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Sinead Donnelly and Vicky Bird
Department for Work and Pensions
Strategy Policy and Analysis Group
Private Pensions and Arm's Length Bodies Directorate
Ground Floor North
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Leeds
LS2 7UA

Dear Ms Donnelly/Ms Bird

Consultation on clarifying and strengthening trustees' investment duties

This letter sets out XPS Investment's response to the above consultation. XPS Investment provides a range of investment consultancy services both to trustees and corporate sponsors. Our clients range from small to large-sized occupational pension schemes and we believe that we are well placed to comment on the above consultation.

General comments on the consultation

As a business, we seek to help add value to our trustee clients' investment strategies in three main ways: firstly, we help them set clear, scheme-specific investment objectives; secondly, we inform them about the risks they may be exposed to and the mitigating actions that may be appropriate; and thirdly we provide advice on implementing strategies in a pragmatic and cost-effective way. To that extent, we support much of the thinking behind the proposals in the consultation, as they will assist us and our clients in these three areas, particularly the first two. We also note that the proposals are clearly intended to develop the existing integrated risk management framework within which trustees are expected to run their pension schemes.

We agree that it is important to take account of financially material risks, supported by clear, relevant advice that will lead to appropriate decision-making. We accept the assertion that "the scientific and public policy consensus is that climate change is a financially material risk to our future. " This is clearly an important area and one which looks to establish trustees' thinking further than at present.

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We also welcome proposals designed to improve the quality of trustees' Statements of Investment Principles ("SIPs") as we have had many examples of being appointed to schemes whose existing SIPs do little to go beyond the regulatory minimal requirements on content.

We do, however, have misgivings about some of the specific proposals in the consultation. One area of concern is where trustees are expected to state their policy in relation to ESG considerations; we believe that many of the proposals are somewhat premature and that the investment advisory industry has some way to go before being able to advise clients sufficiently and appropriately for trustees to make proper informed decisions in these areas. Another area of concern is the proposal for trustees to state how they will take account of members' views in their investment strategies; we feel that the proposal will encourage members' views to be sought (whether this is the intention or not) and that such a proposal will be problematic for a number of reasons.

Consultation questions

We have answered the specific questions raised as part of the consultation in an appendix to this letter and we trust these comments are of some assistance to you.

Yours sincerely

Guy Plater MA FIA

Principal

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Appendix – Responses to questions raised as part of the consultation

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.

Given our comments in the main body of this letter and in our answer to Q2 below, we believe that the timescales proposed are likely to lead to negligible changes relating to the policy intent. We believe that more time should be given for trustees to be better-educated in the areas being addressed and, more importantly, for advisers to assist them with the appropriate risk assessments. Anecdotally, these views are shared by other consultancies when the issues have been discussed at ESG seminars, for example.

More time would also help ensure a significant move towards a standardized approach by asset managers to quantifying ESG involvement and risks etc, that would also be more helpful to trustees.

We believe that if the draft Regulations were to come into force 2 years after laying, they would be more successful in influencing trustee behaviour.

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.

We agree with the observation that ethical considerations are often conflated with broader social and environmental considerations. Advisers like ourselves have a responsibility to help trustees understand these issues more fully.

We also agree with the suggestion that ESG risks are likely to be financial material. The assertion is that trustees should take account of these risks in the same way as other risks in pension scheme investment. Whilst we are supportive of this proposal in theory, we believe that in practice it is very difficult to achieve at this time. The consultation gives examples of ESG considerations but we note that ESG is very broad. Our view is that trustees could easily exclude relevant "ESG considerations" and that this could lead them open to criticism. We believe that it will take time for pension scheme advisers to build up sufficient expertise in this area for them to be able to provide valuable insight that will help trustees quantify ESG risks at anything other than an extremely high level. Attempting to do more in the absence of such expertise is likely to lead to decisions being made on analysis that is, at best, spurious, and at worst, inappropriate.

When referring to trustees taking account of ESG risks, we note the comment that this should happen in the same way as it does "…in relation to interest rate risk, liquidity risk, exchange rate risk, market risk, political risk and counter party risk". Our assertion would be that political risks are likely to be as great, if not greater than, ESG risk, and we question the extent to which such risks are being adequately considered at this time (for the same reasons as set out in the previous paragraph).

