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**Response to: Consultation on clarifying and strengthening trustees' investment duties**

I am a qualified chartered accountant who has worked within the pensions industry for more than 20 years, in audit firms, third party administrators, an in-house pensions investment manager and now as part of an in-house pensions department, where I am the Pensions Investment Manager.

My role includes managing the relationships with the investment advisers, investment managers, and fiduciary managers and acting as Secretary to the Funding Committee. The role includes ensuring that our two occupational pension schemes comply with any changes that will arise from any changes to legislation such as this.

I am also a director of the Pensions Research Accountants Group, who are the body responsible for the Statement of Recommended Practice, Financial Reports of Pension Schemes.

**However, please note the views expressed in this letter are entirely my own and should not be attributed to anyone else.**

**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.**

In Chapter One, paragraph number 20 headed; 'Why we propose to legislate', you set out four reasons for the proposed regulations. I set out below my responses to each of these four reasons.

i) I support the statement that Trustees should take into account financially material risks. However, it must be for the Trustees to determine with their financial advisers what is a financially material risk. The circumstances of one defined benefit scheme approaching a full buy-out will have a significantly different to those of an open scheme with very few pensioners.

ii) I do not disagree with the sentiment that Trustees should fulfil the responsibilities associated with holding investments. The trends I perceive, in pension scheme investing, lead me to think that it is likely only the largest of schemes will invest directly in equities, or other securities. I believe the majority of pension scheme investments are now held through pooled investment vehicles of investment

managers. Trustees have recognised that their individual holding in a company is insufficient to carry any weight with the directors of those companies. By combining their investments through pooled vehicles they will be benefiting from the expertise of the investment manager and the scale that the pooled fund can bring to bear on that company to change its behaviours so as to generate better returns for the Scheme. Schemes have also been appointing fiduciary managers to look after their investment strategy and these arrangements will typically delegate fund and stock selection decisions to that manager. It might help, therefore, if Regulators issued more guidance to the investment management community in this area, rather than add additional duties on trustees who are not professionally qualified investment managers.

iii) The third bullet suggests that the DWP has concluded that ESG is a financially material risk. I do not believe it is appropriate for the DWP to make such a statement. It must be left for the Trustee to determine, based upon appropriate independent financial advice what is a financially material risk based on their specific circumstances. However, it is right for Trustees to ensure they have identified the risks that are financially material to their strategy. Trustees can also consider whether, and how to communicate these to their members, as part of a co-ordinated communications strategy. As I will set out in the responses to the other questions, I do not believe it is appropriate for all schemes to take account of member concerns.

iv) I support the creation of a document (the SIP) which is a reference guide against which all investment decisions should be tested. I would agree that the SIP, as with other pension scheme documents is likely to have become a box ticking exercise for many trustees. I would attribute this to the low levels of engagement from pension scheme members requesting information about their scheme. Without generating much more engagement with the members then any change of tactic is likely, despite good intentions, to fall back into a box ticking exercise.

**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.**

I would expect that most Trustees have a risk register and that they are aware that the key risks they face are covenant risk, investment risk and liability management risk. This is in line with the integrated risk management framework supported by the Pensions Regulator.

Trustees receive advice from their investment consultants or fiduciary managers which will usually identify the biggest three risks to manage within the investment portfolio as interest rate risk, inflation risk and longevity risk.

The materiality of these risks though are assessed against the liabilities of the scheme and its overall objective. Trustees must be able to continue to assess these (and any other risks, including ESG and climate change) against its objectives and asset allocations. Some Trustees will be targeting a buy-out solution in say less than 3 years, while other Trustees may be considering self-sufficiency and run off into the next century. The first scheme may be invested exclusively in UK government securities and derivatives, and as such will have a

very different view of what is financially material to the second scheme, which may have over 50% of their investments allocated in equities and corporate bonds.

I therefore support that Trustees should articulate what they believe to be the most financially material risks to their scheme, however, what is financially material must not be constrained by legislation.

**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.**

My initial instinct was that I did not believe this is appropriate to all schemes that are required to prepare a SIP. The only schemes for which this might be appropriate are those schemes where members bear the investment risk.

**Defined Benefit Schemes**

Investment risk in defined benefit schemes is borne by the principal employer and managed by the Trustee after taking appropriate financial advice from its advisers, including investment adviser, actuary and covenant adviser. The Trustee is required to consult with the employer and obtain a Section36 letter from the investment adviser. To add in an extra responsibility to consult the members will lead to additional complexities and could be something which could not be supported by the Trustee's advisers or the employer. This could lead to conflict and ultimately failure to agree Recovery Plans.

As members do not bear the investment risk in a defined benefit scheme, I do not believe there to be sufficient reward to consider member views.

