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To the Department of Work and Pensions**:**

**Consultation on clarifying and strengthening trustees' investment duties**

The Trustee Directors of the UK Power Networks Group of the Electricity Supply Pension Scheme (UKPNESPS) and the UK Power Networks Pension Scheme (UKPNPS) welcome this opportunity to respond to the DWP's consultation on clarifying and strengthening trustees' investment duties. Given an alignment in our views, for efficiency purposes we are submitting a joint response.

UKPNESPS is one of the major legacy pension schemes of the former nationalised electricity supply industry. We have a very clear principal objective, which is to work with the sponsor to ensure that the scheme is run properly and benefits are paid as promised. Our membership consists mainly of active and former workforce members of what used to be the London, Eastern, and Seeboard areas of the old electricity supply industry. We are a mature scheme, with assets of around £3.5bn, having been closed to new members since 1994, and we currently have around 15,300 members in total, of whom only some 1,215 are active members.

The UKPNPS was established on 8 October 2010. Benefits accruing to all members with effect from 1 January 2011 are provided on a defined benefit basis. However, certain legacy benefits are secured on a Defined Contribution basis and the scheme is therefore a Relevant Scheme for the purposes of the consultation. The UKPNPS has assets of around £330m and 2,600 members, of whom around 1,600 are active members.

The trustees of both schemes have considered the consultation where this is relevant to their schemes and trustees more broadly. We have restricted our feedback to specific questions on the proposals themselves. The legal drafting is not something that, as Boards, we are able to comment on collectively. But please note that one of our UKPNESPS Trustees with a legal background deals with legal aspects of the consultation in a technical note at Attachment 1 (which also forms part of a larger and separate submission he has made in a personal capacity).

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

We broadly agree with the intention behind the proposals, which is to legislate to provide greater opportunity and clarity over what trustees can take into account when considering investment strategy. However, we would urge caution with respect to trustees' ability to define a policy by reference to what will be financially material over the long term. While pension schemes are long-term investors, their investment strategies are much more agile and diversified than in the past.

The proposal does not adequately address delegated investing. In this investing framework, trustees define a range of parameters within which the delegated manager will operate. We would suggest that some of your proposals are not appropriate for this type of investing. Trustees place a high reliance on their investment advisers and managers.

Our key concern around the proposed changes is the requirement to seek members' views. We recognise that for some schemes (allowing for the nature of the sponsor/sector) and for some strategic investment decisions, trustees may want to proactively seek members' views before implementing specific investment ideas. There is nothing to prevent trustees from doing this at present, but it should be up to trustees to choose how and why and whether this is done rather than it being prescribed.

The detail of your proposal suggests that members should routinely be consulted on changes to the SIP. We strongly question the effectiveness of such a suggestion for the following reasons:

- Members may have a view on, for example, large ethical or environmental issues but are unlikely to be able to form a view on more routine changes. In fact, routine consultation is more likely to lead to confusion of members rather than clarity and generate expectations with regard to how members' views would be responded to that are not in line with the consultation's intentions.

- Consultation requires that members' views will be considered. Member engagement on such a complex issue is likely to be low. Properly informed Member Nominated Trustees can play a more useful role here than a generic member consultation.

We strongly urge that the Regulations leave the decision making to trustees. We would support the desire for transparency and would agree that trustees should be able to demonstrate consideration and decision making in the suggested areas. However, this demonstration should be aimed firstly at the trustees' own scheme members to whom the trustees are accountable, and secondly at the sponsor, who could be forced to meet costs arising from both poor investment decisions and the costs of consultations.

Our comments in response to specific questions are set out below.

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

We have no comment on this although some trustees question whether the timings proposed would in fact be sufficient.

**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?**

We agree that the inclusion of trustee policy in relation to financially material risks over both the short and longer term is appropriate. We welcome the expansion of the policy to include flexibility that allows trustees to include factors that may present themselves over the longer term. We also strongly endorse the view that it is for the trustees to determine what is financially material in the context of their specific pension scheme.

We note, however, that the requirement for a policy to be stated does not necessarily address issues that may exist with trustees' level of understanding of this complex area and/or inadequate governance that may be in place to manage such matters.

