OWNERSHIP DAY

USE SHAREHOLDER RIGHTS TO IMPROVE YOUR RETURNS

Understanding and applying fiduciary duty

The trustee best practice guide

The latest legal and expert thinking in fiduciary duty

...

Analysis of both pension and charity funds

...

Policy and sector activity

...

Best practice guidance

UKSIF 25 YEARS ANNIVERSARY

UKSIF

UK Sustainable Investment and Finance Association

Foreword

Fiduciary Duty is an old concept.

It has evolved through case law, which is the rulings of successive court cases, over several centuries. It has changed over time and its flexibility has been an advantage. But as a consequence it is hard to state simply what it is.

A layman might say it is the obligation of a trustee to do the right thing for a beneficiary. In recent years this has raised problems for responsible investment. Anecdotal stories were heard of trustees who wanted to change their approach being told by their advisers that “you can’t do that, it may depress the investment return and breach your fiduciary duty”. The perception grew that fiduciary duty was in conflict with responsible investment.

The Kay review in 2012 reported that:

“..some pension fund trustees equated their fiduciary responsibilities with a narrow interpretation of the interests of their beneficiaries which focused on maximising financial returns over a short timescale and prevented the consideration of longer term factors which might impact on company performance, including questions of sustainability or environmental and social impact…”

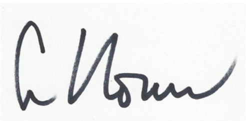
The good news is that as a consequence of the Kay Review the Law Commission was asked to review fiduciary duty and produced an expert report in 2014. Whilst the Government chose not to act on the sensible recommendations of the Law Commission, recommendations which found support from 43 out of 45 responses to a consultation on the matter, the Law Commission report does represent a recent and authoritative review of this important and complex concept.

It is not only in pensions that there has been news. Bates Wells Brathwaite, funded by the Sainsbury Family Charity Trusts, recently commissioned a written opinion from Mr Christopher McCall QC on the question of “ethically questionable investments” in charities. The topic is closely aligned to fiduciary duty in that it discusses the question of how charity trustees should act.

Taken together, the Law Commission report and the McCall opinion mean that in early 2016 we probably have more insight into what Fiduciary Duty means in the UK now than has been the case for many years. **In this report UKSIF seeks to simplify the key points of the two documents and outline to trustees - and others in the investment chain who need to know- the responsibilities that fiduciary duty places on them.** In order that the various pieces can be read separately there is some repetition. We have written the summary in sections and given context. I would like to thank my colleague Fergus Moffatt for his work on this project.

[redacted]

The opinions are those of UKSIF. A key part of fiduciary duty is asking for and acting on advice; trustees should do that and may now be better positioned to phrase the questions.



Simon Howard
Chief Executive
UK Sustainable Investment and Finance Association

UKSIF
UK Sustainable Investment and Finance Association

UKSIF's 25th Anniversary

UKSIF is the UK membership network for sustainable and responsible finance with around 240 financial service members of all types and sizes. We were founded in 1991 by a small group of pioneers and have played a key part in the growth of responsible finance in the UK, and with other national 'SIFs', around the world.

We plan to use the opportunity of our silver anniversary to recognise the work of our predecessors by summing up current thinking on some important issues in sustainable and responsible finance, and to point the way forward for the years ahead.

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Fiduciary duty and pension fund trustees

- **The Law Commission report is an expert summary of the position**
- **Financially material factors *should* be considered by trustees, and trustees may consider any financial factor which is relevant to an investment such as ESG**
- **Non-financial factors, such as quality of life, may be considered by trustees subject to two tests**
- **Trustees linked to DC funds may go further where members choose specific funds**

Context and the Law Commission

Over the past few years, evidence has mounted that environmental, social and governance ("ESG") factors can have a tangible financial impact on investments.

Two recent examples make the point: At COP21 world leaders agreed to limit global average temperature increases to 'well below 2C' forcing us to re-examine our reliance on fossil fuels whilst recent governance failings at Volkswagen resulted in a 30% drop in share price and massive reputational damage. Despite this, there is still some confusion about the extent to which pension fund trustees can reflect concern over issues like these -frequently longer-term and frequently not reflected in conventionally reported financial data- in investment whilst complying with their fiduciary duties. The 2012 Kay Review determined that short-termism was harming the UK equities market and was ultimately to the detriment of the UK economy, and Professor Kay found that some pension fund trustees were using a very narrow lens to view their fiduciary responsibilities. This had resulted in a focus on maximising financial returns over the short-term at the expense of other factors that might impact the performance of a company or the wider interests of savers over the long-term.

