



Briefing on Robert Jenrick MP's amendment to pensions regulations

Summary

An amendment has been tabled at Committee Stage to the 'Public Service Pensions and Judicial Offices Bill' which has huge implications for the ability of the pension schemes of any public bodies such as their Local Government Pension Scheme (LGPS) to invest ethically, and for the rights of members of such pension schemes to express and have their ethical views taken into account in the investment of their own money. The proposed amendment's lack of detail and ambiguous wording with regard to alignment of investments with 'UK foreign and defence policy' also risks creating a chilling effect on risk-averse pension scheme managers fulfilling their fiduciary duties and other responsibilities. Introducing the amendment at this late stage indicates that it is being rushed, with little time for assessment of its impact before it is put to the House of Commons. It is scheduled for debate on 22nd February.

Key reasons to oppose the amendment

- It limits the ability of public sector pension scheme members to express ethical preferences in the investment of their pension fund, subordinating their interests to furtherance of the UK's foreign and defence policies solely because they are or were public sector employees.
- Divesting or 'exiting' a company is an essential part of an investor's toolkit to improve the practices of investee companies. This amendment threatens to remove that option from the LGPS for an uncertain number of companies and industries.
- This amendment is so vaguely worded and potentially so broad in application that it is likely to have a chilling effect on public officials who make investment decisions:
- It will increase the risk that public sector funds will retain certain investments even where to do so increase the risks to the financial performance of the fund.
- It will likely lead to risk-averse pension schemes avoiding issues which may be considered 'foreign and defence policy' which will undermine the pension scheme's compliance with the UN Guiding Principles on Business and Human Rights.
- It could be easily used by the UK government to undermine any human rights or environmental campaign that raises concerns about pension investments in any company operating in a country that is not formally on a UK sanctions list.

The amendment

Robert Jenrick MP has proposed the following clause be added:

“Guidance to public sector pension scheme managers on investment decisions:

(1) The Public Sector Pensions Act 2013 is amended in accordance with subsection (2).

(2) In schedule 3, paragraph 12(a), at end insert “including guidance or directions on investments which it is not proper for the scheme manager to make in light of UK foreign and defence policy.”

The accompanying explanatory statement¹ confirms that “this new clause would enable the Secretary of State to **issue guidance to** those authorities that administer public sector pension schemes, including the **local government pension scheme, that they may not make investment decisions that conflict with the UK’s foreign and defence policy.**” (emphasis added). This could potentially constrain LGPSs from divesting from arms companies, polluting companies and any companies involved in human rights abuses, where such divestment might be in conflict with foreign policy goals.

This appears to be an attempt to overcome a 2017 High Court ruling upheld by the Supreme Court in 2020 that held that similar guidance issued by the Secretary of State was unlawful.

Limits the rights of public sector workers

This amendment would give the UK government the authority to direct investment decisions made by fiduciaries on behalf of and with the financial contributions of pension scheme members simply because they are or were public sector employees. It would limit the ability of public sector employees and pensioners to express ethical choice in the investment policy of their pension fund.

In 2014, the Law Commission confirmed that in general pension fund trustees may take into account “non-financial factors” if two tests are met.² They described non-financial concerns as including “showing disapproval of certain industries.” The tests are as follows:

- (1) trustees should have good reason to think that scheme members would share the concern;
- and

¹Public Service Pensions and Judicial Offices Bill [Lords], As Amended (Amendment Paper). House of Commons, 4 February 2022.

https://publications.parliament.uk/pa/bills/cbill/58-02/0241/amend/public_rm_rep_0204.pdf

² Fiduciary Duties of Investment Intermediaries. The Law Commission, 30 June 2014.

https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/03/lc350_fiduciary_duties.pdf

(2) the decision should not involve a risk of significant financial detriment to the fund.

The amendment seeks - as the previous unlawful 2016 guidance did - to impose an additional test for members of public pension schemes such as Local Authority workers. As Lord Wilson in the Supreme Court pointed out, it “purports to provide that even after the tests recommended by the Law Commission for reaching a potential investment decision have both been met, an administrator is prohibited from taking the decision if it runs counter to UK foreign & defence policy.”³ Lord Carnwath in his Judgement agreed with lawyers challenging the guidance that this means that “administering authorities could not refrain from making particular investments on non-financial grounds, regardless of the views held by the scheme members.”

