Principles for Responsible Investment

CHANGES TO THE LAW ON INVESTMENTS IN OCCUPATIONAL PENSION SCHEMES

CONSULTATION

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PRI Principles for Responsible Investment

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To whom it may concern,

We welcome the opportunity to respond to DWP's consultation on changes to the investment Regulations following the Law Commission's report 'Fiduciary Duties of Investment Intermediaries'.

ABOUT THE PRI

Launched at the New York Stock Exchange, the United Nations-supported Principles for Responsible Investment (PRI) is a global network representing over 1350 asset owners, investment managers and financial service providers with total assets under management of $45 trillion, across 54 countries.

The PRI's UK network comprises 195 asset owners, investment managers and financial service providers, including many of the UK's largest pension funds. The PRI's head office is in London.

ABOUT THE CONSULTATION

The Department for Work and Pension launched a public consultation on 26th February 2015 titled: 'Changes to the Investment Regulations following the Law Commission's report 'Fiduciary Duties of Investment Intermediaries'.

This follows the Law Commission's review of fiduciary duty, which concluded that trustees should take into account factors which are financially material to the performance of an investment, including over the long-term. Where trustees think ethical or environmental, social or governance (ESG) issues are financially material they should take these into account. The Law Commission also concluded that, while the pursuit of a financial return should be the predominant concern of pension trustees, the law is sufficiently flexible to allow other, non-financial, concerns to be taken into account provided trustees have good reason to think that scheme members share their view, and there is no risk of significant financial detriment to the fund.

PRI REPORTING:

- Provides access for policy makers to a unique, global data warehouse on responsible investing, with potential for country-by-country reporting.
- Defines a global standard of responsible investment reporting, styles and terminology.
- Helps identify leading practice with opportunity for peer group comparison and country-by-country comparison of responsible investment policies and actions.
- Provides annual reporting analysis that policy makers can use to demonstrate policy effectiveness, including shareholder voting and engagement statistics.

The PRI reporting framework is already referenced in leading investment legislation in South Africa and Denmark, with discussions underway in other regulatory jurisdictions.

Please do not hesitate to contact Will Martindale, Head of Policy at PRI – will.martindale@unpri.org and Alyssa Heath, Reporting & Assessment Senior Manager at PRI - alyssa.heath@unpri.org for further information on anything contained within this response.

PRI RESPONSE

The Department for Work and Pensions consultation seeks views on recommendations made by the Law Commission on the law governing investments in occupational pension schemes in its report 'Fiduciary Duties of Investment Intermediaries' in July 2014, and potential amendments to the Investment Regulations.

The consultation asks two questions, firstly:

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

In particular, respondents' views are sought on whether trustees should be required to state their policy on:

a) how they evaluate long-term risks, including from ESG and other factors which may be financially material to the performance over their investments; and

b) determining whether and in what circumstances it would be appropriate to make investment decisions on the basis of non-financial factors.

The PRI supports the above recommendations. Trustees should state how they evaluate long-term risks which explicitly include ESG factors. ESG factors are material considerations in all investment decisions. This is consistent with the six Principles and growing interest in the media and amongst beneficiaries to understand how pensions are being managed. The PRI recommends:

- Removing the reference to "social, environmental or ethical" considerations and replacing it with the term "environmental, social and governance". This is a term that has been recognised and adopted by the institutional investment industry, including over 1350 PRI signatories.
- Ensuring that the draft regulation explicitly states that ESG factors should not automatically be classified as "non-financial". ESG factors can and will have a material impact on long-term returns for pension funds and with reference to point "b)" above, should be considered in all investment decisions.

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?

The PRI supports this. Trustees should be required to comply with the current requirements in the stewardship code, or explain why they have not done so. However, we would also encourage the Investment Regulations to refer to the Principles for Responsible Investment. The majority of PRI Signatories are already complying with, or exceeding, stewardship requirements (which map very closely to the PRI's principles).

Currently signatories to the Stewardship Code need only state their intention of their stewardship responsibilities the PRI requires signatories to go further, both promoting active ownership and reporting on their approach to active ownership on an annual basis which is published online, we would therefore recommend that the law commission reference the PRI's annual reporting framework in their communication with investors.

See below for examples of how the PRI Reporting Framework outputs complement the Stewardship Code:

Signatories to the Stewardship Code should:
Publicly disclose their policy on how they will discharge their stewardship responsibilities

Of 102 UK signatories that responded to the PRI indicator OA.01, 71 of 102 UK signatories have a responsible investment policy which is publicly available and 62 of 102 UK signatories have other guidance documents/policies related to responsible investment which is publicly available.

Of the 99 UK signatories that responded to the PRI indicator OA.03.1, all but one have applicable policies that cover either all AUM or the majority of AUM.

