Environment Agency
Pension Fund

DWP: Consultation on Clarifying and strengthening trustees' investment duties

The Occupational Pension Schemes (Investment and Disclosure) (amendment) Regulations 2018

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

pensions.fiduciaryduty@dwp.gsi.gov.uk

Response of the Environment Agency Pension Fund (EAPF)

Craig Martin
Chief Pensions Officer
Environment Agency
Horizon House
Deanery Road
Bristol
BS1 5AH

craig.martin@environment-agency.gov.uk

Dear Sinead and Vicky

DWP: Consultation on Clarifying and strengthening trustees' investment duties

We welcome the opportunity to provide input to the proposed revisions to the Occupational Pension Schemes (Investment and Disclosure) (amendment) Regulations 2018. We commend the quality of the consultation; the issues and proposals are particularly well-articulated. The subject matter is particularly important for us as a Fund and therefore, we have suggested that some of the language in the regulations itself would benefit from some amendment, so it aligns with the policy intent of the consultation. The details of these are provided in the main consultation response.

We would like to highlight the following points in our consultation response;

- We strongly recommend the planned timeline is adhered to as the need for trustees to be actively considering these issues is pressing and note the speed with which the Local Government Pension Scheme (LGPS) of which we are part were able to adhere to their new requirements.
- Strongly support the clarification on financially material ESG issues as distinct from purely ethical considerations.
- We highly commend the clear identification of climate risk, recognising (in line with the Bank of England) its potential to have catastrophic, systemic economic and financial impact and recommend the statutory guidance signposts to the recommendation from the Task Force on Climate Related Financial Disclosures (TCFD).
- Strongly support mandatory publication of the Statement of Investment Principles (SIP), the implementation report and the statement setting out how they take account of members' views.
- We do urge DWP to provide urgent, robust guidance to Trustees to alleviate concerns and reassure them that investments in social and green impact funds are wholly appropriate for consideration as part an effective, financial driven, investment strategy, to offset the impact of not detailing requirements in these regulations.

- When it comes to financially material issues, including those driven by ESG concerns, the requirement to take proper advice remains paramount. We would welcome the implementation of guidance providing support to Trustees to promote the review of the skills, knowledge and competence of those advising them on complex, new or emerging issues of concern e.g. climate change, cyber security and impacts of single use plastics. We commend the work of the AMNT/ UKSIF and PRI.

As part of the LGPS, we are in the process of pooling our assets with 9 other partner Funds through the Brunel Pension Partnership (Brunel). Given the subject matter of the consultation relating to investment duties, Brunel have supported us in providing our consultation response.

We would be delighted to follow-up on any of the comments made in our response and provide further support to the DWP in progressing this area of work. Please contact Craig Martin, Chief Pensions Officer – craig.martin@environment-agency.gov.uk - 07825 451007.

Yours sincerely
Craig Martin

Environment Agency Pension Fund

Environment Agency Pension Fund (EAPF) is an LGPS multi-employer Fund comprising of the employers – Environment Agency, Natural Resources Wales and Shared Services Connected Limited.

Our Active and Closed Funds total 40,000 members and have total assets of £3.694 billion (31 March 2018).

Both our Pensions Committee and Pension Board have member representatives who actively engage with beneficiaries and other stakeholders to ensure the Fund is aware and can respond effectively to all member concerns. We also actively use our website, newsletters and member webinars to engage directly. We also respond, track and report all member and stakeholder enquires as part of standard quarterly reporting. The Fund is accredited with Customer Service Excellence which requires high standards of stakeholder engagement.

We recognise that environmental, social and governance (ESG) issues can adversely impact on the Fund's financial performance and should be taken into account in the funding and investment strategies. Accordingly, the Fund has integrated the consideration of ESG issues throughout the funding and investment decision making process.

Responsible Investment is embedded in our governance, our approach to risk and how we deliver our investment strategy on a day to day basis. We first published our Policy to Address the Impacts of Climate Change in October 2015 and updated this in 2017 to demonstrate to our members we have a credible plan to deliver strong long term financial returns as the impacts of climate change materialise.

Consultation on Clarifying and strengthening trustees' investment duties

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. a) Do you agree with our proposals? b) Do you agree that the draft Regulations meet the policy intent?

We are very supportive of both the proposals and the timeline. The proposals set out a clear path for funds to develop their thinking, where they have not already done so, and put in place the necessary reporting procedures to report progress.

We would be **deeply concerned if there was a delay** in legislative timetable as the need to allay confusion on the consideration of financially material environmental social and governance (ESG) risks is urgent given the numerous recent examples of how the lack of such oversight and active consideration has destroyed shareholder value.