In response to the recommendations of the Kay Review, the Government asked the Law Commission to review the legal concept of fiduciary duties. A core focus of the Law Commission study was the extent to which pension fund trustees may, should or must consider wider factors beyond the short-term maximisation of returns.

The resulting Law Commission report, *Fiduciary Duties of Investment Intermediaries*, incorporated a review of case law, relevant academic thinking, and expert opinion from legal, financial and actuarial professionals before making its recommendations. It represents current opinion on this complex topic, and in the absence of new law cases it may be relied on to accurately outline the role and duties of pension fund trustees.

This section is a thematic summary of the Law Commission's main findings, the Government's response, and a brief survey of some asset-owner responses which reflect the spirit of the Law Commission's thinking.

Financially material and non-financial factors

Pension trustees are required to prepare a Statement of Investment Principles ("SIP") stating their policy on the kinds of investments to be held and the extent (if at all) to which "social, environmental or ethical" considerations are taken into account when making investment decisions. This makes it clear trustees may consider these matters but gives little practical help.

The Law Commission offered that assistance by identifying a key distinction between factors which are financially material and those which are not.

Financially material factors

The Law Commission aimed to remove any misconceptions on the issue by stating:

"Trustees may take account of any financial factor which is relevant to the performance of an investment. These include risks to a company's long-term sustainability, such as environmental, social or governance factors (often referred to as "ESG" factors)."

So to be clear there is no legal impediment to trustees taking account of environmental, social or governance factors into account where they are, or may be, financially material.

And the Law Commission went on *"The law goes further: trustees should take account of financially material risks"* which means in our view exactly what it says: if the risk is material it should be considered.

The Law Commission report on fiduciary duty
http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf
Their more accessible six-page summary document *Is it always about the money?*
http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties_guidance.pdf
UKSIF's policy response on fiduciary duty
http://uksif.org/wp-content/uploads/2015/04/UKSIF-Response-to-OPSR-Consultation.pdf

‘The primary concern of trustees must be to generate risk-adjusted returns. In doing so, they should take into account factors which are financially material to the performance of an investment. These may include environmental, social and governance factors.’ Law Commission

The position now seems clear. If a risk is “material” the Law Commission feels the trustee is under an obligation to consider it.

What is material? That must obviously be discussed and advice taken. But to consider the two examples raised at the beginning, the Governor of the Bank of England said that a third of equity and fixed income assets may be exposed to climate change, and as we write the Volkswagen share price is (by coincidence) down by a third since the emissions scandal.

We think it would be brave of a trustee to say that impacts of this order of magnitude were not material. The Law Comission says that how pension funds are protected from risks of this type “should” now be addressed by trustees.

Non-financially material factors

The Law Commission defined non-financial factors as those which might influence investment decisions motivated by other concerns such as improving members’ quality of life or showing disapproval of certain industries.

The Law Commission gave an example of the distinction between financially material factors and non-financial factors: ‘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.’

The Law Commission said that, generally, non-financial factors may be taken into account provided two tests are met:

1. **Trustees should have good reason to think that scheme members would share the concern; and**
2. **The decision should not involve a risk of significant financial detriment to the fund.**

'In respect of non-financial factors ... trustees do have the discretion to think about member views and how these might be reflected.'

There are two exceptions where significant financial detriment is permitted:

1. **Where the decision is expressly permitted by the trust deed; and**
2. **In DC schemes, where the member has chosen to invest in a specific fund.**

Trustees will not be at fault where DC members make a choice to invest in a specific fund with the understanding that the fund's criteria may lead to a lower return. However, it is worth noting that:

a) The various types of responsible investment (such as "ethical" investment or "SRI" investment) do not necessarily lead to financial detriment of beneficiaries since these strategies have often been shown to outperform the market.
b) According to the most recent polling for Good Money Week, 54% of people said they wanted their investments to achieve something other than just returns e.g. a positive social out come. It may be that reflecting this in DC offers will encourage take-up.

