RESPONSE TO CONSULTATION ON CLARIFYING & STRENGTHENING TRUSTEES' INVESTMENT DUTIES FROM THE IMPLEMENTATION TASKFORCE

Please find below a response from the Implementation Taskforce on 'Growing a Culture of Social Impact Investing in the UK' to your consultation on *Clarifying and Strengthening Trustees' Investment Duties*.

The Implementation Taskforce was commissioned by the Prime Minister in March 2018 to implement and progress a series of actions aimed at helping individuals use their savings, pensions and investments to support the things they care about. These actions arose from recommendations from the independent Advisory Group set up by the UK government in December 2016 and chaired by Elizabeth Corley (Allianz Global Investors).

The Taskforce is a focal point for engagement and cohesion to ensure that as many recommendations as possible from the Advisory Group's work on social impact investing come to fruition and that sustained industry engagement continues at a sufficient pace. The Taskforce is made up of leaders and experts from across the investment spectrum, and who are involved in the working groups focusing on taking the recommendations forward. The Taskforce is also supported by a number of organisational signatories that have confirmed their commitment to support the key recommendations of the Advisory Group, signatories include the Investment Association (IA), NEST Corporation, the Pensions & Life Savings Association (PLSA) and many more.

We welcome the government's commitment to supporting trustees to make long-term investment decisions in a way which positively impacts the environment and society. Fundamentally, we welcome this consultation on clarifying and strengthening trustees' investment duties and **we support all of the proposed changes in the consultation**. It is worth highlighting that one of the recommendations from the Advisory Group report was that the DWP and the FCA should implement the five recommendations for government from the recent Law Commission report on pensions and social investment. We also welcome the reference to the work of the Advisory Group in this consultation.

Whilst welcoming the consultation, we have raised a number of specific observations/comments below. Our proposed amendments seek to clarify and strengthen existing regulations in a way which encourages more involved and forward-thinking conversations with advisers and throughout the investment chain but is also practical and not overly burdensome for trustees to implement. As institutional investors with long-term horizons, pension schemes' goals are best served by investing in a sustainable way which meets the long-term pension needs of their members both through enhanced returns and through positive impact on society and the environment.

The Taskforce is very supportive of seeing additional guidance provided (as per the statement in the Consultation that "The Pensions Regulator will update existing Codes and guidance for both DC and DB schemes and will consider what additional guidance may be helpful for trustees in understanding their duties"). We would be happy to help with shaping such guidance.

Our more detailed responses to each question follows below.

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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?

Yes, we agree with the proposals. We agree that the timescales outlined in the consultation paper seem sensible. This is particularly the case given the FCA proposals on Independent Governance Committees (IGCs) are currently expected to be published in Q1 of 2019 and it makes sense for the timetable for regulatory changes to the environment for contract-based and trust-based pension schemes to be broadly similar.

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

Yes.

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?

Yes, we are very supportive of the proposal and believe it is positive that ESG factors are explicitly recognised as financially material. We agree with the government that the Regulations as currently drafted do not support clear trustee understanding of the difference between financially material ESG factors and non-financial factors and welcome the proposals to make this distinction.

It is important to note, though, that making a distinction between ESG as only financially material and social impact investing as only non-financially material could be confusing for trustees. We believe that ESG factors can be both financially material and non-financially material, and also that there is a clear distinction between funds that incorporate ESG objectives in their investment approach and funds which in *addition* to incorporating ESG objectives in their investment approach are specifically dedicated to social or environmental objectives (i.e. social impact investment funds). This is further explained in our response to the FCA Consultation 18/9 on further remedies – Asset Management Market Study and backed up by the FCA's own response to the Law Commission report on pensions and social investment. To support greater understanding of these complex and evolving issues, we believe that appropriate guidance and support needs to be provided by The Pensions Regulator (TPR).

