Sackers

Finance & investment briefing

December 2019

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

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Abbreviations

DB: Defined benefit

DC: Defined contribution

DWP: Department for Work and Pensions

ESG: Environmental, social and governance

FCA: Financial Conduct Authority

FRC: Financial Reporting Council

LDI: Liability-driven investment

OTC: Over-the-counter

SIP: Statement of Investment Principles

TCFD: Task Force on Climate-related Financial Disclosures

TPR: The Pensions Regulator

Finance & investment focus

“Welcome to the December issue of our finance & investment briefing.

With the deadline for putting in place strategic objectives for investment consultants nearly upon us, this quarter we focus on how trustees should approach this obligation. At the time of going to print, TPR’s guidance was still awaited. We understand it will appear before the end of the year.

Otherwise, there are plenty of developments to keep you going without resorting to discussing Brexit! This quarter has seen the publication of the revised stewardship code, as well as a continuing focus on ESG. The (current) Pensions Minister is demanding action from trustees on climate change and the FCA has set out its intentions in this space for 2020.

Whoever ends up in Number 10, 2020 is set to be yet another busy year.”

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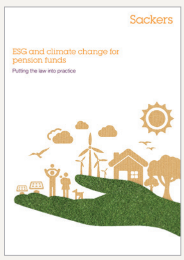

In practice: setting objectives for advisers

From 10 December 2019, trustees will be under new obligations to put in place strategic objectives with any provider of investment advisory services. Trustees will then be required to monitor their advisers against these objectives on an annual basis. For clients with advisers caught by the definitions relating to fiduciary managers, there may be an additional obligation to re-tender.

These new requirements are set out in the Investment Consultancy and Fiduciary Management Market Investigation Order 2019 ("the Order"). The Order is expected to be superseded by DWP regulations (currently in draft and awaiting the outcome of consultation) and is supported by draft TPR guidance. Further details of the requirements can be found here.

Have you caught everyone?

Most schemes have, rightly, focused on putting in place objectives with their main investment consultants, many of whom have prepared more or less tailored documents as a starting point (which we return to below).

However, the obligation applies to all providers who offer investment advice and trustees may need to look beyond their main consultants. For example:

- are you receiving any investment advice from an actuary
- do you have a consultant appointed in relation to a buy-in / out exercise
- is your LDI manager providing investment advice
- does the scheme have ad hoc advisers, for example, in relation to alternatives manager selection
- if you have a fiduciary manager, they will also need to provide investment objectives
- is advice received from an in-house team and, if so, are they exempt?

For the majority of cases, it should be very clear whether a provider is caught, but there are marginal examples which are more problematic in practice. Whether or not the provider is caught may turn on the particular facts of the case.

What do we need to do by 10 December?

Setting tailored, meaningful, strategic objectives, particularly for a full-service provider offering a range of investment services will often be a non-trivial exercise. Many schemes are therefore choosing to adopt an interim, minimum compliance approach ahead of 10 December, with the explicit intention of revisiting the objectives in the course of next year.

It is also worth noting that, under the Order, the obligation is not to take any further advice without objectives being put in place. If you have an ad hoc adviser, it may be possible to park setting them objectives until advice is next required. However, care will be needed to ensure objectives are actually in place when advice is next sought.

Can the consultant draft the objectives?

As noted above, in practice, many investment consultants are coming to their clients with suggested objectives. While trustees will recognise that there is a risk of conflicts here, it is also true that governance budgets between now and 10 December may be limited. It may therefore be preferable for consultants to get trustees off the starting blocks. While trustees do need to exercise their own judgement and think about what is appropriate for their scheme, many are likely to rely on consultants in the first instance.

Setting the objectives

The Order (and draft regulations) are not prescriptive about the form, content or level of detail. While TPR's draft guidance offers an interesting insight into its expectations, it also explicitly goes beyond the minimum legal requirement and may involve an overall approach and layout which is unhelpful for some schemes, particularly those in a hurry to get something done before the deadline.

For now, in practice, the following themes may be helpful.

1 **What are the objectives for?**	The purpose of this exercise is to enable trustees to effectively monitor the service they're receiving. So, while the starting point should be to consider what services are being provided, it will be helpful to go beyond this and consider how the trustees want those services carried out and what success looks like. There is undoubtedly a tendency (usually on an interim basis) to include very high-level objectives which may prove difficult to monitor come next year.
2 **Less is more**	Most of the examples we have seen are shorter than the example in TPR's draft guidance. There is no requirement to set objectives for all services, only investment services; so initially at least, it may be helpful to focus on key service areas and on any key service levels.
3 **Cherry-pick**	While few schemes are adopting TPR's list in full, it does act as a useful prompt, and there is everything to recommend cherry-picking examples which work for the scheme.
4 **Can they do better?**	Even if the approach is to put something in place as an interim measure, if the trustees have any service issues, this is an obvious place to put a marker down.

