Pension trustees fiduciary duties – time for clarification and/or reform?

With the Government's drive for pension schemes to invest in UK growth, is it time to also think about reform of the concept of fiduciary duties?

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Introduction

With the Government's wide-ranging pensions ecosystem review well underway, and significant reform likely to follow further down the line as a result and ahead of the much-anticipated Mansion House speech on Thursday, one issue that has repeatedly been raised within the industry (both in relation to private sector and public sector pension schemes) is that of the concept of fiduciary duties.

With the new and increasing duties on trustees to take account of factors such as ESG when making decisions, and of course more recently with the Government's clear desire for pension schemes to invest in UK equities, it is not hard to see that tension may arise between the fiduciary duties a trustee or manager owes its pension scheme members and those other considerations.

We take a look at the issue, how it might be addressed, and whether ultimately legislative change might be required to clarify what is meant, and what is permitted, by the term "fiduciary duties". It appears to be an area of considerable uncertainty within the industry and legislative clarification could ultimately assist the Government in its objective to use pension scheme assets as a means of boosting the UK economy.

Background

The fundamental guiding principle for trustees and managers when making decisions is to ensure they fulfil their fiduciary duties in respect of the scheme and its members. More on what those duties encompass is set out below.

The issue of fiduciary duties is one that has been very much at the forefront of Government and industry minds for some time now and is being raised again in the run-up to Thursday's Mansion House speech.

The previous Government reviewed the concept of fiduciary duties as part of their Mansion House reform proposals. A recap of what those proposed reforms were are captured in a previous article.

As part of the Mansion House reform package, the Government launched a consultation in relation to accelerated and expanded pooling of funds and investment changes in the Local Government Pension

Scheme ("**LGPS**"), and a Call for Evidence in relation to "Trustee skills, capability and culture" which aimed to explore barriers to trustees doing their job effectively and getting the best outcomes for savers.

The Call for Evidence asked the following question - "*Is fiduciary duty a well-understood concept*?". The Outcome of the Call for Evidence noted that, from the responses, "*It appears that understanding does vary between trustees and there can be some inconsistency in interpretation, In particular, respondents suggested there is a lack of clarity around how fiduciary duty interacts with sustainability and climate change considerations".*

Not long after that and seen as a response to the issues identified in the Outcome of the Call for Evidence, the Financial Markets Law Committee (FMLC) produced an excellent paper in February 2024 which set out the underlying legal analysis of what constitutes fiduciary duties. Whilst it was prepared in the context of climate change and ESG duties owed by pension trustees, it nevertheless set out a thorough analysis of fiduciary duties and some of the issues around them which are covered in this article.

The high-profile Work and Pensions Committee (WPC) had also been looking at the issue of fiduciary duties around the same time. After a thorough investigation into the issue, the WPC held an evidence session (also in February this year) following which the then WPC Chair, Sir Stephen Timms, wrote to the then Pensions Minister, Paul Maynard, to set out the findings of that session. The WPC wrote that it had heard evidence that "*the definition of fiduciary duties is 'permissive' and broad enough for suitably skilled people with the right information to make the right decisions… this did not mean that no change was needed*". The WPC also noted that there were numerous concerns raised surrounding the differing interpretations across the industry of what fiduciary duties actually mean.

In terms of possible action to address the issues identified with the concept of fiduciary duties, the WPC heard calls for the Pensions Regulator (TPR) to put the principles of the FMLC report into guidance for trustees aimed at supporting their decision-making. The WPC heard that "*as well as providing greater clarity on their duties, it could help increase trustees' confidence in the face of potential legal challenges, provided they had operated with 'the right skills, the right advice and the right process'.* WPC also heard calls from some quarters for a change in legislation regarding fiduciary duties.

The WPC again followed up with the then Pensions Minister to ask for more details about the Department for Work and Pensions' (DWP) plans to engage with industry on fiduciary duty issues (the DWP having announced in 2023 that it planned to hold a series of roundtables with the industry to engage on the issue of fiduciary duty in the context of climate change).

In response to that, Mr Maynard had advised that the DWP had organised a number of roundtables for May and June 2024 to discuss the current legal interpretation of fiduciary duty, and the barriers faced by trustees. But of course, the small matter of the General Election then intervened and put paid to those plans.

