

The Change We Need

Model legislation to promote responsible
long-term investment by institutional investors



ShareAction»

ACKNOWLEDGEMENTS

ShareAction gratefully acknowledges the financial support of the funders of its public policy work. Particular thanks are owed to the Friends Provident Foundation.

We would like to thank the experts who gave their time for consultation on the development of this work. We are particularly grateful for the significant contributions made by Charles Scanlan and by Charles Seaford at Demos.

The views expressed are those of ShareAction alone.

Published 2020

About ShareAction

ShareAction is a non-profit working to build a global investment sector which is responsible for its impacts on people and planet. We mobilise investors to take action to improve labour standards, tackle the climate crisis, and address pressing global health issues, such as childhood obesity. Over the last 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. We want a future where all finance powers social progress.

Visit shareaction.org or follow us @ShareAction on Twitter to find out more.

Contact

Fergus Moffatt

Head of UK Policy
ShareAction
policy@shareaction.org

ShareAction

[Shareaction.org](https://shareaction.org)
info@shareaction.org
+44 (0)20 7183 2355

Contents

1. Why do we need a Responsible Investment Act?	04
A vision for change	06
Power to address corporate failings	07
A sustainable environment	08
A transparent and accountable investment system	08
Why we need legislation	09
2. Model legislation with explanatory notes	11
RESPONSIBLE INVESTMENT BILL	12
1. Definition of fiduciary investor	12
2. Duty to act in the best interests of beneficiaries	13
3. Duty to ascertain the views of beneficiaries and related powers	14
4. Duties of accountability and transparency	16
5. UK Council for Investor Due Diligence regarding human rights and the environment	17
6. Alignment with the Paris Agreement on Climate Change	20
7. Duty to provide stewardship of investments	21
8. Duty to avoid conflicts of interest	22
9. Persons to whom the duties of fiduciary investors are owed	22
10. Enforcement	23
11. No contractual or other exclusion of duties or powers	24
12. No effect on wider powers	25
3. Definitions	26
References	31

1.

Why do we need a Responsible Investment Act?

1. Why do we need a Responsible Investment Act?

In 2020, the world faced a health crisis. The coronavirus pandemic has brought with it economic and social turmoil. It has exposed the fragility of societies across the globe and of humankind more widely. In doing so, it has underscored a truth perhaps forgotten in the rapidly developing world: we are all connected. Not just as people, but as the systems that support our lives – the health system, the care system, nature and food systems. And the financial system is as intertwined with society as any other. When one part collapses, we all fall down.

This model Bill focuses on the institutional investment sector. In particular, it looks at the pensions and savings sector. Why? Because this sector is powerful. In the UK alone pensions assets under management amount to approximately £3 trillion¹. Three of the world's largest asset managers oversee assets worth more than China's entire GDP². Crucially, this is mostly money saved by working people each month, in the hope that they will be able to support themselves in retirement.

The actors in this sector – the pension fund trustees and staff, and their asset managers – are 'fiduciaries', thus holding one of the highest legal duties based on trust and good faith. How and where they invest these huge sums of money have consequences not only for their customers', or 'beneficiaries', savings but for everyone in society. Decisions taken in trustee boardrooms and outsourced to asset managers have an impact on how investee companies are run and which sectors get capital investment. This matters to all of us.

“We need our investments to build wealth, but also resilience, in a world where systems and people everywhere are connected.”

There has been much debate about the nature of investors' fiduciary duty – is it to maximise return (and if so, over what timescale)? Can investors pay attention to so-called 'non-financial factors' (which, as the pandemic has shown us, can quickly become financial)? Should investors listen to the views of their beneficiaries? The UK Government has taken steps to clarify some of these questions, bringing in changes to pensions law and regulation³. We also have a much stronger Stewardship Code. However, it is not yet the case that investment practice matches the Government's ambition. Nor that this ambition fully matches the need for major investors to operate transparently and to account for their actions.

Developments in this area, which is often referred to as 'ESG' (environmental, social and governance) or 'responsible investment', have been focused on climate change and the huge financial risks this poses to financial assets. But, in preparing for one crisis, we have been shocked by another – a health and social crisis that has rocked our economy. We need to learn lessons. We need to recognise the fragility of an economy that focuses on individual risk at the expense of collective impact. We need our investments to build wealth, but also resilience, in a world where systems and people everywhere are connected. Otherwise, we will walk into other crises. We will all fall down again.

A vision for change

ShareAction's proposed Responsible Investment Bill applies to those managing and investing money over the long-term, primarily pension fund trustees, managers and their agents or delegates. It sets out a vision for a clearer and stronger role for 'fiduciary investors' within society and the economy. However, it is important to note what the Bill does not try to change. The Bill retains the core legal principles of prudence, loyalty to beneficiaries, and impartiality between them. It fully respects the fact that the purpose of a pension, and savings, is to make money. It does not allow governments to meddle for political ends in how pensions are invested. And it retains fiduciary investors' discretion to make the decisions they believe are in the best interests of beneficiaries.

However, at the core of the Bill is an evolution in how fiduciary investors may think about those 'best interests'. Section 2 of the Bill proposes that a person's best interests are not only financial, but also depend upon the opportunity to live in a healthy, stable, secure society and environment. This is not ideological thinking but instead reflects closer attention to the purpose of a pension: to provide a standard of living to the beneficiary. As Saker Nusseibeh, CEO of Federated Hermes, wrote in 2017,

Let us now assume for [an] example that [someone] invests in energy shares. She might believe that she is making additional economic gain from these investments, but if energy companies, and indeed the rest of the economy do not make substantial changes to their carbon output, the earth will warm by more than 2.0 degrees. This will eventually result in higher tax bills related to the cost of fighting flooding, higher food bills for consumers and economic and political disruption. By looking at both sides of the ledger, we can postulate that any such additional gains are equally a mirage, since as a citizen she has to bear the negative effects of the investment⁴.