Amnesty International considers this could be an unacceptable interference with LGPS scheme members’ right to freedom of conscience.⁴ International human rights bodies have placed limitations on the circumstances under which states can interfere with this right. These relate to the need to maintain public safety, protect public order, health or morals, or protect the rights and freedoms of others. It would be difficult for the UK to argue that any of these limitations apply in the context of a requirement that individual public employees investing collectively via their pension scheme give effect to their country’s foreign and defence policy.

The previous unlawful guidance was defended on the basis that public sector pension schemes were akin to state agencies and that as any shortfall would be met by the taxpayer, they represented ‘public money’. However, this was rejected by Lord Wilson (with whom Lady Hale agreed) in the Supreme Court. Scheme administrators when carrying out their functions are performing duties similar to pension fund trustees and when doing so are not part of the ‘machinery of state’.⁵ Members of public sector pension schemes - like those of any other pension fund - make contributions to that scheme “deducted from their income. The contributions of the employers are made in consideration of the work done by their employees and so represent another element of their overall remuneration. The fund represents their money. With respect [...], it is not public money.”⁶

³ Judgment. R (on the application of Palestine Solidarity Campaign Ltd and another) (Appellants) v Secretary of State for Housing, Communities and Local Government (Respondent). The Supreme Court. 29 April 2020, page 13:

<https://www.supremecourt.uk/cases/docs/uksc-2018-0133-judgment.pdf>

⁴ The right to freedom of conscience is recognized in international treaties including Article 18 of the International Covenant on Civil and Political Rights (ICCPR). UN Human Rights Committee, General Comment 22, Article 18: The Right to Freedom of Thought, Conscience and Religion, A/48/40 vol. I (1993) 208, paras. 11.

⁵ Judgment. R (on the application of Palestine Solidarity Campaign Ltd and another) (Appellants) v Secretary of State for Housing, Communities and Local Government (Respondent). The Supreme Court. 29 April 2020, page 14:

<https://www.supremecourt.uk/cases/docs/uksc-2018-0133-judgment.pdf>

⁶ Judgment. R (on the application of Palestine Solidarity Campaign Ltd and another) (Appellants) v Secretary of State for Housing, Communities and Local Government (Respondent). The Supreme Court. 29 April 2020, page 15:

<https://www.supremecourt.uk/cases/docs/uksc-2018-0133-judgment.pdf>

Despite there being no meaningful difference between the LGPSs and a private sector defined benefit scheme in terms of member contributions and the duties owed to them, this amendment would impose additional burdens on the beneficiaries' ability to have their ethical views taken into account. This is not justifiable.

Interferes with the ability of the LGPS to exercise their duties to members and to exercise leverage as investors over the behaviour of companies

The proposed amendment would force public sector pension schemes to give effect to the Government's own policies "in preference to those which they themselves thought it right to adopt in fulfillment of their fiduciary duties".⁷ This is an unjustified interference with the discretion of pension scheme managers.

Divesting or 'exiting' a company is an essential part of an investor's toolkit to improve the practices of investee companies. A Danish pension fund discussing a decision to divest from oil companies recently pointed out that "...often we get more attention from management and more airtime after we have excluded the company".⁸ This amendment threatens to remove that option from the LGPS for an uncertain number of companies and industries.

In addition, the amendment is potentially so broad in its application or interpretation that it would make all investment decisions subject to compatibility with UK foreign and defence policy - not just those based on ethical concerns.

We have already seen the chilling effect that confusing and ambiguous laws have on pension funds. The Law Commission acknowledged that where trustees were unsure of the procedural steps they needed to take to comply with their duties, they became risk averse and may not have done enough to take account of environmental, social and governance factors or to engage with their beneficiaries.⁹

The wording is so vague that any similarly worded guidance issued thereunder is likely to have a similar effect on public officials who make investment decisions. They will err on the side of caution to avoid running the risk of committing an offence.

