

PENSIONS.FIDUCIARYDUTY@DWP.GSI.GOV.UK

caxtonhouse.legislation@dwp.gsi.gov.uk

Sinead Donnelly and Vicky Bird
Department for Work and Pensions
Strategy Policy and Analysis Group
Private Pensions and ALB Directorate
Ground Floor North
Quarry House
Leeds LS2 7UA

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

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Dear Sinead and Vicky at the DWP

Consultation on Clarifying and Strengthening Trustees' Investment Duties

1. The DWP's recent document on this topic raises important matters of concern and I am pleased to be able to contribute to the consultation.
2. I have been for nearly twenty years an Elected Group Trustee of the UK Power Networks Group of the Electricity Supply Pension Scheme. We run one of the major legacy pension schemes of the former nationalised electricity supply industry, with a membership consisting mainly of the active and former workforce members of what used to be the London, Eastern, and Seeboard supply areas of that industry. We are a mature defined benefits scheme, with around 15,300 members in total and assets under management of some £3.5 billion.
3. You will find two attachments with this covering letter. The first illustrates a neater and simpler method of giving effect to the DWP policy objectives which are enshrined in the consultation document. The second is critical of the quality of the consultation document and of the legal route and legal drafting by which the objectives are proposed to be enacted.

Attachment 1 : Achieving the DWP's Policy Objectives

4. The problems that the proposals in the consultation document purport to solve have been on the pension industry's radar screen for a long time. Within the last six years, the Law Commission – the government's statutory adviser on the development and interpretation of UK law – has publicly opined three times, in detail, on the correct interpretation of trustees' fiduciary duties. The Commission has consistently been clear that the existing investment regulations may be misleading and that, provided that social investments do not involve a significant sacrifice of financial returns, there should be no regulatory barriers to them.
5. DWP responses to the Commission's analyses and recommendations have been equally consistent. The DWP has welcomed the clarifications provided by the Commission and has accepted that incorporating social impact considerations into investment decisions, subject to certain sensible conditions, can be in the best interests both of pension scheme members and of longer-term sustainable economic development.

6. DWP efforts to spread the message widely through the industry have been supplemented by guidance published by the Pensions Regulator. However, the current consultation appears to reflect feelings of exasperation at the highest levels about the widespread persistence of misunderstandings in the pensions industry about the correct scope and interpretation of the fiduciary duties of trustees in their investment decision-making. This is despite all efforts to promote appropriate advice. Such feelings are understandable and should be respected.
7. In my view, however, the DWP's proposals in the consultation document for achieving its policy objectives are disproportionate and are likely to be ineffective. The key proposals consist of poorly drafted new trustee duties to produce statements which explain (i) how they will take account of views which they believe are held by scheme members about SIP-related matters (including non-financial matters), and (ii) their policies with respect to engagement with investment firms and the exercise of voting rights attached to investments.
8. These new measures are likely to result in higher adviser costs, an increased exposure of schemes to the intervention of special interest groups, and the rapid spiral downwards of the required statements into the lowest common (and most politically correct) denominator.
9. Given the widespread confusion that still persists about fiduciary duties, coupled with the pension industry's lingering resistance to the implications of Law Commission, DWP, and TPR advice over many years, I suggest that a better way to facilitate the DWP's objectives is to amend the 2005 investment regulations in two key respects. The first amendment would insert into regulation 2 (statement of investment principles) a new requirement for trustees to certify that in producing the SIP they have had due regard to the provisions of both regulation 2 and regulation 4 (investment by trustees). The second amendment would insert into regulation 4 an appropriate statutory formulation of the Law Commission's recommendations about the scope of fiduciary duties as applied to pension trustees' investment decisions.
10. Attachment 1 contains illustrative drafting, drawing on both Law Commission and DWP language, to show how these proposals could work.

Attachment 2 : The quality of the DWP's consultation

11. Attachment 2 offers a critique of the DWP's general presentation of the consultation and, in particular, of the method of legislative amendment that the DWP proposes to use and the quality of the legal drafting that is employed in support of that method. Alternative drafting is suggested (with reasons) in a number of areas.

Conclusions

12. I hope that this letter and the contents of the attachments will be helpful, and I urge the DWP to consider adopting the kind of alternative approach embodied in Attachment 1.
13. This submission is made in my personal capacity, and it is also being sent to the DWP's Consultation Coordinator because of the nature of my comments in Attachment 2.

Roger Barnard, Elected Group Trustee

UK Power Networks Group of the Electricity Supply Pension Scheme

ATTACHMENT 1

Proposed alternative amendment of the Occupational Pension Schemes (Investment) Regulations 2005

The covering letter for this submission recommends an alternative and, in my opinion, simpler and better way to facilitate the DWP's policy objectives.

This would involve making two key amendments of the 2005 regulations, as follows:

1. *Immediately after paragraph 3 of regulation (2) insert the following new paragraph –*

‘(4) A statement of investment principles must include a formal assurance by the trustees that in preparing or revising the statement they have had due regard to the provisions of this regulation and of regulation 4.’

