Sackers

Consultation on clarifying and strengthening trustees' investment duties

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Introduction

On 18 June 2018, the DWP published a consultation to seek views on changes to the Occupational Pension Schemes (Investment) Regulations 2005 ("the Investment Regulations") which are aimed at "clarifying and strengthening" trustees' investment duties.

Key points

- The proposed changes to the Investment Regulations are intended to make clear that the financially material risks which trustees must take into account when making their investment decisions include environmental, social and governance ("ESG") factors, including climate change.
- Under the proposals, trustees will be required to set out, in their statement of investment principles ("SIP"), how they take account of financially material considerations (including those arising from ESG and, in particular, climate change) and stewardship.
- Trustees will also be required to produce a separate statement which explains the extent to which the views which, in the reasonable opinion of the trustees, scheme members hold on financial and non-financial matters will be taken into account in the preparation of the SIP.
- Additional changes, including publication of the SIP on a website, are proposed for "relevant schemes" (broadly, schemes offering DC benefits, subject to a few exceptions).
- Trustees of relevant schemes will also be required to produce an implementation statement which sets out how they have performed as against the SIP. The DWP intends this requirement to be introduced a year after the changes to the SIP.
- The DWP plans to lay the proposed regulations at the earliest opportunity and to bring them into force "around a year" later, to allow trustees to prepare for the changes.

Background

The Government has been considering making changes to the Investment Regulations for many years. Concerns about the interpretation of fiduciary duties in the context of investment were first identified by the Kay Review in 2012.

In July 2014, the Law Commission concluded that trustees:

- should take into account factors which are financially material to the performance of an investment, whatever their source (ie where ESG risks are financially material, trustees should take account of them.)

- could make investment decisions based on members' views, provided that they had good reason to think that scheme members would share their concern and that the decision(s) would not involve a risk of significant financial detriment to the fund (see our Alert for further details).

However, following consultation in 2015, the Government decided that guidance from TPR, rather than legislative change, would be sufficient. Revised guidance was issued for DB schemes in March 2017 (see our Alert for details).

Following a further Law Commission report on social investment by pension funds, the Government has now decided that, despite TPR's guidance, "confusion and misapprehension over trustees' responsibilities persists", with evidence of trustees incorrectly thinking that ESG risks are irrelevant, or run counter to, financially material concerns. It is therefore proposing to make changes to the Investment Regulations to clarify the position for trustees.

SIP – current requirements

A SIP is a written statement which governs the trustees' decisions about the pension scheme's investments.

The SIP must cover at least the following:

- the trustees' policy for securing compliance with their statutory duty to choose scheme investments
- their policies relating to:
  - the kinds of investments to be held by the scheme
  - the balance between different kinds of investments
  - risks (including the ways these are to be measured and managed)
  - the expected return on investments
  - the realisation of investments
  - the extent (if at all) to which the trustees take into account "social, environmental and ethical factors" in selecting, retaining and realising investments, and
- their policy (if any) relating to how the trustees exercise voting rights attached to investments.

Exceptions

Schemes with fewer than 100 members and certain local authority and public sector schemes are not required to prepare a SIP.

The proposals

The timing set out below is based on the regulations being laid in Autumn 2018.

By **1 October 2019**

- trustees will be required to update or prepare their SIP to set out how they take account of financially material considerations, including but not limited to those arising from ESG considerations, including climate change. This will replace the current requirement to state the extent (if at all) to which "social, environmental and ethical" considerations are taken into account. In addition, the SIP will have to include the trustees' policies in relation to the stewardship of their scheme's investments, including engagement with investee firms and the exercise of the voting rights associated with the investment

- trustees of "relevant schemes" will be required to publish their SIP on a publicly available website and inform scheme members of its availability in their annual benefit statement.

The proposed removal of the current qualification ("if at all") is notable. It suggests that there will be a regulatory expectation that trustees should have considered ESG and climate change factors.

Climate change is specifically referenced because the Government considers it to be "a systemic and cross-cutting risk".

From **1 October 2019** trustees will be required to prepare a statement which explains the extent to which the views which, in the reasonable opinion of the trustees, scheme members hold on financial and non-financial matters will be taken into account in the preparation of the SIP ("the Statement on Members' Views").

The DWP makes clear, however, that trustees will not be required to act on any member concerns or invest in line with members' preferences.

From **1 October 2020**, trustees of relevant schemes will be required to

- produce an implementation report setting out how they acted on the principles set out in the SIP and the Statement on Member's Views

- publish that implementation report online and inform members of its availability in their annual benefit statement. (The DWP intends the information to be published alongside the online costs and charges information (see our Alert) so that trustees can include a single link in the benefit statement.)

The introduction of the requirement to produce and publish an implementation report is timed to ensure that trustees will not be required to report on the implementation of a SIP which has been produced under the current requirements.

The Government is proposing a narrower set of changes for DB schemes as it considers that there are already significant incentives in place for employers to work with trustees to seek to improve their SIPs.

Next steps

The consultation closes on 16 July 2018. As noted above, the Government intends to give trustees around a year from the regulations being laid to prepare for the changes. This means that the earliest date for the first measures to come into effect is 1 October 2019. If the regulations are not laid until early 2019, most provisions will come into force on 6 April 2020.

Once the regulations are in force, TPR will update its existing Codes and guidance for both DB and DC schemes and will consider what additional guidance may be helpful for trustees in understanding their duties.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 (0)20 7329 6699
E enquiries@sackers.com
www.sackers.com