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Dear Sinead, Vicky,

Department for Work & Pensions: consultation on clarifying and strengthening Trustees' investment duties

Please find enclosed, on the following pages, KPMG's Investment Advisory Practice's response to the Department for Work & Pensions consultation as mentioned above.

Yours sincerely

Nick Evans
Partner

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Department for Work & Pensions' Consultation on clarifying and strengthening Trustees' investment duties

KPMG's Investment Advisory Practice welcomes the consultation on clarifying and strengthening Trustees' investment duties following the Law Commission Report.

Whilst we agree with the majority of the recommendations made, we particularly welcome the initiative to use the Statement of Investment Principles ("SIP") as a real, effective and regularly-reviewed guide to investment strategy rather than a generic "box-ticking" document alongside the proposals incorporating improved transparency and accountability.

Our responses to the questions proposed are detailed below.

1. **We propose that the draft Regulations come into force approximately one year after laying, with the exception of the implementation report, which would come into force approximately two years after laying.**
   a) **Do you agree with our proposals?**
   b) **Do you agree that the draft Regulations meet the policy intent?**

KPMG's Investment Advisory Practice agrees with the policy proposal set out by the DWP and believe the draft Regulations broadly meet the policy intent. We feel the suggested timeline gives a sufficiently wide window in which Trustees can consult with their advisers and develop revised/additional documentation.

There is clearly a great deal of emphasis on making the SIP and associated documentation more comprehensive and transparent. We view this as a positive step that should make pension scheme documentation more bespoke and help to address the "box-ticking" issue. Currently we do have concerns that SIPs are generic documents, often prepared with little input from Trustees themselves.

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2. **We propose to require all Trustees of all schemes which are obliged to produce a SIP to state their policy in relation to financially materially considerations including, but not limited to, those resulting from ESG considerations, including climate change.**
   a) **Do you agree with the policy proposal?**
   b) **Do the draft Regulations meet the policy intent?**

KPMG's Investment Advisory Practice agrees with the policy proposal set out by the DWP and believe the draft Regulations meet the policy intent.

In accordance with Trustees' fiduciary duty it is imperative that they act "...prudently, responsibly and honestly" and therefore should consider short and long term risks that a pension scheme may face when making key investment decisions. For a long time this, along with "acting in the best interests of the Scheme beneficiaries", has often been misinterpreted in the context of simply enhancing returns without considering the longer term impact or materiality of such risks that a Scheme may face e.g. climate change. Fiduciary duty is not simply regarding enhancement of long term return but is also, in the context of being prudent, considering the financial materiality of risks such as climate change and other ESG related issues that can have an impact on a Scheme's assets over the longer term.

The current legislation does not ensure Trustees take into account the financial materiality of risks such as ESG and climate change. This results in, for some cases, a dismissive "box-ticking" approach to referring to these risks as part of the SIP rather than incorporating them as part of investment strategy and therefore ignoring the materiality of these types of risks.

Our view is that, by having a policy in relation to financially material considerations, Trustees can more effectively consider the full spectrum of risks that a pension scheme is exposed to in order to successfully meet its objectives.

With reference to "all Schemes which are obliged to produce a SIP", we would encourage the publication of a SIP to be required for all pension schemes regardless of size or number of members. Production of a SIP is best practice and so should be statutory for all.

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3. 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?

KPMG's Investment Advisory Practice is broadly in agreement with the policy proposal set out by the DWP and believe that the draft Regulations largely meet the policy intent.

Although it may be difficult to incorporate pension scheme members' ethical and personal views, we believe it is important for Trustees to consider the profile of a pension scheme's membership and their views in conjunction with their key investment decisions. Giving Trustees freedom to consider issues for which there is a general consensus from the Scheme beneficiaries allows them to ensure members' needs and objectives are being met. A statement on the way in which these views are incorporated helps put into context, from a member's perspective, why a particular decision has been undertaken. This also helps illustrate the thought process that the Trustees have gone through to get a Scheme to where it is at present.

We believe the statement can help create a tool for clearer communication between Trustees and pension scheme members. It can also aid the Trustees in effectively documenting and illustrating the various stages of the investment decision making process, which incorporate pension scheme members' perspectives that have had an impact on Trustees' actions. Clearly member feedback on any statement will be important here.

On the other hand whilst we support the idea of preparing a statement to set out how members' views will be accounted for, we expect that it will be challenging to collect and summarise members' views, particularly since engagement from members will vary from one pension scheme to another. There is a risk that some members will engage more than others, which could lead to a biased view from the members' perspective. Further to this, there is potential for there to be too much data available for the Trustees to consolidate into one policy statement, which perhaps could be counterproductive and take Trustees away from some of the more significant decisions. We would welcome further guidance for Trustees on how they would collect and summarise members' views and how to tackle the risks highlighted above.

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4. 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?

KPMG's Investment Advisory Practice agrees with the proposal not to require Trustees to state a policy in relation to social impact investment.