The Member Nominated Trustee Regulations do give members the right to influence the investment strategy though. If a member believes that the current representatives are not acting in their best interests then they can stand and/or vote against the incumbent.

**Defined Contribution Schemes**

As members do bear the investment risk then my initial thoughts were there may well be some benefit to consulting with members.

However, the Trustee will be taking independent financial advice to determine whether there is a default offering or not and, if so, what is included within the default offering. I perceive it would be quite difficult for a Trustee to overrule the advice regarding the default offering, to take account of member desires, if the adviser considers these may well lead to sub-optimal financial performance.

This though would not preclude the Trustees offering funds, which would meet member requests, as part of the options available to members.

In considering this further though, my expectations are that in defined contribution schemes,

i) there is a significant group who do not engage to receive the higher rates of employer contributions on offer; and
ii) the default fund is selected by a significant majority of members, probably without consideration, rather than by any formal assessment of the alternatives.

It is highly likely that one member's view on ESG (Environmental, Social and Corporate Governance factors) is going to be different to the next. Indexed ethical investment funds do exist for defined contribution schemes but I have not seen clear evidence to support that

these funds consistently and over the long term produce better returns for less risk than traditional indexed funds.

If this were the case then the normal default or 'target date' funds offered by managers would be based on ethical investing, rather than the traditional index trackers.

It would therefore be encouraging if there were some incentives placed on investment managers to put ESG matters in the centre of these funds.

However, to cater for every member's preferred choice would mean creating a significant range of investment options, (for example to provide options to exclude certain securities (e.g. tobacco, fossil fuels), and funds which show positive bias (e.g. renewable energy)). The problem, I perceive, with this is that engagement tends to fall, if too many options are presented to members.

I believe that the method of engagement which has the highest success rate will also depend upon the demographics of the membership. I would expect that pensioner members prefer paper based communications, whereas younger employees may respond to emails, or use internet based solutions.

To take into account member views will also mean that serious consideration will be require over the nature of the question to be asked and how to avoid giving too much weight to the voice of a minority with vested interests.

A consultation exercise could be constructed where the Trustee sets out its view and will only reconsider if more than 50% of the membership write in to object, and set out a revised solution would ensure the Trustee could continue with its current strategy. This would be quick and simple, and relatively cost efficient.

If a broader question was asked and workshops, consultation committees, AGMs etc. were used and then a formal pack of information was provided to all members to make a more informed choice, then a totally different outcome might be achieved.

However, I perceive there is a danger in giving an expectation to members that their views might be enacted. Trustees would not only need to justify their decisions of what to include, but also what not to include.

**Conclusion**

On balance therefore I have decided I am not in favour of any form of member consultation on investment strategy for defined benefit schemes and default funds for defined contribution schemes. These decisions should be left to those with sufficient knowledge and skill to make these decisions.

Member consultation exercises could be undertaken to ensure that there is sufficient demand to offer alternative funds to give members choice about where to invest their contributions.

**Q4: Do you agree with our proposal not to require trustees to state a policy in relation to social impact investment?**

Yes.

**Q5: We propose that trustees should be required in include their policy in relation to stewardship of the investments, (including monitoring, engagement and voting) in the SIP.**

As I have indicated earlier, I believe the vast majority of Trustees delegate this activity to the fund managers they employ. As such a policy is quite easy to prepare, and will probably already exist in most SIPs.

Where this policy is already in place I would expect that the Trustee would receive a regular report from the manager(s) about how they have engaged with all the companies in their portfolio.

It would be more helpful to trustees if consideration was given to introducing more guidance to investment managers in what they should be reporting to their investors.

**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.**

I believe it is entirely appropriate that when Trustees set high level investment beliefs, as recently suggested in guidance from the Pensions Regulator, they are held accountable to those beliefs. As such, I am supportive of the idea for a report to members that confirms the decisions taken during the year follow those beliefs, and where they have taken investment decisions, contrary to those beliefs, then they should explain themselves. The beliefs should be documented in the SIP and changes to those beliefs should also be explained.

However, I have interpreted you definition of 'relevant schemes', to mean this only applies to schemes where there is a purely defined contribution section of benefits. I would find it acceptable if this requirement was applied to all schemes.

I am less convinced however that the Annual Report is the best place for such a document. The Annual Report is only provided to members (and other prescribed persons) upon request. This could result in a tick box approach to the statement.

There are now a number of documents being prepared by Trustees, (including SIP, Summary Funding Statement, Annual Report and Financial Statements etc.) which are being made available to members, and to push one or more of these to the forefront of members attention may not always be appropriate. As such Trustees may need to rethink their overall communication strategy with their members and ensure that they receive appropriate balanced communications.

I would suggest that there is a wider need to ensure that the right information is communicated through the right channels to the members and that there probably should be a different wider consultation on what should be communicated to members, and how.

