Consultation on clarifying and strengthening trustees’ investment duties

The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018

June 2018
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Introduction

This consultation seeks views on the draft Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018. These proposed Regulations would amend the required content of the Statement of Investment Principles (SIP), and the steps which trustees need to take when revising it, or preparing it for the first time. They would also require trustees of schemes offering money purchase benefits, subject to certain limited exceptions, to publish the SIP, and publish an annual report on how they implemented it, and tell members of its availability via the annual benefit statement.

About this consultation

Who this consultation is aimed at

- pension scheme trustees and managers;
- pension scheme members and beneficiaries;
- pension scheme service providers, other industry bodies and professionals;
- civil society organisations; and
- any other interested stakeholders

Purpose of the consultation

This consultation seeks views on both the policy proposals and the draft Regulations as described in this document.

Scope of consultation

Pensions policy is a reserved matter in Scotland and Wales, this consultation therefore applies to England, Wales and Scotland. It is anticipated that Northern Ireland will make corresponding legislation.

Duration of the consultation

The consultation period begins on 18 June 2018 and runs until 16 July 2018. Please ensure your response to the draft Regulations reaches us by that date as any replies received after that date may not be taken into account.
How to respond to this consultation

Please send your consultation responses to:
Sinead Donnelly and Vicky Bird
Department for Work and Pensions
Strategy Policy and Analysis Group
Private Pensions and Arm’s Length Bodies Directorate
Ground Floor North
Quarry House
Leeds
LS2 7UA

Email: PENSIONS.FIDUCIARYDUTY@DWP.GSI.GOV.UK

Government response

We will aim to publish the government response to the consultation on the GOV.UK website. The consultation principles encourage Departments to publish a response within 12 weeks or provide an explanation why this isn’t possible. Where consultation is linked to a statutory instrument responses should be published before or at the same time as the instrument is laid.

The report will summarise the responses.

How we consult

Consultation principles

This consultation is being conducted in line with the revised Cabinet Office consultation principles published in January 2016. These principles give clear guidance to government departments on conducting consultations.
Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
1st Floor
Caxton House
Tothill Street
London
SW1H 9NA

Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:
Email: freedom-of-information-request@dwp.gsi.gov.uk

The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the Freedom of Information Act.
Chapter 1: Background and overview

Background

1. This section summarises the independent reviews, Law Commission reports and Government consultations which have led to these proposed regulatory changes.

The Law Commission’s report on fiduciary duty

2. The Kay Review of UK Equity Markets and Long-Term Decision Making\(^1\), published in 2012 identified concerns about how fiduciary duties were interpreted in the context of investment. In particular, some stakeholders reported confusion over fiduciary duties – there was a belief that these required trustees to maximise returns over a short timescale, precluding consideration of long-term factors which might impact on company performance.

3. Accordingly, one of the Review’s recommendations was that the Law Commission should be asked to review the legal concept of fiduciary duty as applied to investment, to address uncertainties and misunderstandings on the part of trustees and their advisers.

4. The then Department of Business, Innovation and Skills and the Department for Work and Pensions accepted this recommendation\(^2\) and tasked the Law Commission to give effect to the Review’s recommendation.

5. The Law Commission’s report\(^3\), published in July 2014 did not focus on recommendations for legislative reform, but explained the nature of fiduciary and other duties to act in the best interests of savers. It concluded that trustees should take into account factors which are financially material to the performance of an investment, whatever their source. It also concluded that trustees could make investment decisions based on members’ views, subject to a 2-step test being met.

6. Some changes to the Occupational Pension Schemes (Investment) Regulations 2005\(^4\) (“the Investment Regulations”) were however proposed, for the purposes of clarification. The Government consulted on several of these proposals in January

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\(^3\) Fiduciary Duties of Investment Intermediaries (LC350) - July 2014 - https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/

2015. At the time we did not find a compelling case for legislation. Our November 2015 response indicated that we believed guidance issued by The Pensions Regulator was likely to be sufficient to ensure trustees were aware of their responsibilities.

7. Guidance was issued by The Pensions Regulator via its trustee toolkit and separately in relation to Defined Contribution schemes and Defined Benefit schemes.

The Law Commission’s report on pension funds and social investment

8. The Law Commission was subsequently asked by the then Minister for Civil Society, Rob Wilson MP in 2016, to carry out a review of social investment by pension funds, including the extent to which the law allows pension funds to select an investment because it is thought that it would make a positive social impact.

9. The barriers to social investment by pension funds that the Law Commission identified in their June 2017 report were, in most cases, structural and behavioural rather than legal or regulatory. However, they also made some recommendations where the law could be improved so as to reduce the impact of these barriers. These recommendations were broadly similar to those identified in the 2014 report but were updated in light of developments within the pensions landscape.

The Government’s response to the Law Commission

10. In its interim response to the Law Commission, published in December 2017, the Government indicated that it was minded to accept the Law Commission’s proposals for changes to the Investment Regulations, and would consult on those proposed changes to policy and relevant regulations in 2018.

7 The trustee toolkit - https://trusteetoolkit.thepensionsregulator.gov.uk/
10 Pension Funds and Social Investment (LC374) – June 2017 - https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/
11. We have, on the basis of the evidence we have reviewed, concluded that despite The Pensions Regulator’s guidance, confusion and misapprehension over trustees’ responsibilities persists. Whilst there are clearly trustees who understand the issues, are actively engaging with them and are reviewing and where necessary amending their investment strategies accordingly, good practice appears to be far from universal.

12. As we noted in the Government’s interim response, there is evidence of trustees incorrectly thinking that environmental, social and governance risks are irrelevant to, or run counter to, financially material concerns. Research by the law firm Sackers\textsuperscript{12} found that:

   [Trustees] also consider ESG (Environmental, Social and Corporate Governance factors) and external governance reviews to be low priorities. Some participants were not sure what ESG meant... Some see ESG as a distraction or potentially detrimental to achieving the scheme’s goals.

13. ESG is defined in the FT Lexicon as:

   a generic term used in capital markets and used by investors to evaluate corporate behaviour and to determine the future financial performance of companies\textsuperscript{13}.

14. Examples of ESG considerations are:\textsuperscript{14}

   • Environmental: resource depletion, including water waste and pollution, deforestation.
   • Social: working conditions, including slavery and child labour; health and safety; employee relations and diversity; ageing populations; social unrest; local communities, including indigenous communities; and income inequality.
   • Governance: executive pay; bribery and corruption; board diversity and structure.

15. In this consultation, we use the term ESG to refer to considerations (opportunities \textit{and} risks) which affect returns on investing in those companies, or other entities, whether positively or negatively. There are many other considerations which may materially affect investment returns, and ESG factors are not always themselves financially material.

