Sackers

Finance & investment briefing

September 2020

Sackers finance & investment group takes a look at current issues of interest to pension scheme investors

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In this issue

Abbreviations

AVCs: Additional Voluntary Contributions

DB: Defined benefit

DC: Defined contribution

ESG: Environmental, social and governance

FCA: Financial Conduct Authority

HMT: HM Treasury

IGC: Independent Governance Committee

ISDA: International Swaps and Derivatives Association

LDI: Liability-driven investment

LIBOR: London Interbank Offer Rate

OTC: Over-The-counter

PLSA: Pensions and Lifetime Savings Association

SIP: Statement of Investment Principles

SONIA: Sterling Overnight Index Average

TPR: The Pensions Regulator

Finance & investment focus

"Welcome to the September edition of our finance & investment briefing.

Despite the world having turned upside down in March, the focus of this year's September briefing is almost identical to last year's – changes to investment disclosure. The 1 October 2020 deadline for amending and publishing SIPs will soon be upon us, and trustees need to ensure they are ready for this. For an overview of the requirements, please see our timetable.

Trustees should also be starting to think about their implementation statements for the purposes of the scheme's annual report. Our lead article focuses on the content and timing of implementation statements, and sets out our top tips for drafting the document itself.

Our legal update, including the Government's review of the UK funds' regime and the latest on climate change risk reporting, is happily COVID-19 free. On that note, we hope you will all keep safe and well as lockdown eases."

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Implementation statements – start preparations!

Trustees of occupational pension schemes should be preparing for a second raft of changes to their SIPs to be in place by 1 October 2020 (see our Alert for details). But they also need to start looking forward to the new requirements to publish an annual statement from October on how they have implemented their policies ("the implementation statement").

Here we set out a reminder of the implementation statement requirements, as well as some practical tips trustees might consider to prepare for them.

Timing

The timing and content requirements for the implementation statement are not entirely straightforward in the regulations[1] and will apply differently to schemes based on their scheme year. Broadly, the requirement applies to the first report and accounts produced on or after 1 October 2020.

All schemes must prepare an annual report and accounts within seven months of the end of each scheme year. This means that schemes with a year end of 31 March are likely to be among the first to have to produce an implementation statement in their report and accounts for their 2019-2020 scheme year, unless they complete their report and accounts early this year (ie by the end of September).

For further details of when the first implementation statement will be required for your scheme, please speak to your usual Sackers contact.

Content

The requirements apply most fully to "relevant schemes" (broadly, schemes providing DC benefits other than AVCs). Less extensive requirements applying to DB-only schemes. The requirements do not apply to schemes with fewer than 100 members.

Required content	DB-only schemes	Relevant schemes (DC and hybrid)
Set out how, and the extent to which, the scheme's policies on stewardship from the SIP have been followed during the scheme year	✓	✓
Set out how, and the extent to which, the SIP has been followed during the scheme year	✗	✓
Describe any formal review of the SIP (as required by the Occupational Pension Schemes (Investment) Regulations 2005) undertaken during the year, and any other review of how the SIP has been met	✗	✓
Explain any change made to the SIP during the scheme year and the reason for the change	✗	✓
Where no formal review was undertaken during the scheme year, provide the date of the last review	✗	✓
Describe the voting behaviour by, or on behalf of, the trustees (including the most significant votes cast by the trustees or on their behalf) during the scheme year, stating any use of the services of a proxy voter	✓	✓

1 Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (as amended)

Implementation statements – start preparations! cont.

Online publication

As well as including the implementation statement in the annual report and accounts, trustees must also make it publicly available online.

1 October 2020

For relevant schemes, the online publication requirement will apply as soon as the accounts have been signed any time after 1 October 2020 (but in any event no later than 1 October 2021).

1 October 2021

For DB-only schemes, the online publication requirement must be complied with by 1 October 2021.

1 October 2021

Schemes whose next annual report is finalised on or before 30 September 2020 (and who are therefore not required to include an implementation statement) should note that they will need to produce their next annual report (for 2020/21), or at least the relevant part of it, in time for the 1 October 2021 publication deadline.