The UKSIF interpretation of these findings in respect of non-financial factors is that **whilst investing in a manner driven by the trustees' personal beliefs is to be avoided as potentially illegal, trustees do have the discretion to think about member views and how these might be reflected.** They must be extremely careful in how they act, but they can take steps and in DC in particular there may well be options which will meet the aspirations of members.

Stewardship and engagement

Stewardship is clearly linked to the wider concept of fiduciary duty and the Law Commission reviewed its role in the investment process.

The Law Commission defined stewardship as **promoting the long-term success of a company through monitoring and engagement, whether that engagement is formal (for example through voting) or informal (through communications and discussions).** They stated that it is in the interests of pensions funds to do all they can to promote the long-term success of the companies in which they invest.

In the Stewardship Code, the Financial Reporting Council states that *'stewardship aims to promote the long-term success of companies in such a way that the ultimate providers of capital also prosper'.* A well-run company is far more likely to perform over the long-term.

The focus on long-term success clearly speaks to the Law Commission concept of "financial materiality" and to the over-arching idea of "doing the right thing". In short stewardship is clearly linked to the wider concept of fiduciary duty.

Stewardship certainly involves using the voting powers of shares but it goes further and may include, in the words of the FRC, *'monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure and corporate governance. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.'*

Professor Kay saw stewardship as a central function of equity markets which required relationships between investors and investee companies based on understanding and engagement. Pension funds probably have a duty to support this pattern of behaviour. Also, the arguments about fiduciary duty might, in UKSIF's view, make it best practice for them and their fund managers to sign the Stewardship Code and to publicly disclose how they intend to act out their stewardship responsibilities.

The Stewardship Code
https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-govern ance/K-Stewardship-Code.aspx

The Kay Review
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf

The Government's response

In response to the Law Commission report, the DWP undertook consultation on changes to the Investment Regulations ("the regulations") which focused on clarifying the distinction between financial and non-financial factors, including associated considerations such as whether trustees should state their policy on how they evaluate long-term risk, and the best method to encourage trustees to consider their approach to stewardship.

Following analysis of responses, the Government in November 2015 rejected the Law Commission's recommendations and proposed making no changes to the regulations. The Government cited a 'good awareness' of trustees' duty to consider financially material factors and stated the recommended changes 'would not necessarily lead to greater clarification'. **But not only do we continue to see evidence of trustees failing to incorporate financially-material ESG factors into their investment processes we still hear some trustees or advisers cite their "fiduciary duties" as an obstacle to consider these wider factors.**

It is worth noting that of the 45 respondents to the consultation, 43 called for changes to the regulations.

It was the Law Commission's aim to remove misconceptions surrounding fiduciary duties through amendments to the Investment Regulations. The Government's refusal to implement the changes meant that this was not achieved and represents a missed opportunity to put the UK on a more sustainable footing.

DWP's response to clarifying fiduciary duties
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/476447/reducing-regulatory-burdens-and-misc-regs-nov-2015-consultation.pdf

The latest thinking in charity fiduciary duty

- **Socially costly assets (such as investments in companies selling alcohol, tobacco or arms) may be socially costly and may be thought to be *"pregnant with material financial risk"***
- **Corporate trustees have a positive duty to consider the charity's impact stemming from corporate law, and this will affect investments**
- **Other statutes since 2000 mean there may be a positive *"obligation"* to consider a more developed sense of social responsibility in investment**
- **Carbon intensive investment may be *"irreconcilable"* with certain charitable purposes including environment, health and poverty and trustees should divest from such assets regardless of the financial consequences**
- **Trustees should take independent and impartial financial advice and consider current and authoritative scientific research**

Context

Bates Wells Brathwaite, funded by the Sainsbury Family Charity Trusts, recently commissioned a written opinion from Mr Christopher McCall QC on *"The powers and duties of charity trustees as to ethically questionable investments with specific reference to carbon intensive assets".*

We briefly review the full opinion highlighting where we think an evolution in thinking is apparent.

To our mind Mr McCall goes further than the Law Commission does on pension funds, reflecting the slightly greater freedom to act that charity trustees may have.

