

Memorandum

To: Jennifer Devine, Wiltshire Pension Fund Committee
CC: Frank Cain, Head of Legal, Wiltshire Council
From: Elizabeth Muir, Senior Solicitor, Wiltshire Council
Date: 19 March 2021
Subject: Wiltshire Pension Fund Committee, Fiduciary Duties with respect to Investment Decisions

This memorandum is to provide advice to the Wiltshire Pension Fund Committee members of their powers and responsibilities when making certain decisions regarding the investment strategies of the Fund. Following a consideration of the relevant legislation and guidance, it is clear that the Wiltshire Pension Fund Committee must provide an investment strategy statement that sets forth the Administering Authority's policy on how social, environmental and corporate governance considerations affect its investment strategy. This approach to investment would not violate the Wiltshire Pension Fund Committee's fiduciary duty to its beneficiaries as this is consistent with the actions of a "prudent person" when handling its affairs.

Background

The Pension Fund Committee instructed the investment consultants, Mercer, to provide scenario modelling for investments that may be affected by climate change, which is a significant risk with many unknown variables. Mercer's report, among other things, recommended future proofing the Fund's investments up to 2100 with emphasis on investment in renewables, long term growth industries, and sustainability (for example, investment in electric car manufacturers).

The Pension Fund Committee is proposing to include within its investment strategy statement a statement that the Pension Fund Committee supports a global warming scenario with 2 degrees of warming, with the desire to make all portfolios net zero by 2050. This is in line with the Paris Agreement and central UK government goals.

The question that has arisen is whether the Pension Fund Committee can consider environmental concerns such as global warming when making decisions about its investment strategy, and whether this violates their fiduciary duty to their beneficiaries.

The Pension Fund Committee Powers

The Wiltshire Pension Fund Committee receives its authority directly from the Council under the Wiltshire Council Constitution in Article 2.7.2 of Part 3:

2.7.2 [The Wiltshire Pension Fund Committee] will exercise the functions of the Council as administering authority under the Local Government Superannuation Acts and Regulations and deal with all matters relating thereto. The committee will publish meetings attendance records in an Annual Report.

This provision states that the Committee will act as the Council with all of the powers the Council has in determining the investment of funds in the Wiltshire Pension Fund.

Protocol 2A of the Wiltshire Council Constitution contains the full terms of reference for the Wiltshire Pension Fund Committee and states in more detail at article 3:

3. Statement of purpose

3.1 The Committee is to act on behalf of the Administering Authority in its role as a scheme manager of the Scheme.

3.2 In particular:

3.2.1 To have full decision-making responsibility on all aspects of the administration and management of the pension fund;

Protocol 2A confirms this and also lists the documents that the Committee must maintain and abide by at article 12:

12. Functions of the Committee

12.1 The Committee exercises the functions of the Council as Administering Authority. To fulfil its functions the Wiltshire Pension Fund Committee will operate within a framework of key Governance and Compliance documents which it will ensure are maintained.

12.2 The key documents are:

12.2.1 Governance Compliance Statement;

12.2.2 Funding Strategy Statement;

*12.2.3 **Investment Strategy Statement;***

12.2.4 Administering Authority Discretions Policy;

12.2.5 Stewardship Code Statement;

12.2.6 Communications Strategy;

12.2.7 Business Plan;

12.2.8 Administration Strategy;

12.2.9 Cessations Policy; and

12.2.10 Annual Report and Accounts.

In addition, article 3.2.4 specifically states that the Committee must maintain its own investment strategy statement:

*3.2.4 maintain a business plan and other key Wiltshire Pension Fund documents such as the Governance Compliance Statement, Funding Strategy Statement and **Investment Strategy Statement** to facilitate the delegation to officers of key strategic functions of the Scheme.*

Under these provisions of the Constitution, the Committee has the powers of the Council as Administering Authority to determine the investment strategy, and has the obligation to maintain a set of policies, strategies and statements in which to operate. One of these is the investment strategy statement, which the Committee is proposing to amend to include information on its investment strategy in relation to environmental concerns, specifically global warming.

Investment strategy statements are also mandatory under regulation 7(1) of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the LGPS Regulations 2016):

7(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State.

The LGPS Regulations 2016 apply to any authority that has powers under the general power of competence given in the Localism Act 2011. As the Committee are acting as the Administering Authority here, it is proper and mandatory under the LGPS Regulations 2016 for the Committee to formulate this strategy.