**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?**

We do not agree with the suggestion that a statement should accompany the Statement of Investment Principles (SIP) confirming how members' views will be taken into account. We agree that a statement should be included to say **when and how** members' views will be taken into account.

Trustees have available to them expert advisers and wider knowledge about their own schemes, the opportunities and risks they face, and their objectives when assessing their investment strategy. This is not usually available to members and, while we recognise the importance of engaging with the members in some circumstances, taking into account their views in the investment strategy routinely is likely to be burdensome.

We consider the existing requirement for UK pension schemes to have a minimum number of Member Nominated Trustees is, by its nature, a way for members' views to be represented in the management of their pension scheme. The trustees' view is that, given disclosure requirements, pension scheme members are easily able to access contact details for their schemes should they wish to raise any queries or concerns. The Group's experience however is that engagement from the membership can be low where there is not a direct, tangible impact on the member and, in defined benefit schemes, where it is not the member that bears the investment risks, engagement is likely to be concentrated within a minority.

**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 agree with this proposal.

**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?**

As suggested in response to Question 2, we consider that financially material matters should be defined by the Trustees. However, we consider that the investment managers are best placed to implement appropriate policies with respect to good stewardship principles on all material risks including the incorporation of ESG factors.

It is not clear how much additional value would be generated by the inclusion of this, particularly where trustees invest in pooled funds and/or delegate stewardship matters to the investment managers.

Additionally, trusteeship is a voluntary role. Significantly increasing the burden on lay trustees may disengage trustees, which is contrary to the desire for member representation. We do not wish to suggest that trustees abdicate their responsibility for setting parameters and monitoring, but the implementation and performance of the detailed stewardship points should remain delegated to the asset managers.

**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?**

The overwhelming view of our trustees was that we do not agree with this proposal. We agree that these documents should be available for the members. However, trustees should be able to decide how this information is made available.

The consultation contemplates SIPs being made available online so that they are accessible to other interested parties. Trustees' responsibility is to their scheme members and not to the wider members of the public or other external groups. Trustees could not publish such information without being willing to be accountable for it. The concept of being accountable to individuals who have no connection to the sponsor or scheme may be perceived by some to blur the direct accountability of trustees to scheme members and could dilute that relationship with misleading ideas of accountability to the wider public or other external groups.

In addition, online access for many schemes may be a preferred route, but not all pension schemes have online functionality and the need to have it for this purpose would be disproportionate in terms of effort and cost.

**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?**

With regard to the impact assessment undertaken by the DWP, the time (and therefore cost), that trustees could potentially spend on these matters is likely to be higher than expected. The reliance on advisers would increase. If further confusion is introduced to the process around considering members' views, and their expectations cannot be managed, costs are likely to be incurred in managing these.

We hope that our comments are helpful and, in accordance with DWP consultation guidelines, I can confirm that this response was duly approved by all Trustee Directors of both schemes.

**Chris Degg**
**Chairman**
**UKPN Group of the Electricity Supply Pension Scheme**

**Bob Jackson**
**Chairman**
**The UK Power Networks Pension Scheme**

# ATTACHMENT 1

## A technical note on the quality of the DWP consultation

**Part 1 : Introduction**

**1.** This technical note offers a critique of the DWP's general presentation of the consultation and, in particular, of the method of legislative amendment that the DWP proposes to use and the quality of the legal drafting employed in support of that method.

**2.** The note focuses on regulation 2 of the proposed new amendment regulations because that particular piece of legal text is the key element of the DWP's consultative proposals for a large defined benefit scheme such as the UK Power Networks Group of the ESPS (as to which, see the covering letter attached).

**Part 2 : General presentation**

**3.** The consultation document begins by saying that it is about, and is seeking views on, the draft Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018 (I will call these 'the 2018 regulations' from now on). The document then continues in the same vein, with repeated references to 'these regulations' both in the main narrative text containing the policy proposals and in the numerous footnotes.

