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Dear Sinead and Vicky

Department for Work and Pensions (the 'DWP'): Consultation on clarifying and strengthening trustees' investment duties

Thank you for the opportunity to contribute to the consultation on clarifying and strengthening trustees' investment duties on behalf of the Tesco Pension Trustees Limited (the 'Trustee') of the Tesco PLC Pension Scheme (the 'Scheme').

We welcome the work being undertaken by the DWP in looking to clarify and strengthen trustees' investment duties.

We believe that a key part of achieving our mission to "pay the right benefit, to the right person at the right time" is to have a successful long-term investment strategy.

Background on the Tesco PLC Pension Scheme

Our Scheme is one of the largest private sector defined benefit (DB) schemes in the UK, with around 360,000 members with total assets of around £14bn.

The Scheme closed in November 2015 to both new entrants and future accrual of benefits. The Trustee has in-house FCA-regulated investment capability through Tesco Pensions Investment Limited, which is its principal investment manager that also has responsibility for the Scheme's external investment managers.

The Scheme invests responsibly in a wide range of diversified assets and pursues a long-term investment philosophy to deliver appropriate levels of risk adjusted returns – with Environmental, Social and Governance ('ESG') being an integral part of its investment process.

Tesco colleagues are now offered a Retirement Savings Plan (Defined Contribution Scheme) which has around 210,000 contributory members and, after just a few years, has total assets of over £1bn. The Tesco Retirement Savings Plan is managed and ultimately governed by the Legal & General Master Trust – with further oversight, by the Tesco DC Governance Committee – as part of two layer governance.

Introduction

We believe that this is a valuable opportunity to review the content of the Statement of Investment Principles, its use and application and to consider improvements.

We agree with the DWP's view that there is no consistency in how ESG is defined or considered and, as a consequence, this can lead to confusion and misapprehension across schemes.

We welcome the clarity and much needed reassurance in the proposed regulations for Trustees and we fully support the use of a Statement of Investment Principles (SIP) as a real, effective and regularly reviewed guide to investment strategy rather than a generic 'tick box' document.

Finally, it is also important to recognise the differing capability and capacity across different sizes of employers and schemes – and therefore any proposed increase in disclosure and content needs to be proportionate.

We feel it is important to be clear on the purpose and audience for a Scheme's SIP and the other additional governance documents that are being proposed – and be really confident that they add genuine value rather than increasing confusion and complexity leading to unintended consequences.

Whilst we are the Trustee of the Tesco Defined Benefit Scheme we have also contributed thinking towards the proposals that apply to Defined Contribution Schemes. Rather than responding to each individual question, we have provided comments on each of the key proposals – which we hope you will find helpful.

Law Commission's Recommendations

We agree that it is important to consider 'all' risks (not just ESG and Climate Change) and consider the time horizons over which they might apply.

There are clearly many investment and non investment risks that influence outcomes including the 'sponsor / covenant risk' in a defined benefit scheme. We do not think it is therefore useful to specifically single out ESG investment and climate change – but do think that broader guidance on 'financial factors' might be more useful (see below).

We agree it is appropriate to reflect in a written policy, at the appropriate level, how financially material risks and opportunities are evaluated but at an in 'principle' level within the SIP.

We also agree that the prime concern and objective of Trustees is not a measure of the sustainability of the investments but the measure of their long term return allowing for risk, net of costs and charges – i.e. the net risk adjusted return.

Key Observations

The proposals within the consultation require more information in the Statement of Investment Principles and, in addition, new implementation reports to be developed as a supplement to the SIP itself.

We think it is important to recognise that the SIP is a statement of investment 'principles', as opposed to a detailed document that contains exhaustive detail that underpins the investment strategy.

Unless there are material changes to the approach and investment strategy, it would be expected that the SIP would remain unchanged – reflecting the Trustee's and Sponsoring Employer's investment 'principles'.

Whilst this is an important document for the Trustee and the Employer, it should be written in a way that enables members to understand the approach the Trustee takes towards its investment strategy.

It is therefore important to make sure that, in any changes that are made, they are consistent with the 'purpose' of the SIP and, as part of that, to continue to improve its ease of understanding for members – making sure it's clear, relevant, simple and an appropriate length.

Equally, within this consultation it is important to note that the nature of Defined Benefit and Defined Contribution Schemes is different and the SIPs should reflect this. Whilst both DB and DC Schemes are

required to consult with the employer on the SIP, for DB Schemes this is a more central function as the employer is underwriting the risk – whereas, in DC, it's the members who have the risk.

