REPORT TO: POLICY & RESOURCES COMMITTEE – 23 JUNE 2014

REPORT ON: TAYSIDE PENSION FUND – INVESTING IN TOBACCO

REPORT BY: DIRECTOR OF CORPORATE SERVICES

REPORT NO: 275-2014

1 PURPOSE OF REPORT

To review the employer consultation communication received from Tayside Pension Fund regarding views of Dundee City Council as an employer on whether or not the fund should continue investing in tobacco stocks given the potential impact on employer contributions.

2 RECOMMENDATION

The Committee are asked to note that a decision to disinvest from tobacco stocks could result in a significant increase in employer contribution rate. If the Committee were minded to request the Tayside Pension Fund to disinvest from tobacco stocks they would be required to identify alternative investments in order to provide for returns not being seriously diluted. Officers are unable to recommend any other investment which would deliver this objective without materially affecting the volatility of risk and return given the existing investment objectives and constraints. The views of the Committee are sought regarding a response to Tayside Pension Fund.

3 FINANCIAL IMPLICATIONS

The current employer contribution rate is 18% and is provided for in the Revenue Budget. The letter received from Tayside Pension Fund (see Appendix 1) provides an estimate based on actuarial calculation that a decision to disinvest from tobacco stocks could result in the employer contribution rate being increased by 3.1% to 21.1%. This would result in an additional employer contribution cost to the City Council of an estimated £3.38m per annum.

4 BACKGROUND

The Tayside Pension Investment Sub-Committee has been giving consideration as to whether or not to withdraw from investing in tobacco companies. The value of tobacco investments in the main fund was £28.96m at 31 March 2014 (1.18% of the total fund value). The return achieved by tobacco equated to £32m over the 5 year period (1.4% of the overall asset value of the fund as at 30 June 2013).

5 COUNSEL OPINIONS

The fund sought a Scottish Counsel's Opinion and more recently one was commissioned by the Local Government Pension Scheme in England and Wales. These are attached at Appendix 2, and the Committee's attention is drawn in particular to the Scottish Opinion which states that "If the policy is simply not to invest in one company or in one sector then, upon taking proper advice, there should be adequate other sectors to provide returns which are not seriously diluted".

In light of these Opinions, a decision was made by the members of the Tayside Pension Investment Sub- Committee for the officers of Tayside Pension Fund to consult with individual pension fund portfolio managers as to their professional views on the potential impact of not directly investing in the tobacco sector, and whether such a decision would dilute returns and what impact the alternative would have on the risk and volatility of the fund. Financial information was requested for returns from tobacco stocks held over the prior 5 year period compared to the overall portfolio return and volatility.

6 **ACTUARIAL OPINION (Appendix 3)**

In order to ascertain the impact on current and future funding levels and the resultant effect on employer contributions, the information received from the portfolio managers was passed to the pension fund actuaries. Their analysis states that the funds returns would have been reduced by approximately 0.3% of fund value per year over the last 5 years and that future investment returns would also be reduced by the same proportion.

The information received showed that the fund value would have suffered by £32m over the 5 year period (1.4% of the asset value) and that the volatility of the portfolio would increase as tobacco stocks are less volatile than a number of others within respective market universes and removal of these would increase the risk profile of the fund as a whole.

The impact of the analysis based on choosing not to invest in tobacco would have reduced Tayside Pension Funds funding level by 1.4% which would have required a contribution rate increase of 0.8% of payroll.

The actuarial estimations based on the assumptions that the same reduction in funding which would have resulted in the past 5 years without tobacco investment is replicated in the next 5 years show the funding level would drop an additional 3.7% which would result in a requirement for contributions to be increased by an additional 3.1% per annum for each employer in order to generate £10.8m of additional contribution.

7 **CONCLUSION**

Whilst legally the Fund can choose to disinvest from tobacco, it must be able to identify an appropriate alternative asset as a replacement.

8 **POLICY IMPLICATIONS**

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

There are no major issues.

9 **CONSULTATIONS**

The Chief Executive and Head of Democratic and Legal Services have been consulted in the preparation of this report.

10 **BACKGROUND PAPERS**

None.

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES

Dundee City Council
Corporate Services

CHANGING FOR THE FUTURE

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Our Ref MS/at
Your Ref
Date 11 June 2014

Dear Sir

Tayside Pension Fund Employer Consultation

At the last Pensions Investment Sub-Committee, it was reported that officers would obtain a fund report from Barnett Waddingham, the funds actuary, showing the effect on the fund value and the required employer contribution rate if there had been no investments in the tobacco industry over the last 5 years and what the impact would be on the future 5 years if the fund chose not to invest in the tobacco industry.

