The new ESG investment duties top tips for trustees

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Trustees have been grappling for some time with how environmental, social and corporate governance (ESG) considerations should factor into their investment decisions.

At present, under the Occupational Pension Schemes (Investment) Regulations 2005, trustees are required to cover in their scheme's Statement of Investment Principles (SIP) "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments."

However, over the course of last summer, the DWP ran a consultation on 'clarifying and strengthening' trustees' investment duties. This included proposals on changing the requirements surrounding SIPs, particularly in relation to ESG considerations.

On 11th September 2018, the DWP published a response to its consultation, together with a final version of its new regulations: the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 (the 'New Regulations').

Consequently, trustees will need to revisit their SIP to ensure it remains fit for purpose, as by 1st October 2019, they will be required to set out the following:

- 'financially material considerations' over the 'appropriate time horizon' of the investments including how those considerations are taken into account in the selection, retention and realisation of investments
- the extent, if at all, to which 'non-financial matters' are taken into account in the selection, retention and realisation of investments
- their engagement activities in respect of investments (stewardship).

The new definition of 'financially material considerations' clarifies that these include, but are not limited to, ESG considerations, for example, climate change, "which trustees of the trust scheme consider financially material".

Trustees also have the option of including a policy on 'non-financial matters', including not only members' ethical concerns but also social and environmental impact matters and quality of life considerations.

The temptation for trustees, particularly in relation to smaller schemes, will be to ask their investment consultants to provide 'standard template' wording for inclusion in their SIPs. However, this sort of tick box exercise is unlikely to ensure compliance with the New Regulations and leaves trustees open to challenge where there is inconsistency between a stated policy and what is done in practice.

This is not to say that template wording can't be helpful, and for many small trustee boards it may represent an efficient and cost effective way of seeking compliance. However, schemes who take this approach must be careful to ensure that any wording used genuinely reflects what is being done in practice.

Therefore, trustees need to proactively engage with their investment consultants and investment managers about the new requirements to ensure that the wording used in the SIP accurately represents the trustees' actions in regard to their investment decisions and how their managers are implementing the stated policies.

One step that trustees might usefully take is to agree a document with their investment consultants outside of the SIP that sets out the specific actions that will be taken to implement the policies set out within the SIP. This might include specific reporting expectations, including with respect to stewardship, from managers and how the SIP will be monitored and updated as necessary.