Neutral Citation Number: [2018] EWCA Civ 1284

Case No: C1/2017/1935

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
ADMINISTRATIVE COURT
Sir Ross Cranston
[2017] EWHC 1502 (Admin)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 06/06/2018

Before :

LORD JUSTICE DAVIS
LORD JUSTICE HICKINBOTTOM
and
SIR STEPHEN RICHARDS

- -

Between :

The Queen
on the application of

(1)	**Palestine Solidarity Campaign Ltd**	**Claimants/**
(2)	**Jacqueline Lewis**	**Respondents**

- and -

Secretary of State for Communities and Local Government	**Defendant/ Appellant**

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- -

Julian Milford (instructed by **the Government Legal Department**) for the **Appellant**
Nigel Giffin QC and **Zac Sammour** (instructed by **Bindmans LLP**) for the **Respondents**

Hearing date: 17 May 2018

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Approved Judgment

Sir Stephen Richards :

1. This appeal concerns the lawfulness of passages in statutory guidance issued by the Secretary of State for Communities and Local Government in relation to the investment strategy of authorities administering the local government pension scheme. The relevant document, *Guidance on Preparing and Maintaining an Investment Strategy Statement* ("the Guidance"), included a summary requirement that administering authorities "should not pursue policies that are contrary to UK foreign policy or UK defence policy", with a fuller statement in the accompanying text that "using pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries are [*sic*] inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government". Sir Ross Cranston, sitting in the Administrative Court, held that the powers conferred by the legislation could be exercised only for "pensions purposes" and that the Secretary of State had not acted for a pensions purpose in including those passages in the Guidance. On that basis the judge granted a declaration that the passages were unlawful.

2. The Secretary of State appeals against the judge's order, with permission granted by the judge himself. The respondents seek to uphold the judge's reasoning as to unauthorised purpose and, by a respondent's notice, they rely in the alternative on a ground rejected by the judge, namely that the relevant part of the Guidance was contrary to Article 18 of Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision ("the IORP Directive"). Other grounds raised in the claim form or before the judge are not pursued.

3. I shall deal with the position under domestic law before turning to consider the respondents' alternative case under EU law.

The domestic legal framework

4. The preamble to the Public Service Pensions Act 2013 ("the 2013 Act") describes it as "An Act to make provision for public service pension schemes, and for connected purposes". Section 1 contains an enabling power for public service pension schemes to be established by regulations. Regulations made under that section are called "scheme regulations". By section 2 and Schedule 2, the Secretary of State is the "responsible authority" who may make scheme regulations for local government workers in England and Wales.

5. Section 3 provides, so far as material:

> "3(1) Scheme regulations may, subject to this Act, make such provision in relation to a scheme under section 1 as the responsible authority considers appropriate.
>
> (2) That includes in particular -
>
> (a) provision as to any of the matters specified in Schedule 3;

> (b) consequential, supplementary, incidental or transitional provisions in relation to the scheme or any provision of this Act."

The matters specified in Schedule 3 include:

> "11. Pension funds (for schemes which have them)
>
> This includes the administration, management and winding-up of any pension funds.
>
> 12. The administration and management of the scheme, including –
>
> (a) the giving of guidance or directions by the responsible authority to the scheme manager (where those persons are different) …."

6. By section 4(1) and (2), scheme regulations must provide for a person to be responsible for managing or administering the scheme. That person is called the "scheme manager" for the scheme. The scheme managers for local government pension schemes are the administering authorities listed in Part 1 of Schedule 3 to the Local Government Pension Scheme Regulations 2013 (which were made under the Superannuation Act 1972 but, by section 28 of the 2013 Act, have effect as if they were scheme regulations under the 2013 Act). They include county councils and London boroughs.

7. By section 21, before making scheme regulations the responsible authority must consult such persons (or representatives of such persons) as appear to the authority likely to be affected by them. By section 24, scheme regulations have to be laid before Parliament under the negative procedure.

8. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ("the 2016 Regulations") were made by the Secretary of State in exercise of the powers conferred by the 2013 Act. They were laid before Parliament on 23 September 2016 and came into force on 1 November 2016.

9. Regulation 7 deals with an administering authority's investment strategy:

> "**Investment strategy statement**
>
> **(1)** An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State.
>
> **(2)** The authority's investment strategy must include –
>
> (a) a requirement to invest fund money in a wide variety of investments;

> (b) the authority's assessment of the suitability of particular investments and types of investments;
>
> (c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;
>
> (d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
>
> (e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
>
> (f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.
>
> …
>
> (5) The authority must consult such persons as it considers appropriate as to the proposed contents of its investment strategy.
>
> (6) The authority must publish a statement of its investment strategy formulated under paragraph (1) …."

