

*LCP on point* 

# *Member views: implications for your investment strategy*

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# 01 Introduction

Interest is building in the idea of allowing for members' views in pension scheme investment decisions. Policymakers seem keen to encourage it, various civil society groups are lobbying for it, and journalists are writing about it. An increasing number of surveys purport to show what members want: typically to invest in sustainable, responsible companies and avoid companies with ethically questionable practices. Moreover, discussing responsible investment might be a way of increasing members' engagement with their pension scheme and encouraging them to save more.

However, few schemes currently do reflect member views in their investment decisions. In this report, we look at the reasons for this – the practical and legal barriers – and how they might be overcome. We also comment on the different considerations for defined benefit (DB) and defined contribution (DC) schemes, including whether DC member views should be considered for the default strategy or self-select options, and how trustees might respond to member correspondence in this area. We end with suggested next steps for trustees and some recommendations for other parties that would help to address the barriers faced by trustees.

## Different types of DC scheme

In this report, we focus on the situation for trust-based occupational pension schemes. For DC master trusts, the considerations are very similar. In addition, The Pensions Regulator's (TPR) Code of Practice for master trusts encourages them to have a process for members' views to be heard by the trustees at board level as part of good scheme governance<sup>1</sup>.

The legal position is somewhat different for contract-based DC pension schemes. In December 2019, the Financial Conduct Authority (FCA) published a policy statement that extended the remit of Independent Governance Committees to include, among other things, rules about taking account of members' views. These are similar to, but go beyond, the equivalent requirements for trust-based schemes that are the focus of this report. Further information is given in the box on page [5].

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<sup>1</sup> [TPR Code of Practice 15: Authorisation and supervision of master trusts](#).

## 02 The legal position

### Financial and non-financial factors

Central to the debate about member views is the concept of financial and non-financial factors, as defined by the Law Commission in its 2014 guidance<sup>2</sup>. The distinction between these two types of factor is not clear cut. Both types can have a financial impact; the difference is the underlying motivation for considering the factor. Indeed, a particular factor could be regarded as either financial or non-financial depending on the trustees' motivation.

Take gender diversity as an example. This is a factor that can potentially affect investment performance. If trustees decide only to invest in companies with good gender diversity because they believe this will enhance risk-adjusted returns (and they can justify this view), it would be regarded as a financial factor. If trustees want to invest in companies with good gender diversity on moral grounds, it would be regarded as a non-financial factor.

### The Pensions Regulator's guidance

TPR's investment guidance makes it clear that trustees are never obliged to take account of members' views. It says (emphasis added):

- When considering investment decisions/setting investment strategy, you **should** take into account all factors that are **financially material** to the performance of an investment.
- Non-financial factors are factors that are not motivated by 'financial' concerns of balancing rewards against risk in certain circumstances.
- While non-financial factors are subordinate to the main purpose of providing a pension, the Law Commission concluded that trustees **may** take account of **non-financial** factors:
  - *if they have good reason to think that scheme members share a particular view, and*
  - *their decision does not risk significant financial detriment to the fund.*<sup>3</sup>

<sup>2</sup> [Guidance from the Law Commission](#) for pension trustees.

<sup>3</sup> [DC Investment Governance guidance](#), updated July 2019. There is similar wording in TPR's [DB Investment guidance](#), updated September 2019.

In relation to applying the Law Commission's shared members view test, note that trustees' own moral views are not relevant here – it is the members' views that count. TPR advises that:

- If the issue is not controversial, and there is good evidence of agreement from some people, the Law Commission has said that you may act on these views even if many people fail to engage.
- Where there is a disagreement among members around a controversial non-financial investment proposal, the Law Commission comments that the courts are likely to expect you to focus on financial factors.<sup>3</sup>

Note that TPR's guidance explicitly addresses what is permitted in relation to material financial factors, but not immaterial financial factors, so there is a gap in its guidance. The Law Commission did implicitly cover immaterial financial factors when it said: "Trustees *may* take account of any financial factor which is relevant to the performance of an investment"<sup>2</sup> (since a factor can be relevant without being material). Neither the Law Commission nor TPR has attempted to define "material" in this context.

## Terminology: ESG, ethical and responsible investment

It is now widely accepted that taking account of **environmental, social and governance (ESG)** factors can help investment performance, through improving returns and/or reducing risk. Most pension trustees expect their investment managers to incorporate ESG factors into their investment process, at least to the extent that they are financially material.

Similarly, most pension trustees expect investment managers to undertake **stewardship** on their behalf, including exercising voting rights and engaging with company management and other relevant parties, with the aim of creating long-term value for their members.