We have been mindful of a desire to **create parity within pensions provision** within the UK and not further exacerbate a two-tier system of standards. Therefore, throughout our response we have drawn reference to the Local Government Pension Scheme (LGPS), that whilst out of scope, can present a useful precedent on how these issues have been successfully addressed. Similarly, we have also flagged areas where the LGPS regulations or guidance are currently silent and could emulate these proposals.

To address concerns or pushback from pension funds on the timescales, it worth noting that the **LGPS funds had less than 6 months** (from laying of regulations) to draft their new Investment Strategy Statements – the requirements of which are comparable to the policy intent of this consultation.
We would recommend that the Pension Protection Fund's investment regulations are similarly updated to the same timeframe.

Whilst we agree with the exemption for small schemes (under 100 members) we would welcome this issue being considered as part of any proposal to solve the issues around resourcing and empowering of smaller schemes such as 'investor clubs' or fund consolidation. To include as part of the scope would help address the issues within the resource constraints of such schemes.
Whilst we agree that Defined Benefit (DB) schemes should be subject to a "narrower set of requirements", we believe further guidance and messaging from the Pension Regulator is needed to improve the over standard of DB scheme Statement of Investment Principles (SIPs).

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. a) Do you agree with the policy proposal? b) Do the draft Regulations meet the policy intent?

We strongly welcome the clarification on financially material ESG issues and the wording as it appears in the regulations (3) (a) i. We welcome the clear delineation from 'ethical issues'.
Whilst we acknowledge the concerns raised by other commentators as to why should climate change be recognised separately from other deeply concerning issues such as social inequality, we would strongly flag that this debate is not about which 'issue' is more important, but in the context of pension fund investment, which has the **potential to have the highest financially material impact**. To this we note the Bank of England's own response to climate change which recognises the systemic natures of the risks and the potential impacts on financial stability.
We therefore welcome the **recognition of climate change as a financially material issue** and the requirements to address climate change specifically in the SIP reflecting its cross cutting and material financial impact.

The consultation notes the potential overlap of risk definitions in that the current legislation talks about risks in a broadest sense. We think that the current drafting is appropriate in order to make progress and remove the current confusion.

The Consultation notes that financially material environmental, social and governance ("ESG") risks can sometimes be long-term, sometimes short-term, and that references in legislation to either the short- or the long-term could confuse trustees. We think there is merit in this argument, but we are also supportive of the recommendations of the **High Level Expert Group (HLEG) on Sustainable Finance: "To clarify investor duties to extend time horizons and bring greater focus on ESG factors. Linking investor duties to the investment horizon of the individuals or institutions they serve"** (page 13 of the HLEG Sustainable Finance Report).[1]

We think the statutory guidance might make it clear to trustees that financially material ESG risks can materialise over the short term, or over the medium to long term, and that trustees should take ownership of defining the time horizons of importance to their own scheme and how this relates to their investment strategy.

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. a) Do you agree with the policy proposal? b) Do the draft Regulations meet the policy intent?

The consultation articulates well the needs to be mindful of beneficiaries' views. We are wholly **supportive of stakeholder engagement**, with a particular focus on transparency to beneficiaries on how ESG issues have been considered and the views of beneficiaries on non-financial factors. We flag that it is more challenging to take into account the views on beneficiaries on financial factors as pension funds need to take a huge range of issues into account when setting asset allocation and investment strategy.

However, there seems to be a **disconnect between the intent from the consultation and the drafting of the regulations themselves**. We fear that this mismatch may result in a greater level of push back than was intended.

The 2016 LGPS Investment Regulations Guidance asks the fund "to explain the extent to which view of their local pensions board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors" which limits the extent of interested parties. We would recommend redrafting the regulations so mirror a similar requirement for occupational pension schemes.

In terms of implementation we note and commend the DWP's proposals that recognise a number of ways in which views can be sought and to be flexible that allows for **locally appropriate arrangements**. In many cases these arrangements are already in place; the resource cost in requiring investors to take specifically mandated additional actions should not be underestimated. The consultation strikes, from our perspective, an appropriate balance and we welcome the recognition on page 20 of the Consultation of some of the good practices from Funds such as ourselves.
We particularly identify the role of the member nominated trustee and would welcome language in drafting of the regulations or implementation guidance that strengthened and empowered this role within pension fund governance.

When it comes to **financially material issues, including those driven by ESG concerns, the requirement to take proper advice remains paramount.** We would welcome the implementation guidance providing support to Trustees to promote the review of the skills, knowledge and competence of those advising them on complex, new or emerging issues of concern e.g. climate change, cyber security and impacts of single use plastics. We commend the work of the AMNT/ UKSIF and PRI.

[1] https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

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?