10. Regulation 8 empowers the Secretary of State to give directions where he is satisfied that an administering authority is failing to act in accordance with guidance issued under regulation 7(1).

The Guidance

11. The Guidance was published on 15 September 2016 and came into force on 1 November 2016, the same date as the 2016 Regulations came into force. We were told that the Guidance and the 2016 Regulations were treated as parts of a single package and were consulted on together.

12. Part 1 of the Guidance stated that it had been prepared to assist administering authorities in the formulation, publication and maintenance of their investment strategy statement required by regulation 7 of the 2016 Regulations. Part 2 dealt in turn with each aspect of regulation 7(2). The relevant section concerned regulation 7(2)(e). I have italicised the passages that were the subject of the judge's declaration of unlawfulness:

> "**Regulation 7(2)(e) – How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments**

When making investment decisions, administering authorities must take proper advice and act prudently. In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence. This approach is the standard that those responsible for making investment decisions must operate.

Although administering authorities are not subject to trust law, those responsible for making investment decisions must comply with general legal principles governing the administration of scheme investments. They must also act in accordance with ordinary public law principles, in particular, the ordinary public law of reasonableness. They risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it.

The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise.

However, the Government has made clear that using pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries are [sic] *inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.*

Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.

…

Summary of requirements

In formulating and maintaining their policy on social, environmental and corporate governance factors, an administering authority:-

- **Must take proper advice**
- **Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be**

> **taken into account when making an investment decision based on non-financial factors**
> - **Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments**
> - ***Should not pursue policies that are contrary to UK foreign policy or UK defence policy***
> - **Should explain their approach to social investments"**

13. We were told that in the light of the judge's declaration, and pending the present appeal, the Guidance has since been reissued without the italicised passages.

The judgment below

14. The judge outlined the nature of the case as follows:

> "4. At the outset it is perhaps helpful to underline a rather obvious point: this case is about whether this part of the Secretary of State's guidance has a basis in law. The claimants and their supporters, including War on Want, the Campaign Against Arms Trade and the Quakers, object to the limiting effect of the guidance on their ability to campaign around the investment of local government pension funds affecting the Palestinian people and the Occupied Territories. In particular the second claimant, Jacqueline Lewis, wishes, as a matter of conscience, to influence how the pension monies she has earned are invested. On the other hand the government is concerned that local government pension funds should not be involved in such political issues because of the mixed messages it might give abroad; because it might undermine community cohesion at home by legitimising anti-Semitic or racist attitudes and attacks (although it accepts that anti-Israel and pro-Palestinian campaigning is not in itself anti-Semitic); and because it could impact adversely on the financial success of UK defence industries."

15. The judge identified the relevant issue of domestic law as being whether in introducing foreign/defence considerations into the Guidance the Secretary of State was acting in accordance with the statutory purposes authorised. Referring to *Padfield v Minister of Agriculture, Fisheries and Food* [1968] AC 997 and *R (Rights of Women) v Lord Chancellor and Secretary of State for Justice* [2016] EWCA Civ 91, [2016] 1 WLR 2543, he said that that required an analysis of the policy and objects of the legislative scheme and a consideration of the purposes for which the Secretary of State actually exercised the relevant power. He continued:

> "28. The starting point in identifying the statutory purposes is the legislation. The preamble to the 2013 Act makes clear that it is to make provision for public service pension schemes and for connected purposes, and the substantive provisions are on

their face included for pensions purposes. Therefore in the absence of any provision to the contrary, the regulation-making powers conferred by the legislation can only be exercised for pensions purposes. The purposes for which the power to make guidance under the 2016 Regulations can be exercised can be no wider than those behind the making of the regulations themselves. Thus it is a power which may only be exercised for pensions purposes.

29. Yet it is clear from the Secretary of State's own evidence that the parts of the guidance the claimants challenge were not issued in the interests of the proper administration and management of the local government pension scheme from a pensions perspective, but are a reflection of broader political considerations, including a desire to advance UK foreign and defence policy, to protect UK defence industries and to ensure community cohesion.

