ABI

ABI's RESPONSE TO DWP's 'CONSULTATION ON CLARIFYING AND STRENGTHENING TRUSTEES' INVESTMENT DUTIES'

July 2018

Introduction

1. The Association of British Insurers (ABI) is the voice of the UK's world leading insurance and long-term savings industry. Our 250 members include most household names and specialist providers who contribute £12bn in taxes to the Government. It employs nearly 325,000 individuals, of which around a third are employed directly by providers with the remainder in auxiliary services such as broking.

2. The ABI welcomes the opportunity to respond to the Government's consultation. We have responded to questions in the consultation where relevant.

Executive summary

3. We welcome measures to clarify and strengthen trustees' fiduciary duties, which is consistent with the Law Commission's recommendations, and makes clear that trustees can and should take account of environmental, social and governance (ESG) factors in their investment decisions[1].

4. We recognise that the Law Commission found fiduciary duties can focus on short-term financial gains; this is not in line with investment strategies conducted by the insurance industry, and does not reflect the investment horizon of scheme members. This lack of long-term consideration arguably neglects sustainability challenges.

5. We support, where appropriate, the focus on stewardship and the responsible use of voting, monitoring and engagement rights. We believe active stewardship is a fundamental responsibility of investors and should be an integral part of the investment process. Effective stewardship can improve corporate performance and reduce sustainability risks; this has the potential to increase scheme members' pension pots. Greater transparency may also encourage some scheme members to further engage with their pensions, by identifying the positive impact their investments have on the wider economy.

6. We agree with the Government's proposal for trustees to identify and include members' views and their investment preferences where possible. As trustees' duties require them to act in the best interests of scheme members, it is logical that they obtain information as to what members' preferences might be, rather than making assumptions.

7. We acknowledge that there are conditions where trustees do not have control over the day to day investment strategy of the scheme, nor control over where the money is actually invested. However, trustees continue to have full responsibility in these circumstances, and have decision-making power over the investment options made available to them. As such they

[1] https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/

should still be able to disclose in the Statement of Investment Principles (SIP) their approach to ESG factors in their investment strategy.

Response to consultation questions

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?

8. We welcome the proposals on clarifying fiduciary duty and anticipate that it will result in better outcomes for customers. We believe that the draft regulations will help to meet the policy intent. Insurers invest with a long-term view; trustees' investment duties should therefore be aligned with those strategies.

9. We also recognise that the FCA is due to consult on proposals on the role of Independent Governance Committees (IGCs) in the first quarter of 2019. We note that if the intention is that the regulations and new FCA rules are implemented at the same time, it may allow very little time for implementation of the IGC rules. If the proposals for IGCs are similar, it is important to recognise the differences between the responsibilities of trustees, IGCs and decision-making boards at FCA-regulated firms.

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?

10. We agree with the Government's proposals to require trustees to evaluate all factors which impact the financial outcomes for members. This should include evaluating their chosen default and choices of available investments as appropriate for the scheme and their members.

11. We believe that trustees must continue to have discretion over the investment strategy of the scheme, and should not be required to alter the strategy to be in line with member views, or Government's policy objectives.

12. We understand that there are times when trustees prioritise short-term investment strategies, which does not align with the long-standing nature of schemes, and investment strategies taken on by insurers. We believe that implementing a long-term strategy mirrors the investment horizon of scheme members. Where investment returns are impacted by more long-term factors, it is appropriate to refer to them broadly as 'financially material'; this should not limit the evaluation to the existing ESG categorisation.

13. We would suggest that DWP consider adopting the approach set out by the Shareholder Rights Directive which considers the risks and financially material considerations consistently with the profile and duration of the scheme's liabilities. This would also include how the strategy set out in the SIP contributes to the medium to long-term performance of their assets

(SRD II Article 3h (1))[2]. We support the inclusion of this in the definition of 'financially material considerations', to consider ESG factors (without neglecting other factors) over the length of the scheme's liabilities.