Practical tips and guidance

TPR's DC investment guidance explains that the "purpose of the [statement] is to help ensure that 'action follows intent' as far as possible". The process of having to consider the content of the statement is intended to help to "focus trustees' minds on how well their investment policies and stewardship arrangements are delivering against their scheme's agreed investment principles".

Recent guidance published by the PLSA includes some suggested high-level "general principles" for implementation statements, as well as specific guidance on voting behaviour and some "top tips" for responsible investment communication. Trustees drafting their statements for the first time should consider the PLSA guidance essential reading.

At present, the FCA requires asset managers to produce a "general description" of their voting and engagement behaviour – likely to happen at a firmwide level. However, trustee boards need to report their voting behaviour at a scheme-level, which will require mandate-level or fund-level information. The PLSA intends to produce a voting template which will ask asset managers to present information to their clients in a relevant, consistent and comparable way.

Implementation statements – start preparations! cont.

Our top tips include

Confirm with advisers which deadline and content requirements apply to your scheme.

Identify the time period to be covered by the statement and any changes made to the SIP during that period. Trustees will very likely find that, at least for the first year, they will be reporting on policies which have changed during the year.

Start speaking to asset managers (and investment consultants) now to ensure that the required information on voting and engagement will be made available, and in good time, for the trustees to include in their statements. Consider using the PLSA voting template to ensure information is provided in a consistent manner by different managers and over the relevant period for the scheme. The requirement on trustees to describe the "most significant" votes cast by the trustees (or on their behalf) may also need some parameters defining with managers up front.

Think about the purpose of the statement and the intended audience. The PLSA guidance has lots of good tips to consider where trustees want to go further than merely complying with the regulations. Some trustees may want to use the statement to demonstrate how they are acting as responsible investors and to improve member engagement.

Bear in mind that the implementation statement will be public. As with SIPs, we anticipate a significant level of interest from policymakers, regulators and civil society groups, so trustees should consider carefully what public messages they are putting out in their statements.

Write the SIP with the implementation statement in mind. For relevant schemes, all policies under the SIP are in scope for the implementation statement, so trustees should take care not to include general statements in their SIPs which may be hard to report against.

Consider keeping a record of investment policy implementation and actions as you go along. Keeping an investment implementation log of key events (such as asset manager reviews) through the year will make it easier to prepare the statement when due. The PLSA guide provides examples of key actions or decisions taken over the course of the scheme year which trustees might choose to report.

Think about what matters will be prioritised in the implementation statement. For example, for a DC scheme, we would expect most of the focus to be on how policies have been implemented in relation to the default fund. But trustees should consider to what extent they might also include a commentary (including in relation to voting and engagement) on any self-select funds.

Legal update

Review of the UK funds' regime

In this year's Spring Budget, the Government announced that it would undertake a review of the UK's funds' regime during 2020.

On 11 March 2020, HMT issued a consultation which seeks to gather evidence and explore the attractiveness of the UK as a location for the intermediate entities through which alternative funds hold fund assets. The Government understands from engagement with industry and their advisers that, despite the general attractiveness of the UK corporation tax system for holding company structures, there remain barriers to the establishment of these intermediate fund entities in the UK. It is also understood that, within the industry, there is a view that these barriers could be addressed through low cost, targeted changes that are consistent with:

- the principles underpinning the UK corporation tax system, and
- the UK's more general approach to funds taxation.

Following an extension due to COVID-19, the consultation closes on 19 August. The Government will then decide on the merits of action and, if relevant, the legislative timetable. While the Government "recognises the demand for near term changes in this area, this will ultimately depend on the nature of such changes and extent to which there needs to be further consultation".

Further detail on the wider review of the funds' regime (which is intended to cover direct and indirect tax, as well as relevant areas of regulation) will be published "in due course".

LIBOR transition

LIBOR is a measure of the average rate at which banks are willing to borrow wholesale unsecured funds, and is used as a reference rate in a wide range of financial instruments and hedging contracts. It is administered by ICE Benchmark Administration. The FCA has secured panel bank support to continue submitting to LIBOR, but only until 2021. Beyond this date, the future of LIBOR is not guaranteed.

