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UN FORUM SERIES – The UK Local Government Pension Scheme: Can pooled and passive funds adequately address human rights?

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Pensions and Investment Research Consultants (PIRC) has a number of local authority clients who manage their pension funds either directly or through an asset manager. Many of these funds have either passive or pooled investments.

UK Chancellor George Osborne has said that these funds must be further pooled into six sovereign wealth funds. The details of the reform have not been defined. However, the changes might well include further passive investments in order to save costs.

This new mandate could cause problems for local authority pension funds in relation to the United Nations Guiding Principles on Business and Human Rights (UNGPs) in at least three respects.

1

States must protect against human rights abuse within their territory and/or jurisdiction by third parties, including business enterprises. This requires taking appropriate steps to prevent, investigate, punish and redress such abuse through effective policies, legislation, regulations and adjudication (UNGP 1).

It is not entirely clear whether local authority pension funds would be considered state entities or business entities, or whether this status changes when they outsource their investing to asset managers. However, the UNGPs make clear that

- “States should take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State, or that receive substantial support and services from State agencies such as export credit agencies and official investment insurance or guarantee agencies, including, where appropriate, by requiring human rights due diligence.”
- “[T]he closer a business enterprise is to the State, or the more it relies on statutory authority or taxpayer support, the stronger the State’s policy rationale becomes for ensuring that the enterprise respects human rights.”
- States are obliged to “[e]nsure that other laws and policies governing the creation and ongoing operation of business enterprises...do not constrain but enable business respect for human rights.”

Therefore, it would appear that local authority pension funds have either a duty or a responsibility to ensure that the companies in which these funds invest are human rights-compliant, and that asset managers they engage to manage their investments will need to conduct human rights due diligence, as defined by the UNGPs, in certain circumstances.

However, if local authority pension funds are required to pool assets or hold passive investments, they may not have direction over the companies in which they are invested. Therefore, depending on how the reforms are implemented, it could be difficult for them to measure their holdings and take appropriate steps, as suggested above, to ‘prevent, investigate, punish and redress’ such abuse.

In this case, they will be reliant on effective human rights due diligence, conducted either by their own teams or by asset managers, in order to take appropriate steps.

2

Human rights due diligence... should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships (UNGP 17).

Local authority pension funds have a two-pronged obligation or responsibility here. They cannot cause or contribute to adverse human rights impacts through their own activities, but more likely than not, this duty and/or responsibility will be relevant to the second prong – they cannot cause or contribute to activities directly linked to their operations, products or services by their business relationships that abuse human rights.

This provision pertains both to the activities of asset managers and of businesses in which they invest. Additionally, the Norwegian NCP has made it clear in the NBIM case that both asset managers and minority shareholders are subject to these provisions under the OECD Guidelines.

However, if funds hold pooled and/or passive investments, it can be difficult to maintain effective stewardship of their holdings and therefore the extent to which they cause or contribute to adverse human rights impacts, especially if asset managers are not transparent about the extent of fund holdings. Consequently, both funds and asset managers, as part of their due diligence, will need to ensure that they are sufficiently transparent in their investing and reporting to allow the pension funds to uphold their duty to protect human rights and/or responsibility to respect human rights.

3

Where a business enterprise contributes or may contribute to an adverse human rights impact, it should take the necessary steps to cease or prevent its contribution and use its leverage to mitigate any remaining impact to the greatest extent possible. Leverage is considered to exist where the enterprise has the ability to effect change in the wrongful practices of an entity that causes a harm (UNGP 19, Commentary).

Again, because the status of local authority pension funds under the UNGPs is not certain, it is not clear whether some funds would have to use their leverage directly while others would have to work with their asset managers to do so on their behalf. Nonetheless, all of these funds would presumably be required to exercise leverage either directly or indirectly in relation to adverse human rights impacts by the companies in which they invest. Again, assessing leverage is very difficult if funds are pooled and/or passive.

With Chancellor Osborne calling for local authority pension funds to be amalgamated into six sovereign wealth funds that are largely pooled and possibly passive, there are concerns that this arrangement could exacerbate the problem of measuring the impact of local authority pension funds' investments on human rights. Presumably, the UK Government would argue that by pooling funds to facilitate infrastructure investments, the new arrangement will also facilitate the realization of human rights. However, without clear details on how such pooling will occur, it is equally unclear how any new arrangements will allow local authority pension funds to uphold their duty or responsibility to protect human rights.

For such new combined asset formations to be compliant with the UN Guiding Principles, active tracking and disclosure would be essential to assess whether local authority pension funds and asset managers were appropriately measuring, using or seeking to acquire leverage. This measurement requirement highlights a fundamental human rights challenge for Osborne's approach: funds might not be able to assess what appropriate steps are necessary to prevent, investigate, punish and redress adverse human rights impacts.

This direction of travel might cause problems for the UK, not just in relation to its ability to comply with the UN Guiding Principles, but also in fulfilling its obligation under international human rights law to take steps to protect human rights. Therefore, the Government will have to be careful in how it structures its proposed reforms to ensure that it does not outsource its human rights obligations to private entities and reduce its ability to take steps to protect human rights.

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