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John Reynolds
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN
(Sent via email to cp19-15@fca.org.uk)

15th August 2019

Dear Mr Reynolds,

I am writing to respond to the FCA's consultation *CP19/15 Independent Governance Committees: Extension of remit* on behalf of ShareAction[1], a registered charity established to promote transparency and responsible investment practices, including by contract-based pension schemes and other types of institutional investor. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters.

Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the view of clients, beneficiaries and pension scheme members. We would welcome the opportunity to support the FCA's work in drafting guidance for schemes to help them implement new rules. We have experience, through our Asset Owner Disclosure Project initiative, in understanding and assessing many of the issues faced by asset owners in reporting against the Taskforce on Climate-related Financial Disclosures. We sit on the Government's working group to determine best practice in this area for trust-based schemes and we would be very happy to assist the FCA develop its own guidance for contract-based schemes.

Q1: Do you agree that IGCs should report on the adequacy and quality of their firm's policies on ESG issues, member concerns and stewardship?

ESG issues

Yes. As far as possible and appropriate rules for contract-based schemes should mirror the provisions in the new Investment Regulations for trust-based schemes. IGCs should report on the firm's policies on ESG, member concerns and stewardship.

- Proper consideration of ESG factors means the risks and opportunities associated with an investment over the appropriate time-horizon have been fully understood and integrated into that investment decision.
- Contrary to the consultation document we would welcome further clarification that ESG factors are not only "risks" but can present clear opportunities for long-term responsible investors too.
- ESG factors may be macro-level, systemic considerations which might not be easily understood through analysis of a particular asset class, something which makes such factors particularly relevant to pension scheme members with long-term investment time horizons.

[1] More information available at http://www.shareaction.org

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- Climate change is one of the most significant macro-level, systemic factors which asset owners need to consider. We therefore welcome explicit reference to it as part of the *financial considerations* outlined in Annex A.
- We also think schemes should consider the impact their investments have on the society and environment into which their members will retire. This is a crucial point: The financial services sector does not operate in a vacuum and its activities have real world impacts. It is in the best interests of members for schemes both to understand and to mitigate the detrimental societal and environmental impacts of their fund.

Member concerns

Yes. Members' concerns should be considered by firms.

- This does not mean that members should have a say in e.g. the day to day running of the funds in which they are invested, but as the Government has noted in its consultation on the introduction of similar rules for trust-based schemes, '*it is good practice…to inform the design of investment strategies with an understanding of scheme members' views'.*[2] In contract-based schemes, savers' retirement outcomes depend on 1) the level of contributions, 2) the costs deducted 3) the investment performance. Seeking to understand and reflect members' views may play an important role in boosting engagement levels between schemes and members and increasing contributions.
- In a recent speech the Pensions Minister said:
    - *"Pension schemes ought to be thinking about the assets which help drive new investment in important sectors of the economy – smaller and medium firms, housing, green energy projects and other infrastructure – which deliver the sustainable employment, communities and environments which all of us wish to enjoy."*[3]
- We agree that pension schemes should consider the benefits of a properly diversified portfolio as part of a robustly managed fund. This may include investing in assets such as those outlined by the Minister. We also agree with him that schemes should fully consider the effects their investments have on society and the environment and the positive impact they can have if invested in the right way. However, the Law Commission was clear that schemes "may not impose their own ethical views on their beneficiaries".[4]
- Where such schemes focus on more macro-economic issues such as sustainable employment and communities the members of the scheme should be consulted. The FCA should begin to think about appropriate mechanisms through which it can encourage better engagement between schemes and members.

[2] DWP, *Consultation on clarifying and strengthening trustees' investment duties,* 2018 Chapter 2, Para 24 available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/716949/consultation-clarifying-and-strengthening-trustees-investment-duties.pdf
[3] Speech delivered by the Pensions Minister, Guy Opperman, 3rd June 2019, available at https://www.gov.uk/government/speeches/environmental-social-governance-esg-and-responsible-investment
[4] The Law Commission, Fiduciary Duties of Investment Intermediaries, 6.57, 2014 available at https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/03/lc350_fiduciary_duties.pdf

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Stewardship

Yes. Stewardship benefits companies, savers and the wider economy. It is a key aspect of investors' duties to clients. Not only can it create or maintain investment value, a lack of stewardship and oversight by investors may lead to the types of corporate failures or reputational damage we have seen over the past few years, such as BHS and Persimmon, which can have broader societal impacts.