The figures received from Barnett Waddingham based on the last 5 years investment demonstrate that the fund value would have been £32m lower and that employers would have had to contribute an additional £2.5m per annum (requiring an additional 0.8% of individual payrolls). Going forward, if the reduction in returns is replicated then there would be a requirement for an additional £10.8m employer contribution (3.1% of individual payrolls). An individual estimate of the impact on your organisations contributions is attached.

This information is now being submitted to all employers in the fund asking for their views in light of these figures and whether they believe that the fund should seek to withdraw from tobacco investments. I would ask that you respond in writing if you have any views regarding this that you would wish considered by Friday 26th September 2014.

I attach the Counsel's Opinions which have been received in Scotland and in England and Wales regarding this issue for your information.

Yours sincerely

Marjory M Stewart

Marjory M Stewart
Tayside Pension Fund

TAYSIDE PENSION FUND

Appendix 1

Employer :- Dundee City Council

2013/2014 Employers Pension Contributions (Actual)	£19,664,412
Future Employers Pension Contributions based on 2013/2014 +3.1% (21.1% contribution rate)	£23,051,061
Estimated Increase of Employers Pension Contributions (1 Year)	£3,386,649
Estimated Increase of Employers Pension Contributions (5 Year)	£16,933,244

OPINION OF COUNSEL

for

DUNDEE CITY COUNCIL

regarding

The Tayside Superannuation Fund and the Tayside Public Transport Co Limited Superannuation Fund

1. I refer to the Memorial sent to my clerk on 31 December 2012.

2. I have considered the various papers and have the following advice to offer in respect of the questions put before me.

Query (i)

3. In this question I am asked to what extent, if any, the Council or its finance committee and superannuation investment sub-committee, as administering authority for the Tayside Superannuation Fund and the Tayside Public Transport Co Limited Superannuation Fund, has power to withdraw

investments in tobacco companies on grounds which are not based purely on the financial interests of members and beneficiaries.

4. In my opinion the Council and sub-committee do have such a power and I shall proceed to identify why that power exists and its ambit.

The existence of the power

5. In matters requiring consideration of obligations arising under any trust, contract or similar arrangement where funds are held and administered by one person for another or for a specified purpose, it is important to identify at the outset what is the foundation of the obligation in order to understand both its legal nature and its ambit. Many Occupational Pension Schemes exist by virtue of trust deeds and may share certain characteristics with other types of trusts such as private trusts, public trusts and charities. In such instances there will be a definitive deed of some sort setting out that the trust has been established, identifying trustees and stating the powers of the trustees in a manner which may be very general or very specific. Often, for example, the trustees of an occupational pension scheme may be authorised specifically to hold shares, or quantities of shares, in particular companies associated with the employers: an act which, otherwise, might be at variance with general duties as to diversification and indeed risk.

6. Here, the schemes for which the Council and its sub-committee are responsible as administering authority are established under and by virtue of the Superannuation Act 1972. As was explained in *Bain, Petitioner* 2002 SLT 1112, such a scheme is not a trust scheme but a public service scheme and it is to Statute and to Regulations made under statute that one looks in order to identify particular characteristics, provisions and powers: see page 1116.

7. Such schemes have for long been subject to Regulations dealing with management and investment of funds. For schemes such as the Tayside schemes, the salient regulations are currently comprised within the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (SSI No. 233). In my opinion the important provision for present purposes is that set out in Regulation 12, which provides that an administering authority must, after consultation with such persons as it considers appropriate, prepare, maintain and publish a written statement of investment principles. As provided for in Regulation 12(2)(f) that statement must cover its policy on the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. These regulations were promulgated under and by virtue of the 1972 Act and succeeded similar regulations promulgated in 1998, 2000, 2003 and 2004. So far as I am aware, the provisions now found in Regulation 12 and, in particular, 12(f) were inserted under the Local Government Pension Scheme (Management and Investment of Funds)(Scotland) Amendment Regulations 2000 (SI 2000 No. 74) Regulation 5. The provision is not

unusual. Almost identical provisions are to be found, currently, in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009/3093 at Regulation 12, in the Pension Protection Fund (Statement of Investment Principles) Regulations 2005/675 at Regulation 4 and the Occupational Pension Scheme (Investment) Regulations 2005/3378 at Regulation 2.