Christopher McCall QC considers whether trustees of charities should avoid certain investments on the grounds that :

(i) they involve what have been historically underappreciated financial or other risks to the charities concerned; and/or

(ii) [they] should be ruled out of contention for a given charity's portfolio on the grounds that it would be for the public benefit or otherwise ethically appropriate so to do.

These are two quite precise questions which are answered in the opinion, but the importance of the opinion stems in part from its views on other matters.

The McCall opinion

Christopher McCall QC draws a distinction between "patent" and "latent" conflicts for trustees.

The former are where an investment conflicts with the very objects for which the charity exists and where the charity must divest regardless of financial consequences; the latter are where the conflict is less obvious and the trustees must weigh the risks to the charity's work against the risk of divestment. This is an important distinction and initial feedback suggests it is the area which has stimulated most immediate debate among trustees.

Central to wider opinion is the idea that **some assets can be mispriced**, notably carbon intensive assets and potentially *"socially costly assets"*, meaning any assets which may come to be taxed to mitigate social impacts and costs. The opinion uses the memorable phrase *"pregnant with material financial risk"*.

The point is that the existence of these risks mean owners of all types- not just charity trustees- run the risk of overpaying. (In the past legal opinion has perhaps been too cautious in respect of financial theory. It is nice to see the idea that mispricing can exist and persist is accepted).

Mr McCall reminds us that the law is clear that there are limits on the degree to which trustees can invest driven solely by their "ethics" but in what we see as an important development he says:

"Without hesitation I would however stress that it seems to me that these financial and non-financial (i.e. ethical) types of objection cannot be kept entirely separate the one from the other, because as indicated above, a growing sense of principled objection may be reflected in a socially costly asset becoming taxed, subject to licences or other permissions or regulated, and its financial value may reduce as a result"

The idea that what were considered by the Law Commission to be different elements - financial and non-financial issues - may need to be combined is fundamental to how Christopher McCall QC sees things having developed with charities. This extract is the answer to the first question posed above: **Historically underappreciated financial or other risks should be considered.**

The McCall QC opinion
http://www.bwbllp.com/file/summary-and-opinion-pdf

CC14 guide for charity trustees
https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14

‘...corporate trustees need to consider whether they should exclude investments which might be harmful to the community or the environment, or might damage the reputation of the charity or of charity at large.’

The next important development is covered in several parts of the opinion and concerns how Mr McCall sees statute law bearing on trustees.

He references section 172 of the Companies Act 2006 to say that directors of a corporate charity *“have the duty of having regard to the impact of the company’s operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the likely consequences of any decision in the long term “*, and believes that these criteria need to be applied to the management of investments.

His conclusion is that in the case of corporate charities, corporate trustees need to consider whether they should exclude investments which might be harmful to the community or the environment, or might damage the reputation of the charity or of charity at large. Importantly Mr McCall believes these obligations cast light on the powers and duties of trustees in unincorporated charitable trusts when it comes to the application of the *“suitability”* test laid down in section 4 of the Trustee Act 2000.

This thinking plays an important part in the series of deductions which are then detailed:

The first deduction highlights that trustees must be careful not to make “moral or ethical” statements in investment unless it is “necessary or permissible so to do to achieve the purposes of the charity, or financial advice renders it acceptable or desirable”. **But the opinion confirms that trustees may adopt an ethical approach where failing to do so may alienate beneficiaries or supporters, or where not doing so may impede the achievement of the charity’s objectives.** This seems to fully echo the guidance of Charity Commission 14 and is the *“patent”* case mentioned above.

Section 172 Companies Act 2006
http://www.legislation.gov.uk/ukpga/2006/46/section/172

Section 4 Trustee Act 2000
http://www.legislation.gov.uk/ukpga/2000/29/section/4

'...there is scope and, to a certain extent, an obligation to consider the adoption of a more developed sense of social responsibility in matters of investment...'

The next deduction breaks new ground. Driven by his view of statute Christopher McCall QC argues:

"In sum it seems to me that, in the ordinary course, the task of justifying the pursuit of ethical policies of investment may well be less onerous than Harries would suggest.... section 4 of the Trustee Act 2000 and section 172 of the Companies Act 2006 have been enacted since Harries was decided, and their terms stress the positive need to consider whether (i) ethical policies of investment are required (on the part of directors of a charity under section 172), or (ii) whether trustees of a charity have special duties to test the "suitability" of particular investments to their trust."