More recent questions being raised about the concept of fiduciary duties

However, more recently, since the General Election, the issue of fiduciary duties has again been raised. as a potential issue in relation to the Government's pensions eco-system review. The Government has been very clear that one of its key objectives is to encourage and incentivise pension funds to invest in

productive finance and UK equities as one means of reviving the UK economy. Whilst many do not disagree that pension schemes need to be investing more locally and nationally (and that this has been done and is happening already), in order to do so, trustees and managers of pension schemes need to be confident that it would be in beneficiaries' best interests.

Fiduciary duties were yet again one of the main talking points following the recent PLSA conference in Liverpool. The Pensions Minister, Emma Reynolds, told PLSA conference delegates that she would not rule out mandating minimum levels of UK investments for pension schemes. Not surprisingly, quite strong opposition to this idea has been voiced publicly by some of the biggest UK public service pension schemes, including the Universities Superannuation Scheme (USS) and the Greater Manchester Pension Fund. And of course, that raises the inevitable question of how it would fit with trustees' fiduciary duties. The USS, the UK's largest pension scheme, in its response to the suggestion of mandatory investment levels was quite clear that they would see it as being "*wholly inconsistent*" with a trustee's duty to invest in a way that is in the best interests of members. Would this also be fettering discretion which is prohibited?

And even this week in the run-up to the Mansion House speech on Thursday, fiduciary duties is again been raised in response to rumours that the Chancellor will use the speech to announce plans to push forward the consolidation of LPGS assets into a few large LGPS pools with a view to using them to encourage pension investment in the UK.

What are the fiduciary duties a trustee or manager of a pension scheme owes to the scheme and its members?

So what constitutes the fiduciary duties that are owed to pension scheme beneficiaries?

Broadly, a trustee's fiduciary duties (emanating from general principles of trust law) include:-

- To promote the "purpose" of the trust and to use their powers properly and lawfully to do so (often referred to as the "proper purpose" test);
- Administering the pension trust in accordance with its terms;
- Not acting under dictation (trustees must be free to exercise their own judgement);
- Acting impartially;
- Acting prudently, responsibly and honestly;
- Not exercising their power in their own or third parties' interests; and
- Acting in the best interests of the scheme beneficiaries.

TPR has also outlined its view of what comprises fiduciary duties. However, there is no definite list of those duties – they derive mainly from case law. How they apply in any particular case will differ and depend on the particular circumstances of that case, and therefore each will have its own nuances. This is of course one of the main challenges with this area.

In addition, case law has expanded on these duties to include certain principles that must be followed when trustees decide whether or not to exercise a discretion (e.g. they must ask themselves the right questions; directly themselves correctly in law; must not arrive at a perverse decision; and must take into account all relevant factors and ignore irrelevant ones).

So there are number of components which can be said to comprise “fiduciary duties” and there is no one particular duty or objective that can be pointed to each time when considering them (e.g. trustees cannot make a decision each time based on what will maximise scheme returns for the members).

For the purposes of this article, we will not examine the difference between “financial” interests and “non-financial interests” which is quite a complicated and discursive topic of itself, but do look out for a future blog from our ESG pension colleagues which will be considering that in the context of ESG and climate change.

Whilst fiduciary duties owed in the context of public service pension schemes differ slightly by dint of the fact such schemes are statutory schemes and not trust-based schemes, the general principles are the same. We look at the concept of fiduciary duties in the context of public service schemes in more detail below.

Why might compliance with fiduciary duties be an issue?

The FMLC paper pinpointed the issue that exists with compliance with fiduciary duties in the context of today’s ever-changing pensions world, with an increasing number of requirements and factors for trustees and managers to take into account in decision-making:-

“….This has given rise to renewed uncertainty over what the “fiduciary duties” or trust duties owed by trustees of pension funds require in this context. Today it is sometimes easier to state the duties than it is to apply them.

The issue is a legal issue. It sits in the context of legislation and regulation that applies to pension funds, pension schemes and pension fund trustee”’

Whilst pension practitioners (and we include ourselves in this – see above!) can easily rhyme off the different components of what constitutes a trustee’s fiduciary duties, how to ensure compliance with those in practice, when trustees have difficult decisions to make involving many different considerations, is a tricker issue. It is not hard to see how inconsistencies in interpretation and approach to what fiduciary duties mean, and how they are taken into account in practice, might start to creep in.