- The FRC is currently undertaking a review of the Stewardship Code. We broadly agree with its new definition of stewardship:
  - *'The responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society.'*[5]
- The Law Commission notes that stewardship includes how schemes will promote an investment's long-term success, through monitoring, engagement or voting, either directly or through their investment managers.[6]
- However, gauging the success of stewardship strategies is not always possible. The FCA has recently introduced new rule changes to its handbook to transpose the Shareholder Rights Directive II into UK law. It decided against the introduction of mandatory voting disclosure – something which remains "comply or explain". Yet fund managers who refuse to disclose the way they have voted will make it more difficult for IGCs to perform their new duties. It remains to be seen how an IGC can assess the extent to which a firm is delivering value for money, where stewardship activities undertaken on the provider's behalf are not fully disclosed to it.
- A recent report by the Association of Member Nominated Trustees highlighted a market failure and insufficient transparency in the stewardship market. Referring to fund managers, the Pensions Minister was clear that "it's utterly unacceptable that most pension fund managers don't have published policies and practices to combat climate change, and public commitments to tackle excessive pay and promote gender and ethnic diversity are all too rare. Being vague or secretive with the trustees and savers they represent is out of order". We agree.
- A legal framework where the pension schemes being regulated by the FCA are expected to publish and implement policies on ESG, member views and stewardship but that operate in a market where this information may not be disclosed is clearly undesirable and the FCA should provide clarity on this point.

Q2: Do you agree that IGCs should report on how the firm has implemented its policies on ESG issues, member concerns and stewardship?

Yes. This provision mirrors a new requirement for trust-based to produce an implementation report to set out how they have acted on the principles in the SIP. Trust-based schemes will also have to

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[5] FRC, Proposed Revision to the UK Stewardship Code, 2019 available at https://www.frc.org.uk/getattachment/dff25bf9-998e-44f6-a699-a697d932da60/;.aspx

[6] The Law Commission, Pension Funds and Social Investment, 2017 available at https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2017/06/Final-report-Pension-funds-and-socia....pdf

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publish the statement online and inform members of its availability in their annual benefits statement.

- Having a policy on ESG, member concerns and stewardship is a welcome step forward, but this alone is not enough to ensure firms are proactively meeting their own commitments in these areas.
- From October the Investment Regulations will require pension scheme trustees to publish an annual implementation report to outline how they have followed the policies in the Statement of Investment Principles, including on ESG, member views and stewardship.
- DWP's consultation[7] identified several benefits of schemes publishing implementation reports, including:
    - Transparency for scheme beneficiaries and members over how trustees have acted in line with the policies in the SIP.
    - The requirement to report will ensure the policies reflect what schemes aim to do, and that scheme act on the policies they have set out.
    - The requirement to report will encourage schemes to draft more realistic and less generic statements.
    - The principle of reporting back on the delivery of a strategy, policy or investment is well-established and practiced in many circumstances.
- DWP did not specify what information should be included in the implementation report, but instead proposed that The Pensions Regulator publish guidance for trustees. The FCA should publish similar guidance on implementation reports for the schemes it regulates.

Q3: Do you agree that IGCs should report on the firm's policies on these issues for both pathway solutions and workplace personal pensions?

Yes. ESG factors may be relevant over the short-term and should be considered by firms. A 2018 report by UKSIF found that 90% of fund managers expected climate risk to significantly impact the valuation of oil companies within the next two years.[8]

We note the lack of reference to "appropriate time horizons" in the proposed changes to the rulebook in Annex A. Given ESG factors may be material over the short, medium and long-term we feel the text would benefit from clarification on this point.

Q4: Do you agree that firms should make the IGC's annual report publicly and prominently available, with 2 prior year reports for comparison?

Yes.

Q5: Do you agree that the proposed guidance should apply more widely, to all firms that provide pension products and all life insurers that provide investment-based life insurance products?

