

UNIVERSITIES SUPERANNUATION SCHEME

RESPONSIBLE INVESTMENT - LEGAL CONSIDERATIONS

1. SUMMARY

- 1.1 The purpose of this paper is to set out our advice to the Trustee Company¹ with regard to the legal considerations to be taken into account when exercising its investment duties. In particular, we were asked in 2016 to update our previous advice² in relation to the extent to which ethical, environmental, social and governance grounds (“ESG”) can be taken into account when considering the exercise of the Trustee Company's investment duties.
- 1.2 It remains our advice that that the Trustee Company's primary duty is to invest Scheme assets in the best financial interests of members and beneficiaries. It is consistent with that duty to take into account ethical and ESG issues where these are relevant financial factors.
- 1.3 However, it would be incompatible with the investment duties of the Trustee Company to operate a policy of investment exclusion on the grounds of non-financial considerations alone. To do so would be to fetter the exercise of the Trustee Company's discretion.
- 1.4 The Trustee Company must observe certain procedural duties when making investment decisions. It must take into account relevant considerations, it must not fetter its discretion, it must have the correct decision-making process (including consultation with the Scheme's participating employers) and it must take advice.
- 1.5 The Trustee Company must have regard to financial factors when considering how best to exercise its powers and duty to invest (including to retain or to disinvest) Scheme assets. Only once that has happened could the Trustee Company give consideration to any non-financial factors.
- 1.6 Non-financial factors should only be taken into account in limited circumstances, namely where the Trustee Company has good reason to believe that members would share its views and that there is no risk of significant financial detriment to the Scheme.
- 1.7 Consequently, where ESG or ethical considerations are non-financial factors (i.e. they do not pose a risk to the prospect of the financial success of the investment) these should not drive investment decisions. They are to be considered only once financial factors have been taken into account, and then only in the limited circumstances outlined above.
- 1.8 The Law Commission's reports, and the consequent Government consultations, have been helpful in clarifying the scope of trustees' fiduciary duties. Subsequently, the law has been changed to require certain amendments to the Statement of Investment Principles with effect from 1 October 2019.
- 1.9 Our advice relates to the investment duties of trustees of a defined benefit pension scheme. Different considerations apply in defined contribution schemes where members have a choice in where their funds are invested, albeit from a range of investments selected by the Trustee Company.

¹ USS Limited as sole corporate trustee of the Universities Superannuation Scheme

² Letter from DLA Piper to David Russell, 8 September 2006

2. THE LAW COMMISSION REPORT

- 2.1 There were a number of developments in relation to responsible investment between our advice in 2006 and revised advice in March 2016, (updated June 2019). In particular, the Law Commission was tasked by the Department of Business, Innovation and Skills, and by 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 the ultimate beneficiaries.
- 2.2 It is worth noting briefly the status of the Law Commission. The Law Commission is a statutory independent body created to keep the law under review and to recommend reform where it is needed. It has no power to make or change the law, only to recommend that the Government does so.
- 2.3 The Law Commission issued a consultation in October 2013 and published its final report on 30 June 2014.³ In summary, and so far as relevant to this advice, the Law Commission concluded that it did not advocate legislation to codify the law, noting that fiduciary duties are difficult to define and inherently flexible.⁴ It did, however, suggest that more guidance is needed⁵ and that this should be provided primarily by the Pensions Regulator in a new Code of Practice.
- 2.4 The Law Commission also considered potential changes to the Investment Regulations⁶, recommending that the Government review two particular aspects: the reference to "social, environmental or ethical considerations" as one of the matters to be included in the Statement of Investment Principles, and whether trustees should be required to state their policy (if any) on stewardship.
- 2.5 In response to the Law Commission's report, the DWP issued a consultation⁷ on changes to the Investment Regulations, and in November 2015 they published the response to that consultation.⁸ At that time, the Government did not propose any changes to the law. However, in November 2016 the Government did ask the Law Commission to look at the law governing how far pension funds may or should consider issues of social impact when making investment decisions. The Law Commission issued its findings and recommendations in June 2017.⁹
- 2.6 The Government published an interim response in December 2017 and a final response in June 2018¹⁰ on clarifying and strengthening trustees' investment duties. Following a period of consultation, the Government published final regulations in September 2018.¹¹ The proposals set out in those consultations and the responses are covered in more detail in section 6 below.

