ASSOCIATION OF CONSULTING ACTUARIES

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Dear Sirs

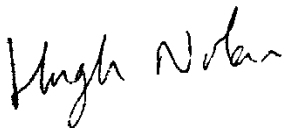
Clarifying and strengthening trustees' investment duties

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the above named Consultation issued by the Department for Work and Pensions (DWP).

The comments from our DC and Investment Committees on the specific questions raised in the consultation are set out in the Appendix.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful.

Yours sincerely



Hugh Nolan
Chair, DC Committee
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

Clarifying and strengthening trustees' investment duties

Response to Consultation questions

Question 1)

a) Yes, we agree with the sentiment behind these proposals, and to a large extent with the proposals themselves. We believe this to be a positive step, in line with the evolution of the subject. The DWP's wording seems to us to be clear and constructive. We suggest that an accompanying Code, or similar, should set out examples of how some of these proposals could be implemented in practice.

The DWP have picked up on a couple of worthy themes:

- transparency and accountability; and
- greater focus on the DC default option rather than the self-select ranges. This is eminently sensible given the low levels of members making independent investment strategy decisions where self-select funds are available.

In terms of the suggested designation date, we note that trustees of smaller schemes often meet on a quarterly or even half-yearly basis. When legislative changes are brought forward, it can take two or three meetings for them to consult with their advisers and implement them robustly so we would ideally suggest a timescale of up to 18-24 months to bring the draft Regulations into full force.

We also note that such policies could provide a further nudge to small schemes to consolidate. If this is the intention, then the additional time suggested above allows them sufficient time to carry out a consolidation exercise.

The suggestion to allow a further year before the requirement to publish an implementation report comes into force also seems sensible.

b) The draft regulations are a step in the right direction as they attempt to push Trustees (where they are not already doing so) to think more widely about the types of risks that they could be exposed to, albeit that this is yet another increase in the level of work that Trustees are being required to undertake. Having said this, if there is no interaction from the members then it is likely for many schemes this could become a "box-ticking" exercise as it is likely that statements may not change much each year.

One element that may need further guidance / consideration is around members' views. If trustees are required to state how they take into account members' views, then the natural question will be around the reasonable actions to take to establish these views. This has been a notoriously difficult exercise in the past, with typically very low engagement rates. There will also be a concern about things like vocal minorities.

There is some reference to the use of appropriate proxies, e.g. national surveys, or treaties that the UK has signed up to (with the seeming subtext being that this might lead to the exclusion of certain sectors, like controversial weapons). In our view, a few worked examples of what is appropriate and proportional would be helpful.

The draft Regulations on consideration of financially-material considerations and stewardship are likely to have the greatest impact on direct member outcomes. There is likely to be a wider benefit to increasing members' engagement with their pension investments in terms of education, responsibility and a feeling of ownership. The statement on members' views may help with this, particularly if it is published as suggested. Additionally, the implementation report could help members understand the Trustees' motivations for establishing a particular investment strategy.

Question 2)

a) Yes, we agree with the sentiment of the proposal as the intention is to require Trustees to think more widely about the risks that investment portfolios are exposed to. The issue could be that in many cases it is difficult to assess these considerations except in anything but the broadest terms and when this occurs it can become less useful. It may be beneficial to provide some guidance although we are also cognisant that this could lead people towards particular areas when the objective is to make investors think more widely.

   We are keen to facilitate broad and evolving risk awareness. As outlined in the Consultation document, there is very mixed awareness amongst trustees of what ESG is, and the possible financial implications that may arise from Climate Change.

b) Yes, we believe these proposals will increase trustees' focus on these financially material issues although, given it is not that easy to actually carry out the assessment, we do believe that some trustee boards will find this difficult to implement in the manner envisioned. It might be useful to provide some examples to trustees to provide colour on how to go about the assessment and what they should be looking for.

   In particular, it would be useful to have guidance on the level of detail expected. My understanding is that the principles should be set out in the SIP with details on how the trustees act in line with these to be stated in the annual implementation document.

Question 3)

a) The intent of the policy to ensure that members' views are considered when setting an investment strategy is both reasonable and desirable. However, we believe there could be a number of issues - particularly in relation to agreeing what the underlying member views are. From previous exercises, the level of member response has been extremely low and, as a result, the use of questionnaires or similar could bias the results towards the most vocal. However, many trustee boards include member nominated trustees representing various cohorts of the membership. In these cases, they may be expected to provide an insight into their cohort in a way that consultants may not be able to.

There would also be a cost to undertaking this exercise which in the additional cost analysis it is admitted is very uncertain. We do note that consultation states that it is not anticipated that schemes would be required to canvas members and we believe this should be made very clear. In the case of taking account of any views as they are understood by the trustees this could also be difficult as weighing up varying opinions is more than likely going to lead to no change and as such will just be increased governance. Our preference would be for some clear worked examples on how the proposal is likely to work in practice.

b) Whilst the policy intention may be good, we are unsure that it is easy to genuinely understand the requirements of a diverse member base although this is less an issue with the regulations and more about the fact that member engagement on these types of topics can often be low (and still contradictory). Additionally, given that trustees are not required to act on the views of their membership, there is scope for perception difficulties to arise if members do engage yet responsive changes do not occur or are seen to take a long time to take effect. Given the timeframe often required to change a strategy from the initial discussion to the moment assets are invested in the desired strategy, there may be need for members' expectations to be managed.

