Department for Work and Pensions Consultation on changes to the Investment Regulations following the Law Commission’s report ‘Fiduciary Duties of Investment Intermediaries’

Response from The Pensions Management Institute

Response from the Pensions Management Institute to DWP consultation "Consultation on changes to the Investment Regulations following the Law Commission's report 'Fiduciary Duties of Investment Intermediaries'"

Introduction

Following the publication of the Kay Report in July 2012, the Government asked the Law Commission to review the fiduciary duties of trustees when making investment decisions. In particular, the Law Commission was asked to examine the extent to which trustees should value sustainable growth over short-term financial gain and the role of Environmental, Social and Governance (ESG) in formulating investment strategy. The Law Commission published its report in July 2014.

The PMI

The Pensions Management Institute (PMI) is the professional body which supports and develops those who work in the Pensions Industry. PMI offers a range of qualifications designed to meet the requirements of those who manage, advise on or govern workplace pension schemes. Our members (currently some 6,500) include pensions managers, trustees, lawyers, actuaries, consultants, administrators and others. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response.

PMI as a body does not hold opinions on matters of pensions policy (although its members as individuals may do so). It is focused on supporting its members to enable them to perform their jobs to the highest professional standards, and thereby benefit members of retirement arrangements for which they are responsible. Comments made by the PMI are intended to improve outcomes for the members of those arrangements and should be read in that context.

PMI's response

Q1: How could regulation 2(3)(b) of the Investment Regulations be amended so that it more clearly reflects the distinction between financial and non-financial factors?

Regulation 2(3)(b) currently provides for a statement of investment principles to cover the trustees' policies in relation to

"…

(iii) risks, including the ways in which risks are to be measured and managed;

…and

(vi) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments."

We consider that the existing requirement to detail risk management policies (as well as the other policies to be recorded in the statement of investment principles) is sufficient to cover the need for trustees to consider financial factors and identify their policies in relation to them. In essence, the Law Commission report identified that taking account of many so-called "Environmental, Social and Governance" concerns is no more than normal management of portfolio risk that ought, in the normal course, to be part of trustees' investment decision-making.

It might be helpful to reinforce regulation 2(3)(b)(iii) so that it explicitly records that the risks to be covered may include, amongst other things, risks which could have financial implications but which arise from factors such as environmental, social or governance concerns.

We therefore consider that the only change required to regulation 2(3)(b)(vi) is to make it provide for disclosure in the statement of investment principles of whether trustees take account of non-financial factors in choosing investments, and if they do, identifying what those factors are and how the trustees have identified them as being of importance to include in their investment decision-making.

Note that we do not think it necessary or helpful to require trustees to specify the "extent" to which they have taken account of non-financial factors. All that is required is for trustees to specify whether they have done so.

We consider this approach would enable and facilitate trustees to distinguish clearly between financial and non-financial factors as outlined in the Law Commission Report.

Q2: Do you agree that amending the Investment Regulations to require trustees to comply with the current requirements in the Stewardship Code or explain why they have not done so, is the most appropriate way to implement the Law Commission's recommendation? If not, what approach would be more appropriate to encourage trustees to consider their approach to stewardship?

We believe that the Investment Regulations should be amended to require trustees to disclose in their statement of investment principles whether they have *signed up* to the Stewardship Code or explain why they have not done so. In addition, for those who have signed up to the Stewardship Code, the Investment Regulations could require them to specify in their statement of investment principles the extent to which they implement/depart from the Code.

From the consultation question, it is unclear whether this is the amendment that is being proposed or whether the proposal is that the Investment Regulations should require trustees to specify whether they have or have not complied with each of the principles of the Code, irrespective of whether they have formally signed up to the Code. The distinction is important because there will be many schemes for which it is not practicable to exercise any active stewardship and it would be unduly onerous for these schemes to make disclosures against each of the principles in the Code.

Q3: What steps would trustees need to take to comply with any amendments to the Investment Regulations, as set out in Chapter 2? What if any costs would be involved in meeting any new requirements?

We consider the "comply or explain" approach to stewardship means that trustees who see no benefit from active engagement with investee companies need do no more than reformulate their statement of investment principles. This should not generate material additional costs.

In any event, costs can be minimised by ensuring that changes to the statement of investment principles are not required to be made until the next occasion on which the statement is otherwise revised and we would recommend that the legislation includes transitional provisions to facilitate this.

Trustees who already take stewardship activities seriously, are again unlikely to incur material additional costs from providing further explanations of what they do and don't do in respect of stewardship in their statement of investment principles.

A number of trustees may be prompted by the "comply or explain" approach to reconsider their stewardship activities and so may incur additional cost through any decision they take to increase engagement. However, as they are likely to do this only where they perceive that additional engagement to be in their members' interests, this does not appear to us to be a reason against implementing the proposed amendments to the Investment Regulations.

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