A response to the Law Commission consultation on Fiduciary Duties of Investment Intermediaries

Who we are...

The Intergenerational Foundation (www.if.org.uk) is a think tank which researches fairness between the generations in the UK, in order to protect the interests of younger and future generations, who are at risk of being ignored by current policy-makers.

Our response...

IF believes it is imperative that the trustees of pension funds and other long-term investment vehicles should be compelled to take more account of the interests of future generations in their decision-making than they are at present.

IF considers there to be two important legal issues in relation to the intergenerational aspects of fiduciary responsibility. The first of these concerns how impartial trustees are when it comes to dealing with different generations of beneficiaries. The second important legal issue involving the intergenerational aspects of fiduciary duties concerns how much leeway pension fund trustees have to include environmental, social and governance (ESG) factors in their decision-making.

Impartiality of trustees: reflecting interests of younger beneficiaries

This issue can be broken down into two separate sub-issues. The first sub-issue is whether pension scheme trustees are empowered to give adequate consideration to the interests of their younger members. Although the consultation document does a good job of explaining most aspects of the fiduciary duties which trustees have under current law, we believe that further clarification of the existing rules is needed regarding how trustees should adjudicate between the interests of younger pension scheme members, who will not begin drawing their pensions until some distant point in the future, and the interests of current retirees and older pension scheme members who are either already drawing their pensions or are on the verge of doing so. Under the current laws, trustees are supposed to act impartially towards all their beneficiaries, yet in practice the focus which many trusts place on achieving the highest possible returns in the short-term effectively discriminates in favour of their older beneficiaries, who receive the higher returns in the form of pensions, while possibly endangering the money invested by their younger beneficiaries if such investment strategies involve greater risk.

Recommendation

IF recommends that the Law Commission should investigate how the existing law is being applied in this area, to discover whether pension scheme trustees are correctly applying their duty of impartiality towards all their members, or whether short-termist investment strategies systematically disadvantage younger beneficiaries. This should result in the law surrounding impartiality between younger and older beneficiaries being clarified.

Impartiality of trustees: fiduciary duty towards future generations

The second sub-issue concerns whether trustees have a fiduciary duty towards future beneficiaries which ought to be recognised in law. The consultation document placed significant weight on the legal precedent which was established by *Cowan vs Scargill* that the principle duty of trustees is to put the financial interests of their beneficiaries first, but it does not explicitly set out to what extent this duty extends to future beneficiaries. IF believes that the law needs to recognise that many pension funds are essentially perpetual investors; in addition to their current beneficiaries they will have future beneficiaries who are not yet paying into the scheme, but who will do so at some point, for example when they become employees of the company who created it. As the needs of these future beneficiaries can only be met if the pension scheme continues to exist in a decent state of financial health, it seems clear that the present-day trustees should have some kind of fiduciary responsibility towards the interests of these future beneficiaries, in addition to the fiduciary responsibility they have towards their present-day beneficiaries. However, the exact strength of this fiduciary responsibility and the precise legal ramifications which it has for present-day trustees both require further clarification in law.

Recommendation

IF recommends that the Law Commission should attempt to clarify the existing law in this area and, if necessary, propose the introduction of new regulations which would recognise a fiduciary duty between present-day trustees and the future beneficiaries of their trusts.

There are circumstances under which it could be prudent for the present-day trustees to choose a long-term investment strategy which sacrifices achieving the highest possible short-term returns for present-day beneficiaries in order to concentrate on generating a more stable flow of returns which would benefit these future beneficiaries, but as trust law stands it appears that trustees could well face litigation for doing this if the present-day beneficiaries could claim that the trustees were neglecting their fiduciary responsibility towards them. Therefore, further clarification of the law, and possible changes to it, may be necessary to enable trustees to take more of a long-term perspective towards their responsibilities.

Including ESG factors

At present there appear to be widespread misconceptions among pension fund trustees about how far they can take an ESG approach before it risks coming into conflict with their fiduciary duties, especially following the rulings in cases such as *Harries v Church Commissioners for England* which are cited by the consultation document. As IF would argue that pension fund trustees have a fiduciary responsibility to ensure they can deliver returns in perpetuity, they are in many ways the ideal investors to adopt an ESG approach, as this is likely to improve the sustainability of their future returns, while the consultation document also points out that there is a body of evidence to suggest that trusts which use an ESG approach can deliver greater returns for their beneficiaries than those that use a non-ESG approach.

Recommendation

IF recommends that the Law Commission should clarify the existing law surrounding fiduciary duties and the adoption of ESG principles, in order to provide trustees with more certainty about whether they are legally allowed to adopt them or not.

Conclusion

Overall, IF believes that pension fund trustees need to have a better understanding of what their duties are towards younger and future generations under the existing law, so a key goal of the Law Commission consultation ought to be clarifying these responsibilities. In order to help promote the interests of younger and future generations, IF would be willing to discuss any of these ideas further with the Law Commission.

For more information about the Intergenerational Foundation and its work, please visit www.if.org.uk or contact Liz Emerson, Co-Founder at liz@intergenerational.org.uk.

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