At LCP, we use **responsible investment (RI)** as an umbrella term which encompasses both ESG integration and stewardship, undertaken for financial reasons.

In contrast, **ethical investment** applies restrictions to investment decisions on ethical grounds, regardless of their expected financial impact. Examples include:

- Excluding "sin" sectors such as weapons and tobacco manufacturers.
- Excluding companies with certain business practices, e.g. those that have violated the United Nations Global Compact principles or test their products on animals.
- Investing in companies with high ESG standards irrespective of their financial prospects.

## Trustees' policy on non-financial matters

Since 1 October 2019, Statements of Investment Principles (SIPs) must include the trustees' policy on:

*the extent (if at all) to which **non-financial matters** are taken into account in the selection, retention and realisation of investments*

*where "non-financial matters" means the **views of the members and beneficiaries** including (but not limited to) their ethical views and their views in relation to social and environmental impact and present and future quality of life of the members and beneficiaries of the trust scheme.<sup>4</sup>*

Note that the regulations equate non-financial matters with member views, which is arguably narrower than the definition used by TPR and the Law Commission but is consistent with the first test specified by the Law Commission.

In our experience, very few trustees have so far opted to take non-financial matters into account in their investment decisions, other than by providing an ethical investment option in the DC self-select range. The exceptions are mainly schemes sponsored by organisations with a strong ethos, such as charities and religious organisations, where member views can be inferred from that ethos.

<sup>4</sup> [The Occupational Pension Schemes \(Investment\) Regulations 2005 \(SI 2005/3378\), as amended.](#)

## Non-financial matters for contract-based DC schemes

The FCA has defined non-financial matters as “factors which may influence a firm’s investment strategy or decision, and which are based on the views (including ethical concerns regarding environmental, social and governance issues) of the firm’s clients or relevant policyholders”. It says that providers of contract-based DC schemes may take such matters into account if the Law Commission’s two tests are met.

In addition, independent governance committees must provide an independent consideration of the provider’s policies on ESG financial considerations and non-financial matters. They must also consider and report on the adequacy and quality of these policies and the extent to which the provider has implemented them.<sup>5</sup>

### Summary: Implications for investment decisions

If trustees want to take account of a particular factor which is of concern to their members, the courses of action open to them depend on the implications for investment risk and return. Our interpretation is that:

- If the factor is financially material, then the trustees should be allowing for it anyway.
- If allowing for the factor is expected to be financially beneficial or neutral, trustees can allow for it without needing to justify their decision with reference to member views.
- If it would risk slight financial detriment, the trustees need to have good reason to think that scheme members would want them to allow for it.
- If it would risk significant financial detriment, the trustees cannot take it into account (except possibly through offering a DC self-select option, but the risks should be clearly communicated to members).

Of course, whether investing in a particular way will lead to better or worse financial performance cannot be known in advance. We understand that the key thing here is process rather than outcome: trustees should be able to demonstrate that they’ve followed a proper process in deciding whether and how to take the factor into account, with appropriate evidence and justification of likely financial impact and member views.

**This is a tricky area and trustees should consider taking legal advice, particularly if they wish to follow a course of action that might risk some financial detriment.**

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<sup>5</sup> [FCA Policy Statement PS19/30 – Independent Governance Committees: extension of remit.](#)

## 03 Arguments for and against allowing for member views

In this section, we outline some of the reasons given for trustees to take account of their members' views and then look at some of the opposing reasons. We then highlight how the considerations may vary depending on whether the trustees are setting a DB investment strategy, DC default investment strategy or DC self-select range.

### Arguments in favour

1. **As a point of principle** – an argument often used by civil society organisations is that members should have a say over how their money is invested, on democratic grounds. The relevance of this argument depends to some extent on whether the scheme is DB or DC (see table on page [8]).
2. **Member expectations** – members might reasonably want and expect their views to be taken into account. Some organisations help and encourage members to contact their pension scheme to express their views and request they are reflected in investment decisions. We expect such requests will become more common<sup>6</sup>.
3. **Member engagement** – research has shown that members care about ESG and ethical issues and that this can be a route to engaging them on the topic of pensions generally. Some studies show that communicating a scheme's responsible investment practices can increase members' trust in their pension and may even encourage them to contribute more<sup>7</sup>.
4. **Political and public expectations** – policymakers, regulators, journalists and others are showing increasing interest in member views (see box below). In our view, pressure to take account of member views is only going to increase. Trustees might want to get on the front foot.

