

Finance & investment briefing

September 2018

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



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Abbreviations

CMA: Competition & Markets Authority
DB: Defined benefit
DC: Defined contribution
DWP: Department for Work and Pensions
EMIR: European Market Infrastructure Regulation
ESMA: European Securities and Markets Authority
ESG: Environmental, social and governance
EU: European Union
FCA: Financial Conduct Authority
FCP: Financial counterparty
FRC: Financial Reporting Council
LDI: Liability-driven investment
OTC: Over-the-counter
PLSA: Pensions and Lifetime Savings Association
PRA: Prudential Regulation Authority
SIP: Statement of Investment Principles
TPR: The Pensions Regulator

Finance & investment focus

“Welcome to our third finance & investment briefing of 2018.

After a summer of sun and sport (didn't they do well?) you would be forgiven if you had not read some of the important pensions investment developments in too much detail. Undeterred by distraction or dehydration, we did it for you. This edition will cover the provisional findings of the CMA on its investigation into the investment consulting and fiduciary management sectors. The CMA's investigation will have been a considerable strain on the consultant teams bearing the brunt of the process. They may now feel the hard work has paid off, as some of the more wide-reaching proposals have not made their way into the CMA's suggested remedies. We go on to discuss the much anticipated DWP draft regulations on ESG. Much of what the DWP has proposed was expected and is welcome, but the approach on member views seems to be causing confusion. As usual, our legal update will touch on the other important regulatory developments over the period including the EMIR refit and the PRA's consultation on equity release mortgages.

Thank you for reading our briefing and don't hesitate to get in touch with your usual contact if you have any questions.”



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CMA market investigation into investment consultancy

Following a reference from the FCA, in September 2017 the CMA launched a market investigation into investment consultancy (IC) and fiduciary management (FM) services. Its provisional findings were published on 18 July 2018.



Background

The purpose of a market investigation is to decide whether any feature or combination of features of a market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK, or a part of the UK. If the CMA finds that there is an adverse effect on competition, it then decides whether remedial action should be taken and, if so, identifies “effective and proportionate” remedies.



Provisional decision

The CMA has provisionally found that, whilst IC and FM are not highly concentrated markets and customers have access to a significant number of providers, there is an adverse effect on competition. Material customer detriment (for example, higher prices and a lower quality of service) may be expected to result from it in both the IC and the FM markets, with greater concern about the FM market.



General conclusions

- There are weaknesses in the demand side of both markets due to lack of engagement by some pension trustees with investment matters. It is difficult, even for the engaged, to access the necessary information to assess the services' value for money.
- Firms providing both IC and FM services have an incumbency advantage with respect to their advisory customers. This is of particular concern at the point at which pension schemes first purchase FM.
- The incumbency advantage could lead to greater market concentration in the future which, in turn, could increase barriers to expansion for other FM providers, weaken competitive pressure and make it harder for FM customers to get a good deal.



Proposed remedies

FM

- Require pension trustees to carry out a competitive tender before awarding an FM mandate for the first time.
- Require pension trustees who use FM but did not make the appointment following a competitive tender process to put the role out to tender within five years.
- Place duties on FM firms to:
 - disaggregate FM fees to current customers and enhance disclosure of underlying investment fees
 - be clearer about FM fees with prospective customers, including costs relating to transition or exit
 - develop and use a standard approach to report their performance track record to prospective customers.

IC & FM

- Firms should report the performance of recommended asset management products and their own investment products to an agreed set of standards.



Recommendations

To support its package of remedies, the CMA proposes making the following recommendations to government and regulators:

- to ensure greater oversight of the industry, the FCA's regulatory perimeter should be extended to include the relevant services provided by IC and FM firms

CMA market investigation into investment consultancy cont.

- TPR should develop guidance to support pension trustees in asking for and using the enhanced information they will now be able to access and with running competitive tender processes
- the work of the FCA's Institutional Disclosure Working Group should be implemented and its use and effect monitored.



DC schemes

While not a key component of its conclusions, the CMA found that there are “some indicators that DC schemes spend less time on investment matters than DB schemes”. For example, DC schemes’ use of IC and FM is much lower (at 38%) than DB schemes (an average of 82%). When they do use these services, their switch rates (16% have switched in the last five years, compared to 27% of DB schemes) suggest lower levels of engagement.

