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Interactive Legal Update

Ian D'Costa (Sacker & Partners LLP)



19 June 2014



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Fiduciary duties

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ponsorship
Thought leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

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Agenda

- Background
- What are fiduciary duties
- Short case study

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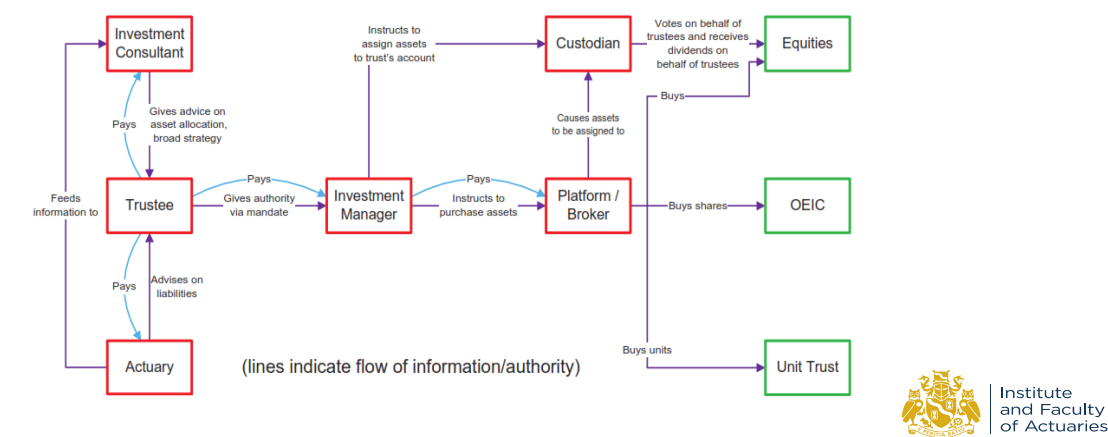
The Law Commission review – why?

- Kay Review
 - Investment chains too long
 - Short-termism
 - Principle 5 – ‘all participants in the equity investment chain should observe fiduciary standards in their relationships with their client and customers
 - The Law Commission should be asked to review the legal concept of fiduciary duty as applied to investment to address uncertainties and misunderstandings on the part of trustees and their advisers.
- “There are few legal concepts more frequently invoked but less conceptually certain than that of the fiduciary relationship” (*LAC Minerals Ltd v International Corona Resources Ltd (1989)*)
- Consultation closed in January 2014 and the response is expected in June 2014



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The Investment Chain



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Do you agree?

- Do we think there is a problem with short-termism?

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Core concepts of fiduciary duties

- Irreducible core of fiduciary duty – loyalty
- Fiduciary's duties attached to exercising a power
- Pitt v Holt (2013)



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Investment decisions

- Duty to invest in the “best interests” of others?
- *Cowan v Scargill* [1985] Ch 270.
 - Five trustees appointed by the National Union of Mineworkers (NUM) refused to approve an investment plan unless it was amended to prohibit certain investments
 - Held the NUM trustees were in breach of their fiduciary duties. Their duty was to put the interests of their beneficiaries first, and normally this meant their best financial interests
 - On the facts, the court found the proposed exclusion of certain investments (overseas companies or in oil and gas on the basis that such investments were against union policy) was not in the beneficiaries' best interests



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The exclusion of tobacco

- The Trustees of the XYZ Pension Scheme hold interests in tobacco companies. Should they seek to exclude these investments?
- These holdings are either:
 - Directly held through segregated IMAs
 - Indirectly held through pooled funds
- Duty to act in the best interests of the members
- Can other factors be taken into account by the Trustees?
 - Environmental, social and governance factors?
 - Ethical factors and viewpoints?



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What is ESG?

- ESG (environmental, social and governance) is a generic term used in financial markets and used by investors to evaluate corporate behaviour and to determine the future financial performance of companies.
- ESG factors are a subset of non-financial performance indicators which include sustainable, ethical and corporate governance issues such as managing the company's carbon footprint and ensuring there are systems in place to ensure accountability. (FT lexicon)



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Environmental, Social and Governance Factors

- May Trustees take ESG into account?

“Given the evidence that ESG factors can lead to better returns in the long run, the answer is clearly that pension trustees may use wider factors. There can be no objection to using ESG factors as a way of increasing long-term performance.”

- Must Trustees take ESG into account?

- Trustees should consider, in general terms, whether their policy will be to take account of ESG factors in their decision-making, bearing in mind the resources available to them
- There is no right way to make money. Views legitimately differ, and the decision is ultimately one for trustees rather than judges



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Environmental, Social and Governance Factors

- ESG factors can be used to:

- negatively screen
- positively screen
- select “best of sector” or “best of class” companies

- ESG factors in this context are about improving financial outcomes for the beneficiaries: they are not about ethical preferences



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Ethical investing

- Affinity groups
 - E.g. pension fund is set up by a religious group, other charity or political organisation
- Consent - DC schemes
 - Acceptable to offer members an ethical pension which will or may produce a lower return, provided that that the scheme has been explained fully and each member has given informed consent



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Ethical investing

- Trustees should not:
 - pursue their own particular moral, ethical or political purposes with their beneficiaries' money
 - be swayed by the many views urged on them by narrow interest groups
- A tie-breaker
 - Where trustees think that scheme members would hold a particular moral view, they may use this as a tie breaker. They may avoid investments which they consider scheme members would regard as objectionable, so long as they make equally advantageous investments elsewhere



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Questions



Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

