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Response to DWP Consultation on Clarifying and Strengthening Trustees' Investment Duties.

About Law Debenture

The Law Debenture Pension Trust Corporation p.l.c. ("Law Debenture") welcomes the opportunity to respond to the proposals in the consultation document on Clarifying and Strengthening Trustees' Investment Duties.

Law Debenture is the longest established and one of the largest providers of professional trustees in the UK. Our clients' pension schemes have over two million members with over £250 billion in assets invested on their behalf. As well as working with some of the largest and most complex pension arrangements in the country, we also work with more than 50 schemes that each has fewer than 500 members.

Our responses below to each of the questions posed in the consultation document reflect the perspective of, and our position as, a professional trustee of pension schemes. The comments are Law Debenture's own and do not necessarily reflect the views of the trustee boards of schemes on which Law Debenture serves.

We would be pleased to discuss any of our comments, or to provide any further information which we can which might be helpful. Please do not hesitate to contact Sean Burnard on 020 7696 5937 sean.burnard@lawdeb.com or Brian Kilpatrick on 020 7696 5264 brian.kilpatrick@lawdeb.com

In summary, Law Debenture accepts the DWP's stated purpose of the measures which is to help dispel perceived trustee confusion around the extent to which ESG risk analysis can be factored into asset allocation and portfolio construction decisions, although we are doubtful about the extent of such confusion.

We are broadly supportive of the proposals contained in the consultation paper, but we recognise the challenges of proactively soliciting and reconciling the views of a diverse scheme membership base.

We also consider that the proposed implementation timetable may be too short given the lack of experienced stewardship resource within pension schemes' in-house trustee support teams and within smaller asset managers.

We believe that resource challenges will constrain the development and implementation of comprehensive scheme specific stewardship and engagement policies before 1 October 2019 and hence trustees' ability to report on implementation from 1 October 2020.

We consider that it is more appropriate for legal advisers to undertake analysis of whether the draft regulations deliver the policy intent and to comment on the technical drafting. We will not therefore be commenting on the draft regulations.

The following text reproduces the questions listed in the consultation paper together with our comments on each question.

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 broadly supportive of the proposals made in the consultation paper subject to the comments below. We regard the implementation timetable to be challenging for reasons explained below.

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 welcome the attempt in the consultation document to clarify how trustees may treat ethical considerations and how they should treat ESG considerations. This is a welcome differentiation in explaining how trustees should approach such questions, as is the attempt to define ESG more broadly than purely social and environmental issues.

We note the prominence given to climate change risk in the consultation paper but note that this is one of many ESG-related risks that the proposals seek to encourage trustees to address, and we therefore question why it is highlighted separately.

We support trustees being encouraged to identify, analyse and to design risk mitigation strategies for all ESG risks that they regard as being material. However we are unclear as to why ESG risks should be given prominence over other risks that may affect investments.

We support the proposal in question 2 and welcome the absence of an attempt to define "financially material considerations" in the consultation document. We regard this as a matter for trustee boards and their advisors to discuss and agree in consultation with the scheme sponsor.

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?

We understand the policy proposal and welcome trustees considering members' views in their management of the pension scheme on members' behalf. However we regard the suggested requirement to take members' views into consideration to be somewhat at odds with the statement in paragraph 26 of the consultation document.

We welcome paragraph 26's acknowledgment that trustees have a discretion as to whether to take into account member views, and that their prima facie focus is to deliver a return to members.

We welcome DWP's decision not to be highly prescriptive with respect to how member views should be solicited by trustee boards and believe flexibility with respect to how trustees canvas member views is appropriate. Trustees can canvass members' views when and if they wish to and also decide not to do so when they believe that is an appropriate course of action.

Our preferred way forward with regards to this question is that trustees prioritise their fiduciary responsibilities and use financial resources available to secure high quality professional advice to support their decision making and, with respect to DC schemes, to engage with members to attempt to maximise retirement savings outcomes.

Where there is a particular membership demographic, strong company ethos, an inferred membership preference with regard to particular risk factors, or clearly communicated views from the membership through existing communication channels we support trustees considering these factors in their management of the scheme.

Consequently, clarification from DWP on the acceptability of a policy to take account of members' views as they are communicated to the trustees or inferred as described above compared with proactively canvassing members' opinions would be welcome.

We note the prominent reference to the Law Commission's 2-stage test[1] in the consultation paper which is applicable when trustees consider member views on investment strategy. We consider that this 2-stage test potentially could be interpreted as being a higher threshold

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[1] The 2-stage test which must be satisfied is that:
• trustees should have good reason to think the scheme members hold the concern; and
• the decision should not involve a significant financial detriment.

test than is currently applied to traditional asset allocation and asset management questions considered by trustees.

