PRI RESPONSE TO THE TPR CONSULTATION ON THE FUTURE OF TRUSTEESHIP AND GOVERNANCE

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 2,500 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $89 trillion in assets under management.

366 of these signatories, representing $9 trillion, are based in the United Kingdom.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

SUMMARY OF THE PRI'S POSITION

Trustees are required to consider ESG issues in their investment approach, and initiatives such as the UK Green Finance Strategy will increase the need for pension schemes to be engaging with these issues. As such, TPR must ensure that trustees are ESG-literate, are able to challenge their asset managers and service providers on ESG-related service provision, and are able to futureproof pension investments to protect their beneficiaries from emerging material risks, such as climate change and economic inequality.

It is also important that trustees at small- and medium-sized schemes in particular are informed about processes for consolidating into larger schemes. The fragmented nature of the UK pensions market is the root cause of many of the issues identified in this consultation, while larger schemes also tend to outperform on responsible investment metrics..

RECOMMENDATIONS FOR TPR

Given the heightened expectations – including, but not limited to, the revised Investment Regulations – for trustees to consider ESG issues – improving trustee competency on how to hold their investment managers and service providers to account on these issues should be a key priority for TPR going forward. In particular:

1. **The 21st Century Trusteeship campaign should explicitly address the need for ESG-related knowledge**. At a minimum, sample documents on board skills matrices and evaluation questions should reference ESG knowledge.
2. **Requirements for minimum trustee knowledge and understanding (TKU) and ongoing training should include ESG.**
3. **TPR should ensure trustees at relevant schemes are informed of processes around winding up.** Market fragmentation contributes to many of the issues TPR identifies in this consultation.

RESPONSE TO DETAILED QUESTIONS

Q1: Do you agree that the expectations set out in the 21st century trusteeship campaign (Annex 1) is a good starting point for defining a minimum standard for trustee knowledge in the code? Is there anything else that should be added that would be necessary for all trustees to know?

TPR's work on 21st century trusteeship should set out explicit expectations for knowledge of material ESG issues on trustee boards, and ensure relevant schemes are informed about winding up processes.

(i) ESG

ESG literacy within the financial services industry remains limited, yet incoming regulatory expectations and the increasing relevance of ESG issues such as climate change to long-term financial returns increase the urgency for pension portfolios to be managed with ESG risks and opportunities in mind. It is therefore crucial that trustees, with the ultimate responsibility of ensuring members' savings are protected, have the necessary knowledge to hold their investment managers and service providers to account on their integration of ESG issues. Yet TPR research demonstrates that only 20% of UK schemes consider climate change in their investment approach.[1]

As such, at a minimum TPR's sample board skills matrix[2] and sample board evaluation questions[3] should include explicit reference to the need for ESG knowledge to enable compliance with the revised Investment Regulations.

(ii) Winding up

The PRI notes that many of the shortcomings with existing governance mechanisms identified in this consultation have the fragmented nature of the UK pension system as a contributing factor, and as such it is crucial that TPR and DWP prioritise efforts to encourage consolidation of small- and medium-sized pension schemes. As noted in a previous PRI consultation response[4], incorporation of material ESG issues in investment strategy – as explicitly required under the revised Investment Regulations from October 2019 onwards – tends to be significantly superior at the largest schemes, and that even schemes with single-digit billions in assets could reap benefits from consolidation. Consolidation could also enable schemes to attract more qualified trustees and dedicate more resources to recruiting a diverse trustee board more representative of its membership.

Q2: Should there be legislative change for trustees to demonstrate how they have acquired a minimum level of TKU, for example through training or qualifications?

Yes, the PRI believes that such a requirement could improve scheme governance, and improve oversight of environmental, social and governance (ESG) issues in particular.

TPR research[5] has shown consistently low levels of compliance among smaller schemes with governance requirements identified as "key", which include trustee knowledge and competency. At some schemes, these gaps have led to governance failures which have damaged retirement outcomes for savers.[6] The introduction of a legal requirement to demonstrate minimum TKU is likely

[1] https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/new-figures-show-why-small-schemes-must-quit-the-market

[2] https://www.tpr.gov.uk/-/media/thepensionsregulator/files/import/pdf/board-skills-matrix.ashx?la=en&hash=19A10223AE6A02A0FAD444367B1A2E1261FE7A47

[3] https://www.tpr.gov.uk/-/media/thepensionsregulator/files/import/pdf/board-evaluation.ashx?la=en&hash=50384142FE0B9ADC4167B1A10CD7BA85A7776B0F

[4] https://www.unpri.org/Uploads/q/a/k/investmentinnovationandfutureconsolidationconsultationpriresponse_645347.pdf

[5] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dc-research-summary-report-2018.ashx

[6] For example at Henry Davison Limited Pension Scheme (https://www.pensions-ombudsman.org.uk/determinations/2019/po-7292/henry-davison-limited-pension-scheme-po-7292-po-7951-po-8118-po-6703-po-12813-po-7616-po-8801-po-11753-po-11759-po-10259-po-12802-po-12801-po-10848-po-10229/) and Dunnes Stores (Bangor) Limited Management Pension Scheme (https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dunnes-stores-pension-scheme-determination-notice.ashx).

to improve overall governance, either by compelling trustees to undertake relevant training or causing schemes unable to improve their governance to wind up and move savers to a better-governed alternative.

