



Law Commission
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Submitted by e-mail

Subject: Eumedion's response to the UK Law Commission consultation on fiduciary duties of investment intermediaries
Ref: B.14.04

The Hague, 17 January 2014

Dear Sir, dear Madam,

Eumedion welcomes the opportunity to submit comments on the Consultation Paper nr. 218 on fiduciary duties of investment intermediaries which was issued by the UK Law Commission on 22 October 2013. By way of background, and to put our comments in context, Eumedion is the shareholder engagement platform of 69 Dutch and non-Dutch institutional investors – all with a long term investment horizon – and aims to promote good corporate governance and sustainability in the listed companies our participants invest.

We prefer making some general comments instead of responding to each question posed in the document.

I. General

The Law Commission has been asked by the UK Department for Business, Innovation and Skills (BIS) and the Department for Work and Pensions (DWP) to investigate how the law of fiduciary duties applies to investment intermediaries and to evaluate whether the law works in the interests of end investors. The project arises from the 2012 Kay Review of UK equity markets and long-term decision

making. In the same spirit the European Commission adopted a Green Paper on long-term financing in March 2013, which also addresses problems of financial intermediation.

Although the geographical scope of the paper is the United Kingdom and the Law Commission has not considered the needs of foreign owners of UK companies, the paper's central question of how the (fiduciary) duties in the investment chain serve the long term interests of the end investors is also highly relevant for other markets.¹ We believe that foreign market participants and policymakers looking at the functioning of the intermediation chain could greatly benefit from the intellectually profound analyses conducted by the Law Commission.

In the consultation paper, the Law Commission differentiates between duties of pension trustees and duties of other parties in the investment chain, including asset managers and custodians. Below we will comment on these respective categories.

II. Pension trustees

Eumedion recognises the Law Commission's statement that the primary duty in case of a pension scheme is that trustees use their investment powers so that they earn returns to provide a pension.² Pension trustees should exercise their investment powers to ensure the security, quality, liquidity and profitability of the portfolio as a whole, without excessive reliance on any particular asset, issuer or group of undertakings.³ The Law Commission concludes that with these broad parameters pension trustees *may* take wider environmental, social and governance (ESG) factors into account in making investment decisions, but *are not required to do so* if they consider that another strategy would better serve the interests of their beneficiaries.⁴

ESG factors

While Eumedion acknowledges the importance of trustees having considerable discretion, we recommend the Law Commission to take a stronger position. There is increased evidence that taking account of ESG factors can reduce risks and can lead to better returns in the long run.⁵ A more holistic view, including ESG factors, could also help to solve the problem of "short-termism", addressed in the Kay Review, in which investors trade on the basis of short-term movements in the share price rather than investing on the basis of company value. ESG aspects are relevant and can be very material across all asset classes that any pension fund or other institutional investor may be invested in, apart from cash or exotic investments like music rights.

Therefore, we would welcome duties of care that clearly encourage pension trustees to take account of ESG factors. One method to achieve this is requiring pension trustees to consider in their investment policies not only financial but also ESG aspects of investee companies' performance and

¹ Consultation paper, para 1.28.

² Consultation paper, para 10.25.

³ UK Occupational Pension Scheme (Investment) Regulations 2005 SI 2005 No 3378.

⁴ Consultation paper, para 10.53-10.66.

⁵ Consultation paper, para 10.48-10.51.

report annually on how they have taken these factors into account. A new provision in the Dutch Pension Act, which entered into force on 1 January 2013, requires pension funds to disclose how ESG factors are taken into account in their investment policies; and is similar to the requirement for UK pension funds to comment to this effect in their Statement of Investment Principles (chapter 7).⁶ Moreover, stronger enforcement of fiduciary principles so that they serve their intended purpose could also help to resolve short-term pressure.

