UKSIF
UK Sustainable Investment and Finance Association

New Government rules could hinder councils' long-term investment and damage savings

- *Government misunderstands the financial materiality of ESG investment*
- *Government could cause breaches of pension fund fiduciary duty*
- *Long-term investment decisions could be hindered by Government*
- *Government disruption to pension fund investment decisions could put long-term returns at risk*
- *UKSIF responds to Government consultation on new rules for Local Authority Pension Fund investment.*

London, 24 February 2016 – The significant progress that has been made in new rules for the Local Government Pension Scheme (LGPS) which requires policies on how funds consider environmental, social and governance (ESG) factors and stewardship is at considerable risk unless remaining concerns relating to the draft regulations are addressed.

The industry body representing long-term investors in the UK are extremely concerned that:

- The Government has conflated ESG issues and non-financial factors. The Law Commission's 2014 report on fiduciary duties made very clear that ESG factors can be financially material and should be taken into account.
- funds should be invested in-line with UK foreign policy and a new 'Power of Intervention' will allow the Secretary of State to interfere in the investment processes of a fund where investment decisions run contrary to it. The power to determine how funds are best invested should remain with the local authorities accountable to pension scheme members.

Fergus Moffatt, UKSIF Head of Public Policy, said:

"The proposed investment regulations have taken strides forward in terms of requiring schemes to have policies on ESG and stewardship and they have finally started to reflect industry best practice. However the apparent confusion over what factors are financial and non-financial remains extremely concerning. As does proposals that investments should reflect UK foreign policy- something that changes with the Government of the day, potentially every five years. The disruption could pose a serious risk long-term investment strategies.

"The Government should publish its guidance making clear that the Secretary of State's new power of intervention will only be used when a fund is seen to be in breach of its fiduciary duty to scheme members".

-ENDS-

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<u>Notes to Editors:</u>

UKSIF's response to the DCLG consultation is available here.

To summarise, our five key concerns that need to be addressed by the Government are as follows:

1. <u>The Conflation in Terms</u>
   The misperception that non-financial factors and ESG factors are the same is dangerous and wrong. Many ESG are financially material. Many fund managers in the UK now have entire teams tasked with analysing current and emerging environmental, social and governance factors to enable them to identify long-term risks and opportunities in line with their fiduciary duties.

   An example of the distinction is as follows: Withdrawing from tobacco because the risk of litigation makes it a bad long-term investment is based on a financial factor. Withdrawing from tobacco because it is wrong to be associated with a product which kills people is based on a non-financial factor. It is crucial a distinction is explicitly recognised by the Government.

2. <u>UK Foreign Policy</u>
   First, the Government's views on the use of pension policies to pursue boycotts, divestment and sanctions in relation to UK foreign policy have been made clear. Factors which are financially material should be taken into account and it is unreasonable to expect funds to continuously analyse the extent to which their investment policies are in line with the foreign policy of the Government of the day. It is also very dangerous to expect pension funds, which have extremely long-term time horizons, to be expected to change their investment approach based on foreign policy potentially every five years. The Government should clarify that this does not apply to investment policies that integrate financially material ESG factors.

   Second, this should not exclude authorities from considering other non-financial factors during the investment process. It remains unclear why LGPS members should not have their values reflected in their investments like members of private DB schemes. The ability for funds to consider the extent to which ethical considerations are taken into account should be reinstated in the regulations. NB what is important here is the views of the scheme members (i.e. the fund's investment policy should not be decided via a council vote) and that there is no risk of significant financial detriment to the fund.

3. <u>The Power of Intervention</u>
   Much more detail is needed on the Secretary of State's power of intervention. Greg Clarke's views on appropriate investment policies have been made clear, but the power to intervene should only ever be used when an administering authority has breached its fiduciary duty. The power to determine what is or is not an appropriate investment strategy should remain with the administering authority.

4. <u>Responsible Investment</u>
   Reference is needed *within the regulations* in relation to responsible investment i.e. ESG integration and stewardship. The consultation states the regulations aim to ensure

authorities' investments are made prudently and reference to this aim within the regulations would be very helpful. A definition of what 'prudence' entails would also be useful. LGPS funds are international investors and should therefore be expected to adhere to international best practice. An expert working group should be set up to establish best practice and this should be reflected in guidance.

5. Collective Investment Vehicles
   Pooling of funds will result in benefits of scale for some LGPS funds, and active ownership and stewardship have rightly been recognised by the Government as helping to enhance the value of investments. However no details have yet been given on how stewardship activities will be conducted on investments from pooled funds. More thinking needs to be done on this, one option is for each of the new "British Wealth Funds" to sign the Stewardship Code or join the LAPFF and for each to have an individual approach and policy on stewardship.

About UKSIF:
UKSIF is the membership network for sustainable and responsible financial services in the UK. We promote and support responsible investment and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 240+ members and affiliates include financial advisers, institutional and retail fund managers, pension funds, banks, research providers, consultants and NGOs. For more information about UKSIF, please visit www.uksif.org.