

Consultation on clarifying and strengthening trustees' investment duties: Aon response

Date: 16 July 2018

Prepared for: Department for Work & Pensions

Prepared by: Aon

Response to the consultation on clarifying and strengthening trustees' investment duties

Introduction

We set out below Aon's response to the Department for Work & Pensions (**DWP**) consultation on clarifying and strengthening trustees' investment duties, including the draft Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018 (the **Regulations**).

Aon is a leading global professional services firm providing a broad range of risk, retirement and health solutions, with more than 50,000 colleagues in 120 countries. We work with the trustees and sponsors of around 1,000 UK pension schemes. Globally, we work with more than 2,300 clients with assets totalling \$3.8 trillion.

General comments / executive summary

We firmly believe that environmental, social and governance (**ESG**) considerations are key for long-term value creation and risk management considerations. Our published Responsible Investment (**RI**) policy¹ attests to this.

By way of context, we see four important drivers for increased capital deployment by institutional asset owners into responsible and ESG-related investments:

- a) The regulatory framework and key policymaker guidance;
- b) The asset owner's investment beliefs and governance capabilities;
- c) The quality and consistency of data to analyse and act upon; and
- d) Academic evidence associated with the investment case.

This important consultation can be related to all of these areas.

Looking to a) above we think that the fact the consultation proposes to legislate with defined "action by" timelines is the most important and significant driver of change. We support that. Even so we suspect that barriers may still arise particularly with respect to interpretations of "fiduciary duty" in different jurisdictions.

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¹ Responsible Investment Policy, Aon

**General comments /
executive summary
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More regulatory clarity on helping investors see responsible and sustainable investing through the lens of financial risk and return would be helpful. Investing is a global activity for institutional asset owners and we recognise that, for example, the Department of Labor (**DOL**) may give different guidance in the US than, say, the DWP and tPR in the UK.

Looking to b), as intermediaries we recognise we have an important role of influence in the value chain. However, the investment beliefs of asset owners are variable in our experience, especially in nascent or developing areas of investment like RI, but often in well-established areas too (such as running interest rate risk, active versus passive etc.).

We work with a wide range of individuals responsible for the running of pension schemes. The range of views, opinions and understanding of ESG considerations is more variable than almost any other important investment topic at this time. Our recent report, "Global Perspectives on Responsible Investing", provides many examples of this variability.

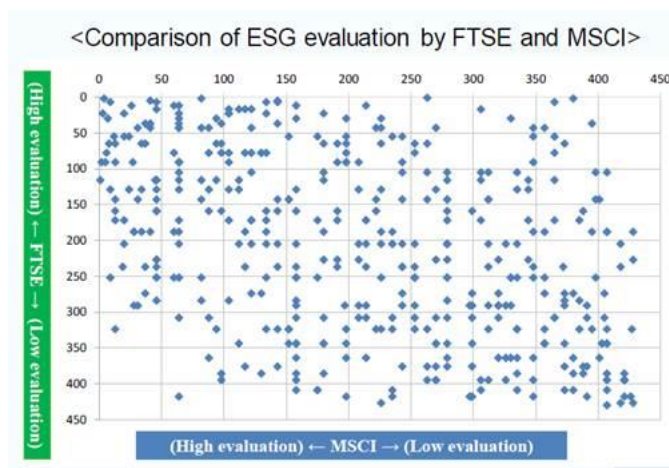
Given this breadth of opinion, we cannot easily represent the views of an average trustee client, and certainly not every client. Our response is primarily reflective of our own views, although we have made reference in our response to comments that we have received from trustee clients in reaction to this consultation.

Referencing c):

- Across major market leading data providers, ESG scoring exhibits disappointingly or confusingly low correlations. We have shown overleaf the scatter chart comparing MSCI against FTSE. This is based on 430 firms that have been ranked by each provider (from 1 to 430). You will see that a very wide dispersion is evident here.
- One of the issues behind this is that disclosure is in its infancy and there is variability in the level of disclosure, meaning that evaluation of ESG factors is problematic. From the investor's viewpoint this can legitimately be used as a reason to not act. So from the perspective of governments, a key action should be to encourage and improve consistent, standardised and transparent disclosure.
- Unlike other forms of fundamental financial analysis, analysis of these factors doesn't have a long history (if we look at the FTSE4Good index as an example, it was launched in 2001 but was completely overhauled in 2014 to double the number of criteria considered), and therefore there is little standardisation of historical evaluation.
- Quality of data is therefore critical if we are to see systematic policy re-evaluation by asset owners. The ability to draw meaningful conclusions is dependent on this being robust and a standardised framework applied. The TCFD is an example of an area where standardisation would be applied, and this could be instrumental in analysis and decision making.