16. A survey by Professional Pensions\textsuperscript{15} found that more than half of respondents do not take ESG considerations into account when making or advising on investment

\textsuperscript{13} http://lexicon.ft.com/Term?term=ESG
\textsuperscript{14} https://www.unpri.org/pri/what-is-responsible-investment
\textsuperscript{15} https://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry
decisions, or think of climate change as a financially material risk to their investments or those of their clients.

17. Hermes Investment Management\textsuperscript{16} conducted a survey with institutional investors which echoed the findings of Professional Pensions. In addition a third of respondents did not believe that significant financially material ESG risks would justify rejecting an otherwise attractive investment. They explain there is confusion about the nature of ESG:

‘People believe it naturally excludes certain areas that have done well in recent years – tobacco stocks, for example. However, this is to misunderstand ESG, which is about understanding the long-term sustainability of a company and having strong governance. It is about being aware of the risks’.

18. The consultancy Grant Thornton have interviewed a number of asset owners to discuss their understanding and activities to date on the risk to their portfolios from the energy and climate transition. There are a number of organisations with an advanced understanding but in general, levels of adoption around this risk appear relatively basic. It seems that attitudes and implementation around other financially material risks are broadly similar.

19. In the interim response, we also indicated that Government planned to engage with stakeholders to identify approaches which are likely to be most effective in delivering the right level of evaluation and consideration. This consultation, which is published today alongside the Government’s final response to the Law Commission\textsuperscript{17} is the output of that consideration and engagement.


Why we propose to legislate

20. Our proposed Regulations are intended to reassure trustees that they can (and indeed should):

- take account of financially material risks, whether these stem from investee firms’ traditional financial reporting, or from broader risks covered in non-financial reporting or elsewhere;
- fulfill the responsibilities associated with holding the investments in members’ best interests – whether directly or by others on their behalf - not just through voting, but the full range of stewardship activities, such as monitoring, engagement and sponsoring or co-sponsoring shareholder resolutions;
- have an agreed approach on the extent, if at all, to which they will take account of members’ concerns, not only about financially material risks such as ESG, including climate change, but the scheme’s investment strategy as a whole; and
- use the SIP as a real, effective and regularly-reviewed guide to investment strategy and not as a generic ‘box-ticking’ document.

21. Independent reports commissioned by Government from the Green Finance Taskforce and the Advisory Group on Growing a Culture of Social Impact Investment in the UK have both supported action on the Law Commission’s recommendations to clarify trustees’ fiduciary duty.

Responsibility for investment strategy

22. For the avoidance of doubt, none of our proposals seek to direct pension scheme trustees to invest in line with scheme members’ wishes, or in line with Government’s policy objectives.

23. Government respects trustee independence and is not seeking to direct trustees’ investment or divestment decisions. These proposed Regulations do not seek to change that approach in any respect.

24. As the Law Commission have emphasised, the ability to take account of members’ wishes is permissive, and then only when the 2-stage test set out below is met.

- firstly, trustees should have good reason to think the scheme members hold the concern; and
- secondly, the decision should not involve a significant financial detriment.

25. The Law Commission made clear that where an investment issue is contested, as divestment from fossil fuels or from some regimes will generally be, the first stage

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of the test is not met. In these circumstances, the trustees should instead focus exclusively on financially material risks and opportunities, rather than seek to weigh up the relative strengths of views.

26. Therefore these proposals are not intended to give any support to activist groups for boycotts or divestment from certain assets. Trustees have primacy in investment decisions and, whilst they should not necessarily rule out the ability to take account of members’ views, they are never obliged to, and the prime focus is to deliver a return to members. The Law Commission’s advice on the duties and powers of trustees in this area is clear.

27. Instead the purpose of these proposed regulatory changes is to help dispel trustee confusion, and give institutional investors renewed confidence, if they so choose, to begin or increase the allocation of capital to investment opportunities such as unlisted firms, green finance and social impact investment.

28. Neither do we seek to dictate to trustees which opportunities and risks they should judge to be financially material. Trustees are required to come to their own conclusions about the materiality of risks, taking into account the advice they receive from their consultants. Nevertheless, sixteen of the largest investment consultants have agreed with the Association of Member Nominated Trustees (AMNT) and the UK Sustainable Finance and Investment Association (UKSIF) to recognise the importance of addressing risks around long term sustainability, including environmental, social and governance considerations, and to draw this to the attention of pension scheme trustees.

29. More broadly, however, the scientific and public policy consensus is that climate change is a financially material risk to our future. The financial analysis relied on by the market to determine valuations is often based on the extrapolation of short term cash flow estimates so longer-term risks are not necessarily priced into the market. Disruption to underlying asset values may also be rapid and unpredictable. Nico Aspinall a former Chair of the Institute and Faculty of Actuaries Resources and Environment Board has described attempts to time the market in relation to known financially material risks which have not yet landed as:

   “discovering you are driving towards a cliff and rather than just stopping safely, gunning it and hoping to halt right on the edge.”

30. Our expectation is therefore that the range of instances where trustees conclude that there is no requirement for consideration of financially material risks, including those arising from ESG, including climate change, to be limited and focused on very particular circumstances – for example imminent scheme wind-up. In these instances, whilst the risks with the underlying assets may continue to apply, trustees of schemes entering wind-up might feasibly argue that previously identified financially material considerations were unlikely to crystallise in the remaining lifespan of the scheme.

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20 All Swans are Black in the Dark: how the short-term term focus of financial analysis does not shed light on long term risks [https://www.genfound.org/media/1383/all-swans-are-black-in-the-dark.pdf](https://www.genfound.org/media/1383/all-swans-are-black-in-the-dark.pdf)
Overview of our proposals

31. Our informal engagement with trustees has told us that a Statement of Investment Principles can take as long as 6 months to prepare. We therefore propose to allow around a year between the laying of these regulations, which are subject to the negative resolution procedure, and the coming into force of the majority of the regulations to help trustees familiarise themselves with the changes.

32. The timing of laying regulations is subject to demands on Parliament’s time, but if the draft Regulations were to be laid in Autumn of this year, we would propose a coming into force date for the first measures of 1 October 2019. However, if the regulations were not laid until early 2019, most provisions would have a coming into force date of 6 April 2020.

