Regulations 2005, by the fiduciary and public law duties that are in play? I am not sure that it is, even if (as I think on balance is the case – see paragraph 47 above) such duties are in principle capable of amounting to sufficient implementation of the Directive. I say that because I should have thought, as set out in my previous Opinion, that the administering authority's fiduciary duty was owed both to employers and to members and beneficiaries, and would require it to strike a balance between their interests, whereas article 18(1)(a) requires that in a situation of potential conflict with the interests of the decision-maker, the interests of the members and beneficiaries should be the sole consideration. To this limited extent, I think that the present state of the law does not comply with article 18(1)(a).

51. Turning now to the choice of investments and the requirements of articles 18(1)(c), (d) and (f) and 18(5), these need to be set against Schedule 1 to the Investment Regulations[22]. I am not a financial services specialist, and I have not been provided with any further instructions or information to assist me in comparing the different types of investment referred to in article 18 on the one hand, and Schedule 1 on the other. However, there is certainly no express requirement to invest predominantly on regulated markets as contemplated by article 18(1)(c), and I do not think that the combined effect of the Schedule 1 provisions has that effect. Further, since the Schedule 1 restrictions are quantitative in nature, and do not constitute an exhaustive list of possible investments, they do not impose

[22] Again, r.4 of the Occupational Pension Schemes (Investment) Regulations 2005 would be relevant in the case of a trust scheme, but not here.

the rules in relation to investment in derivatives that are contemplated by article 18(1)(d). Article 18(1)(f) concerns investment in the sponsoring undertaking. This is, I assume, of less practical significance in relation to the LGPS, and as I understand it the LGPS as an occupational pension scheme is subject to the restrictions on employer-related investments contained in s 40 of the Pensions Act 1995 and in rr. 11 to 13 of Occupational Pension Schemes (Investment) Regulations 2005 – these restrictions are not confined to trust schemes. Further, I do not understand anything in Schedule 1 to be inconsistent with the type and volume of investment that article 18(5) requires to be permitted.

52. So it appears to me that the existing state of the law does not properly implement IORP articles 18(1)(c) and (d) in relation to the LGPS, and nor do I think general fiduciary duty or public law principles fill this gap, although in reality I should be somewhat surprised to find that any LGPS funds were acting inconsistently with them. There is room for debate as to whether articles 18(1)(c) and (d) are sufficiently precise to be directly effective, but any administering authority should certainly, in my view, seek to observe them – there is a general duty to observe EU law requirements, whether directly effective or not (albeit that the absence of direct effect might impact on what remedy was available for a failure to do so).

53. Finally, I have been asked what form any challenge concerning the compatibility of the LGPS with IORP I might take. If the issue was whether the legislation governing LGPS in fact complied with article 8 (my own view, as set out above, being that it does), it seems to me that would have to be raised in a claim for judicial review against the Secretary of State[23] as the author of the relevant legislation. I do not see what any administering authority could do to remedy any deficiency in the legislation, if such a deficiency existed. The same would be true if,

[23] Or conceivably the Attorney General, as representing central government more generally.

contrary to my view, article 18(1)(a) required administration by a body which was not a scheme employer.

54. The position in relation to some other provisions of the Directive might be different: if a particular provision was of a kind intended to confer rights upon individuals, and was sufficiently clear, precise and unconditional to pass the test for having direct effect, then it might be possible for a claim to be made directly against an administering authority to require compliance with that provision, regardless of what the domestic legislation said. Any such issue would have to be addressed on a case by case basis, depending upon the nature of the alleged non-compliance. I have already indicated that in my view an administering authority is obliged to comply with the IORP article 18 investment rules, whether or not they are directly effective.

CONCLUSIONS

55. In reality it is extremely unlikely that a situation would be allowed to develop in which an LGPS fund could not meet benefits as they fell due, or in which a local authority was unable to pay its debts (including LGPS contributions) as they fell due, without some form of prior central government intervention – although what form that intervention might take is largely a political rather than a legal question. Further, contributions should continue to be payable so as to meet benefits for as long as there is any employing authority with active members.

56. However, in my view the strict position in law is that:

(i) An LGPS administering authority is only obliged to pay benefits to the extent that the assets of the fund permit. Neither it, nor central government, acts as ultimate guarantor of those benefits;

(ii) If an employing authority was unable to pay its creditors, unpaid contributions to the LGPS would have no preferential status. A local authority cannot be subject to formal insolvency procedures.

57. If an employing authority fails to pay contributions, the administering authority can (and if necessary, should) sue for them as a statutory debt. It also can, and normally should, charge interest on late contributions. There may also be some legal constraints on how far a local authority could refuse to raise council tax (or how far the Secretary of State could prevent it from doing so) if there were no other means of paying LGPS contributions.

58. On balance, I consider that IORP I applies to the LGPS. If it does, then in my view the current system complies with article 8 of the Directive, because it would not be possible for fund assets to be used to meet any liabilities incurred by the administering authority in any other capacity. There are some respects in which I do not think that the current state of the law complies with article 18: in particular, article 18(1)(a) to the limited extent set out in paragraph 50 above; article 18(1)(c); and article 18(1)(d). It would in any event be preferable for legislation transposing the requirements of article 18 to be made expressly applicable to the LGPS. Administering authorities should in any event seek to act in a manner consistent with article 18.

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

NIGEL GIFFIN QC

11KBW

13 September 2014

11 King's Bench Walk
Temple
London EC4Y 7EQ

IN THE MATTER OF
THE LOCAL GOVERNMENT
ASSOCIATION

AND IN THE MATTER OF THE
FINANCING AND REGULATION OF
THE LOCAL GOVERNMENT PENSION
SCHEME

OPINION

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