**4.** However, despite all such references, the 2018 regulations cannot be found anywhere in the consultation document. Given that 'these regulations' are only four pages long, it would have been easy to incorporate them as an appendix to the main narrative, or even to intersperse the substantive provisions of the legal text alongside the relevant policy proposals.

**5.** This failure to include the draft text of the 2018 regulations in the main policy document is a defect of the DWP's consultation – not a major defect, but a material one, because it makes life more difficult than it should be for the interested reader. It is not a user friendly approach to the consultation, and could so easily have been avoided.

**Part 3 : Method of legislative amendment**

**6.** Such difficulties as may be created by the separate publication of the policy proposals and the corresponding legal text are minor compared to those that arise from the DWP's decision to use piecemeal legislative amendments to give statutory effect to its policy objectives. This makes it very difficult to make an accurate assessment of the effects of the drafting.

**7.** The simplest way of proceeding would have been for the DWP to formally revoke the Occupational Pension Scheme (Investment) Regulations 2005 ('the 2005 regulations') and to produce a single unified replacement text. (The same approach would also have been equally appropriate for the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013, which are also part of this consultation, but are not the focus of this note.)

**8.** Instead, because of the decision to use amending regulations to change other regulations, the interested reader can have little idea of the proposed state of the future legislation unless he/she brings the old and new texts together and does the work that the draftsman should have done. This is a long way from presenting law in an intelligible and accessible way.

**9.** In fact, under the DWP's proposals, readers now need to conflate five different statutory instruments to arrive at the combined legal meaning of the 'investment regulations' that are to be applicable in future for the trustees and advisers of UK pension schemes**:**

- the 2005 regulations,
- the Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2006,
- the Occupational, Personal and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2009,
- the Occupational Pension Schemes (Investment) (Amendment) Regulations 2010 ('the 2010 regulations', as to which see my separate comment at the end of this note), and
- the 2018 regulations.

**10.** In practical terms, finding out which are the relevant texts and how to assemble them, and then combining the work produced and executed by different draftsmen at different times, are complex tasks with the potential to produce error and misinterpretation.

**Part 4 : Parliamentary and procedural considerations**

**11.** The chaotic state of this area of UK pensions law, as illustrated by paragraph 9 above, is now so pronounced that it is time for the DWP to take this opportunity to remedy the situation. I therefore urge the DWP, following this consultation, to decide to produce and implement a unified text, 'the Occupational Pension Schemes (Investment) Regulations 2018', as a single new consolidated statutory instrument.

**12.** It is difficult to see why the DWP would resist this proposal, least of all on grounds of parliamentary procedure. However the law-making is to be achieved, whether by the DWP's proposals for proceeding with amending regulations or in accordance with this proposal to produce unified replacement regulations, the necessary statutory instrument will in either case be subject to the negative resolution procedure under the provisions of the Pensions Act 1995, and the same procedural requirements will apply regardless of the route adopted.

**Part 5 : Regulation 2 of the 2005 regulations, as amended**

**13.** The legal text following this note presents the text of regulation 2 of the 2005 regulations ('statement of investment principles') in its revised form, as amended by regulation 2 of the 2018 regulations ('amendment of the Occupational Pension Schemes (Investment) Regulations 2005'). Physically conflating the texts in this way, as one must in order to understand the legal meaning of the amended text, reveals at least two problem areas in the DWP's drafting. My fully revised text flags up these areas with yellow highlighter.

**14.** The first problem area arises from the DWP's insertion of a new sub-paragraph (c) into paragraph 2 of regulation 2**:**

> '(c) prepare a statement explaining the extent to which the views which, in the reasonable opinion of the trustees, members of the scheme hold (including the views they hold on non-financial matters) will be taken into account in preparing or revising the statement of investment principles'.

The text of this sub-paragraph is what lawyers sometimes describe, politely, as 'clunky'. It could be rewritten as follows, and I so recommend**:**

> '(c) prepare a statement explaining the extent to which the views which the trustees reasonably believe are held by members of the scheme (including their views on non-financial matters) will be taken into account in preparing or revising the statement of investment principles'.

This means exactly the same thing as the DWP's text, but is more neatly and more naturally expressed, and so is more likely to be easily assimilated by the reader.

