LCP INSIGHT CLARITY ADVICE

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Dear Sinead and Vicky

Pension trustees: clarifying and strengthening investment duties consultation

I am writing on behalf of Lane Clark & Peacock LLP in response to the consultation on the draft Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018, issued on 18 June 2018.

Lane Clark & Peacock LLP ("LCP") is a specialist consulting firm with over 600 personnel in the UK and Europe, including 116 partners. We have offices in London, Winchester and Ireland.

The provision of actuarial, investment and pensions administration advice, benefits, and directly related services, is our core business. About 90% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 10% relates to insurance consulting and business analytics.

Our responses to the consultation questions are attached as an Appendix. In summary:

- We support the proposal to require trustees to state their policies on financially material considerations and stewardship, and the publication of SIPs by relevant DC schemes.
- We do not the support introduction of statements setting out how member views will be taken into account. Trustees may feel pressured to consult members and yet, in our experience, such consultations are expensive, time-consuming and may

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not yield useful insights. We believe policy measures should instead focus on increasing member engagement and understanding of pensions.

- We feel that more clarity is needed on what an implementation report might look like. We would support the introduction of an "Investment Policy Implementation Document" which is updated from time to time (rather than an annual implementation report) with the SIP refocused on principles.
- We are concerned by the increasing governance burden for trustees and think that this risks further accelerating the closure of trust-based schemes. We believe that, next time changes in compliance documentation and disclosure requirements are proposed, there should be a wider overarching review with a view to consolidating and streamlining the number of documents required.

We are happy for our comments, which represent the collective view of a number of people within LCP, to be attributed to LCP. We hope that our response is helpful and if you have any questions, or would like to discuss anything further, then please contact me.

Yours sincerely

Prepared as an attachment to an email at 18:30 on 16 July 2018

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Pension trustees: clarifying and strengthening investment duties

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, we agree. The proposed timeframes look reasonable as most pension schemes would be able to update their SIP within a year.

We note, however, that the implementation statement is required to state how trustees acted on the member views statement, and yet the first member views statement may not need to be prepared until after the first implementation statement. We query whether that is the policy intention.

b) Do the draft Regulations meet the policy intent?

Yes, we believe they do.

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 agree. It is reasonable to expect trustees to have a policy that describes how they are considering these matters. We note the alternative formulations outlined in paragraphs 10 to 17 of the consultation document and confirm that we support the one proposed.

However, we propose that trustees are also required to state their policy, if any, on non-financial matters (as defined in the draft Regulations). If trustees do take into account such matters, we think this should be stated in the SIP. This is consistent with the current requirement for trustees to state their policy, if any, in relation to ethical considerations. Moreover, it is proposed that the member views statement explains how members' views on non-financial matters are taken into account in the SIP, which implies that such matters should be covered by the SIP.

b) Do the draft Regulations meet the policy intent?

We note that there has been a subtle change in the wording: the policy intent includes the phrase "those resulting from" whereas the draft Regulations do not. We believe this changes the intended meaning. The definition of "financially material considerations" in the draft Regulations seems to imply that ESG factors are *always* financially material, however this may not be true for individual ESG factors, particularly in relation to individual investments. We therefore recommend that the missing words are added to the draft Regulations.

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?

No, we disagree. Although we are sympathetic to the objective of the policy, we believe it may cause unintended consequences and there could be more effective ways of achieving this policy objective. Moreover, we do not think there is a strong rationale for DB schemes to consider members' views as their benefits are not directly affected by the choice of investments.

Although it is proposed that trustees would not be obliged to seek members' views, they may feel pressured to do so, particularly for DC schemes which would be required to publish a statement on the topic. We are also concerned that consulting members about their views may create unrealistic expectations that trustees will act upon them.

In any case, we believe that member views will be hard to gather, will likely be diverse and so difficult to distil to a single set of views, and will change over time. Our experience of running member consultation exercises on DC investments is that they are expensive and time-consuming, and may yield few useful insights due to members' low familiarity with, and understanding of, their existing investment options. We note the general lack of member engagement on DC pensions, where typically circa 90% of members do not make an active decision about their investments.

We would draw a parallel with the representative democracy used by the House of Commons. In the same way that MPs represent their constituents' interests without canvassing their views on individual issues, trustees represent members' interests in the pension scheme without needing to consult them on specific decisions. Instead of the proposed statement on member views, we suggest that the DWP considers how members could be encouraged to engage with their pension savings. There is also a role for broader financial education, but we do not think this should be the responsibility of pension scheme trustees.