30. The Secretary of State attempted to meet the point with the argument that these foreign/defence affairs purposes are pension purposes since non-financial purposes, not connected with prudential management, can be pension purposes. Certainly the general law recognises that non-financial factors can be pension purposes, so long as there is no risk of significant financial detriment from taking investment decisions with such factors into account: for example, *Harries v Church Commissioners for England* [1992] 1 WLR 1241 and see Law Commission, *Fiduciary Duties of Investment Intermediaries*, Law Com No 350, 2014, [6.33]-[6.34].

31. So, too, with regulation 7(2)(e) of the 2016 Regulations and that part of the guidance stating that non-financial considerations can be taken into account provided that doing so would not involve significant risk of financial detriment and where there is good reason to think that scheme members would support the decision. There can be no objection to this part of the guidance: it is issued for pension purposes by imposing a base-line of risk and taking into account the role the legislative design gives local government pension scheme members through local pension boards and otherwise.

32 But the flaw in the Secretary of State's approach is that the guidance has singled out certain types of non-financial factors, concerned with foreign/defence and the other matters to which reference has been made, and stated that administering authorities cannot base investment decisions upon them. In doing this I cannot see how the Secretary of State has acted for a pensions' purpose. Under the guidance, these factors cannot be taken into account even if there is no significant risk of

> causing financial detriment to the scheme and there is no good reason to think that scheme members would object. Yet the same decision would be permissible if the non-financial factors taken into account concerned other matters, for example, public health, the environment, or treatment of the workforce. In my judgment the Secretary of State has not justified the distinction drawn between these and other non-financial cases by reference to a pensions' purpose. In issuing the challenged part of the guidance he has acted for an unauthorised purpose and therefore unlawfully."

The Secretary of State's appeal: unauthorised purpose

16. The single ground of appeal is that the judge erred in law in concluding that the Secretary of State acted for an unauthorised purpose in issuing the challenged part of the Guidance. Mr Milford's submissions started from the common ground that a power conferred by legislation must be used so as to promote the policy and objects of the legislation: *Padfield* (cited above). He cited *R (One Search Direct Holdings Ltd) v York City Council* [2010] EWHC 590 (Admin), [2010] PTSR 1481 for the proposition that the intention of Parliament must be deduced from the words of the statutory provisions themselves, looked at in their context. He referred to *R v. Secretary of State for the Environment, Transport and the Regions, ex parte Spath Holme Ltd* [2001] 2 AC 349 at 358F, as indicating that an Act may have more than one statutory objective. He submitted that on the straightforward language of the 2013 Act and the 2016 Regulations, the relevant part of the Guidance fell within them and that there is no reason for giving the statutory language a narrow meaning.

17. For the respondents, Mr Giffin QC submitted that the judge was right at para 28 of his judgment that the relevant powers could only be exercised for "pensions purposes". Nothing in the 2013 Act suggests that its contemplation goes any further than pensions, whereas the rationale for the distinction drawn in the Guidance is not to do with pensions: it concerns matters of perceived public interest having nothing to do with the proper administration of a pension from a pensions perspective. Mr Giffin submitted further that the judge was right in the way he characterised the Secretary of State's actual purposes at paras 4 and 29 of the judgment, and to hold in para 32 that those were not purposes authorised by the legislation. It was not sufficient that the Guidance had non-financial considerations as its subject-matter; it was necessary for the relevant part of the Guidance to have a pensions purpose. It was permissible for the Secretary of State to say that authorities should not risk significant financial detriment to the scheme in taking non-financial considerations into account, since that was purely a pensions purpose. The requirement to have good reason to think that scheme members would support the decision also had a pensions purpose. But the Secretary of State had failed to justify by reference to any pensions purpose the relevant part of the Guidance which treated some non-financial considerations differently from others.

18. Citing *Harries v Church Commissioners for England* [1992] 1 WLR 1241 and the Law Commission's Report on Fiduciary Duties of Investment Intermediaries (Law Com No. 350), to which the judge referred at para 30, Mr Giffin submitted that the position of an administering authority of the local government pension scheme in its capacity as such is closely analogous to that of any other pension scheme trustee; that under the general law a pension scheme trustee may take account of non-financial considerations but only if there is no risk of significant financial detriment to the fund and if there is good reason to think that scheme members share the relevant concern; and that a pension scheme trustee cannot act for the dominant purpose of serving its own wider political agenda or of what the public interest demands. It followed in his submission that there was a false premise to the Secretary of State's argument that, as a corollary of what administering authorities can do, the Secretary of State must be in a position to give guidance based on what the public interest demands.