### Policy developments

In its **2018 consultation on changes to the SIP requirements**<sup>8</sup>, the Department for Work and Pensions proposed that trustees prepare and publish a separate "statement on members' views", setting out how they will take account of the views which, in their opinion, members hold, in relation to the matters covered in the Statement of Investment Principles. The pensions industry was generally not supportive, and the proposal was withdrawn, but it raised the profile of the member views debate and found favour in some quarters.

When the Financial Reporting Council recently revised the **UK Stewardship Code**<sup>9</sup>, it introduced an expectation that asset owner signatories explain:

<sup>6</sup> For example, the [Make My Money Matter campaign](#) which is launching in 2020 is likely to trigger requests.

<sup>7</sup> [NEST – Building new norms: An update on our responsible investment activities 2018](#) and [Franklin Templeton – The Power of Emotions: Responsible Investment as a Motivator for Generation DC](#).

<sup>8</sup> [DWP consultation – Pension trustees: clarifying and strengthening investment duties](#).

<sup>9</sup> [FRC - UK Stewardship Code](#).

- how they have sought beneficiaries' views (where they have done so) and the reason for their chosen approach; and
- how they have taken account of the views of beneficiaries where sought, and what actions they have taken as a result.

Although the Code is voluntary, TPR's investment guidance says it would like trustees to adhere to the Code.

The **EU Sustainable Finance Plan** involves a large programme of legislative measures that includes greater emphasis on the sustainability preferences of both institutional and retail investors. Although the direct implications for UK investors are currently unclear, there could be indirect implications through EU influence on UK practices.

The **Principles for Responsible Investment (PRI)** has undertaken a programme of work in which they proposed a 21st century definition of fiduciary duty that includes understanding and incorporating beneficiaries' sustainability-related preferences, regardless of whether these preferences are financially material<sup>10</sup>.

## Arguments against

The reasons that trustees give for not taking account of their members' views are often practical in nature. They include:

1. **Challenges of identifying member views** – the obvious approach is to run a member survey, but surveys may not always yield useful results. Response rates are typically low and the results may not be representative since those with strong views are more likely to respond. Members may have divergent views, leaving trustees unsure how to respond.
2. **High legal hurdle** – we find scheme lawyers tend to set a high bar for satisfying the Law Commission's test that trustees "have good reason to think that scheme members share a particular view", even though TPR's investment guidance suggests a fairly relaxed interpretation<sup>11</sup>.
3. **Members are not investment experts** – trustees may be reluctant to take account of members' views that run counter to achieving the best financial outcome or may lack understanding of the implications. They may prefer instead to base their investment decisions on the expertise of their investment consultants and managers.
4. **Limited options for action** – trustees have limited flexibility to incorporate member views if they invest via pooled funds, particularly if they use an investment platform. They are understandably reluctant to seek members' views if they might not then be able to act upon them, as members could then feel let down (and the exercise could be seen as a waste of time and money).

<sup>10</sup> [PRI – Fiduciary Duty in the 21st Century](#).

<sup>11</sup> See "Example: Considering members' views" in TPR's [DC Investment Governance guidance](#) and [DB Investment guidance](#).



## Extra considerations for different types of investment strategy

DB	DC default strategy	DC self-select range
<p>The employer bears the investment risk, except to the extent that it is ultimately unable to fund benefits in full. The employer may not support any approach that risks lower financial returns (although it is generally not required to consent).</p> <p>If the scheme uses pooled funds, the options for allowing for member views are constrained by the funds available. Many ESG/ethical funds invest in equities, but equities typically comprise a modest and decreasing share of DB asset allocations.</p> <p>There may be relatively few members who are current employees, particularly if the scheme is closed, making it harder to use company ethos as a guide to member views.</p>	<p>The default strategy is where DC members' views are most relevant since it is where the vast majority of their money is invested.</p> <p>However, if members do not feel the default strategy reflects their views, they can invest in self-select funds instead.</p> <p>Inviting member views can be a way of engaging members with their pension savings. This is typically a greater concern for DC trustees than DB.</p> <p>The average age tends to be lower in DC schemes and surveys suggest most appetite for ESG and ethical investment at younger ages.</p> <p>DC typically invest in pooled funds via an investment platform. Platforms only offer a limited range of ESG/ethical funds.</p>	<p>Trustees are less likely to be able to persuade platform providers to make available additional ESG/ethical funds for the self-select range than for the default strategy, due to the much smaller value of assets.</p> <p>Members may not make good investment decisions, so some trustees are reluctant to promote the self-select range. For example, ethical funds are often 100% equities which is often not appropriate for older members.</p> <p>ESG/ethical funds may offer less good value for money than those used in the default strategy. For example, they may have higher fees due to being actively managed and may be less well-resourced if little money is invested in them.</p>

## 04 *How can trustees obtain member views?*

An obvious way for trustees to find out what their members want is to run a survey, but it is not the only way. For example, trustees may have insights into their members' views from member correspondence (see Section 6). They could solicit information by inviting feedback through a member newsletter, running a focus group or holding a members' event.