   Sections 25 to 29 do set out some useful guidance on engagement methods. It may be that employers are willing to support such engagement initiatives as a way of promoting appreciation of the pension benefit that they do provide.

Question 4)

- We agree that requiring Trustees to take account of Social Impact when investing would not be a beneficial aim as it could prove contradictory to the objective of generating investment returns for members. In this light, it makes perfect sense that there is no requirement for Trustees to have a policy. That said, it may not be obvious to members who read statements why trustees are not commenting on Social Impact or taking it into account and as such it could still prove beneficial for trustees to make explicit reference to it, even if just to highlight that their main objective is to generate sufficient levels of return. Ultimately if these proposals were to lead to greater member engagement then it may be that Social Impact investments are made without further legislation.

Question 5)

a) Yes the policy proposal in explicitly widening the scope of Stewardship should be beneficial. The volume of assets held in relation to pension schemes is vast, and could have a significant influence if deployed appropriately. As stated, a lack of stewardship from trustees in the investment chain "can have the effect of weakening oversight of corporate governance, both in the UK and internationally, impairing the level of productive return on investment." It is worth highlighting that there is currently confusion over how wide ranging stewardship activities can be and that asset classes with voting rights may also be influenced by trustees. There is the additional point that how pension scheme assets are invested shapes the world that members are going to retire into. Therefore, one could argue that beneficial outcomes may occur both from positive monetary investment returns and from promoting desirable companies to work in or source goods and services from.

b) Although we agree with the widening of the scope and note that this only applies to schemes above 100 members we are also conscious that this is further additional governance required for trustees. To make this as simple as possible for trustees to implement we believe it would be beneficial to provide some examples of positive stewardship and more importantly to what extent trustees should be expected to go. Perhaps this is an area where fund managers can provide more information as part of their standard reports? The point (section 20) on the Financial Reporting Council carrying out a tiering exercise indicates that bodies other than trustees can provide support in nudging investment professionals to carry out their stated commitments to stewardship.

Question 6)

a) In relation to the SIP there is no doubt that it should give a representation of how the trustees are investing money on behalf of the members. That said, we do not believe that the SIP should be so prescriptive as to constrain Trustees unnecessarily. There can be circumstances where schemes with extensive governance in place will not do something positive because it is not quite in line with a policy that was written previously and as such they need to both update the policy before they can implement the change. The SIP should be very clear on the Trustees' beliefs but should enable them to make positive decisions on behalf of the members. This policy also appears to be attempting to improve how the SIP is used. However, ultimately the SIP is only a representation of the overall strategy and an open question is whether this will improve the way the money is invested. There is a note that due to badly put together SIPs trustees will risk ill-considered decisions but this is not something that we have seen as a major problem.

b) On the face of it the draft regulations should go someway towards the policy intent however there is a possibility that the annual statements could become "boilerplate" as this is another piece of governance that needs to be conducted. Unless it is made clear to Trustees how this will benefit them and improve the way the money is invested it may not work. The key here seems to be improving the quality of decisions made by forcing trustees to explain their actions and rationale. It may be that this additional administrative burden only replicates information that other parts of the Consultation suggest will be published anyway e.g. the implementation policy and report on members' views. If the benefit statement sets out what these documents are and where to find them, it may be that interested members reap little additional benefit from the statements in the annual report.

Question 7)

a) We agree that increasing transparency and accountability is likely to promote trust in pension schemes and increase member engagement. It feels appropriate for members to have easy access to key documents setting out how their scheme is run. The majority of members are comfortable internet users but we also suggest that printed copies should be available on request. To make sure that the SIP, implementation report and statement on how members' views are taken into account are accessible, they should be found by a sensible internet search, indexed and written in non-technical language (or at least have a glossary of technical terms).

b) The draft Regulations clearly set out that these documents should be published alongside the cost and charges disclosure. It may be helpful to set out in the annual benefit statement a short description of what each available document intends to convey. Perhaps it is also worth considering how approachable the benefit statement is for members in terms of length, language and general appeal. This may have a more significant impact on whether members do choose to look into their pension investments in greater detail than the content of the documents themselves.

The ability for Trustees and other interested parties to access all SIPs across the market may prove valuable in terms of promoting best practice and closer scrutiny.

Question 8)

- The monetary costs in terms of implementing the new regulations do not seem unreasonable on an individual basis, i.e. the likely costs of updating a SIP and reporting on it. Having said this and as previously noted, this will place additional governance burdens on trustees in terms of the implementation report which will have to compete with other issues for the trustee board.

Question 9)

- While these proposals seek to ensure that trustees take into account a wide range of pertinent investment considerations and convey both the decision-making process and outcomes to members, there will still be limits to members' abilities to change how their pension assets are invested. This is because transferring out of their employer's designated scheme often leads to the loss of employer contributions. Therefore members have little choice in practice. Given that diversity tends to occur within a scheme's membership, perhaps more so than between schemes, this access to choice may be a point for future thoughts.

Question 10)

- The revised Statutory Guidance explains what needs to be produced but, as noted above in some questions, it would be very beneficial to have some further guidance on the level of detail that trustees should be expected to include, particularly in relation to understanding members views.

Question 11)

- The requirement to set out how a DC default strategy relates to analysis of the membership profile and investment objectives provides good clarity. As strategies become more dynamic the level of detail that can be stated may change, to allow flexibility throughout a year and across different retirement buckets. Interestingly, some trustees have chosen to focus on those members whose smaller pot sizes mean that they are least likely to pay for external financial advice so are more dependent on the trustees providing them with an appropriate strategy as a default.

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