We recognise that the issue of what to invest in, including 'green' and 'social' impact funds is different to the matters addressed in the rest of the consultation which focus on the considerations of all investment decision making. However, we also think that Trustees, provided with good guidance will not be confused, as suggested, and does not credit them sufficiently to understand the evolving legislation. We also note that the LGPS funds already have the requirement to 'explain their approach to social investment'.[2]

Your consultation response does acknowledge the considerable work of the **Social Impact Investment Advisory Group/ Taskforce and the Green Finance Taskforce** and the recommendations that have been made by these groups. It is critical to the implementation of the recommendations made by both Task Forces' that the investments are given legitimacy and clear permission for consideration.

We think it is possible to define the types of social, local, green, SDG, etc, investment products available and to describe the circumstances in which a pension scheme might consider investing in them. Not providing such clarification at this time represents a missed opportunity, if options are not immediately taken up to offset this risk. Therefore, whilst we reluctantly agree with the DWP recommendation to not include a regulatory requirement at this time, we do urge **DWP to provide urgent, robust guidance to Trustees to alleviate concerns and reassure them that such investments are wholly appropriate for consideration as part an effective, financial driven, investment strategy**. Furthermore, the current drafting of the regulations defining the terms in 2. (4) – defining non-financial factors includes 'social impact'. This is confusing as it may lead Trustees to believe that such investments are to be made solely on a 'non-financial' basis whereas many social and environmental impact funds return comparable investment returns to mainstream funds. There is a spectrum of implementation options with social impact funds and therefore it would strongly recommend removing this wording.

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. a. Do you agree with the policy proposal? b. Do the draft Regulations meet the policy intent?

We welcome this proposal. We make one observation and three recommendations for consideration.

We observe the draft regulations in defining the scope of Stewardship in relation to the policy to '**engage with relevant persons'** extends the current UK Stewardship Code definition to cover investee companies, investment managers and shareholders. We strongly commend and welcome this extended scope but also recommend adding policy makers and regulators to relevant persons list. Furthermore, the definition of "**relevant matters"** limits the its scope to **"investee company"** and ideally should capture any relevant investment instrument.

In addition, we recommend that the statutory guidance should signpost to the UK Stewardship Code and that pension schemes should consider becoming signatories. The code, which operates on a comply or explain basis, is a flexible and consistent method for investors to explain their approach to stewardship. This again would make align the Occupational Pension Scheme with the best practice found in LGPS.

[2] Statutory Guidance relating to the LGPS Regulations 2016, last update 12 July 2017

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. a) Do you agree with the policy proposal? b) Do the draft Regulations meet the policy intent?

We think this is **one of the most important aspects of the consultation** and welcome and commend this development.

In order that the additional reporting meets the spirit of the consultation and is not a boiler plate exercise, guidance and best practice examples need to be actively shared and encouraged by policy makers and regulators. We would be happy to support this.
Asset managers could and should play a role in assisting their pension fund clients with the implementation and disclosure of policies in the SIP.
For climate-related risks, we **recommend that the TCFD's recommendations are used as the best-practice common framework for annual disclosure**.

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. a) Do you agree with the policy proposal? b) Do the draft Regulations meet the policy intent?

As linked to the comments above, we think this is one of the most important aspects of the consultation and welcome and commend this development. We support mandatory publication of the SIP, the implementation report and the statement setting out how they take account of members' views online and inform members of this in the annual benefit statement. Transparency across the investment chain right through to end beneficiaries is critical for robust pension fund governance and will enhance the engagement of beneficiaries in one of the most important financial aspect of their lives, frequently overlooked.

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?

ESG considerations are increasingly strong influences on a company's reputation and market value, making these factors ever more crucial when working to meet a client's long-term investment goals. As stated by McKinsey & Company in October 2017, Responsible Investment (RI) is set to become an intrinsic part of any investment approach (https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/from-why-to-why-not-sustainable-investing-as-the-new-normal). The costs may be easier to quantify but the benefits of considering all financial materially risks, including those which we cannot be defined in clear monetary terms, to long term investment returns are enormous.

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

We offer our on-going support in developing the implementation guidance, which we see as crucial to the intent of the consultation being realised. We would welcome the TPR being robust in its oversight of these proposals and that these considerations are factored into any review of its powers and penalties.

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?
We welcome the clarity contained in the Consultation, but have not had the opportunity to review the updated guidance, but would welcome the opportunity to provide input.
We would re-iterate points made above with regards to signposting in the Statutory Guidance to TCFD, GFI's Data, Disclosure and Risk Paper, and the UK Stewardship Code.

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 would welcome the opportunity to discuss this further as the standard and quality of SIPs is variable and much more needs to be done to empower end beneficiaries in understanding what is being done, or not, on their behalf.

Conclusion
In conclusion we welcome the work undertaken by the DWP and would be open to discuss the points made in our response and provide any further assistance. Please contact Craig Martin (craig.martin@environment-agency.gov.uk).