PRI | Principles for Responsible Investment

PRI RESPONSE TO THE TPR CONSULTATION ON DRAFT GUIDES TO DELIVER THE CMA RECOMMENDATION ON INVESTMENT CONSULTANTS AND FIDUCIARY MANAGERS

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. Originally set up by the UN in 2005, 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 globally 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 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

The PRI welcomes the proposed guidance for trustees to set objectives for their investment consultants. This was a key recommendation of the PRI's *Fiduciary Duty in the 21st Century – UK* Roadmap[1] in 2016, which noted the tendency among trustee boards to interpret consultant advice as

[1] https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-uk-roadmap/264.article?adredir=1

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instruction, and the possibility for TPR guidance to improve the accountability of investment consultants.

Given the entry into force of the revised Investment Regulations in October this year – which explicitly require the consideration of ESG factors – this guidance comes at a time when many pension funds will be reviewing their investment approach and attempting to address these issues for the first time. As such, this guidance should more explicitly set out how pension funds should set objectives and challenge investment consultants on ESG issues, particularly considering research by the PRI[2] and others[3] suggesting many investment consultants are falling short in their provision of ESG-related services.

RECOMMENDATIONS FOR TPR

The PRI recommends that the guidance:

1) **Provide sample questions which trustees can pose to their consultants to ensure an alignment of objectives and investment beliefs.**
2) **Embed common challenges trustees face regarding ESG issues into the case studies.** Many trustees will be addressing this for the first time, and would be assisted by guidance on how to navigate these issues.
3) **Provide example(s) of objectives that larger or more proactive pension funds may set for their investment consultants on ESG.** While the example scorecard notes the use of ESG in asset manager selection, larger schemes - especially schemes with in-house investment management - will need to do more.

RESPONSE TO DETAILED QUESTIONS

The PRI will be responding to the questions regarding objective-setting.

Q5: Is the language used in the guidance clear and unambiguous? If not, what would provide clarity?

The PRI recommends the inclusion of sample questions in the guidance to enhance its practical usability for trustees.

Much of the proposed guidance is focused on "what" pension trustees should be doing regarding their investment consultant, with the "how" primarily confined to the case studies and scorecard, which provide non-exhaustive examples of how to ensure consultants contribute to scheme objectives.

[2] https://www.unpri.org/sustainable-financial-system/investment-consultants-services-review/571.article?adredir=1
[3] See for example, a recent guide by AMNT and UKSIF - https://amnt.org/holding-investment-consultants-to-account-a-guide-for-trustees/

Investment Consultants and ESG: An Asset Owner Guide[4], which was produced by PRI earlier this year, provides some more guidance on the "how". The guide breaks down the crafting of the investment strategy and selection of asset managers into a series of stages, sets out the relevance of consultants to each of these stages and provides a laundry list of questions to be posed to either existing or prospective consultants at each stage.

Sample questions include:

- What does the consultant understand is the asset owner's fiduciary responsibility in relation to ESG?
- Does the investment consultant have a set of its own principles in relation to incorporating ESG considerations into its business practices and advice to clients?
- If the investment consultant provides advice on portfolio construction which incorporates ESG issues, how are these issues integrated into tools and services such as portfolio modelling and scenario planning?
- How does the investment consultant include (a) ESG incorporation (including integration, screening, thematic) (b) active ownership (including engagement and voting), (c) policy engagement and (d) reporting into asset manager research and ratings? Please provide examples.

The PRI recommends that inclusion of such questions in TPR's guidance would improve trustees' ability to ensure investment consultants' beliefs and objectives are aligned to those of the scheme.

Q6: Are the case studies useful in illustrating the elements of services trustee should consider setting objectives in relation to? Do these present an accurate representation of how trustees may set objectives for their investment consultants? Do you have any other examples that could be usefully included to demonstrate the different approaches that schemes of different sizes, and with varying available resources, might take to comply?

Yes, the case studies are useful in setting out common challenges faced by trustees. The PRI recommends adding the challenge of incorporating ESG issues into investment consultant service provision, given this is an emerging issue for many schemes and industry performance on this aspect has been mixed.

While the revised Investment Regulations explicitly require schemes to consider ESG issues including climate change in their Statement of Investment Principles, recent TPR research show that only 1 in 5 schemes take climate change into account when considering their investment approach.[5] Schemes

[4] https://www.unpri.org/asset-owners/investment-consultants
[5] https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/new-figures-show-why-small-schemes-must-quit-the-market

thus need further support to ensure they are compliant with the legislation and are protecting their beneficiaries from such systemic risks.

Investment consultants play a significant role in how ESG issues are addressed by their clients. The PRI's *Investment Consultant Service Review*[6] found that in some cases consultants posed a barrier to appropriate integration of ESG issues, and treated ESG-related services as an optional add-on to be provided at extra cost rather than a part of core service provision. More recently, research produced by AMNT and UKSIF[7] suggested that while ESG competence at the organisational level of investment consultants tended to be adequate, it was poorer among the field consultants dealing directly with clients.

Given that these are common challenges faced by schemes and have been given an added urgency by recent legislative and policy changes[8], the case studies should set out how trustees can navigate these issues to improve outcomes for their members.

Q7: Is the example balanced scorecard an effective way to assess the performance of providers of investment consultancy services? Are there alternative methods trustees could use?

Yes, the example scorecard is a very useful template for consultant performance evaluation. It would be helpful if there could be an indication of what larger and more ambitious schemes might wish to include within consultant performance metrics.

The scorecard includes a criterion relating to the use of ESG in asset manager selection. For many schemes, particularly small- and medium-sized, resource-constrained schemes, asset manager selection is the most significant opportunity to ensure the effective integration of ESG issues into their investments. However, this is a minimum standard rather than a ceiling, and larger schemes in particular should take a more proactive ESG approach regarding, for example, strategic asset allocation, investment strategy and stewardship. As noted by the FRC, "Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, institutional investors cannot delegate their responsibility for stewardship".[9] As such, the scorecard should give examples of how pension funds may be more ambitious on ESG with their investment consultants, or indicate that schemes with more resources have the capacity to set higher expectations of their consultants.

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

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[6] https://www.unpri.org/sustainable-financial-system/investment-consultants-services-review/571.article?adredir=1
[7] https://amnt.org/holding-investment-consultants-to-account-a-guide-for-trustees/
[8] Aside from the entry into force of the revised Investment Regulations, the UK's Green Finance Strategy sets an expectation for large asset owners to report against the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) by 2022.
[9] https://www.frc.org.uk/consultation-list/2019/consulting-on-a-revised-uk-stewardship-code