The Bill allows fiduciary investors, in their selection and stewardship of investments, to take a broader perspective of people's interests. It allows them to think about the consequences of investment decisions for the wider economy, communities and the environment and, as explained below, to be informed by the views of beneficiaries themselves. However, the task of balancing these factors with the more purely financial ones is left up to the investors.

“the Bill proposes that a person's best interests are not only financial, but also depend upon the opportunity to live in a healthy, stable, secure society and environment.”

Power to address corporate failings

This links to another innovation within the Bill. Section 2 sets out the idea of ‘double materiality’ which is taking hold in the finance sector. This is the idea that investors should think not just about the likely consequences of ESG factors on the financial value of their portfolios, but should also think about the impact their portfolio and decisions have *on* society and the environment. Without making this change, the investment system will continue to operate as if in a vacuum, as if the way it functions has no impact on the real world. And in doing so, it puts other systems, systems important to our survival, at risk.

It is, however, a huge ask to expect investors to analyse the social and environmental impacts of their investment decisions. Therefore, the Bill requires the Government to establish a “UK Council for Investor Due Diligence”, modelled in part on similar councils in Sweden and Norway, which serve their major investors.

The Council would be tasked with undertaking due diligence into company activities and issuing alerts and recommendations to fiduciary investors where companies are liable for adverse human rights impacts or environmental damage. Fiduciary investors would retain their discretion on how to respond to an alert, but would be required to publish their response. For their response, they can draw on frameworks such as the OECD’s guidelines on responsible business conduct for institutional investors⁵. These suggest a range of actions investors can take in reaction to poor company practice.

It is important to note that there is no suggestion that investors are responsible for remedying the damage done by companies, but they can use their considerable leverage to steward companies, to highlight damage, and, ultimately, they may divest. The process undertaken by the Council would also strengthen the case for human rights and environmental due diligence by companies themselves and the influence of large investors would no doubt be a powerful driver for preventing abuses in companies’ operations and supply chains.

A sustainable environment

In fulfilling their general duty under section 2 of the Bill, fiduciary investors will think about the way environmental factors impact their portfolios and vice versa. However, in recognition of the particular risks posed by climate change, a section of the Bill is dedicated to ensuring that fiduciary investors build portfolios that are fit for the future.

“for the UK and other nations to make significant progress in reducing emissions, it is necessary for the investment sector to align with these goals.”

Section 6 requires investors to ensure that their ‘default’ fund and any funds marketed as ‘sustainable’ align with prudent consideration of the ambitions set out in Article 2(1) and 4(1) of the Paris Agreement. These Articles address the need to limit global temperature increases to well below 2°C above pre-industrial levels, and ideally to 1.5°C. Section 6 also provides important education and monitoring roles for the financial regulators in this respect.

‘Paris alignment’ could be achieved in a number of ways and there are already industry-led initiatives for this process. It is not the case that the Government would direct *how* investors do this. However, for the UK and other nations to make significant progress in reducing emissions, it is necessary for the investment sector to align with these goals. Doing so is very much in the interests of pension savers. However action is needed across the whole investment sector, and all must play their part – this requires legislation. It is notable that the Swedish financial regulator has already been tasked with monitoring the Paris alignment of Swedish financial actors’ investments and loans.

A transparent and accountable investment system

Threaded throughout the Bill are moves for greater transparency. The pensions sector, in particular, is very opaque. As people’s expectations around technology and customer experience have increased in the financial sector, the pensions sector has failed to keep pace. This is despite the fact that the structure of pensions has changed so that most people now bear all the investment risk (i.e. the shift from ‘defined benefit’ to ‘defined contribution’ pensions). The investment sector has seemed nervous about increased transparency, particularly in light of low levels of financial literacy. However, there is increasing evidence that people would contribute more to a pension that they could see was sustainably invested⁷.

The Bill makes clear that fiduciary investors would be under a duty to understand their beneficiaries’ views and sets out ways this could be done. It makes clear that beneficiaries will not be entitled to direct the investors’ decisions or fetter their discretion. Instead, it allows investors to use this information, as they wish, to inform their stewardship and investment decisions, and – importantly – their communication with beneficiaries.

“there is increasing evidence that people would contribute more to a pension that they could see was sustainably invested”.”

The Bill also empowers beneficiaries to be able to request information about how and where their money is invested – a fundamental right given that they bear the risk. Equally, the Bill includes protections to avoid onerous requests. Finally, the Bill ensures that fiduciary investors must be transparent about conflicts of interest and resolve these in their beneficiaries’ interests. Conflicts may arise from the way in which investors are remunerated, by short-term bonuses for example, or from a group business model where companies in the group are service providers. They may even arise from the client relations held by others within their group. Regardless of how they arise, people should be made aware of potential and real conflicts of interest and how they are minimised.

Why we need legislation

The Government has taken important steps to clarify and strengthen the laws around pension assets and ESG, particularly in relation to climate change. However, further reforms are necessary to address blind spots in our investment system that leave pension savers less well protected and less well served than they deserve. The size of the investment sector means that the decisions made on where to invest and how to steward companies have a powerful impact.

“further reforms are necessary to address blind spots in our investment system that leave pension savers less well protected and less well served than they deserve.”

Most fiduciary investors are universal owners holding assets in all sectors of the economy. It is therefore in their interests to think on a systems-wide level. As explained by Hiro Mizuno in his former role as the CIO of Japan’s Government Pension Investment Fund, the largest pension fund in the world,

Conventional wisdom...ignores the fact that when a company makes profit at the expense of the environment, for example, that cost still has to be incurred somehow, somewhere, some time⁸.

This Bill helps investors to think long-term and at a systems-level. Of course, legislation is not a silver bullet, but it does drive change in ways that reflect the public interest. In introducing a Responsible Investment Act, the UK would show global leadership in the face of challenges that know no borders.



2.

Model legislation with explanatory notes

2. Model legislation with explanatory notes

Responsible Investment Bill

A BILL TO make provision for responsible and accountable long-term investment by institutional investors; and for connected purposes.

