Pension Schemes Bill: briefing for Lords 2nd reading

This briefing is on behalf of ShareAction, the responsible investment charity, ahead of Second Reading of the Pension Schemes Bill on Thursday 18th December.

ShareAction is working with pension trustees, pensions lawyers and other advisors as well as civil society organisations and thinktanks to provide the much-needed clarification in law of pension schemes' "fiduciary duties" – the legal duties which govern how pension schemes invest in members' interests.

What the Bill does

The Bill aims to boost pension saver outcomes through consolidation and an increased focus on value for money. These measures are broadly supported by all parties.

More controversial are measures to prompt schemes to invest in a wider range of assets. Clause 38, which inserts new section 28C into the Pensions Act 2008, takes a "reserve power", enabling Government to set binding investment targets for some schemes. Subject to appeal to The Pensions Regulator, this blocks schemes from receiving contributions from members and employers if they do not meet certain levels of "private market" investments (those in firms not traded on an exchange).

Government's proposal builds on the Mansion House Accord under which 17 schemes voluntarily agreed minimum allocations to certain investments, including UK investments, by 2030. Some industry figures, and opposition MPs have raised concerns that the powers will undermine pension scheme fiduciary duties, although Government rejects this.

The need to clarify fiduciary duty

Fiduciary duties (the legal duties to act in savers' interests, similar to the duties company directors have to their investors) govern how trustees of occupational pension schemes act to fulfill their purpose of providing retirement benefits, but are only briefly covered in statute. Similar provisions apply to the Local Government Pension Scheme (LGPS) and personal pensions. Fiduciary duties are mainly understood through case law, with many key cases centuries-old and others being widely misunderstood and misapplied.

The result of the case law is that many scheme governance bodies do not feel able to take account of system-level considerations such as the impact on investment returns from climate change and nature loss, housing and infrastructure, health, education, employment or skills.

Legal uncertainty also prevents most schemes from taking account of the impacts (positive and negative) of the companies in which they invest on savers' standard of living such as – for example, their economic practices or impact on the environment or the local community. Fiduciary duty is also unclear on the ability to take account of pension savers' views about scheme investments.

Government has recently committed to bring forward guidance, but guidance alone will not provide the legal certainty that is needed to enable schemes to act. Guidance without a robust legislative framework will also limit parliamentary scrutiny and could be misused by future administrations.

To ensure that pension schemes are *voluntarily* able to invest productively in members' interests, including in the UK economy, we recommend that Peers advocate for clarification of fiduciary duty in law, rather than via guidance alone.

What Government has said

At Commons Report stage, Government committed to issuing statutory guidance for trustees of private sector occupational schemes (but not the LGPS or workplace personal pension schemes) on their investment duties. To do this, it needs to bring forward an amendment to give it the powers to issue such guidance. We expect to see this tabled at Lords Committee stage. Government has not given a timescale for the production of the guidance.

Government has previously underdelivered on fiduciary duty clarification. The Sunak administration's 2023 Green Finance Strategy committed to a series of Government roundtables to understand how it might clarify the law. One roundtable was held before the 2024 general election but none have been convened under the new administration. The current Government has also publicly welcomed - but not endorsed, the work of the Financial Markets Law Committee (a legal charity) which indicated that schemes should consider broader financial risks like climate change; as well as the NatWest-Cushon/Eversheds opinion on fiduciary duty, which concluded that schemes should take account of savers' standard of living.

Summary of activity in the Commons

At Commons Second Reading in July several MPs expressed interest in making it easier for pension schemes to invest in social housing, green technology and jobs, regeneration, infrastructure, care, education and skills, and to address climate and nature issues more broadly. Debbie Abrahams, Chair of the Work and Pensions Committee, raised the case for clarifying fiduciary duty to make clear that schemes can consider the impact of their investments on the economy and the environment.

In oral evidence to Commons Committee, the Trades Union Congress and Age UK both supported clarification of pension scheme fiduciary duty.

At Report, Liam Byrne, Chair of the Business and Trade Committee, tabled an amendment (NC17) to clarify fiduciary duties of the occupational pension schemes, the Local Government Pension Scheme and workplace personal pensions. The amendment was signed by 34 MPs from multiple political parties.

Liam Byrne welcomed Government's announcement of statutory guidance but added that

> "mere guidance is not enough, because sometimes it can be ignored. Guidance does not eliminate liability risk and does not give trustees a solid statutory floor … I urge him to go big, by pairing guidance with underpinning regulation that gives trustees legal clarity; [and] to go broad, by ensuring that every single kind of scheme falls within the ambit of the legislation … That clarity, if we get it right, could avoid the need to resort to the mandating powers that some Members of this House have objected to. It could unlock investment by giving schemes confidence to act, rather than making them fearful and hesitant."

Benefits from clarifying fiduciary duty

With new legislative powers, fiduciary duty could be clarified in regulations and statutory guidance in less than 12 months, applying to all pension schemes with immediate effect. This would unlock **more investment in the UK as well as empowering schemes to focus on climate, nature**, infrastructure, health and skills. Legislation would enable a shift in investment decision-making attitudes and practices, whilst ensuring schemes retain complete discretion and control in serving member interests.

