FairPensions™
The campaign for **responsible** investment

Fairshare Educational Foundation
Trowbray House
108 Weston Street
London SE1 3QB
020 7403 7800
fairpensions.org.uk

Amendment Briefing: Financial Services Bill
House of Lords - Committee of the Whole House

Savers depend on those who manage their money. With the launch of auto-enrolment this year, millions more people will be saving for a pension through the capital markets, many of them low-paid workers. The success of auto-enrolment – both in terms of consumer outcomes and in terms of trust in the system – requires these savings to be managed, and seen to be managed, in the interests of savers and not of financial intermediaries.

The FCA will be responsible for regulating asset managers and insurance companies, including those managing funds on behalf of pension schemes and individual pension savers. It is vital that the FCA is properly equipped to ensure that these savers' interests are protected.

Amendment 107 would make a significant contribution to this agenda. Below we provide further briefing on this amendment and its context.

Amendment 107 (Baroness Drake, Lord Stoneham of Droxford)

Page 17, line 2, at end insert—

"(ea) the general principle that, where consumers properly repose trust in a firm's discretion and are vulnerable to the exercise of that discretion, the firm has a duty to act in the consumer's best interests"

This amendment adds a new requirement for the FCA to 'have regard' to the general principle that, where consumers put trust in a firm's discretion and are vulnerable to their exercise of that discretion, the firm must act in their best interests. This builds on the requirement for firms to have regard to the principle that firms must provide consumers with an 'appropriate level of care'.

The amendment does not impose additional burdens on financial services providers; rather, it clarifies the duties they already have under common law. This point was observed by Martin Wheatley in oral evidence to the Joint Committee, when he argued that "under our rules [firms] have responsibilities in terms of appropriateness, in terms of their conduct *and in many cases they also have a fiduciary responsibility to clients*."[1] The need for an explicit reference in the Bill arises from the fact that this responsibility is not currently understood or applied.

[1] Joint Committee Evidence Q972 (p616)

The issue

The investment industry's duties to savers appear to be poorly understood and observed. As the Law Commission has confirmed, where firms are managing other people's money or giving financial advice, they have strict fiduciary duties to act in those people's interests (see box below).[2] This includes both individual clients and institutions such as pension funds who represent large numbers of underlying savers. Yet this fact is not generally accepted within the industry.

Moreover, because these are common law duties, they do not form part of the FSA's regulatory approach. Indeed, there is confusion over whether it is appropriate for the FSA to enforce them, with some arguing that it is for beneficiaries to pursue court actions if duties are breached. Where pension savings are concerned, this is unrealistic and unsatisfactory as a means of achieving high standards of care across the market. An explicit 'best interests' principle in the Financial Services Bill would give the FCA a powerful tool to ensure consumers' interests are protected.

What are fiduciary duties?

A fiduciary is someone who acts on behalf of another in circumstances which give rise to a relationship of trust and confidence. The Law Commission has defined the key features of a fiduciary relationship as *"discretion, power to act and vulnerability"*. These are the features set out in the amendment, which therefore reflects existing common law principles.

Fiduciaries must act in their clients' best interests, must avoid conflicts of interest and may not profit from their trust without the client's consent. These duties are stricter than FSA rules.

Effectively, fiduciary duties require those entrusted with other people's money to put those people first, and not to exploit their position to make an unfair profit. If these duties were properly observed and enforced, it would mark a sea change in the prevailing culture of the financial services industry – one which would lead to better outcomes for consumers.

Examples where consumers are suffering from fiduciary duties not being observed include:

- *Unauthorised profits*. Recent research has shown that fund managers make significant profits from lending out clients' shares, with only two-thirds of the income from these activities returned to the fund.[3] Under fiduciary duties, this may be unlawful, as any such profit should go back to the underlying investors.
- *Exercise of shareholder rights*. Asset managers acting on behalf of pension savers should exercise their voting rights at major companies in the best interests of the savers, without regard for the interests of the firm. Yet there is anecdotal evidence of, for example, fund managers being pressured by others in the firm to wave through excessive CEO pay to avoid upsetting potential clients.[4] In this way the interests of the business are placed ahead of those of the savers whose money is at stake.

