



CONSULTATION ON CLARIFYING AND STRENGTHENING INVESTMENT DUTIES OF PENSION TRUSTEES

Issued 16 July 2018

ICAEW welcomes the opportunity to comment on the consultation *Pension trustees: clarifying and strengthening investment duties* published by the Department for Work and Pensions on 18 June 2018, a copy of which is available from this [link](#).

We note that the short, four week consultation period (which is only one third the recommended 12 week period, see <https://www.gov.uk/government/publications/consultation-principles-guidance>) and was too short to allow ICAEW to undertake a detailed consultation with our members affected by these changes. Therefore, we have not been able to provide detailed responses to all the questions. We are also concerned about the DWP's ability to draw valid conclusions from the consultation exercise, given that respondents have had so little time to review the proposals.

This ICAEW response of 16 July 2018 reflects consultation with the Business Law Committee and the Corporate Governance Committee.

The Business Law Committee includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

Corporate Governance Committee members are drawn from the business and investment communities. The Committee informs our thought leadership and policy work on corporate governance issues and related submissions to regulators and other external bodies.

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Q1. We propose that the draft Regulations come into force approximately 1 year after laying, with the exception of the implementation report, which would come into force approximately 2 years after laying.

a) Do you agree with our proposals?

b) Do you agree that the draft Regulations meet the policy intent?

No specific comment.

Q2: We propose to require all trustees of all schemes which are obliged to produce a SIP to state their policy in relation to financially material considerations including, but not limited to, those resulting from environmental, social and governance considerations, including climate change.

a) Do you agree with the policy proposal?

The consultation paper is confusing in that it states that the proposals relate to requirements for the SIP and for the default fund (see paragraph 9 of the consultation) but Q2 does not make this clear nor does it ask for views on each aspect of this proposal.

The DB and DC environments are quite different and although there is recognition of the different impact of the proposals on DB and DC, further consideration could be given to the differences. In particular, DB schemes are being encouraged by the Pensions Regulator to consider funding, covenant and investment issues collectively as part of Integrated Risk Management. The nuances and intricacies of this approach clearly impact on investment decisions.

It is also relevant that environmental, social and governance considerations have been perceived historically to reduce return. Whilst less apparent when considering governance, such reductions in return are now less apparent and, given regulation in other areas, arguably enhance value. As such, such factors are now more likely to be part of investment decision making without the need for new regulations.

In such circumstances, the need for further regulation of pension schemes on one specific aspect of investment decision making could, therefore, be regarded as an unnecessary additional burden and, potentially, distract from more substantial risks such as covenant.

We note that the policy proposal requires that trustees state their policies in relation to an unlimited number of considerations, because DWP do not want to be too prescriptive and industry terminologies, in time, may change. However, as currently drafted the regulations do not restrict these ESG considerations to those with financially material significance (see our comments at (b) below) and therefore the draft regulations need to be corrected otherwise it may be unworkable (ie where should trustees draw the line as to what they should take into account)..

There is also concern that, although the consultation explicitly states there is no such intention, in time, the requirement for pension schemes to invest in certain manners becomes prescriptive.

b) Do the draft Regulations meet the policy intent?

The consultation paper on p18 states “the Law Commission made clear in their 2014 response that trustees’ fiduciary duty is to take account of financially material considerations, whatever their source. Where environment, social or governance risks or opportunities are financially material, trustees should take account of them” and the DWP are seeking to implement the Law Commission recommendations.

However, the draft regulations simply define ESG considerations as “financially material considerations”, which is misleading and moreover does not meet the policy intent because not all ESG considerations will be financially material and therefore the new definition of “financially material considerations” must include a qualification along the lines of “to the extent they are financially material”.

Q3: When trustees prepare or revise a SIP, we propose that they should be required to prepare a statement, setting out how they will take account of scheme members’ views.

a) Do you agree with the policy proposal?

b) Do the draft Regulations meet the policy intent?

The question here is misleading because the proposed draft regulations would require trustees to state the extent to which members’ views have been taken into account, whereas this question 3 is asking whether trustees should be required to state how members’ views are taken into account, which is not the same thing as this latter wording implies that member views must have been taken into account. We support the drafting of the regulations, ie a requirement for trustees to state the extent to which members’ views have been taken into account.

As explained in response to Q2, consideration should be given to the different structures of DB and DC schemes. In particular, the concept of seeking members’ views seems not directly relevant and, more importantly, impractical in the context of a DB scheme because members are not directly subject to investment risk.

In a DC scheme, we agree that there should be sufficient choice of investments to satisfy member needs and in those schemes there could be some value in seeking members’ views when deciding what range of funds to offer. However, as we explain in more detail below, there is a risk that the collection of views is costly, the identification of a consensus difficult and undue consideration given to matters that are not relevant. Whatever the outcome of such a process, there will always be some individuals or groups that are dissatisfied, and these proposals could lead to trustees being subject to increasing levels of lobbying from protest groups.