I have already set out that I do not believe in member engagement on investment strategy, so cannot support the second element of this question.

**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.**

Trustees are accountable to their members and not the public. As such there should be no requirement to publish anything online and in the public domain for the majority of occupational pension schemes.

It is important that the membership have access to this information through appropriate channels, and this is not necessarily via internet based methods.

I am concerned by the term 'relevant schemes' which defines those schemes which would be impacted by this regulation. My understanding is that this definition would also capture schemes with very small closed defined contribution sections. Compliance with these draft regulations would be significantly disproportionate and could lead to confusion when there is only information in the public domain for part of the overall benefits being provided.

I do perceive there may be a benefit to online publication for defined contribution schemes which are not specific to individual employers, and are open to new members, for example Master Trusts. I could also see merits for online communications of this nature to be appropriate for contract based defined contribution schemes as well. This could influence the choice of scheme by employers.

I would therefore suggest, as a minimum, that if there is no other change to the draft Regulations, that this section is changed to only apply to those schemes which provide benefits, which are purely on a defined contribution basis, and the member is bearing the whole of the investment risk.

**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?**

I have set out two different styles of consultations in my response to Q3 above. I believe the questions asked will have significant influence on the outcome of the consultation.

Where Trustees perceived there to be an ideal outcome and little budget, the quick and simple consultation may be the outcome if there was a short time frame to implement the final regulations.

Company budgets for 2019 are probably already determined, or will be by the time the outcome of the consultation is announced. As such it may preclude a well planned consultation with an appropriate budget in the timeframes set out in the draft legislation.

The short timeframe may therefore lead to more limited consultations being adopted unless more time is granted.

I would urge re-consideration of the timeframes for any requirement to consult with members as this may not generate the results that this consultation is hoping to generate.

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

I have three further areas for comment

i) I am not of the opinion that these Regulations will add significant value to the investment decision making process and they are unlikely to have a positive impact upon the overall returns while also reducing the risk of not achieving the desired returns. If they do add value then it calls into questions the current suitability of the advice being given by the investment consultancy industry. It would be interesting to see if someone could, in the future, determine whether these regulations, if enacted, actually delivered a positive contribution.

ii) I perceive that one of the objectives is to encourage a higher allocation to socially responsible investment strategies, to further investment in projects that will benefit the wider community.

   If this is part of the aim, then the government could consider how it influences the investment opportunities available to pension schemes. Defined benefit schemes today will have an allocation to UK government debt, and based on the management of interest rate and inflation rate risk these allocations are probably only going to increase.

   Is there is an opportunity being missed by the government to tap into pension schemes increasing demand for government debt? Would it not be better for the government to take advantage of this demand to issue debt linked to environmental and social impact projects, which pension schemes can purchase, without bearing any greater counterparty risk?

iii) I note that there is no specific policing of compliance of these new regulations by a regulatory body, as there is no requirement to submit statements to such a body. When there is a requirement to disclose items within the Annual Report this will lead to the discussion regarding compliance to be left to the preparer of this document and the scheme auditors.

   These discussions may or may not lead to reports to the Pensions Regulator, as it becomes a judgement call. I note this is consistent with the approach taken on most pension regulations and so I am comfortable that it is suitable at this time. If a wider review of pension regulations was to be undertaken, I would like to see this revisited.

**Q10: Do you agree that the revised Statutory Guidance clearly explains what is expected of trustees in meeting their fiduciary duty to publish the SIP, implementation statement, and statement of members' views?**

I believe it would be clearer if existing regulations are repealed and the new regulations written as a stand alone document without the need to refer to other pieces of legislation.

**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?**

The SIP is just one document which reflects some of the risks the Trustees manage. It does not really reflect how the Trustee manages all its risks, for example, covenant risk. The SIP has been used over time to list many risks (some of which are included to assist with compliance to accounting standards) and as such it does not necessarily reflect the principles or beliefs by which trustees actually make decisions.

The content of the SIP has evolved over time, as has the views and expectations of the Pensions Regulator and trustee advisers. As such Trustees should be considering whether their SIP would benefit from a compete overhaul.

However, I feel that there is merit to a wider review to generate a single document for Trustees to communicate to members on all aspects of their pension on a regular basis. This would need to be holistic and the content be proportionate to the risks being taken. The SIP is just one part of the picture to paint to members. Today there is a danger that are too many documents, too much information, such that we are not encouraging engagement from members.

I believe engagement is best delivered without prescription so it can be tailored appropriately to the audience. As such more government regulations and legislation is probably not the answer. Trustees and members would benefit more from clearer guidance from regulators and industry bodies.

I look forward to hearing from you regarding the next stage of this process.

Yours sincerely

Andrew Chambers

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