We agree that climate change represents a significant material, systemic and cross-cutting risk and that it should be included as a specific risk. We support the Task Force on Climate-related Financial Disclosures (TCFD) and their view that asset owners and asset managers have an important role to play in influencing the organisations in which they invest to provide better climate-related financial disclosure. However, the significance and materiality of any ESG risk – including climate change – will vary according to each scheme's investment approach/portfolio and accompanying guidance must emphasise that trustees remain free to reach their own judgements about which risks they consider to be material.

b) Do the draft Regulations meet the policy intent?

We agree with the removal of the 'if at all' clause 3 (3)(a). As outlined above, we believe that ESG factors can be both financially material and non-financially material and this should be reflected in regulations.

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?

We are supportive of this policy proposal and think it has absolutely the right intention. We note that the core legal principle that trustees have discretion to invest and members have no rights to dictate investment policy is maintained and welcome the government's clear recognition of trustees' primacy both in the consultation paper and in its communication strategy around the paper's release. One of the recommendations of the Advisory Group's report was as follows:

"43. Pension scheme trustees and employers – *Engage better with pension scheme members: Trustees should work with employers and pension providers to develop best practice for better engaging scheme members with their pension investments and encouraging them to register on their pension platforms. This should lead to better alignment with members' non-financial values, with social impact investments as potential fund choices providing they have an appropriate risk/reward profile. As product track records mature, we also envisage growth in social impact investing as a natural part of default funds."*

We do, however, urge the government to recognise that there are important implementation considerations here: for both smaller pension providers and large default schemes, the resource implications of member engagement can be considerable, even allowing for the variety of methods to gauge member views which current TPR guidance sets out. Equally, we are cognisant of the drive towards more efficient, low-cost solutions, and that auto-enrolment means more people than ever before are saving for retirement– for many of these individuals, it will be their first encounter with the investment sector. It is worth noting that steps taken to canvass (and engage with) member views is a possible opportunity for those trustees which want to raise low engagement levels, as well as to build trust in the pensions and savings industry; the Government's review of auto-enrolment (published in December 2017) found that engagement with members has an important role to play in improving outcomes. So these policies could be mutually reinforcing.

We therefore believe that this is an area where there should be clear guidance on how trustees are to fulfil this duty, how to pick an appropriate and proportionate engagement approach with members, and how this feeds back into the investment strategy; and that is an area of work where toolkits and good practice guides could add significant value.

We also believe it is important for member expectations to be managed through careful messaging. The government must continue to highlight at every stage of its communication surrounding the Regulations and accompanying guidance that the proposals in this area do not mean that trustees must take account of member views. If this does not happen, there is a risk that members could misinterpret the new Regulations to mean that their views *will* be taken on board, become disappointed if this does not happen, and be less inclined to engage with their pensions.

Do the draft Regulations meet the policy intent?

Yes.

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 believe that it should be a clear goal for trustees to state a policy in relation to social impact investment and ideally included now. However, if there are concerns that trustee needs to develop a deeper understanding of this area first for it to be effective then, as a minimum, there should be a commitment to introduce within a clear timeframe (say within two-to-three years). We appreciate that work needs to be done to prepare the way and therefore believe that it is necessary to have further guidance for trustees on what social impact investment is and how it could be incorporated into a portfolio investment strategy. This guidance needs to be clear and practical and could also signpost to a 'library' of further resources and evidence which demonstrate the potential benefits of adding some social impact investment to a scheme's portfolio. The Taskforce would be happy to provide practical support in drafting this guidance as we believe that it is vital that additional work reinforces and does not undermine existing initiatives undertaken by organisations including ourselves[1] and the Green Finance Taskforce.

