Pension Schemes Bill: briefing for Commons 2nd reading

This briefing is on behalf of ShareAction, a responsible investment charity, ahead of Second Reading of the Pension Schemes Bill later this month.

What the Bill does

The Pension Schemes Bill is intended - amongst other things - to help pension schemes to play a greater role in supporting the UK economy and delivering larger pensions at retirement.

Most controversially, it seeks to achieve this by taking a "backstop power" which will enable the UK Government to direct UK pension scheme investment. No Government has ever previously taken powers to direct the investment decisions of pension schemes – organisations tasked with acting solely in their savers' interests. This builds on the Mansion House Accord under which 17 schemes made a voluntary commitment to minimum allocations to certain investments, including UK investments, by 2030. In case schemes do not do so voluntarily, Government is proposing to take powers via clause 38, and new section 28C inserted into the Pensions Act 2008, to block schemes from receiving new funds from employers under their legal duties to automatically enrol workers into a pension – if they do not meet certain levels of "private market" investments (those in businesses not traded on a stock exchange), including private markets investments in the UK.

Crucially, the voluntary commitment is dependent on the "fiduciary duties" of pension scheme trustees (the governance bodies of occupational schemes) and corresponding duties of personal pension providers.

The need to clarify fiduciary duty

Fiduciary duties (legal duties for trustees to act in savers' interests, similar to the duties company directors have to their investors) govern how pension scheme trustees should act to fulfill the scheme's goal of providing retirement benefits, but are only briefly covered in statute. (Similar provisions apply to the Local Government Pension Scheme and personal pensions, which do not have trustees.) They are mainly understood through case law which has evolved over centuries, with many key cases being more than 100 years old and other more recent cases widely misunderstood.

The result is that many trustees do not feel able to take account of system-level considerations such as the impact on investment returns from climate change, poor housing and infrastructure, poor population health, or a shortage of education, employment or skills.

Uncertainty about fiduciary duty also prevents most schemes from taking account of other factors which might affect the quality of savers' retirements such as the impact of the companies in which they invest, including their impact on savers' standard of living. Fiduciary duty is also unclear on the ability to take account of pension savers' views.

To ensure that pension schemes are voluntarily able to invest productively in members' interests in the UK economy, without invoking a Government power to direct pension savers' money, we recommend that MPs advocate for clarification of fiduciary duty on the face of the Bill.

What Government has said and done

Under the Mansion House Accord, 17 schemes made a voluntary commitment of a minimum 10% allocation to private markets (as opposed to listed markets) across all main "default" funds in their defined contributions schemes by 2030, with at least 5% of the total going to UK private markets. The Accord covers £252bn of assets - 8% of the £3tn invested in UK pensions - although it is expected to grow through continued contributions by savers and employers, investment growth and smaller schemes consolidating into signatory schemes.

The previous Sunak administration's 2023 Green Finance Strategy committed to a series of Government roundtables to understand how it could further clarify the law, something welcomed by the Work and Pensions Select Committee. One of these roundtables was held before the general election.

The current Government has publicly welcomed the work of the Financial Markets and Law Committee paper (a legal charity) - which indicated that trustees should consider broader financial risks like climate change; as well as the Eversheds opinion on fiduciary duty commissioned by the pensions firm NatWest Cushon, which argued that trustees should take account of savers' standard of living. However, even in the event that the Government went further and endorsed either or both, this would not give schemes which acted on them protection from litigation, or ensure that all schemes aligned with the position taken by these papers.

Risks from not clarifying fiduciary duty

Whilst the Mansion House Accord is very welcome, Government's current approach risks producing a flow of funds to UK growth which are smaller and slower than they might be, were fiduciary duty to be clarified alongside.

- The Mansion House Accord only applies to the main "default" funds (the fund members save into if they do not make an active choice) in 17 schemes, out of more than 6,000. Whilst these are large and fast-growing funds, they only represent 8% of assets. Without fiduciary duty clarification, no other measures are currently in place to unlock investment by the other 92%.