The CMA “encourage” policy makers to consider how best to address DC schemes’ lower level of engagement in DC matters. This area will be one to watch.



Timing

The consultation on the CMA's proposals closes on 24 August 2018. Its final decision must be published by 13 March 2019.

DWP proposed trustee duties on climate change – update

On 18 June 2018, the DWP published a [consultation](#) on clarifying and strengthening trustees’ investment duties with accompanying [draft regulations](#). Under the proposals, trustees would be required to set out, in their SIP, how they take account of financially material considerations including those arising from ESG factors and, in particular, climate change. Separately, trustees of DC schemes would be required to produce an annual “implementation statement” setting out how they have performed as against the SIP. (For greater detail on the consultation see our recent [Alert](#)).

Somewhat controversially, the consultation also proposes that all trustees would be required to produce a separate statement that explains the extent to which the views that, in the reasonable opinion of the trustees, scheme members hold on financial and non-financial matters will be taken into account in the preparation of the SIP.

Whilst we are broadly supportive of the proposals, in our view the requirement to have a statement about members’ views is probably the least helpful, and potentially most confusing, of the proposed regulatory changes. On this we agree with the views of the PLSA, in [their response to the consultation](#), that the proposals in this area “run the risk of causing greater confusion for trustees, raising false expectations amongst members and potentially reducing members’ willingness to engage with their pension savings”.

The consultation closed for comment on 16 July 2018 and the DWP plans to lay the proposed regulations at the earliest opportunity, to then bring them in to force “around a year” later.



See [Sackers comment on the consultation: DWP investment duty proposals creates further pressure around ESG](#)

For a broader look at ESG and more detail on forthcoming changes you can read our new guide: [“Where next for ESG?”](#)

EMIR refit: clearing obligation for pension scheme arrangements

On 3 July 2018, ESMA issued a [statement on the clearing obligation for pension scheme arrangements](#).

EMIR includes a temporary exemption from the clearing obligation for trades that are “objectively measurable as reducing investment risks directly relating to the financial solvency” of pension scheme arrangements. This exemption is due to expire by 17 August 2018 and can only be extended by new legislation.

The planned Regulation amending EMIR (Regulation 648/2012)(2017/0090 (COD)) (the “EMIR Refit Regulation”) is expected to be finalised this year. It includes a further temporary exemption from the mandatory clearing of derivatives for pension scheme arrangements, as well as other proposals for small and non-financial counterparties.

Under the current legislation, from 17 August 2018 (until the EMIR Refit Regulation is agreed), category 2 firms (FCPs whose notional trade exceeds €8bn) are technically required to adhere to the mandatory clearing obligations. The deadline for category 3 firms is 21 June 2019 by which time we would expect the EMIR Refit Regulation to have been agreed.

However, ESMA indicates that it expects national competent authorities “to not prioritise their supervisory actions towards entities that are expected to be exempted again in a relatively short period of time, and to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a proportionate manner”. On 4 July 2018 the FCA confirmed that it supports ESMA’s approach and that it will not require pension scheme arrangements and their counterparties to start putting processes in place to clear derivatives which are currently exempt during the timing gap. This is subject to any further statements that may be made by ESMA or the FCA.

See [March 2017 Finance & investment briefing](#)

Clarifying statement

PRA consultation on treatment of equity release mortgages

On 2 July 2018, the PRA published a [consultation paper](#) and “[Dear CEO](#)” letter on ‘Solvency II: Equity Release Mortgages’ (CP13/18). These documents discuss key regulatory concerns in respect of equity release mortgages.

The consultation paper and letter are relevant to insurance and reinsurance companies holding equity release mortgages (for example, as an asset class to back buy-in and buy-out business). The PRA is concerned that some insurers should be holding additional capital when using these assets. The proposed changes may have significant implications for the capital position of insurers with large equity release portfolios and potentially cause an increase in buy-in and buy-out pricing.

The deadline for comments to the consultation is 30 September 2018 with the proposed implementation date for draft changes set at 31 December 2018.

Impact on buy-in and buy-out pricing

Contact

Sackers is the UK's leading commercial law firm for pension scheme trustees and employers. Over fifty 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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