Be it enacted [etc] as follows –

1. Definition of fiduciary investor

- (1) In this Act “*fiduciary investor*” means any of the following persons or institutions
- (a) the trustees of a trust scheme as defined in section 124(1) of the Pensions Act 1995;
 - (b) the managers of a personal pension scheme, other than a self-invested personal pension;
 - (c) any person or institution to whom the trustees of a trust scheme or managers of a personal pension scheme have delegated any of their investment functions (including, in particular, an investment manager) and any sub-delegates, in relation to the performance of such functions only;
 - (d) any person or institution whom the trustees of a trust scheme or managers of a personal pension scheme have appointed to advise or assist them in the performance of any of their investment functions and any sub-contracted party, in relation to the giving of such advice or assistance only; and
 - (e) any person or institution designated in regulations under subsection (2) as a fiduciary investor, either generally or in relation to prescribed investment functions only.

Broadly, the Act is intended to cover those who are managing ordinary savers’ money over the long-term. ‘Fiduciary investor’ covers pension fund trustees (section 1(1)(a)) and managers of contract-based pensions (section 1(1)(b)), on the grounds that the legal nuance of how someone’s money happens to be managed is irrelevant to the standard of care that should be applied to it.

In recognition of the fact that much of the day-to-day management of money will be delegated to others, the term also applies to investment managers (section 1(1)(c)) and advisors (section 1(1)(d)) working on behalf of pension trustees. It also includes these agents’ sub-delegates, but in respect only of certain functions.

Beyond pensions, certain provisions of the Act also apply to those providing retail investment services and managing self-invested personal pensions, as these are also long-term investments.

The section provides powers for the Government to expand the scope of ‘fiduciary investors’ to cover other roles and investment functions (section 1(2)).

(2) The Secretary of State may by regulations designate further categories of persons or institutions as fiduciary investors either

generally or in relation to prescribed investment functions only, including specifying the person to whom duties are owed.

2. Duty to act in the *best interests* of the *beneficiaries*

(1) In the performance of any *investment functions* a *fiduciary investor* must act in the way the *fiduciary investor* considers, in good faith, would be most likely to be for the *benefit* of the *beneficiaries* as a whole and to be fair as between the *beneficiaries*, including as between present and future *beneficiaries* and in doing so have regard (amongst other matters) to:

- (a) the likely consequences of any *investment activities* in the long term;
- (b) the impact of any *investment activities* on the financial system, the economy, communities and the environment;
- (c) environmental, social and governance considerations (including, but not limited to, climate change) which the *fiduciary investor* considers financially material; and
- (d) the views of *beneficiaries*.

(2) A *fiduciary investor* shall publish a *policy statement* of its understanding of *benefit* as relevant to its *beneficiaries* and of how it has regard to the matters in subsection 2(1)(a) to (d) and to the recommendations of the Council in section 5 below. The Secretary of State may make regulations regarding such *policy statements*.

(3) A *fiduciary investor* shall report to *beneficiaries* the performance of the portfolio in delivering the *benefit* as defined in the *policy statement* and shall do this at the same time as it reports on the financial performance of the portfolio.

At the heart of the bill is an evolution of fiduciary investors' responsibilities for how they invest and manage other people's money. Despite recent welcome changes to the law, there is still a live debate about the nature of fiduciary investors' duties: what does it mean to act in the 'best interests' of beneficiaries?

This section sets out to clarify this, whilst raising the ambition of what is expected of fiduciary investors as key actors in the economy and society. It retains the core legal principle of loyalty to beneficiaries but the Bill extends the concepts of 'best interests' to encompass the wider benefits to beneficiaries of a stable and sustainable society, economy, and environment. In practice, this could see fiduciary investors factoring considerations of environmental or societal impact into their investment and stewardship decisions.

In particular, in line with existing best practice, section 2(1)(c) states that, in taking a long-term view, fiduciary investors should consider ESG factors. Section 2(1)(b) also requires them to consider the consequences of their investment activities on the financial system, the economy, communities and the environment. This is the idea of 'double materiality' developing amongst leaders in the financial sector.

In order to ensure that fiduciary investors take their duty seriously and

- (4) A *fiduciary investor* shall take all reasonable steps to ensure that all of its delegates and advisers who are *fiduciary investors* comply with this section.
- (5) In relation to a *fiduciary investor* who is a delegate of or adviser to another *fiduciary investor*, this section shall take effect subject to the terms of any mandate or instructions under which the delegate or adviser is performing *investment functions*.
- (6) This section applies to those managing self-invested personal pensions or providing *investment functions* for retail clients, except that the duties are to clients and not *beneficiaries*. Where these duties are sub-contracted, such investors have a duty to take all reasonable steps to ensure that its sub-contractors comply with its duties under this section.

act transparently, section 2(2) requires a fiduciary investor to publish a policy statement setting out its understanding of 'benefit' in the context of the matters set out in sections 2(1)(a) to (d).

It will be noted that this section echoes company directors' duties under section 172 of the Companies Act (Duty to promote the success of the company). That section should be strengthened by the alignment of the duties of directors and their largest shareholders. However, in recognition of the questionable effectiveness of section 172, this Bill contains stronger accompanying provisions for transparency and enforcement.

3. Duty to ascertain the *views of beneficiaries* and related powers

There is much confusion about the extent to which fiduciary investors, particularly those providing pensions, should engage with their beneficiaries.

Section 3 therefore sets out clear duties for fiduciary investors to understand their beneficiaries' views and – in order to reassure the pensions industry – clearly upholds the principle that fiduciary investors have full discretion on whether or not to act on these views. There is no suggestion that beneficiaries will direct investment activities. Instead, however, the section requires that fiduciary investors seek to understand beneficiaries' views (section 3(1)) and sets out possible mechanisms for how to do this (section 3(4)). Fiduciary investors may find that a better understanding of what their beneficiaries care about will also help to drive up engagement and contributions.