We also note that certain recommendations linked to commentary on environmental, social and ethical considerations were introduced under the Myners' review in the early 2000s and in our experience these have done little to change

behaviour since then.

In short, we have concerns around trustees having the ability to form meaningful policies in this area at this time.

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.

We note that the Law Commission points out how current legislation "allows" member views to be taken into account and the "some trustees will wish to [do so]". Now, we note that it is considered "good practice for trustees to inform the design of investment strategies with an understanding of scheme members' views". Therefore, whilst we note that the proposal does not preclude the possibility that trustees simply state that they have chosen not to take account of members' views, there seems to be a change of emphasis here – intended or otherwise – such that trustees are likely to feel that they are being encouraged to take account of members' specific views.

Trustees need to act in members' interests but a requirement to articulate how they take account of members' views is only likely to be appropriate if trustees feel they are sufficiently informed to comment on members' views and that views are clearly expressed in matters of relevance. We therefore have a number of concerns in this area including:

- Trustees misinterpreting/misrepresenting members' views;
- Trustees struggling to reconcile different (sections of) members having different (opposing) views;
- Trustees inadvertently ignoring the views of some members by only focusing on view expressed via certain communication channels;
- Trustees trying to be seen to take account of members' views where those views could lead to a materially detrimental financial outcome, if implemented, but where the members are unaware of that likely outcome.

Further problems may arise around consultation with the employer if members' views have been sought and the employer has different views.

Ultimately, we have no evidence from our clients of members actively requesting that more is done to reflect their views and this further supports our view that the current requirements regarding member views remain appropriate.

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?

Yes, we agree.

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.

Yes, we support the proposal that trustees be required to include their policy in relation to stewardship in the SIP and the assertion that a broader consideration of stewardship beyond those merely related to voting rights is appropriate.

We believe that a requirement to include such a policy in the SIP is likely to lead to trustees of larger schemes, in particular, establishing a clear policy (as opposed to a "policy of no policy") and that that is consistent with desire to strengthening corporate governance within the economy.

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.

We agree with the observation that many SIPs simply contain "generic text which simply meets the legal requirements but does not reflect trustees' investment beliefs or the scheme's specific characteristics". We believe more should be done to ensure that, in preparing a SIP, trustees give proper consideration to their specific, investment-related views and risk appetite and that these are then recorded. This will then improve the value of a SIP and ensure it is more likely to serve its intended purpose.

We do not have a strong view in support of the proposal that trustees are required to prepare a statement within their annual report setting out how they have implemented the policies in the SIP. We believe that it is more important that trustees *are* investing in accordance with the policies and principles in the SIP; members take this as "a given" (and trustees are currently required to report on any departures). We do, though, support the proposal to include commentary around any *changes* to the SIP in the trustees' annual report as this should be a reflection of a change in principles. Trustees may alter, for example, their investment objectives or attitudes to risk and to the extent that such changes lead to the implementation of a materially different investment strategy, it is in members' interests to understand the changes.

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.

We agree with the proposal to publish the SIP online as we believe that this is consistent with trustees becoming more accountable as regards having (and documenting) a clear philosophy on investment objectives, principles and policies.

We are less supportive of the proposal to publish the implementation report and statement setting out how trustees will take account of members' views online for the reasons explained elsewhere in this response.

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?

We do not have any comments on these matters.

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

We believe the FCA Rules would need to be changed in order that in assessing the ESG suitability of certain funds, we as advisors, could take such matters into consideration.

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?

Broadly speaking, we do agree, although the intentions around providing a statement of members' views could be clearer, as discussed above.

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?

We have seen examples of SIPs being drafted in very different ways, from a "minimal compliance" type approach at one extreme to a highly-prescriptive document incorporating detailed description of the investment strategy itself, at the other. In many cases, we note that trustees have taken the approach – presumably under advice – of recording strategic investment details in a document that is separate to the main SIP. We would like to see all relevant information included within the SIP itself, but with employer consultation only required where there is a significant shift in strategy.