Trustees might also infer information from the employer's ethos and policies. In addition to the traditional cases of charities and religious organisations, trustees could look at the nature of any public commitments the employer has made on sustainability, ethical and ESG topics. For example, if the company has taken a strong stance on climate change, such as committing to align its strategy with net-zero greenhouse gas emissions by 2050, the trustees might consider adopting an equivalent policy for the pension scheme. Mirroring the employer's approach is more likely to be appropriate if it is embedded in the company culture, particularly if the approach is well-established and was in place when many of the non-active members were employees.

Trustees might look at surveys of the general public or members of other pension schemes, although they should consider the relevance of the survey sample to their scheme and whether the results are consistent with the trustees' knowledge of their own members. Various published surveys have sought views on ESG and ethical matters in connection with investment decisions and these generally show strong support for high ESG and ethical standards. The box below summarises results from a recent survey commissioned by LCP.

Trustees may also be able to cite social norms to justify allowing for non-financial matters in their investment strategy. For example, the Law Commission suggested this justification for excluding manufacturers of cluster bombs.

If trustees do decide to run a survey, they should think carefully about what they aim to achieve and design the survey accordingly. For example, if their options for action are constrained by the funds available (see Section 5), the questions could be tailored to reflect the options available. If representativeness is a concern, steps can be taken to encourage a good response rate such as promoting the survey through multiple channels and making the survey easy for members to complete. It may even be possible to undertake "stratified random sampling" to obtain a representative cross-section of the membership, although this would increase the costs. In anticipation of response rates being low or views being mixed, trustees could set some minimum requirements for response rates, so that action is only taken where there is demonstrable support. Clearly, working to increase the response rate is preferable.

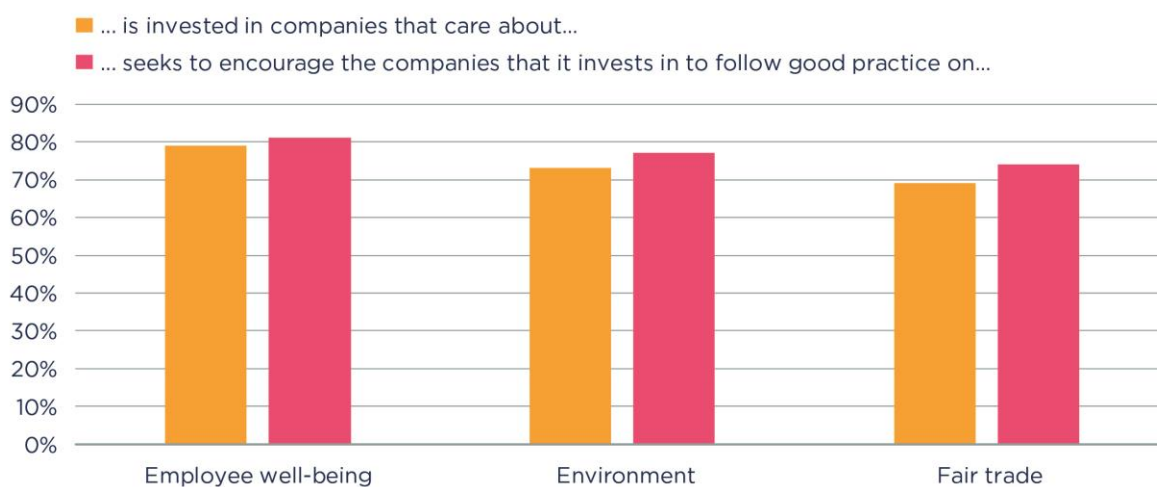
**Trustees should take legal advice before allowing for non-financial matters in their investment strategy.**

## LCP survey of member views

LCP commissioned a survey which asked the general public about ESG and ethical investment issues in December 2019.