Whilst it is right that trustees should take into account all relevant factors (such as ESG and climate change factors), ultimately trustees must be satisfied that to act in a particular way (for example investing in productive finance as urged by the Government) is not in breach of the “proper purpose” duty. Additionally, they must be confident that taking particular action would be in the best interests of scheme members. Trustees must be able to point to clear, tangible evidence of how that would benefit its members. Otherwise, they could be at risk of breaching their fiduciary duties. They cannot simply say “We invested in X or Y because the Government told us we should invest more in UK equities”.

The Government clearly has its own agenda, and the pensions industry seems more than willing to engage with it, recognising that many aspects of it will benefit everyone in the long term.

However, there remains the fact that trustees and managers of pension scheme still owe fiduciary duties to their members and beneficiaries and must always act with that in mind. Many within the industry have urged the Government to be mindful not to over-reach its authority and recognise the boundaries

between what it wants to do, the way in which pension scheme operate and the fiduciary duty framework that overlays all decisions taken in relation to pension schemes.

Nigel Peaple, Chief Policy Counsel at the Pensions and Lifetime Savings Association (PLSA) re-iterated views repeatedly voiced within the industry in an article in Pensions Expert where he commented:-

"The UK's recent period of political and policy uncertainty, which has affected things like government decisions on infrastructure projects and the UK's approach to climate change, has sometimes made the case for investing in the UK less compelling. Rightly, pensions must ensure investments operate in the interest of scheme members and savers."

Looking to address that particular issue, the PLSA recently issued a very interesting report *entitled "Pensions & Growth Creating a Pipeline of Investable UK Opportunities"* which sets out how the UK could go about establishing a pipeline of investable assets.

Fiduciary duties in the public service pension scheme sphere

As mentioned above, the difficulty with the somewhat amorphous concept of fiduciary duties exists not only in relation to private sector pension schemes, but also in relation to public service pension schemes. Whilst they are a different beast and are largely governed by their own regulatory regime (therefore as mentioned above, not trust-based and so the "trustee" and "trust" concepts would not apply, but instead "the manager" of the scheme), the concept of fiduciary duties applies similarly to, for example, the LGPS, in the same way it does to a private sector pension scheme. Of course the LGPS is the only funded public sector pension scheme hence it is grappling with similar issues around investment as private sector schemes, albeit with the public law/public sector "sponsor" distinction.

The issue of fiduciary duties, what they are, who they are owed to and how to ensure compliance with them, is certainly not a new one for the LGPS. It is an issue the LGPS has grappled with for some time now. Indeed, the LGPS Scheme Advisory Board (SAB) has sought several legal opinions over the years in order to assist their administering authorities understand the nature of fiduciary duty in the context of LGPS investments.

In a 2014 opinion, Nigel Giffin QC said that LGPS administering authorities owe a fiduciary duty "*both to the scheme employers, and to the scheme members*", and clarified that the views of scheme members are a factor to take into account (although the latter is not a view that has been met favourably within the industry for obvious reasons).

More recently, the SAB issued a "*Statement on Fiduciary Duty*" which provides an update on the latest position for the LGPS and which was prepared with input from various interested parties. The statement was specifically on the issue of fiduciary duty in the context of lobbying. The intention behind the Statement was to clarify SAB's view on the flexibility LGPS decision makers have to respond to lobbying, the standards of behaviour expected when discussing often emotive topics, and signposting support if those standards are not being met. SAB has also stated that it is seeking an opinion from Counsel as to whether there is a need to update the previous legal advice it received on the nature of fiduciary duty for LGPS administering authorities.

All of this demonstrates how thorny an issue fiduciary duties is for the LGPS.

And it has been brought into sharp focus again for the LGPS as a result of the Government's pensions review. One of its stated objectives is to review the LGPS structure with a view to driving consolidation of LGPS pools and investment in the UK economy. But again, it raises the question of how that sits with the LGPS funds' duty to act in the best interests of their members and employers in the scheme.

As may be expected, the Government's stated objectives for LGPS funds as part of its review, has raised concern and alarm within the LGPS field. This article in the Local Government Chronicle captures the concerns - LGPS consolidation 'could fail to meet government's objectives' | Local Government Chronicle (LGC) (lgcplus.com).

Contributors to the article also suggest that the concept of fiduciary duty should be codified. This has been repeatedly suggested as a solution within the industry.

Is legislative change really required in order to ensure the concept of fiduciary duty is wide enough?