2. *Immediately after paragraph 1 of regulation (4) insert the following new paragraph –*

‘(1A) In making investment decisions, trustees may take account of –

- (a) any material financial considerations which they reasonably believe are (or are likely to become) relevant to a decision; and
- (b) any non-financial concerns which they reasonably believe are (or are likely to become) relevant to a decision, provided they are satisfied that –
 - (i) members of the scheme would share the concern in question, and
 - (ii) taking account of it would not involve a risk of significant financial detriment to the scheme;

(c) in this paragraph –

‘material financial considerations’ includes (but is not limited to) environmental, social, and governance considerations (including climate change), and

‘non-financial concerns’ includes (but is not limited to) ethical matters and matters relating to social impact, as well as the present and future quality of life of members of the scheme.’

Roger Barnard, UK Power Networks Group of the ESPS, July 2018

ATTACHMENT 2

A technical note on the quality of the DWP consultation

Part 1 : Introduction

1. This technical note offers a critique of the DWP's general presentation of the consultation and, in particular, of the method of legislative amendment that the DWP proposes to use and the quality of the legal drafting employed in support of that method.
2. The note focuses on regulation 2 of the proposed new amendment regulations because that particular piece of legal text is the key element of the DWP's consultative proposals for a large defined benefit scheme such as the UK Power Networks Group of the ESPS (as to which, see the covering letter attached).

Part 2 : General presentation

3. The consultation document begins by saying that it is about, and is seeking views on, the draft Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018 (I will call these 'the 2018 regulations' from now on). The document then continues in the same vein, with repeated references to 'these regulations' both in the main narrative text containing the policy proposals and in the numerous footnotes.
4. However, despite all such references, the 2018 regulations cannot be found anywhere in the consultation document. Given that 'these regulations' are only four pages long, it would have been easy to incorporate them as an appendix to the main narrative, or even to intersperse the substantive provisions of the legal text alongside the relevant policy proposals.
5. This failure to include the draft text of the 2018 regulations in the main policy document is a defect of the DWP's consultation – not a major defect, but a material one, because it makes life more difficult than it should be for the interested reader. It is not a user friendly approach to the consultation, and could so easily have been avoided.

Part 3 : Method of legislative amendment

6. Such difficulties as may be created by the separate publication of the policy proposals and the corresponding legal text are minor compared to those that arise from the DWP's decision to use piecemeal legislative amendments to give statutory effect to its policy objectives. This makes it very difficult to make an accurate assessment of the effects of the drafting.
7. The simplest way of proceeding would have been for the DWP to formally revoke the Occupational Pension Scheme (Investment) Regulations 2005 ('the 2005 regulations') and to produce a single unified replacement text. (The same approach would also have been equally appropriate for the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013, which are also part of this consultation, but are not the focus of this note.)
8. Instead, because of the decision to use amending regulations to change other regulations, the interested reader can have little idea of the proposed state of the future legislation unless he/she brings the old and new texts together and does the work that the draftsman should have done. This is a long way from presenting law in an intelligible and accessible way.

9. In fact, under the DWP's proposals, readers now need to conflate five different statutory instruments to arrive at the combined legal meaning of the 'investment regulations' that are to be applicable in future for the trustees and advisers of UK pension schemes:

- the 2005 regulations,
- the Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2006,
- the Occupational, Personal and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2009,
- the Occupational Pension Schemes (Investment) (Amendment) Regulations 2010 ('the 2010 regulations', as to which see my separate comment at the end of this note), and
- the 2018 regulations.

10. In practical terms, finding out which are the relevant texts and how to assemble them, and then combining the work produced and executed by different draftsmen at different times, are complex tasks with the potential to produce error and misinterpretation.

Part 4 : Parliamentary and procedural considerations

11. The chaotic state of this area of UK pensions law, as illustrated by paragraph 9 above, is now so pronounced that it is time for the DWP to take this opportunity to remedy the situation. I therefore urge the DWP, following this consultation, to decide to produce and implement a unified text, 'the Occupational Pension Schemes (Investment) Regulations 2018', as a single new consolidated statutory instrument.

12. It is difficult to see why the DWP would resist this proposal, least of all on grounds of parliamentary procedure. However the law-making is to be achieved, whether by the DWP's proposals for proceeding with amending regulations or in accordance with this proposal to produce unified replacement regulations, the necessary statutory instrument will in either case be subject to the negative resolution procedure under the provisions of the Pensions Act 1995, and the same procedural requirements will apply regardless of the route adopted.

Part 5 : Regulation 2 of the 2005 regulations, as amended

13. The legal text following this note presents the text of regulation 2 of the 2005 regulations ('statement of investment principles') in its revised form, as amended by regulation 2 of the 2018 regulations ('amendment of the Occupational Pension Schemes (Investment) Regulations 2005'). Physically conflating the texts in this way, as one must in order to understand the legal meaning of the amended text, reveals at least two problem areas in the DWP's drafting. My fully revised text flags up these areas with yellow highlighter.