This is of great importance, leading a little later to the view that:

"Thus statute has, I think, given room to argue that there is scope and, to a certain extent, an obligation to consider the adoption of a more developed sense of social responsibility in matters of investment....it seems to me strongly arguable that charity trustees may-and, in some cases, should- take a broader view of their investment responsibilities and the suitability of particular species of investment to their trust than has hitherto been thought to be the case."

The appearance of the word "should" is obviously important; who the "some cases" are becomes apparent in the opinion summary:

"It is for charity trustees to determine whether there is a link between the specific purposes of a charity and the dangers posed by the investments concerned, such as in the case of carbon intensive assets, in the light of the prevailing evidence.

Though the conflict may not always be clearcut I think it at least arguable that investment in carbon intensive assets could be said to be irreconcilable with the intent behind charities with:

(a) general or specific environmental purposes;
(b) general health purposes;
(c) general poverty purposes;
(d) other purposes relating to matters where the properties of carbon intensive assets and the consequences of dangerous climate change are of particular concern."

'Mr McCall recognises that it may not be easy to identify if there is a conflict between the purpose of the charity and proposed investments. In such cases he maintains a cautious approach is needed.'

Mr McCall recognises that it may not be easy to identify if there is a conflict between the purpose of the charity and proposed investments. This is the latent conflict referred to earlier. In such cases he maintains a cautious approach is needed. If an adviser highlights material financial risks in the investments then *"it must be proper"* to ignore those investments; if the advice is less strong then such investments may be ignored if there is no material risk of financial detriment from excluding them.

These are clearly broad criteria and Mr McCall does see the issue as very broad. In paragraph 11 of the opinion he highlights that charitable purposes must be such as to secure *"public benefit"*. Mr McCall does not regard this as requiring investment to be carried on in a manner plainly conducive to the public benefit but it does permit trustees to invest ethically where *"investments are in the reasonable opinion of the charity trustees not suited to the investment of public moneys because they are perceived to offer public disbenefits not outweighed by the financial advantages."*

This answers the second question posed at the outset: **there are situations when investments may be rejected because of consideration of the public benefit.**

As Mr McCall outlines his deductions he stresses that the courses of action he believes are permitted may only be taken after *"advice"*.

We do not see this advice burden as excessive, but we recognise it may require an evolution in behaviour. **Many charity service providers will be able to provide data on weightings and past performance. Fund managers who have properly considered the issues at stake should be willing to discuss the extent to which prices do or do not reflect conceivable risks .**

Conclusions and the way ahead

Christopher McCall QC concludes his opinion by saying that a reference to the charity tribunal would be the *"only profitable means of obtaining general guidance from the courts"* on these points. A request for that would have to come from the Attorney General or the Charity Commission. In the absence of such a request he thinks it *"essential"* that the Charity Commission issue guidance.

Our review of the opinion is clearly just that, our thoughts. But we feel **charity trustees would be well advised to take some steps to position themselves with this latest thinking on charity fiduciary duty**.

First, consider if there is a conflict between your charitable purpose and your investments. It has previously been established that if there is a **patent** conflict there is probably a breach of duty. A frequently cited example is of a cancer charity holding tobacco shares.

Second, consider Mr McCall's view that trustees now need to think more widely on the issue of **latent** conflict. Thus he says concerns, for instance on how investments affect the community and the environment, will require thought. His list of purposes highlighting those charitable areas most affected should probably be considered too.

Third, consider how you can ensure that these matters aren't forgotten. We would suggest putting the matter on your risk register and raising the issue annually with your advisers and/or fund managers. Questions to ask them include:

- How do you assess non-financial issues in your work?
- How do you ensure that you are aware of emerging issues?
- Can you give us assurance that when you vote in respect of our shares you are fully consid ering the wider impact of company activity, so that this crucial tool is used to meet our obligation to consider the community and environment?

The UKSIF view on the matter of working with your agents is simple: if they don't help you fulfil obligations the law places on you, you should consider changing agent.

Other policy and sector developments

The McCall charity opinion is very recent and its impact is yet to emerge. But reaction to the Law Commission report in the pensions area has been important.