More particularly, the LGPS Regulations 2016 state under regulation 7(2)(e) that the investment strategy must include:

*(e) the authority's policy on how **social, environmental and corporate governance** considerations are taken into account in the selection, non-selection, retention and realisation of investments; and*

The Committee, on behalf of the Administering Authority, must review and revise the statement every three years, however this must be in accordance with guidance issued by the Secretary of State. Under regulation 8 of the LGPS Regulations 2016, where the Secretary of State is not satisfied that the Administering Authority is acting in accordance with guidance, the Secretary of State has certain actions it may take to remedy this.

The Department for Communities and Local Government released Guidance on Preparing and Maintaining an Investment Strategy Statement in July 2017 which provides some more information on how administering authorities can apply regulation 7(2)(e):

*When making investment decisions, administering authorities must take proper advice and **act prudently**. In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence. This approach is the standard that those responsible for making investment decisions must operate.*

Although administering authorities are not subject to trust law, those responsible for making investment decisions must comply with general legal principles governing the administration of scheme investments. They must also act in accordance with ordinary public law principles, in particular, the ordinary public law of reasonableness. They risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it.

*The law is generally clear that **schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors**, and over the long term, dependent on the time horizon over which their liabilities arise.*

Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.

This guidance makes reference to certain fiduciary duties that administering authorities have for their beneficiaries, which is that it must "act prudently". Since the legislation and the guidance is

clear that the Committee must consider environmental concerns when making investment decisions, the question is whether it is also acting in accordance with its fiduciary duties when doing so.

Fiduciary duties

The Wiltshire Pension Fund Committee members are not subject to trust law, however they may be treated as trustees for the purpose of fiduciary duties to the Wiltshire Pension Fund, and owe specific duties of care and skill in the administration of the Fund, as well as certain fiduciary duties such as loyalty, honesty and good faith. Fiduciary duties are set out in common law and under statute, but for the LGPS the Pensions Regulator sets out these fiduciary duties as:

- Acting in line with the trust deed and rules. In the case of the Pension Fund Committee, these will be the governance and compliance documents listed within Protocol 2A of the Constitution.
- Acting in the best interests of the scheme beneficiaries. The beneficiaries of the Wiltshire Pension Fund are the members of the scheme and potentially their own beneficiaries, such as dependents or surviving spouses. This could also be, in some circumstances, the employer who may receive a payment on cessation. The beneficiaries of the Wiltshire Pension Fund are guaranteed to receive predetermined benefits in line with legislation from the rate payer of Wiltshire even if the Fund collapses, however the Committee members are still required to act in their best interests.
- Acting impartially. This would be to balance the interests of all of the possible classes of beneficiaries and give appropriate weight to each. Each member of a class of beneficiaries should be treated the same, and the interests of individuals should be balanced against the needs of all beneficiaries.
- Acting prudently, responsibly and honestly. This is the most complicated aspect of fiduciary duties, and covers the following:
 - Conflicts of interest – the Pension Fund Committee should follow its internal procedures on conflicts of interest;
 - Acting prudently – Committee members should act in the way that a prudent person would in their own affairs, using their own skills and experience. **The Pensions Regulator states, “This is the relevant duty when selecting and dealing with the scheme’s investments”. However for the avoidance of doubt we may also consider other sources that state that acting prudently also includes:**
 - Having regard to the need for “diversification of investments” as appropriate.¹
 - Having regard to the “suitability” of each investment²;
 - Obtaining “proper advice” on certain matters³;
 - Reaching decisions – Committee members must consider the circumstances impartially and make reasonable decisions on the relevant facts only;
 - Personal profit – Committee members must not make a personal profit at the Fund’s expense.

¹ Cowan v Scargill [1985] Ch 270

² The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093) in relation to ESG within Statements of Investment Principles

³ The Trustee Act 2000, section 5

The relevant standard under the guidance from the Pensions Regulator states that the fiduciary duty in these circumstances is for the Committee members to act in *“the way a prudent person would act in its own affairs, using their own skills and experience”*, whereas the standard under the Department for Communities and Local Government’s guidance is whether the members of the Committee are acting prudently, exercising *“care, skill, prudence and diligence”*. The consideration therefore is whether the Wiltshire Pension Fund Committee is acting prudently when it considers changing its investment strategy to take into account the recommendation by Mercer to make certain strategic investment decisions that may protect the Fund against future concerns with respect to climate change. Some thought should be paid for each aspect of what it means to be acting prudently, to include the Department for Communities and Local Government and the Pensions Regulator guidance along with other sources.