The "significant financial detriment" second leg of this test would fail to recognise the potential for negative outcomes from trustee investment decisions based on good judgement and robust advice but predicated on the inherent uncertainty in financial markets.

Given its implied higher level of prudence we note a potential danger that the use of this 2-stage test may evolve over time and be inadvertently applied to all material future trustee decisions. This is not what we understand is intended and we are concerned that one outcome may be unintended behavioural changes in trustee decision making. This might be unlikely, but we would encourage references to this 2-stage test to make clear that the second leg of the test is referring very clearly to an ex-ante expected significant financial detriment.

We support a trustee decision-making framework that is consistent across the governance terrain where trustees operate and does not set different stringency thresholds for investment ideas from scheme members compared with investment ideas from the trustees themselves, investment consultants or asset managers.

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 support the proposal.

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 support the proposal.

In supporting the proposal we recognise that there are (in some cases substantial) resourcing challenges associated with its (detailed) implementation where stewardship and engagement policies are highly client specific for the reasons stated below.

The predominant pension scheme organisational model in the UK is one where schemes typically employ a small in-house trustee support team and outsource many specialist roles across administration, fund management and professional advice etc.

Given this organisational model, stewardship and engagement activities in relation to individual investee companies are typically undertaken by the asset managers who manage portfolios on behalf of pension scheme clients.

One potential benefit of this model is that asset managers will typically invest several institutional clients' assets in any particular investee company. This should give the asset manager greater likelihood of access to board level executives given the aggregated percentage holding of the company's equity held compared with individual asset owners' holdings.

We recognise that the UK investment industry has made material progress over recent years in improving its commitment to good stewardship and engagement with respect to investee companies. There are many examples, particularly across larger asset managers and stewardship engagement specialists where well-resourced and experienced teams are delivering high quality engagement and stewardship services to institutional asset owners.

However, in our experience many others do not undertake comprehensive stewardship and engagement activities, particularly so where the asset managers are more boutique sized organisations or are implementing macro / quantitative investment strategies.

Furthermore, UK in-house pension scheme teams typically do not have the governance resource and expertise to manage their own stewardship and engagement programs.

The ability of trustees therefore to develop and implement highly bespoke stewardship and engagement policies is arguably constrained in the short term both by a lack of in-house resource and resource within a significant number of asset managers.

We note that such constraints are likely to restrict trustee flexibility in the short term to develop and implement highly bespoke stewardship and engagement policies.

This may be particularly challenging for small schemes invested in pooled funds where there is less scope to negotiate bespoke stewardship programs with the relevant asset manager.

Given the reasons discussed above, we are concerned that the market may not have the capacity to develop stewardship policies which are bespoke to each trustee board, which can be implemented by 1 October 2019 and then be reported to scheme members through implementation statements from 1 October 2020.

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 support the proposal to produce the statement setting out how the policies in the SIP have been implemented and any changes to it.

Our concerns with respect to proactively canvassing members' views are detailed above in the response to question 3.

Our concerns with the industry's capacity to implement the stewardship proposal by October 2019 and hence to produce implementation reports by October 2020 are explained in our answer to question 5 above.

We therefore believe that the proposed timelines to implement fully the proposal and to be able to produce implementation reports are aspirational.

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?

We support online publication of policy documents and annual updates to members where it is cost-efficient to do so, subject to the reservations on proactively canvassing members' views and with the implementation timetable explained above.

We therefore believe that the proposed timelines to fully implement the proposal and to be able to produce implementation reports may well be unrealistic.

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?

We recognise that the estimates contained in the draft impact assessment for policy development, documentation updates and producing implementation reports, are based on a range of assumptions but we do not consider that they are unreasonable.

A material increase in experienced stewardship and engagement resource across pension schemes and asset managers would require a significant additional spend.

We would prefer clear guidelines to be provided as we have seen being provided for DC Chair Statements and for a moratorium on any fines for non-compliant statements to be implemented to give the industry time to adopt the new standards.

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

No further comment.

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 regard the revised Statutory Guidance as being sufficiently clear.

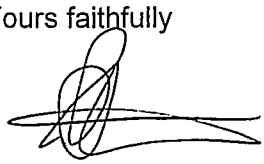
Q11: What evidence or views do you have of how well the other requirements in the SIP are working? What areas for further consideration and possible future change would you suggest?

No suggestions to make at this time

Law Debenture

Law Debenture Pension Trustees is happy to discuss its responses to the questions raised in the consultation paper with representatives from DWP if that would be helpful.

Yours faithfully



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