UKSIF
UK Sustainable Investment and Finance Association

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Dear Ms Latham,

21st Century Trusteeship and Governance

Thank you for the opportunity to feed-in to TPR's consultation on 21st Century Trusteeship and Governance. We appreciate the chance to put forward our views both face-to-face and here, where we focus on the issues surrounding pension fund investment.

UKSIF is the membership network for sustainable and responsible financial services in the UK. We promote and support sustainable and responsible investment (SRI) and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. We have around 240 members and affiliates including financial advisers, institutional and retail fund managers, pension funds (including local government schemes), banks, research providers, consultants and NGOs.[1]

1. There are currently no barriers to entry for professional trustees. Should there be? For example, should all professional trustees be required to be qualified or registered by a professional body?

Professional trustees can improve trustee board effectiveness and we welcome TPR's research which shows a correlation between the increasing professionalisation of the industry and increased governance standards.[2] Despite TPR's findings that schemes with only professional trustees were more likely to have better governance arrangements we would urge caution against a transition towards a fully professional model. Sufficient balance and diversity on the trustee board is crucial to the overall success of the scheme as a whole. Professional trustees are expected to operate to a higher standard and are considered to be experts. Given the trend TPR research has outlined, greater scrutiny of the profession may be necessary and a qualification is one way to achieve this. Since professional trustees purport to be experts and receive remuneration for their expertise they should be able to demonstrate this. Achieving appropriate qualifications would be helpful in enabling professional trustees to exhibit such expertise.

The ever changing nature of financial risk and the acknowledgement by trustee boards that the most significant knowledge gaps are understanding of pension scheme investments, pension law and the roles and responsibilities of trustees are two key reasons to introduce qualifications for professionals as well ongoing training for all trustees. We would encourage TPR to introduce such a qualifications,

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[1] For more info about UKSIF, please visit www.uksif.org.
[2] TPR and OMB Research, Trustee Landscape Quantitative Research, available at http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf

on the understanding that it would be updated to reflect the changing nature of pension regulation on a regular basis. We are well placed to support in the creation of any syllabus, particularly in relation to investment governance, given our Analyst Programme which highlights and examines emerging financial risks and opportunities for investment analysts.

2. Do you think it is the role of the chair of trustees to support trustees and use their leadership skills to improve the likelihood of appropriate scheme processes being put in place?

3. Should the requirement to appoint a chair and report on compliance with governance standards be introduced for DB schemes?

An effective chair of trustees is key to a successful pension scheme and having the right individual as chair is far more important than the introduction of any specialist qualification. Part of the chair's role should be to set high standards of governance for the board as a whole and to ensure the board is utilised effectively when examining the issues which affect their scheme. The chair should be a good negotiator, "able to achieve compromise where possible and not constantly attempt to achieve consensus via the lowest common denominator".[3] It is also vital the chair has a sound understanding of pension scheme regulations and trends within the sector.

Chairs are vital for good governance and therefore integral for schemes to achieve good member outcomes. For chairs in DC schemes there are other governance requirements i.e. signing the annual chair's governance statement. We were therefore surprised with TPR's research which showed that 20% of schemes did not have a chair of trustees. On the DC side of the market, schemes have benefitted from the chair's statement confirming compliance with governance standards. These reporting requirements help improve scheme governance and similar standards should therefore also be required in DB schemes.

4. How can we help trustees to be aware of, understand and apply the TKU framework?

5. Do you have any views as to how we can help new trustees bring their knowledge and skills up to the required standard within the statutory period?