8. Accordingly, the present schemes are not trust schemes and the administering authority is, in consequence, not a trustee. It follows that common law provisions and authorities relating to trustees must be treated with caution if it is sought to apply them in considering the position of an administering authority. In particlular, for the reasons which I have given, ethical considerations may be taken into account by an administering authority in the selection, retention and realisation of investments in such schemes.

The ambit of the power

9. I turn now to consider the ambit of the power or the considerations which ought to be taken into account in exercising it. In doing so I shall consider certain of the authorities in respect of trusts. I shall do so as, in my view, the proper characterisation of the relationship between the administering authority and members may to an extent be fiduciary in respect that the funds are made up from, among others, members' contributions. I am also conscious that

certain local authority schemes, such as a scheme for industrial injury allowances, have been held to come within the ambit of the jurisdiction of the Pensions Ombudsman: see *City and County of Swansea v Johnson* [1999] Ch. 189.

10. A leading authority on the duty of trustees in regard to investment is the speech of Lord Watson in the House of Lords in *Learoyd v Whiteley* (1887) 12 LR App. Cas. 727, 733 where his Lordship indicated that whilst, as a general rule, trustees were required to show no higher degree of diligence than a man of ordinary prudence, it was the duty of the trustee to confine himself to the class of investments permitted by the trust and to avoid all investments of that class which were attended with hazard. Applying that to the present case, an ethical stance towards investments is permitted but that does not absolve the authority from avoiding hazardous investments. The proposition put to me, of course, is as to negative screening as opposed to some form of positive screening seeking a positive approach towards some types of investments.

11. Coming more closely to the point under present consideration is the decision of Megarry V-C in *Cowan v Scargill* [1985] Ch 270. The judgment covers many aspects relating to the investment of the funds of pension schemes and its effect has been much debated. In the Vice-Chancellor's view, the paramount duty of trustees is to exercise their powers in the best interests of beneficiaries which usually meant their best financial interests: see pp. 286-287. His Lordship then went on to indicate that, whilst in the conduct of their

own affairs trustees were free to abstain from making investments in, say, certain countries or certain companies concerned with alcohol, tobacco or armaments, if, as a trustee, the individual was aware that investments of that type would be more beneficial to the beneficiaries than other possible investments, the trustee must not refrain from making such investments by reason of the personal views held: see pp. 287-288. It will be appreciated immediately that the practicalities involved in such an assessment will vary from era to era: it may well be that there are a sufficiently significant number of sectors with similar levels of anticipated profitability that an adequately diverse portfolio can be maintained without resort to the sector over which an ethical or similar concern has been expressed: see paragraph 13 below.

12. Shortly thereafter a not dissimilar issue arose for a decision in the Scottish case of *Martin v The City of Edinburgh District Council* 1988 SLT 329. The case concerned a council's policy of disinvesting in South Africa and a breach of trust arose because the Council did so without considering expressly whether to do so was in the best interests of the beneficiaries and without obtaining professional advice on the matter: see p. 334. However the judge, Lord Murray, went on to express the view that trustees did not have an unqualified duty simply to rubber stamp an investment manager's advice or to invest trust funds in the most profitable investment available. It was not practicable to expect a trustee to divest himself of all personal preferences, political beliefs, moral, religious or other conscientiously held principles; nonetheless the trustee had to do his best to exercise fair and impartial

judgment on the merits of the issue before him: p. 334. Here, for the reasons which I have given, an ethical approach is permitted, but a fair and impartial approach is required thereafter.

13. The fourth decision of importance is that in *Harries (Lord Bishop of Oxford) v The Church Commissioners for England and Another* [1992] 1 WLR 1241. The Church Commissioners are a charity and in this decision of the then Vice-Chancellor (Sir Donald Nicholls, as he then was) consideration was given to similar issues in respect of investment powers in respect of the trustees of a charity. His Lordship accepted that there could be cases (albeit in his view comparatively rare) where the objects of the charity were such that investments of a particular type would conflict with the aims of the charity. In such cases, if trustees were satisfied that investing in a company engaged in a particular type of business would conflict with the very objects the charity was seeking to achieve, they should not so invest even if it would be likely to result in significant financial detriment to the charity. His Lordship went on to state, however, that, in practice, the exclusion for such a reason of one or more companies or sectors from the whole range of investments open to trustees would not be likely to leave them without an adequately wide range of investments from which to choose a properly diversified portfolio: see p. 1246.

14. These decisions are now between 20 and 30 years old, a period which has seen an increasing amount of interest from many quarters in ethical concerns and

socially responsible investment and in which, at certain stages in recent years, the volatility in even blue chip investments has shown that the performance of any particular investment can rarely be guaranteed. There has also been a significant growth in the availability of ethically orientated funds and in the opportunity to have negative screenings.