19. In considering this issue there is, in my judgment, a risk of over-elaborating what is in truth a simple point. The 2013 Act confers a broad discretion upon the responsible authority, in this case the Secretary of State. It provides a framework for the establishment of public service pension schemes by means of regulations which, subject to the Act, may make such provision in relation to a scheme as the responsible authority considers appropriate. That may include provision as to the administration and management of the scheme, including in turn the giving of guidance to the scheme manager. The power to make regulations and to give guidance must of course be exercised so as to promote the policy and objects of the legislation but the discretion conferred is nonetheless a wide one, and the range of considerations that may in principle be taken into account in its exercise is likewise wide.

20. It is plainly within the scope of the legislation for an authority's investment strategy to make provision for non-financial considerations to be taken into account in making investment decisions. Thus, nobody suggests that regulation 7(2)(e) falls outside the powers of the statute in requiring that an authority's investment strategy must include the authority's policy on how social, environmental and corporate government considerations are taken into account in the selection, non-selection, retention and realisation of investments. Since the Secretary of State is empowered to give guidance as to an authority's investment strategy, it seems to me to be equally plainly within the scope of the legislation for the guidance to cover the extent to which such non-financial considerations may be taken into account by an authority. The detailed content of that guidance is a matter for the Secretary of State, subject to *Wednesbury* reasonableness. In particular, I can see nothing objectionable in his having regard to considerations of wider public interest, including foreign policy and defence policy, in formulating such guidance. In no way does that run counter to the policy and objects of the legislation. The public service pension schemes to be established under the 2013 Act include central as well as local government schemes. It must be possible to have regard to the wider public interest when formulating the investment strategy for central government schemes; and it would be very surprising if it could not also be taken into account in the giving of guidance to local government authorities, themselves part of the machinery of the state, in relation to the formulation of the investment strategy for schemes administered by them.

21. With great respect to the judge, I think that his analysis in terms of the "purpose" for which the relevant part of the Guidance was included is unduly narrow. If one approaches the matter on the basis that the powers conferred by the legislation must be exercised for a "pensions purpose", then in giving guidance as to the extent to which non-financial considerations might be taken into account in an authority's investment strategy the Secretary of State was in my view acting for an obvious pensions purpose; and the fact that he took into account considerations of foreign policy and defence policy in formulating the relevant part of the Guidance did not convert it from a pensions purpose into a non-pensions purpose. So too, whilst the judge took the view that the Secretary of State had to justify the distinction drawn between the relevant part of the Guidance and the parts relating to other non-financial considerations by reference to a pensions purpose, the Secretary of State was entitled in my view to take into account wider considerations of public interest in drawing the distinction he did, and by drawing such a distinction he did not cease to act for a pensions purpose in issuing the Guidance. For my part, however, I would avoid the language of "pensions purpose", which is at best a shorthand and is liable to mislead; and I would say the same about the expression "from a pensions perspective" which was used by the judge. In considering whether the relevant part of the Guidance falls within the scope of the 2013 Act and the 2016 Regulations, I find it more helpful to put the question in terms of whether the legislation permits wider considerations of public interest to be taken into account when formulating guidance to administering authorities as to their investment strategy; and as I have said, given the framework nature of the statute and the broad discretion it gives to the Secretary of State as to the making of regulations and the giving of guidance, I can see no reason why it should not be so read.

22. I have therefore reached a different conclusion from that of the learned judge on this issue. I do not accept that the relevant part of the Guidance was issued for an unauthorised purpose, and I am satisfied that it fell within the powers conferred by the legislation.

The respondent's notice: the IORP Directive

23. The alternative basis on which the respondents seek to uphold the judge's order is by reference to the IORP Directive. It is common ground that the Directive applies in relation to the local government pension scheme.

24. Recital (6) to the Directive states that it "represents a first step on the way to an internal market for occupational retirement pensions organised on a European scale". Recital (7) states that the prudential rules laid down in the Directive are intended both to guarantee a high degree of security for future pensioners through the imposition of stringent standards, and to clear the way for the efficient management of occupational pension schemes. Recital (8) reads:

> "Institutions which are completely separated from any sponsoring undertaking and which operate on a funded basis for the sole purpose of providing retirement benefits should have freedom to provide services and freedom of investment,

> subject only to coordinated prudential requirements, regardless of whether these institutions are considered as legal entities."

Recital (32) reads:

> "Supervisory methods and practices vary among Member States. Therefore, Member States should be given some discretion on the precise investment rules that they wish to impose on the institutions located in their territories. However, these rules must not restrict the free movement of capital, unless justified on prudential grounds."