6. How can trustees demonstrate they have the minimum level of competence required to fulfil their role?

7. Do you have a view as to whether a CPD framework would assist trustees to meet the challenges of scheme governance?

We note the findings that half of schemes with one or more non-professional trustees did not believe that all trustees had a level of Trustee Knowledge and Understanding (TKU) that met TPR standards. This was concerning given the biggest gaps between perception of importance and knowledge were pension scheme investments, pensions law and the responsibilities of trustees. This increases the potential for trustees to misunderstand their legal responsibilities, miss important regulatory developments and investment trends, and become wholly reliant on their advisers and therefore miss the opportunity to challenge them where appropriate and in the best interests of

[3] Member feedback.

scheme members. We welcomed the latest update to TPR's DC code of practice, but these findings call into question the extent to which trustees will take the new rules on-board, particularly the new guidance on investment governance which references environmental, social and governance factors, and long-term risks stemming from climate and poor governance practices.[4] Indeed the research shows that the biggest gap between perception of important and skill rating was trustees' ability to challenge advice or advisers. Clearly this is not in the best interest of scheme members.

We note that 45% of schemes have a training plan in place and that 59% keep a training log for trustees, rising to 67% and 87% for large schemes. Although we would welcome action from TPR to increase the number of schemes employing these practices, we understand resource constraints can be a barrier for some smaller schemes from putting into place training plans. Nonetheless, the Scheme Management Skills guidance published alongside the recent DC Code of Practice contains useful information which is relevant for trustees in DB and DC schemes. We see no reason why this guidance could not be extended to DB trustees or appropriately amended for the use of trustees in DB schemes.

There are a variety of ways TPR can raise trustees' knowledge and skills to the required standards. We acknowledge that 10% of schemes referred to entry level qualifications as the preferred route, however question the extent to which this additional layer of administration would encourage more people to become trustees. The trustee toolkit is particularly effective at bringing new trustees up to the required standards in a timely fashion, although it is unlikely to be of use to trustees on an ongoing basis. We would be in favour of it being completed within six months, with new trustees operating on a probationary basis until they have demonstrated sufficient TKU. In this case TPR will need to outline what steps it plans to take where trustees do not take or fail the trustee toolkit within the six month period.

While the trustee toolkit is undoubtedly useful, more focus should be placed on Continuing Professional Development (CPD). The issues of concern to our members are ones relating to environmental, social and governance factors and stewardship of assets. We welcomed the inclusion of aspects in the investment governance guidance to the new DC code of practice and they, along with the other identified knowledge and kill gaps, should be the focus of such sessions. These knowledge gaps are material enough that CPD is the most effective way to allow trustees to keep refreshed with regard to their own responsibilities and legal duties, as well as keep up to date with emerging trends to help and to ask their advisers the appropriate questions and challenge them where appropriate. We also note that changing regulations and investment were two of the top three main issues identified by trustee boards with regard to their scheme's overall governance. This is concerning.

We go on to discuss the evolving regulatory landscape in question 12, but we are shifting to a new paradigm in terms of investment thinking. The global deal to combat climate change at COP21 heralded the beginning of the transition to a low-carbon economy through an agreed limit to average temperature increases of no more than 2ºC. The Governor of the Bank of England

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[4] TPR, A guide to investment governance, available at http://www.thepensionsregulator.gov.uk/docs/draft-dc-investment-guide-2016.pdf

highlighted risks stemming from this transition including from stranded assets (where the vast majority of fossil fuel reserves are rendered unburnable due to this limit) and was clear:

> *"The exposure of UK investors… to these shifts is potentially huge."*[5]

Subsequent to this speech and a report by the PRA on the exposure of the UK insurance industry to climate risks,[6] the Financial Stability Board set up the Taskforce on Climate-related Financial Disclosures with an objective to better identify climate risks and opportunities. Climate risk is so material that a global initiative was set up at the request of the G20 to make recommendations for climate-related financial reporting specifically to help investors make informed investment decisions. We were therefore extremely concerned to see recent polling for Professional Pensions that 53% of pension professionals did not consider climate change as a financially material risk to their own or their clients' portfolios.[7] Trustees are at risk of falling further behind the curve in terms of current regulatory and investment developments: They must be aware of climate risk, and other financially material investment risks where the impact and severity can be more dynamic as more data is released and more analysis undertaken on a specific sector. It is for this reason a one-off qualification or test will not be sufficient to give trustees the required understanding. We do not expect trustees to be expert investment analysts, but to be educated to the extent where they are at least able to ask the appropriate questions of their investment advisers. We agree with TPR's statement that CPD could help strike a balance between enabling trustees to meet required standards without discouraging people from becoming trustees.