Section 3 also explicitly sets out that fiduciaries should not act on beneficiaries' views on non-financial factors where to do so would involve any material risk of significant financial detriment to any beneficiaries. This is in line with the UK Law Commission's conclusions on the current law.

- (1) A *fiduciary investor* shall be under a duty to take reasonable steps to ascertain the actual or likely *views of beneficiaries* in relation to any matters pertaining to its *investment functions* (and in particular, but without limitation, any views on the general principles governing investment or stewardship policies) in order to be able to discharge its duty under section 2 to have regard to those views in the performance of its *investment functions*.
- (2) A *fiduciary investor* shall every 12 months publish its *policy statement* and invite comments from beneficiaries and any representatives.
- (3) Except as prescribed by subsection (7) of this section, a *fiduciary investor* shall have absolute discretion as to the procedure it adopts in order to discharge its duty under sub-sections (1) and (2).
- (4) Without prejudice to the generality of subsection (3)
- (a) where its duties under this Act are owed directly to the *beneficiaries*, a *fiduciary investor* may choose to seek to discharge its duty under subsection (1) in any one or more of the following ways:
- i. by making what it believes to be reasonable assumptions as to the likely views of beneficiaries based on evidence of public opinion in general, the demographics of the beneficiaries, the nature of their occupations or of their employers, any international conventions to which the United Kingdom is a party, or such other factors as the *fiduciary investor* considers relevant;
 - ii. by taking account of representations made to them by beneficiaries;
 - iii. by direct consultation or dialogue with the beneficiaries or with their elected or appointed representatives; or
 - iv. by conducting surveys of opinion amongst the beneficiaries; and
- (b) in any other case, a *fiduciary investor* may seek to discharge its duty under this section by ascertaining the views of beneficiaries from the person to whom it directly owes its duties under this Act or by ascertaining such views itself in accordance with any procedure which may be agreed with that person.
- (5) In having regard to the *views of beneficiaries*, a *fiduciary investor*, shall have absolute discretion to balance or prioritise various views or concerns amongst the *beneficiaries* and, in the case of opposing views, may choose to adopt what it considers to be the most widely held or expressed view or may choose to adopt a synthesis or compromise of such views, provided that, in relation to *non-financial matters*, any such adoption would not, in its judgement, involve any material risk of significant financial detriment to any *beneficiaries*.
- (6) Nothing in this section shall be interpreted as giving beneficiaries any power to direct a *fiduciary investor* in the performance of its investment functions or as restricting in any other way its absolute discretion in that regard.
- (7) The Secretary of State may by regulation prescribe procedures which *fiduciary investors* may choose to adopt in pursuance of their duties and powers under this section and Section 4.
- (8) A *fiduciary investor* shall take all reasonable steps to ensure that all of its delegates and

advisers who are *fiduciary investors* comply with this section.

- (9) In relation to a *fiduciary investor* who is a delegate of or adviser to another *fiduciary*

investor, this section shall take effect subject to the terms of any mandate or instructions under which the delegate or adviser is performing *investment functions*.

4. Duties of accountability and transparency

- (1) A fiduciary investor shall be under a duty to account for all its investment activities and shall also be under a duty to act transparently in that regard.
- (2) A fiduciary investor shall comply with any reasonable request for information relating to the performance of its investment functions, where such request is made by the person to whom its duties under this Act are directly owed or by or on behalf of one or more of the beneficiaries (whether or not its duties under this Act are directly owed to the beneficiaries).
- (3) For the purposes of this section, a request for information shall be presumed to be reasonable unless:
- (a) the requested information has already been supplied to the person making the request within twelve months before the date of the request; or
- (b) the requested information is otherwise readily and freely available in easily comprehensible form to the person making the request and that person has been advised accordingly; or
- (c) the financial costs of providing the information would be disproportionate, having regard to the best interests of the beneficiaries as a whole and to whether the requested information is relevant to those best interests, and the

Building on the idea of modernising the investment system, section 4 seeks to improve transparency and accountability. As expectations around transparency generally have increased, the investment sector currently looks inadequate.

Section 4 places fiduciary investors under a duty to account to beneficiaries for investment activities and to act transparently. In practice, this would allow beneficiaries to better understand where their money is invested and how it is being managed. The section requires fiduciary investors to respond to any reasonable request for information in relation to investment activities from a beneficiary. It gives investors some discretion on how to respond and section 4(3) provides for a reasonableness test to avoid fiduciary investors being overburdened.

Section 4(4) is necessary because certain case law, such as *Re Londonderry's Settlement*, would, if not overturned, allow trustees to refuse to give reasons for the exercise of their discretions. This precedent evolved in the context of private trusts with a view to avoiding family disputes, and is therefore inappropriate in the context of modern pensions.

fiduciary investor has stated that to be its view and has given its best estimate of such costs to the person making the request; or

- (d) there are commercial considerations, including (without limitation) confidentiality constraints, that, for so long as such considerations subsist, would make it either unlawful or not in the best interests of the beneficiaries for the fiduciary investor to give the requested information, and the fiduciary investor has stated that to be its view and, so far as practicable, has indicated the nature of the relevant considerations to the person making the request.
- (4) A *fiduciary investor* shall comply with any reasonable request for information relating to the reasons for the manner in which the *fiduciary investor* has exercised or is

proposing to exercise, or not, a discretion in the performance of its *investment functions* notwithstanding any common law rule or equitable principle that might otherwise permit or require the *fiduciary investor* not to disclose those reasons.

- (5) A *fiduciary investor* shall take all reasonable steps to ensure that all of its delegates and advisers who are *fiduciary investors* comply with this section.
- (6) This section applies to those managing self-invested personal pensions or providing *investment functions* for retail clients, except that the duties are to clients and not *beneficiaries*. Where these duties are sub-contracted, such investors have a duty to take all reasonable steps to ensure that its sub-contractors comply with its duties under this section.