25. The focus of the respondents' argument is Article 18 which provides as follows:

> "**Investment rules**
>
> (1) Member States shall require institutions located in their territories to invest in accordance with the 'prudent person' rule and in particular in accordance with the following rules:
>
> (a) the assets shall be invested in the best interests of members and beneficiaries …
>
> (b) the assets shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole …
>
> (c) the assets shall be predominantly invested on regulated markets …
>
> (d) investment in derivative instruments shall be possible …
>
> (e) the assets shall be properly diversified …
>
> (f) investment in the sponsoring undertaking shall be no more than 5% of the portfolio as a whole…
>
> (2) The home Member State shall prohibit the institution from borrowing or acting as a guarantor on behalf of third parties …
>
> (3) Member States shall not require institutions located in their territory to invest in particular categories of assets.
>
> (4) Without prejudice to Article 12, Member States shall not subject the investment decisions of an institution located in their territory or its investment manager to any kind of prior approval or systematic notification requirements.
>
> (5) In accordance with the provisions of paragraphs 1 to 4, Member States may … lay down more detailed rules, including quantitative rules, provided they are prudentially justified, to

> reflect the total range of pension schemes operated by those institutions …
>
> (6) Paragraph 5 shall not preclude the right for Member States to require the application to institutions located in their territory of more stringent investment rules also on an individual basis provided they are prudentially justified, in particular in the light of the liabilities entered into by the institution …."

26. Article 12, to which Article 18(4) refers, provides that each Member State "shall ensure that every institution located in its territory prepares and, at least every three years, reviews a written statement of investment-policy principles" which is to contain, at least, such matters as the investment risk methods, the risk-management processes implemented and the strategic asset allocation with respect to the nature and duration of pension liabilities.

27. The judge understood the respondents' challenge to be that the Guidance imposed a form of prior governmental approval of the investment decisions made by administering authorities, contrary to Article 18(4) of the Directive. He noted that there did not appear to be any jurisprudence regarding the meaning of "prior approval" in Article 18(4) but he referred to a number of cases before the Court of Justice of the European Union, to which I will come back, on a similar provision in Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance ("the Non-life Insurance Directive").

28. The judge then summarised the respondents' case as follows:

> "52. The claimants submit that making the permissibility of an investment decision depend upon the guidance is to subject it to a form of prior approval for the purposes of article 18(4). Prior approval is not confined to situations where the administering authorities have to go cap in hand, as Mr Giffin QC put it: it covers the restrictions in the guidance at issue in this case. Article 18(4) cannot be sidestepped simply by making the necessary approval or otherwise of an investment decision a function of the state's general policy, rather than of some more explicit or individual approval process. The application of the Directive must depend upon substance, not form. The broader reading is reinforced, it is also said, by the descriptive phrase "any kind of" which precedes "prior approval" in article 18(4).
>
> 53. The claimants' construction accords, the claimants also submit, with the purpose of the Directive where the only limitations which Member States can lay down are so that investments are made prudentially. Otherwise there can be no restrictions as to where to invest. In that context the claimants contend that article 18(4) is the corollary of article 18(3): article 18(3) precludes positive interference, i.e. the state demanding investment in particular assets, whilst article 18(4)

> precludes negative interference, i.e. the state being able to withhold a required approval for a particular investment decision, whether such approval has to be sought in advance or by way of subsequent notification. Finally, it is said, the breadth of article 18(4) explains why it opens with a saving for article 12, which obliges states to require institutions to prepare periodic statements of their investment policy principles."

29. He gave the following reasons for rejecting that case:

> "54. In my view the phrase "any kind of prior approval" connotes an obligation to subject individual investment decisions to external oversight before investments are made. It does not cover what the guidance in this case does, in allowing administering authorities to decide what investments to make, but providing a framework for the content of statements of investment policy which administering authorities must prepare. Further, as Mr Milford for the Secretary of State pointed out, prior approval in article 18(4) is linked with notification, both phrases connoting circumstances in which an administering authority must inform some external body about its investment decisions. This distinction between a general framework for investment decisions and a system of prior approval seems supported by the jurisprudence of the CJEU in the context of the use of that phrase in the Non-life Insurance Directive 92/49/EC.
>
> 55. This reading of the phrase prior approval is supported both by its immediate context and the Directive as a whole. Recital (32) and Articles 18(5) and (6) of the Directive permit Member States to impose general rules. These cannot mean the same thing as prior approval, since prior approval is by Article 18(4) always impermissible. Article 18(4) is without prejudice to Article 12, that is, Member States' duty to ensure that every institution prepares a strategy. So Article 18(4) itself makes clear that Member States do not subject occupational pension providers to any form of prior approval, merely by requiring them to produce a strategy in accordance with such rules as Member States themselves may determine. As we have seen the guidance does not mandate investment or disinvestment in any particular class of asset. More generally, the Directive is concerned to ensure the smooth functioning of the single market, in particular, the free movement of capital, and the manner in which Member States can legitimately govern the prudential investment decisions of occupational pension providers. These purposes are unaffected by the guidance addressing the non-financial decisions of providers."