15. Whilst I have addressed these authorities, they are of limited assistance in the present matter because, as I have already indicated, the administering authorities working in terms of the Regulations have a power to adopt an ethical stance as at least part of their investment policy. In my view, having particular regard to the views of Lord Murray in *Martin v City of Edinburgh District Council*, the administering authority is entitled to take ethical considerations into account but, in doing so, must apply its mind to the appropriateness of the way in which to do so. Then, following the views of Vice Chancellor Nicholls in *Harries v Church Commissioners*, so long as the policy was one which left the range of investments as sufficiently wide to permit broad diversification within sound sectors, no issue of breach of fiduciary duty should arise. Two examples may be sufficient. If the policy is simply not to invest in one company or in one sector then, upon taking proper advice, there should be adequate other sectors to provide returns which are not seriously diluted. At the other end of the spectrum, were the administering authority to take the view that any form of investment in UK equities was not ethical that would, in my opinion, be likely to be open to serious challenge.

16. In the matter put before me the only issue relates to whether or not there was a power to withdraw investments from tobacco companies. For the reasons which I have given a decision of that nature relating, as it does, only to one sector and relating, as it does, to a matter seen by many as involving ethical considerations, is open to the council as administering authority. Further, if one is looking for some guidance as to the appropriate stance of local authorities in respect of that industry, the provisions of the Tobacco and Primary Medical Services (Scotland) Act 2010 are an indication of the level of proper concerns of those in government.

Query (ii)

17. In my opinion this is a matter within the decision making competence of the administering authority and is not a matter upon which any public consultation is required.

18. There is little more general guidance that can be given but it is noteworthy that, in a time of increasing interest in ethical concerns on investment, the independent regulator of charities for England and Wales, the Charity Commission in 2012 published guidance to support trustees on their investment duties: see publication CC 14. The Commission was in no doubt but that trustees could decide to invest ethically even if that might provide a lower rate of return. By ethical, the Commission had in mind investing in a way that reflected a charity's values and ethos and did not run counter to its

aims. Ethical approaches might include negative screening and positive screening.

19. However, in the view of the Commission, charity trustees adopting that course had to be able to justify why the approach was in the best interests of the charity, for example that a particular investment conflicted with the charity's aims. Equally, there could be justification where there was no significant financial detriment. Trustees adopting this course ought to be clear about the reasons why certain companies or sectors were excluded or included, ought to evaluate the effect of any proposed policy on investment returns and might wish to balance any risk in lower returns against the risk of alienating support and damaging reputation. The Commission emphasised, however, and very much in line with the views expressed by Lord Murray, that trustees were not free to use investment powers to make moral statements at the expense of the charity.

20. In my opinion therefore:

- Dundee City Council and its sub-committee have power to withdraw from investments which it considers are not ethical having regard to its values, ethos and aims;
- Given the widespread concerns as to the effect of tobacco on health it would seem to be within the power of Dundee City Council to determine that investment in such a sector was contrary to its values, ethos and aims;

- Were the Council or sub-committee to consider making such a policy it should express clearly the reasons why that sector was to be excluded. An example might be that it was part of the function of a local authority to promote public health, that there were well authenticated concerns as to the effect of tobacco use on health (see the 2010 Act) and that it would be inconsistent on the part of the authority to be participating in campaigns to dissuade people from using tobacco products and at one and the same time supporting the tobacco industry by investing in it.
- Prior to reaching a decision the effect of the proposed policy on investment returns should be evaluated with investment managers; and
- In the event that the advice of investment managers was that there was a significant risk of materially lower returns overall, the Council and sub-committee should take that point into account prior to reaching their decision. Such a view would not preclude a decision to withdraw from the sector but would be a material consideration to be taken onto account along with all other material considerations.

Query (iii)

21. For the reasons given above I do not agree with the opinions expressed by Mr. Brailsford QC (as he then was) in his opinion of 11 September 2005. Again for the reasons given above, I would not have agreed with those opinions as at that date.

Query (iv)

22. I have nothing further to add.

THE OPINION OF

J.W. McNeill, Q.C.

Advocates' Library,
Parliament House,
Edinburgh, 21 January 2013

OPINION OF COUNSEL

for

DUNDEE CITY COUNCIL

regarding

The Tayside Superannuation Fund and the Tayside Public Transport Co Limited Superannuation Fund

<u>2013</u>

<u>DUNDEE CITY COUNCIL</u>
Ref: DAB

DUTIES OF ADMINISTERING AUTHORITIES UNDER 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 is by way of confirmation of advice previously given in consultation.