5. UK Council for Investor Due Diligence regarding human rights and the environment

- (1) The Secretary of State shall by regulations require the establishment of a UK Council for Investor Due Diligence (the Council) and the terms by which it operates.
- (2) Regulations under subsection (1) may mandate that a *fiduciary investor* with 100 members or more is required to pay an annual fee to enable and support the establishment and running of the Council.
- (3) Regulations under subsection (1) may among other things prescribe the following role and powers to the Council:
 - (a) Establishing and operating a due diligence process designed to identify any *adverse human rights impacts*

Section 2 states that a fiduciary investor will have regard to “the impact of any *investment activities* on the financial system, the economy, communities and the environment”. This raises the question of how they might do so. Some progressive investors will already think about the positive and negative consequences of their investment decisions in these areas, but this is far from common practice. Many only confront these questions when faced with high profile disasters such as the Rana Plaza factory disaster, BP’s Deepwater Horizon oil spill or the 2008 financial crash.

or any *damage to the environment* for which any investee company or potential *investee company* is or may be responsible for or linked to in accordance with subsection (9) below.

- (b) Establishing and operating an alert procedure to enable *fiduciary investors* to be made aware as soon as possible that there are reasonable grounds to believe that an *investee company* or a potential *investee company* is responsible for or linked to *adverse human rights impacts* or *damage to the environment* (or both).
 - (c) Issuing advice and non-binding recommendations on how a *fiduciary investor* could respond to the alert, including but not limited to actions set out in the *OECD's guidance on responsible business conduct for institutional investors*.
 - (d) Undertaking stewardship and engagement with companies in order to address their role in *adverse human rights impacts* or *damage to the environment* (or both).
- (4) The Council may prioritise its analysis of companies based on its view of the likelihood that certain companies may be at greater risk of *adverse human rights impacts* or *damage to the environment* (or both) whether by virtue of the sector, jurisdiction, their historic record, or context in which they operate.
- (5) For the purposes of the Council's powers, it does not matter how a *fiduciary investor* is or plans to be invested in an *investee company* including direct investment or investment via a collective investment fund.

It is becoming increasingly evident that we cannot have an investment system which operates as if in complete isolation from the real-world consequences of its investments. Section 5 therefore proposes a practical way in which the UK could embed into the investment system the consideration of the consequences of its investments. It proposes a 'Council' tasked with researching companies' practices and issuing alerts and recommendations to fiduciary investors. This draws inspiration from existing counterparts in Sweden and Norway, linked to their largest investors. The section empowers the government to set out details about the Council in further legislation.

The Council would look at human rights and environmental harm within companies and their operations and has the power to prioritise certain companies or sectors as it sees fit. If an alert is issued, investors could then decide how to act (based, perhaps, on the already well-established OECD guidelines for investors) and will need to publish, within 60 days, a statement explaining their decision.

In deciding how to respond, section 5(8) requires fiduciary investors to prioritise addressing the human rights violation or the environmental damage, rather than focusing maximising financial return. As a society, we need to decide whether it is acceptable for investors to make money at *any* cost. However, it should be noted that there is no suggestion that the responsibility to address violations shifts to the investor from the company – the purpose of the mechanism is to incentivise companies to address these

- (6) Nothing in the regulations or powers of the Council will allow it to direct how *fiduciary investors* make investments or undertake *investment activities*.
- (7) If, following an alert and recommendation by the Council, a *fiduciary investor* decides to retain, or to make, an investment in an *investee company* it must publish within 60 days of making this decision a statement explaining its decision and where relevant the actions it will take to exert leverage to address the *adverse human rights impacts or damage to the environment* (or both).
- (8) In deciding whether to exercise its discretion under subsection (7), the *fiduciary investor* shall have regard solely to adopting the course of action which it believes is most likely to contribute to ending or mitigating the *adverse human rights impacts or damage to the environment* (or both) or to securing substantial and effective remedial action and it shall not have regard to the respective financial implications of retaining or disposing of its interest in the *investee company*.
- (9) For the purposes of this section, an *investee company* (or an *underlying investee company*) shall be considered as having a responsibility to prevent, mitigate, and address *adverse human rights impacts or damage to the environment* in the following circumstances:
- (a) where it has caused the impact or damage through its own activities or the activities of its subsidiaries;
 - (b) where it has contributed to the impact or damage through its own activities or the activities of its subsidiaries,

breaches through pressure from their shareholders.

Many investors already seek to better understand these risks within companies but are hampered by lack of research. The work of the Council would therefore help investors avoid the financial and reputational risks of bad practice within investee companies and to respond to increasing demand for sustainable investment.

This section would be strengthened by clear legislation setting out mandatory human rights due diligence for companies themselves. It would also strengthen the effectiveness of such legislation, by incentivising companies to comply in order to address the Council's requests.

either directly or through some outside entity (whether governmental or non-governmental);

- (c) where it has neither caused nor contributed to the impact or damage but is involved because the impact or damage is caused by the operations of the subcontractors or suppliers with whom it maintains an established and direct commercial relationship; or
- (d) where it has neither caused nor contributed to the impact or damage but is involved because it exercises, attempts to exercise, should have exercised or is capable of exercising influence over the human rights, labour, environmental or health and safety policies and practices of the entity that has caused the violation or damage.

6. Alignment with the *Paris Agreement* on Climate Change

- (1) A *fiduciary investor* with 100 members or more is responsible for ensuring that *investment activities* performed in relation to the default fund or its equivalent and any funds marketed to *beneficiaries* as ethical, sustainable or equivalent are aligned with prudent consideration of the ambitions set out in Article 2(1) and 4(1) of the *Paris Agreement* and the UK Government's commitments made as a result of the *Paris Agreement*.
- (2) The Financial Conduct Authority and The Pensions Regulator shall be under a duty to pursue the following objectives:
 - (a) to disseminate and advocate guidance on climate finance standards consistent with the ambitions set out in Article 2(1) and 4(1) of the *Paris Agreement* and the UK Government's commitments made as a result of the *Paris Agreement*;
 - (b) to require the *fiduciary investors* within the scope of their regulatory remit to submit annual reports as part of the report required under section 2(3) of this Act on the extent to which their *investment activities* are consistent with subsection (1); and
 - (c) to review and report publicly on the extent to which the *investment activities* of the *fiduciary investors* within the scope of their regulatory remit are consistent with subsection (1).
- (3) The Secretary of State may stipulate by regulation further requirements for alignment with the *Paris Agreement* and reporting thereof under this section including but not limited to extending the categories of investors to which it applies.