As an example of best practice in terms of clear wording that aims to clarify ESG and social impact investment for pension scheme decision-makers, we would recommend the Local Government Pension Scheme (LGPS) guidance below:

"*Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.* ***Investments that deliver social impact as well as a financial return are often described as 'social [impact] investments'. In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with the prudent approach. In other cases, some part of the financial return may be forgone in order to generate the social impact. These investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund****."*

Our view is consistent with recommendation 45 from the Advisory Group's report:

"45. Pension scheme trustees – *Expand the Statement of investment principles (over time): Over time trustees may consider including wording in the Statement of investment principles relating to their intent to favour investments with positive impact and/ or to avoid investments with a negative impact."*

We acknowledge that further consideration is needed on how financial and non-financial matters are categorised, and where social impact investment fits. However, we question the inclusion of social impact considerations only under wider non-financially material matters. We believe that social impact investments currently span the full breadth of investment opportunities and that the difference between ESG and social impact investing comes down primarily to *intention*; whereby social impact investing specifically targets companies and organisations that intentionally create a positive social benefit, either as a primary or secondary purpose.

Finally, if the government wants to further promote and encourage social impact investment, then work to support the other recommendations of the Taskforce, as and where possible, should also be undertaken or continued. These can be found in full in the report – *Growing A Culture of Social Impact Investing in the UK*.

[1] For instance, in March 2018 the PLSA published a trustee guide to impact investment, together with Hermes Investment, as part of their commitment to 'Growing a Culture of Social Impact Investing in the UK'.

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?

We are very supportive of this proposal. We believe it has the potential to encourage forward-looking stewardship activities which both protect and enhance the value of investments.

We believe that any accompanying guidance should also make clear that the list of risks is very broad and that different risks will be priorities in different circumstances and at different points in the life of a pension scheme.

To quote the recommendation from our report,

"44. Pension scheme trustees – *Statement of investment policies: Trustees to state their policies in relation to stewardship, long-term risks and members' ethical and other concerns in the scheme's Statement of investment principles"*

b. Do the draft Regulations meet the policy intent?

We believe that regulation should state clearly that stewardship includes but is not limited to voting, engaging and monitoring. Indeed, we would welcome the fact that it is made explicit that responsible investment includes engagement. Furthermore, as there remains a misperception amongst some pension fund trustees that it is impossible to undertake stewardship of assets invested passively or in pooled funds, we would welcome additional accompanying guidance which highlights the full spectrum of ways in which schemes can be good stewards of their assets (from full and direct engagement with investee companies, to collaborative engagement, to scrutiny of a scheme's asset manager on how the manager undertakes stewardship activities on clients' behalf).

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?

Yes, we believe that this is a very positive step and will encourage a positive reaction through the investment chain in terms of stewardship and reporting by asset managers. It should encourage pension trustees to undertake a considered and meaningful approach to ESG investment and stewardship and reduce the amount of 'box-ticking' that inevitably follows new regulatory requirements.

As in other areas, we believe guidance and practical advice will be important here, particularly in relation to taking account of members' views. We would also welcome a proportionate approach to enforcement of these new regulatory requirements, particularly for smaller schemes, in the early stages of implementation. A SIP can cover many different areas and monitoring, assessing and reporting against each area will requirement a significant proportion of resources, particularly from smaller schemes.

b. Do the draft Regulations meet the policy intent?

Yes.

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?**

We are supportive of the proposal but note that changes will take time to take effect in a meaningful way. We also acknowledge that smaller pension schemes are more likely to be on a triennial review cycle and therefore the first round of SIPs may be drafted in a way that simply complies with new regulation rather than reflects real thought and analysis. Aligning the implementation with the triennial review process may lead to more meaningful change.

b. **Do the draft Regulations meet the policy intent?**

Yes.

Q8: Do you have any comments on the business burdens and benefits, and wider nonmonetized impacts we have estimated in the draft impact assessment?

Although we have no specific comments on the draft impact assessment, we would like to reinforce the broad point that when looking at the cost/benefit analysis it is vital that this takes into account the long-term consequences of ineffective corporate environmental and social policies.

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

No comments.

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?

Yes, we agree however as described above we are supportive of seeing additional guidance provided and would be happy to help with shaping such guidance.

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 believe that over time trustees may consider including wording in the SIP relating to their intent to favour investments with positive impact and/ or to avoid investments with a negative impact.

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We are grateful for the opportunity to comment on this consultation and would be pleased to provide any further information, evidence or clarification as required.

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