33. For the purposes of this consultation and the draft Regulations we are assuming a September or October laying date.

34. We propose to require trustees to, by 1 October 2019:

- (where they are required to produce a Statement of Investment Principles (SIP)\textsuperscript{22}, update or prepare their SIP to set out:
  - how they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance (ESG) considerations, including climate change;\textsuperscript{23}
  - their policies in relation to the stewardship of the investments, including engagement with investee firms and the exercise of the voting rights associated with the investment;\textsuperscript{24}
- in relation to relevant schemes\textsuperscript{25} – broadly, schemes offering money purchase benefits, subject to a few exceptions, to:
  -

\textsuperscript{22} Exclusions from the requirement to produce a Statement of Investment Principles are shown in regulation 6 of the Occupational Pension Schemes (Investment) Regulations. 2005 (S.I. 2005/3378) (“the Investment Regulations”). These are principally schemes with fewer than 100 members, and schemes which are both established by or under an enactment (including a local Act) and guaranteed by a public authority.

\textsuperscript{23} Regulation 2(3)(a) and (4) of these draft Regulations amends paragraph(3)(b)(vi) of (and inserts paragraph (4) into) regulation 2 of the Investment Regulations.

\textsuperscript{24} Regulation 2(3)(b) and (4) of these draft Regulations amends paragraph(3)(c) of (and inserts paragraph (4) into) regulation 2 of the Investment Regulations.

\textsuperscript{25} “relevant schemes” is defined in the Occupational Pension Schemes (Scheme Administration) Regulations (S.I. 1996/1715) (“the Administration Regulations”) and cover occupational pension schemes offering money purchase benefits, other than the following:
- executive pension schemes and relevant small schemes (which will rarely, if ever, be required to produce a SIP anyway);
- schemes that do not fall within paragraph 1 of Schedule 1 (description of schemes) to the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (S.I. 2013/2734) (“the Disclosure Regulations”) – which principally excludes schemes which are not tax registered, and schemes which only provide death benefits;
o publish their Statement of Investment Principles on a website so that it can be found and read by both scheme members and interested members of the public, and inform scheme members of its availability via the annual benefit statement;

o prepare or update their default strategy\(^{26}\) to set out how they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance (ESG) risks, including climate change.

35. Secondly, we propose that from 1 October 2019:

- (where trustees are required to produce a SIP) when they next prepare or update their SIP, to prepare a separate ‘statement on member’s views’ setting out how they will take account of the views which, in their opinion, members hold, in relation to the matters covered in the SIP\(^{27}\).

36. Finally, from 1 October 2020, we propose to require trustees of relevant schemes which are required to produce a SIP to:

- produce an implementation report setting out how they acted on the principles set out in the SIP, and how they acted on the statement which covered how they would take account of the views which, in their opinion, members hold;
- publish that implementation report online in the same way as the SIP itself, and inform scheme members of its availability via the annual benefit statement.

37. Our intention in setting a later coming into force date for this last measure is that trustees should not be required to report on the implementation of a SIP which was produced under the ‘old’ requirements, and was not required to be published. Such an implementation report would be of considerably less benefit for members or other stakeholders.

38. We also anticipate that trustees will be much more confident and comfortable reporting on a SIP which they have prepared knowing that it is for wider public consumption than reporting on a potentially relatively generic SIP which had largely been produced for compliance purposes.

39. While we do not believe that SIPs in defined benefit schemes are uniformly of a higher standard, there are significant incentives already in place for employers to work with trustees to seek to improve them. We therefore propose that a narrower set of requirements should apply to DB schemes, and that these should be

- funded and unfunded public service pension schemes, as defined by section 318 of the Pensions Act 2004. In practice, we are aware of no such schemes which are required to produce a SIP or would be caught by this definition, were this inclusion not to apply;
- schemes which provide no money purchase benefits other than benefits which are attributable to additional voluntary contributions.

\(^{26}\) The requirements for the default strategy are set out in regulation 2A of the Investment Regulations, which was inserted by the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (S.I. 2015/879)

\(^{27}\) Regulation 2(2)(a), (b) and (c) of these draft Regulations amends paragraphs (2)(a) and (b) of (and inserts paragraph (2)(c) into) Regulation 2 of the Investment Regulations.
predominantly clarifying measures. More information on the details and the rationale behind each of these proposals is covered in the following diagram and in subsequent chapters.

Illustration of the effect of these proposals on different scheme types

<table>
<thead>
<tr>
<th>All benefits are money purchase ('pure DC')</th>
<th>Mix of non-money purchase and money purchase from sources other AVCs ('dual section')</th>
<th>Non-money purchase apart from AVCs ('almost pure DB')</th>
<th>Wholly non-money purchase ('pure DB')</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>C</td>
<td>C</td>
<td>A</td>
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<tr>
<td>B + C + D</td>
<td>B + C + D</td>
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<td>B</td>
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<table>
<thead>
<tr>
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<th>Less than 100</th>
<th>100</th>
<th>More than 100</th>
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<tr>
<td>A</td>
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<td>B</td>
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<td>B + C + D</td>
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<td></td>
</tr>
<tr>
<td>No new requirements</td>
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</tr>
</tbody>
</table>

By 1 Oct 2019 - Update SIP to take account of financially-material considerations (including ESG and climate change) and stewardship.

Next revision of SIP on or after 1 Oct 2019 - Statement on how members’ views are taken into account.

By October 2019 - Update default strategy to take account of financially-material considerations.

By 1 October 2019 – Publish SIP

From 1 October 2020 – Produce and publish implementation report on SIP.

Next revision of SIP on or after 1 Oct 2019 - Publish statement on how members’ views are taken into account.
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?

**Next steps**

40. Subject to the outcome of this consultation, we plan to lay the proposed Regulations at the earliest opportunity which the Parliamentary timetable allows. If the draft Regulations were to be made, we understand that The Pensions Regulator will update existing Codes and guidance for both DC and DB schemes and will consider what additional guidance may be helpful for trustees in understanding their duties.
Chapter 2: Accounting for financially material considerations and members’ views

1. This chapter sets out the Government’s proposals to take forward recommendation 1 from the Law Commission’s 2017 report. This recommended that the Government clarify the distinction between financially material risks and members’ views in the Occupational Pension Schemes (Investment) Regulations 2005.

2. This chapter:
   - offers a background to the current legislative provisions, and why the wording of certain requirements is unhelpful;
   - summarises the Law Commission’s recommendations; and
   - explains how we intend to meet those recommendations.

Financially material considerations

Current legislation

3. Current regulations— require trustees to report their policy 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”.

4. In practice, this drafting has proven to be confusing and misleading because:
   - it conflates purely ethical considerations, which trustees can take account of, with social and environmental considerations which trustees should take account of, if they are financially material;
   - it appears to limit the broader financial considerations which trustees can take account of to social and environmental considerations and implicitly excludes the possibilities of others;
   - the use of “if at all” suggests that trustees are permitted to take no account of such considerations, even when the risks are financially material.