2. The LGPS is a defined benefit scheme, the terms of which are prescribed by delegated legislation made under s 7 of the Superannuation Act 1972. The main current governing instruments are the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007 No 1166), and the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008 No 239). From 1 April 2014 it will be the Local Government Pension Scheme Regulations 2013 (SI 2013 No 2356 – "the 2013 Regulations"), albeit with transitional provisions to protect benefits accrued under the earlier version of the LGPS. The 2013 Regulations are designed in part to satisfy the requirements of the Public Services Pensions Act 2013 when it comes into force. Although there are important differences between the old and new schemes from a benefits perspective, I do not see any changes which would affect the issues discussed in this Opinion. Since the LGA is principally concerned with the position going forward, I shall refer below to the provisions of the 2013 Regulations. Also relevant to the question of investment of scheme funds are the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009 No 3093 – "the Investment Regulations"), which will continue in force after 1 April 2014.

3. Under r.53 of the 2013 Regulations, each of the administering authorities listed in Part 1 of Schedule 3 must maintain a pension fund for the LGPS, and the administering authority is "responsible for managing and administering the Scheme" in relation to any person for whom it is the appropriate administering authority. Under r.2(2), it is also the scheme manager (as provided for by s 4 of the 2013 Act) "responsible for the local administration of pensions and other benefits payable under these Regulations". All of the administering authorities are local authorities, save for the London Pension Funds Authority, the South Yorkshire Pension Authority, and the Environment Agency.

4. There may be, and usually will be, a number of different employers in relation to any given LGPS fund. They may be the bodies listed in Schedule 2 to the 2013 Regulations, or they may be admission bodies[1]. They are required to make the pension contributions and other payments into the fund provided for at r.67 et seq of the 2013 Regulations.

5. The first question I am asked to address in this Opinion is whether the administering authority owes fiduciary duties, and if so, to whom[2].

6. In my view the administering authority does owe fiduciary duties, both to the scheme employers, and to the scheme members. I would accept that, as the Court of Session held in relation to the similar Scottish scheme in *Re Bain* 2002 SLT 1112, there is no free-standing trust apart from the statutory scheme, and therefore that the administering authority is not a

[1] It is possible for separate admission agreement funds to be established, but I understand that this is unusual (if indeed it has occurred at all), and this Opinion is directed to the position of the ordinary fund.

[2] I am aware that there is a pending claim, due to be tried in the early part of 2015, which involves a dispute between a claimant administering authority (Wolverhampton CC) and a defendant contractor/admission body, and in which the counterclaim raises certain issues about alleged fiduciary obligations owed by the claimant to the defendant. There is some potential for any judgment that may be given in this case to affect the issues discussed in this Opinion.

trustee as such[3]. But fiduciary duties are not limited to trustees. A classic case in which fiduciary duties are held to exist is that in which one person administers the property or the financial affairs of another (see the speech of Lord Browne-Wilkinson in *White v Jones* [1995] 2 AC 207). Although not strictly speaking a trust fund, an LGPS fund is closely analogous to one. The way in which it is administered may have a significant financial impact upon employers and members.

7. That is most acutely true, and most immediately apparent, in the case of scheme employers, who are liable to have to pay for mismanagement through increased contributions. But it is also true of members. Whilst a member's statutory entitlement to his or her defined benefits subsists regardless of whether the fund is doing well or badly (and the contributions required of the member do not vary with that performance), it would be naïve to suggest that there is no scope for members to be affected by fund performance. If the fund is doing badly, and employer contributions rise as a result, it is easy to see that the various discretions for which the 2013 Regulations provide are less likely to be exercised in members' favour. Further, as a practical proposition, if the fund is running into severe financial problems and employer contributions threaten to reach unsustainable levels, legislative measures are likely to be taken to curtail benefits or raise employee contributions well before the point of exhausting the fund is reached, regardless of what the position might be if such exhaustion actually occurred[4].

8. I should say, however, that I rather doubt that the existence of fiduciary duties will in this context make very much difference to what the position

[3] 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).