Macroeconomic factors

Pension funds with diverse portfolios have a clear interest in a good performance of the economy as a whole. To maximise their returns they essentially need to make investment decisions that contribute to a sustainable and successful economy. At the same time, a single pension fund's primary duty is to provide long term financial benefits for its own beneficiaries and it is unlikely that a single pension fund's actions can make a real difference to a macroeconomic problem. In light of this, we support the Law Commission's approach that trustees should consider whether they take macroeconomic factors into account.⁷

Macroeconomic factors can be better addressed through collective stewardship initiatives such as engagement, where costs and benefits can be shared across many investors, as the Law Commission rightly points out. However, only a minority of pension funds conducts stewardship responsibilities, either individually or collectively.⁸ This is a concerning fact as indeed engaging with companies on their long-term strategy can be highly effective even without acquiring a meaningful stake.⁹

Therefore, there is an urgent need that much more pension funds commit sufficient resources to take up their roles as engaged owners. More of them should work directly with investee companies to build long-term relationships, preferably collaboratively. Asset owners need to make sure that both their internal investment professionals and their external fund managers are committed to their stewardship responsibilities.

Quality of life factors

We agree with the Commission that while the effect of an investment on the quality of life may be seen as an investment factor, one cannot expect from pension trustees to accept a lower return from an investment just because it will improve some people's lives. The Law Commission's states that one group's quality of life factors will be another group's financial loss. Nevertheless, more can be done to encourage pension fund trustees to look at the best of both worlds; investments that both improve quality of life and provide good financial returns. We would be pleased if the Law Commission could come up with recommendations in this regard.

⁶ Article 135 of the Dutch Pension Act.

⁷ Consultation paper, para 10.77.

⁸ Consultation paper, para 10.38.

⁹ D. Bartman en M. Wiseman, 'Focusing on the long term', Harvard Business Review 2014, p. 48-50.

Ethical factors

As for ethical factors, we agree with the Law Commission that pension funds should not invest in activities which are illegal or which contravene international conventions (e.g. the Convention on cluster munitions).¹⁰ While other ethical factors could also be an investment factor, trustees should be reluctant to pursue ethical purposes with beneficiaries' money unless they have ascertained that it is their beneficiaries' wish to do so, and the participants accept the potentially negative impact on returns. The morality and ethics pension funds apply, should essentially be those that would be appropriate to the beneficiaries.

III. Fiduciary duties in the rest of investment chain

The Law Commission has also considered to what extent the other parties in the chain of intermediation should be subject to fiduciary duties (including brokers, asset managers, collective investment funds and custodians). The other parties operate under contracts and duties of care, which duties are largely compatible with fiduciary duties but more flexible and less certain. It is important that vulnerable and non-expert individuals are protected by sophisticated duties of care.

Using the word 'fiduciary' for other parties' duties in the chain might be confusing as the word has so far only be used for pension funds' duties, at least under the Dutch legal framework. Therefore, we endorse the UK government approach in its response to the Kay Review to avoid the word 'fiduciary' and instead set out that other parties should act (i) in good faith, (ii) in the best long-term interest of their clients (beneficiaries) and (iii) in line with generally prevailing standards of decent behaviour. For asset managers and fund managers, these important principles are to a large extent already laid down in contractual agreements and derived from relevant European directives, including MiFID, UCITS and AIFMD.

IV. Custodians

We support the Law Commission in its view that there is a clear need to bring legal clarity in the international legal framework under which intermediated shares are held. Over the years, however, it has proven to be almost impossible to achieve that legal certainty objective. The 2009 Unidroit convention has not been ratified by any country and the European Commission has not come up with any legislative proposals following their two successive consultation papers of 2010 and 2011 on this subject. Meanwhile, internationally operating institutional investors have continued to struggle with the severe problems of a poorly functioning cross border voting chain.

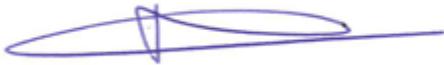
For institutional investors and their asset managers a well functioning investment chain between them and the issuers is of utmost importance, particularly the ability to receive information, to vote at shareholders' meetings and to receive confirmation that the vote instruction has been received by the issuer. This is essential for institutional investors and their asset managers in relation to being 'responsible and active owners'. We believe that in principle the entity who bears the economic risks

¹⁰ Consultation paper, para 14.25.

and receives dividends on any shares or other securities purchased, should be able to use the voting rights attached to the shares in a effective manner. Also shareholders should have the right to know whether their shares have been voted as instructed.

Again, Eumedion welcomes the Law Commission's project and appreciates this opportunity for comment. If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Wouter Kuijpers (wouter.kuijpers@eumedion.nl, +31 70 2040 302).

Yours sincerely,



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