



Green Finance Initiative
Guildhall
PO Box 270
London
EC2P 2EJ
July 2018

To Sinead Donnelly and Vicky Bird,

I write with reference to the *Consultation on clarifying and strengthening trustees' investment duties* ("the Consultation"), to which we are pleased to respond on behalf of the Green Finance Initiative ("GFI").

The City of London Corporation – the body responsible for running London's Square Mile – regards green finance as prudent, profitable and one of the best tools available in the race to cut carbon. That's why, in January 2016, we launched our Green Finance Initiative in partnership with government. The initiative brings together international expertise from across the financial and professional services sector. It aims to: provide public and market leadership on green finance; advocate for specific regulatory and policy proposals that might enhance the green finance sector worldwide; and promote London and the UK as a leading global centre for the provision of green financial and professional services.

We are therefore delighted to have the opportunity to respond positively to what we feel is a welcome improvement to the language surrounding fiduciary duty insofar as it relates to environmental, social and governance ("ESG") issues, particularly climate change.

Our responses to each of the consultation questions are appended to this letter. By way of opening remarks, I would like to make reference to a recent report¹, issued by the GFI's Working Group on Data, Disclosure and Risk ("the Working Group"). Among other things, the report argues for the use of the recommendations issued by the Taskforce on Climate-related Financial Disclosures ("TCFD") as the primary framework to use to guide disclosures by preparers of reports pertaining to climate change risks. It is our contention that the requirement to explain in Statements of Investment Principles ("SIP") the approach taken to climate risk management is thoroughly meritorious, and this is an opportune moment to encourage UK pension schemes to adopt the TCFD framework either in the SIP, or the Implementation Reports, or both.

This could be achieved through appropriate signposts in the statutory guidance, and could also extend further, for example to the TPR's Trustee Toolkit. The timeline described in the consultation is consistent with the timeline we recommended in the Working Group's report. Disclosure preparer forums could be created to assist with this journey.

We think there are strong economic and financial arguments for greater disclosure of environment-related risk, opportunity and impact (particularly those related to climate change). Greater disclosure is linked with trust in capital markets, financial stability and economic outcomes. There are also compelling reasons for UK leadership on these issues.

¹ <http://greenfinanceinitiative.org/wp-content/uploads/2018/04/Data-Risk-and-Disclosure-Paper.pdf>

Thank you for the opportunity to participate in this consultation. Should you wish to contact GFI for further information, please email our Senior Advisor, Derek Ip: derek.ip@cityoflondon.gov.uk

Yours faithfully,



Sir Roger Gifford

Chairman of the GFI

City of London Corporation

Responses to specific 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?

We are supportive of the proposals and the consultation at large, which is very clearly written. With regards to timing, the suggested timeline appears to us to be optimal because it balances speed of laying legislation with understanding of the time required to update SIPs and issue Implementation Reports. In fact, the timeline is consistent with our own recommended timeline (see the Working Group's recent report², p7) for integrating the TCFD framework into UK climate-related disclosures.

It is likely that some pension schemes will aim to be "ahead of the curve" and will either be already implementing the proposed SIP amendments and Implementation Reports, or will do so in advance of October 2020. Indeed, as the proposed changes reflect issues that trustees should already be considering as part of their existing legal duties to consider financially material factors we do not expect implementation of the proposals to create a significant compliance burden for trustees.

We think that asset managers and advisers can assist their pension fund clients in achieving implementation of the reforms in a manner that goes beyond mere compliance. We also think that "preparer forums" should be established in order to facilitate TCFD- aligned disclosures that are useful to the reader, are efficient to prepare and yet avoid genericity and boiler-plate language.

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?

We welcome this proposal and commend the clarity of language employed. We agree that ESG and climate change risk management have sometimes been confused with philanthropy, and therefore seen as optional. With your new wording, there can be no doubt that SIPs must describe the approach to managing financially material climate-related risks.

In particular, we support the approach taken to the definition of "financially material considerations". The current drafting of the Regulations refers to "social, environmental or ethical" which is broad and conflates financial and non-financial considerations. Although it may be appropriate and desirable for trustees to consider non-financial factors in their investment strategy, the proposals provide welcome clarity on how these factors relate to trustees' existing fiduciary duty to act in the best interests of members. Specifying that ESG considerations, including climate change, may encompass financially material considerations will prevent trustees from discounting these factors without due consideration.

The Consultation notes that financially material environmental, social and governance ("ESG") risks can sometimes be long-term, sometimes short-term, and that references in legislation to either the short- or the long-term could confuse trustees. We think there is merit in this argument, but we are also supportive of the recommendations of the High Level Expert Group (HLEG) on Sustainable Finance: "To clarify investor duties to extend time horizons and bring greater focus on ESG factors.

² <http://greenfinanceinitiative.org/wp-content/uploads/2018/04/Data-Risk-and-Disclosure-Paper.pdf>

Linking investor duties to the investment horizon of the individuals or institutions they serve” (page 13 of the HLEG Sustainable Finance Report).³ Rather than remaining silent on the question of termism, which we think would lead to the status quo – i.e. a greater focus on the short term than the long term – we think the statutory guidance might make it clear to trustees that financially material ESG risks can materialise over the short term, or over the medium to long term, and that trustees should take ownership of defining the time horizons of importance to their own scheme. With reference to trustees’ requirement to prioritise delivery of returns to members: it is clear that returns are delivered (or otherwise) over a time horizon, not at a point in time, and that risks to this return stream, including financially material ESG risks, should be considered within a time frame of relevance to the scheme.

