IN FOCUS

BACK BRITAIN - BUT AT WHAT COST?

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Introduction

On 7 August 2024, the Chancellor used her first Mansion House Address to call on UK pension schemes to invest more in the UK economy. She stated that she wanted British pension schemes to "*continue backing Britain*" and "*fire up the UK economy*"[1]. On 4 September 2024, the government invited submissions for its pension investment review, which closed for submissions on 25 September 2024[2]. It is not clear what the conclusions of the review will be, but a safe bet is that the new government will conclude that more needs to be done to encourage or, according to some reports[3], mandate British pension schemes to invest more of their money in British businesses.

Such measures will no doubt be welcomed by many. It has been widely reported that British pension schemes invest only 4.4% of their assets in British equities, compared to a global average of 10.1%[4]. That figure has plummeted over the last two decades, from around 40% in the early 2000s. Given that the new government's first and central "*mission*" is to deliver economic growth, it may well ask itself whether it can afford not to intervene to reverse that trend.

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[1] Chancellor Reeves: Pension funds can fire up the UK economy - GOV.UK (www.gov.uk)

[2] Pensions Investment Review: Call for Evidence - GOV.UK (www.gov.uk)

[3] Is Rachel Reeves about to force pension funds to back Britain? (cityam.com)

[4] https://www.ft.com/content/875606ba-a67c-4ad0-842a-259d90908022

A number of business leaders have also got behind the idea of pension schemes "*backing Britain*"[5]. Indeed, the need for British pension schemes to invest more in British businesses appears to be the subject of cross-party consensus, with the previous Chancellor having proposed measures to force pension schemes to disclose their levels of investment in British businesses and publicly compare their performance data against competitor schemes[6].

However, there has been little consideration to date as to how these proposals interact with the fiduciary duties that apply to pension trustees and which govern the exercise of their investment powers. To what extent is "*backing Britain*" consistent with those fiduciary duties, including the duty to exercise such powers only for proper purposes and in the best interests of the beneficiaries? This article considers that question, and concludes that the devil will be in the detail of the specific proposals that are brought forward by the new government[7].

The fiduciary duties of trustees when exercising investment powers

The traditional formulation of the fiduciary duties of pension trustees in the exercise of investment (and other) powers stems from the decision of Sir Robert Megarry VC in *Cowan v Scargill* [1985] Ch 270 at 286H-287B, who stated the following:

> *"The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries. This duty of the trustees is paramount. They must, of course, obey the law; but subject to that, they must put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests…*

[5] [Chancellor announces new plans to secure UK investment - GOV.UK (www.gov.uk)]

[6] [Chancellor backs British business with pension fund reforms - GOV.UK (www.gov.uk)]

[7] Similar issues have arisen in relation to the consideration of ESG issues when exercising investment powers, as masterfully discussed in an article on this website: [A Change of Climate for Trustee Investment Duties? (pensionsbarrister.com)]

I reach the unhesitating conclusion that the trusts of pension funds are in general governed by the ordinary law of trust, subject to any contrary provision in the rules or other provisions which govern the trust. In particular, the trustees of a pension fund are subject to the overriding duty to do the best that they can for the beneficiaries … "

Consequently, as per the traditional formulation:

- The trustees of a pension scheme have a duty to act in the best interests of the beneficiaries of the scheme, including when exercising powers of investment.

- The best interests of the beneficiaries are normally their best financial interests.

In *Re: Merchant Navy Ratings Pension Fund* [2015] EWHC 448 (Ch) at [228]-[229], Asplin J explained that the duty to act in the best interests of the beneficiaries should not be viewed as a paramount stand-alone duty. Rather, it forms part of the principle that trustees should only exercise their powers for a proper purpose, and flows from and is moulded by the trustee's obligation to promote the purpose for which the trust is created.

MNRPF was a DB scheme, and consequently the primary purpose of the scheme was securing the entitlement of members to the benefits as specified under the scheme rules. That meant that the pension trustees did not necessarily have to act in the best interests of members, particularly insofar as that meant granting them benefits in excess of those in the scheme rules, and could take into account the interests of the employer. It is submitted that the position should be different in a DC scheme, where members are not entitled to any particular level of benefits and therefore the purpose of the scheme is much more closely aligned with the members' best financial interests.