³ [Law Commission Report](#)

⁴ At paragraphs 7.36 to 7.37

⁵ At paragraphs 7.43 and 7.51 to 7.57

⁶ Occupational Pension Schemes (Investment) Regulations 2005 SI 2005/3378

⁷ Consultation on changes to the Investment Regulations following the Law Commission's report "Fiduciary Duties of Investment Intermediaries" 26 February 2015

⁸ The consultation and the response can be viewed [here](#)

⁹ [Report and Summary](#)

¹⁰ Pension Funds and Social Investment

¹¹ The interim response, final response and consultation can be viewed [here](#)

3. CURRENT LAW

The law, which has remained substantially unchanged in the area of investment duties since our 2006 advice was given, may be summarised as follows.

3.1 Where is the law?

As noted by the Law Commission,¹² the law comes from several sources including the scheme rules, legislation, duties which attach to a power and duties of care.

The Trustee Company has both a power and a duty to invest the assets of the Scheme in accordance with the very broad investment powers conferred on it under USS rules. The trust law duties of the Trustee Company in this regard have not changed in that trustee investment powers must be used solely for the purposes for which they were conferred and exercised in accordance with fiduciary care and skill in a prudent manner. USS is a trust established for the provision of pensions and related benefits. The investment powers of the Trustee Company must accordingly be exercised so as to fulfil the objective of having an investment policy which is designed to enable those benefits to be provided.

3.2 The statutory duty

Under Section 36(1A) Pensions Act 1995 when read with regulation 4 of the Investment Regulations, the Trustee Company must exercise its investment powers in the best interests of members and beneficiaries, and in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. The Regulations go on to specify further requirements in relation to the exercise of investment powers, including that the assets must be invested in a manner appropriate to the nature and duration of the scheme's liabilities. This emphasises the long term nature of the Trustee Company's investment policy. Assets must also be properly diversified so as to avoid excessive reliance on any particular investment or accumulations of risk in the portfolio as a whole.

Any fund manager with a discretionary mandate in respect of USS investments must have regard to the same criteria when exercising its delegated investment powers.

3.3 Case law: best interests of members and beneficiaries

Pension scheme assets must be invested in the best interests of the members and beneficiaries of the Scheme and in the case of any potential conflict of interest, in the sole interest of those members and beneficiaries. Both *Cowan v Scargill* (1984) and *Bishop of Oxford v the Church Commissioners* (1991)¹³ are clear authority for the view that the best interests of beneficiaries of a pension scheme is their best financial interests. This is also consistent with the primary purpose of a pension trust which is to deliver financial benefits for the members and beneficiaries of the Scheme. The Judge in the *Cowan v Scargill* case puts the position clearly as follows:¹⁴

"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. In the case of a power of investment, as in the present case, the power must be

¹² At paragraph 7.35

¹³ [1991] PLR 185

¹⁴ [1984] 2 All ER 750 at paragraph 41

exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question and the prospects of the yield of income and capital appreciation; both have to be considered in judging the return from the investment".

3.4 Case law: risk across the portfolio as a whole

The Trustee Company's powers of investment must also be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. The courts have recognised that the concept of risk must adapt to current economic conditions and contemporary understanding of the markets¹⁵. Accordingly, trustees are "*entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment in isolation*".¹⁶

3.5 Trustee duties

When exercising its investment powers, the Trustee Company has a duty to take all relevant and material considerations into account. The Trustee Company owes a duty to exercise care, skill and diligence on a prudent person standard and must apply the special knowledge and experience which the Trustee Company possesses (both on the Investment Committee and through USS Investment Management Ltd).

3.6 Challenging trustee decisions

As a general principle, the courts will not interfere in a trustee decision properly made. This is equally true of investment decisions where the court will not be concerned with the outcome of the investment, but rather that the trustees made the decision in the right way and took into account the right considerations.

4. APPLICATION OF THE ABOVE PRINCIPLES TO "RESPONSIBLE INVESTMENT"

4.1 Terminology: financial and non-financial factors

It is apparent from the Law Commission's report that clarity is needed around terminology, with references to "ESG"¹⁷ or "ethical" being potentially misleading. Instead the Law Commission refers to "financial factors" and "non-financial factors".¹⁸ This is now reflected in the Investment Regulations (see section 6 below).

Financial factors are those which are relevant to increasing returns or reducing risks. Non-financial factors are motivated by broader concerns such as improving members' quality of life or showing disapproval of certain industries.