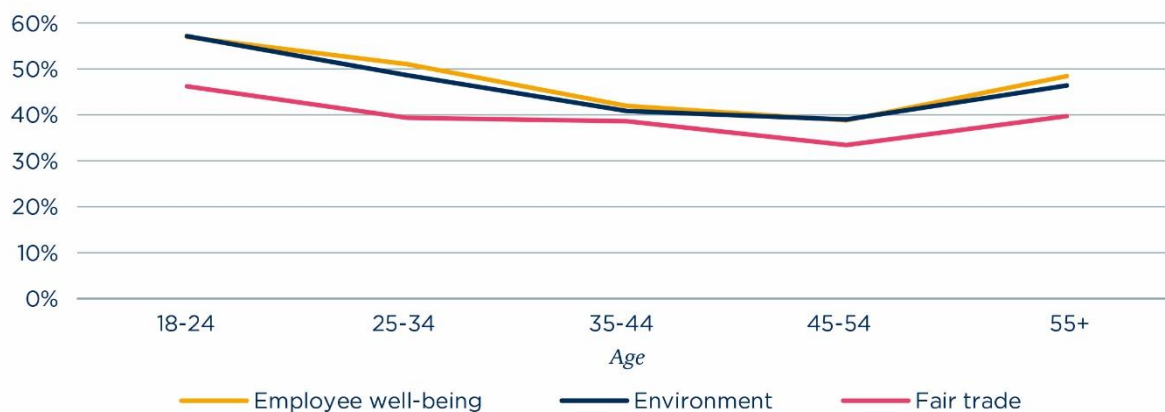
We found strong support for taking account of three specific ESG topics:

### It is important that my pension scheme...



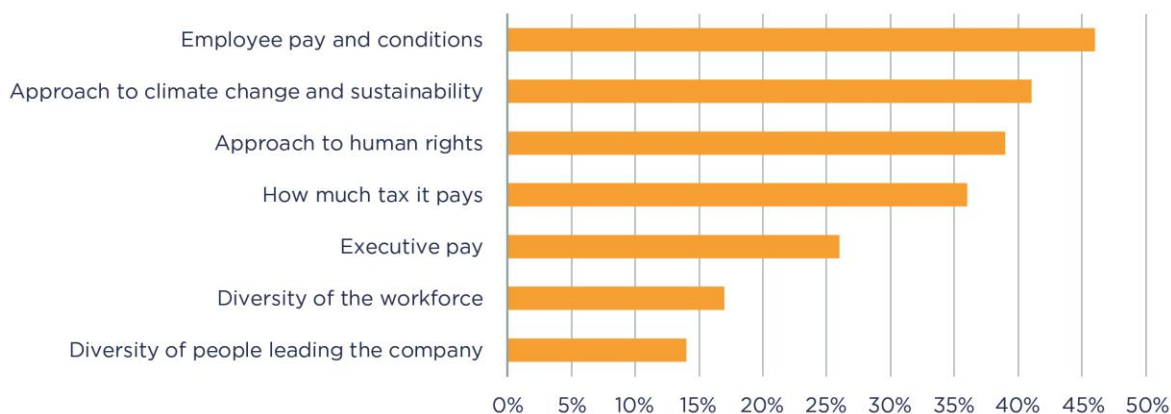
A significant proportion of people wanted to invest in companies that care about these three topics, even if it meant accepting a slightly lower return on their investment.

### I would be willing to accept a slightly lower return if I was investing in companies that care about...



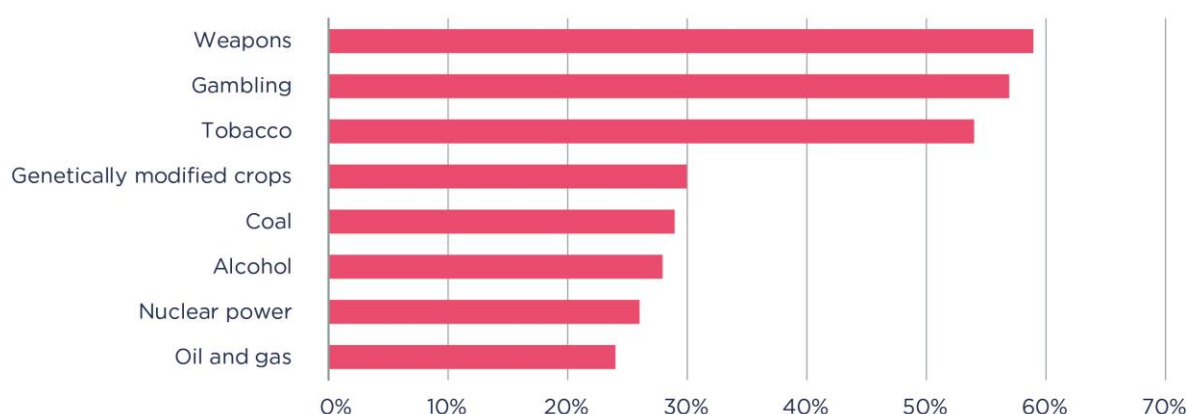
We asked respondents to imagine they were going to invest £1000 of their work-place pension into a company and then asked which, if any, of the following ESG-related company policies or actions would they take into consideration before choosing which company to invest in.

