

Policy update: DWP clarifies trustees' fiduciary duties in law

What has happened?

The Department for Work and Pensions (DWP) announced this week (11th September) [new regulations](#) which will clarify trustees' fiduciary duties including consideration of ESG factors. These new rules for trust-based pension schemes follow a public consultation which took place over the summer and are a response to the [Law Commission's 2017 report](#) on pension funds and social investment.

How does this relate to responsible investment?

The Law Commission's 2017 report recommended (for the second time in three years) that the Government should legislate to clarify trustees' fiduciary duty in law. They identified confusion amongst trustees around what factors could, should or must be taken into account in the investment process. In part this stemmed from a misconception that trustees were under a sole duty to 'maximise returns' for members which often resulted in them disregarding long-term impacts on performance. Equally unhelpful was the conflation between financially material and non-financially material factors in the wording of the existing regulations e.g when requiring trustees to outline the 'extent (if at all) to which social, environmental or ethical considerations' are considered. This confusion was a key obstacle to trustees fulfilling their fiduciary duty and to the growth of responsible investment in the UK.

UKSIF's submission to the Government on the new regulations is [available here](#). Following additional positive feedback from elsewhere in the sector DWP has decided to amend the Investment Regulations in-line with the Law Commission's and UKSIF's recommendations. Specifically they have decided to clarify trustees' duties in relation to consideration of financially material ESG factors, non-financially material factors, and stewardship activities and to boost transparency in scheme governance.

The Government's View

The Department for Work and Pensions this week laid the new regulations and published a full response to its summer consultation. Key aspects of this response are outlined below.

The new regulations are listed in [Annex 3, here](#).

Financially material considerations

*All schemes which are required to produce a Statement of Investment Principles will need to update or prepare it to set out **financially material considerations over the appropriate time horizon of the investments**, including how those considerations are taken into account in the selection, retention and realisation of investments*

The Government clarifies that **financially material considerations includes (but is not limited to) environmental, social and governance considerations (including but not limited to climate change)**, which the trustees of the trust scheme consider financially material.

It goes on to define the ‘appropriate time horizon’ as the length of time trustees consider is needed for the funding of future benefits by the investments of the scheme. This was not included in the original consultation wording and is a welcome addition which will help focus minds on long-term investment while not precluding the fact that ESG factors can impact investments over the short, medium and long-term.

Also welcome is the specific mention of ‘climate change’. The Government has concluded that its ‘systemic and cross-cutting nature’ means it should be included as a named factor for consideration.

Non-financial matters

*All schemes which are required to produce a Statement of Investment Principles will need to update or prepare it to set out **the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments;***

To address some confusion following the public consultation the Government has changed its approach to ensure expectations on consideration of members’ views are expressed more clearly. The phrase “(if at all)” has been added to the final regulations to emphasise that trustees retain primacy in the investment process and to correct the ‘misapprehension that trustees must survey or take account of members’ views, or any other non-financial factor’. Schemes will therefore not be required to prepare a statement on members’ views as had been proposed. We welcome this clarification which is aligned with the Law Commission’s report that trustees are permitted to consider non-financially material considerations, although not required to do so.

Impact investment

The Law Commission’s 2017 report examined the extent to which pension funds could do social investment and found that a key barrier to this was confusion about trustees’ fiduciary duty. It recommended this should be clarified as a key first step. The Government’s initial consultation did not propose to set out any requirements in legislation around trustee consideration of social impact investment and it has maintained that position.

Stewardship

*Schemes will need to update or prepare their SIP to set out their policy in relation to **the exercise of rights (including voting rights) attaching to the investments and undertaking engagement activities in respect of the investments** (including the methods by which, and the circumstances under which, trustees would monitor and engage with relevant persons about relevant matters.*

Until now the regulations only required trustees to ‘report their policy (if any) in relation to the exercise of rights (including voting rights) attaching to investments’. This has now been enhanced and expanded to *require* DB and DC schemes with 100 or more members to have a policy. The inclusion of ‘engagement activities’ in the regulation is welcome. The original wording referred to ‘investee firms’ which has been amended to indicate trustees may have policies on engagement with issuers of bonds or private debt and others.

Implementation statement

Historically schemes needed only to report against their investment policies where they had been breached. The new rules require schemes to ‘proactively consider and set out how they have implemented the policies, explaining any change made during the scheme year and the reason for the change’ and also to publish the report online. This is a welcome step forward and the increased transparency on the aims of the scheme will help to prevent boiler plate language. This will be required of schemes from October 2020.

Publishing the Statement of Investment Principles

The Government’s consultation proposed schemes should publish their SIP and it has maintained that position. This will boost transparency and better enable parties to scrutinise and compare schemes in the market. It will also mean trustees can share best practice and enable members to question poor policies or implementation.

What schemes have to do now

By 1st October 2019 some schemes will have been required to do some or all of:

- Updating their Statement of Investment Principles
- Updating the Statement of Investment Principles in respect to their default arrangement
- Publishing their Statement of Investment Principles

Additionally from 1st October 2020 some schemes will have been required to produce and publish their implementation statement.

13th September 2018

For more information or if you have any questions please email me at fergus.moffatt@uksif.org