10. What do you think are the key challenges faced by trustees in engaging effectively with administration and investment governance and third party providers and advisers? What could we do to help them in addition to what we outline above?

We have already outlined some major challenges facing trustees of all schemes. In our view the key challenges in engaging with administrator and investment governance advisers are:

- Resource constraints- relating in particular to time and costs;
- Breadth and complexity of investment governance issues;
- Lack of confidence in asking technical investment questions;
- Lack of understanding of trustees' own legal responsibilities;
- Lack of understanding or interest on the part of providers or advisers.

We would reiterate our desire to see qualifications for professional trustees as well as updated trustee toolkit modules, but particularly thinking around CPD which could address most or all of the above challenges.

12. Would you find it useful to see overarching guidance covering issues common to all schemes, with more specific issues being covered in technical guidance?

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[5] Mark Carney speech at Lloyd's of London, September 2015 available at http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx
[6] PRA, The impact of climate change on the UK insurance sector, available at http://www.bankofengland.co.uk/pra/Documents/supervision/activities/pradefra0915.pdf
[7] Professional Pensions poll, available at http://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry

Overarching guidance covering issues common to all schemes would be very helpful in clarifying the law for trustees. There are a range of areas where recent thinking by TPR can easily be extended to cover trustees operating in all trust-based schemes. As you are aware, UKSIF has worked with TPR on the development of the recent DC code of practice and related investment guidance. This is a prime example of one area where much of the new guidance recently published is applicable to both DB and DC schemes and this overlap should be explicitly recognised and addressed by the regulator. For example the section on financial and non-financial factors rightly recognises that where environmental, social and governance (ESG) factors are financially significant they should be taken into account by trustees. Increasing evidence has shown ESG integration by investors can have positive impact on the performance of investments.[8] A 2015 report by Oxford University and Arabesque Partners highlights the positive impact of ESG integration and specifically references the role of trustees and investors with regard to ESG or 'sustainability parameters':

> *'It is in the best interest of institutional investors and trustees, in order to fulfil their fiduciary duties, to require the inclusion of sustainability parameters into the overall investment process.*
>
> *Investors should be active owners and exert their influence on the management of their invested companies to improve the management of sustainability parameters that are most relevant to operational and investment performance.'*

In 2014 the Law Commission was commissioned by the Government to review the legal duties of trustees in relation to the compatibility of ESG factors with their fiduciary duties. It said:

> *'Whilst it is clear that trustees may take into account environmental, social and governance factors in making investment decisions where they are financially material, we think the law goes further: trustees should take into account financially material factors.'*[9]

This is applicable to trustees in both DB and DC pension schemes and has been reflected in the new DC code of practice investment governance guidance. Indeed, at a recent DC pensions conference we welcomed Andrew Warwick-Thompson's unequivocal statement that:

> *"With regards to ESG our guidance is clear that we expect trustees to take ESG issues into account when assessing portfolios over the long term," he said. "It is also worth noting that if the revised Institutions for Occupational Retirement Provision directive (IORP II) comes into effect then it will be a legal requirement that trustees take these issues into account"*

There is no such guidance for DB trustees, however. TPR still refers to 'social, ethical and environmental issues' (SEE) and states that, if trustees have a SEE policy, they must state it in their SIP. This lags far behind the most recent legal and financial thinking. The Law Commission report

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[8] Oxford University, *From the Stockholder to the Stakeholder*, available at http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11

[9] Law Commission, *Fiduciary Duties of Investment Intermediaries*, available at http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf

recognised that this SEE clause was particularly unhelpful since the reference to ethical factors alongside social and environmental factors was a major source of confusion for trustees due to a conflation of ESG factors with ethics. TPR has already made progress in clarifying the difference for DC trustees, it should now do the same for trustees of DB schemes.

I trust the above information is clear. If you have any questions please do not hesitate to contact me via fergus.moffatt@uksif.org.

Yours sincerely,

Simon Howard
Chief Executive
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