### ESG factors I would take into consideration before investing in a company



We also asked which types of company they would not want their pension scheme to invest in:

### Types of company I would not want my pension invested in



*All figures in this box are from YouGov Plc. Total sample size was 2,162 adults. Fieldwork was undertaken between 3rd – 4th December 2019. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).*

# 05. How might trustees act on member views?

We assume here that members' views relate to ESG and/or ethical factors.

## Types of fund

Pension schemes that use segregated mandates have considerable flexibility to alter the instructions they give to their investment managers in order to reflect members' views. For example, they can require the managers to adopt a bespoke list of ethical exclusions. Some schemes use pooled funds but are sufficiently large that they can seed a new fund if there isn't one currently available that meets their needs. Other trustees are limited by the pooled funds that are already available. If they use an investment platform, they are further constrained by the funds offered by the platform, although they may be able to persuade the provider to add further funds to the platform.

In the rest of this section, we focus on pooled investment funds. There are three main types of fund that trustees may consider when taking member views into account.

### 1. Funds with strong responsible investment practices

These funds would be consistent with general member support for favouring companies with good ESG standards and encouraging companies to improve their ESG practices. Many trustees are already increasing their emphasis on RI and member support could justify a further increase in emphasis (without losing the focus on improving financial outcomes).

At LCP, responsible investment is an integral part of our manager research and is reflected in our manager selection and monitoring advice. We can impose minimum standards for manager shortlists (such as only including managers who are PRI signatories and/or only putting forward funds with an LCP RI score of at least 3 out of 4<sup>12</sup>). We can also help trustees to quiz their managers on RI, so they hear about their managers' approach first-hand and can judge for themselves how well it meets their requirements.

### 2. Specialist ESG funds

Trustees can take RI one step further by investing some of the scheme's assets in funds with a specific focus on ESG factors and/or offering such funds in the self-select range. This would be consistent with general member support for investing in companies with high ESG standards. If trustees ask members for their views, they could ask questions designed to identify which of the following types of fund their members would prefer. This is reliant on a reasonable level of member understanding of investment and would need to be carefully worded.

- **Index-tracking** or multi-factor equity funds that select or weight securities using **climate** metrics (e.g. giving higher weight to companies with green revenues and lower weight to companies with fossil fuel reserves).
- **Index-tracking** or multi-factor equity funds that select or weight securities using **ESG** metrics (e.g. giving higher weight to companies which generally score well across a wide range of ESG factors).
- **Sustainable funds** that are actively managed and only invest in securities that meet certain ESG standards.
- **Impact funds** that are actively managed and seek to deliver positive social and/or environmental impacts alongside a financial return.

<sup>12</sup> LCP's RI scores are measured on a 1 to 4 scale where 4 is best practice. For more information, see the [LCP Responsible Investment Survey 2020](#).

## LCP's view on specialist ESG funds

Our manager research focuses on funds that seek to incorporate ESG factors without compromising financial returns. Unless instructed to the contrary, the ESG funds that we put forward for clients to consider are therefore consistent with trustees' primary focus on financial outcomes for members. We would therefore not expect trustees to need to satisfy the Law Commission's "shared member views" test before investing in these funds, although they should check with their lawyers.

If trustees wish to invest in index-tracking or multi-factor ESG funds, we normally recommend funds that incorporate climate tilts rather than a wider range of ESG metrics. This is because of the strong investment case for mitigating climate-related risks and because, in our view, data availability and quality are generally higher for climate factors. We can advise on funds that incorporate broader ESG metrics, in which case we recommend that trustees ensure they understand the rationale behind the metrics used and confirm the rationale is aligned with the trustees' own objectives. This is because there is currently relatively low correlation between the ESG tilts used by different providers and hence the choice of provider can have a material impact on the portfolio construction.

### 3. Ethical funds

As noted in the box on page [4], ethical funds apply restrictions to the investments held regardless of the expected financial impact. This contrasts with the "specialist ESG funds" we research where the investment constraints are aimed at improving (or, at least, not harming) financial performance.

Many of the ethical funds available invest in equities; others invest in bonds or a mixture of the two. Equity funds include both actively managed and index-tracking options.