Accounting for Financially Material Considerations and Members' Views

1.1 Proposal to state the Trustee Policy on the Evaluation of Financially Material Considerations in the SIP – but not on social impact investment

We agree with and support the proposal to include, within the SIP, the Trustee's policy on financially material considerations including, but not limited to, environmental, social and governance.

However, it is important that the expectation of the 'content' of the SIP continues to focus on 'principles' rather than detailed disclosure. This, in itself, should contribute to a SIP that is less about 'box ticking' and more about a statement that provides real clarity and value to the Trustee, Scheme and its members.

Careful consideration should be given to the proposal to publish the SIP online where, with a very public audience, this itself may influence Trustees to minimise and standardise information in a very controlled way and by delegating its production to their consultant – which would seem to go against the policy aim.

We think it would be helpful to provide guidance around the meaning of 'financially material considerations' and, across all forms of communication and guidance, to create a consistent and simple explanation of relevant terms to help schemes of all sizes.

We agree with the DWP's view that whilst we should clarify the meaning of ESG in a simple and consistent way, again, by referring to 'social impact' this may create too much emphasis in a few key areas and could also lead to confusion.

We also therefore agree with your proposal not to require Trustees to have a policy on social impact investment.

1.2 Proposal to prepare a statement setting out how Trustees have taken account of scheme members' views on both financial and non financial matters relevant to investment and stewardship decisions

The context for this consultation is the recognition that Trustees and Schemes are sometimes confused by the terms and responsibilities surrounding ESG and material financial and non-financial matters that relate to investment and stewardship decisions.

With Trustees and Schemes about to essentially go through a major transition of both learning, understanding and disclosure of the principles around ESG and material financial and non-financial risks, it seems premature to be gathering views from members (especially DB members) – without members themselves having the benefit of a clear understanding of 'all' these areas and their implications – not just climate change.

As an industry we already recognise that member engagement is low and challenging – even in the most fundamental areas. To start a simple conversation with members, with informed views that would ideally be representative of the 'whole' membership feels premature at the moment. Instead, we should develop some building blocks starting with clear and simple communication by Trustees of the approach being taken followed by building awareness and understanding with members.

Point 26 on page 11 of the consultation document states that the 'proposals are not intended to give any support to activist groups for boycotts or divestment from certain assets'. With that aim, we think that it is important to consider whether, through the proposals to consult and disclose on consulting with members, there would be any unintended consequences that could lead to going against this policy intent.

Finally, if Trustees are not required to act on any particular member concern (ie Trustees can listen to members' views but do not have to act on them), we feel this could lead to potential unintended consequences of how this might influence both the relationship with members, the decisions that members may take (eg to opt out of a perfectly good Defined Benefit Scheme) and the negative publicity this might create.

More specifically, as we believe that there are different considerations for DB and DC Schemes, we have outlined them separately where appropriate.

Defined Benefit:

The key objective of the Trustees of a Defined Benefit Scheme is to fund, deliver and pay an entitlement to an income determined by a member's service and pay.

Investment risk and strategy is agreed between the Trustee and the sponsoring employer – as investment risk is generally met by the employer.

The Trustee's primary obligation is to invest the assets in a way that will generate the most return at an acceptable level of risk. Only in extremely limited circumstances is a Trustee able to consider other non-financial factors such as the views of the members and, even then, only when they are sure that the majority of the members would hold a particular view.

As noted earlier regarding member knowledge and understanding in these complicated areas, the responsibility on the Trustee and Employer to deliver the benefits that are due through the investment strategy, with no requirement to reflect members' views in the investment strategy, it is difficult to realistically understand at this stage how the proposal would add clear and uncompromised value.

Defined Contribution:

We agree that to just simply offer 'self select' funds with particular ethical or social characteristics does not meet the needs of Trustees in considering ESG and other related matters.

We totally support the need to explain to members how material financial matters have been considered but in a way they would understand – where the application of particular policies within the investment strategy would benefit the majority of members.

Equally, whilst good progress has been made, we think that there is further product development needed to allow Trustees a real choice of investment propositions to meet material financial matters (in a way the consultation describes) that creates choice and value. Equally, we feel that some cultural change is required to reposition what appears to be the current focus from 'low cost' to 'optimising (net risk adjusted) outcomes' for members.