5. This is evidenced by the continuing confusion that issues such as climate change are purely ethical considerations, or that trustees’ fiduciary duties are discharged by providing an ethical fund choice. Neither point is correct.

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The Law Commission’s recommendations

6. 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. This applies in exactly the same way as other risks in pension scheme investment – for example in relation to interest rate risk, liquidity risk, exchange rate risk, market risk, political risk and counter party risk.

7. The only difference between the two types of consideration is that there is a broad recognition of the immediate financial impacts of factors such as interest rate risk, liquidity risk, currency risk and counter party risk. Risks such as ESG, including climate change, tend – although not exclusively – to be felt over the longer term. They can make their presence felt at individual company level in different – but related – ways. For example, in relation to climate change, a power firm may suffer a sudden loss in value due to rapidly announced tariffs on carbon emissions; a motor manufacturer may see a gradual leakage of value due to a failure to invest in alternative transport fuels; a water company may see an increase in value due to investment in linkages between regional pipelines which mitigate against water stress.

8. We therefore agree with the Law Commission’s 2017 recommendation that the legislation should be amended to clarify for trustees that they should state a policy in relation to the evaluation of financially material risks and opportunities. We also agree with the proposal – to make the expectation around the more widely misunderstood factors absolutely clear – to specifically mention environmental, social and governance considerations, including climate change.

Our proposals

9. We are proposing that trustees should be required to state their policy on the evaluation of financially material considerations. This includes but is not limited to environmental, social and governance considerations, including climate change, in the selection, retention and realisation of investments. The draft Regulations would amend the requirements of the SIP and also the default strategy, where a scheme has one, to include the consideration of financially material matters.

10. We are not proposing to exclusively refer to ESG, including climate change. We do not want to be too prescriptive and industry terminologies, in time, may change. Future systemic risks may also not be readily compartmentalised into one or more aspects of ESG.

11. However, we are also mindful that the revised wording of 2(3)(b)(vi) could be perceived as overlapping with existing consideration of risks referred to in

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29 Regulation 2(3)(a) and (4) of these draft Regulations amends paragraph (3)(b)(vi) of (and inserts paragraph (4) into) regulation 2 of the Investment Regulations.
regulation 2(3)(b)(iii) of the Investment Regulations. We would welcome the views of stakeholders on the draft wording.

12. We have deviated from the Law Commission’s proposed drafting in a few respects. The Law Commission suggested that we refer to risks relating to sustainability. We note that sustainability is the term used by the High Level Expert Group on Sustainable Finance. However, we have some reservations of the use of this terminology.

13. As the Law Commission made clear in the 2017 report, the primary purpose of the investment power given to trustees is to secure the best realistic return over the long term, given the need to control for risks. Therefore the prime concern of the trustees is not a (potentially multi-dimensional) measure of the sustainability of the investments, but the measure of their long term return, net of costs and charges. As ‘sustainability’ is liable to create confusion amongst trustees about the purpose of the pension, by being variously read as environmental sustainability, financial sustainability or an unspecified combination of the two, we do not propose to use it.

14. The Law Commission advocated a reference to long term risks – informal stakeholder feedback has suggested that whilst many financially material risks such as ESG risks are longer term, they are not so exclusively. For example poor governance, or good handling of social opportunities such as improvements in pay or working conditions can in some circumstances have relatively rapid impacts on company valuations. As the use of ‘long term’ may create the impression for trustees that there are no short term impacts to be considered, we do not propose to specify either short or a long term, allowing appropriate discretion over the period to be considered.

15. The term ‘corporate governance’ was proposed by the Law Commission. However, we believe that this could be unduly constraining or confusing for trustees. Pension schemes can and do invest in debt issued by non-corporates – for example, government debt. In addition the term ESG is widely used and understood, and the use of slightly different terminology might create the misconception that trustees are expected to consider something different, when they are not.

16. ‘Social impact’ was also suggested by the Law Commission. We have set out our concerns about this terminology in this chapter. In summary, the social impact of an investment (the broader societal benefit) is different from the risks and opportunities to beneficiary returns from social considerations. Again, we believe to subtly alter the reasonably long-standing use of ESG terminology by referring to social impact is liable to create confusion for trustees when we are seeking to limit the risk of this.

17. Finally, the Law Commission did not suggest specifically referring to climate change. However, we are proposing to include climate change as a specific item.

because it is a systemic and cross-cutting risk. That is to say, it affects not only environmental risks and opportunities, but also social and governance considerations. The UK’s commitment to the Paris Agreement on Climate Change demonstrates the Government’s view that climate change represents a significant concern.

18. Extracting climate change and presenting it as a separate item also makes clear to trustees that climate change is not the only development which presents environmental risks and opportunities, for example air quality, water stress, soil or waste are also considerations, which trustees may believe to be financially material.

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?

   b) Do the draft Regulations meet the policy intent?

Members’ views

Current legislation

19. The Law Commission concluded that, although financial return should be trustees’ predominant concern, the law is sufficiently flexible to allow other, subordinate, concerns to be taken into account in some circumstances. In order to clarify the law, the draft Regulations seek to capture this flexibility.

20. In relation to scheme members, the Law Commission has made clear that, based on case law, trustees can take account of their preferences, subject to a 2-stage test being met. Trustees are not obliged to take account of these non-financial factors. The 2-stage test which must be satisfied is that:

   • trustees should have good reason to think the scheme members hold the concern; and
   • the decision should not involve a significant financial detriment.

21. We expect that some scheme trustees will wish to take account of members’ views when the 2-stage test is met. The Law Commission has noted that it is not necessary to survey scheme members before taking an investment decision.

22. The current Investment Regulations make no specific reference to taking account of scheme members’ views, although it is implicitly referred to by the option to have a policy on ethical considerations.
The Law Commission’s recommendations

23. The Law Commission recommended that trustees should be required to state their policy in relation to considering and responding to members’ ethical and other concerns.

24. As stated in the interim response to the Law Commission report, we agree that it is good practice for trustees to inform the design of investment strategies with an understanding of scheme members’ views. This also aids with assessing value for members, which trustees of DC schemes must do. Existing TPR guidance supports this position and explains that pension scheme trustees have a range of options for establishing members’ views:

“The DC code sets out a number of areas where having an understanding of your members is key, particularly in gauging member views to inform the design of investment strategies and the assessment of value for members.

There are a number of ways you can find out about their views and needs in relation to the scheme. You should choose methods that are appropriate and proportionate according to the size of the scheme and available resources, and which are most likely to engage the scheme members, or groups of members.”