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[7] DWP, Clarifying and strengthening trustees' investment duties, 2018 available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739331/response-clarifying-and-strengthening-trustees-investment-duties.pdf

[8] UKSIF, Not Long Now, 2018 available at http://uksif.org/2018/04/26/not-long-now-survey-of-fund-managers-responses-to-climate-related-risks-facing-fossil-fuel-companies/

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Yes. We welcome FCA guidance on the new rules, including on the issues we have identified above. ShareAction has recently undertaken research on AE providers around responsible investment, member engagement and member communications which may be useful to consider as the regulator drafts this guidance.

- *The Engagement Deficit,* analysed and ranked the 10 biggest automatic-enrolment pension providers (by members) firstly on responsible investment and the content and quality of communications and engagement with members. The research made a number of findings:
    - Contract-based automatic-enrolment providers delegated almost all oversight for responsible investment to their in-house asset manager, rather than having their own RI policy.
    - Only two of the six IGCs in the survey stated they considered ESG factors as part of the Value for Money assessment.
    - Each automatic-enrolment provider should produce a statement of responsible investment policy.
    - AE providers frequently rely on members being proactive to find out pertinent information.
    - Best practice has emerged from a minority of providers to show members how the investment of their savings impacts the real world.
    - The report also recommended that the FCA and TPR should be encouraged to commit to annual public meetings and require providers to annually report on their strategies to increase both saver engagement in general and member contributions.
- With regard to member engagement we also note the Pensions Minister's recent statement to the EAC in which he stated:
    - *"The Pensions Regulator advocate other supplementary approaches such as focus groups, forums and member panels. The important point is that these approaches should investigate the views of the broad swathe of the membership – not just the members with strong views who put themselves forward. Finally, it is worth highlighting the Law Commission's view that survey evidence is not necessarily even required. In some cases, trustees may be able to make assumptions: an example might be activities which contravene international conventions, such as manufacturing cluster bombs. The fact that these are banned by the Convention on Cluster Munitions, ratified by the UK, may give trustees reason to think that most people would consider them to be wrong."*[9]
- Clearly there are many approaches by which schemes can engage with their members on their views around investment. Guidance from the FCA on their expectations for firms wishing to do so would be welcome.

The Taskforce on Climate-related Financial Disclosures

- The Government's recent Green Finance Strategy committed to TCFD reporting by large asset owners by 2022. The FCA should therefore publish guidance on how contract-based schemes are expected to report against the TCFD recommendations. While we welcomed

[9] https://www.parliament.uk/documents/commons-committees/environmental-audit/180215-Guy-Opperman-to-Chair-Green-Finance.pdf

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the FCA's DP 18/8 paper on climate change and green finance, we were disappointed to see TCFD not given prominence in this paper.

- In a letter to the Environmental Audit Committee, the Pensions Minister recently said:
  - *"An institutional investor's climate risks are the risks of its own holdings. Therefore, by their very nature institutional investors including pension schemes are reliant on the adoption of TCFD by a broad cross-section of the listed firms in which they invest, if they are to carry out the disclosures on the basis advocated by TCFD. To remedy this, we see pension schemes, like other long-term institutional investors, as having an important role on the demand side of TCFD, by requesting disclosure of climate-related risks from the firms in which they invest."*
- We are aware that DWP is currently working on guidance for trust-based schemes wishing to report against TCFD.
- Following the Environmental Audit Committee's evidence session, as part of its inquiry into green finance the Pensions Minister wrote to the Chair and stated the following:
  - "Since the provider of a workplace pensions might equally well be a personal pension provider regulated by the FCA or an occupational scheme regulated by TPR, there is an argument for continued harmonisation of legislation, and increased collaboration between the bodies."[10]
- We agree with this sentiment. It is difficult to understand why a saver, enrolled automatically into a contract-based scheme should be at a disadvantage in terms of the manner in which their pension savings are invested, than e.g. a peer in a trust-based scheme, based purely on the legal structure of a scheme in which they had no part selecting.
- The FCA should consider bringing together a working group from the sector to introduce similar guidance.

I hope our comments are clear, but please let me know if we can provide any clarifications at fergus.moffatt@shareaction.org.

Yours sincerely,

Fergus Moffatt
Head of UK Policy

[10] https://www.parliament.uk/documents/commons-committees/environmental-audit/180215-Guy-Opperman-to-Chair-Green-Finance.pdf