In addition to the usual considerations when selecting an investment fund (e.g. quality of the investment team and process), it is important that trustees review the ethical restrictions because these vary widely between funds. Some ethical funds apply a much broader range of restrictions than others. On the one hand, fewer restrictions would be expected to have less impact on financial performance (all else being equal). On the other hand, a "light touch" ethical fund may invest in companies that do not meet members' ethical expectations.

### Extra considerations for trustees of DC schemes

- If you decide not to incorporate explicit ESG or ethical criteria into your default strategy, you may wish to consider introducing an alternative lifestyle strategy that uses ESG-focused or ethical funds. This would help to address the concern that members may not make appropriate choices from the self-select range, for example because the level of risk taken does not reflect their duration to retirement.
- Typically, trustees offer a single ESG or ethical fund in the self-select range. Given the potential variety of member views, you might want to offer several funds, e.g. an ethical fund, a climate-tilted index-tracking fund and an impact fund.
- Any self-select ESG/ethical options should be clearly communicated to members so that they understand what types of company their money would be invested in. This is particularly important if an ethically-labelled fund does not exclude all the sectors that members might expect (see box on page [11] for example sectors).
- If you are not satisfied with the ESG/ethical funds in your current self-select range, you may wish to consider changing them. If your platform provider offers suitable alternatives, then this should be reasonably straightforward if your existing funds are white-labelled. However, if the funds are not white-labelled, it may not be feasible to move members' existing savings from the old to the new funds unless they individually consent (otherwise the new funds could be treated as "default" arrangements which are subject to regulatory requirements such as the charge cap).
- If you have good reason to think that your younger members have stronger ESG/ethical preferences than your older members, you could consider placing greater emphasis on ESG/ethical factors in the earlier years of the default lifestyle strategy (if doing so does not risk significant financial detriment). If these stronger preferences persist as the younger members age, you could consider increasing the emphasis in the later years of default lifestyle strategy over time.

## 06. Responding to member queries

Trustees may receive unsolicited correspondence from members, asking about the scheme's investments and its position on various investment matters, for example:

- Where is my pension money invested?
- Is any of it invested in fossil fuel companies?
- What action are you taking to address climate change?
- How is my money helping to build a better world?

Various organisations help and encourage members to write to their pension scheme on ESG and ethical topics, particularly fossil fuel divestment<sup>13</sup>.

### Divestment or engagement?

A common demand from fossil fuel campaigners is that investors sell (i.e. "divest" from) their holdings in fossil fuel companies. Whilst selling these holdings may sometimes make financial sense, if the market price does not fully reflect their exposure to climate-related risks, a blanket rule not to invest in fossil fuel companies may not be in members' best financial interests.

Proponents of divestment often seem to think that divestment reduces the money that is available to fossil fuel companies to expand their operations. However, this is not the case – buying existing shares or debt of fossil fuel companies is not giving the companies more money, it is simply changing the owner of the securities.

An alternative to divestment is for investors to use their voting and engagement powers to encourage fossil fuel companies to anticipate and support the transition to a low carbon economy. Engagement has the potential to be more influential than divestment and it is often the approach favoured by investment managers. They can increase the effectiveness of their engagement by threatening to sell their holdings if the company is unresponsive. Selling holdings in individual companies after careful consideration and attempts at persuasion can send a more powerful signal to the market than divesting from all companies in the sector as a matter of principle.

Our [blog](#) explores this debate in more detail.

It is easier to respond to members' queries if you already have a well-thought-out position on the topic and can highlight actions you are taking. You might direct members to relevant information in public documents such as the SIP and annual implementation statements<sup>14</sup>, and send them documents available on request such as the scheme accounts. For DC schemes, you will also have member-friendly information about their investment options that you can share.

<sup>13</sup> For example, [ShareAction](#), [38 degrees](#) and [Make My Money Matter](#).

<sup>14</sup> From 1 October 2020, schemes with any DC benefits other than Additional Voluntary Contributions are required to report annually on how they've implemented their SIP. By 1 October 2021, other schemes must report annually on how they've implemented their voting and engagement policies. These implementation statements will be included in the annual accounts and published online. See our [RI Guide](#) for more information.

Members might ask for detailed information such as a list of holdings, but you are not required to provide this<sup>15</sup>.

