

Finance & investment briefing

March 2021

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



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Abbreviations

AVCs: Additional Voluntary Contributions

CETV: Cash equivalent transfer value

ESG: Environmental, social and governance

DC: Defined contribution

DWP: Department for Work and Pensions

EEA: European Economic Area

EMIR: European Market Infrastructure Regulations

EU: European Union

GMP: Guaranteed Minimum Pension

HMT: HM Treasury

IGC: Independent Governance Committee

IORP: Institution for Occupational Retirement Provision

ISDA: International Swaps and Derivatives Association

LDI: Liability-driven investment

OTC: Over-the-counter

PRA: Prudential Regulation Authority

TCFD: Task Force on Climate-related Financial Disclosures

TPR: The Pension Regulator

UK: United Kingdom

Finance & investment focus

“Welcome to our March 2021 finance and investment briefing.

In this issue, we look back over last year's buy-in market and share some top tips for trustees. Over the last three years, Sackers are proud to have advised on a significant proportion of buy-in/out transactions in the market, including some of the largest deals and industry leading longevity transactions. See pages 6-7 for further details.

Now we have reached the end of the transition period and the UK and EU have concluded a Trade and Cooperation Agreement, we review what issues are worth considering in relation to Brexit.

We are publishing our fifth guide on ESG which will guide trustees through disclosure requirements from 2021. Look out for this guide on our website.

Lastly, the Sackers investment team will be at the online PLSA investment conference between 9-11 March and we would be delighted to see you at our virtual stand.”



Paul Philips

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Environment

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Brexit and pension scheme investment



At the eleventh hour, the UK and EU concluded a Trade and Cooperation Agreement (“TCA”) effective from 1 January 2021. However, the TCA does not deal with the future of cross border financial services provision. The UK and EU are currently in talks and are aiming to have a memorandum of understanding in place by March 2021.

Financial services firms in the UK and EU have been preparing for this eventuality and there are no immediate actions required by trustees of UK registered pension schemes. However, at the time of writing, the following issues are worth noting:

1

Brexit and regulatory permissions

- Most EU banks and financial services firms offering services in the UK will have previously relied on the EU passporting regime, meaning that they would have only needed to be authorised by their home regulator to offer services in the UK.
- Those entities will need to have considered how they can continue to provide services after the transition period, and trustees will likely have received continuity of service letters (either directly or through their managers) describing how services will continue to be provided.
- For EU banks and financial services firms to continue to operate in the same way as they did prior to the end of the transition period, unless special arrangements are made in the talks between the UK and the EU, many will need to be authorised by the UK’s PRA and this is a time-consuming process. The UK has put in place a temporary permissions regime which allows EU (and EEA) firms who were formerly using a passport to continue to provide services for a period while they seek authorisation.

2

Brexit and financial regulation

- Much financial regulation has been implemented through EU law. For instance, trustees who transact uncleared OTC derivatives will generally have been subject to certain requirements under EMIR.
- A number of steps have been taken to ensure that this regulation continues to operate with the minimum of disruption. For instance, the European Union (Withdrawal) Act 2018 transposes EMIR and its delegated regulations into UK law and so a version of “UK EMIR” became applicable after the end of the transition period. This is substantially the same as that applied in the EU, although not identical in certain places due to the manner in which the regulation has been transposed.
- Future documentation exercises may be required to deal with the fallout of Brexit issues.

3

Brexit and mandatory clearing

- Now the Brexit transition period has ended, there is a risk that certain uncleared OTC derivatives which schemes transact with EU derivative providers will be treated as subject to mandatory clearing.
- This would only apply to the limited set of interest rate swaps and equity and index credit default swaps that are subject to mandatory clearing. The issue is that UK pension schemes may no longer be treated as an EU/EEA IORP under EMIR. If that were the case, UK pension schemes would not technically be entitled to the pension scheme exemption from mandatory clearing where it transacts with EU derivative providers.