In line with the proposal set out by the DWP, we believe that social impact investment should be considered separately from the "S" for social considerations found within the context of ESG, which are more specifically related to the impact of an investment to pension scheme members.

Whilst social impact investing plays a key role in society it does not necessarily imply there will be a financial gain to pension schemes by investing in this way. For this reason it would be difficult for Trustees to incorporate a policy on social impact investment. Additionally, guidance allows for Trustees to include a social impact investment either as an option or as part of the default strategy (in the case of Defined Contribution ("DC") pension schemes), which provides Trustees with flexibility to decide whether a social impact investment is appropriate for a Scheme. With reference to Defined Benefit ("DB") pension schemes, it would be necessary to consider the materiality of the risks involved with investment in social impact funds and the extent to which this investment could hinder returns (if at all) before incorporating it within the investment strategy.

Furthermore a common myth of ESG is that it takes into account moral and ethical views which can lead to Trustees mistakenly ignoring ESG risks. Social impact investment, on the other hand does, in our opinion, have an ethical angle and imposing requirements on Trustees to disclose a social impact investment statement may add to the confusion that ESG considers morals and ethics. We are therefore supportive of the DWP's decision not to include this as a requirement. The purpose of these policies should be to make Trustees aware of all financially material risks – of which ESG is one.

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5. 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?

KPMG's Investment Advisory Practice agrees with the policy proposal set out by the DWP and believe that the draft Regulations broadly meet the policy intent.

Stewardship over investments is an important and often neglected aspect of investing. Many Trustees delegate the responsibility of voting rights and engagement to their asset managers and are often unaware of the stewardship decisions that asset managers are making on their behalf.

Whilst governance costs may limit the extent to which Trustees are able to engage with stewardship, requiring Trustees to explicitly state their policy will both encourage them to have a greater awareness of both the stewardship of their investments and the impact that these measures can have.

Where pension schemes are invested in pooled funds, these measures will encourage Trustees to engage with their asset managers to assess their stewardship policies. When making the decision of which asset managers to invest with, the manager's policies on stewardship of investments should be assessed in line with other aspects and form part of the view on investment process and risk management.

It is mentioned elsewhere in the policy proposal that pension schemes with less than 100 members will not be required to produce a SIP and KPMG's Investment Advisory Practice does not agree with this proposal. It may be argued that stewardship of investments is burdensome to small Schemes and is not a priority, however stewardship decisions can be delegated to asset managers.

ESG is an evolving field with managers investing resources in improving their ESG offerings. This would mean that smaller pension schemes who have less leverage in their choice of manager should have more choice as the market continues to develop and competition between managers on ESG offerings increases.

Whilst the option of a 'policy of no policy' is still open, Trustees should still be required to state why this decision has been made to show reasonable judgement and thought has been given.

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6. **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 changes 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?**

KPMG's Investment Advisory Practice agrees with the policy proposal set out by the DWP and believe that the draft Regulations meet the policy intent.

We feel the annual report should provide the user with sufficient information to be able to evaluate the performance of a pension scheme/Trustees over the period. Linking the decision making and performance captured throughout the reporting period, with the formal objectives and intentions documented in the SIP, should increase the level of accountability on Trustees and improve the ability of members to evaluate them.

We agree that this should not be onerous and should be a form of self-evaluation for Trustees ahead of making decisions. It should also encourage Trustees to act in a manner more closely aligned to the SIP and associated documentation, which is likely to be more detailed than what is currently practiced.

As a suggested improvement to the policy, where Trustees have opted to change a SIP mid-reporting period, we would expect explicit justification for doing so to be clearly explained within the annual report.

We think the time frame suggested for implementing this policy is reasonable.

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7. 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?

KPMG's Investment Advisory Practice agrees with the policy proposal set out by the DWP and believes that the draft Regulations meet the policy intent.

Online access to pension scheme reporting and documentation has two distinct benefits. The first is making it easier for Scheme members to access the documentation which is guiding the decisions made on their behalf. Increased engagement and understanding of these decisions should increase the alignment between members and Trustees in their decision making.

Part of the policy proposal mentions that Trustees should follow a two-stage process when making decisions to take account of members' wishes. The first step being that Trustees should have good reason to think the pension scheme members hold the concern, but often it is difficult to understand the wishes of members without proactively engaging with them on issues, which can be costly. Members are more likely to proactively come forward and make their wishes known if they can see that the pension scheme is currently investing in a manner that is against their wishes, and so online access will increase the potential for Trustees to be aware of members' wishes.

The second benefit is peer review. Within other industries where peer review is prevalent, whether financial reporting or academic research, it tends to have two beneficial effects. The first is that public scrutiny, or the potential for it, causes laggards within the field to improve their standards to be more in line with the average. This would lead to better SIP documentation and better engagement by Trustees on the decisions that go into producing a SIP. The second is that peer review of documentation leads to a better overall standard throughout the industry, as pension schemes can learn from each other and share best practices.