30. Mr Giffin presented much the same argument to us as he had advanced before the judge below, whilst making clear that the respondents' case did not rest solely upon the "prior approval" point in Article 18(4). He submitted that Article 18 works as follows. There are mandatory investment rules in Article 18(1), all designed to ensure prudent investment. Member States have the option to lay down further investment rules, but only where they are prudentially justified, either on a general or on an individual basis: Article 18(5) and (6). Even without further express provision, it would be implicit in Article 18(5) and (6) that where the test of prudential justification is not satisfied, the state is not to interfere in the investment decisions of institutions, save as mandated by Article 18(1) and (2). This is also in accordance with recital (8). However, the prohibition upon interference on non-prudential grounds is in fact spelled out in Article 18(3) and (4): the former precludes "positive" interference by the state demanding investment in particular assets; the latter precludes "negative" interference by the state withholding a required approval for a particular investment decision, whether such approval has to be sought in advance or by way of subsequent notification. Thus the overarching purpose is to give freedom of action to schemes, subject to the prudent person rule.

31. Mr Giffin went on to submit that the challenged part of the Guidance was not prudentially justified; it clearly interfered with an administering authority's freedom of investment; the interference was not mandated by Article 18(1) or (2); accordingly, it was in breach of Article 18 and unlawful. In his submission, that conclusion could be reached solely on the basis of Article 18(5) and (6), but Article 18(4) should be construed so as to achieve the same result. The challenged part of the Guidance had the effect of submitting the investment decisions of administering authorities to a form of prior approval, because its effect was that certain types of investment decision were only permissible where formal legal sanctions, embargoes and restrictions had been put in place by the government (an effect summarised in the Guidance by saying that investment decisions must not be contrary to UK foreign policy or defence policy). Hence, a particular form of disinvestment policy would be lawful if, but only if, the government had previously signified its own approval of such an approach by putting some form of formal measures in place. Article 18(4) was not to be sidestepped simply by making the necessary approval or otherwise of an investment decision a function of the state's general policy rather than of some more explicit or individual approval process. The position was in substance the same as if the regulations or Guidance required an investment decision based on non-financial considerations to be vetted first by the Secretary of State to see whether it was contrary to UK foreign or defence policy.

32. Mr Giffin submitted that the judge wrongly limited the "prior approval" limb of Article 18(4) to cases in which prior approval had to be sought for investment decisions on an individual basis, excluding from its reach cases in which approval was conferred or withheld by way of general rules. The judge was wrong to rely on the provisions of Article 18(5) and (6) concerning general rules: the rules with which those provisions are concerned must be prudentially justified. Article 12 lays down that Member States must require institutions to prepare an investment strategy, but that is different from regulating the substantive content of the strategy and thus of the investment decisions taken pursuant to it, which is what the challenged part of the Guidance did. The judge was wrong to link the concept of prior approval with that of

notification: they are different forms of prohibited requirement, separated by "or". The fact that the challenged part of the Guidance may not itself have had much effect on the single market is immaterial to the question of construction, which is whether Article 18 catches general rules whereby investment decisions are only permissible if they comply with some specified facet of state policy. Finally, Mr Giffin submitted that the judge fell into error in finding that the case-law of the Court of Justice on the Non-life Insurance Directive supported his reading of Article 18(4).

33. For the Secretary of State, Mr Milford submitted that the judge was right in relation to the IORP Directive for the reasons he gave. Rather than summarise the way in which Mr Milford then developed his submissions, I will take his points into account in setting out my own reasons for concluding that the judge reached the correct conclusion as to the compatibility of the relevant part of the Guidance with the Directive.