25. Examples of other engagement methods suggested in that TPR guidance include:

- Running workshops or speaking events through the employer can give members an opportunity to hear about the scheme and retirement planning generally, and a chance to ask questions and voice their views.
- Holding a member AGM or inviting members to the scheme’s AGM can provide similar opportunities.
- Focus groups or forums to ask for members’ views on particular aspects of the scheme and its services.
- Larger, more complex schemes could consider setting up a regular member panel to represent the wider membership and provide feedback to the trustee board on particular issues.

26. In its 2017 review, the Law Commission offered guidance on how trustees can deal with differences of opinion when considering member survey results:

“We do not think that there needs to be 100% agreement, which is usually unachievable. If a significant number (for example, the majority of members who engage) are opposed to an investment while the rest remain neutral, that may be enough. The more difficult question is where a significant number hold one view but a minority disagree strongly. We said that where the issue was clearly controversial, the courts would expect trustees to focus on financial

factors, rather than becoming embroiled in disagreements between the members on non-financial factors. If the issue is not controversial, and there is good evidence of agreement from some people, we think that trustees may act on these views even if many people fail to engage.”

27. The Law Commission are therefore clear that there is not a threshold response rate which must be met for trustees to decide to act on the results of a member survey. However, trustees can gauge members’ views in other ways. The Law Commission has also made clear that it is not always necessary for trustees to survey scheme members to understand their concerns. It should be possible to make assumptions based on the information they already know about the membership of the scheme or the population as a whole. The Law Commission use the decision not to invest in the manufacture of cluster bombs as an example of this. The fact that the Convention on Cluster Munitions, which prohibits cluster bombs, has been ratified by the UK should give trustees reason to believe most people would consider them to be wrong.

28. Trustees may therefore use knowledge of broad public opinion or ratification of relevant treaties by the UK Government to draw conclusions about members’ views.

29. Finally, informal stakeholder engagement has also suggested other situations where trustees might make judgements without significant member engagement, about the views of scheme members. One example of this might be a scheme where all the members work in cancer research, where trustees may think it appropriate to avoid investments in the tobacco industry.

Our proposals

30. We are proposing that trustees should consider and make a statement on how they will take account of the views which they consider scheme members hold in the development of the policies within the SIP\(^{32}\). This can include members’ views on both financial and non-financial matters that may be relevant to the trustees’ investment and stewardship decisions.

31. We believe this is a proportionate approach. Whilst setting such a policy out may help trustees formalise their decision-making process for taking account of scheme members’ concerns, they are never required to act on any particular concern. Trustees retain control of investment decisions, and their prime focus is to deliver a return to members over an appropriate investment horizon.

32. If a trustee board has received or gathered evidence that members have, or are likely to have, a particular view on a non-financially material matter, they are free to consider whether or not they will act on this view. Their statement on how they will consider scheme members’ views should provide a structure for their decision-making process. By way of example, they may decide that they wish to

\(^{32}\) Regulation 2(2)(a), (b) and (c) of these draft Regulations amends paragraphs (2)(a) and (b) of (and inserts paragraph (2)(c) into) Regulation 2 of the Investment Regulations.
address any specific matter via their stewardship activities rather than divesting entirely from relevant companies or sectors.

33. The proposed requirement is to prepare a statement on how scheme members’ views will be considered in the preparation or revision of the SIP. By linking this requirement to the development of the investment policies, rather than having it as a policy within the SIP, we wish to avoid giving trustees any impression that investments should be made in line with scheme members’ preferences.

34. Trustees would first be required to prepare this statement from October 2019, whenever the SIP is first prepared and each time it is reviewed. This aligns with the requirement trustees already have to consult with the employer(s) which makes it the appropriate time to consider how they might also engage with their scheme members.

35. We are also proposing that they should include the current statement about members’ views in their annual report.

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?

Social impact investment

42. We do not currently propose to set out any requirements in legislation around trustee consideration of social impact investment.

43. Social impact investment is defined in the Advisory Group’s report as:

   Investment in the shares or loan capital of companies and enterprises that not only measure and report their wider impact on society — but also hold themselves accountable for delivering and increasing positive impact.

44. It is therefore related to, but different from, social considerations (the ‘S’ in ESG) which are focused on the risks and opportunities to member outcomes stemming from investment in particular companies and enterprises.

45. In many instances, social impact investment will be in members’ best interests, and it will be appropriate for trustees to seriously consider its inclusion within the investments of defined benefit schemes or the default funds of defined

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33 Regulation 2(2)(c) of these draft Regulations amends paragraph (2) to insert sub-paragraph (c) into Regulation 2(2) of the Investment Regulations.
contribution schemes. No sacrifice to members’ returns need automatically follow from investments which seek to deliver a broader positive impact on society.

46. However other types of social impact investment will involve an element of sacrifice of market returns, or an unacceptable sacrifice of liquidity to deliver comparable returns. Decisions to invest in this kind of social impact investment will be subject to the 2-stage test mentioned above.

47. Government is supportive of the aims of the Advisory Group on Social Impact Investment, and the encouragement of trustees to:

- consider including in the Statement of Investment Principles, specific policies relating to social impact, including their intent to favour investments with positive impact or to avoid investments with a negative impact;
- include social impact options into pension scheme chosen funds, where there is good evidence that their scheme members are actively engaging in pension choices;
- incorporate social impact investment into pension scheme default funds, subject to Law Commission guidance around appropriate risk-adjusted financial returns.

48. However, these are recommendations for trustees, not for Government. In line with our policy outlined in chapter 1, we do not intend to direct pension schemes to select social impact investments or any other kind of investment.

49. We have also considered whether we might legislate to require pension schemes to set out their policy, if any, in relation to social impact investments.

50. However, we have concerns about such an approach. We are legislating to clarify for trustees the distinction between financially material considerations, which they must take account of, and wider non-financially material matters (including but not limited to ethical and social impact considerations), which they can take account of in certain circumstances.

51. There would be a danger in requiring trustees to set out a policy in relation to a type of investment which is sometimes compatible with, and indeed desirable from the perspective of delivering the appropriate return, but at other times could only be selected in particular narrowly defined circumstances. Including a reference to social impact investment might therefore create new confusion and risks of poor trustee decision making and engagement. The clarification of legislation – between the requirement to consider financially material risks and opportunities which can enhance member returns, and the option to consider scheme members’ views – may be sufficient to give trustees the confidence to invest in social impact investment.

52. We therefore do not propose to require trustees to have a policy in relation to social impact investment at the present time. We will, however, continue to monitor trustee behaviour, trends in terminology and the availability and labelling of social impact investment products, and we will consider consulting in future if
there is evidence that the benefits of legislating in this area would significantly outweigh the risks.