Other points you might include in your response are:

- Your fiduciary duty to act in members' best financial interests.
- You welcome feedback from members, but are not obliged to take account of their views.
- Your position on taking account of member views and the legal restrictions on you doing so.
- The actions you have taken, have agreed to take, or are considering taking to incorporate ESG (or the specific topic in question) into your investment processes.
- Your investment managers' approaches to ESG factors and the steps you've taken to satisfy yourself that their approaches are appropriate, or how you're encouraging the managers to improve.
- How your investment managers use voting and engagement to encourage companies to improve their ESG practices, and why this may be preferable to divesting from companies (such as those with fossil fuel reserves).
- Any specific investments you have made to improve the ESG characteristics of your assets, such as an allocation to specialist ESG funds.
- Any data you have on your assets' ESG characteristics, such as the carbon footprint of your equity holdings (ideally compared to a relevant benchmark) and the percentage held in companies with "green" revenues.

The information elsewhere in this report will help you flesh out some of these points.

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<sup>15</sup> An exception is trust schemes whose members are earners in employments under different employers, which must list the scheme's 100 largest investments by value in their annual report.



## 07. Actions for trustees

Discuss your opinions on the member views debate. If you are inclined to act:

1. **Review existing evidence of member views** – look at published surveys and any scheme-specific information (including ad hoc member feedback).
2. If you use an investment platform, find out which ESG/ethical funds are already available on the platform and the provider's criteria for adding funds to the platform.
3. For DB and DC default strategies, **consider stronger ESG options which do not compromise financial returns**, i.e. funds with strong responsible investment practices or specialist ESG funds.
4. If the sponsoring employer has a strong ethos, consider whether this suggests any ethical restrictions that might be incorporated into DB and DC default strategies (subject to legal advice that this is permissible).
5. For DC self-select ranges, review the ESG/ethical options offered to members and the way these are communicated.
6. **Include responsible investment in your member communications**
  - As a minimum, you need to provide some information in your SIP and annual implementation statements. Consider covering RI in more accessible publications too, e.g. member newsletters.
  - Be careful – unless your scheme applies strong ESG and ethical restrictions, it may invest in companies that members could consider ethically dubious. If relevant, explain why such restrictions are not applied and how the scheme uses its ownership rights to influence corporate practices.
  - Try using RI as a tool for member engagement – explaining how their pension is invested and how this relates to issues they may care about (e.g. employee well-being, human rights and climate change).
7. Consider opening a member dialogue on ESG/ethical topics – you could invite feedback in member newsletters, run a focus group, hold a members' event or run a survey of members.

## 08. Recommendations for third parties

As explained in Section 3, there are various practical reasons why most trustees do not currently take account of member views in their investment decisions. In this final section, we set out our recommendations to address the practical barriers that are beyond trustees' control.

### Investment managers and DC providers

1. Strengthen ESG integration and stewardship within your existing fund range.
2. Offer more non-equity specialist ESG funds (these should be aligned with trustees' financial objectives and mirror the funds typically used by trustees).
3. Review the exclusions in your ethically-labelled products to ensure these reflect the typical preferences of pension savers (e.g. our YouGov survey found strong support for excluding gambling companies, yet some ethical funds do not apply this exclusion).
4. Ensure your ESG/ethical funds offer good value for money – fees can be a barrier for DC schemes (especially in default strategies) and some ethical funds seem under-resourced.
5. Increase the number and range of ESG/ethical options available on DC platforms.

### Policymakers and regulators

1. If you wish to encourage trustees to take account of member views, clarify the rationale for doing so and identify an appropriate approach:
  - If the aim is member engagement, this could be achieved through communication rather than changes in investment practices.
  - If the aim is to give greater weight to member preferences, thereby reducing the weight given to financial considerations, this may require changes to the legal framework (and there are good reasons why this may not be desirable).
  - If the aim is to encourage sustainable/ethical business practices through directing investment towards such companies (in line with member surveys), this could be addressed more directly through targeting corporate practices.
2. Acknowledge the practical and legal barriers to allowing for member views:
  - It is not currently feasible to tailor investments to individual preferences – this might become possible as technology and product design evolves, and innovation in this area could be encouraged.
  - There are relatively few pooled funds that might be suitable to express members' collective views, other than funds with strong responsible investment practices. Encourage providers to increase the number and quality of ESG/ethical pooled funds available, particularly on DC platforms.
  - The "shared member views" test is typically interpreted by pensions lawyers as setting a high bar for taking collective views into account. Work with the industry to clarify the intended interpretation and consider whether amendments to TPR guidance and/or the legal framework are desirable.
3. Address the "unintentional default" problem which prevents DC trustees from moving members' money between self-select funds without their consent, for example if the trustees want to replace their existing ethical fund with one they consider to be of higher quality.

## Contact us

If you would like more information please contact your usual LCP adviser or our specialist below.



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