**15.** The other problem area is new paragraph 4 (a dedicated definitions paragraph) which has been inserted into regulation 2. Two of the definitions in this paragraph need to be revised**:**

> **non-financial matters:** using the two words 'social impact' adjectivally is on the margin of acceptability, but turning eight words, 'present and future quality of life of members', into a compound adjective applying to the word 'matters' is simply inept. In fact, this definition as a whole is so woolly and so open-ended that it is difficult to see how best to revise it. The following alternative wording is suggested**:**
>
> 'non-financial matters', in relation to investment principles, includes (but is not limited to) ethical matters and matters relating to social impact, as well as the present and future quality of life of members of the scheme.
>
> **relevant persons:** as drafted by the DWP, a relevant person is defined as being three things at once – an investee company *and* an investment manager *and* a shareholder of an investee company. This is plainly incorrect and should be revised**:**
>
> 'relevant persons' includes, in particular, investee companies, investment managers, and shareholders of investee companies.

**Part 6 : A comment on the 2010 regulations**

**16.** Reverting to my mention of the 2010 regulations at paragraph 9 above, these were a statutory instrument laid before Parliament at the last minute in September 2010 without prior warning because the DWP had belatedly realised that certain technical changes were needed to make the 2005 regulations fully compliant with EU pensions law.

**17.** Perhaps because they were a rushed job, the text of the 2010 regulations was defective in its application to the 2005 regulations in a number of significant respects, not least because it deleted paragraph 7 of regulation 13 without making provision for any consequential changes, so that paragraph 8 of regulation 13 continues to refer to paragraph 7 as if the provisions of that paragraph had not been deleted and were still in force.

**18.** Errors such as this that arise and become embedded in the course of textual amendment and re-amendment are probably inevitable, given the chaotic state of secondary pensions law that I described earlier. They underline the need to take this opportunity to legislate, as I recommend above, for the 'Occupational Pension Schemes (Investment) Regulations 2018' as a new statutory instrument with a unified text that replaces all of its predecessors.

**Roger Barnard, UK Power Networks Group of the ESPS, July 2018**

## Regulation 2 of the Occupational Pension Schemes (Investment) Regulations 2005 as amended by Regulation 2 of the draft Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018 (currently under consultation)

**Statement of investment principles**

**2.**—(1) The trustees of a trust scheme must secure that the statement of investment principles prepared for the scheme under section 35 of the 1995 Act is reviewed—

(a) at least every three years; and

(b) without delay after any significant change in investment policy.

(2) Before preparing or revising a statement of investment principles, the trustees of a trust scheme must—

(a) obtain and consider the written advice of a person who is reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of the investments of such schemes;

(b) consult the employer; and

(c) prepare a statement explaining the extent to which the views which, in the reasonable opinion of the trustees, members of the scheme hold (including the views they hold on non-financial matters) will be taken into account in preparing or revising the statement of investment principles.

(3) A statement of investment principles must be in writing and must cover at least the following matters—

(a) the trustees' policy for securing compliance with the requirements of section 36 of the 1995 Act (choosing investments);

(b) their policies in relation to

(i) the kinds of investments to be held;

(ii) the balance between different kinds of investments;

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

(iv) the expected return on investments;

(v) the realisation of investments; and

(vi) financially material considerations, including how those considerations are taken into account in the selection, retention and realisation of investments; and

(c) their policies in relation to—

(i) the exercise of the rights (including voting rights) attaching to the investments; and

(ii) undertaking engagement activities in respect of the investments (including the methods by which and the circumstances under which trustees would monitor and engage with relevant persons and other persons about relevant matters).

(4) For the purposes of this regulation—

'financially material considerations' includes (but is not limited to) environmental, social and governance considerations (including climate change);

'non-financial matters' includes (but is not limited to) ethical matters, social impact matters and present and future quality of life of members matters;

'relevant matters' includes matters concerning an investee company, including its performance, strategy, risks, social and environmental impact, and corporate governance; and

'relevant persons' means an investee company, an investment manager and a shareholder of an investee company.