14. We note conditions where trustees do not have control over the day to day investment decision-making of the scheme. This is the case where schemes are fully insured; in this scenario, trustees have limited control over where the money is actually invested. However, insurers do make a range of investment options available to trustees, who have ultimate responsibility over the investment options that are chosen. They should therefore still be able to disclose in the SIP their approach in choosing the insurer and the investment package.

<u>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?</u>

15. We agree that scheme members would benefit from greater transparency around the investment decisions made by trustees, and the extent to which all financially material factors have been considered in the investment options should be included in the SIP. We anticipate that some scheme members would be interested in the impact of their investments, and that it presents a positive way in which to further engage customers in their savings and long-term investments. In addition, this could grow consumers' trust in the financial institutions they are invested in.

16. We do not believe preparation of a statement on member views would be overly burdensome for trustees. This information could be gathered by forming a panel with member representatives from schemes, or communications with a sample of scheme members.

17. We believe that trustees should be required to communicate how they have obtained views of their scheme members; this may only need comprise a paragraph on how they communicate with scheme members for their views. Government could include in their policy guidance, with examples, how trustees could reflect members' preferences in their investment strategy. Whilst trustees retain both responsibility for, and discretion over, the investment strategy of the scheme, their obligation is to act in the best interests of members. They should not be required to alter the strategy to be in line with member views, or Government's policy objectives.

<u>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?</u>

18. We agree and recognise that requiring trustees to state a policy on social impact investment (a non-financially material consideration) may risk expectations that the investment strategy is obliged to take account of this, when it is not a financially material factor for the scheme. Disclosure of the trustees' policy relating to social impact investment should be made at the trustees' discretion, dependent on whether they believe it is applicable to their investment strategy, or in the interests of their members. Legislation should therefore make clear that trustees are not bound by a statement on social impact investment.

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2014%3A213%3AFIN

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?

19. We believe where trustees have responsibility over the stewardship of the investments (including monitoring, engagement and voting), they should be required to include their policy in the SIP. We believe that it would be beneficial for consumers to have access to that information and that stewardship is a fundamental responsibility that improves corporate performance, mitigates ESG risks and can maximise investment returns.

20. We do not believe that there is reason to exclude the default strategy from stewardship. This is due to the vast majority of customers investing in the default fund. As such, the Draft Regulation should amend regulation 2A of the Investment Regulations to include meeting the requirements of new paragraph 2(3)(c), as well as 2(3)(b).

    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?

21. We support, where relevant, transparency of a scheme's SIP policy. This should reflect that the inertia harnessed for auto-enrolment excluded requiring investment choice. This comes with the security that a default option will consider the needs of the broad membership and be appropriate to their risk attitude and to the risk and return of the investment. In addition, this proposal should be fairly easy to implement, as it only requires gathering members' views on one aspect of the investment.

22. It is important that it is made clear what trustees are responsible for, and that they can be held to account for the SIP. We agree with Government that this has been delegated to consultants and asset managers in the past.

23. We believe, where possible, that publishing statements on members' views is positive and could combat the inertia members feel towards their pension. The investment decision-making will still remain at the discretion of the trustees; however, preparing a statement on scheme member views opens up the discussion and provides scheme members with greater transparency over the running of the scheme.

    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?

24. We agree that where relevant, transparency of the scheme's SIP is appropriate, and it should be made available online. The annual benefits statement is a key way of communicating with scheme members, and it is also useful for members to have all information in one place, which will be disclosed alongside information on costs, charges and member investment. This should also make the process less costly and onerous for the scheme. However, we are well aware of, and in principle supportive of, other initiatives to simplify and standardise annual benefit

statements and other regulated communications. It is important, therefore, that these two policy objectives are reconciled.

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?

25. We do not have any comments.

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

26. We do not have any comments.

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?

27. We believe that the Statutory Guideline should include the implication of the requirements for a fully insured scheme, and the impact this has on trustees' abilities to report on their policies on SIP and stewardship. We note however, that ultimately trustees have responsibility over the investment strategy of the scheme even in these conditions.

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?

28. We do not have any further views.