The Pensions Regulator has incorporated some of the thinking into their Trustee Toolkit to enable pension fund trustees to better understand their responsibilities. Later in 2016 they will include it in guidance for defined-contribution trustees. Some of its influence can be discerned in comments on the role of the newly introduced Independent Governance Committees which have been set up in the DC value chain .

This section examines other developments either directly related to fiduciary duty or which emphasise the importance of ensuring trustees are aware of their role and responsibilities.

Since the Law Commission's report the COP21 process has produced a much sharper focus on the impacts of climate change. The build-up to the Paris Agreement saw several developments which recognised the materiality of climate-related risks and showed an increasing understanding that these factors can no longer be ignored by investors. These included:

- **Bank of England work on risks stemming from climate change to the insurance industry:** A speech from the Governor of the Bank of England, Mark Carney and a report by the Prudential Regulator Authority explicitly recognised the significant financial risks arising from "stranded assets" and other financial risks to the insurance industry.

- **The Financial Stability Board's Task Force on Climate Disclosures (TFCD):** In December the FSB announced the industry-led disclosure task force on climate related financial disclosures. The TCFD will develop voluntary, consistent climate related financial risk disclosures for use by companies in providing information to lenders, insurers and investors to enable them to understand their climate-related risks.

The Bank of England work on climate related risks
http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx

The Financial Stability Board's Task Force on Climate Disclosures
https://www.fsb-tcfd.org/

‘The momentum generated by COP21 has forced policy makers and institutions to re-examine the role of the financial services sector in addressing social problems.’

- **The French Energy Transition Law:** France has become the first country in the world to introduce mandatory climate change related reporting for institutional investors. Under Article 173 all investors including pension funds, asset managers and insurance firms are required to report on ESG factors, their exposure to climate related risk and contributions to climate and energy policy goals.

- **US fiduciary changes:** In October 2015 the US Department of Labor changed guidance to confirm that fiduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social, or other such factors

The momentum generated by COP21 has forced policy makers and institutions to re-examine the role of the financial services sector in addressing social problems. The above initiatives represent a significant shift in thinking about the way we invest. For the first time serious top-down pressure is being applied by central banks, international finance organisations and governments to encourage the identification and analysis of risks stemming from ESG factors and financial performance.

Investors are being strongly encouraged or even mandated to take these factors into account. Climate change is increasingly being discussed as a financially material factor, the risks from which can have a tangible impact on investments.

The French Energy Transition Law
http://www.developpement-durable.gouv.fr/IMG/pdf/14123-8-GB_loi-TE-mode-emploi_DEF_light.pdf

US fiduciary duty
http://www.dol.gov/opa/media/press/ebsa/ebsa20152045.html
http://www.ussif.org/blog_home.asp?Display=64

‘...we have also seen “bottom-up” practical approaches to responsible, long-term investment by asset owners in the UK.’

We have also seen “bottom-up” practical approaches to responsible, long-term investment by asset owners in the UK. While work on these initiatives was underway well before its decision, the Government’s failure to implement the Law Commission’s recommendations emphasises the importance of these initiatives.

Recent examples have included:

- **The Pension Fund Roundtable’s Guide to Responsible Investment Reporting in Public Equity:** The guide, created by 16 UK pension funds with AUM of over £200bn, outlined the type of reporting on ESG issues and on stewardship they wanted from their asset managers. The guide was developed through open consultations with fund managers and aims to encourage best practice.

- **The Association of Member Nominated Trustees’ (AMNT) Red Lines Voting Initiative:** The AMNT has recently launched its “Red Lines” voting initiative under which DB trustees will issue voting directions to their fund managers. These voting instructions cover the full range of ESG issues and are in line with the UN Global Compact, CDP’s reporting guidance and the FRC’s Corporate Governance Code.

- **The “Aiming for A” coalition:** The coalition was organised ahead of the 2015 AGMs at BP and Shell and persuaded the companies to adopt a series of policies linked to environmental assessment and disclosure. The coalition recently announced its intention to ask Anglo American, Glencore and Rio Tinto to be more transparent over climate change risks and will back shareholder resolutions at those companies’ AGMs later this year.