Brexit and pension scheme investment cont.

3

Brexit and mandatory clearing cont.

- It is not clear that this is the intention of EMIR and (for example) the German regulator (the BaFIN) appears to be permitting German derivative providers to transact non-cleared transactions with UK pension schemes despite this technical issue.
- Schemes may wish to check with their managers whether they have any direct exposure to European banks or investment firms in relation to trades within mandatory clearing where this could be an issue.

4

Brexit and Jurisdiction clauses

- Prior to the end of the transition period, the UK courts and courts of EU member states were subject to EU law governing the recognition of choice of court agreements and enforcement of foreign judgments. Certain other EU laws also applied in connection with cross-border disputes.
- As a general matter, these laws will still apply to legal proceedings which commenced prior to 31 December 2020.
- The key question is how the UK and EU will recognise choice of court agreements and the enforcement of foreign judgments going forward, and this area remains uncertain. The UK has sought to accede to the 2007 Lugano Convention which is broadly similar to the current EU regime. This would require agreement by the other signatories of the Convention, which has not yet been confirmed.
- The UK has acceded to the Hague Convention in its own right. This provides some protection for the allocation of jurisdiction and its enforcement where parties have agreed exclusive jurisdiction clauses, although it represents a material change from the previous regime.

5

Brexit and other documentation issues

- Whether Brexit gives rise to consequences for a particular derivatives, stock lending or repurchase transaction will depend on the terms negotiated for such transaction.
- In relation to uncleared OTC derivatives, we consider it unlikely that the terms of the pre-printed 1992 or 2002 ISDA Master Agreement would be triggered, or adversely affected, by Brexit. For example, we consider it unlikely that Brexit would cause performance under an ISDA Master Agreement to become illegal, impossible or impractical so as to cause an "Illegality" Termination Event to occur.
- Given the potential for economic disruption as a result of Brexit, particular consideration may need to be given in relation to ratings triggers or other provisions relating to creditworthiness or market conditions in due course.

New disclosure obligations in relation to climate change

DWP publish draft climate change regulations

On 27 January 2021, the DWP published a [consultation](#) on draft regulations which introduce new requirements to report in line with the TCFD recommendations, as well as accompanying draft statutory guidance. The regulations require trustees to implement TCFD-aligned governance measures and produce and publish a TCFD report. The document contains the government's response to the August 2020 consultation (see our [Alert](#)). The new requirements will be phased in starting with trustees of schemes whose net assets are £5bn or more, as well as authorised master trusts and collective DC schemes, having to comply from 1 October 2021. Trustees of such schemes will be required to publish their first TCFD report within 7 months of the end of the scheme year which is underway on 1 October 2021. For further information please see our [Alert](#) and upcoming ESG guide.

In addition, following their previous consultation in March 2020, the Pensions Climate Risk Industry Group have also published final [guidance](#) on applying the TCFD recommendations to a pension scheme.

Questions being more widely raised

Investment in overseas legal cannabis industry

Pension schemes may be invested in funds with exposure to or companies involved in the production and distribution of cannabis for medicinal and recreational purposes (in countries where this is legal). This area raises some interesting questions and is starting to be more widely raised with trustees by their investment providers. Please speak to your usual Sackers contact if you have any questions.

COVID-19 guidance updated

TPR updates guidance on DC transfer requests and gated funds

TPR has updated its guidance on COVID-19 and DC scheme investment to include a new section on transfer requests where a member's savings are held in a gated (temporarily closed) fund. TPR acknowledges that payment of a CETV may be problematic where all or part of a member's investment is held in a gated fund. However, in such a case, TPR does not consider that it has the power, under legislation, to grant an extension to the statutory timeframe for payment of a CETV.