It is unclear where documentation is expected to be hosted, whether on a centralised Government website in the style of Companies House and the Charity Commission or whether Trustees would be expected to host themselves. The latter could cause issue where Trustees do not have a website and/or pension schemes are relatively distant from a sponsoring employer. We would like to see further guidance on this.

Overall, whilst some members will not have access to the internet, informing members of the access available to them via their annual benefit statement will allow them the opportunity to seek access and should give every member the opportunity to engage with their pension schemes' investment principles.

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8. **Do you have any comments on the business burdens and benefits, and wider non-monetised impacts we have estimated in the draft impact assessment?**

Naturally, increased disclosure of information will result in some additional business burdens in the form of time and expense. However, we believe additional information can improve transparency and improve decision making. Regulation is expected to change as the world evolves and it is widely believed that ESG factors are financially material and therefore should be included in the decision making process. The lack of ESG disclosure requirements has led, in some instances, to ESG factors being ignored in decision making. This, in our view, has blurred the lines of Trustees' fiduciary duty.

The stated purpose of these policy proposals is "to improve decision making by pension Trustees and enable a more uniform consideration of financially material risks." Providing guidance and requirements to Trustees on specific ESG disclosures should assist in achieving this goal. Any associated burden may dissipate over time as the benefits of Trustees gaining a greater ability to make more informed investment decisions accrue.

We believe it is difficult to quantify the costs and benefits of the proposed policies, however we expect the business burden will be greatest in the short-term and the benefits will continue over the long-term.

In theory, it would be preferable to take members' views into account as part of investment strategy, however, we believe that greater consideration should be given to the indirect costs associated with Trustees updating existing policies to take into consideration members' views. We expect that this would be challenging, could place a great deal of uncertainty and pressure on Trustees and will vary from one pension scheme to another. This could represent potentially prohibitive costs and should be reviewed. If this directive is initiated clear guidance should be provided to Trustees.

We agree with the benefits you have outlined in principle, in particular the policies:

- May encourage greater recognition of Trustees' duty with regards to stewardship;
- Will help reduce confusion – we are seeing uncertainty around whether ESG is financially material or not. These policies are likely to reduce this confusion;
- May result in increased engagement in DC Schemes.

Overall we view the burden of disclosing ESG factors in SIPs as a small cost relative to the potential benefits for pension scheme members.

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

We are broadly comfortable with the policy proposals and draft regulations, however, we would encourage this to be extended to all pension schemes, including smaller pension schemes, as we believe that best practice should be imposed on all Trustees, regardless of the size of the pension scheme or number of members.

Initially, we believe that statutory guidance should be introduced, but agree with your assessment that options 4 or 5 are the preferred approach.

We are comfortable with the implementation time frame that has been proposed and agree that it is important to allow sufficient time for Trustees to become familiar with the changes and be able to implement the changes accordingly.

As referenced in question three, the proposal to publish a statement of pension scheme members' views online sounds good in principle, but we are sceptical of the practicality of this. It would be very difficult to gather and summarise each individual member's views and could potentially cause a lot of headaches for Trustees. We therefore suggest issuing guidance on collecting and publishing members' views if this proposal is implemented.

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10. 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?

As it stands the Revised Statutory Guidance is limited with regards to details required for Trustees to meet these duties. We would encourage the guidelines be elaborated to include details for the requirements relating to the disclosure and publications of the SIP and other related materials. Examples, templates and further guidance on how to implement the changes would be welcomed, to assist Trustees with the changes.

The guidance makes reference to publishing "how members' views are taken into account as part of the annual report", however it is not clear if this relates to members' ESG views or investment views or both.

KPMG's Investment Advisory Practice encourages the publication of guidance on collecting, clarifying, summarising and publishing members' views to avoid confusion.

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11. 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?

The purpose of the SIP is to set out how Trustees make strategic decisions. KPMG's Investment Advisory Practice agrees that, often, the text used in SIPs can be generic with limited information included into them. As a result of the generic approach that is often taken, writing and reviewing SIPs has in some cases turned into a "box-ticking" exercise to meet legislation requirements.

With regards to ESG, the disclosure requirements are limited in our view. At the very minimum, a SIP should specify that Trustees have considered ESG risks and agreed whether they would be managed by the Trustees or delegated to the investment managers. Experience suggests that Trustees are unaware that asset managers might in fact already be managing ESG risks themselves.

There is a danger that too much information will make SIPs complex documents that Trustees may not be able to digest, but including some additional requirements has the potential to increase the effectiveness of these documents. Some considerations that KPMG's Investment Advisory Practice would encourage exploring include the addition of the following:

- A measure and attribution of risk e.g. inclusion of Value at Risk
- The degree of hedging, particularly interest and inflation hedging
- Time horizons on different bases
- Management & performance fees
- Expected evolution of asset allocation over time
- Cashflow management policies for DB Schemes

In addition to the above and as mentioned earlier, we would encourage the publication of a SIP to be required for all pension schemes regardless of size or number of members. Production of a SIP is best practice, so should be statutory for all.

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