[4] That is one of the issues to be addressed in further written advice. For present purposes it suffices to say that, whilst I think it unlikely as a matter of political reality that matters would ever be allowed to reach the stage of exhaustion of the fund, there is at any rate a theoretical potential for members' interests to be prejudiced in that scenario.

would be if analysed simply in terms of the obligations imposed upon the administering authority as a matter of public law – notably, the normal *Wednesbury*-type obligations to exercise discretionary powers rationally, for a proper purpose and by reference only to legally relevant considerations. It is well established that the nature and content of a fiduciary duty will vary according to the circumstances of the case and the precise nature of the relationship between the parties: the classic analysis is that of Millett LJ, as he then was, in *Bristol & West Building Society v Mothew* [1998] Ch 1. There is an analogy to be drawn with the recent decision of the Court of Appeal in *Charles Terence Estates Ltd v Cornwall Council* [2013] LGR 97, where the court acknowledged the line of authority which stated that local authorities owe a fiduciary duty to local taxpayers, but nonetheless treated the content of that duty in a manner which was for practical purposes indistinguishable from *Wednesbury* unreasonableness. The defendant authority's contention in *Charles Terence* was that it was free of any obligation to make further payments under certain leases concluded by its predecessors, because those leases were void, having been entered into in breach of fiduciary duty. The alleged breach of fiduciary duty consisted of a failure to have regard to market rents when the leases were concluded. At paragraph 20, Maurice Kay LJ said that the facts, taken at their highest, established significantly less culpability than in cases where breach of fiduciary duty arguments had succeeded. Those had been cases of "eccentric principles" or "flagrant violation" or the making of a gift or present of public money, or of the doubling of ratepayers' financial burden. It was pointed out that it was wrong to seek to justify excessive judicial intervention "by adopting an expansive approach to *vires* and fiduciary duty". Caselaw about *Wednesbury* unreasonableness in the balancing of different interests was said to "resonate" in the context of fiduciary duty arguments as well. In *R (Nash) v Barnet LBC* [2013] EWHC 1067 (Admin) the language of "reckless disregard" of proper financial principles was used to indicate what was necessary to make good a claim of breach of fiduciary duty.

9. One potential difference is that a breach of fiduciary duty is capable of sounding in damages (or at any rate an obligation to pay compensation in equity), whereas a breach of public law, as such, is not. Equitable compensation was described in *Target Holdings Ltd v Redferns* [1996] 1 AC 421 as being designed "to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach." But it is to be noted that acting negligently but in good faith is not a breach of fiduciary duty: see e.g. *Royal Bank of Scotland plc v Chandra* [2011] EWCA Civ 192. It is not necessary for the purposes of this Opinion to consider whether an administering authority owes a duty of care in negligence to scheme employers[5], although in view of the fact that the authority's role is imposed upon it by statute and without any element of profit, this seems to me unlikely.

10. The next issue I am asked to address is how an administering authority may approach the discharge of its functions, and in particular, what considerations may legitimately influence the exercise of investment decisions.

11. The practical context is that the way in which superannuation fund monies are invested is capable of having an impact upon matters with which administering authorities are legitimately concerned in the context of their broader local government responsibilities. Such an impact might be positive or negative. For example:

    (i) Looked at positively, the investment of fund monies might enable or sustain some project or activity which is of benefit to the authority's area. That might be an infrastructure project, it might

[5] I cannot imagine that any such duty is owed to individual scheme members, at least in relation to the general administration of the fund.

be the provision of social housing, or it might be an undertaking offering local employment[6];

(ii) Looked at negatively, there might be certain investments which were thought[7] to be harmful to the broader interests of the authority's area or in its inhabitants – such as their health (e.g. equity holdings in manufacturers of alcohol or tobacco), or their environment (e.g. oil companies engaged in fracking). There might be other cases in which a particular investment was regarded by the administering authority as ethically objectionable (e.g. in a company alleged to be engaged in aggressive tax avoidance, or to be sourcing supplies from factories with inadequate labour conditions).

12. How far can any such considerations legitimately influence the investment decisions of the administering authority (or the instructions which it gives to appointed investment managers)? I shall assume for present purposes that any investment decisions taken would be consistent with the investment policy formulated by the administering authority under r.11 of the Investment Regulations.

13. It seems to me that there are two relevant points to make. The first point is that the power (in fact the duty) to invest fund monies under r.11 is a power of investment. Therefore it must be exercised, when it comes to the discretion to choose one investment rather than another, for investment purposes, and not for some other purpose. This must be right

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[6] Some of these possibilities might, in addition to the issues upon which I have been asked to advise, raise questions of state aid. However, there would not normally be unlawful state aid if the so-called market economy investor principle was satisfied i.e. if the public body in question has acted in a way that a private commercial investor would act in a market economy. As will be apparent from the analysis below, if that test was not passed, it is unlikely that the investment would in any case be a proper one for the administering authority to make.

