Clarification of Fiduciary Duty is Essential… But We're Not There Yet

When, in July 2000, an UKSIF-led campaign successfully amended the 1995 Pensions Act, it was hailed as a triumph for responsible investors. The result was the world's first regulation requiring trustees of occupational pension funds to disclose the extent to which long-term social, environmental or ethical ('SEE') considerations were taken into account during the investment process.

The approach practiced by UKSIF members is a long-term one. Consequently, over the past fifteen years this has become increasingly mainstream particularly among pension funds.

We see this reflected in the breadth of our membership as well as recent quasi-regulatory developments, but the financial landscape is vastly different now than it was fifteen years ago.

The materiality of long-term considerations has become ever clearer; thinking long-term reduces risk and increases value. Yet the concept of fiduciary duty has become a source of confusion for investors, many of whom who do not understand the extent of the powers and duties entrusted to them.

Professor Kay's year-long review into equity markets in 2012 found that an excessive focus on short-term performance was impeding sustainable value creation. A long-term approach was required. One significant barrier to this was a lack of certainty over the concept of fiduciary duty which had resulted in some investment intermediaries overlooking factors which could impact investment performance. A reason for this may be that fiduciary duty developed under the UK's common law system making it inherently flexible, but difficult to define.

The 2014 Law Commission report on fiduciary duty, which arose from the Kay Review, confirmed in its findings that the law in this area was uncertain, but made clear that trustees *should* take into account financially material long-term and environmental, social and governance ('ESG') factors and may consider ethical concerns.

It also stated that, while there was no duty on investors to undertake stewardship activities, it was in the interests of pension funds, regardless of size, to do all they can to promote the long-term success of the companies in which they invest. Active ownership benefitted not only investee companies that were made more successful, but also the investors and the economy as a whole.

In its October 2014 progress report, the Government welcomed the Law Commission's recommendations and committed to consulting on changes to the Investment Regulations.

The consultation, published by the Department of Work and Pensions in February seeks views on two of the Law Commission's recommendations to provide clarification on:

- The distinction between financial and non-financial factors when taking investment decisions; and
- The role that a 'stewardship' approach can play when taking investment decisions.

The potential impact of these changes should not be underestimated. The Law Commission's report was a huge step in the right direction but we still hear of cases where trustees are being advised they may not consider material long-term financial factors.

This change needs to makes it crystal clear to trustees, their advisers and others in the investment chain that their duty to beneficiaries goes further than maximisation of short-term returns.

The significance of this review has been reflected not only in UKSIF member feedback, but through industry-wide collaboration and the excellent work being done by other organisations in the sector including NAPF, Share Action and UNPRI.

Achieving clarity over the concept of fiduciary duty is essential and the hard work by many in the sector has secured a rare opportunity to achieve it.

UKSIF will be holding a member event this Friday to enable us to submit a comprehensive response to the consultation, incorporating views from across the industry. We are also encouraging all those who are able to submit their own responses. The deadline for submissions is the 24th April.

DWP has asked for submissions from a range of stakeholders including pension industry bodies and professionals, trustees, scheme managers, scheme members and others. The Department has also expressed a particular interest in receiving case studies to better understand the issues surrounding fiduciary duty. If you are unable to submit your own response but interested in having your views or comments represented to DWP then please get in touch at fergus.moffatt@uksif.org.

In the short-term we still have the small matter of a general election to contend with. But this will be one of the first items of business for whoever becomes the next Pensions Minister, so it is vital that a wide-ranging and robust response is put forward from the industry. We hope you will take part.