4.2 Extent to which ethical and ESG factors can be taken into account

It is clear that trustees *may* take ethical, environmental, social and governance factors into account. Where ethical, environmental, social or governance issues can be regarded as having a current or potential financial impact on an investment, whether from the point of view of

¹⁵ See *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260

¹⁶ *Nestle v National Westminster Bank plc* (1996) 10(4) Trust Law International 112 at 115

¹⁷ Environmental, social and governance

¹⁸ See paragraphs 5.61 and 5.62, and Chapter 6

expected return, liquidity or underlying capital value it is in our view entirely consistent with the Trustee Company's duties referred to above to take those considerations into account.

This is the case both for investment, and disinvestment. A decision to retain an investment, or to disinvest, is subject to the same legal considerations, including as to ethical and ESG factors, as a decision to make the investment. Where the impact of those factors is assessed by the Trustee Company to be sufficiently serious, it may lead to a decision not to make an investment or to disinvest from it.

4.3 Non-financial factors

It is clear that the law is sufficiently flexible to allow non-financial considerations to be taken into account but these should not inhibit the proper exercise of the Trustee Company's powers. Non-financial factors should be second order, i.e. only taken into account once the financial factors have been considered. We consider this further in paragraph 4.4 below.

We would also note the Law Commission's conclusion that non-financial factors should be taken into account only in limited circumstances, namely where the Trustee Company has good reason to think that members would share their view, and there is no risk of significant financial detriment to the Scheme. We agree with this conclusion.

As noted above non-financial factors only fall to be considered after financial factors have been taken into account. If decisions are then made taking non-financial factors into account which could have a significant detrimental financial impact on the Scheme, this could prejudice the proper fulfilment of the duty to act in members' best financial interests. The Law Commission also notes in this context that trustees of defined benefit schemes have to weigh their duties to members against any possible threat to the employer's ability to make contributions and not impose burdens which "*imperil the continuity and proper development of the employers' business*". It notes that trustees should not become distracted from these core tasks by the consideration of non-financial factors.¹⁹

We would make three further observations, all on the subject of members' views. The first is that in order to take account of non-financial factors when setting investment strategies and making investment decisions, the Trustee Company would need to have good reason to think that members shared its concerns. Trustees may not impose their own ethical views on their beneficiaries but must act in the best interests of those beneficiaries. Ultimately investment is a trustee decision, having exercised "fair and impartial judgment".²⁰

Second, whilst the Trustee Company may take members' views into account, it is not under any obligation to do so.²¹ The Trustee Company must make the ultimate decision and it should not fetter that decision by ruling out particular investments or classes of investment on non-financial grounds, whether on account of their own views or the views of members. This was confirmed by the Government in its response to the 2018 consultation.²²

The final observation that we would make, and which is also made in the Law Commission's report,²³ and repeated in its 2017 recommendations,²⁴ is that the views of a member or group

¹⁹ At paragraph 6.82

²⁰ *Martin v City of Edinburgh District Council* (1989) Pensions LR 9 at 33

²¹ A conclusion shared by the Law Commission, see paragraph 6.82

²² See Ministerial Foreword and paragraphs 27 to 46 of the response

²³ At paragraphs 6.57 to 6.67

of members may not be shared by other members. The Trustee Company has a duty to the membership as a whole and it would not be appropriate potentially to prejudice the position of one group of members by selecting (or excluding) investments on non-financial grounds supported by another group of members. That does not necessarily mean that there has to be unanimity amongst members, but it does mean that the Trustee Company should not act in accordance with some members' views without more evidence of the views of the wider membership.

4.4 Policy of investment exclusion

We were specifically asked in 2006 to advise in relation to whether it is appropriate for the Trustee Company to operate a policy of investment exclusion. We can see no difficulty from a legal point of view in selecting investments with a particular ethical, environmental, social or governance profile as part of building a balanced and properly diversified portfolio, including "screening in" investments that are expected to yield an attractive return because of those factors. Similarly it is right to exclude investments where there are concerns that ethical, environmental, social and/or governance factors could pose a risk to the financial success of the investment.

It is important to draw a distinction between (a) an assessment of the likely financial impact that the failure to meet particular ESG standards will have on the return or value of an actual or contemplated investment and (b) the ethical or moral aspects of that failure in the absence of any such financial impact, or as the Law Commission puts it, between financial and non-financial factors.

