

# Investment, Governance and Engagement Sub Committee

## Item 6 Paper B

### Consultation on clarifying and strengthening trustees' investment duties

#### **Background**

1. On the 18<sup>th</sup> June 2018, the Department for Work and Pensions (DWP) issued for consultation draft regulations amending The Occupational Pension Schemes (Investment) Regulations 2005 and The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013. The consultation closed on the 16<sup>th</sup> July 2018.

2. The consultation paper and draft regulations can be found here <https://www.gov.uk/government/consultations/pension-trustees-clarifying-and-strengthening-investment-duties>

3. It is important to note that the amending regulations apply only to schemes based on trust law and therefore have no direct application to pension schemes based on statute law such as the LGPS in England and Wales. However, there may be matters of best practice included in the consultation proposals that could have some application to the LGPS and which the Scheme Advisory Board, on recommendations made by the Investment, Governance and Engagement committee, may wish to consider.

4. This paper therefore summarises the proposed changes to the law as it affects trust based schemes and compares them with the provisions on responsible investment and related matters in the LGPS' investment regulations and associated statutory guidance. A copy of the statutory guidance can be found here

<https://www.gov.uk/government/publications/local-government-pension-scheme-guidance-on-preparing-and-maintaining-an-investment-strategy-statement>.

Commentary on the position of the LGPS is shown in red text at the end of each change proposed by DWP. Any subsequent recommendations are shown in blue text.

#### **Changes to the 2005 Investment Regulations**

5. It is proposed that Regulation 2 should be amended at :

a) paragraph 2 to require trustees to explain the extent to which the views which, in the reasonable opinion of the trustees, members of the scheme

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hold, including the views they hold on non-financial matters, will be taken into account in preparing or revising the statement of investment principles.

Under section 7(2)(e) of the Guidance on Preparing and Maintaining an Investment Strategy Statement published by MHCLG in July 2017, administering authorities “should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors”

The statutory guidance could be strengthened by making specific reference to who the interested parties are rather than leaving it to the discretion of individual administering authorities and also by clarifying how the views of local pension boards and other interested parties are to be taken into account. To match what is being proposed for trust based schemes, the LGPS statutory guidance could be amended to require administering authorities to publish the view taken by their local pension board on the extent to which non-financial factors should be taken into account when investment policies and decisions are made.

b) paragraph 3 to replace “the extent (if at all) to which social, environmental or ethical” with “financially material”

Section 7(2)(e) of MHCLG’s statutory guidance makes reference to “social, environmental and corporate governance factors and requires administering authorities to “explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments” The statutory guidance also states that “The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors and over the long term, dependent on the time horizon over which their liabilities arise.”

In their consultation paper, DWP takes the view that all investment decisions should take account of financially material risks including ESG and climate change, or from broader non-financial considerations. MHCLG’s statutory guidance makes reference to the same point but only in the narrative of section 7(2)(e). Consideration could be given to amending the third bullet point in section 7(2)(e) to read “Must explain the extent to which financially material considerations, including social, environmental and corporate governance matters (including climate change) will be taken into account in the selection, retention and realisation of investments.”

c) sub-paragraph 3(c) to require trustees to include in their statement of investment principles their policies on :

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i) the exercise of rights (including voting rights) attaching to the investments.

Under section 7(2)(f) of MHCLG's statutory guidance, an administering authority must give reasons in their Investment Strategy Statement for not adopting a policy of exercising rights, including voting rights, attaching to investments.

MHCLG's statutory guidance goes further than what DWP is proposing for trust based schemes by establishing a "comply or explain" requirement. It also goes further by recommending that administering authorities should, where appropriate, explain their policy on stewardship with reference to the Stewardship Code.

ii) undertaking engagement activities in respect of the investments (including the methods by which and the circumstances under which trustees would monitor and engage with relevant persons and other persons about relevant matters.

Under section 7(2)(f) of MHCLG's statutory guidance, an administering authority is requested to strongly encourage their fund managers to vote their company shares in line with the policy agreed under section 7(2)(f) and also to publish a report of voting activity as part of their pension fund annual report under Regulation 57 of the 2013 Regulations. Administering authorities are also encouraged to appoint an independent proxy voting agent to exercise their proxy voting and monitor the voting activity of fund managers and for reports on voting activity to be submitted annually to the administering authority.

Again, MHCLG's statutory guidance appears to go further than what is being proposed by DWP for trust based schemes but it is open to question whether the relevant provisions in the statutory guidance should be promoted from "should" or "may" to "must."

("Financially material considerations" includes, but is not limited to, environmental, social and governance considerations (including climate change)

("non-financial matters" includes, but is not limited to, ethical matters, social impact matters and present and future quality of life of members matters)

("relevant matters" includes matters concerning an investee company, including its performance, strategy, risks, social and environmental impact and corporate governance)

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(“relevant persons” means an investee company, an investment manager and a shareholder of an investee company)

## **Changes to the Disclosure Regulations**

6. These include :

a) a requirement for the latest statement of investment principles governing decisions about investments prepared for the scheme under section 35 (investment principles) of the 1995 Act and the information which must be included in the annual report to be made publically available free of charge.

Under Regulation 7(6) of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, an administering authority was required to publish its first Investment Strategy Statement formulated under Regulation 7(1) by 1<sup>st</sup> April 2017 and, under Regulation 7(7), to review it from time to time and, at least every three years, publish a statement of any revisions. Under Regulation 7(5), an authority must consult such persons as it considers appropriate as to the proposed contents of its investment strategy. Under Regulation 57(2) of The Local Government Pension Scheme Regulations 2013, an administering authority must publish their pension fund annual report on or before the 1<sup>st</sup> December following the scheme year end.

The LGPS provisions are equivalent to those being proposed by DWP for trust based schemes. However, although no reference is made to either the Investment Strategy Statement or Pension Fund Annual Fund Report being made available free of charge, by the same token, no provision is made for a charge so the clear inference is that they must be provided free of charge.

In both cases, “publish” is given its ordinary and every definition which can include electronic means including signposting. Consideration could perhaps be given to clarifying the means of publishing both documents in either regulations or statutory guidance.

b) a requirement to publish a statement including :

i) the extent to which in the opinion of the trustees the statement of investment principles has been followed during the year;

**No corresponding LGPS provision.**

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Consideration could be given to including a similar provision in Regulation 7 of the Investment Regulations 2016.

ii) a review of the statement of investment principles undertaken during the year including any review of how the statement has been met;

**No corresponding LGPS provision.**

Consideration could be given to including a similar provision in Regulation 7 of the Investment Regulations 2016.

iii) any change made to the statement of investment principles during the year and the reason for the change;

**Regulation 7((7) of The Local Government Pension Scheme (Management and Investment Funds) Regulations 2016 requires an administering authority to publish and revised Investment Strategy Statements.**

Regulation 7(7) could be amended to include a requirement to publish the reasons for any change to the statement.

iv) where no review was undertaken during the year, the date of the last review.

**No corresponding LGPS provision.**

Consideration could be given to including a similar provision in Regulation 7 of the Investment Regulations 2016.

**Bob Holloway  
Pensions Secretary  
Local Government Pension Scheme Advisory Board**

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