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(continued)**



Source: GPIF, May 2018

Regarding d), we are fully aware of the many studies on ESG issues where, to some extent, you can pick the studies to support your views. We welcome further academic research and we support the work of some through our associations – for example, Aon is a member of the Investment Leaders Group within the Cambridge Institute for Sustainability Leadership where we are carrying out various research initiatives in this area.

What is clear through our involvement and interaction with trustees and other institutional asset owners is that while there are many groups that are engaging with this topic, there is still significant confusion around terminology, materiality and, more relevantly, what trustees' duties are in this area.

We therefore believe that the Government has an important role to play in setting standards, clarifying duties and responsibilities and providing the tools and access to reliable data that is necessary to assess financially material risks. Regulation is a very important part of the Government's toolkit.

Our own research² shows that while over 60% of representatives of pension schemes in the UK thought RI was important to some degree, less than 40% have an RI policy in place currently.

Conversely, these findings do suggest that almost 40% of respondents believe that themes around RI and ESG are **not** important.

Our research also highlighted the fact that a large proportion (40%) of respondents believe that more agreement on terms and definitions would make responsible investing easier and more compelling. We believe that the Government's proposals will encourage and ultimately lead to greater standardisation and agreement across the industry, which we see as a necessary first step towards greater adoption of RI principles by trustees.

² Global Perspectives on Responsible Investment, Aon

Question 1

We propose that the draft Regulations come into force approximately 1 year after laying, with the exception of the implementation report, which would come into force approximately 2 years after laying.

a) Do you agree with our proposals?

b) Do you agree that the draft Regulations meet the policy intent?

Response

We agree with the proposals and believe that they meet the policy intent.

Question 2

We propose to require all trustees of all schemes which are obliged to produce a SIP to state their policy in relation to financially material considerations including, but not limited to, those resulting from environmental, social and governance considerations, including climate change.

a) Do you agree with the policy proposal?

b) Do the draft Regulations meet the policy intent?

Response

We agree with the proposal and believe that it meets the policy intent.

The current regulations that govern the SIP can cause confusion when it comes to factoring ESG considerations into decision-making. In particular, the use of “if at all” in the current regulations has led to some seeing ESG as an after-thought (if it is given any thought at all).

We believe that trustees should be encouraged to give consideration to ESG risks in much the same way they give consideration to other risks (e.g., liquidity risk, interest rate risk, etc.). Having said that, care should be taken not to single out and elevate ESG risks above other risks faced by pension schemes. One client noted that “specific regulation in this area may concentrate minds on those [risks mentioned in the draft Regulations] rather than the other financial risks”.

We therefore agree with the Government's rationale for referring to the more open-ended *financially material risks*.

It should be emphasised that ESG risks are to be considered *alongside* the myriad other risks trustees consider. However, it is also important that the decision on what risks are financially material, for the given circumstances, should rest exclusively with the trustees. The singling out of ESG risks in the proposed policy wording, despite the caveats, does have the potential of being interpreted as though ESG risks are financially material in all circumstances, which we think could be counterproductive to the intention of the policy. We believe the wording could be made clearer in this regard.

Finally, our research has shown that one of the biggest hurdles for investors is the lack of consensus about the impact of responsible investing on returns and the lack of standardisation of definitions across the industry.

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Question 2 (continued) For the Regulations to be effective, we would recommend that the Government, in cooperation with the industry, work towards establishing an agreed responsible investing framework.

Question 3 **When trustees prepare or revise a SIP, we propose that they should be required to prepare a statement, setting out how they will take account of scheme members' views.**

a) Do you agree with the policy proposal?

b) Do the draft Regulations meet the policy intent?

Response

In our view, this is the most problematic aspect of the proposed policy changes.

Under the draft Regulations, regardless of caveats, most trustees will feel they have to actively seek those views from members, especially in DC schemes where the information will be made public. This could be a difficult and costly exercise for schemes, with substantial challenges to obtaining members' views in a meaningful way.

There is the risk that the views of a certain subset of the membership are included, as only those actively interested members may engage, and that the results are unduly influenced by focus groups that may not represent the broader membership. Getting a 'real' sense of member concerns can be difficult if questions are not framed carefully so as to not be leading in nature and result in members giving what they perceive as the 'correct' answer.

Any policy in this area should therefore avoid being prescriptive and allow sufficient flexibility for trustees to make decisions that they believe are in the membership's best interests. Further reassurance that there is no explicit requirement for trustees to act on particular views would be helpful.

We are supportive of the general direction of the proposal, but believe there could be a significant underestimation of the challenges involved in obtaining members' views in a meaningful way, and it would be imperative for additional clarification to be provided on what trustees would be expected to do in practice.