The courts in both *Cowan v Scargill* and in *Bishop of Oxford v the Church Commissioners*, go out of their way to stress that it is not the role of the trustees of a pension scheme or other trust whose objects are to produce financial benefits for the beneficiaries to exclude certain investments solely on moral or other non-investment grounds. It is not for the trustees to impose their own moral, ethical or political views on members; instead they must do their "best to exercise fair and impartial judgment" in the interests of their beneficiaries.²⁵ Both cases concede that for certain charitable trusts with very specific charitable objects, it is possible to conclude that particular investment decisions may be repugnant to what may be considered to be the views of the generality of those who benefit from the trust. Examples are given of the trustees of a cancer charity deciding that its investments should not include tobacco companies and the trustees of a temperance charity deciding that its investments should not include companies which manufacture alcohol.

In *Cowan v Scargill*, the Judge added the following:²⁶

"But I would emphasise that such cases are likely to be very rare, and in any case I think that under a trust for the provision of financial benefits, the burden would rest, and rest heavy, on him who asserts that it is for the benefit of the beneficiaries as a whole to receive less by reason of the exclusion of some of the possibly more profitable forms of investment..... Under a trust for the provision of financial benefits, the paramount duty of the Trustees is to provide the greatest financial benefits for the present and future beneficiaries."

²⁴ At paragraphs 1.46 to 1.48 of the Summary

²⁵ See *Martin* above

²⁶ Paragraph 48

The courts have recognised that a consensus or majority view from beneficiaries may affect the investment decisions made in certain charitable trusts. However, we do not see that this provides any authority for the proposal that such a principle might be applied in the differing context of USS, which is not a charity and does not have charitable objects.

The Law Commission is undertaking a separate review on investment by charitable trusts, but it notes in this report that a charity can invest having regard both to financial return and the investments which best further the objects of the charity.²⁷ It also notes that particular regard may be had to members' views where a pension scheme is established by an "affinity group"²⁸ which shares a particular moral or political viewpoint.

As noted above, USS is not a charity and does not have charitable objects; its function is solely to provide pensions and related benefits to its beneficiaries. Neither it is established by an affinity group, but instead has a significant number of sponsoring employers, and a large and diverse membership. As noted at paragraph 4.3 above, it would not be appropriate for the Trustee Company to act on the views of one group of members without more evidence of the views of the wider membership. Similarly, the Trustee Company is required by statute to consult with the employers in relation to its investment strategy. In doing so it must consider the views of the employers generally having regard to the overall financial health of the Scheme, and therefore the impact on all employers under the cost sharing arrangements.

We should also take this opportunity to note that although some participating employers in USS have charitable status, USS itself is not a charitable trust. Once contributions have been paid into the Scheme they become Scheme assets and the Trustee Company is bound to invest those assets in a manner consistent with the legal obligations set out in this paper.

The right approach in law for the Trustee Company is therefore to pay regard only to financial factors, and not to some extraneous moral factor, when considering how best to exercise their investment powers. Only once that process has been undertaken, and in the limited circumstances outlined above, should consideration be given to non-financial factors. Those non-financial factors should not drive the investment decision.

4.5 A further note about charitable trusts - Opinion of Mr McCall QC

We have been made aware of an Opinion from Leading Counsel on the subject of "*The powers and duties of charity trustees as to ethically questionable investments with specific reference to carbon intensive assets*".²⁹ Counsel was instructed by a firm of solicitors acting on its own account but Counsel has agreed to the publication of the Opinion for general consumption.

The Opinion is specific to charitable trusts and is therefore of limited application to a multi-employer pension trusts such as USS. However, it does touch on the duties of other fiduciaries and we summarise below some of the relevant conclusions from the Opinion.

4.5.1 Counsel concludes that "*investment is a word which denotes the intent to secure a financial return for the beneficiaries and so the starting point when investing is to*

²⁷ Paragraphs 1.28 and 1.31

²⁸ Paragraph 6.93

²⁹ Opinion of Mr Christopher McCall QC, November 2015 available [here](#)

seek to find the best financial returns in the market, whilst having regard to the need to manage risk."³⁰

- 4.5.2 Counsel notes³¹ that the risk of paying too much for an investment because its price does not properly reflect the cost to the investee business of taxes, duties or other regulation designed to offset a social cost is a consideration that must properly be taken into account by any fiduciary, including pension fund trustees. He goes on to note that it will be hard for charity trustees to justify the exclusion of certain assets from the range of assets open to them unless it is possible to combine financial doubts with what those trustees consider to be relevant social or environmental doubts as well. This is consistent with our conclusions at paragraphs 4.2 and 4.4 above.
- 4.5.3 He also notes³² that where the financial considerations applicable to two alternative investment strategies are such that either could be justified, then trustees have discretion to make their choice on ethical grounds. This is consistent with our conclusion that non-financial grounds are only to be taken into account once financial factors have been considered (see paragraph 4.3 above).
- 4.5.4 Even in the case of charity trustees, Counsel urges caution before using charitable trust assets to make moral or ethical statements unless it is necessary or permissible to do so to achieve the purposes of the charity.³³

