BARNETT WADDINGHAM
beyond the expected

Response to consultation on clarifying and strengthening Trustees' investment duties: The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations

Barnett Waddingham welcomes the opportunity to respond to this consultation and sets out below our responses to the particular questions posed.

Introductory comments

We believe there has been a definite rise in the level of conversation amongst trustees of pension schemes, both for DB and DC schemes, on matters relating to Environmental, Social and Governance factors. To date, the extent to which this has led to action has been limited, in our experience. Organisations with specific ESG issues that they wish to account for (e.g. avoiding certain "sin" stocks) typically already reflect this in their strategies. In our experience the focus is now on trustees looking at ways in which ESG criteria can be used as a positive factor in setting a successful investment strategy. An example would be ESG featuring as an explicit item of discussion when new investment manager appointments are being considered.

There is no clear "standard" approach to how pension schemes have engaged to date, possibly due to the lack of clear direction on "best practice". This is changing, however. For example, the Institute and Faculty of Actuaries has recently issued a risk alert to its members to raise awareness around the financial risks posed by climate action. The emissions scandals within the motoring industry highlight how governance can impact company performance too. "Headlines" of this type tend to stimulate action, and the development of a consensus approach. We believe the recent consultation from DWP on clarifying and strengthening trustees' investment duties will benefit trustees from this standpoint.

General points of note

There are a number of terms used within the consultation document and draft regulations. Clear definitions of each would be useful and consistency with already defined terms (e.g. within UNPRI) should be sought.

The consultation document seeks to enable scheme member views to be reflected in the investment strategy where deemed appropriate. We would welcome clarity on the way views are sought, and how trustees then interpret the responses.

Whilst trustees are responsible for the setting of strategy we note that it is often in consultation or with the agreement of the sponsor. To that end we believe that reflecting the sponsors' views as well as the members' views would provide greater clarity to any actions taken by trustees.

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Response to consultation questions

Question 1: 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.

a) Do you agree with our proposals?
Yes.

b) Do you agree that the draft Regulations meet the policy intent?
Yes.

Question 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 material considerations, including, but not limited to, those resulting from environmental, social and governance considerations, including climate change.

a) Do you agree with the policy proposal?
Yes, we believe it will help trustees understand what is required of them in relation to these areas.

b) Do the draft Regulations meet the policy intent?
Yes, subject to our General Points of Note (above) on clarifying the meaning of environmental, social and governance considerations and achieving consistency with terms used elsewhere in related areas (e.g. UNPRI)

Question 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?
In principle we agree with the policy. However, we believe it should be extended to also cover the sponsor's views. We believe greater clarity is needed on how trustees should seek the members' views and how to react if there is very little response. In our experience, the response to requests for member nominated trustee nominations has been lacklustre in many schemes. If this is a sign of apathy by the pension scheme members, clarity needs to be given on how trustees should deal with a similarly apathetic response in relation to ESG matters.

b) Do the draft Regulations meet the policy intent?
We have not commented, since we view this aspect of the policy to not be fully clear or potentially incomplete.

Question 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?

We believe including a statement is desirable but recognise the difficulty in doing so when faced with feedback from a limited number of members. We agree with the proposal. As noted in our General Points of Note, the meaning of the term "social impact matters" needs to be covered within the draft regulations. As mentioned above we believe the legislation should provide guidance in relation to this and should also require the trustees to disclose any views of the sponsor which may differ from those of the members who have responded.

Question 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?

We believe that proposals which will see the level of good governance increase are to be welcomed, as this should improve long term outcomes. The proposal should help improve the SIP, moving it more towards a governance, rather than simply compliance, driven document.

b) Do the draft Regulations meet the policy intent?
Yes.

Question 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 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.**

a) Do you agree with the policy proposal?
We agree with the policy proposal.

b) Do the draft Regulations meet the policy intent?
Yes, subject to the regulations clarifying in detail how schemes should assess whether they are subject to the "100 member" requirement.

Question 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?
We believe that schemes should be made to make available electronically their SIP (or the relevant section of it – see comment below), implementation report and the statement setting out how they will take account of members' views. We agree this should be referenced in the annual benefit statements. The reason we refer to the relevant section of the SIP being published is that some elements of the SIP, such as investment manager fee information, may be private.

However, we are mindful of the very few requests to view the SIP we receive from scheme members despite members being informed of its existence. We do not feel the distinction between publishing and making available electronically will materially alter the accessibility of the documents to engaged members. Rather, we believe policy and regulation should seek to improve member engagement generally and further thought be given as to how this could be achieved.

b) Do the draft Regulations meet the policy intent?
Yes, but they do not reflect our concerns over the difference between publishing and making available electronically.

Question 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?

There is a general lack of understanding from trustees on their obligations, with limited clarity on whether they may be subject to legal action if they implement an ESG policy which, with the passage of time, has demonstrably come at the cost of financial performance. In the absence of clarity, trustees have hitherto erred towards the 'no policy' approach. Guidance or examples of what might be considered reasonable would address this. We believe

it is important that the regulation keeps the focus on the governance of ESG issues from a financial standpoint and does not concentrate on members' ethical views alone.

We believe the challenges of achieving sufficient member engagement in relation to these areas, and their financial consequences, should not be underestimated and efforts should be made to improve member engagement. Given the impact will extend to defined contribution scheme members, we would urge the DWP to make this a priority.

We also recognise the increased scrutiny of SIPs by pension scheme auditors and believe it is important that clear guidance and regulation is given to trustees, in order that they can easily demonstrate their compliance with the regulation and guidance in order to avoid incurring unnecessary third party costs.

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

No.

Question10: 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?

We broadly agree.