Interrelationship between Chancellor's proposals and traditional fiduciary duties

The extent of the tension between these duties and the Chancellor's proposals is likely to depend on the way in which the proposals are intended to operate in the decision-making process of pension trustees.

One possibility is that the new government will pass a series of measures intended to stimulate growth in British businesses, and pension trustees will simply be asked to buy in to the fact that those provisions will be effective. This approach is reflected in some of the comments from the Chancellor, who has suggested that pension schemes investing in British businesses are giving a "*vote of confidence in our work to fix the foundations of the economy*". The form of reasoning which pension trustees would be encouraged to adopt in this scenario would be consistent with their fiduciary duties in the traditional sense - they would be asked to back Britain because British businesses will grow and therefore it is in a member's financial interests to do so. Whilst of course pension trustees would have to form an independent view as to whether an investment in British businesses was, in fact, the best choice for the members from a purely financial perspective (and would also - no doubt - have to take into account investment principles such as diversification in order to appropriately manage any risks) conceptually this form of reasoning would be in line with the orthodox understanding of the fiduciary duties of trustees.

But what about if the legislation goes further, and seeks in some way to encourage pension trustees to invest in British businesses even if that would not otherwise be in a member's best financial interests? There are a number of ways in which this could be done, which (at a high level) include the following:

- Schemes could be granted financial incentives or tax reliefs for investing in British businesses.

- Schemes could be mandated to invest a certain proportion of their assets in British businesses.

- A new duty could be introduced, under which pension trustees would be required (for example) to support the growth of British businesses and take into account the impact of their investment decisions on the overall British economy.

- Schemes could be required to disclose the extent to which they are invested in British businesses, with the expectation that customers would be unlikely to choose providers who did not invest heavily in British businesses[8].

In the case of financial incentives or tax reliefs, this fits reasonably neatly within the traditional conception of the trustees' fiduciary powers. The trustees would continue to act in the best financial interests of the beneficiaries, but taking into account the impact of the relevant financial incentives or tax reliefs.

Similarly, pension trustees have always had to comply with mandatory requirements imposed by legislation, such as applicable Inland Revenue limits. Consequently, the constraint of trustees' duties by reference to these duties is relatively orthodox, even if a mandatory requirement to invest in British businesses is unorthodox. The duty on pension trustees would be the same - to act in the best financial interests of members within the context of the applicable legislative and regulatory environment.

More difficult is the situation where a new duty is introduced to take into account the impact of investment decisions on the British economy or British businesses. Such a duty would seemingly be in tension with the traditional idea of the trustees being under a duty to act in the best financial interests of the members. Whilst it may well be true that growth of the British economy as a whole would be likely to be in the interests of members (or at least those who are still in employment in Britain), it is difficult to say that any particular investment decision will give rise to a tangible financial benefit for the members of the scheme. Certainly, any financial benefit would likely be

[8] As was the case with the proposals from the previous Chancellor.

outweighed by the benefit in making a more profitable investment in an asset situated outside Britain. Under those circumstances, the introduction of such a duty would amount to a substantial erosion of the traditional fiduciary duties of pension trustees.

Perhaps the greatest tension is where pension trustees are required to disclose the extent to which they are invested in businesses. In this scenario, the intention is that employers and savers will choose to invest in schemes with a greater proportion of investments in British assets, such that pension scheme trustees are encouraged to make more British investments[9]. In that way, pension trustees are encouraged to consider their own interests (or the interests of their firm) in attracting investors, even where those interests may potentially be in conflict with the financial interests of the members. That is, of course, the antithesis of traditional fiduciary principles, and it is difficult to see how pension trustees could properly continue to be regarded as fiduciaries if such reasoning was permitted (or even encouraged) by the legislative and regulatory regime.

Conclusion

It remains to be seen what proposals the government will bring forward. However, it is submitted that an important metric by which any proposals should be assessed is the extent to which they are consistent with (or, conversely, erode) the traditional fiduciary duties of pension trustees. Whilst "*backing Britain*" is not necessarily inconsistent with these fiduciary duties, the devil will be in the detail of the specific proposals and the way in which they are intended to interact with the decision-making processes of pension trustees.

Published October 2024

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[9] This was the expressed intention of the previous Chancellor's proposals: Chancellor backs British business with pension fund reforms - GOV.UK (www.gov.uk)

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