Policy Brief: The Law Commission’s Review into Pension Funds and Social Investment: Recommendations and Options for Reform

In November Civil Society Minister, Rob Wilson, asked the Law Commission to look at how far pension funds may or should consider social impact when making investment decisions. Its report which was published last week builds on many of the suggestions made in its 2014 report, Fiduciary Duties of Investment Intermediaries.

The Law Commission is clear that there are no legal or regulatory barriers to social investment by pension funds. It first makes five recommendations relating to both trust and contract-based scheme governance. Specifically, it recommends the Investment Regulations be amended to require trustees to state their policies relating to ESG, ethical investing and stewardship. For contract-based schemes it recommends FCA rules be changed to require Independent Governance Committees (the rough equivalent of trustee boards) to report on their firms’ approach on ESG, ethical investing and stewardship. It further recommends the FCA publish guidance on financially material and non-financial factors, similar to that published by the Pensions Regulator for trust-based schemes.

The Law Commission argues that since most of the barriers to social investment it identified were structural and behavioural barriers within the pensions industry it would be inappropriate for it to make recommendations in those areas and instead sets out various options for reform. There are 11 options for reform which include requiring pension schemes to ask members for their views on social and ethical investment, monitoring the impact of the charge cap on schemes’ ability to directly invest in infrastructure and encouraging providers to work towards an agreed set of terminology relating to social investment.

The full list of recommendations and options for reform are set out below.

The Law Commission’s recommendations:

Recommendation 1

Regulation 2(3)(b)(vi) of the Occupational Pension Schemes (Investment) Regulations 2005 should be amended to require trustees to state their policies in relation to:

(1) evaluating risks to an investment in the long term, including risks relating to sustainability arising from corporate governance or from environmental or social impact;

(2) considering and responding to members’ ethical and other concerns.

Recommendation 2

(1) Regulation 2(3)(c) of the Occupational Pension Schemes (Investment) Regulations 2005 should be amended to require the Statement of Investment Principles (SIP) to state trustees’ policy (if any) on stewardship. Stewardship would include the exercise of formal rights (such as voting) and more informal methods of engagement.

(2) This requirement should apply to both the SIP prepared under regulation 2 and regulation 2A.

Recommendation 3

COBS 19.5 should be amended to require IGCs to report on the firm’s policies in relation to:
(1) evaluating risks to an investment in the long term, including risks relating to sustainability arising from corporate governance or environmental or social impact;

(2) considering and responding to members’ ethical and other concerns.

This requirement should apply to policies reflected in investment strategies including default investment strategies.

Recommendation 4

COBS 19.5 should be amended to require IGCs to report on the firm’s policy (if any) on stewardship.

This requirement should apply to the policy reflected in investment strategies including default investment strategies.

Recommendation 5

The Financial Conduct Authority should issue guidance for contract-based pension providers on financial and non-financial factors, to follow the guidance given by The Pensions Regulator in its Guide to investment governance.

The Law Commission’s options for reform:

Option for reform 1

Government should consider creating a new register of security interests which can be used by Charitable Incorporated Organisations (CIOs).

Option for reform 2

The Regulator of Community Interest Companies should consider reviewing the dividend cap to ensure that it is in the best interests of industry stakeholders and, in particular, whether it should be raised.

Option for reform 3

Government should consider whether the registration and regulation of registered societies and community interest companies should be overseen by a single regulator.

Option for reform 4

The Pensions Regulator should consider providing trustees with further guidance on how to reconcile the requirement to process transactions promptly with the benefits of holding some illiquid assets.

Option for reform 5

The Financial Conduct Authority should consider providing guidance about the permitted links rules and, in particular, guidance about how pension schemes can manage some element of illiquid investment within their funds and how they can produce unit prices for illiquid assets.

Option for reform 6

The Department for Work and Pensions should consider investigating whether the need for member consent is a barrier to consolidation of pension schemes and whether this could be removed.
Option for reform 7

Government should consider whether a legal obligation should be introduced in England and Wales to require pension trustees to determine on an annual basis whether their members are disadvantaged in comparison to members of other funds due to insufficient numbers of members or pooled assets.

Option for reform 8

The Department for Work and Pensions and the Financial Conduct Authority should continue to monitor the charge cap as pension schemes make more direct investments in innovative ways in physical assets, such as property.

Option for reform 9

Government should encourage pension providers to work towards agreeing a set of terminology for social investments.

Option for reform 10

Government should encourage pension providers and pension industry stakeholders to work together to develop examples of good practice of impact reporting.

Option for reform 11

Government should consider whether pension schemes should be required to ask their members periodically for their views on social investment and non-financial factors.

More information

- The Law Commission's report is available [here](#).
- An article by UKSIF Chief Executive, Simon Howard, on the report is available [here](#).
- UKSIF's press release is available [here](#).
- For more information please contact [fergus.moffatt@uksif.org](mailto:fergus.moffatt@uksif.org).

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