[7] Obviously these are issues upon which views would differ, but an opinion that the activities I mention are harmful in nature would be unlikely to be one which was *Wednesbury* unreasonable in itself.

as a matter of principle, again regardless of whether the situation is analysed in terms of fiduciary duty or in terms of public law principles (or in terms of r.11(2) of the Investment Regulations, which requires a policy to be formulated with a view to suitability and to a wide variety of investments). The same point about purpose was made in *Harries v Church Commissioners for England* [1992] 1 WLR 1241, a case of a statutory obligation to hold and invest assets for certain charitable purposes.

14. It therefore follows that it would be impermissible, for example, for the administering authority to invest fund monies in the local football club, because it was thought important to the area to keep the club afloat, in circumstances in which that was not likely to be a good or prudent investment (as compared with other investments that might be made). Similarly, it would not be permissible to invest in social housing just because there was a need for more such housing, if that was not a good and prudent investment. Nor would it be permissible to exclude from the fund investments to which objection was taken on the sorts of grounds set out in paragraph 11(ii) above, if that was likely to have an adverse impact upon the returns achieved or to lead to the fund being exposed to an unduly narrow and undiversified investment portfolio.

15. The harder question is how far such broader considerations may influence an investment decision where such adverse consequences would not follow. This has been much debated since *Harries* and the earlier decision in *Cowan v Scargill* [1985] Ch 270[8]. Leaving aside the case (irrelevant for LGPS purposes) where all the beneficiaries share a particular ethical position, *Cowan* seems to contemplate that such considerations could only be relevant on a strict "tie break" basis, i.e. where there is absolutely nothing else to choose between two possible investments. However,

[8] Again, *Martin* (see footnote 3 above) is a decision in the specific context of the LGPS, and relating to South African disinvestment, but the judgment is difficult to follow. The council's decision was struck down primarily on the basis that it had been approached in the wrong way.

although the judge in *Harries* said that his conclusions were consistent with *Cowan*, I read the judgment as going a little further, so as to permit wider considerations to be taken into account where to do so would not risk significant financial detriment to the fund.

16. That would in any event be my view of the position in relation to the LGPS. I think that is consistent with r.12(2)(f) of the Investment Regulations, which requires the investment policy to state how far social, environmental or ethical considerations are taken into account. That would be an implausible provision if such considerations were invariably or almost invariably impermissible ones to take into account, and what is a proper consideration must be determined in the light of the statutory scheme as a whole.

17. It therefore follows that the administering authority can in principle have regard to wider considerations where that does not run the risk of material financial detriment to the fund. So, for example, if social housing was a good investment financially, and the precise location was immaterial[9], the authority for the Greater Manchester Pension Fund could in my view choose to invest in social housing in Greater Manchester rather than in Cornwall. Likewise, if tobacco investments were seen as deleterious to the health of the population, they could be avoided if but only if that did not endanger the diversity of investments or the returns likely to be achieved.

18. Nothing I have said above, is in my view, affected by authorities' duties under the s 2B of the National Health Service Act 2006, or under s 149 of the Equality Act 2010. The duty under the former is only to take steps that an authority considers appropriate for improving health. It cannot be appropriate to exercise an investment power in a manner not consistent with the principles above. The administering authority *could* also lawfully decide that it was inappropriate, in that capacity, for it to try to make

[9] Perhaps not a plausible assumption in reality, but useful for illustrative purposes.

difficult judgments about the health implications of investments. The s 149 duty is to have "due regard" to equalities considerations, which again does not require an investment power to be exercised in a way inappropriate from an investment perspective (cf. *R (Lewisham LBC v Assessment and Qualifications Alliance* [2013] EWHC 211 (Admin) at paragraphs 145 to 148). At most, the administering authority might be obliged to have regard to health or equalities implications in cases where it was apparent that there were significant relevant implications of choosing one investment rather than another, and that choice was entirely neutral from an investment perspective: I would expect such situations to be rare, and it would be for the administering authority to judge whether (for example) the choice really was neutral in investment terms.

19. The second point is that, even where it is permissible to have regard to wider considerations when choosing between investments, it still cannot be legitimate for the administering authority to place its own wider interests (whether those of the authority itself, or those of its own area or inhabitants) above those of the other scheme employers, assuming that the administering authority is not itself the sole employer[10]. This is simply an application of the principle that at the core of a fiduciary relationship is a duty of loyalty. The fiduciary cannot, when acting as such, prefer his own interests to those of the party to whom the fiduciary duty is owed, and cannot use his position for his own profit (or not without informed consent). I have no doubt that the same result follows from public law principles of improper purpose and irrelevant considerations.