Signatories to the Stewardship Code should:
Have a clear policy on voting and disclosure of voting activity

PRI module "Overarching Approach", OA.03.1 asks "Indicate the components/types and coverage of your responsible investment policy and guidance documents."

Of the 99 UK signatories that indicated the components/types and coverage of their responsible investment policy and guidance documents, 97 of 99 UK signatories have a policy setting out the overall approach, 81 of 99 UK signatories have an engagement/active ownership policy and 70 of 99 UK signatories have specific guidelines on corporate governance (figure 1). Over half of 99 UK signatories have a voting policy, a screening/exclusion policy, specific guidelines on environmental issues and specific guidelines on social issues (figure 1).

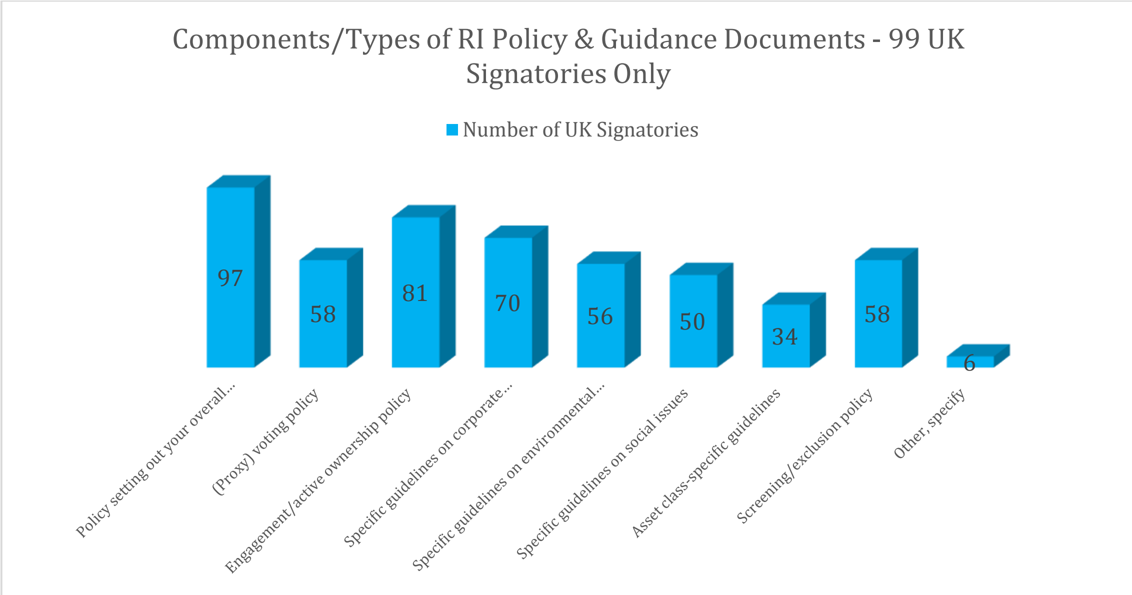

Figure 1.

Signatories to the Stewardship Code should:
Report periodically on their stewardship and voting activities

Of 57 UK signatories that responded to the PRI indicator LEA.15, 44 of 57 UK signatories stated that they either publicly disclose information on their engagements or they disclose it to clients and/or beneficiaries only.

Of 56 UK signatories that responded to the PRI indicator LEA.26, 48 of 56 UK signatories stated that they either publicly disclose information on their voting activities or they disclose it to clients and/or beneficiaries only.

Signatories to the Stewardship Code should:
Have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed

Of 102 UK signatories that responded to the PRI indicator OA.04, 92 of 102 UK signatories have a policy on managing potential conflicts of interest in the investment process.

Signatories to the Stewardship Code should:
Monitor their investee companies

Overall, PRI signatories are active owners and care about dialogue with companies. Globally, of the 578 signatories holding listed equity (directly and indirectly), 523 of 578 signatories engage or vote on ESG issues, either directly or engage through external providers. Good disclosure and transparency is also a priority. Looking specifically at environmental, social and governance data, 359 of 578 signatories holding listed equity assets engaged to improve disclosure on these issues (global data).

Signatories to the Stewardship Code should:
Be willing to act collectively with other investors where appropriate

PRI module "Listed Equity Active Ownership", LEA.02.1 asks "Indicate your reasons for interacting with companies on ESG issues and indicate who carries out these interactions."

Of the 59 UK signatories that responded (regarding collaborative engagements only) 53 of 59 UK signatories stated that they engage via collaborative engagements. The most popular reason for engagement was "to influence corporate practice (or identify the need to influence) on ESG issues" (47 of 59 UK signatories), followed by "to encourage improved ESG disclosure" (45 of 59 UK signatories) and "to support investment decision-making (e.g. company research) (26 of 59 UK signatories). 43 of 59 UK signatories gave 2 or more reasons for engagement.

PRI does not propose to respond to Question 3 of the consultation.

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