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?
Chapter 3: Stewardship of the investments

The importance of stewardship

1. Stewardship is the activity of investors engaging with the managers of the underlying investments in order to promote the investments’ long term success. Pension savers invest via their pension scheme - therefore it is up to the people managing the scheme to exercise stewardship and ensure, as far as they are able, that this is done through the whole length of the investment chain. Trustees can promote an investment’s long term success through monitoring, engagement and/or voting, either directly or through their investment managers. In this context, an investment could be equities (shares) in a company, but it could also be listed or unlisted debt, or investment in an alternative asset class, for example in relation to an infrastructure project.

2. The UK Stewardship Code, published by the Financial Reporting Council (FRC), explains that “stewardship is more than just voting”:

   Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration.

Current legislation

3. Current regulations require trustees to report their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to the investments.

4. As with the trustees’ policy in relation to social, environmental and ethical considerations, we believe that this requirement is confusing and misleading for trustees. The effect is typically to limit trustees to stating policies in relation to voting rights.

   - This means it does not acknowledge that there is any other stewardship in relation to investments where the trustees do not have voting rights, for example in relation to public or private debt, or investment in physical assets such as property and infrastructure.
   - It also means that when trustees do have voting rights, the legislation suggests that their only engagement need be, or can be, via voting at AGMs, and tends to exclude engagement or monitoring of any kind through the rest of the financial year. This perception could result in missed opportunities to influence the firms they invest in, to improve member outcomes.
   - In addition, the focus on voting rights alone can be taken to suggest that when the trustees do not have voting rights – for example, because they have invested via unit-linked contracts, or in pooled funds where the asset
manager will not agree to vote in line with their wishes – then it is not necessary for the trustee to have any kind of policy at all.

5. Each of these can have the effect of tending to undermine the strength of the trustee link in the investment chain. By implicitly communicating to trustees that stewardship of the underlying investments need not be a concern, this can have the effect of weakening oversight of corporate governance, both in the UK and internationally, impairing the level of productive return on investment.

The Law Commission’s recommendations

6. The Law Commission proposed that we amend regulations to require the Statement of Investment Principles (SIP) to state trustees’ policy (if any) on stewardship. Stewardship would include the exercise of formal rights (such as voting) and more informal methods of engagement.

7. They also proposed that this requirement should apply both to the SIP, produced under regulation 2, and the Default Strategy produced under regulation 2A of the Investment Regulations. The SIP and the default strategy cover broadly similar policies – however the SIP must be produced by both DC and DB schemes with 100 or more members and applies to the whole scheme, whilst the default strategy must be produced by DC schemes, regardless of membership size, in relation to the default funds. The default strategy must include the policies in relation to the matters listed in regulation 2(3)(b) of the Investment Regulations, such as the kinds of investments to be held, risks, the expected returns and (currently) the extent if at all to which social, environmental or ethical considerations are taken into account. It does not, however, require trustees to state any policy in relation to the exercise of the rights.

8. At the time of our interim response we indicated that we were minded to accept the proposal to amend the requirements around the SIP, but not minded to accept the proposal around the default strategy. Whilst we are proposing to go further than what the Law Commission recommended in relation to the SIP requirement (see ‘Our proposals’ below), it remains our view that an amendment to regulation 2A is unnecessary and unduly burdensome.

9. We highlighted in December 2017 that, if we followed the Law Commission’s recommendation in relation to the default strategy, the additional schemes which would be required to set out their policy in relation to stewardship were the smallest DC schemes that would be least equipped to engage with investee firms or to exercise the voting rights.

10. There are around 32,000 DC trust schemes with fewer than 100 members. Although these represent 97% of the total number of DC trust schemes they constitute less than 1% of memberships and that has been steadily declining. In

contrast, memberships in larger schemes are increasing significantly because of automatic enrolment (AE) and the associated growth of multi-employer ‘master trust’ schemes. The assets in these larger schemes will continue to grow proportionally as AE matures.

11. Therefore we consider requiring schemes with fewer than 100 members to produce additional documentation would impose disproportionate burden to business and the benefits could not be justified. Our informal engagement has not yielded any views that the extension of this policy to the smallest schemes will be proportionate or effective. Whilst we are proposing that even schemes with just over 100 members must have a policy on stewardship, it is necessary to draw the line somewhere, and these schemes will have long familiarity with the option of a policy on voting rights, and the production of a SIP more generally.

12. Therefore we propose to enhance and extend the requirement for DC and DB schemes with 100 or more members, from the statement of any policies on rights and voting, to a policy on stewardship, but not make provision for schemes with 99 or fewer members.

Our proposals

13. We propose to amend the Investment Regulations to require that the Statement of Investment Principles includes the trustees’ policy, in relation to the various activities which make up the role of stewardship. To capture the various activities we are proposing to cover:

   a) voting
   b) engaging, and
   c) monitoring.

14. We are proposing, via the definition of ‘relevant persons’ to explicitly acknowledge that stewardship can include direct engagement with an investee company, indirect engagement via an investment manager and ‘peer-to-peer’ engagement with fellow shareholders of an investee company. This is because, depending on the size and the way pension schemes hold their assets, they will not necessarily engage directly with the investee firm - but they will engage with someone who does this, typically their asset manager. Also we wish to specifically acknowledge that trustees might engage with each other on particular proposals, whether those be votes at AGMs, or engagement at other points in the reporting year.

15. We are also proposing to capture the breadth of matters on which trustees might engage through the definition of ‘relevant matters’, including issues which are

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35 Regulation 2(3)(b) and (4) of these draft Regulations amends paragraph (3)(c) of (and inserts paragraph (4) into) regulation 2 of the Investment Regulations.

36 The passage of the ‘Aiming for A’ resolution in 2015 signalled a major development in global financial markets. Investors expressed their interest in oil and gas companies disclosing more about their climate-related financial risks. Investors have a critical role to play in encouraging companies to put such measures in place and in holding the company to account against its chosen metrics.
reported via a firm’s financial reporting, as well as those found in its non-financial reporting, such as social and environmental impact and corporate governance.

16. The Law Commission recommended that trustees be required to state any policy, and make explicit in the regulations that a policy was optional. We are proposing to set an expectation that all schemes required to produce a SIP should have a policy on stewardship.

17. Trustees’ fiduciary duty would tend to imply that all trustees should consider their approach to stewardship of the investments, to maximise financial returns for the scheme members over the long term. Having considered the approach, we believe it is reasonable for trustees to document that approach for the benefit of members and others, and most likely helpful to the trustees themselves, in serving as a reminder and guide to action.

18. We envisage that even relatively small schemes can have some impact through the consideration of stewardship. For example, they will regularly need to make decisions about the appointment of asset managers and the selection of funds.

19. We recognise that the very smallest schemes may expect to have limited leverage over the firms they hire to manage the assets on their behalf, which is one of the reasons why the Government is actively pursuing measures to remove barriers to consolidation, both in DC and in DB schemes.

