Sackers

Government response: clarifying and strengthening trustees' investment duties

Alert | 12 September 2018

Introduction

On 11 September 2018, the DWP published a response to the consultation on changes to the Occupational Pension Schemes (Investment) Regulations 2005 (the "2005 Regulations") together with a final version of the regulations, now called the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 (the "Regulations").

Key points

- From 1 October 2019, trustees will be required to set out, in their statement of investment principles ("SIP"), how they take account of financially material considerations and stewardship.
- The Regulations now make clear that the financially material considerations which trustees must consider when making their investment decisions include, but are not limited to, environmental, social and governance ("ESG") factors, including climate change.
- Following consultation, the requirement to produce a separate statement on members views has been removed and replaced with an optional policy on non-financial matters, including not only members' ethical concerns but also social and environmental impact matters and quality of life considerations.
- "Relevant schemes" (broadly schemes offering DC benefits) will be required to publish the SIP on a website and, on and from 1 October 2020, produce and publish an implementation statement setting out how they have implemented their investment policies and explaining and giving reasons for any change made to them.

Background

The Government has been considering making changes to the 2005 Regulations for many years. Concerns about the interpretation of fiduciary duties in the context of investment were first identified by the Kay Review in 2012.

In July 2014, the Law Commission concluded that trustees:

- should take into account factors which are financially material to the performance of an investment, whatever their source (ie where ESG risks are financially material, trustees should take account of them.)
- could make investment decisions based on members' views, provided that they had good reason to think that scheme members would share their concern and that the decision(s) would not involve a risk of significant financial detriment to the fund (see our Alert for further details).

However, following consultation in 2015, the Government decided that guidance from TPR, rather than legislative change, would be sufficient.

Following a further Law Commission report on social investment by pension funds, the Government found that barriers to social investment were structural and behavioural rather than legal and that, despite TPR's guidance, "confusion and misapprehension over trustees' responsibilities persists", with evidence of trustees incorrectly thinking that ESG risks are irrelevant, or run counter to, financially material concerns. Therefore, in June 2018, the Government published a consultation proposing changes to the 2005 Regulations to clarify the position for trustees (see our Alert for details).

SIP – current requirements

A SIP is a written statement which governs the trustees' decisions about the pension scheme's investments.

The SIP must cover at least the following:

- the trustees' policy for securing compliance with their statutory duty to choose scheme investments
- their policies relating to:
  - the kinds of investments to be held by the scheme
  - the balance between different kinds of investments
  - risks (including the ways these are to be measured and managed)
  - the expected return on investments
  - the realisation of investments
  - the extent (if at all) to which the trustees take into account "social, environmental and ethical factors" in selecting, retaining and realising investments, and
- their policy (if any) relating to how the trustees exercise voting rights attached to investments.

Exceptions

Schemes with fewer than 100 members and certain local authority and public sector schemes are not required to prepare a SIP.

SIP – on and from 1 October 2019

Before **1 October 2019**, trustees will have to update or prepare their SIP to set out their policies in relation to:

- "financially material considerations" over the "appropriate time horizon" of the investments including how those considerations are taken into account in the selection, retention and realisation of investments
- the extent (if at all) to which "non-financial matters" are taken into account in the selection, retention and realisation of investments
- undertaking engagement activities in respect of investments (stewardship).

Following industry response to the consultation, the DWP has amended the original proposal and introduced a requirement for schemes to have a policy in relation to financially material considerations over the "appropriate time horizon". This is defined as the length of time that trustees consider is needed for the funding of future benefits by the investments of the scheme. The length of time is intended to refer to the scheme (and not the duration of individual investments) and to prompt schemes which are approaching buy-out or wind-up to consider financially material short-term risks, whilst encouraging other schemes to also look towards the longer term in a way which reflects the demographics of members and beneficiaries.

The new definition of "financially material considerations" also clarifies that these include (but are not limited to) ESG considerations (including, but not limited to, climate change), "which trustees of the trust scheme consider financially material".

Trustees also have the option of including a policy on "non-financial matters", including not only members' ethical concerns but also social and environmental impact matters and quality of life considerations.

Disclosure requirements for relevant schemes

In addition to the SIP requirements above, before **1 October 2019**, trustees of relevant schemes (broadly schemes offering DC benefits):

- with 100 or more members are required to state a policy in relation to the stewardship of their scheme's investments in their default investment strategy
- will be required to publish their SIP on a publicly available website and inform scheme members of its availability in their annual benefit statement.

The Regulations extend the stewardship requirement to now include trustees of relevant schemes with 100 or more members. The DWP explains the redrafting from the consultation proposal is to address any confusion over the expectation of stewardship in relation to investments which make up the default arrangements and close the loophole through which wholly-insured relevant schemes did not need to produce a stewardship policy.

From **1 October 2020**, trustees of relevant schemes will be required to:

- produce an implementation report setting out how they acted on the principles set out in the SIP
- publish that implementation report online in the same way as the SIP and inform members of its availability in their annual benefit statement.

The introduction of the requirement to produce and publish an implementation report is timed to ensure that trustees will not be required to report on the implementation of a SIP which has been produced under the current requirements.

The DWP has published related guidance for occupational pension scheme trustees and managers providing information on disclosure and administration regulations. The Pensions Regulator is due to produce high level guidance on the key changes by the end of November 2018.

Next steps

We recommend trustees begin preparations in relation to the above requirements sooner rather than later to meet the first deadline of 1 October 2019.

If you have any questions on any of the above, **please speak to your usual Sackers contact**.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 (0)20 7329 6699
E enquiries@sackers.com
www.sackers.com