Acting in the way that a reasonable, prudent person would when dealing with their own affairs.

Considering environmental concerns with investments is routine in many types of organisations. Here are a few examples: BlackRock made climate change central to its investment strategy in 2021. The CFA Institute released a “Climate Change Analysis in the Investment Process” in 2020. The New Zealand Superannuation Fund released a white paper on their climate change investment strategy in 2019. AIGCC released “Integrating Climate Change into Investment Strategy” in 2017. These disparate organisations have all made the decision to consider climate change in investment strategies and therefore it is likely that that prudent person would also consider this when dealing with its own affairs.

Using care, skill, experience and diligence.

The Trustee Act 2000 states that trustees owe duties of skill and care in the administration of trusts. Section 1(1) requires that a trustee “must exercise such care and skill as is reasonable in the circumstances, having regard in particular (a) to any special knowledge or experience he has or holds himself out as having, and (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession”. Again, the members of the Committee are not trustees under the Trustee Act, however their standard is the same under relevant guidance.

Members are to act with:

Care – members of the Committee fulfil their duty of care if they take all those precautions that an ordinary prudent person would take in their own affairs. See previous section on acting prudently;

Skill – to have regard to any special knowledge and experience that they have or hold themselves out as having, or to any special knowledge or experience that is reasonable to expect of a person acting in their position;

Experience – similar to the duty of skill, above, this would be the experience (or specialist experience) that the Committee members have in the subject area, or reasonably expected of a person in the position of member;

Diligence – this would be the same level of diligence that a reasonably diligent person would have in carrying out the functions of the Committee member.

The Pension Fund Committee members, when making their decision to include environmental considerations into the investment strategy, were acting reasonably, in line with major investment firms and government goals and guidance. When considering the significance of this, they applied their skills and experience to determine their goals, received and applied advice, and diligently considered their options.

The guidance from the Department for Communities and Local Government states that “[administering authorities] risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it”. Given the above, there is only a small risk that this decision would be challengeable.

From the further sources listed above, acting prudently may also consist of:

Taking in account relevant considerations and ignoring irrelevant ones. Climate change and global warming may change the landscape of investment as markets react to changing customer needs. The UK government has agreed with the Paris Agreement that as far as possible the goal is to keep warming under 2 degrees, and business and investment must change to match that. Wiltshire Council has also declared a climate emergency and has reflected this within its business case, indicating that this is an ongoing issue for the Council and a relevant consideration for its business;

Having regard to the need for “diversification of investments” as appropriate. Trustees should consider the full range of investment options available to them, which would include environmental concerns;

Having regard to the “suitability” of each investment. The Committee secured the advice of Mercer to determine the suitability of investments and considered this when making its decision;

Obtaining “proper advice” on certain matters. Under the Trustee Act 2000, advice is "proper" if it is taken from a person who the trustees reasonably believe to be qualified to give such advice in terms of that person's ability in, and practical experience of, financial and other matters relating to the proposed investment. The Wiltshire Pension Fund Committee obtained advice from Mercer, which is a multi-national asset management firm who provides investment consultant advice as well as many other financial management services. This is a well known firm which routinely provides advice to central government on investments and can be considered a provider of proper advice.

From this analysis, it would seem likely that the Wiltshire Pension Fund was acting in accordance with its fiduciary duty when considering environmental factors.

Conclusion

There is little question that the Committee can consider environmental concerns, which would include climate change, when making certain investment decisions. In fact, the LGPS Regulations 2016 requires that this is included in the investment strategy statement.

The Committee, acting in accordance with the Wiltshire Council Constitution and as the Administering Authority, properly secured investment advice. In accordance with its fiduciary duty to its beneficiaries and with its powers under the Wiltshire Council Constitution, it has acted in the way a reasonable and prudent person would in its own affairs and duly followed the expert advice

given to it to take into account global warming and climate change in its investment strategy. This is compliant with advice issued from central government and with the Wiltshire Council business case.