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?

As noted above, scheme members are becoming more engaged with respect to the management of their pension fund savings, particularly on matters pertaining to ethical investment. It is right that the DWP’s proposals recognise this, and that they do so in a flexible way that allows for locally appropriate arrangements. In many cases these arrangements are already in place; the resource cost in requiring investors to take specifically mandated additional actions should not be underestimated.

We also think that it is important to note that the proposal will not change the core legal principle that trustees retain responsibility for determining the scheme’s investment strategy. Instead, the proposed statement of members’ views provides a mechanism for promoting greater engagement with members, whose views may be taken into account by trustees provided that either there is no financial detriment to the scheme or that trustees are confident that they are acting on the views of the majority and that the issue is not controversial. Greater transparency on member engagement will help scheme trustees demonstrate the steps they are taking to determine investment decisions where members raise concerns over non-financial issues.

The consultation strikes, from our perspective, an appropriate balance and we welcome the recognition on page 20 of the Consultation of some of the good practices, some of which are already in place. When it comes to financially material issues, the requirement to take proper advice remains paramount.

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?

We think that this suggestion is not charitable enough to trustees and their advisers in terms of their ability to understand legislation and statutory guidance that is clearly written and well defined (which the Consultation is). We also note that the LGPS funds already have the requirement to ‘explain their approach to social investment’.⁴

We think it is possible to define the types of social, local, green, SDG, etc, investment products available and to describe the circumstances in which a pension scheme might consider investing in

³ https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

⁴ Statutory Guidance relating to the LGPS Regulations 2016, last update 12 July 2017

them, and to make it clear that there is no obligation to invest in these types of products. Not providing such clarification at this time might represent a missed opportunity.

Your consultation response does acknowledge the considerable work of the Social Impact Investment Advisory Group/ Taskforce and the Green Finance Taskforce and the recommendations that have been made by these groups. It is critical to the implementation of the recommendations made by both Task Forces' that the investments are given legitimacy and clear permission for consideration.

Therefore, whilst we defer to the judgement of DWP to not include a regulatory requirement at this time. We do urge DWP to provide urgent, robust guidance to Trustees to alleviate concerns and reassure them that such investments are wholly appropriate for consideration as part an effective, financial driven, investment strategy.

Furthermore, the current drafting of the regulations defining the terms in 2. (4) – defining non-financial factors includes 'social impact'. This is confusing as it may lead Trustees to believe that such investments are to be made solely on a 'non-financial' basis whereas many social and environmental impact funds return comparable investment returns to mainstream funds. There is a spectrum of implementation options with social impact funds and therefore it would strongly recommend removing this wording.

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?

We welcome this proposal. Engagement, voting and monitoring are important stewardship techniques that can be value accretive to investments in individual investee firms, and at an aggregated, market-wide level. Whether at the firm or the market level, successful engagements and informed voting execution are beneficial to UK investors. The proposals are helpful in that they seek to broaden the way in which trustees approach stewardship and, in doing so, emphasise that there are a range of techniques available to schemes irrespective of size or the nature of investments held. We support the statement made in the Consultation that trustees should, as far as possible, ensure that stewardship is properly exercised throughout the whole length of the investment chain.

We think additionally that the statutory guidance should signpost to the UK Stewardship Code and that pension schemes should consider becoming signatories. The code, which operates on a comply or explain basis, is a flexible and consistent method for investors to explain their approach to stewardship.

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?

We think this is a development that contains a lot of merit. For climate-related risks, we recommend that the TCFD's recommendations are used as the best-practice common framework for annual disclosure. However, we should be mindful of the limited resources available to a lot of pension schemes and should be wary of adding unnecessary burden. With the introduction of additional

reporting requirements, we should guard against simply introducing more reports of a generic nature, containing boiler-plate language.

Notwithstanding these points, we feel that the implementation statement may present an opportunity for trustees to engage with the outcomes of their agreed investment policy and to reflect upon how they are achieving the scheme's investment aims. It will also provide an opportunity for members to understand any factors that may have caused trustees to deviate from the SIP. This goes beyond the current requirement for trustees to explain in the annual report if they have breached the principles contained in the SIP.

Q7: We propose that trustees of relevant schemes should be required to publish the SIP, the implementation report and the statement setting out how they will take account of members' views online and inform members of this in the annual benefits statement. a) Do you agree with the policy proposal? b) Do the draft Regulations meet the policy intent?

This appears to us to be an appropriate way to achieve transparency on this matters, but again we should be careful of providing additional obligations to funds with fewer resources. We agree that these proposals are appropriate for defined contribution schemes, as the member bears the investment risk and therefore has a greater interest in understanding how their money is being invested.

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?

No comments.

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

No 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?

We welcome the clarity contained in the Consultation but would need to see the updated guidance before commenting further.

We would re-iterate points made above with regards to signposting in the Statutory Guidance to TCFD, GFI's *Data, Disclosure and Risk Paper*, and the UK Stewardship Code.

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?

No comments.