Question 4 **Do you agree with our proposal not to require trustees to state a policy in relation to social impact investment? If not, what change in legislation would you propose, and how would you address this risk of trustee confusion on this point?**

Response

We agree with the proposal.

Question 5 **We propose that trustees should be required to include their policy in relation to stewardship of the investments, (including monitoring, engagement and voting) in the SIP.**

- a) Do you agree with the policy proposal?**
- b) Do the draft Regulations meet the policy intent?**

Response We agree with the proposal and believe that it meets the policy intent.

It is important that this does not become a box-ticking exercise. In particular, trustees should be encouraged to require their investment managers to include an update on their stewardship activities as part of their regular meetings and reporting.

From a DC perspective, this requirement should reflect the fact that in most DC schemes the funds are held in the name of the platform provider and there is little or no opportunity for trustees to engage and none to vote. Having a statement to this effect in the SIP would therefore be counter-productive. Trustees can, of course, engage directly with the underlying fund managers but, while we encourage trustees to do so, it should be recognised that the limitations of platform providers can serve to impede trustee engagement.

Finally, we agree that applying this proposal to schemes with fewer than 100 members would impose a disproportionate burden on those schemes. We therefore believe that the Government's exemption of small schemes is sensible.

Question 6 **When trustees of relevant schemes produce their annual reports, we propose that they should be required to:**

- **Prepare a statement setting out how they've implemented the policies in the SIP, and explaining and giving reasons for any change made to the SIP, and**
 - **Include this implementation statement and the latest statement outlining how trustees will take account of members' views in the annual report.**
- a) Do you agree with the policy proposal?**
 - b) Do the draft Regulations meet the policy intent?**

Response We agree with the proposal and believe that it meets the policy intent.

While this will extend the SIP to three documents—the SIP itself, the implementation report and the statement on members' views—we believe that this will make the SIP more useful than it is in its current form.

Question 7 **We propose that trustees of relevant schemes should be required to publish the SIP, the implementation report and the statement setting out how they will take account of members' views online and inform members of this in the annual benefits statement.**

- a) Do you agree with the policy proposal?**
- b) Do the draft Regulations meet the policy intent?**

Response While we agree that effective disclosure and accountability are vital, there is a significant risk of schemes trying to reduce the scope of helpful policies they might otherwise have put in place because of the pressure to meet those published policies in the future.

Question 8 **Do you have any comments on the business burdens and benefits, and wider non-monetised impacts we have estimated in the draft impact assessment?**

Response In reality, the direct costs may be higher than estimated as many schemes have more than two trustees and may also require additional training or support around the topic.

There is also no reference to the cost of obtaining member views e.g., through a survey or face to face discussions and depending on the route selected this cost could be significant.

Question 9 **Do you have any other comments on our policy proposals, or on the draft Regulations which seek to achieve them?**

Response DC schemes face challenges around implementation through platform providers, particularly around their ability to make strategy changes and also because of the funds that are available to them. This can place limits and restriction on the options that are available to trustees of DC schemes and make it more difficult to implement particular views on different issues.

Without support from the platform providers it can be difficult for trustees of DC schemes to truly engage on the subject of ESG and reflect this within their strategy.

Finally, our informal engagement with trustees of DB schemes has highlighted that, while many trustees are supportive of the Government's proposals, there is a sense that the regulatory and governance burden on trustees is ever-increasing.

Question 10 **Do you agree that the revised Statutory Guidance clearly explains what is expected of trustees in meeting their duty to publish the SIP, implementation statement, and statement of members' views?**

Response We do not have any additional comments to add to the specific points made elsewhere.

Question 11 **What evidence or views do you have of how well the other requirements in the SIP are working? What areas for further consideration and possible future change would you suggest?**

Response Overall, we believe the requirement for pension schemes to have a SIP and to review it periodically is being met.

In our experience however, the SIP is often not used as or considered to be a "working document". The existing content and consultation requirements for the SIP can make it cumbersome to use more actively. What this means in practice is that completing and updating the SIP is often viewed as a compliance exercise, and so the content of the SIP is sometimes minimised and simplified in order to make compliance more straightforward.

Many schemes we work with will use some other form of strategy framework document to steer and govern future decisions on investment strategy. As a non-regulated document, it can be shaped to the specific needs of the scheme and so is often more useable.

References

- Aon. (2018, March). *Aon's Global Responsible Investment Policy*. Retrieved July 10, 2018, from http://www.aon.com/getmedia/0da05d5b-d189-4e74-89bf-4de570c2a15c/Aon-RI-Policy0-March-2018_F.aspx
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