⁷ Lord Carnwath agreeing with the submission of counsel for those challenging the 2016 guidance. Judgment. R (on the application of Palestine Solidarity Campaign Ltd and another) (Appellants) v Secretary of State for Housing, Communities and Local Government (Respondent). The Supreme Court. 29 April 2020, Pages 19-20:

<https://www.supremecourt.uk/cases/docs/uksc-2018-0133-judgment.pdf>

⁸ "We get more attention from management after we have excluded the company" - AkademikerPension's CIO on its divestment and exclusion push". Dominic Webb. Responsible Investor. 10 February 2022:

<https://www.responsible-investor.com/articles/we-get-more-attention-from-management-after-we-have-excluded-the-company-akademikerpension-s-cio-on-its-divestment-and-exclusion-push>

⁹ Fiduciary Duties of Investment Intermediaries. The Law Commission. 30 June 2014, para 7.3, page 128: https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/03/lc350_fiduciary_duties.pdf

This could have a knock-on effect even where the reasons for the investment decision extend beyond purely ethical concerns. Given that unethical business practices and controversial behaviour can impact financial performance, the lack of clarity will increase the risk that public sector funds will retain certain investments even where to do so may have adverse effects on the financial performance of the fund. This could lead to additional financial burden on the taxpayer.

Potentially undermines pension schemes' responsibilities under the UN Guiding Principles on Business and Human Rights

The LGPS has responsibilities under the UN Guiding Principles on Business and Human Rights ('**UNGPs**').¹⁰ The UNGPs, published in 2011, is a landmark document authoritatively recognising that states, businesses and civil society have a key role to play in enhancing business respect for human rights. In relation to pension investment decision-making, the UK National Action Plan on Business and Human Rights recognises the link between its central objective of promoting business respect for human rights and the role of pension funds: "*Companies increasingly understand that there is a business case for respect for human rights and that this brings business benefit in various ways by... appealing to institutional investors, including pension funds, who are increasingly taking ethical, including human rights, factors into account in their investment decisions.*"¹¹

While the UK government confirmed that the 2016 guidance "did not affect administering authorities' ability to implement the United Nations Guiding Principles on Business and Human Rights, and to act in accordance with international law", it is unclear how pension scheme managers will differentiate between their responsibilities under the UNGPs and international law on the one hand, and the need to not conflict with UK foreign and defence policy on the other. This confusion will be likely to encourage risk-averse pension schemes to avoid issues which may be considered in the sphere of 'foreign and defense policy' even in situations that would undermine pension schemes' compliance with the UNGPs.

¹⁰ Lawyers for Palestinian Human Rights briefing to local authorities. July 2017, para 11, page 18:.. <http://lphr.org.uk/wp-content/uploads/2017/07/LPHR-briefing-to-LAPFs-and-LAs-on-pensions-investment-and-public-procurement-decision-making-relating-to-companies-operating-in-the-occupied-Palestinian-territory-and-or-Israel-July-2017.pdf>

¹¹ Investor Alliance for Human Rights: <https://respect.international/good-business-implementing-the-un-guiding-principles-on-business-and-human-rights/>

Where is the line drawn between a good investment decision, compliance with the UN Guiding Principles on Business and Human Rights, and a conflict with UK foreign or defence policy?

Public sector pension schemes would be faced with a considerable dilemma as to when a decision to divest would be lawful or prohibited. Where would the following example of divestment fall?

- the UK arms industry because of human rights and civil liberties concerns - contrary to UK defence policy because arms companies play a central role?
- companies sourcing products made with forced labour from Uyghur communities – contrary to UK foreign policy as might impact the UK's relationship with China?
- companies using cotton from Uzbekistan and Turkmenistan in their supply chain – prohibited because no sanctions have been imposed on these countries?
- the majority-state owned oil company Saudi Aramco on the basis of human rights and climate change issues – prohibited to protect the UK's relationship with Saudi Arabia?
- Companies doing business in territories that are illegally occupied – prohibited unless the UK has imposed sanctions against the occupying powers?

Practical challenge

It is difficult to see how a pension scheme - and the fund managers appointed by them - could practically ensure its investments were always compliant with UK foreign and defense policy. Such policies are continuously evolving with international events and shifting alliances. As these change, the pension scheme's obligations would too. Who would be responsible and pay for ongoing monitoring of the totality of the UK government's foreign and defence policies and understanding their complex application in the investment sphere across sectors and supply chains, jurisdictions, and asset classes?