It is well understood that addressing the risks (and opportunities) around climate change is critical for investors to protect their portfolios, particularly over the long-term. As states move towards action in line with the Paris Agreement, investors need to ensure they are not at risk of stranded assets. Furthermore, if the ambitions under the Paris Agreement are not met, investors need to address the impact of an increasingly unstable global society and environment.

Section 6 is therefore intended to set up a regulatory regime which assists fiduciary investors with developing and following a smooth trajectory towards a carbon-neutral society. It seeks to encourage them to make their contribution in a timely and planned manner, minimising loss to beneficiaries as well as mitigating the worst impacts of the climate crisis. However, it is important to note that 'Paris alignment' may be achieved in any number of ways – through stewardship, positive investment, collaborative engagement, screening etc- at the discretion of the fiduciary investor. The government would not be mandating how investments are made. It is notable that the Swedish financial regulator has already been tasked with monitoring alignment by financial actors within its remit.

Section 6(2) places a duty on the relevant regulators (the FCA and TPR) to support the achievement of these goals through issuing guidance and supervising fiduciary investors. It would mirror the recent work of the Swiss and Dutch governments by requiring investors to report on their plans

- (4) This section applies to those managing self-invested personal pensions or providing *investment functions* for retail clients, except that the duties are to clients and not *beneficiaries*. Where these duties are sub-contracted, such investors have a duty to take all reasonable steps to ensure that its sub-contractors comply with its duties under this section.

to align with the Paris Agreement goals, reviewing these reports and publishing a comprehensive account of the progress made by the sectors as a whole. The provisions would require further legislation.

7. Duty to provide stewardship of investments

- (1) A *fiduciary investor* shall be under a duty to provide the *investment function* that is the stewardship of investments as defined by this Act. In doing so it shall aim to influence the directors of *investee companies* to act so as to advance the *benefit* of beneficiaries in line with the *policy statement*.
- (2) A *fiduciary investor* shall take all reasonable steps to ensure that any *fiduciary investor* to whom it has delegated this function performs it in accordance with subsection (1).
- (3) A *fiduciary investor* who is acting as a delegate for or adviser to another *fiduciary investor* shall do so in accordance with the requirements of subsection (1).
- (4) This section applies to those managing self-invested personal pensions or providing *investment functions* for retail clients, except that the duties are to clients and not *beneficiaries*. Where these duties are sub-contracted, such investors have a duty to take all reasonable steps to ensure that its sub-contractors comply with its duties under this section.

The UK Stewardship Code is voluntary and although pension trustees have to publish a stewardship policy as part of their Statement of Investment Principles, commitment to stewardship varies greatly across the sector. This section seeks to address this by confirming that stewardship is part of fiduciary investors' duty.

As stewardship itself is a neutral activity – what matters is the quality and focus of the engagement – section 7(1) also clarifies that stewardship should be in line with the core duties set out in section 2. In practice, this will include looking at the long-term and not only at short-term gains at the cost of wider economic stability or other goals (such as addressing climate change).

8. Duty to avoid conflicts of interest

If the investment system is to put first beneficiaries and clients – the providers of capital – then it needs to be incentivised to do so. One current disincentive is the existence of conflicts of interests, particularly those inherent within remuneration practices that reward short-term success and business models/corporate structures that have in-built conflicts. This section aims to address this.

- (1) A *fiduciary investor* must wherever possible avoid a situation in which the *fiduciary investor's* interests conflict, or may conflict, with the interests of *beneficiaries*.
- (2) In the event of an actual or possible conflict of interest between a *fiduciary investor* and *beneficiaries* the *fiduciary investor* shall as soon as possible disclose the conflict to the person or persons to whom the duty is owed and shall manage the conflict in the sole interest of the *beneficiaries*.
- (3) For the purposes of this section, short-term remuneration incentives for *fiduciary investors* or their employees may constitute an actual or possible conflict of interest.
- (4) A *fiduciary investor* shall take all reasonable steps to ensure that all of its delegates and advisers who are *fiduciary investors* comply with this section.
- (5) This section applies to those managing self-invested personal pensions or providing *investment functions* for retail clients, except that the duties are to clients and not *beneficiaries*. Where these duties are sub-contracted, such investors have a duty to take all reasonable steps to ensure that its sub-contractors comply with its duties under this section.

9. Persons to whom the duties of fiduciary investors are owed

This clarifies to whom the duties in the Act are owed. It is important to note that the principle of loyalty to beneficiaries is maintained.

- (1) Notwithstanding the requirement under section 2 for all *fiduciary investors* to act in the *best interests* of the *beneficiaries*, the duties of *fiduciary investors* specified in this Act are owed directly as follows:
 - (a) in the case of persons described in section 1(1)(a) (trustees of a trust scheme), to the *beneficiaries* of the trust scheme;
 - (b) In the case of persons described in section 1(1)(b) (managers of personal pension schemes), to the members of the scheme;

- (c) in the case of persons described in section 1(1)(c) (trustees' investment delegates), to the trustees of the trust scheme or, in the case of sub-delegates, to the immediate delegator;
- (d) in the case of persons described in section 1(1)(d) (trustees' investment advisers), to the trustees of the trust scheme or, in the case of sub-contracted parties, to the other party to the contract;
- (e) in the case of persons described in section 1(1)(e) (further designated *fiduciary investors*), to the person specified in regulations under section 1(2); and
- (f) in the case of sections applying to those managing self-invested personal pensions or providing *investment functions* for retail clients, the duties are to clients and not *beneficiaries*.

