



SCOTTISH PUBLIC PENSIONS AGENCY

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The Secretary General
Convention of Scottish Local Authorities

The Chief Executive
Scottish Local Authorities

The Chief Executive
Water Authorities

The Principal Reporter
Scottish Children's Reporter Administration

The Chief Executive
Scottish Environment Protection Agency

The Director General
Strathclyde Passenger Transport Executive

The Clerk
Strathclyde Passenger Transport Authority

The Chief Executive/Director
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Your ref:
Our ref: LGT/01/08/00

23rd April 2004

Dear Sir/Madam

THE LOCAL GOVERNMENT PENSION SCHEME (MANAGEMENT AND INVESTMENT OF FUNDS) (SCOTLAND) AMENDMENT REGULATIONS 2004 – SSI 2004/134

1. I am writing in regard to the above mentioned regulations which amend the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998, and which come into force on 1st May 2004. The new regulations introduce a degree of flexibility into the investment limits prescribed by regulation 11 and Schedule 1 of the investment regulations. The amendments will apply to LGPS fund authorities in Scotland. A copy of SSI 2004 No. 134 can be purchased from the Stationery Office or can be accessed via the Scottish Legislation Web Pages on www.legislation.hmso.gov.uk/stat.htm.

Background

2. Following earlier consultations on the principle of optional extra flexibility, a statutory consultation document containing draft regulations was circulated in September 2003. The

responses to this showed general support for the proposals, although inevitably there were differences of opinion on some of the details.

Increased flexibility

3. The amendments provide LGPS fund authorities with the opportunity to increase their exposure to certain types of investments specified in Schedule 1 of the investment regulations – but only where proper advice has been obtained; where the decision has been taken in accordance with the general provisions of the regulations including those relating to risk, prudence and diversification and where the Statement of Investment Principles has been revised and published showing the information set out in new Regulation 11A (4). While introducing a degree of flexibility into the prescribed investment limits, the amending regulations therefore seek to maintain the essential basic principles of prudence and diversification which should govern the management and investment of LGPS funds.
4. The new headrooms are not mandatory. The extent to which they are used in practice will be for the investment committees of individual LGPS administering authorities to decide, having taken proper advice in the matter. Individual authorities may prefer to maintain their existing investment policy, and may decide not to adopt for their fund any of some of the new limits for the time being.
5. The new power to set higher limits is provided under regulation 11(2A).
6. Regulation 11A sets out detailed requirements which will apply where an administering authority decides to use any, or all, of the new headroom limits. These include the provision of regulation 11A(2) on taking “proper advice”, which is already defined in regulation 2(1). Regulation 11A(3) also ensures that the need for diversification and suitability of investments, as prescribed by existing regulation 9(3), is taken into account when use is made of the new headrooms.

Reviews

7. Regulation 11A(5) and 11A(6) contain provisions relating to any review of a decision to use a new headroom limit.

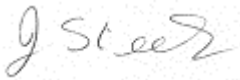
Transparency

8. Regulation 9A already imposes requirements about the content, publication and revision of each authority’s Statement of Investment Principles (SIP). New regulation 11A(7) requires the administering authority to state in a revised SIP the relevant policy underlying any decision they make to increase their pension fund’s exposure to a Schedule 1 investment to a level above the Column 1 limit. Other details to be included in the revised SIP include, by virtue of regulation 11A(4), a description of the investments subject to the new limits; the new limit; the reason for the decision; the period for which the decision will apply (including any earlier review period); and a statement that the decision complies with the 1998 Regulations (as amended). Similar provision is made about any decision taken after a review.
9. Under regulation 11A(7), the revised SIP must be published before any decision made under regulation 11(2A), or under regulation 11A(6) following a review, can legally take effect. In this context “publish” means to make available, which includes publication via any electronic media, eg, web site or e-mail.
10. The only substantive difference between the amending regulations and the draft version is the statutory consultation document affects the limit on investments in single holdings. This remains at 10% following concerns expressed by some consultees about the proposed provision

of an upper limit of 15% on this type of investment. Regulation 3(3) and paragraphs 4,6 and 7 of Part 1 of Schedule 1 refer.

11. Although the consultation paper included no proposals to increase the headroom on stock-lending, a minority of those responding did make a case for such a change in the regulations. These views have been considered carefully but no change is proposed to the current provision in paragraph 9 of Schedule 1 to the 1998 Regulations. However, following a meeting in February with interested parties, ODPM intend to issue a consultation paper in England and Wales on the subject. The paper will also seek comments on corporate governance and activism. When the paper issues we will ensure that fund authorities in Scotland have an opportunity to put their views forward on these matters.
12. Any queries should be sent in writing to David Lauder at the above address. Alternatively he can be contacted by 'e' mail at david.lauder@scotland.gsi.gov.uk or by telephone on 01896 893227.

Yours faithfully



JEAN STEEL
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