20. What this means in practical terms is that the administering authority, when acting as such, must be blind to its own wider interests insofar as they may diverge from or conflict with those of the other parties interested in the fund. So it would not be permissible to invest in, say, a

[10] It is unlikely that, so far as this aspect of the discussion goes, there would be conflicting interests as between scheme members and the administering authority.

social housing project in the administering authority's own area, rather than one in the area of another employing authority within the fund, because of that location[11].

21. I think it also follows that the administering authority should not impose its own view on, for example, the desirability of investing in oil companies, if that would differ from views likely to be generally held by other scheme employers and scheme members. For completeness I add that it is equally not open to employing authorities to impose their own views of such matters upon the administering authority. There is no mechanism by which they could seek to do so: investment decisions are for the administering authority to take. Save perhaps in the rare cases mentioned at the end of paragraph 18 above, the administering authority is in my view under no legal *obligation* to consider investment decisions from any perspective other than the maximisation of returns, whatever precise scope there may be for it to take account of wider matters if it chooses to do so.

CONCLUSIONS

22. In managing an LGPS fund, the administering authority has both fiduciary duties and public law duties (which are in practice likely to come to much the same thing).

23. The administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the fund (balancing risk and return in the normal way).

[11] Obviously the location would not preclude the investment if that project was chosen simply because it was the best investment proposition.

24. However, so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund. In taking account of any such considerations, the administering authority may not prefer its own particular interests to those of other scheme employers, and should not seek to impose its particular views where those would not be widely shared by scheme employers and members (nor may other scheme employers impose their views upon the administering authority).

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

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25 March 2014

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IN THE MATTER OF
THE LOCAL GOVERNMENT
ASSOCIATION

AND IN THE MATTER OF
ADMINISTERING AUTHORITIES
UNDER THE LOCAL GOVERNMENT
PENSION SCHEME

OPINION

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Client Advice Note

Client	Tayside Pension Funds
Subject	Tobacco Investments
Prepared by	Roisin McGuire FFA
Reviewed by	Graeme D Muir FFA
Date	1 April 2014

1. Introduction

1.1. We have been asked by Tracey Russell to undertake some analysis on the potential impact on the funding position and contribution requirements if the Main Fund was to avoid investing in tobacco stocks.

2. Data

2.1. Tracey has provided us with some data supplied by the Fund managers on what the assets values would have been as at 30 June 2013 had they not invested in the tobacco sector in the previous 5 years.

2.2. This analysis shows that the assets would have been £32m less had the Fund avoided tobacco stocks over that 5 year period. £32m represents approximately 1.4% of the total assets as at 30 June 2013 which equates to a reduction in return on the Fund of approximately 0.3% per annum over the previous 5 years.

3. Analysis

3.1. To assess the impact on funding position we have taken as our starting point the Inter-valuation Monitoring Report prepared by ourselves as at 30 June 2013.

3.2. We have then recalculated the results of the intervaluation monitoring assuming

- Assets lower by £32m
- Future investment returns 0.3% lower than previously assumed

4. Results

4.1. The following table sets out the result of the analysis:

Smoothed Valuation June 2013	Published	Lower Assets	Lower Assets and Lower Returns
Assets (£000s)	2,321,365	2,289,282	2,289,282
Liabilties (£000s)	2,212,434	2,212,434	2,293,409
Surplus/(Deficit) (£000s)	108,932	76,849	(4,126)
Funding Level %	104.9%	103.5%	99.8%
Ongoing Cost (% of payroll)	16.2%	16.2%	16.8%
Past Service Ctbn (% or payroll)	(2.5%)	(1.8%)	0.0%
Total Ctbn (% of payroll)	13.7%	14.5%	16.8%
Total Payroll (£(000s) at 31 Mar 2013)	350,000	350,000	350,000
Total Ctbn (£000s)	48,080	50,648	58,871

A1.1. As we see the funding level would have been 1.4% lower and the total required contribution rate would have been 0.8% of payroll higher if we only allow for the lower asset value. Assuming a total payroll of £350m this would equate to an extra £2.5m or so in extra contributions

A1.2. If we also assume that the reduction in return over the last 5 years is replicated in all future years then the funding level drops by a further 3.7% and results in extra contributions of 3.1% of payroll or an extra £10.8m in contributions.

4.2. We would be pleased to answer any questions arising from this note.

Graeme D Muir FFA

Roisin McGuire FFA