For example, the UK government's policy position is that settlements in the Occupied Palestinian Territories are illegal under international law.¹² It also appears to be government policy that it opposes boycott campaigns related to this issue. Which of these two policy positions would a pension scheme

¹² Guidance. Overseas Business Risk - The Occupied Palestinian Territories. Foreign, Commonwealth & Development Office. 4 January 2021: <https://www.gov.uk/government/publications/overseas-business-risk-palestinian-territories/overseas-business-risk-the-occupied-palestinian-territories>

be expected to comply with? To further complicate matters, the UK's Overseas Business Risk advice on Israel's illegal settlement activities in the Occupied Palestinian Territories warns "There are therefore clear risks related to economic and financial activities in the settlements, [...] This may result in disputed titles to the land, water, mineral or other natural resources which might be the subject of purchase or investment.[...] and UK citizens and businesses should be aware of the potential reputational implications of getting involved in economic and financial activities in settlements, as well as possible abuses of the rights of individuals."¹³

In this instance would a public sector pension scheme's divestment decision from companies operating in the Occupied Palestinian Territories be assessed to be: i) compliant with the UK's policy position regarding international law; ii) not compliant with UK foreign policy as it represents a 'boycott'; iii) an example of compliance with the UNGPs; iv) or simply a sound financially driven investment decision arising from the financial and reputational risks that the UK government itself warns British businesses about?

Chilling effect on human rights campaigns involving investors

At a time when there is so much public concern about the impact of unethical business practices, it is more important than ever that companies that fall short of international standards be held to account. The broadness of the terms 'UK foreign and defence policy' could be easily used against any human rights campaign raising concerns about pension investments in any company that does business with a country that is not formally on a UK sanctions list.

There is a long tradition of investors using their leverage - including by exiting their investments - to improve corporate practices on human rights issues such as divesting from companies operating in South Africa under apartheid. Investor networks such as the Investor Alliance on Human Rights¹⁴ work on issues including Uyghur forced labour, human rights violations in Myanmar, and digital rights in the Information and Communications Technology (ICT) sector.

There are many examples of international mainstream investors deciding to exit investments because of human rights concerns even where formal sanctions aren't in place.¹⁵ Engagement with NGOs and human rights defenders is a normal part of investor information gathering on issues they consider

¹³ Guidance. Overseas Business Risk - The Occupied Palestinian Territories. Foreign, Commonwealth & Development Office. 4 January 2021: <https://www.gov.uk/government/publications/overseas-business-risk-palestinian-territories/overseas-business-risk-the-occupied-palestinian-territories>

¹⁴ <https://investorsforhumanrights.org>

¹⁵ Think Twice: Can companies do business with Israeli Settlements in the Occupied Palestinian Territories while respecting human rights. Amnesty International. 2019, pages 31-32: <https://www.amnesty.org.uk/files/2019-03/Think%20Twice%20report.pdf?BrN9N0VX3RkzTJROuKYC46LE43hCPTu=>

pertinent to their investment decisions. Recently, it was reported that an advisory committee on investor responsibility at Yale University is assessing the eligibility of a number of Chinese companies for investment on human rights grounds.¹⁶

The proposed amendment would encourage risk-averse public sector pension scheme managers to view any human rights issue in a country not under formal sanctions as 'out of bounds' for fear of breaching the law regardless of the views of their members, of potential breaches of international human rights standards like the UNGPs, or indeed of the investment risk arising.

This may extend beyond decisions to buy or sell shares and bonds from companies and countries to the exercise of investor voting rights on shareholder resolutions aimed at improving human rights practices and reducing resulting investor risk. The exercise of such investor rights has been a powerful tool for investors on issues including apartheid in South Africa and the MacBride Principles in Northern Ireland. Public sector investors may now restrict their interactions with NGOs for fear of their investment activities being labeled a 'political campaign' thereby removing a key information source for managing risk. Accordingly, the proposed amendment and resulting guidance will likely operate in practice as a means of undermining any human rights campaign with which the government disagrees.

Conclusion

The proposed amendment represents an unjustifiable interference with the rights of individual pension savers to exercise their freedom of conscience, the ability of public sector pension schemes to exercise their fiduciary duties, in addition to their investor responsibility to improve corporate practices and to meet their obligations under the UNGPs. It effectively conscripts individual public sector pension scheme members' own money to promote central government's foreign and defence policies regardless of their own wishes or the judgment of those appointed to act in their interests. It also poses significant risks to multi-stakeholder efforts to ensure companies respect human rights in their operations and are held accountable when they do not.

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¹⁶ <https://yaledailynews.com/blog/2022/01/26/yale-to-begin-investigating-its-chinese-investments-in-light-of-human-rights-concerns/>