34. The respondents' case depends on spelling out of the IORP Directive a prohibition on interference by Member States with the freedom of institutions to take into account non-financial considerations that do not have prudential implications for investment decisions. The whole Directive, not just Article 18, is silent on the subject. We were shown the replacement Directive, Directive (EU) 2016/2341 of 14 December 2016, which does contain provision in its Article 19(1)(b) about taking into account environmental, social and governance factors within the prudent person rule; but the final date for transposition of the replacement Directive has not yet passed and it is unsafe in any event to draw inferences from a comparison between it and the earlier Directive. In my view, the earlier Directive has to be assessed on its own terms.

35. I do not accept that a prohibition on interference by Member States with the freedom of institutions to take into account non-financial considerations can be spelled out of any part of Article 18. First, the article places obligations on Member States to require institutions to invest in accordance with the prudent person rule as more particularly set out in Article 18(1), and to prohibit institutions from borrowing or acting as a guarantor for third parties (Article 18(2)). It then prohibits Member States from requiring institutions to invest in particular categories of assets (Article 18(3)). None of those matters carries with it an implication that Member States are prohibited from limiting the non-financial considerations that may be taken into account. One then gets to Article 18(4) which is at the heart of the respondents' case but in relation to which, as explained below, I agree with the conclusion reached by the judge. Finally, Article 18(5) and (6), far from placing any restriction on Member States, permit them to lay down more detailed rules provided they are prudentially justified, whether generally or on an individual basis. They reflect the statement in recital (32) that Member States should be given some discretion on the precise investment rules that they wish to impose, save that such rules must not restrict the free movement of capital unless justified on prudential grounds. The discretion granted to Member States in relation to prudential rules does not warrant the inference that they are prohibited from limiting the non-financial considerations that may be taken into account.

36. Subject to Article 18(4), the nearest the Directive comes to supporting the respondents' case concerning non-financial considerations is recital (8), which states

that institutions should have freedom to provide services and freedom of investment "subject *only* to coordinated prudential requirements" (my emphasis). But in circumstances where neither the recitals themselves nor the substantive provisions of the Directive say anything about non-financial considerations, and having regard to my comments on the various paragraphs of Article 18 itself, I do not think that recital (8) is sufficient to sustain the respondents' case that the relevant part of the Guidance is in breach of the Directive.

37. That brings me to Article 18(4). I agree with the judge's reasoning at para 54 of his judgment that "the phrase 'any kind of prior approval' connotes an obligation to subject individual investment decisions to external oversight before investments are made" and that "[i]t does not cover what the guidance in this case does, in allowing administering authorities to decide what investments to make, but providing a framework for the content of statements of investment policy which administering authorities must prepare". As a matter of ordinary language, the giving of such guidance is very different from the imposition of a requirement of "prior approval" of any kind for investment decisions. By affecting the policy to be included in an administering authority's investment strategy, it may have an indirect effect on investment decisions, but actual investment decisions are left to the administering authority without any form of vetting by the Secretary of State. In so far as the Guidance lays down general rules as to the policy to be included in the investment strategy, it is clear from the Directive itself that the laying down of general rules is not to be equated with a requirement of prior approval: as the judge said at para 55 of his judgment, Article 18(5) and (6) permit Member States to impose general rules (albeit subject to the proviso that they are prudentially justified), yet a requirement of prior approval is by Article 18(4) always impermissible. The judge was also right to observe in the same paragraph that the opening words of Article 18(4), "Without prejudice to Article 12", make clear that a requirement to produce a statement of investment policy principles in accordance with Article 12 does not amount to subjecting investment decisions to any kind of prior approval. All those matters point away from the construction of Article 18(4) contended for by the respondents.

38. I also consider that the judge was correct to rely as he did on the case-law of the Court of Justice on the Non-life Insurance Directive. Various provisions of that Directive prohibit Member States from introducing or retaining provisions requiring the prior approval or systematic notification of scales of premiums and other matters. The case-law on those provisions supports, as the judge said, a distinction between a general framework for investment decisions (such as the Guidance provides) and a system of prior approval.

39. In Case C-59/01, *Commission v Italy* [2003] ECR I-1780, the Court described the effect of the Non-life Insurance Directive as follows:

> "29. It is apparent that the Community legislature clearly meant to secure the principle of freedom to set rates in the non-life insurance sector, including the area of compulsory insurance such as insurance covering third-party liability arising from the use of motor vehicles. That principle implies the prohibition of any system of prior or systematic notification

> or approval of the rates which an undertaking intends to use in its dealings with policy-holders. The only derogation from that principle allowed by Directive 92/49 concerns prior notification and approval of 'increases in premium rates' in the framework of a 'general price-control system'."