10. Enforcement

One of the weaknesses of the directors' duties introduced under section 172 of the Companies Act 2006 is the lack of enforcement powers where directors have fallen below a reasonable standard. Section 10 seeks to provide a clear process in respect of this new Act.

It is important to note that the right to seek redress extends only to those to whom the duties are owed (generally, those whose money is being managed). The section requires that a person make a complaint to the relevant financial regulatory authority and empowers that authority to take enforcement action in respect of the new duties and powers within the Act.

The section also provides judicial redress for those to whom the duty is owed. Although these mechanisms are not novel, the current system is opaque and complex, therefore this section seeks to provide clarity.

- (1) A person to whom a duty is owed under section 9 of this Act may make a complaint to the relevant regulatory authority in respect of alleged breach of a duty under this Act.
- (2) The relevant regulatory authority will be the following or its successor:
 - (a) in the case of persons described in section 1(1)(a) (trustees of a trust scheme), The Pensions Regulator; and
 - (b) in the case of persons described in section 1(1)(b) (managers of personal pension schemes), to those managing self-invested personal pensions or providing *investment functions* for retail clients, the Financial Ombudsman,
- (3) The relevant authority will have a duty to investigate the complaint and take enforcement action where necessary. In the case of a complaint made to the Financial Ombudsman, the Financial Ombudsman shall also inform the Financial Conduct Authority of the complaint.
- (4) In addition to the above, a person to whom a duty is owed under section 9 of this Act who claims that there has been a breach of such duty may bring legal proceedings in respect of that breach or proposed breach.

(5) In relation to any action or inaction of a *fiduciary investor* or other investor covered by this Act which the court finds to be in breach of duties established by this Act, it may grant such relief or remedy, or make such order, as it considers just and appropriate where such relief may include

an order to perform or cease to perform a function required by this Act.

(6) The Secretary of State may by regulations give powers to the relevant regulatory authorities to provide additional remedies.

11. No contractual or other exclusion of duties or powers

This section provides that the duties of investment intermediaries should not be subject to contractual overrides. The wording draws on section 33 of the Pensions Act 1995 which prohibits any exclusion or restriction of trustees' or fund managers' duty of care in relation to investment functions.

(1) The duties and powers of *fiduciary investors* under this Act cannot be excluded or restricted by any instrument or agreement including but not limited to:

- (a) making the duty or its enforcement subject to restrictive or onerous conditions;
- (b) excluding or restricting any right or remedy in respect of a breach of duty, or subjecting a person to any prejudice in consequence of their pursuing any such right or remedy; and
- (c) excluding or restricting any rules of evidence or procedure.

(2) In this section, references to excluding or restricting a power include making the exercise of the power subject to restrictive or onerous conditions.

(3) Any provision in any instrument to the effect that a pension scheme to which the instrument relates is established for the sole purpose of providing financial retirement benefits shall be interpreted so as not to exclude or restrict any of the powers conferred by this Act and any related provision in any such instrument limiting the exercise of any power to amend the pension scheme shall be similarly interpreted.

(4) This section applies to those managing self-invested personal pensions or providing *investment functions* for retail clients, except that the duties are to clients and not *beneficiaries*. Where these duties are sub-contracted, such investors have a duty to take all reasonable steps to ensure that its sub-contractors comply with its duties under this section.

12. No effect on wider powers

Nothing in this Act shall be interpreted as affecting any provisions in any instrument or agreement that confer on a *fiduciary investor* any wider powers than those conferred by this Act, including (without limitation) any powers to invest in accordance with the *views of beneficiaries on non-financial matters* in priority to financial considerations.

This section confirms the established principle that express authorisation in a trust instrument can override general rules of law relating to investment.



3.

Definitions

3. Definitions

In this Act –

“Adverse human rights impacts” includes actual and potential violations of human rights recognised under international human rights agreements including (but not limited to) –

- (a) the International Bill of Human Rights (comprising the Universal Declaration of Human Rights of 1948, the International Covenant on Civil and Political Rights of 1966 and the International Covenant on Economic, Social and Cultural Rights of 1966);
- (b) the International Labour Organization’s Declaration on Fundamental Principles and Rights at Work and related conventions; and
- (c) United Nations instruments covering the rights of indigenous peoples; women; national or ethnic, religious and linguistic minorities; children; persons with disabilities; and migrant workers and their families.

For the avoidance of doubt, **adverse human rights impacts** will include (but are not limited to) the following –

- (a) genocide,
- (b) slavery and slavery-like practices;
- (c) summary or arbitrary executions;
- (d) torture
- (e) enforced disappearances;
- (f) arbitrary and prolonged detention;
- (g) systematic discrimination;
- (h) grave and systematic violations of economic, social and cultural rights (including violations on a large scale or targeted at particular population groups); and
- (i) violations that constitute “international crimes”, as defined under the Rome Statute of the International Criminal Court.

“beneficiaries” means persons for whose benefit investments are being, will be or may be applied, whatever the particular form of ownership under which investments are held for the time being (including whether or not the legal or beneficial ownership of the investments is at any given time vested in the beneficiaries, a fiduciary investor or a third party). For the avoidance of doubt this may include members of a personal pension scheme other than a self-invested personal pension.

“benefit” includes –

- (a) financial benefit provided out of *investments*;

- (b) any other financial benefit, including, but not limited to, benefit relating to *beneficiaries'* security of employment or to the prosperity of their local community;
- (c) benefit resulting from the process prescribed in section 5; and
- (d) non-financial benefit as assessed by the *fiduciary investor* based on the circumstances and views of *beneficiaries* provided that the *fiduciary investor* considers that the decision to take into account those circumstances or views would not involve a material risk of significant financial detriment to any *beneficiaries*.

and **“best interests”** shall be interpreted accordingly as acting for someone's *benefit*.