5. APPLICATION OF THE ABOVE PRINCIPLES TO DEFINED CONTRIBUTION INVESTMENTS

The focus of this paper is on the Trustee Company's duties to invest the assets of the defined benefit section of the Scheme. However, as USS is now a hybrid scheme, with both defined benefit and defined contribution benefit structures, it is worth noting the application of the investment obligations to the selection and monitoring of defined contribution (DC) investment options.

The statutory framework that applies to defined benefit schemes applies in substantially the same terms to defined contribution schemes. There is also additional legislation and supporting guidance from the Pensions Regulator for DC schemes, covering such matters as fees, value for money and governance, and providing for increased transparency. Evidence suggests that a considerable proportion of DC scheme members are not engaged with pensions and do not make active investment choices. Much of the legislation and regulation is therefore focused on trustees providing and monitoring a suitable default fund, and this is also the primary focus of the sections of the Law Commission's report dealing with DC arrangements.³⁴

However, the Report does note that trust law must be interpreted flexibly in order to fit the fundamentally different risk model of DC. In a DC scheme, members bear both the benefits

³⁰ Paragraph 35 of the Opinion

³¹ Paragraph 4 of the Opinion

³² Paragraph 14 of the Opinion

³³ Paragraph 20 of the Opinion

³⁴ Chapters 8 & 9

and the risk of the investment decision. Members should therefore be able to make informed ethical choices. The Law Commission notes that where trustees are faced with members' clearly articulated views, they should attempt to provide a suitable choice of funds.³⁵

6. CHANGE TO THE INVESTMENT REGULATIONS

Whilst the Law Commission concluded that no codification of the law on fiduciary duties was required, it did conclude that the Government should consider two changes³⁶ to the Investment Regulations.

6.1 Statement of Investment Principles (SIP): statement on ESG

Prior to 1 October 2019, the Investment Regulations provided that the SIP has to contain a statement on "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments".³⁷

The Law Commission concluded in its 2014 report that this does not help trustees to understand what factors they should take into account in their investment decisions, and recommended that the Investment Regulations be clarified to separate out financial and non-financial factors. This recommendation was repeated in the June 2017 report. The Government initially concluded (in its response to the 2016 consultation) that changing the Investment Regulations would not necessarily lead to greater clarity for trustees and that guidance would be more effective in this area than regulatory change.³⁸ However, the position changed following the Law Commission's 2017 report, and the Government proposed changes to the Investment Regulations.

With effect from 1 October 2019, Regulation 2(3) has been amended.³⁹ The former requirement (summarised above) has been replaced with a requirement to include in the SIP a statement covering:

- (a) "financially material considerations over the appropriate time horizon of the investments, including how those considerations are taken into account in the selection, retention and realisation of investments; and
- (b) the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments."

"Financially material considerations" include (but are not limited to) environmental, social and governance considerations (including but not limited to climate change) which the

³⁵ At paragraph 6.83

³⁶ Three areas were put forward, but only two are relevant here. The third relates to the application of the Investment Regulations to small schemes of fewer than 100 members

³⁷ Regulation 2(3)(vi)

³⁸ See paragraph 23 of the Response to Consultation

³⁹ The Pension Protection Fund (Pensionable Services) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 SI 2018/988

trustees consider financially material.⁴⁰ The “appropriate time horizon” is the duration of the liabilities of the scheme, not the duration of the investments themselves.

“Non-financial matters” are defined as the views of the members and beneficiaries, including (but not limited to) their ethical views and views in relation to social and environmental impact and present and future quality of life of the members and beneficiaries.

It is clear from the consultation response and the wording of the Regulations that any policy on non-financial considerations is voluntary, although if trustees do not have a policy they should say so in the SIP.

6.2 Compliance with the UK Stewardship Code

The Law Commission also concluded that it is in the interests of pension funds to engage with the companies in which they invest, whilst noting that there is no legal obligation to comply with the Code. Again, the Government consulted on changing the Investment Regulations explicitly to require trustees to state that they comply with Code, or to explain why they have not done so. Responses to the consultation were mixed and the Government has decided not to legislate in this regard.