20. However, many schemes do have opportunities to take account of the stewardship records of managers, for example when appointing or switching asset managers and funds. As well as the advice of their consultants, schemes can call on published resources and asset managers’ adherence to, and reporting against codes, such as the Stewardship Code37, overseen by the Financial Reporting Council (FRC). The tiering exercise carried out by the FRC in 2016 also saw them assess signatories based on the quality of their Code statements, to improve quality of reporting against the Code. It distinguishes between signatories who report well and demonstrate their commitment to stewardship, and those where reporting improvements are necessary.

21. There are a number of other public reporting, or independently published reports available for schemes to refer to which outline the benefits of stewardship - for example, the signatories to Principles for Responsible Investment38, as well as independent reports produced by civil society groups such as Share Action.39

22. We are not explicitly barring schemes from having a ‘policy of no policy’ on stewardship. However, we would generally expect that trustees and managers would wish to satisfy themselves that they were complying with their fiduciary

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38 What are the Principles for Responsible Investment? - https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment
duty, though there will be cases, such as a scheme in wind-up, where this will be less relevant. In addition, for those schemes signed up to the Stewardship Code, they would be expected to comply or explain.

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?
Chapter 4: Improving the quality of the SIP

1. The SIP should set out how trustees will actually make strategic investment decisions. Unfortunately, the broad consensus from a wide range of stakeholders including law firms, consultants, asset managers and advocacy groups suggests SIPs are often written by a scheme’s investment consultants with limited input from trustees. This can lead to generic text which simply meets the legal requirements but does not reflect trustees’ investment beliefs or the scheme’s specific characteristics and which rarely serves as a guide to trustees’ decision making. Share Action’s 2015 review of the responsible investment policies of automatic enrolment pension providers cited an example of this practice:

‘The Trustee believes that ESG issues can affect the performance of investment portfolios and should therefore be taken into account as part of the Scheme’s investment process.

The Trustee has given the investment managers full discretion when evaluating ESG issues and in exercising rights and stewardship obligations relating to the Scheme’s investments.’

2. Effective SIPs reflect the needs of the membership, taking account of appropriate target returns, risk levels and investment horizons. Trustees relying on standardised SIPs risk ill-considered or ad hoc investment decisions that may be inappropriate for their members.

3. For defined benefit schemes, the financial implications of poor investment decisions will generally be addressed by the sponsoring employer. It is therefore in the interest of the sponsoring employer to ensure that the investment strategies of the scheme are as effective as possible. Employers have access to the SIP and are already consulted by the trustees when it is being prepared and revised. So while we do not believe that SIPs in defined benefit schemes are uniformly of a higher standard there are significant incentives already in place for employers to work with trustees to seek to improve them.

4. With schemes that offer money purchase benefits, the investment risk is borne by the members; the employer – or multiple employers, in the case of master trusts - has less incentive to scrutinise and influence the investment policies. For these types of schemes we consider that improved practices would follow if trustees had access to other schemes’ SIPs. By reviewing examples of robust, well-tailored SIPs, trustees would be able to share best practice when developing their own policies. This is why we are proposing two additional requirements: annual reporting on how the policies in the SIP have been implemented; and online publication of the SIP. There may also be a role for engaged scheme members to hold trustees accountable for the investment decisions made, and for interested

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commentators, researchers and civil society organisations to work with trustees to improve SIP quality.

5. Requiring review and publication of the SIP is intended to encourage trustees to reflect on the decisions that have been made and how the SIP could be refined to better capture their considerations. This should remove ‘boilerplate’ text and ensure trustees focus on documenting and following existing or improved scheme practices. As mentioned earlier, it has been reported that different schemes engaging the same investment manager with the input of the same consultant sometimes have identical SIPS. Even where schemes start from this position the iterative process of reporting against and refining the SIP each year will mean that SIPs will tend to diverge and end up more reflective of the needs of an individual scheme’s membership.

6. The schemes which would be in scope of this proposal are relevant schemes with at least 100 members. This covers most schemes offering money purchase benefits, subject to a few exceptions. It does not cover defined benefit schemes.

The annual implementation report

Current legislation

7. Current regulations[41] require trustees, as part of the annual report, to produce a statement “providing details of any investments made for the schemes during the year that were not made in accordance with the statement of investment principles” and, where there have been investments made in breach of the SIP, a statement “giving the reasons why and explaining what action, if any it is proposing to take or has already taken to remedy the position”. These statements form part of the annual report and are available upon request to members and other relevant people but do not need to be made publicly available.

8. These requirements mean that trustees must only report against the policies in the SIP if they have been breached. We intend to expand this requirement so that trustees of relevant schemes[42] must proactively consider and set out how they have implemented the policies. This will allow trustees to demonstrate that the SIP is effective.

Our proposals

9. We are proposing that trustees report each year on how they have implemented the SIP policies[43], explaining any change made during the scheme year and the reason for the change. This report should be published online by trustees of

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[42] See footnote 25 above for the definition of relevant schemes.
[43] Regulation 3(5)(b) and (c) of these draft Regulations, replaces sub-para (e) of (and inserts sub-para (f) into) paragraph 30 of Schedule 3 to the Disclosure Regulations.
relevant schemes\textsuperscript{44} (see ‘Publication of the SIP’ below). When preparing the annual report, trustees would be required to set out how, in their opinion, they have followed the policies. The draft Regulations do not prescribe the content of the implementation statement; it will be dependent on the details of the SIP and the trustees’ judgement of how this has been effected. We believe requiring trustees to report on how they have followed the principles set out in the SIP will ensure that the text reflects what pension schemes aim to do, and that schemes act on the principles they set out.

10. Early engagement with a range of stakeholders, including trustees and asset managers, has suggested that this is a key step in improving the effectiveness of SIPs. By requiring trustees to proactively report on how the SIP has been implemented the generic statements cited above would no longer satisfy the regulations.

11. Our assessment at this stage is that this would not be an onerous duty. The process of considering how the policies have been applied will already form part of trustees’ due diligence when they review the SIP. It may prove more difficult for trustees where a SIP contains broad statements about the value of considering, for example, ESG issues but no specific policy for how this will be done. However, where this is the case it should, in turn, encourage the development of well-defined policies which trustees feel able to report against.

12. The requirement to report against the policies in the SIP would apply to the first annual report produced on or after 1 October 2020. By this point, schemes will have had a SIP which includes the amendments proposed in Chapters 2 and 3 for at least a year. This will give schemes time to prepare for this new reporting requirement.