Call for input on UK funds regime

HMT call for input on review of UK funds regime

On 26 January 2021, HMT published a [call for input](#) on its review of the UK funds regime. The Government announced at Budget 2020 that it would carry out a review of the UK funds regime, covering tax and relevant areas of regulation. This review began with a consultation on the tax treatment of asset-holding companies in alternative fund structures, to which the government responded and launched a [second consultation](#) in December 2020.

The call for input sets out the scope and objectives of the review, inviting stakeholders to provide views on which regulatory and taxation reforms should be taken forward and how these should be prioritised.

The overarching objective of the review is to identify options which will make the UK a more attractive location to set up, manage and administer funds, and which will support a wider range of more efficient investments better suited to investors' needs.

Responses are requested by 20 April 2021. The Government will analyse responses and intends to consult on any specific proposals for reform.

Derisking update

Trustees have derisking high on the agenda, with many targeting buy-in/out in five to ten years. Schemes looking to derisk can act now to maximise their opportunities for a successful derisking transaction, in what will continue to be a busy marketplace for the foreseeable future.

Sackers have advised on 20-30% of buy-in/out transactions over a three-year period. Our transactions include many of the largest in the market as well as industry leading longevity transactions (see page 7). In 2020, we acted on Rothesay Life's further pension buy-in with National Grid (bringing the total business transacted to £3.6bn¹) and the largest transaction of the year, which is yet to be publicly reported.

Estimated transaction levels for 2020 fell short of the record breaking £43.8bn transacted in 2019 but, based on reported numbers, transaction volume remained high and is likely to be around £25 to £30bn. Predictions so far are that buy-ins and buy-outs in 2021 will reach similar levels.

Insurers have focused on smaller numbers of very large transactions as attractive low-hanging fruit. As the market matures, we anticipate higher numbers of lower value transactions. This means more work for insurers to transact the same levels of business by value. In this environment, insurers will be incentivised to deal with trustees who are able to make the insurers' job as easy as possible. Our top tips are as follows:

¹ Sackers advises National Grid on £800m buy-in with Rothesay Life



Focus on governance

Putting in place a properly resourced and empowered committee to supervise the transaction is essential. It is becoming increasingly normal for these to be structured as joint working groups between the trustee and company.



High quality benefit specification and data

Insurers accept liability for the benefit specification and the data supplied. They do not insure the trustees' legal liability to members (though they may, for a price, accept some categories of "residual risk"). A key workstream for trustees will therefore be cleansing data and preparing the specification. As part of this, trustees will need to work with their legal advisers to understand the scope of any differences between what they are insuring and their legal liabilities. This is a core concept for any buy-in/out and work can start well in advance of any proposed transaction.



