The Scottish Local Government Pension Scheme
c/o the Head of Service,
Convener of the Pensions Committee and Chair of the Pension Board of the respective Scottish LGPS Fund

24 June 2016

Fiduciary Duty

The Scheme Advisory Board (**SAB**) has been considering the application of the legal principles of Fiduciary Duty by the Pensions Committees of the Local Government Pension Scheme (**LGPS**) in Scotland. In doing so it has, following a tender exercise, appointed specialist legal advisors in this sector to produce a legal report and opinion (**Opinion**) which builds on the extensive advice from industry experts already obtained in this area but also provides clarity of the position under Scottish law.

We therefore attach the Opinion to assist your Pensions Committee and Pension Board in applying this fundamental principle in practice. We believe the Opinion is helpful in that it reaffirms the substantial majority of advice already obtained on this matter, and its consistent application in Scotland, but also provides further clarification on a number of important matters.

The SAB is acutely aware of the need for the Scottish LGPS to have the flexibility to apply these principles to specific circumstances and the latitude that this will necessarily require. With that in mind, the SAB would request that Pensions Committees and Pensions Boards have regard to the following when exercising their fiduciary duties in relation to their investment programmes and, more generally, in ensuring best practice stewardship of their assets:

1. *The Opinion of 11 February 2016 enclosed with this letter.*

2. *The expectation that Funds within the Scottish LGPS will:*

    a. *have long-term investment horizons which are appropriately aligned to their member and employer stakeholders and investment strategies that (when taken as a whole) reflect this;*

    b. *dedicate sufficient time and resource, taking advice from suitably expert and reputable advisors where appropriate, to properly inform their asset allocation, investment and manager selection decisions;*

    c. *exercise sufficient levels of attention, care and diligence, taking advice from suitably expert and reputable advisors where appropriate, in appraising particular investment opportunities. It is recognised that due to the large amount of potential investment opportunities available, Funds will necessarily require to manage their*

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resource to focus on those opportunities that are best aligned to their asset allocation and investment strategy;

d. *have due regard to any conflicts of interest when appraising particular investment opportunities and/or manager mandates;*

e. *have appropriate governance arrangements in place to effectively implement and review their investment strategies; and*

f. *incorporate Environmental, Social and Corporate Governance (ESG) factors as an active and embedded principle of risk and return assessment in managing and determining its investment portfolio and ensuring that any managers appointed by the Funds are doing likewise. Dedicating sufficient time and resource to monitoring the proper application of ESG factors in the manner set out above.*

These guidelines are deliberately broad to ensure that they do not conflict with the legal principles or analysis and take into account the fact that this is a complex area where the detail will necessarily be required to be considered on a case by case basis by Pensions Committees and Pension Boards. Nevertheless, they are also viewed as being sufficiently detailed to ensure that Funds will be required to take a responsible approach, grounded in industry best practice, to administering their investment programmes and in exercising their fiduciary duty. Importantly, the SAB is keen to guard against extremes or selective interpretation of the legal principles by Pension Committees and Pension Boards, for instance which might unduly restrict the consideration of ESG and other wider factors which the Opinion makes clear may influence the choice of investments so long as that does not risk material financial detriment to the Fund (with some more detailed advice and parameters included to assist Funds in assessing this).

Yours sincerely

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