- The Accord and the reserve power in the Bill both focus on private investments. However, many other investments support UK growth. These include publicly traded investments in UK infrastructure projects ("infrastructure investment trusts") and - for firms with extensive operations in the UK - corporate bonds (borrowing by listed firms) and even shares in listed companies (by providing support for valuations and allowing new borrowing). None of these are included in the Accord targets, whereas a private equity buyout of a large listed UK company *would* be classed as productive and count towards the target even if it had no effect on investment in the UK. Fiduciary duty clarification would help pension schemes to evaluate assets on their benefits to the UK economy, rather than by blunt distinctions between public or private.

- Given the focus on private market investments, which are less easily traded, the Accord targets do not apply until 2030 - there are no interim targets. However members of the Lords Science and Technology Committee (Don't fail to scale: seizing the opportunity of engineering biology and subsequent debate) have flagged the need for reforms to be more ambitious and faster. Fiduciary duty clarification could be legislated for and guidance published in less than a year, delivering immediate benefits to key UK sectors.

- Finally, any possible regulations by Government requiring private market investment would be a necessarily blunt instrument and, with no safeguards other than a Government-led review, risk lowering returns. A group of pension funds, including signatories to the Mansion House Accord, have warned that "without full discretion to invest in a way that aligns best with their members' financial interests, fiduciary duty as it is understood today would be weakened."

Benefits from clarifying fiduciary duty

With new powers, fiduciary duty could be clarified by Government in regulation and guidance in less than 12 months, applying to all pension scheme assets with immediate effect. This would unlock more investments in UK growth by enabling a shift in investment decision-making attitudes and practices, whilst ensuring trustees retain primacy and discretion in investment decisions.

The duty to manage **system-level risks** will improve returns by encouraging investments that lift the returns of other companies in which the scheme is invested . For example, the success of most UK-based companies will be affected by the extent to which the markets they operate in have healthy and well-educated and -trained populations with adequate housing and good transport infrastructure.

The ability to take account of pension scheme **member standard of living** by considering the real-world buying power of that pension - not just its nominal value - will also improve saver outcomes. Savers who retire into a world of high inflation, where goods such as housing, energy, food or water are more expensive, would experience a worse standard of living than if the trustees had been clearly permitted in law to take account of living standards and invested to help tackle those risks.

Each of these measures would support new investment in the delivery of UK clean energy, homebuilding, local employment, healthcare and transport infrastructure, as well as investments which make it easier for Government to provide these services by boosting growth and enhancing the UK tax base.

The ability to **take account of impacts from firms in which schemes invest,** and to **take account of member views** will also help drive investments that are good for the UK economy.

All of this would be delivered within a continued duty on schemes to act in members' financial interests. It would not remove or undermine the existing legal requirement for schemes to "ensure the security, quality, liquidity and profitability of the portfolio as a whole".

Fiduciary duty clarification has the potential to significantly increase the average allocation of UK pension funds to the UK economy. **If average allocations to the UK were to increase across all schemes to the level shown by large schemes with the most advanced understanding of fiduciary duty, this would lift investment in the UK significantly.**

Other points to make

Government guidance is insufficient - *Non-statutory guidance* issued by Government or The Pensions Regulator is non-binding. Schemes cannot defend their investment decisions with complete confidence by pointing to guidance, particularly where the legal position is unclear. Trustees would be required to at least have regard to *statutory guidance*, but Government has no powers to issue it.

Regulations on their own are also inadequate - Government has long had the powers under the Pensions Act 1995 to make regulations about how trustees "exercise their powers of investment". However it has no powers to issue statutory guidance in plain English on Government's expectations of trustees. Without such guidance there would still be legal uncertainty for trustees in relying on the letter of the law alone.

Schemes cannot simply rely on legal advice - Many lawyers have divergent views on fiduciary duty and have arrived at different conclusions. If all 6,000 UK schemes seek their own legal opinions they will pay 6,000 different times and still not arrive at a consensus. Only clarification in statute can provide this.

Having fewer, larger, better governed schemes is not a solution - Larger schemes still face uncertainty about whether they can or should act on system-level risks and opportunities, impacts, members' standards of living and members' views.

ShareAction is an independent charity and an expert on responsible investment. We work to build a world where the financial system serves our planet and its people.

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