1.3 Proposal for Trustees to include their policy on stewardship of investments (including monitoring, engagement and voting) in the SIP

We agree and support the need to include a Trustee's policy on stewardship in the SIP as a matter of best practice – but, again, recognising this is a Statement of Investment 'Principles' and therefore expectations should not be to include huge amounts of detail.

If the aim is to also have a policy on stewardship sitting alongside the SIP then we would recommend that the SIP simply refers to the policy on stewardship without repeating what is already likely to be included in the stewardship policy.

1.4 Proposal to produce and disclose a policy alongside the SIP setting out how the Trustee has implemented the policies in the SIP

Unless there is a fundamental change to the Trustee's and sponsoring employer's long term investment strategy, it is unlikely that there will be a change to the SIP or a change in the explanation of the implementation of the SIP since a change was last made. In addition, in DC, the SIP will look at the portfolio as a whole, not necessarily the specific investments that individual members are invested in.

Creating another governance document to explain and confirm the implementation of the strategy in line with a statement of long term investment 'principles' feels unnecessary and burdensome with little or no real value. We don't believe it will necessarily provide members with any useful information about their own funds.

However, we believe that an alternative key step in improving the effectiveness of SIPs and a more helpful one for members could be to include in the Chair's Statement confirmation and an explanation of:

- Compliance with the SIP during the year
- Key developments in the investment strategy during the year – if any, and
- Key expected future developments in the implementation of the investment strategy – in line with the SIP

If, as Trustees, we put members at the heart of everything we do, we should recognise members' plea that we keep communications simple, relevant and, importantly, 'in one place', as best as possible.

Implementation reports alongside SIPs appears to further fragment and complicate the simple communication we should be having with members on the things that matter most.

Also, with no planned prescription of the content of the implementation statement it would therefore also lead to inefficiency, high consultancy costs particularly for small to medium sized schemes and the inevitable continuous change in the statement for a number of years to come (further increasing cost) as learnings gradually transfer across schemes.

1.5 Proposal that Trustees should 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

As mentioned earlier, we believe the further burden and cost of schemes producing additional online implementation reports and statements of how they will take account of members' views is disproportionate to the value that would gained – where we have also outlined the potential unintended consequences.

For change to be meaningful and to truly add value, we need to take proportionate steps at the right pace and at the right time to avoid increasing fragmentation of reporting, costs and administrative burden - without total confidence that this will contribute to the point made in the consultation that 'the Trustees' prime focus is to deliver a return to members over an appropriate time horizon'.

We have, however, suggested ways in which we believe policy aims and members' needs can be met, and where we also believe value can be truly added.

It would be helpful to have a clearer distinction of the different requirements of DB Schemes and DC Schemes within the proposals.

For example, as the SIP of a DB Scheme is an agreement between the Trustees and Sponsoring Employer of the investment principles to be adopted, it is difficult to understand the value and benefit of publishing the SIP publicly online. However, we wholeheartedly support providing full access to the SIP for members on the Scheme's website.

1.6 The effectiveness of the current use of SIPs

We believe that an effective SIP is one that sets out the key 'principles, in the areas that are relevant to the investment strategy.

We believe that it should be written in a clear and simple way, that doesn't contain unnecessary detail – and which is 'used' and 'monitored' by Trustees, can be understood by members, and which therefore serves a useful purpose.

The challenge for some of the proposals that are included in this consultation is ensuring it doesn't create a purely 'compliance tick box' document that loses the whole essence of its original aim.

Finally, we believe that it would be helpful to consider separating out the requirements that apply to SIPs of DB and DC Schemes. Primarily we believe that the use and therefore the purpose of the SIP is different for DB and DC Schemes – where the investment objective for one is about investing to deliver benefits provided to members by their employer and the other (DC) is to optimise (net risk adjusted) outcomes for members.

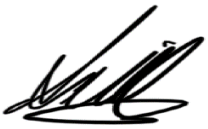
1.7 Proposed Timelines of Implementation

We believe the proposed timelines are fair and appropriate.

We hope that our response has been helpful to you where we have tried to 'live and breathe' the practical implications of the proposals in this consultation to really understand how they might apply and the net value they will deliver - alongside the extent to which they will really meet your policy aims.

We welcome the DWP's challenge to continuously improve the use of SIPs and would be delighted to discuss our thoughts with you should you wish.

Yours sincerely



Ruston Smith
Chairman, Tesco Pension Trustees Limited