The duty to manage **system-level risks** should improve returns by encouraging investments that lift the returns of other companies in which the pension 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 standards of living** by considering the real-world buying power of their pension - not just its nominal value - would also improve saver outcomes. Savers who retire into a world of high inflation and resource scarcity, where goods such as housing, energy, food or water are more expensive, would experience a worse standard of living than if pension schemes had been clearly permitted in law to take account of living standards and invested member assets to help tackle those risks.

Each of these measures would support new investment in the delivery of UK clean energy, nature protection, homebuilding, local employment, healthcare and transport infrastructure, as well as investments which make it easier for Government to provide these services by **boosting productivity and 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 undermine financial returns or remove the existing legal requirement for schemes to "ensure the security, quality, liquidity and profitability of the portfolio as a whole".

Fiduciary duty clarification can significantly increase investment by UK pension funds to benefit UK savers. Independent modelling prepared to support this proposal suggests that it has the potential to move over **£100bn into UK assets, boosting GDP by 0.3-1.4%** by 2029 and reducing emissions by **19 million tonnes a year**, similar to the annual emissions of the UK's 3 largest power stations.

Why guidance alone is not enough

The Pensions Minister indicated at Report stage that "guidance will encapsulate those wider factors set out in his new clause… including what we mean by systemic risks and standards of living" and noted that "there is good support in the industry for providing that clarity".

However Government's current proposals for guidance risk underachieving for UK savers and UK growth, whilst also doing nothing to boost climate resilience or nature protection.

- **The government's proposal makes no provision for two out of the three main types of workplace pension scheme**. The Local Government Pension Scheme, overseen by the Ministry of Housing, Communities and Local Government, and workplace personal schemes, overseen by the FCA, are not in scope. Consistency in law across all schemes would ensure all savers benefit.

- The Lords Science and Technology Committee has flagged the need for ambitious and rapid reforms to encourage a change of thinking by pension schemes, but **Government has offered no timescales for guidance to be produced or come into force**. The previous unwillingness to progress roundtables inherited from the Sunak administration or to endorse the Financial Markets Law Committee paper or the Eversheds legal opinion suggest that this may not be a high priority.

- Whilst they must have regard to statutory guidance, **pension schemes can choose not to follow it** and it is virtually impossible to enforce on its own. For example, earlier Government statutory guidance said that pension schemes should produce a plain English summary of their report on how they have managed climate risk; several of the largest schemes have, with no explanation, not produced such a summary, but no compliance action has been taken.

- **Schemes could not rely on statutory guidance alone in the courts.** Statutory guidance without suitable legislative clarification will not give schemes that wish to act the complete confidence to do so. Where the underlying law remains unclear, pension schemes will be exposed to the risk of litigation if they follow statutory guidance, as they could still be found in breach of their fiduciary duty.

- **Statutory guidance on its own could be misused by a future Government**. Statutory guidance is not reviewed by Parliament. Without a clear legislative framework on pension schemes' investment duties, a future Government could bring forward guidance without parliamentary scrutiny which sought to subvert pension schemes' duties to act in savers' best interests and pressure them into investing in accordance with that Government's political priorities – for example, by discouraging them from investments that were in members' interest, but of which it disapproved, or by pressing schemes to provide capital to sectors which that Government did not wish to fund itself. Statutory guidance can only provide the certainty and stability that schemes need where the legislation governing the investment duties of pension schemes is clear.

Other points to make at Second Reading

Pension schemes are not clear on their duties. 31 senior pensions and investment figures have written to Ministers requesting clarification, including both chairs of a large trustee representative body, a large business leader representative body and 12 chief executives or equivalent. The chief executive of the UK's largest automatic enrolment scheme, Nest, has also called for clarification.

Clarity in law will maintain or enhance pension saver outcomes. Schemes would still be required to take a "finance first" approach – exercising their powers of investment "in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole", as regulations require. But they would have clarity that they can act on wider issues like productivity, health, skills and infrastructure, as well as climate and nature issues, which drag down returns across the portfolio.

Clarification in law will not override trustee fiduciary duties. Schemes would retain all their investment duties, established through case law, including exercising investment powers for their proper purpose, taking account of material financial factors and exercising their investment powers with the care, skill and diligence that a prudent person should exercise. Clarification in law will provide a clear foundation that better enables governance bodies to act in the ways they decide are most appropriate for their scheme.

Compliance will not be complicated for schemes. Fiduciary duty clarification would simply make clear that schemes should manage financially material risks whatever their source, and permits them to consider other additional matters too.

Statutory clarification will benefit the UK. Clarification will facilitate investment in assets which deliver wider benefits to other parts of their portfolio and lower the cost of living for savers, including investments which boost UK economic growth. However schemes would not be required by these proposals to invest more in the UK or in particular assets, only enabled to do so.

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. For questions or further information please contact Luke Hildyard, Head of UK Policy, luke.hildyard@shareaction.org