This is a particularly acute problem regarding ESG issues. Pension schemes regularly fail to adequately consider ESG issues despite their materiality to investment returns[7], a materiality that is likely to increase over the coming years given the increasing exposure of companies and the economy at large to physical and transition risks arising from climate change. While PRI's *2019 Climate Snapshot Report* shows that a growing number of PRI signatories are conducting scenario analysis to understand the financial impacts of these risks, they remain a minority.[8]

While the amended Investment Regulations explicitly require schemes to set out their approach regarding material ESG issues, it is crucial that they possess the ability to ensure these policies are effective in practice and to challenge their asset managers and service providers on their integration of ESG issues. As such, a requirement to demonstrate minimum TKU regarding ESG is likely to improve outcomes for savers.

Q3: Should there be a legislative change to introduce a minimum level of ongoing learning for all trustees, for example through CPD-type training? If so, how many hours a year would be suitable?

Yes. Pension fund investments are made in a complex and constantly changing world, and thus it is important that trustee training is not limited to a snapshot in time but rather is regularly updated to ensure cognisance of emerging risks.

ESG risks such as climate change[9], economic inequality[10] and modern slavery[11] are projected to have an increasing effect on financial returns in the coming years, and policy requirements related to ESG are also rapidly evolving. Across the world's 50 largest economies, the PRI finds that there have been over 730 hard- and soft-law policy revisions , across some 500 policy instruments, which support, encourage or require investors to consider long-term value drivers, including ESG factors.[12] The pace continues to increase – the PRI identified over 80 new or revised policy instruments in 2019 so far. In the UK alone, 2019 has seen proposed revisions to the Stewardship Code, proposals to boost

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[7] https://www.ft.com/content/a681b422-91a3-11e8-9609-3d3b945e78cf

[8] https://app.powerbi.com/view?r=eyJrIjoiYzc4YmQwMTItZmRhNC00MzY4LWI0ODYtZDE3OTcwYTk4ZDNiIiwidCI6ImZiYzI1NzBkLWE5OGYtNDFmMS1hOGFkLTEyYjEzMWJkOTNlOCIsImMiOjh9

[9] https://www.ft.com/content/e8e73d86-d98d-11e9-8f9b-77216ebe1f17

[10] https://www.unpri.org/academic-research/why-and-how-investors-can-respond-to-income-inequality/3777.article

[11] A recent review of the Modern Slavery Act 2015 suggested the introduction of fines for companies who fail to comply with the Act's requirements: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/796500/FINAL_Independent_MSA_Review_Interim_Report_2_-_TISC.pdf

[12] https://www.unpri.org/Uploads/c/j/u/pripolicywhitepapertakingstockfinal_335442.pdf

pension investments in illiquid assets and an expectation that large asset owners will disclose against the Taskforce on Climate-Related Financial Disclosures (TCFD) by 2022.

This will continue. The UK Green Finance Strategy at its core aims to drive investment towards green projects ("financing green") and mainstreaming climate and environmental indicators with the financial industry ("greening finance"). Pension beneficiaries are also increasingly expecting ESG issues and impacts to be addressed in their investments.[13] Trustees will require ongoing training to familiarise themselves with the policies and best practice around beneficiary preferences that will drive their priorities going forward

Q5: Should we focus more on establishing and setting standards and ensuring all trustees are aware of them, while relying more on industry to have the main role in educating trustees in ways more tailored to their individual needs?

While industry will continue to play a key role in delivering tailored training to trustees, TPR should supplement this with direct training to trustees of smaller schemes in particular, while also ensuring that the quality of training trustees receive, in particular around ESG issues, is sufficient to comply with regulation and ensure material risks and opportunities are addressed.

Small schemes tend to face particular barriers when accessing training and services. They tend to be much more resource-constrained and less likely to be members of industry groups such as the PRI. They are also not guaranteed the same quality of service; for example, the recent CMA review into the investment consultancy industry found that smaller and less engaged trustees were sometimes served by a less experienced consultant team.[14]

Concerns also remain around the quality of ESG-related services and training available from investment consultants and other service providers. The PRI has found that ESG services are often treated as an optional add-on at extra cost rather than a part of core service provision, and clients' ability to access ESG-related information and expertise is critically dependent on the individual consultants who manage the client relationship. An AMNT-UKSIF review further found a "a disconnect between the quality of the advice at head office in the ESG teams (adequate), and that of the field consultants who had the primary relationship with the trustees (poor to non-existent)".[15] That same review found that while 80% of consultants indicated some type of ESG training was provided to their clients, many of these consisted of one-way communications such as emailing guidance documents, and there was a general lack of evidence of any impact from such training.

Any questions or comments can be sent to policy@unpri.org .

[13] https://shareaction.org/resources/pensions-for-the-next-generation-communicating-what-matters/
[14] https://assets.publishing.service.gov.uk/media/5c0fee5740f0b60c8d6019a6/ICMI_Final_Report.pdf
[15] https://amnt.org/holding-investment-consultants-to-account-a-guide-for-trustees/