PRESS RELEASE

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An ethical approach will help Pension Fund Trustees make the right decisions says a new report from the Institute of Business Ethics

"Trustees need to have a clear understanding of where their obligations, both legal and moral, actually lie ," says Peter Montagnon

29th October 2014: A new report published today by the Institute of Business Ethics looks at twelve key questions which pension fund trustees need to ask to help guide them in making sound decisions.

Pension fund trustees come under pressure from a range of different people and interests: the regulator; the sponsoring company; labour unions; investment firms; politicians and lobby groups. The result can be confusion and uncertainty, especially since many of the decisions they face involve choosing between competing interests.

The report looks at these ethical challenges - ranging from fiduciary duty, investment decisions and conflicts of interest to employing consultants. It offers answers that, by applying an ethical approach, aim to cut through the uncertainty and help trustees make the right decisions.

"The primary purpose of the fund is to deliver on its promise to provide pensions to those who rely on it, even into the distant future. Trustees have an over-arching obligation to scheme members to deliver on the pension promise," says Peter Montagnon, the author and IBE's Associate Director. *"The biggest threat to sound decision-making comes from conflicts of interest where the pressure on trustees is greatest."*

On investment decisions, Peter Montagnon says *"Many suggest that pension funds should be promoting corporate responsibility because it is both ethical and in the broader interest of their beneficiaries. While the social benefits that flow from well-behaved corporations will improve their members' quality of life, and trustees may have strong personal views about how companies should behave, their primary ethical responsibility remains to the beneficiaries."*

Ethical Challenges Facing Pension Fund Trustees will help pension fund trustees understand the nature of the choices they face, and encourage them to approach decision making in ways that will serve their beneficiaries well. This report will also be of use to any organisation wishing to align its pension fund with its ethical values as well as those working with pension fund trustees: actuaries, investment managers, advisers and consultants. Philippa Foster Back CBE, IBE's Director says: *"Ethical values such as fairness, respect and openness can guide trustees to make better quality choices. The twelve questions Peter Montagnon asks in this report will assist pension fund trustees exercise their judgement in an ethical, fair and impartial way to the benefit of those they serve."*

Will Pomroy, Policy Lead: Stewardship and Corporate Governance, NAPF, commented: *"While the Law Commission's recent report has brought welcome clarity and certainty to the legal concept of fiduciary duty, the concept of acting in scheme members' best interests still requires trustees to make a broad range of judgements on a vast range of issues.*

"As with the nature of any subjective decision making there is plenty of scope for ethical quandaries and dilemmas; this report is a helpful illustration of some of the ethical challenges pension fund trustees must navigate. It is right that trustees are encouraged to approach their duties in a thoughtful and considered manner,

this guide should prove helpful in framing discussions and in turn fostering decision-making which is in the interests of all scheme members."

Saker Nusseibeh, CEO of Hermes Investment Management said: *"Trustees should see no conflict on the one hand between an ethical approach to looking after the interests of the beneficiaries; the use of their advantage in having a long time horizon thus ignoring advisors' and regulators' obsession/fixation with short-term volatility; the moral obligation to stakeholders in the allocation of capital as well as the need to provide the pension promise as one of lifestyle, rather than a nominal sum; and on the other what is erroneously perceived by some as the narrow confines of Trustee authority."*

To obtain an advanced press copy of the report, or to organise interviews, please contact k.bradshaw@ibe.org.uk

EDITOR'S NOTES

Ethical Challenges Facing Pension Fund Trustees: 12 key questions

By Peter Montagnon

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Launch event and information

The report will be launched on Wednesday 29 October 2014 17.00 to 19.00

At National Association of Pension Funds, 138 Cheapside, London EC2V 6AE

With Peter Montagnon, Associate Director, Institute of Business Ethics, Saker Nusseibeh, Chief Executive, Hermes Investment Management and Robin Ellison, Head of Strategic Development for Pensions, Pinsent Masons.

Please email events@ibe.org.uk if you would like to attend.

The Institute of Business Ethics is a registered charity which promotes high standards of business practice based on ethical values.

We help organisations to strengthen their ethics culture through the sharing of knowledge and good practice.

www.ibe.org.uk

The author: Peter Montagnon

Peter Montagnon joined the IBE as an Associate Director in September 2013. Prior to that he was Senior Investment Adviser at the Financial Reporting Council, which he joined after almost ten years as Director of Investment Affairs of the Association of British Insurers.

For two decades from 1980 Peter was a senior journalist on the Financial Times, including spells as Head of the Lex Column and in charge of coverage of the international capital markets. His last assignment, from 1994 to 2000, was as Asia Editor, responsible for the FT's coverage of a region stretching from Pakistan to New Zealand.