This issue has the potential to seriously undermine the aims of auto-enrolment. In trust-based pension schemes, it is very clear that the trustees are there to act in beneficiaries' best interests. Indeed, as the ABI pointed out in oral evidence to the Joint Committee, one positive feature of the National Employment Savings Trust (NEST) is that it has "*a trustee structure which*

---

[2] Law Commission, 1992, 'Consultation Paper No. 124: Fiduciary Duties and Regulatory Rules' (HMSO), paras 2.4.7 & 2.4.14

[3] 'Fund managers make millions from lending clients' shares, study shows', Guardian, 31/08/2011. http://www.guardian.co.uk/business/2011/aug/31/stock-lending-short-selling

[4] See for example Wong S. (footnote 2)

looks to protect its members".[5] However, many savers are likely to be auto-enrolled into contract-based pension products where, as things currently stand, no such protection exists.

Amendment 107 would give the FCA the scope and the tools to protect consumers, combat abuse and encourage high standards of behaviour in financial services.

Problems with the current Bill

During pre-legislative scrutiny, concerns were raised that the Draft Bill was unbalanced, enshrining the principle that consumers are responsible for their decisions but not placing any equivalent responsibility on firms. The Joint Committee on the Draft Bill recommended that the Bill *"place a clear responsibility on firms to act honestly, fairly and professionally in the best interests of their customers."*[6] This reflected wording proposed by the FSA. The Financial Services Consumer Panel meanwhile recommended that this should take the form of an explicit fiduciary duty to clients.[7]

In response, the government has inserted a new principle to which the FCA must have regard: that "*those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate",* having regard to the risks involved and to consumer capabilities.[8]

However, the Bill's new wording is significantly weaker than that proposed by the Joint Committee, and may not provide a high enough level of protection for consumers. It lacks clarity on what might constitute an 'appropriate' level of care, thereby leaving open the very question it was intended to resolve. Where those managing people's long-term savings are concerned, the problem is precisely that there is confusion and misinformation about what is the 'appropriate' level of care. Explicit confirmation that those managing other people's money must act in their best interests would be a clear and effective way to help achieve the Joint Committee's intention. Amendment 107 would provide this confirmation, since anyone managing someone else's money would meet the criteria of discretion and consumer vulnerability.

Debate in the Commons

Various amendments were tabled in the Commons with the aim of writing an explicit reference to fiduciary duty into the Bill. In response, the Minister argued that "*customers should not have to dust down the old statute books and dig out their dictionaries … to identify what standards they can expect from providers",* and that it was better for the FCA to set out clear and specific standards via its rules. He also said that he was "*not convinced that [fiduciary duty] is the right standard to impose across the board between providers and consumers".*[9]

Amendment 107 addresses these objections:

- It does not rely on the term 'fiduciary duty', but rather seeks to enshrine the common-sense principle that underpins these duties: that, where consumers rely on a firm's discretion, that discretion must be exercised in the consumer's best interests.
- It would not supercede or restrict the specific standards to be laid down in FCA rules, but rather would provide an overarching principle which the FCA should bear in mind when setting those rules.
- It would not apply 'across the board' but only where appropriate, i.e. where consumers have a particular relationship with providers which justifies a 'best interests' standard.

[5] Joint Committee Evidence Q592 (p156)
[6] Joint Committee Report, para 126
[7] Joint Committee Report, para 117; Written Evidence from Financial Services Consumer Panel
[8] Clause 5: New Clause 1C(2)(e) of FSMA (page 16, line 44)
[9] House of Commons Hansard, Public Bill Committee, 1 March 2012, Col 271-272

Further information

For more information about the issues covered in this briefing, please contact:

Christine Berry | Policy Officer, FairPensions
christine.berry@fairpensions.org.uk | 0207 403 7833

About FairPensions

FairPensions is a registered charity that promotes Responsible Investment (RI) by pension schemes and fund managers, and seeks to ensure that the City acts in the long-term best interests of savers. RI generally involves shareholder engagement with companies to ensure that environmental, social and corporate governance (ESG) risks with the potential to affect long-term financial returns are monitored and managed. We are a member organisation, whose members include representatives of pension savers (such as the National Federation of Occupational Pensioners, UNITE and Unison), a number of leading UK charities (including Oxfam, Amnesty International and WWF), and thousands of individual pension fund members.