



**O**n the evening of 28 April, as most

political journalists gorged themselves on the latest round of the Peter Mandelson scandal playing out in the Foreign Affairs Committee, government ministers finally found a compromise that allies of the pensions industry in the House of Lords were prepared to accept, allowing passage of the Pension Schemes Bill through parliament to receive Royal Assent and become law.

By far the most contentious element of the Bill was the proposed inclusion of a reserve power that could allow government to mandate investment in specific types of UK assets. The scope of this power has been narrowed significantly in the final version of the Bill, but it is still present. Why did an argument over this power end up threatening to sink the whole Bill, which contains so many other elements embraced by the pensions industry?

During March and April the House of Commons and the House of Lords were engaged in a classic bout of parliamentary 'ping-pong', with government ministers having to keep amending the Bill in the Commons so that the Lords would vote for it. Three times the Lords rejected a redrafted Bill, but on 28 April the government found a successful compromise, not by removing the possibility of mandation, but by proposing some final concessions.

These included promising independent regulatory assessment of

## A power struggle

### Summary

- A last-minute compromise, including a narrowing of a reserve power that would enable investment mandation by government, allowed the Pension Schemes Bill to complete its passage through parliament to become law in April.
- Significant opposition to mandation throughout the industry had been based in part on concerns that it could force trustees or scheme managers to choose between ensuring legal compliance and upholding their fiduciary duty to achieve the best possible outcomes for scheme members.
- Government ministers insisted the reserve power will only ever act as a backstop measure to help ensure signatories of the Mansion House Accord fulfil their commitments under that agreement; and that it is unlikely to be used at all.
- Many in the industry do want to see more investment by schemes in the types of productive and UK-based assets in which the government would like schemes to invest, but opponents of mandation stress the need for schemes to retain control of when and how these investments are made.
- Concerns persist that now the reserve power is on the statute book, a precedent has been set for future governments to interfere in pension scheme investment strategies or governance.

**At the end of April, the long-running dispute about including investment mandation powers in the Pension Schemes Bill was finally settled with a last-minute compromise, after the row had threatened to sink the whole Bill. But why did this proposal to compel investment in some UK assets unite most of the pensions industry in opposition to it – and is the issue now really resolved? David Adams reports**

competitive conditions that might restrict relevant master trusts and group personal pension schemes from investing in the assets in which the government would

like them to invest. The test for granting exemptions to mandation has also been altered, so that a scheme's trustees or managers would no longer have to

prove that compliance with mandation rules “would be likely to cause material financial detriment” to the scheme’s members, but would instead need to show that such investments would be “likely not to be in the best interests of members”. The time period during which the reserve power could be used has also been narrowed.

Speaking in the Lords on 29 April, Viscount Younger of Leckie (Conservative) welcomed these changes.

“By placing members’ best interests at the heart of the policy, this reform helps to mitigate the risk that mandation could cut across fiduciary duties,” he told the House, adding later: “The situation is far from perfect and we remain of the view that the mandation power is wrong in principle, but this settlement, which we might now call ‘mandation-lite’, is far better than that in the Bill as originally drafted.”

#### Chillaxation in short supply

Earlier versions of the Bill would have required many schemes to invest up to 10 per cent of funds in unlisted high-risk illiquid assets, possibly through use of open-ended Long-Term Asset Funds (LTAFs), regardless of market conditions at the time. This would certainly have risked breaching trustees’ fiduciary duty to scheme members by leading to materially worse outcomes.

The government had argued that mandation would only be a ‘backstop’ power, used only to ensure the schemes and providers that have entered into the Mansion House Accord, a voluntary agreement among 17 of the largest DC pension providers to increase investment in productive unlisted assets, would meet their commitments under that agreement.

Back in October, Pensions Minister, Torsten Bell, had told Pensions UK’s Annual Conference that the reserve power was not intended to interfere with trustees’ fiduciary duties, “won’t need to be used, in my view”; and that the pensions industry should “chillax” about mandation.

There was very little chillaxing thereafter, unfortunately. Bell’s words completely failed to pacify opposition to mandation across the industry. There is still widespread bafflement as to why the power is needed in the Bill, says Pensions Management Institute (PMI) chief strategy officer, Helen Forrest Hall.

“People are very supportive of the scale measures in the Bill, the value for money measures – a whole host of measures in the Bill,” she says. “This is the only thing anybody’s got a really major issue with.”

Pensions UK has also been strongly opposed to mandation.

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“Mandation is something that almost everyone in the industry opposes, but we’ve got lots of things in the Bill which the industry really wants,” says Pensions UK head of parliamentary and stakeholder affairs, Katy Holmes. She describes the compromise agreed at the end of April as “a welcome step that address concerns about the breadth of the power”.

“While we oppose the principle of mandation we are glad to see that parliament has reached a compromise, and the Bill has made its way onto the Statute Book,” she says.

LCP partner, Stephen Budge, says his company is also still opposed to mandation. “We think power should remain with trustees, and that fiduciary duty is the right way to think about investment strategy,” he says.