The Court went on to say that the parties agreed that the rules governing premium rates laid down in the Italian legislation "significantly restrict the freedom of insurance undertakings … with regard to the fixing and altering of rates for insurance policies covering third-party liability arising from the use of motor vehicles in relation to risks situated in Italy" (para 32). Those rules were held not to be covered by the exception relating to a general price-control system. This led to the conclusion that the legislation infringed the relevant provisions of the Directive.

40. The reasoning in *Commission v Italy* is not entirely clear. Although the conclusion is expressed by reference to the provisions relating to prior approval or systematic notification of rates, it appears to rest in practice on the existence of an underlying principle of freedom to set rates and a finding that the national legislation had the effect of setting actual rates. That is the basis on which the decision is distinguished in subsequent cases. Thus, in Case C-346/02, *Commission v Luxembourg* [2004] 3 CMLR 1106, which concerned national legislation requiring the incorporation into motor vehicle insurance contracts of a system linking insurance premiums with claims records (a "bonus-malus" system), the Court stated:

> "23. The Luxembourg bonus-malus system with which the present action is concerned is, as regards its impact on insurance undertakings' rates, different in nature from the Italian legislation which was at issue in *Commission v Italy*. It is true that the Luxembourg system has effects on changes in the amount of premiums. However, the system does not result in the direct setting of premium rates by the State, since insurance undertakings remain free to set the amount of the basic premium. In those circumstances, the Luxembourg bonus-malus scheme cannot be equated with a system of approving premium rates that is contrary to the principle of freedom to set rates, as defined by the court in para [29] of the judgment in *Commission v Italy* …."

41. The same approach is apparent in a later case concerning Italian legislation, Case C-518/06, *Commission v Italy* [2009] 3 CMLR 22, in which the Court analysed the matter as follows:

> "102. In the present case, [the national provisions] oblige undertakings providing third-party liability motor insurance to calculate pure premiums and loadings separately, accordingly to their technical bases that must be sufficiently broad and refer to at least five years.
>
> 103. On the question whether that rule is compatible with the principle of freedom to set rates as set out previously, it must

> first be noted that it does not introduce a system of prior approval or systematic notification of premium rates.
>
> …
>
> 105. Thirdly, to the extent that [the national provisions] are likely to have repercussions on premium rates in that they outline a technical framework within which insurance undertakings must calculate their premiums, it is clear that such a restriction on the freedom to set rates is not prohibited by Directive 92/49."

42. So too in Case C-577/11, *DKV Belgium SA v Association belge des consommateurs Test-Achats ASBL*, the Court, referring to its previous case-law, stated that "national legislation introducing a technical framework governing how insurance undertakings are to calculate their premiums is not contrary to the principle of freedom to set rates on the sole ground that that technical framework affects premium rate changes" (para 23) and that the national system in issue, which did not impact on undertakings' freedom to set their basic premiums, had the features of such a technical framework (para 25) and was not contrary to the provisions of the Directive prohibiting a system of prior approval or systematic notification of premium rates.

43. Running through those cases, therefore, is a distinction between, on the one hand, national rules that restrict the freedom of undertakings to set their basic rates and, on the other hand, rules that lay down a technical framework which may have an impact on rates. The provisions of the Non-life Insurance Directive relating to prior approval or systematic notification, or at least the underlying principle of freedom to set rates, may be infringed by the former but not by the latter. Applying that approach across to the present case, the Guidance is closer in character to a technical framework than to a set of rules prescribing the investment decisions that may be taken by an administering authority. It relates to the policies to be included in an administering authority's investment strategy and as such it may have an indirect effect on individual investment decisions, but the authority is left with the freedom to take those decisions and is not required to invest or not invest in any particular financial product.

44. It follows in my view that the reasoning in the cases on the Non-life Insurance Directive supports the conclusion that the Guidance does not infringe the prohibition in Article 18(4) of the IORP Directive on subjecting an institution's investment decisions to any kind of prior approval or systematic notification requirements.

45. I have dealt with what I consider to be the most important of the judge's reasons for his conclusion on the IORP Directive. The rest of his reasons do not seem to me to have the same weight but equally there is nothing in them to undermine his conclusion. In summary, I agree with that conclusion and I am satisfied that the respondents' challenge to it should be rejected.

Conclusion

46. For the reasons given above, I would allow the Secretary of State's appeal and set aside the judge's declaration.

Lord Justice Hickinbottom :

47. I agree.

Lord Justice Davis :

48. I also agree with the judgment of Sir Stephen Richards.