TOWERS WATSON

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Dear Sir or Madam,

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

I am writing on behalf of Towers Watson and am pleased to respond to the three questions in the above consultation document.

Question 1: 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?

We would replace the existing wording of 2(3)(b)(vi) with "the use of non-financial factors in the selection, retention and realisation of investments".

Whilst financial considerations should drive trustee decisions, there may be legitimate circumstances when the trustees should reasonably consider other issues, subject to broad membership approval and no material financial impediment on the scheme. These circumstances include, but are not limited to:

- Considering the reputation of the fund and its members
- Avoiding activities that pose a threat to the robustness of the underlying economic system
- Seeking to avoid an investment in assets that violate local laws and international conventions

We also recognise that there is a bias towards the identification, assessment and monitoring of shorter-term risks and opportunities, which clearly filters through to the investment decision-making process. This point is fundamental to this consultation because ethical, environmental and social issues may not be financially material in the short term, but may be financially material thereafter. For example, risks relating to climate change, corruption, bribery and labour standards may not be financially material over three years, but are highly material over a twenty-year period. As with many issues, early consideration and management of these risks can be more efficient and effective than postponing a decision to a time when it may be considerably more expensive to adapt, innovate or mitigate any unwanted impacts.

Furthermore, we believe that trustees should be comfortable in making statements about non-financial factors (which is not always the case today). How could this be achieved? We argue that the proposed changes to regulation 2(3)(b)(vi) would help, but only if accompanied by wording on non-financial factors in a Code of Practice from the Pensions Regulator, in keeping with the Law Commission's proposal. However, and perhaps worryingly, this consultation is silent on such wording from the Pensions Regulator, as it seems is the Pensions Regulator itself.

Question 2: 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?

Yes, although the regulation could be amended to require the trustee have a policy position on stewardship for its fund. This could even include setting stewardship objectives, an implementation strategy and a requirement to report to its beneficiaries on stewardship. The Pensions Regulator could point to the NAPF guidance document as good practice for UK pension schemes and the Stewardship Code as good practice for investment managers.

After all, poor stewardship of assets by investors is often cited as a factor that can have a detrimental impact on the economic and investment system. However, good stewardship benefits the whole economic and investment system and so we believe that it is appropriate for all investors, except for the very smallest, to have a well-designed, monitored and reported stewardship policy in place.

It would therefore be prudent to highlight this connection within guidance to trustees and their intermediaries, along with guidance about better stewardship. This has become an issue over time for two main reasons:

1 Pension scheme investments are highly susceptible to the fortunes of whole economies and the robustness of the investment system; and

2 Stewardship activity has largely become limited to the world's largest investors with smaller investors often failing to play an appropriate role in the stewardship of their assets.

Whilst understandable, these behaviours have been unhelpful in setting investor culture, behaviour and practice around good stewardship.

Question 3: 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?

The steps required to comply with any amendments to the Investment Regulations are noted above. We would be happy to provide further advice on these, should you wish.

A little more governance time/resource would be required by pension schemes to meet the new requirements as described above. However, much practical guidance is already available to pension fund trustees but needs to be drawn together, perhaps by The Pensions Regulator. If this were the case, we would not foresee the amendments to the Investment Regulations as being overly costly or burdensome for the Trustee, particularly when offset against the potential benefits to the scheme members.

Please feel free to contact me if you require any clarification or further detail.

Yours sincerely

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