Market participants have been taking measures to ensure that, if LIBOR ceases to be published or becomes non-representative, there are fallback rates which can be applied in contracts referencing LIBOR. For instance, the derivatives industry body (ISDA) has been working with Bloomberg to formulate a SONIA-based term rate that can be used in place of LIBOR, and this is now being published by Bloomberg.

For legacy OTC transactions referencing LIBOR, trustees would need to specifically agree with their counterparties for the new fallback rates to apply. ISDA will soon launch its IBOR Fallback Protocol to help facilitate this. Alternatively, trustees could agree to amend the reference rate in those transactions directly with their swap providers ahead of LIBOR ceasing or becoming non-representative. In that case, trustees may wish to get legal advice to ensure that no unintended consequences arise as a result of the amendment.

On 23 June 2020, HMT published a statement relating to LIBOR transition which explained the Government's approach to legislative steps that could help deal with "tough legacy" contracts that cannot transition from LIBOR before the end of 2021.

The Government intends to use the forthcoming Financial Services Bill to make provision to ensure that the FCA's powers are sufficient to manage an orderly transition from LIBOR. However, it notes that regulatory action may not be able to address all issues or be practicable in all circumstances. It is therefore important that parties, including trustees of occupational pension schemes, who can transition away from LIBOR work with their counterparties to agree terms on which they can do so.

Climate change risk reporting

The Government set out its expectation for all listed companies and large asset owners to disclose in line with the Task Force on Climate-related Financial Disclosures ("TCFD") recommendations by 2022, as part of its Green Finance Strategy (July 2019).

Provisions in the Pension Schemes Bill 2019-21 ("the Bill"), currently before Parliament, would require trustees and managers of occupational pension schemes to explicitly consider climate change goals, including the Paris Agreement temperature goal, for the purpose of ensuring the effective governance of their schemes with respect to the effects of climate change. It sets out the kinds of activities trustees and managers of pension schemes may be required to undertake.

Timing for these new requirements remains uncertain, with the Bill due to complete its journey "later this year" and no clear date for the underlying regulations to be published for consultation. However, our assumption is that the Government intends to meet its 2022 goal. This means occupational pension schemes, particularly larger schemes which have been identified as likely to be required to comply first, should start preparing to make disclosures along these lines now.

For further details on climate risk and the TCFD recommendations, please see our 2020 guide, "ESG and climate change for pension funds".

Palestine Solidarity Campaign & ors v Secretary of State for Housing, Communities and Local Government

The investment strategies of scheme managers for local government pension schemes are governed by regulations[2] which, broadly, require local authorities to formulate their investment strategy in line with guidance issued by the Secretary of State for Housing, Communities and Local Government ("the Secretary of State").

Guidance on preparing and maintaining an investment strategy statement ("the Guidance") was published in September 2016. It provided that administering authorities "should not pursue policies that are contrary to UK foreign policy or UK defence policy" and, further, that "using pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries are [sic] inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government".

In June 2017, the Palestine Solidarity Campaign issued a judicial review challenging the Guidance, on the basis that the above limitations fell outside the proper scope of the Secretary of State's statutory powers.

On 29 April 2020, the Supreme Court ruled that it was unlawful for the Secretary of State to use statutory guidance to prohibit certain local government pension scheme investments. Arguably, this is of limited interest as it relates to public sector schemes and the offending sections have already been removed from the Guidance. However, the judgment also includes useful comments on pension scheme trustees' ability to take into account non-financial factors. In particular, it seemingly sanctions the view, expounded by the Law Commission in its 2014 report on the fiduciary duties of investment Intermediaries, that the law permits trustees to make investment decisions that are based on non-financial factors, provided that:

- they have good reason to think that scheme members share the concern, and
- there is no risk of significant financial detriment to the fund.

The Supreme Court's endorsement of this approach should be borne in mind by trustees, as it confirms that the circumstances in which it is appropriate for them to take non-financial factors into account in their investment decisions remain extremely limited.

2 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

Sackers

Contact

Sackers is the UK's leading commercial law firm for pension scheme trustees and employers. Over sixty lawyers focus on pensions and its related areas, including Sackers' finance and investment group, a team of lawyers who provide cutting edge advice to trustees, employers, corporate investors and providers on all aspects of pension scheme finance and investment.

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