ASSOCIATION OF PENSION LAWYERS

By email to: **reinvigorating.pensions@dwp.gsi.gov.uk**

Date 24 April 2015 Our Ref CLS/60500771 Your Ref

Dear Sirs

Response to Consultation on changes to the Investment Regulations following the Law Commission's report "Fiduciary Duties of Investment Intermediaries"

We are commenting on the above consultation on behalf of the Investment Sub-Committee of the Association of Pension Lawyers of the United Kingdom ("**APL**").

The APL is a not-for-profit organisation whose members comprise over 1,100 UK lawyers, including most of the leading practitioners in the field, who specialise in providing legal advice on pensions to sponsors and trustees of pension funds and others, including the largest pension funds in the UK. Its purposes include promoting awareness of the importance of the role of law in the provision of pensions and to make representations to other organisations or governments on matters of interest to APL members.

Q1 – How could regulation 2(3)(b) of the Investment Regulations be amended so that it more clearly reflects the distinction between financial and non-financial factors?

Regulation 2(3)(b) currently provides for a statement of investment principles to cover the trustees' policies in relation to

"...
(iii) risks, including the ways in which risks are to be measured and managed;

...and

(vi) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments."

We consider that the existing requirement to detail risk management policies (as well as the other policies to be recorded in the statement of investment principles) is sufficient to cover the need for trustees to consider financial factors. In essence, the Law Commission report identified that taking account of many so-called "Environmental, Social and Governance" concerns is no more than normal management of portfolio risk that ought, in the normal course, to be part of the trustee's investment decision-making.

It might be helpful to reinforce regulation 2(3)(b)(iii) so that it explicitly records that the risks to be covered may include, amongst other things, risks which could have financial implications but which arise from factors such as environmental, social or governance concerns.

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We therefore consider that the only change required to regulation 2(3)(b)(vi) is to make it provide for disclosure in the statement of investment principles of whether trustees take account of non-financial factors in choosing investments, and if they do, identifying what those factors are and how the trustees have identified them as being of importance to include in their investment decision-making.

Note that we do not think it necessary or helpful to require trustees to specify the "extent" to which they have taken account of non-financial factors. All that is required is for trustees to specify whether they have done so.

We consider this approach would enable and facilitate trustees to distinguish clearly between financial and non-financial factors as outlined in the Law Commission Report.

Q2 – Do you agree that amending the Investment Regulations to require trustees to comply with the current requirements in the Stewardship Code or explain why they have not done so, is the most appropriate way to implement the Law Commission's recommendation? If not, what approach would be more appropriate to encourage trustees to consider their approach to stewardship?

We believe that the Investment Regulations should be amended to require trustees to disclose, in their statement of investment principles, whether or not they have signed up to the Stewardship Code and, if not, explain why they have not done so.

From the consultation question, it is unclear whether the proposal is for the Investment Regulations to require trustees to specify whether they have or have not complied with each of the principles of the Code, irrespective of whether they have formally signed up to the Code. This would be unduly onerous and impracticable for most schemes.

Q3 – What steps would trustees need to take to comply with any amendments to the Investment Regulations, as set out in Chapter 2? What if any costs would be involved in meeting any new requirements?

We consider the "comply or explain" approach to stewardship means that trustees who see no benefit from active engagement with investee companies need do no more than reformulate their statement of investment principles. This should not generate material additional costs.

In any event, costs can be minimised by ensuring that changes to the statement of investment principles are not required to be made until the next occasion on which the statement is otherwise revised and we would recommend that the legislation includes transitional provisions to facilitate this.

Trustees who already take stewardship activities seriously, are again unlikely to incur material additional costs from providing further explanations of what they do and don't do in respect of stewardship in their statement of investment principles.

A number of trustees may be prompted by the "comply or explain" approach to reconsider their stewardship activities and so may incur additional cost through any decision they take to increase engagement. However, as they are likely to do this only where they perceive that additional engagement to be in their members' interests, this does not appear to us to be a reason against implementing the proposed amendments to the Investment Regulations.

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Finally, we would like to draw your attention to a further point which is beyond the scope of this consultation but which might usefully be addressed, in part, by amendments to the Investment Regulations. This is the point that there are various provisions in the Investment Regulations and indeed in primary legislation (specifically, sections 33-36 and 47 of the Pensions Act 1995) that do not work well in the context of an investment manager appointed with discretion to invest a subset of a scheme's assets. Such a manager will not have visibility over the scheme's entire portfolio and so it is difficult, for example, for the manager to invest assets in a manner "*calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole*" as required by Regulation 4. We invite the DWP to consider this matter and would welcome the opportunity to discuss an appropriate solution.

If you would like to discuss any of the issues raised in this response please contact Carolyn Saunders at the email address shown on the front of this letter or Rosalind Knowles (rosalind.knowles@Linklaters.com)

Yours faithfully,

Carolyn Saunders
for and on behalf of the Association of Pension Lawyers