Legislative reform of the concept of fiduciary duties was first properly considered by the English Law Commission in 2014 when it published a major report about the wider pension sector, Fiduciary Duties of Investment Intermediaries. However, the case law on this area does of course go much further back (for example, trustees acting prudently and their duty of care to their pension scheme was examined in *Learoyd v Whiteley* in 1887 and over a century later, *Cowan v Scargill,* which looked at a trustee's duty to act prudently). So this is not a "new area" as such, but rather one that has been examined and developed over a long passage of time.

The 2014 report concluded that legislation was not required to codify the law in relation to fiduciary duties as they apply to pension scheme trustees.

However, since then, the pensions landscape has shifted significantly with a plethora of new duties and obligations imposed on pension scheme trustees, not least climate change related disclosures and ESG duties. The calls for clarification of the concept of fiduciary duty have only increased in recent years, as those new obligations and requirements have put increased pressure on trustees and managers in terms of ensuring they are still acting in the best interests of their members and how to assess and evidence that.

ShareAction, a not-for-profit organisation aiming to improve corporate behaviour on ESG issues, has just issued a paper entitled "*The need for fiduciary duty reform*" which sets out their arguments for amending, not the definition of fiduciary duty as such but the concept of "best interests". They suggest defining what is meant by the "best interests" of members and beneficiaries and that an amendment to the Occupational Pension Schemes Investment Regulations 2005 could clarify and expand the legal definition of savers' "best interests". This of course would apply solely in the investment context rather than more widely as an over-arching legislative concept applying to trustees which is perhaps what is required for any overhaul – i.e. fiduciary duty obligations that would apply across trustees' day to day management of the pension scheme, rather than restricted to trustee investment decisions.

There are a number of aspects relating to fiduciary duty which could be ripe for clarification, for example, if it is correct that, as Mr Giffin QC said above, member views are to be considered: to what extent should they be considered and what might members want to know and offer their views on? Specifically on ESG,

could more be done to codify current pension scheme ESG considerations which many feel is the only means by which to achieve genuine change in the pensions and wider market place?

Any changes would of course need to be carefully navigated for the very same reasons that give rise to the issues in the first place – whilst at present it is perhaps hard to pin down how they apply in practice, the flipside of that is that because of the somewhat fluid nature of the concept of fiduciary duties, it allows trustees and mangers to consider new factors and considerations as they develop.

Nevertheless, secondary legislation setting out the parameters of what fiduciary duties are and what trustees may and may not consider in fulfilment of those duties could serve to remove some of the uncertainty surrounding the application of those duties in practice. If legislative change was to be taken forward, in an investment context there are certainly existing powers under the Pensions Act 1995 (s35(1A)) and under the Investment Regulations 2005 which could be relied upon.

A more general fiduciary duty obligation may be tricker to legislate for as there is no obvious non-investment specific existing statutory power that could be used to enact secondary legislation. However, any codification of the concept of fiduciary duties could of course be captured in the upcoming Pension Schemes Bill – in the same way that Climate Change and TFCD requirements were set out in the Pension Schemes Act 2021 (which inserted provisions into the Pensions Act 1995).

Conclusion

It does seem that quite a head of steam has built up on the case for revisiting the concept of fiduciary duties and it is being brought into sharp focus again ahead of the expected announcements in the Chancellor's Mansion House speech on Thursday. We can certainly see the benefits of clarifying what those duties mean, whether that is in legislative form or otherwise (for example in Guidance from TPR as suggested above) – it would seem that the somewhat fluid concept of fiduciary duties would, in today's complex and ever-evolving pensions world, benefit from being defined. Whatever the outcome of the Government's pensions ecosystem review, it seems likely that the issue of fiduciary duties is one that is going to rumble on for some time to come unless it is specifically addressed in pensions legislation or Guidance.

It will be interesting to see if the new Pensions Minister will revive the previous work of Sir Stephen (who is now a Minister in the DWP and so may still have some influence here albeit he is now in the area of Social Security and Disabilities) on looking at fiduciary duties. One suspects she might have to, if she is to stand any chance of persuading the pensions industry to engage with the Government's agenda for pension schemes and, in particular, the drive to encourage them to invest in productive finance. Trustees and managers of pension schemes will have to be satisfied that there are clear, justifiable grounds for their scheme to invest in the way the Government wants, and that to do so would be in the best interests of scheme beneficiaries. Her ambitions for the LGPS in particular have already raised real alarm within that industry and will need to be properly and thoughtfully engaged on.

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