\textbf{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.

\begin{enumerate}
\item[a)] Do you agree with the policy proposal?
\item[b)] Do the draft Regulations meet the policy intent?
\end{enumerate}

\textsuperscript{44} Regulation 3(2) and (4) of these draft Regulations inserts regulations 12(5) and 29A(2A) into the Disclosure Regulations.
Publication of the SIP

Current legislation

13. Under current regulations\(^{45}\) members, and other relevant persons, can request a copy of the current SIP and trustees are required to provide it within 2 months of the request. There is no requirement for the SIP to be made publicly available. Even the most engaged member, industry commentators, researchers or interested civil society organisation might struggle to evaluate the SIP without understanding how the policies are applied in practice or how they compare to the policies of other schemes.

14. Recent research\(^{46}\) carried out on behalf of the Defined Contribution Investment Forum found that 61% of those surveyed were interested in their pension savings being responsibly invested. 40% believed that trustees are already doing this. This suggests that there is a desire for greater transparency about investment decisions and that, where assets are well-invested, it could improve member engagement.

Our proposals

15. We are proposing that trustees of relevant schemes will be required to publish the SIP\(^{47}\), the implementation report\(^{48}\) and the statement setting out how they will take account of members’ views\(^{49}\) online. As with cost and charges disclosure, trustees will be required to inform members about the published documents in the annual benefit statement\(^{50}\).

16. By making all SIPs for relevant schemes publicly available this will enable interested parties to scrutinise and compare across the market. Trustees will be able to share best practice and members and others will be more able to question poor policies or implementation. This proposal has been supported by a broad range of stakeholders, including trustees, asset managers, commentators and regulators.

17. Subject to laying the proposed Regulations this Autumn, the planned publication of the SIP will be required from 1 October 2019 when the proposed new requirements, set out in Chapters 2 and 3 will also be in place. This will give


\(^{47}\) Regulation 3(4)(a) of these draft Regulations inserts regulation 29A(2A)(d) into the Disclosure Regulations.

\(^{48}\) Regulation 3(4)(b) of these draft Regulations inserts regulation 29A(2A)(b) into the Disclosure Regulations.

\(^{49}\) Regulation 3(4)(b) of these draft Regulations inserts regulation 29A(2A)(b) into the Disclosure Regulations.

\(^{50}\) Regulation 3(6) of these draft Regulations amends paragraph 5B of Schedule 6 to the Disclosure Regulations.
schemes enough time to prepare the new SIP with publication in mind. It will also allow for any commercially sensitive information which may have been included in earlier SIPs to be removed.

18. This will only apply to trustees who are already required to publish costs and charges online\(^5\) so we expect that they will have a web publication process already in place. Our intention is that all published information specified in paragraph 15 above, as well as costs and charges information, can be located in one place on the website, and trustees can include a single link in the annual benefit statement to point to where the information can be found. By doing this there would be only a minor amendment to the annual benefit statement needed\(^6\).

<table>
<thead>
<tr>
<th>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.</th>
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</thead>
<tbody>
<tr>
<td>a) Do you agree with the policy proposal?</td>
</tr>
<tr>
<td>b) Do the draft Regulations meet the policy intent?</td>
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\(^6\) The legal requirements for references in the annual benefit statement to the publication of the information online and the availability of hard copies of the published information are in regulation 17 of (and paragraph 5B of Schedule 6 to) the Disclosure Regulations.
Chapter 5: Penalties, impacts, Guidance and the wider SIP

Penalties

1. We are not proposing to introduce any new penalty regime for failure to comply with the requirements of the Investment Regulations or the Disclosure Regulations. However as the draft Regulations would amend the requirements of those regulations the existing penalties would apply to breaches of the new requirements.

2. The penalties for failure to comply with the requirements related to the preparation, review and revision of the statement of investment principle are set out in section 10 of the Pensions Act 1995. The penalties for failure to comply with requirements under the Disclosure Regulations are set out in Regulation 553 of those Regulations. In both instances the Pensions Regulator may impose a penalty of up to £5,000 for an individual and up to £50,000 for an organisation.

Impacts

3. A draft impact assessment estimating the direct and indirect financial impacts on business and on others has been published alongside this consultation. We would welcome any evidenced comments on the impact assessment.

4. Comments on any other aspects of the policy or on the proposed Regulations are also invited.

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?

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

Guidance

5. In February 2018 the Government published Statutory Guidance titled ‘Cost, charge and related information reporting: guidance for trustees and managers of occupational schemes’ to assist pension scheme trustees with meeting certain new cost and charges disclosure requirements introduced in the Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations

53 Regulation 5 of the Disclosure Regulations,
2018. We propose to make changes to this Statutory Guidance to state how trustees should meet the requirements to publish the SIP, implementation statement and statement about members’ views, as outlined in this consultation and the draft Regulations. This revised Statutory Guidance would replace the current Statutory Guidance dated February 2018 which was issued under section 113(2A) of the Pension Schemes Act 1993.

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?

The wider SIP

6. This consultation on policy and regulations to clarify and strengthen trustees’ investment duties focuses on the treatment of financially material considerations and stewardship.

7. However, we also wish to use this consultation to seek additional evidence on how well the other components of the Statement of Investment Principles (SIP) are working. Regulation 2(3)(b) of the Investment Regulations sets out that the SIP, where produced, should as a minimum, set out the trustees’ policy in relation to, amongst other things, the following:

- the kinds of investments to be held;
- the balance between different kinds of investments;
- risks, including the ways in which risks are to be measured and managed;
- the expected return on investments; and
- the realisation of investments.

8. The regulations are supported by codes and guidance published by The Pensions Regulator, which contain further suggestions of issues trustees might voluntarily cover in their SIP. These include investment beliefs and objectives, and additional details about the factors or assumptions relating to member characteristics that were used to set the scheme investment objectives and strategy.

9. Overall, then, the legislation is relatively non-prescriptive, setting out the high level building blocks of an investment strategy. It does not, for example, require schemes to specify the investments which will be held from a controlled list, to

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quantify ranges for the balance of investments or prescribe specific risks in relation to which trustees must have a policy.

10. Whilst regulation 4 of the Investment Regulations sets out further expectations for the liquidity, diversification and regulatory status of pension scheme investments, there is no requirement on trustees to set out their policies on these matters in the SIP. Neither does it explicitly require trustees to justify any particular policy.

11. It may well be that providing a higher level of detail in the SIP is appropriate. Alternatively it may be that more specific or additional requirements could be helpful to trustees or of benefit to members. In addition, there may be scope for nudges or prompts in regulations, for example about the types of assets which they may consider investing in.

12. Whilst we do not have any immediate plans to regulate in this area, we would welcome respondents’ evidence and views on these points to inform future policy development.

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?