In common with many UK pension funds, USS does comply with the Stewardship Code; indeed it was one of the founder signatories in 2010. It is also a signatory to the Principles for Responsible Investment and publishes a considerable amount of information on its website about its approach to responsible investment. It has also set out its approach to investment in particular asset classes in its PRI USS RI Transparency Report.⁴¹ USS therefore goes beyond its legal duties in terms of its approach to stewardship, and also to communicating its approach to responsible investment, including ESG factors and stewardship, with members and beneficiaries.

6.3 The legislative requirement for trustees to set out in the SIP their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to the investments are also updated with effect from 1 October 2019. The new reporting obligation is to set out the trustees’ policy in relation to the exercise of rights (including voting rights) attaching to investments and in relation to undertaking engagement activities in respect of the investments. Engagement with asset managers

Further changes are to be made to the Investment Regulations⁴² to ensure compliance with the second EU Shareholders’ Rights Directive.⁴³ These Regulations will further amend Regulation 2(3) of the Investment Regulations to require trustees to include in the SIP their policy in relation to any arrangement with an asset manager, setting out certain matters or explaining the reasons why any of those matters are not set out. One of the matters to be included is how the arrangement with the asset manager incentivises the manager to align its investment strategy and decisions with the trustees’ policies on the matters contained in Regulation 2(3)(b). This includes the two new provisions relating to financially material considerations and non-financial matters referred to in 6.1 above. Trustees will therefore need to state their policy on how the asset manager’s investment strategy and decisions align with the trustees’ own in relation to ESG matters.

⁴⁰ New Regulation 2(4) of the Investment Regulations as amended

⁴¹ [PRI Transparency Report](#)

⁴² The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 SI 2019/982

⁴³ EU 2017/828

SIPs will need to be updated to include these matters by 1 October 2020.

6.4 Publication of the SIP and reporting on compliance with policies

The 2019 amendments also impose a new obligation on trustees of defined benefit schemes to make their SIP freely available on a website by 1 October 2020.

Trustees will also need to repeat their policies on financially material considerations, non-financial matters, voting rights and asset manager engagement in the scheme's annual report. This obligation will apply from 1 October 2020.

In addition, trustees will need to prepare a statement each year setting out how, and the extent to which, in the opinion of the trustees, their policy in relation to voting rights and engagement activities referred to in 6.2 above has been followed during the year and describing voting behaviour over that year. This statement must also be made freely available on a website by 1 October 2021.

7. CONCLUSIONS

- 7.1 The Trustee Company must comply with its duties both under trust law and legislation.
- 7.2 Specific investment or sector exclusions are permitted only insofar as they are consistent with the above duties of the Trustee Company and with the purpose for which the investment powers must be exercised.
- 7.3 The courts have recognised that pension fund trustees need to ensure proper diversification of their assets in order to ensure that the risks are properly spread and to ensure that the assets are invested in a manner appropriate to the nature and duration of the scheme's liabilities. This in turn means that a long-term view has to be taken, and that in turn must properly involve the consideration of financial factors, including ethical, environmental, social and governance factors which could have an impact on the success of that investment.
- 7.4 Pension scheme trustees are expressly required to exercise their investment powers in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. It is clear that ethical, environmental, social and governance factors can be relevant here as regards asset allocation, the choice of particular categories or sectors of investment and for the portfolio as a whole. However, this is only where those factors could have a financial impact on those investments.
- 7.5 The right approach in law for the Trustee Company is to pay regard to financial factors, and not to some extraneous moral factor, when considering how best to exercise their investment powers. Only once that decision is made can they consider non-financial factors (noting that they need not do so). Non-financial factors may, however, only be taken into account in limited circumstances, namely where the Trustee Company has reason to believe that the membership shares its view and there is no risk of significant financial detriment to the Scheme. It is clear that non-financial factors should not drive the investment decision.
- 7.6 USS has a policy of constructive engagement which is consistent with the trust law and Pensions Act duties of the Trustee Company, without any legal obligation being imposed on the Trustee Company to operate a policy of exclusion by reference to pre-set criteria. There is judicial comment, referred to above, to the effect that it is not the role of trustees to attempt to reconcile conflicting moral positions as regards investment of funds under their stewardship in trusts for the provision of financial benefits.

DLA Piper UK LLP
21 October 2019