Conclusion & Recommendations

A fresh look at fiduciary obligation has much to contribute to some of the biggest policy challenges we face: preventing another financial crisis, providing for our ageing population, and moving towards a low-carbon economy. There is an urgent need to strip away the myths and rediscover what fiduciary obligation is really about - and how these principles can be applied to a world that has changed radically in ways the law has only partially caught up with. In addition to our specific recommendations on particular issues, our overarching conclusion is that the government must conduct a review of investors' fiduciary obligations. Its goal should be to ensure the legal framework is serving its purpose: to protect us all from irresponsible, short-sighted or self-serving behaviour by those on whom we depend to act on our behalf.

Although the recommendations set out below are directed towards UK government, regulators and investors, we hope that the conclusions of this report will also be of interest to overseas readers.

Recommendations for Government

- Conduct a fundamental cross-departmental review of investors' fiduciary obligations, both to ensure that this valuable concept remains relevant in the 21st century, and to step back and reconsider whether the law is fulfilling its purpose of protecting beneficiaries. The goal should be to achieve enlightened fiduciary standards of care over all private pension savings and other long-term savings.
- Establish a cross-departmental group to carry forward the outcomes of this review and to act as a nexus for institutional investment issues within government.
- In particular, the review should consider:
  - whether the existing legal framework is ill-equipped to deal with the problem of systemic risk, and whether new law or guidance might be needed to ensure that trustees feel free to take account of systemic issues with implications for their members; and
  - the legal obligations that apply to contract-based pension providers, with the aim of ensuring that standards of care and accountability mechanisms are consistent across the market.

Recommendations for the Department for Work and Pensions

- Issue a comprehensive guide for pension scheme trustees on their fiduciary duties in relation to exercising investment functions, setting out the key relevant obligations and providing guidance on their interpretation.
- Ensure that any new guidance for trustees:
  - provides confirmation that fiduciaries should consider ESG issues which may be financially material. This could be accompanied by more detailed guidance on the respective roles of trustees, asset managers and consultants; and
  - clarifies the relationship between member involvement and the duty of impartiality, and should consider statutory clarification of this point if necessary.
- Provide statutory clarification on the extent to which ethical and social considerations can be taken into account by pension scheme trustees. This would help end current confusion and disagreement as well as over-reliance on often questionable interpretations of a small number of legal decisions with doubtful relevance to contemporary circumstances.

Recommendations for the Department for Business, Innovation and Skills

- Introduce a provision parallel to section 172 of the Companies Act for institutional investors.
- As part of its review 'A long-term focus for corporate Britain':
  - facilitate pension providers' efforts to align asset managers' incentives with those of their beneficiaries – for instance, through a 'lab' enabling experimentation as to the practical form such mandates might take.
  - explore ways to ensure that pension funds are acting as long-term investors and avoiding high levels of 'churn' which create transaction costs for beneficiaries and generate financial instability. Possible tools could include tax incentives, regulations and disclosure requirements.
- Clearly state its willingness to make use of reserve powers to introduce mandatory voting disclosure if voluntary initiatives do not prompt sufficient improvements by a specified date. They should also explore other ways of improving transparency and accountability among institutional investors.
- As part of its review 'The future of narrative reporting', seek to promote the concept of integrated reporting, and explicitly clarify the need to ensure that environmental and social reporting is forward-looking and strategic rather than being siloed into backward-looking CSR or sustainability reports.

Recommendations for the Treasury

- Take the opportunity presented by the current review of financial regulation to ensure that the regulatory structure is streamlined and delivers equal levels of protection to all pension savers regardless of the form of their pension arrangements.
- Clearly state its willingness to make use of reserve powers to introduce mandatory voting disclosure if voluntary initiatives do not prompt sufficient improvements by a specified date. They should also explore other ways of improving transparency and accountability among institutional investors.

Recommendations for Regulators

Recommendations for the Financial Services Authority/Financial Conduct Authority

- Remind asset managers of their fiduciary status and of the fact that this may entail stricter obligations than those imposed by regulatory rules; seek to improve firms' understanding and application of fiduciary obligations, with a particular focus on the prevention, management and disclosure of conflicts of interest.
- Confirm that investment consultants are fiduciaries in relation to their clients and work to ensure that these obligations are understood and applied in practice, with a particular focus on the prevention, management and disclosure of conflicts of interest.

Recommendations for The Pensions Regulator

- Take steps to ensure that the training available to trustees on the critical matter of monitoring asset managers is sufficiently robust and independent. There is also a role for trade unions in providing continued support for member-nominated trustees.
- Seek to facilitate and support funds to engage with their members, for instance through the dissemination of model surveys or best practice guidance.
- Small pension schemes should be encouraged and enabled to consolidate, bearing in mind the per member unit costs of running small schemes and the generally higher quality of scheme governance and member communications in larger schemes.

Recommendations for the Financial Reporting Council

- Ensure that future revisions of the Stewardship Code place explicit emphasis on environmental and social issues as well as on governance.
- Seek to promote the concept of integrated reporting and explicitly clarify the need to ensure that environmental and social reporting is forward-looking and strategic rather than being siloed into backward-looking CSR or sustainability reports.

Recommendations for investors

Recommendations for all pension providers

- (For DC providers) Offer an ethical option based on an assessment of members' ethical preferences.
- Consult with members and encourage and welcome member engagement, including by providing full and open disclosures on their investment policies and practices.
- Consider how to embed appropriate incentives in contracts with asset managers – for instance, by incorporating longer-term performance measures on a wider range of factors than benchmark relative financial performance.

Recommendations for trustees

- Seek to avoid and manage conflicts of interest not just within the trustee board itself, but also among their service providers. In particular, funds should request information regarding the policies their asset managers and consultants have in place to ensure that specific relevant conflicts are properly managed.
- When asked by members to consider an ethical issue, perform an analysis of its effect on their portfolio, in line with the 'ethical tie break' principle. Currently many funds wrongly invoke fiduciary duty to justify a refusal even to consider a non-financial issue.

Recommendations for insurance companies

- Devote more attention to outreach, communication and accountability to policyholders, for instance by organising roadshows.