Trustees are required to take professional advice regarding investment strategy and the SIP. However, most members are not experts and how schemes collect information as to member views could result in bad outcomes. For example, if a member is asked to tick a box to pick what DC funds they would like, some people will tick everything, some will tick the first one, some will be blindly pick. The Trustees have no way of knowing who is making an informed choice and who isn’t. We acknowledge that the draft regulations leave it to the reasonable discretion of the trustees as to how to assess member views, which could, for example, be to set up small focus groups of members, rather than surveying all members. We therefore support this approach of leaving it to the reasonable discretion of the trustees as this is not overly prescriptive, and actually may provide trustees with an opportunity to manage increasing pressure from action groups. However, the proposed draft Statutory Guidance is misleading in respect of this new requirement as it states that schemes are required to publish a statement on “how members’ views are taken into account”, which implies that member views must have been taken into account (whereas the requirement in the proposed regulations is to state the extent to which members’ views have been taken into account) and therefore this should be amended to be in line with the draft regulations (see also Q10 below).

Although this may take place through the advisers for most schemes, to avoid the risk that trustees mistakenly believe they should canvass all members, it would be useful if TPR could monitor implementation and supplement with guidance setting out examples of best practice.

Q4. Do you agree with our proposal not to require trustees to state a policy in relation to social impact investment? If not, what change in legislation would you propose, and how would you address this risk of trustee confusion on this point?

Agreed.

Q5: We propose that trustees should be required to include their policy in relation to stewardship of the investments, (including monitoring, engagement and voting) in the SIP.

a) Do you agree with the policy proposal?

b) Do the draft Regulations meet the policy intent?

This is an extension of the requirements of the Stewardship Code and this is a positive. The difficulty that needs to be considered is the pooled nature of many investments made by trustees and how the policy can be made meaningful.

Q6: When trustees of relevant schemes produce their annual report, we propose that they should be required to: - prepare a statement setting out how they have implemented the policies in the SIP, and explaining and giving reasons for any change made to the SIP, and - include this implementation statement and the latest statement outlining how trustees will take account of members' views in the annual report.

a) Do you agree with the policy proposal?

b) Do the draft Regulations meet the policy intent?

No. This would be an additional burden on trustees and the annual report is not widely seen as a document through which members receive information and, more importantly it is not a document that members refer to. (For example, of the 77,000 members in one hybrid plan, less than 5% access the electronic version of the document and no one asked for a printed copy last year). Furthermore, the annual report is already extensive, and most members are bewildered by it.

Even if this disclosure is not required to be included in the annual report, we do not believe that member interest is driving these proposals and (as we explain at Q7 below) we believe that member interest generally is likely to be low so we query the value in preparing it; it will be an increase in governance burden and will it actually help members?

Regarding the proposal for an implementation report, we note that it is currently not uncommon in practice for there to be a time lag between the trustees revising their investment strategy and implementing these changes and any such changes being reflected in a revised SIP. These proposals could pave the way for helping reduce such discrepancies for example, when considering changing investment strategy, the trustees could at the same time propose changes to the SIP to discuss with the employer so that changes to the investment strategy and SIP are made at the same time.

Q7: We propose that trustees of relevant schemes should be required to publish the SIP, the implementation report and the statement setting out how they will take account of members' views online and inform members of this in the annual benefits statement.

a) Do you agree with the policy proposal?

b) Do the draft Regulations meet the policy intent?

This is consistent with the transparency now being made available to DC members but would be an additional burden on trustees (and, as we mention at Q3 above, could lead to trustees being subject to increasing levels of lobbying from protest groups) and member interest is likely to be very low so there is little actual value to preparing and publishing this information. If publication is intended to improve the quality of SIPs by promoting best practice, then we question why this proposed publication requirement is limited to money purchase schemes. There could also be unintended consequences from this publication requirement, eg SIPs could become very high level with the detail moved to underlying documents (we acknowledge SIPs need to contain principles rather than prescription, but the requirement to publicise them could tip the balance too far meaning SIPs no longer include sufficient detail).

However, if publication is deemed necessary, we would prefer that this was by way of making the documents available electronically (rather than including them with the annual report – see also Q6 above).

Q8: Do you have any comments on the business burdens and benefits, and wider non-monetised impacts we have estimated in the draft impact assessment?

The additional costs of seeking member views and assessment of these by the trustees could become substantial and introduce pressures on governance time/budgets

Q9: Do you have any other comments on our policy proposals, or on the draft Regulations which seek to achieve them?

No

Q10: Do you agree that the revised Statutory Guidance clearly explains what is expected of trustees in meeting their duty to publish the SIP, implementation statement, and statement of members' views?

No.

For example, this guidance is misleading in that at paragraph 14 it states that schemes are required “amongst other things” to publish a statement on “how members’ views are taken into account”. This wording implies that member views have been taken into account (whereas the requirement is to state the extent to which members’ views have been taken into account). The ‘amongst other things’ wording is also very unhelpful. See also our comments at Q3 above.

In general, given Statutory Guidance is inflexible, any meaningful guidance should instead be issued as tPR guidance. Although implementation of these changes will take place through the advisers for most schemes, it would be useful if TPR could monitor implementation and supplement with guidance setting out examples of best practice.

Q11: What evidence or views do you have of how well the other requirements in the SIP are working? What areas for further consideration and possible future change would you suggest?

None