- **The Sustainable Stock Exchanges Initiative’s Model Guidance on Reporting ESG Information to Investors:** The SSE Initiative has developed a voluntary tool for stock exchanges to guide issuers to disclose ESG information to investors. Stock exchanges and index providers are well placed to promote transparency and ESG disclosures to help enhance sustainable and long-term value creation.

‘Intermediaries throughout the investment chain are actively working to meet their obligations in terms of ESG... despite the lack of regulatory certainty’

These initiatives show how intermediaries throughout the investment chain are actively working to meet their obligations in terms of ESG integration, stewardship and transparency despite the lack of regulatory certainty that might should reasonably have been given by the Government.

Trustee boards of all kinds should consider whether they too should pay more regard to wider ESG factors and, if so, what steps they can take to integrate those considerations into their investment process. The initiatives cited show that other trustees are already acting and a trustee body acting in the ways we suggest will be in good company.

The Pension Fund Roundtable’s Guide to Responsible Investment Reporting in Public Equity http://www.lgcplus.com/Journals/2015/01/26/d/u/g/Guide-to-Responsible-Investment-Reporting-in-Public-Equity---26.01.15.pdf

Red Lines Voting
http://amnt.org/red-line-voting/

Sustainable Stock Exchanges
http://www.sseinitiative.org/

Best practice for trustees

Why this is important

Informed by our review of the Law Commission report and the McCall opinion we suggest the following as best practice tools and steps for trustees of all types. The Law Commission concepts of materially financial and non-financial factors will be helpful for all trustees; the McCall concepts will apply most closely to charity trustees.

In terms of frequency of review, we would suggest that annual is best whilst more fundamental thinking might occur every three years, the timescale in pensions for review of SIPs.

The Risk Register

Trustees should identify and assess the key risks to their fund with their advisers.

This should include the likelihood of the risk materialising and the severity of the impact if it does. As has been shown, ESG factors are very likely to be financially material and should be considered by trustees.

Climate change in particular has now been widely recognised as a serious risk to companies, investors and the wider economy and so we believe trustees should include it in their risk register, including an assessment of the likely impact it could have on the fund. As we write, Mercer, a leading investment consultant is advising trustees who consider climate change to add it to their risk register to ensure proper monitoring and mitigation of the risk is built into the fund's governance processes.

Pension fund consideration of financially material factors

Trustees should state in their reports to stakeholders:

- How they and their agents consider ESG issues
- How they and their agents make provision to identify emerging financially material ESG issues on an ongoing basis and if extra resources are required to achieve this
- How those identified financially material ESG risks are managed

Pension fund consideration of non-financial factors

Trustees should consider their approach to non-financial factors and how they integrate them into their decisions and report to stakeholders.

In particular pension trustees should consider as part of drafting their SIP every three years:

- Their approach to investment in industries or places that may be associated with unethical conduct e.g. investment in companies that manufacture cluster bombs
- How they intend to engage with members to gauge ethical views where necessary
- Their approach to investment in local infrastructure, social impact investment and other type of investment that may benefit the local or wider UK economy

For charity trustees

- Ultimately it is for charity trustees to consider if a clear or patent conflict exists with its objects
- Trustees must weigh up the following when making a divestment decision
    - Qualified and independent financial advice
    - The percentage of the market that would be excluded by divesting
    - The most authoritative and current scientific evidence on causes of climate change
- Where there is no clear investment-mission conflict, trustees must show they are not making moral gestures

Stewardship

Trustees should affirm their commitment to well governed companies. This might include:

- Signing the Stewardship Code or explaining why this was considered to not be relevant to them
- Asking their agents to do the same
- To annually publish their approach to stewardship including how they comply with the principles of the code
- To annually publish how their expectations regarding stewardship are conveyed to their agents and the methods by which they monitor agents' activities on their behalf
- To annually publish a report outlining, where appropriate to commercial sensitivity, activi ties carried out on their behalf over the previous 12 months and how they have met their expectations.

Ongoing support and knowledge

Trustees should keep up to date with fiducariary duty developments, ESG and long-term investment issues and the progress of their peers by:

- Joining UKSIF (asset owners join as free affiliates)
- Joining your national SIF if not UK-based
- Becoming a signatory to the PRI
- Becoming an investor signatory at CDP

Get in touch

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