If the proposal is implemented, we would prefer the trustees' policy on seeking member views to be stated in the SIP rather than in a standalone statement as we are concerned that trustees are already required to produce a large number of documents. We note that some schemes make minor changes to their SIPs quite frequently (although our suggestion in response to Q6 could address this) and we do not think it proportionate to require them to prepare a statement on member views each time.

b) Do the draft Regulations meet the policy intent?

We note that the consultation document has slightly different wording to the draft Regulations. The Regulations say "explaining the *extent to which* the views… will be taken into account", whereas the consultation says "setting out *how* they will take account of…". We would prefer the Regulations to say "how (if at all)".

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?

Yes, we agree. Trustees should not be required to state a policy on this topic, at least until social impact investing has a longer history of returns and its characteristics are better understood.

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?

Yes, we agree. Trustees should be required to state a policy on this topic.

b) Do the draft Regulations meet the policy intent?

Yes, we believe they mostly do. However, we believe that the definition of "relevant persons" should be extended to include regulators and policymakers, as they may be appropriate targets for engagement activities, particularly for systemic issues such as climate change that are relevant to a wide range of investments.

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.

- 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 feel that more clarity is needed on what an implementation statement might look like. We would not support its introduction unless we are convinced that its value justifies the further increase in the governance burden for DC trustees.

We note that it is quite common for SIPs to describe the implementation of the trustees' investment policy as well as the principles themselves. An approach that we find works well, for both DB and DC schemes, is to include only principles in the SIP, with a separate Investment Policy Implementation Document (IPID) for details of how these principles are implemented. This seems similar to the policy proposal except that the IPID would be updated each time there was a change in implementation approach, rather than on an annual basis.

We would support a new requirement for schemes to produce an IPID, to be included in the annual report, if it was accompanied by guidance from the Pensions Regulator that clarified expectations on the content of the SIP (see our response to Q11) and refocused the SIP on principles. This could significantly shorten some SIPs and reduce the frequency of updates. With this format, trustees would not have to consult with the employer each time an implementation change was made (eg an investment manager), which would be more efficient.

b) Do the draft Regulations meet the policy intent?

Yes, we believe they do.

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 agree with the publication of the SIP and the implementation report, if one is introduced. However we don't support the production of the member views statement (as stated in response to question 3) and would not support its publication. We note that the Pensions Regulator has already recommended publication of the SIP, as part of the DC Chair's statement.

b) Do the draft Regulations meet the policy intent?

Yes, we believe they do.

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?

We believe that the assessment materially underestimates the costs.

Firstly, for many of the schemes that would otherwise not review their SIP before 1 October 2019, we do not think it would just be a case of bringing forward the next review. Many DB schemes typically update their SIP every three years as part of an investment review tying in with the triennial valuation. Hence the review to address the new Regulations would be an extra cost for many DB schemes as an "out-of-cycle" SIP update.

Secondly, we think the implementation statement is likely to cost much more than £1,000 per scheme if it is to be a meaningful document, particularly the first time it is produced. Moreover, we think the impact assessment should include an allowance for gathering and distilling member feedback into a set of member views, at least for larger schemes. We expect this would be a costly exercise.

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

We note that changes may be required to the SIP and schemes' stewardship disclosures as a result of the revised EU Directives on Institutions for Occupational Retirement Provision and Shareholder Rights. Whilst we recognise that the position is complicated by the uncertainties surrounding the UK's future relationship with Europe, our strong preference would be for any such changes to be made at the same time as those proposed in this consultation, to avoid having two or more sets of changes in quick succession.

10. 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 agree, except that paragraph 60 of the guidance does not include an explicit reference to the member views statement.

11. 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 note that pension schemes are currently required to produce several documents and are concerned that this consultation is proposing to introduce further documents. We believe that, next time proposals are made in this area, there should be a wider

overarching review of the disclosures required by pension schemes, with a view to consolidating and streamlining the number of documents required. This might, for example, remove the overlap between the SIP and the DC Chair's Statement, and combine the SIP with the DB Statement of Funding Principles to reflect the Pension Regulator's emphasis on integrated risk management. Having a smaller number of documents would reduce the time spent by trustees on governance, make it easier for trustees to understand the purpose of the various documents, and be more accessible for members.

The Pensions Regulator issued some useful best practice suggestions for DB scheme SIPs last year in its DB Investment Guidance. We recommend that the relevant parts of that guidance are extended to DC schemes, namely the general guidance plus references to:

- investment governance structure;
- investment beliefs (if trustees have developed these);
- investment objectives (in the context of the default);
- risk capacity and risk appetite (in the context of the default and fund range);
- risk management approach (in the context of the default and fund range);
- monitoring (in the context of the default and fund range);
- investment manager selection; and
- manager implementation.