#### Commitment to fiduciary duty

Indeed, the idea that mandation could force trustees to compromise their

fiduciary duties is one of the two most important reasons why opposition to including it in the Bill became so entrenched. In March, shadow Pensions Minister, Helen Whately, speaking at the Pensions UK Investment Conference, claimed it would put trustees in “an invidious position” by forcing them to choose between legal requirements or their fiduciary duty to act in scheme members’ best interests.

Now that the Bill has become law, Whately and the Conservatives have hailed the fact that it “now protects fiduciary duty – the foundation upon which trust in our pension system rests”; and have welcomed “the government’s U-turn on this fundamental flaw in the Bill.”

Forrest Hall says the PMI’s greatest concern is “the impact of this reserve power on trustees’ fiduciary duty, and their ability to operate unfettered in their members’ interests”.

“That is something that our members feel very, very strongly about,” she says.

Society of Pension Professionals (SPP) president and XPS Group head of DC and partner, Sophia Singleton, makes a similar point.

“We’ve got a very diverse membership, but the idea of getting the best outcomes for members is just so, so strong in the industry,” she says. “I don’t think people outside the industry really understand that.”

She suggests that the government’s ongoing work to create statutory guidance regarding fiduciary duty in private, trust-based pensions is now even more important than was already the case.

“That guidance is going to be a really important piece of work, to ensure that trustees retain their autonomy to act in their members’ best interests,” she says.

Former Pensions Minister, Baroness Altmann, who was one of the most prominent opponents of the reserve power during the Lords debates on the Bill, suggests mandation could be made subject to fiduciary duty.

“It would mean trustees can take account of market conditions or possible asset bubbles, and invest in a wider range of ways to achieve the best outcomes for members as they view the situation at that date – rather than being forced to buy assets just because the government says so,” she explains.

### Retaining control

It is certainly the case that many scheme trustees, pension providers and their advisers are in favour of investing in UK-based and productive assets, in line with, or at least in the spirit of, the commitments made in the Mansion House Accord – but when this is practicable, according to a timetable based on members’ best interests.

Budge says significant progress has been made by larger schemes and providers seeking to work with these investments, and that this progress has been boosted by other government actions.

“Two years ago, private market investment was almost unheard of for pension scheme investment strategies, but all master trusts and DC providers have investment strategies that involve private market investments now,” he says. “DC schemes have benefitted from the push from government to remove some of the perceived barriers.”

Singleton emphasises the significance of the measures in the Bill that will lead to a larger number of larger schemes, which will be better positioned to make these types of investments.

“Scale helps, because a really important element of investing in private market assets is going to be the governance and expertise required,” she says.

Budge agrees. “These are illiquid assets and you have to invest in them carefully,” he says. “It’s the forcing of the speed of that investment that causes us concern.” He fears that a rush to invest is likely to undermine necessary due diligence.

Forrest Hall points out that forcing schemes to invest in a specific set of assets within a short period of time may also have other unintended or undesirable consequences.

“It inadvertently restricts broader opportunities, because if everybody’s trying to ... [*invest in*] private markets



they might be ignoring other things that are equally worthy, including some that would support UK economic growth,” she explains.

“It is this idea that ministers in future will know better than pension schemes managers which assets will be best for their portfolios that is at the heart of the problem,” says Altmann. “The government does not seem to understand that forcing pension funds to invest in high-risk assets is not the way to achieve better outcomes for pension scheme members; and that interfering with fiduciary duty by forcing funds to buy some unspecified assets, by a specified date, could create asset bubbles and damage returns.”

### A worrying precedent

But the other fundamental reason why so many in the industry oppose mandation is the fact that the reserve power sets a precedent for direct government involvement in scheme investment strategies – or perhaps other aspects of scheme governance.

“A power like this on the statute book could be repurposed or extended, or applied differently by future government,” Forrest Hall warns. “Once you have opened the door to government potentially mandating how pension schemes invest, where does that end? You have made an argument for other future governments to come in and say ‘We’re going to tweak this power’ or ‘extend this power.’”

Even if that doesn’t happen, there is a danger public trust in pensions could be undermined, says Altmann.

“If government can decide what schemes will invest in, people will not be able to trust that their pension will be invested for their benefit and there will be no comeback if things go wrong,” she warns.

Forrest Hall says the compromise made by the government to secure passage of the bill, is, at least, “a welcome recognition of the sector’s concerns, with the mandation power now more tightly defined, with clearer limits on its use”.

“That provides a degree of reassurance for trustees who were focused on the primacy of their fiduciary duty,” she says. “But the presence of any reserve power on the statute book inevitably carries long-term implications.

“While the amendments reduce the scope for future governments to direct investment decisions they do not eliminate the possibility entirely. Trustees and the wider industry will need to remain alert to how this power is interpreted over time, and to ensure that any future use is consistent with established fiduciary principles. Trustees must never be placed in a situation where they are required to compromise their duty to members.”

So, while the debate about mandation may now continue in the background, rather than in parliament, it will definitely continue.

**Written by David Adams, a freelance journalist**