Small does not mean easy

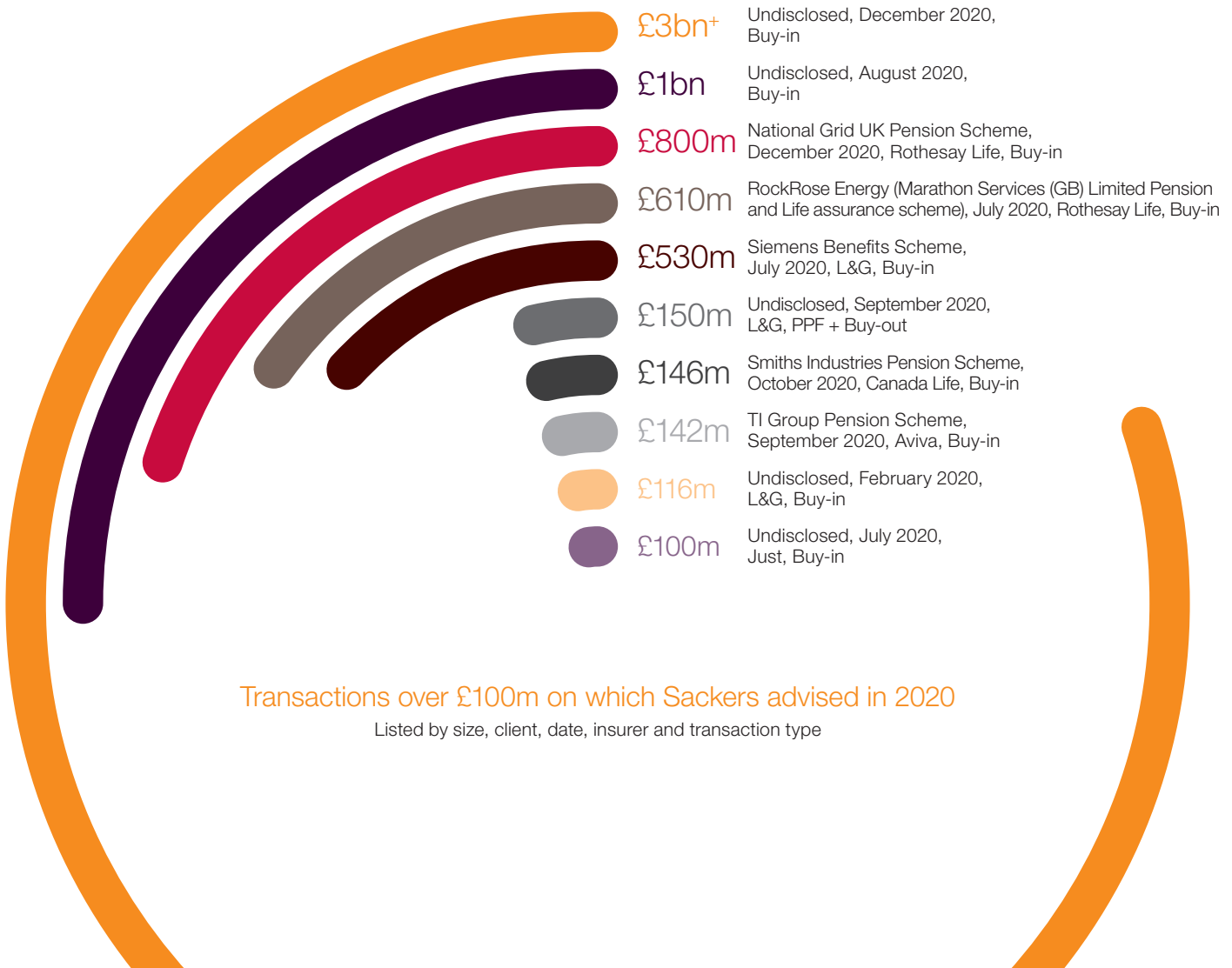
A multi-billion transaction with a simple benefit spec and clean data may be an easier transaction than a deal with a fraction of that value, which has complex benefit structures, multiple sections and data issues. Trustees should plan and budget accordingly.



Think outside the transaction window

Trustees can be very focused on the three to four weeks leading up to signing a buy-in transaction. However, for schemes looking to buy out and wind up, signing the contract is the beginning of the journey. Moving to a buy-out and winding-up can be a significant transaction in its own right. Trustees will do well to think early and strategically about the workstreams adjacent to the core buy-in transaction; such as trustee protections, AVCs, GMP equalisation, refund of surplus and the wind-up project.

Derisking facts & figures



Transactions over £100m on which Sackers advised in 2020
Listed by size, client, date, insurer and transaction type

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Some of our key highlights of 2020

£10bn

We have advised on longevity swaps totalling £10bn in the last three years

£500m

We advised on 13 bulk annuity transactions, five over £500m

£23bn


We have advised on deals totalling more than £23bn in the past three years

£150m

We advised on a £150m PPF+ buy-out transaction, securing the benefits of over 360 deferred members and 650 retirees

42

We have advised on 42 bulk annuity transactions in the past three years



We advised on bulk annuity transactions representing more than a quarter of the anticipated market value of around £30bn in 2020

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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