

DWP confirms new investment duties for trustees

► In brief

- Most of the original proposals will go ahead unchanged
- From 1 October 2019, trustees must include in their SIPs their policies on financially material considerations and the stewardship of investments
- The requirement to produce a statement on members' views has been dropped
- Most money purchase schemes will have to make additional disclosures, including making the SIP freely available online

► Next steps

- The bulk of the changes will be introduced with effect from 1 October 2019
- In practice, SIPs will need to be revised before 1 October 2019 to incorporate the new requirements
- Your XPS consultant will be able to help you prepare for the changes

On 11 September 2018, the Department for Work and Pensions (DWP) published its response to its summer 2018 consultation on proposals to 'clarify and strengthen' trustees' investment duties, including how they take account of financially material environmental, social and governance (ESG) matters.

Background

The original consultation was the latest in a series of reviews and previous consultations over the last six years, starting with the Kay Review of UK Equity Markets and Long-Term Decision Making in 2012. One of Kay's recommendations was that the Law Commission review the legal concept of fiduciary duty as applied to investment.

Following reviews by the Law Commission in 2014 and 2016, the Government concluded that 'confusion and misapprehension over trustees' responsibilities persists' and that there is evidence of trustees 'incorrectly thinking that [ESG] risks are irrelevant to, or run counter to, financially material concerns'. The DWP consulted in summer 2018 on proposals that were intended to address this state of affairs as well as to implement a requirement in the IORP (Institutions for Occupational Retirement Provision) II Directive for the Statement of Investment Principles (SIP) to set out how the investment policy takes ESG factors into account.

The consultation gave a number of examples of ESG considerations including:

- Environmental: resource depletion including pollution and deforestation.
- Social: working conditions including slavery and child labour; health and safety; ageing population and income inequality.
- Governance: executive pay, bribery and corruption, and board diversity.

Changes to proposals following consultation

The majority of the original proposals from the DWP's summer 2018 consultation are being implemented as planned; however, there are some changes in the final regulations, which were made on 10 September 2018.

Arguably the most significant change is that the proposed requirement for trustees to prepare a statement on how members' views are taken into account has been dropped. The majority of respondents to the consultation did not support the original proposals, with many interpreting them as requiring trustees to survey members' views (something that the DWP says was a misapprehension). The consultation response makes it clear that this is not required, nor will trustees be required to take account of members' views. Instead, there will be a new requirement for a SIP to include the trustees' policy on the extent (if at all) to which non-financial matters are taken into account in the 'selection, retention and realisation of investments'. Non-financial matters' mean the views of members and beneficiaries, which include (but are not limited to) their ethical views and their views in relation to social and environmental impact and quality of life considerations. (The original definition of non-financial matters proposed in the consultation did not include environmental impact considerations; however, this was added in the final regulations.) In effect this

means that trustees will not be *required* to have a policy on the extent to which non-financial factors are taken into account, although they may *choose* to have one.

Another significant change relates to the proposal that, by 1 October 2019, the SIP for all occupational pension schemes (except those with fewer than 100 members) must include the trustees' policy on how they take account of 'financially material considerations'. The final regulations now explicitly require trustees to take account of such considerations 'over the appropriate time horizon of the investments'. This time horizon is intended to refer to the scheme, not to the durations of individual investments held by it, and so could potentially be short (for example, for schemes that are likely to wind up or have their benefits bought out with an insurer in the short term).

Changes affecting all schemes

By 1 October 2019, trustees of all schemes that are required to produce a SIP (which excludes schemes with fewer than 100 members) must prepare or update it to set out their policies in relation to:

- financially material considerations over the appropriate investment time horizon, including how those considerations are taken into account in the selection, retention and realisation of investments. Financially material considerations include (but are not limited to) ESG factors (including climate change); and
- the stewardship of investments, including the exercise of voting rights associated with, and undertaking engagement activities in respect of, those investments.

In addition, as mentioned above, from 1 October 2019, SIPs will also need to include the trustees' policy on the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments.

Changes affecting money purchase (MP) schemes

Some of the new requirements apply only to so-called 'relevant schemes', which are broadly either MP schemes or schemes with MP sections (other than a few exceptions, including schemes where the only MP benefits are MP AVCs). Such schemes are already required to produce a separate SIP covering their default arrangement, *regardless of size*.

However, from 1 October 2019, in addition to the SIP requirements above, the separate SIP on the default arrangement must also include the trustees' policies on financially material considerations and non-financial matters in respect of that default arrangement.

Furthermore, where the relevant scheme has 100 or more members, the trustees will also be required to:

- state their policy on the stewardship of the investments in the default arrangement; and
- publish their (overall) SIP on a publicly available website and include a link to this information in the annual benefit statement sent to members.

Finally, from 1 October 2020, trustees of relevant schemes that are required to produce a SIP will be required to prepare an annual implementation statement which:

- sets out how, and the extent to which, (in the opinion of the trustees) the SIP has been followed over the year in question; and *either*
- describes any review of the SIP carried out during the year, explaining any changes that have been made to it and the reasons for them; *or*
- where there has been no review (as there is only a requirement to review a SIP every three years), gives the date of the last review.

This implementation statement must be published on a publicly available website. Members must be made aware of it in their annual benefit statement.

Guidance

Alongside the consultation response, the DWP has updated its statutory guidance (originally published in February 2018) to help pension scheme trustees with their duties to report charges, transaction costs and other information relating to the new SIP requirements. According to the consultation response, TPR is also due to publish high-level, non-statutory guidance on the key changes by the end of November 2018.

Next steps

In the original consultation, the DWP mentioned the possibility of a delay to the introduction of the proposals (to April 2020) if the regulations bringing in the changes were held up (say, due to time pressures as a result of Brexit). However, the regulations were laid in September and consequently the original timetable applies, with most of the proposals coming into force on 1 October 2019.

Comment

Some trustees might well be feeling relieved at the confirmation that they will not have to survey members' views. Nevertheless, the regulations are still a firm nudge that trustees should be taking ESG factors into account in their investment decisions.

For further information

Please get in touch with William Fitchew.



@xpsgroup.com



01483 330 100



company/
xpsgroup



william.fitchew@
xpsgroup.co.uk