Securing Jobs and Growth:

Can our pension savings aid the economic recovery?

SUMMARY

Securing growth and jobs is one of the biggest political challenges facing this parliament. Against a backdrop of austerity, policymakers are beginning to turn towards the huge pool of capital held in our pension funds.

Pension savers have a clear interest in stable and sustainable UK economic growth. The health of the UK economy has a double impact on savers' prospects of a decent and secure retirement, affecting both long-term investment returns and their general quality of life as UK jobholders and taxpayers. It seems likely that many pension savers would like to see some of their money invested in kickstarting the UK economy – whether by supporting small businesses or funding green infrastructure.

The Treasury's efforts to encourage pension funds to invest in UK infrastructure are grounded in this alignment of interests. Yet this logic does not in practice form part of pension funds' decision-making. It is commonly assumed that pension funds' legal duty is simply to maximise return on their investments: any broader concerns cannot be taken into account. If pension funds are to play the role envisaged for them as drivers of the economic recovery, turning our savings into productive investment, this narrow interpretation of the law needs to be tackled.

> *Your investment in the UK economy can drive economic change and that change should generate more stable and sustainable returns, benefitting Britain's pensioners.*
>
> – Mark Hoban, Financial Secretary to the Treasury, Speech to the National Association of Pension Funds (NAPF)

LEGAL BACKGROUND

The idea of a 'fiduciary duty to maximise return' comes in part from the 1984 case of Cowan v Scargill, which concerned an attempt by union trustees of the mineworkers' pension scheme to exclude investments overseas or in industries competing with coal. The judge ruled their actions to be a breach of fiduciary duty.

A close reading of the judgement shows that it does not limit trustees solely to considering investment performance.[1] Yet it continues to have a significant 'chilling effect' on pension fund decision-making. Of particular relevance to the growth debate, the judge ruled that the benefits of the proposed policy were "too remote and speculative", since the scheme's assets were not large enough to have a material impact on the health of the UK economy.[2]

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POLICY BRIEFING

PENSION FUNDS AND LOCAL JOB CREATION

Yet even where schemes can make investments which clearly do make a difference – for instance, investing in local businesses or infrastructure – myths about the law appear to be holding back progress. Most funds assess their investments solely in terms of risk and return, arguing that the law prohibits them from taking into account wider benefits to the communities and economies in which their beneficiaries live. Indeed, it is often assumed that funds which make decisions with regard to these wider factors may be exposed to legal liability.

In short, there is a disconnect between the assumptions behind government engagement with pension funds – i.e. that contributing to UK economic growth serves savers' interests – and the way in which pension funds approach their responsibilities.

CASE STUDY: STRATHCLYDE PENSION FUND

Strathclyde Pension Fund's £100 million 'New Opportunities Fund' invests in job-creating businesses in Glasgow in exchange for a 'reasonable return' for the pension fund.[3] Investment from the fund is conditional on the jobs created paying the Living Wage. This offers an example of what can be achieved when pension funds interpret their duty as seeking out sound investments which add genuine economic value for their beneficiaries, rather than simply feeling obliged to chase the best return wherever it may be found. However, as Jon Cruddas noted in a recent parliamentary debate, this interpretation of the law is "very much the exception rather than the rule".[4]

PENSION FUNDS AND INFRASTRUCTURE

Vince Cable recently described it as "extraordinary" that foreign institutions will invest in British infrastructure but British investors won't.[5] But in light of current interpretations of the law, it is not so extraordinary: there is no reason for British investors to look at British infrastructure any differently from, say, Chinese infrastructure. Indeed, most pension funds would feel legally obliged to choose the latter if the risk/return profile were more attractive.

At the moment, defined benefit pension schemes do have reasons to favour UK infrastructure investments, since they offer inflation-linked returns which help match their liabilities. However, addressing this underlying legal issue will be critical to the long-term success of government plans in two respects:

- Pension assets are increasingly shifting from defined benefit to defined contribution schemes, where liability-matching is not a relevant consideration. If pension funds are to play a role in the sustainable growth of the UK economy in the long-term, narrow interpretations of their legal duties will need to be addressed.
- The level of government backing for infrastructure investments will depend to some extent on investors' readiness to invest at a given level of risk. If pension funds feel unable to consider the wider benefits of infrastructure investment, it follows that they may demand more attractive investment terms – which in turn could result in poorer value for the taxpayer.

> "*The debate around infrastructure is also part of a wider debate about how to engender long-term investment in the interests of sustainable growth.*[6]
> – Vince Cable"

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RECOMMENDATIONS FOR GOVERNMENT

FairPensions' recent report on investors' fiduciary duties[7] concludes that the prevailing narrow interpretations of pension funds' duties are a distortion of the underlying legal principles. However, these interpretations are so entrenched that statutory clarification is necessary to overcome them.

We are therefore calling on government to introduce legal provisions to make clear that the law does not restrict pension funds from considering factors beyond profit maximisation, or from pursuing innovative ways to put their capital to work in the best long-term interests of savers. This would not add to the regulatory burden on trustees: on the contrary, it would create a more flexible and enabling environment, restoring the primacy of trustee discretion over dogmatic interpretations of the law.

This recommendation is currently being considered by the Kay Review of UK equity markets. We recommend that BIS, DWP and HM Treasury liaise with each other and with Professor Kay to take this important agenda forward.

ABOUT FAIRPENSIONS

FairPensions is a registered charity that promotes Responsible Investment (RI) by pension schemes and fund managers. 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 also work with policymakers to improve transparency and accountability to savers, and to remove regulatory barriers to RI.

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1. See FairPensions, 2011, 'Protecting our Best Interests: Rediscovering Fiduciary Obligation,' Ch4
2. Cowan v Scargill [1984] All ER 750; [1985] Ch270, page 767c.
3. http://www.glasgow.gov.uk/en/News/New+Opportunities+Fund.htm
4. Hansard, 20 Jan 2012: Col 1039
5. Sunday Times interview: see also http://www.guardian.co.uk/politics/2011/nov/13/pension-funds-stimulate-uk-economy?INTCMP=SRCH
6. Vince Cable, 2010, 'Moving from the financial crisis to sustainable growth', CentreForum, p28
7. FairPensions, 2011, 'Protecting our Best Interests: Rediscovering Fiduciary Obligation', available online at http://www.fairpensions.org.uk/fiduciaryduty