14. The first problem area arises from the DWP's insertion of a new sub-paragraph (c) into paragraph 2 of regulation 2:

'(c) prepare a statement explaining the extent to which the views which, in the reasonable opinion of the trustees, members of the scheme hold (including the views they hold on non-financial matters) will be taken into account in preparing or revising the statement of investment principles'.

The text of this sub-paragraph is what lawyers sometimes describe, politely, as ‘clunky’. It could be rewritten as follows, and I so recommend:

‘(c) prepare a statement explaining the extent to which the views which the trustees reasonably believe are held by members of the scheme (including their views on non-financial matters) will be taken into account in preparing or revising the statement of investment principles’.

This means exactly the same thing as the DWP’s text, but is more neatly and more naturally expressed, and so is more likely to be easily assimilated by the reader.

15. The other problem area is new paragraph 4 (a dedicated definitions paragraph) which has been inserted into regulation 2. Two of the definitions in this paragraph need to be revised:

non-financial matters: using the two words ‘social impact’ adjectivally is on the margin of acceptability, but turning eight words, ‘present and future quality of life of members’, into a compound adjective applying to the word ‘matters’ is simply inept. In fact, this definition as a whole is so woolly and so open-ended that it is difficult to see how best to revise it. The following alternative wording is suggested:

‘non-financial matters’, in relation to investment principles, includes (but is not limited to) ethical matters and matters relating to social impact, as well as the present and future quality of life of members of the scheme.

relevant persons: as drafted by the DWP, a relevant person is defined as being three things at once – an investee company *and* an investment manager *and* a shareholder of an investee company. This is plainly incorrect and should be revised:

‘relevant persons’ includes, in particular, investee companies, investment managers, and shareholders of investee companies.

Part 6 : A comment on the 2010 regulations

16. Reverting to my mention of the 2010 regulations at paragraph 9 above, these were a statutory instrument laid before Parliament at the last minute in September 2010 without prior warning because the DWP had belatedly realised that certain technical changes were needed to make the 2005 regulations fully compliant with EU pensions law.

17. Perhaps because they were a rushed job, the text of the 2010 regulations was defective in its application to the 2005 regulations in a number of significant respects, not least because it deleted paragraph 7 of regulation 13 without making provision for any consequential changes, so that paragraph 8 of regulation 13 continues to refer to paragraph 7 as if the provisions of that paragraph had not been deleted and were still in force.

18. Errors such as this that arise and become embedded in the course of textual amendment and re-amendment are probably inevitable, given the chaotic state of secondary pensions law that I described earlier. They underline the need to take this opportunity to legislate, as I recommend above, for the ‘Occupational Pension Schemes (Investment) Regulations 2018’ as a new statutory instrument with a unified text that replaces all of its predecessors.

Roger Barnard, UK Power Networks Group of the ESPS, July 2018

**Regulation 2 of the Occupational Pension Schemes (Investment)
Regulations 2005 as amended by Regulation 2 of the draft
Occupational Pension Schemes (Investment and Disclosure)
(Amendment) Regulations 2018 (currently under consultation)**

Statement of investment principles

- 2.—(1) The trustees of a trust scheme must secure that the statement of investment principles prepared for the scheme under section 35 of the 1995 Act is reviewed—
- (a) at least every three years; and
 - (b) without delay after any significant change in investment policy.
- (2) Before preparing or revising a statement of investment principles, the trustees of a trust scheme must—
- (a) obtain and consider the written advice of a person who is reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of the investments of such schemes;
 - (b) consult the employer; and
 - (c) prepare a statement explaining the extent to which the views which, in the reasonable opinion of the trustees, members of the scheme hold (including the views they hold on non-financial matters) will be taken into account in preparing or revising the statement of investment principles.
- (3) A statement of investment principles must be in writing and must cover at least the following matters—
- (a) the trustees' policy for securing compliance with the requirements of section 36 of the 1995 Act (choosing investments);
 - (b) their policies in relation to
 - (i) the kinds of investments to be held;
 - (ii) the balance between different kinds of investments;
 - (iii) risks, including the ways in which risks are to be measured and managed;
 - (iv) the expected return on investments;
 - (v) the realisation of investments; and

- (vi) financially material considerations, including how those considerations are taken into account in the selection, retention and realisation of investments; and
- (c) their policies in relation to—
 - (i) the exercise of the rights (including voting rights) attaching to the investments; and
 - (ii) undertaking engagement activities in respect of the investments (including the methods by which and the circumstances under which trustees would monitor and engage with relevant persons and other persons about relevant matters).

(4) For the purposes of this regulation—

‘financially material considerations’ includes (but is not limited to) environmental, social and governance considerations (including climate change);

‘non-financial matters’ includes (but is not limited to) ethical matters, social impact matters and present and future quality of life of members matters;

‘relevant matters’ includes matters concerning an investee company, including its performance, strategy, risks, social and environmental impact, and corporate governance; and

‘relevant persons’ means an investee company, an investment manager and a shareholder of an investee company.