After graduating in Modern Languages from Cambridge University in 1972, he joined Reuters news agency as a financial journalist. At Reuters he completed assignments in Hong Kong, Zurich and Washington before joining the Financial Times.

Peter served on the European Commission's Corporate Governance Forum from 2005 - 2011. He is past Chairman of the Board of the International Corporate Governance Network and is also a visiting Professor in Corporate Governance at the Cass Business School of the City University, London, a member of the Corporate Governance Advisory Board of the Norges Bank Investment Management and of the Board of the Hawkamah Institute for Corporate Governance, Dubai.

The IBE is grateful to the NAPF and Hermes for their generous support of this Report.

The NAPF is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than £900 billion of assets. We also have 400 members from businesses supporting the pensions sector. We aim to help everyone get more out of their retirement savings. To do this we promote policies that add value for savers, challenge regulation where it adds more cost than benefit and spread best practice among our members.

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We believe in **Excellence**, **Responsibility** and **Innovation**

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*Please note the total AuM figure includes £3.6bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.4bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 30 June 2014.

The 12 questions trustees need to ask are:

1. What exactly is my role as a trustee with regard to the fund's investment?
Quick answer: Your core task is to ensure that the fund can provide a pension for the beneficiaries in line with the promises made to them.

2. So what is my fiduciary duty as a trustee?
Quick answer: The key word is loyalty. Trustees must be loyal servants of their beneficiaries. This means they must put the interests of their beneficiaries before their own.

3. Does this mean that I must focus exclusively on the maximum financial return?
Quick answer: No. The ultimate issue is whether the fund can generate the returns needed to meet its obligations as they fall due. Maximising short term returns is sometimes thought of as the best way of complying with fiduciary obligations, but may not be the best or only way of providing the promised pensions.

4. Surely pension funds should be promoting corporate responsibility anyway because this is both ethical and in the broader interest of their beneficiaries? The social benefits that flow from well-behaved corporations will improve their members' quality of life.
Quick answer: Trustees may have strong personal views about how companies should behave, but their primary ethical responsibility remains to the beneficiaries. They should not impose their views at the expense of beneficiaries and they should be clear about the reasons behind the decisions they take.

5. What is therefore the right way of including corporate responsibility in investment decision-making?
Quick answer: Trustees have a large range of choices. They should choose an approach which suits their fund and brings most benefit to their beneficiaries. Beneficiaries should not suffer a lower return as a result of the approach taken. Having an effective engagement policy can be an effective way of dealing with pressure from beneficiaries, or even the media, to divest from certain stocks.

6. How can I recognise conflicts of interest and what should I do about them?
Quick answer: Trustees cannot serve the interests of beneficiaries if their loyalties lie elsewhere. They should always be aware of conflicts, both actual and potential, and ensure that procedures are in place for disclosing and managing them. Trustees should be open and transparent about the conflicts they face. They should withdraw from decisions where they are conflicted.

7. How can I ensure that my asset manager lives up to the expectations of my beneficiaries?
Quick answer: Trustees need to pay close attention to the terms of the mandate awarded to asset managers and exert their right as customers to ensure that managers act in the interests of beneficiaries.

8. What should I expect from my consultants?
Quick answer: Consultants are there to provide advice, but taking advice does not absolve the trustees from responsibility for their own decisions. Trustees do not have to follow the advice and should challenge it, if they feel there is good reason to do so. They should ensure that the advisers are free of conflicts, particularly if they are considering them for other services such as fiduciary management.

9. Consultants nowadays offer to manage investments as well as providing advice. Is this ethical?
Quick answer: This service, known as fiduciary management, involves an inherent conflict of interest, because the same firm is involved in choosing investment services and delivering them. Trustees have to proceed very carefully and may find it best to take independent advice from a source which is not involved in managing their investments.

10. Surely all that matters is closing the deficit?
Quick answer: Funds with large deficits are clearly at risk of not being able to meet their pensions promise, so this is an obvious priority, but trustees have broader stewardship responsibilities as well.

11. How can I take the interests of all beneficiaries into account when these may conflict with each other?
Quick answer: You have to consciously weigh up the different interests, taking care not to ignore the needs of those who are least vocal, notably the scheme members who are no longer in the sponsor's employment but also not yet drawing their pensions. A good guide is to ask how you yourself would expect to be treated in the circumstances.

12. How does my duty differ when I am dealing with a defined contribution scheme?
Quick answer: Defined contribution schemes are quite different from defined benefit, not least because the scheme member has choice over his or her investments. But the two key principles for trustees, of acting in the interests of beneficiaries and addressing conflicts of interest, are both highly relevant.

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