There is no obligation to agree the objectives with your consultant (and therefore no obligation to amend the consultancy agreement) though clearly getting provider input is appropriate. It's worth bearing in mind, particularly in relation to some of the example objectives proposed by TPR, that the consultants will be very mindful of the scope of their contractual responsibilities and will not want, even by implication, to accept responsibilities which go beyond their current appointment terms.

Legal update

"Revised and strengthened" UK Stewardship Code

On 24 October 2019, the FRC published the UK Stewardship Code 2020 ("the Code"). It will take effect on 1 January 2020.

The Code focuses on protecting the interests of UK savers and pensioners by ensuring that their money is managed responsibly, with a new emphasis on creating long-term value and on considering beneficiary and client needs. Key changes include:

- an extended focus that includes asset owners, such as pension funds and insurance companies, and service providers as well as asset managers. This is intended to help align the approach of the whole investment community in the interest of end-investors and beneficiaries
- a requirement to report annually on stewardship activity and its outcomes
- signatories will be:
  - expected to take ESG factors, including climate change, into account and to ensure their investment decisions are aligned with the needs of their clients
  - expected to explain how they have exercised stewardship across asset classes beyond listed equity, such as fixed income, private equity and infrastructure, and in investments outside the UK
  - required to explain their organisation's purpose, investment beliefs, strategy and culture and how these enable them to practice stewardship. They are also expected to show how they are demonstrating this commitment through appropriate governance, resourcing and staff incentives.

Organisations wanting to become signatories to the Code will be required to produce an annual stewardship report explaining how they have applied the Code in the previous 12 months. The FRC will evaluate reports against its assessment framework, and those that meet the reporting expectations will be listed as signatories to the Code. To be included in the first list of signatories, organisations must submit a final report to the FRC by 31 March 2021.

TPR is encouraging DB and DC trustees to adhere to the Code.

Equitable Life update

On or before 1 November 2019, Equitable Life policyholders voted on its proposal to:

- increase with-profits policy values with an immediate one-off uplift, remove any investment guarantee and to convert with-profits policies to unit-linked policies ("the Scheme")
- transfer most of Equitable's business to Utmost ("the Transfer").

As they voted for both the Scheme and the Transfer in the required majorities, there will now be a second court hearing on 22 November 2019 to seek the High Court's approval. If the High Court approves the Scheme and the Transfer, Equitable intends to publish confirmation of this on its website on or around 25 November 2019.

Assuming court approval is obtained, for Equitable to process members' investment choices at the implementation date (1 January 2020), it must receive investment choice forms by 13 December 2019. However, members should note that they will be able to make choices later.

Opperman focuses on ESG

Since 1 October 2019, trustees have been required to set out, in their SIP, how they take account of financially material considerations and stewardship (for details please see our Q3 briefing). Hot on the heels of this requirement coming into force, Guy Opperman, the Minister for Pensions and Financial Inclusion, wrote to the 50 largest pension schemes requesting action to combat climate change. We understand he also asked whether the schemes are reporting in line with the TCFD framework.

Plans for TCFD disclosures to become a requirement for occupational pension schemes are already in train with the FCA due to consult in 2020 (see below). A joint working group (chaired by Stuart O'Brien), established by the government and TPR earlier this year, is tasked with delivering best-practice guidance across governance, risk management, scenario analysis and disclosure. This is also expected next year.

FCA publishes feedback on climate change and green finance

In October 2018, the FCA issued a discussion paper on climate change and green finance. It has now published a feedback statement which sets out its actions and next steps. These include:

- consulting on new rules (in early 2020) to align climate-related disclosures by certain issuers with the TCFD's recommendations, and clarifying existing disclosure obligations relating to climate change risks
- finalising rule changes requiring IGCs to oversee and report on firms' ESG and stewardship policies (by the end of 2019), as well as separate rule changes to facilitate investment in patient capital opportunities
- publishing a feedback statement in response to a joint discussion paper with the FRC on stewardship, setting out actions to address the most significant barriers to effective stewardship
- challenging firms where it sees potential "greenwashing", clarifying its expectations and taking appropriate action to prevent consumers being misled
- contributing to several collaborative initiatives, including the Climate Financial Risk Forum, the Fair and Effective Markets Review working group, the Government-led cross-regulator taskforce on disclosures, and the European Commission's Sustainable Finance Action Plan.

Sackers

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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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