“circumstances of beneficiaries” refers to all the material circumstances of beneficiaries, including but not limited to their income, their assets, their employment, their financial commitments, their dependents, their age and where they live.

“damage to the environment” includes (but is not limited to):

- (a) damage resulting from the pursuit or financing of a business model which is based on assumptions that are fundamentally incompatible with the *Paris Agreement*;
- (b) damage resulting from activities which are fundamentally incompatible with the sustainability objectives of the United Nations Convention on Biological Diversity;
- (c) damage that also amounts to a crime under generally recognized international human rights law;
- (d) damage which is significantly more severe than is the norm for companies engaged in the same or similar activities as the investee company;
- (e) damage which is on a large scale; and
- (f) damage which is wholly or mainly irremediable.

“investment activities” means any actions taken in the performance of any *investment functions*.

“investee company” means any company or other entity (corporate or unincorporate) in which a *fiduciary investor* acquires an interest (whether by way of equity or debt) and **“underlying investee company”** means any company or other entity in which the manager of a collective investment fund in which a *fiduciary investor* has invested acquires an interest.

“investment functions” includes (among other matters) such of the following as pertain to the particular description of *fiduciary investor*.

- (a) the selection, retention and realisation of *investments*
- (b) the stewardship of investments which is the responsible allocation, management and oversight

of capital to create long-term value for clients and *beneficiaries* leading to sustainable benefits for the economy, the environment and society and includes (without limitation)

- i. the exercise of rights, including voting rights, attaching to *investments*,
- ii. engagement with the managers of investee companies (whether as issuers of equity or of debt) and other investee entities in relation to (amongst other matters) their performance, strategy, risks, social and environmental impact (including in relation to climate change), corporate governance (including management remuneration) and corporate actions, and
- iii. collaboration with other market participants on these two functions whenever a common interest exists

(c) collective action with other market participants to further any common interests,

(d) the selection, appointment and monitoring of investment managers and other agents to whom the *fiduciary investor* delegates any investment functions,

(e) the selection, appointment and ongoing review of any investment funds which are operated by insurance companies or other institutions acting as principals and in which the *fiduciary investor* invests,

(f) the selection, appointment and monitoring of investment consultants and of other advisers in relation to the performance of any *investment functions*,

(g) advising or assisting another *fiduciary investor* in relation to the performance of any *investment functions*,

(h) ascertaining the actual or likely *views* of *beneficiaries* and determining how these may be addressed in the *fiduciary investor's investment activities*; and

“investments” means the investments in relation to which any *investment functions* are performed and, where the context admits, includes assets of any kind representing such investments.

“non-financial matters” includes (but is not limited to) social and environmental impact, *beneficiaries’* present and future quality of life and *beneficiaries’* ethical views (whether or not any such matters also have financial implications).

“OECD’s guidance on Responsible business conduct for institutional investors” means the OECD’s 2017 publication (as amended and updated) “Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises”

“Paris Agreement” means the agreement within the United Nations Framework Convention on Climate Change dealing with greenhouse-gas emissions mitigation, adaptation and finance signed in 2016.

“the long term” means the length of time that the *fiduciary investor* considers is needed for the funding of future *benefits* by the *investments* or for the addressing of any *non-financial matters*.

“views of beneficiaries” means the views of *beneficiaries* in relation to any of the *investment functions* or *investment activities* of a *fiduciary investor*, whether regarding financially material matters or *non-financial matters*.



References

- 1 Thinking Ahead Institute/Willis Towers Watson, (2019). *Global Pensions Asset Study – 2018*. Available online at: <https://www.thinkingaheadinstitute.org/en/Library/Public/Research-and-Ideas/2019/02/Global-Pension-Asset-Survey-2019> [accessed 20 April 2020]
- 2 Greenfield, P. (2019). The Guardian, *World's top three asset managers oversee \$300bn fossil fuel investments*. Available online at: <https://www.theguardian.com/environment/2019/oct/12/top-three-asset-managers-fossil-fuel-investments> [accessed 8 January 2020]
- 3 For example, the changes to The Occupational Pension Schemes (Investment) Regulations 2005 in relation to policies on stewardship and ESG within the SIP and the proposed equivalent updates in the Financial Conduct Authority's Handbook
- 4 Nusseibeh, S. (2017). *The Why Question*. Available online at: <https://www.the300club.org/wp-content/uploads/2018/10/white-papers-the-why-question.pdf> [Accessed 10 May 2020]
- 5 OECD, (2017), *Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises*. Available online at: <http://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>
- 6 For example, the IIGCC's Paris Aligned Investment Initiative (<https://www.iigcc.org/resource/iigcc-paris-aligned-investment-initiative/>) and the PRI-commissioned work by Energy Transitions Advisers (<https://www.mainstreamingclimate.org/publication/asset-owner-governance-and-paris-agreement-alignment-role-of-governance-in-achieving-paris-agreement-alignment/>)
- 7 Franklin Templeton and Adoreboard. (2019). *The Power of Emotions*. Available online at: <https://www.franklintempleton.co.uk/institutions/campaigns/the-power-of-emotions> [accessed 20 April 2020].
- 8 Hiro Mizuno in conversation at Said Business School, Oxford, 17 January 2020 <https://www.sbs.ox.ac.uk/news/hiro-mizuno-investors-have-pay-attention-whole-system>

About ShareAction

ShareAction is a non-profit working to build a global investment sector which is responsible for its impacts on people and planet. We mobilise investors to take action to improve labour standards, tackle the climate crisis, and address pressing global health issues, such as childhood obesity. Over the last 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. We want a future where all finance powers social progress.

Visit shareaction.org or follow us @ShareAction on Twitter to find out more.

shareaction.org
info@shareaction.org
+44 (0)20 7403 7800

63/66 Hatton Garden
Fifth Floor, Suite 23
London UK
EC1N 8LE

ShareAction»