Sackers

Finance & investment briefing

March 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

DB: Defined benefit

DC: Defined contribution

DPO: Deputy Pensions Ombudsman

DWP: Department for Work and Pensions

ESG: Environmental, social and governance

FCA: Financial Conduct Authority

FRC: Financial Reporting Council

IGC: Independent Governance Committee

LDI: Liability-driven investment

OTC: Over-the-counter

PO: Pensions Ombudsman

SIP: Statement of Investment Principles

TCFD: Task Force on Climate-related Financial Disclosures

TPR: The Pensions Regulator

Environment

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Finance & investment focus

"Welcome to our March 2020 finance and investment briefing.

In this issue, we are pleased to present an overview of our involvement in the ever increasing buy-in / buy-out market. Over the last three years, we have worked with all the major insurers quoting for business and advised on more than 30 bulk annuity transactions. Our aggregate deal volume in 2019 totalled over £18 billion, keeping us at the forefront of this work. In the last year we have also been involved in significant longevity swap activity.

The initial margin requirements will soon be an issue for some schemes and we explain the actions trustees should be taking to prepare. A recent case also reminds trustees (not that they need it) of the importance of properly disclosing how they manage ESG risks, including climate change. We also note the introduction of a new EC Regulation on sustainability-related disclosures. For those with a keen interest in this subject, we are pleased to report a new ESG guide (our fourth) is on its way!

Last but not least, the Sackers investment team will be at the PLSA investment conference in Edinburgh. We would be delighted to see you at our stand."

Paul Phillips
Partner

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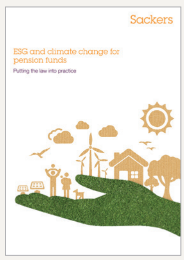

Legal update

Initial margin requirements fast approaching

In response to the global financial crisis of 2008-2009, the G20 agreed to a financial regulatory reform agenda covering the OTC derivatives markets and market participants. As a result, regulations have been implemented in a number of jurisdictions requiring parties to uncleared OTC derivatives transactions to exchange collateral. In the EU, regulation (EU) No 648/2012 ("EMIR") applies.

New collateral requirements for uncleared OTC derivatives

Pension schemes which trade uncleared OTC derivatives will already be familiar with the variation margin requirements that were introduced in 2016/2017 for in-scope derivative transactions. The final phase-in of the initial margin ("IM") requirements is now imminent, and their implementation is a much more significant exercise.

Under EMIR, the following will be in scope:

- from 1 September 2020, a relevant party (including a pension scheme) belonging to a group whose aggregate month end average notional amount ("AANA")[1] of uncleared derivatives exceeds EUR 50bn[2] (phase 5)
- from 1 September 2021, a relevant party with a total above EUR 8bn (phase 6).

Key actions

First, trustees should take the following steps:

- liaise with their asset managers as soon as possible to determine whether / when their scheme will be required to comply with the IM requirements and to ensure all relevant counterparties are informed of the scheme's status
- determine whether a relevant exemption will apply and make associated determinations with its allocation and monitoring. For instance, if the amount required to be posted would be below a threshold (EUR 50 million per pair under EMIR) then no posting is required
- work with their managers to identify the scheme's in-scope counterparties so that they can request and share key information about the trustees' proposed approach
- determine, with their managers, how IM will be calculated and the method that will be used. Under EMIR, any model used (which in practice would be the ISDA SIMM) will now need regulatory validation.

If their scheme is in scope, trustees:

- should familiarise themselves with the key legal requirements, so as to determine the best approach to managing implementation and determining the role of investment managers in the process
- will be required to appoint a custodian. The scheme's existing custodian(s) may or may not offer IM services or, if they do, the trustees may prefer another custody service.

Finally, IM implementation will require a number of documents to be negotiated and executed with each counterparty and their chosen custodians. The approach and method of negotiation will need to be considered.

1 The denomination and amount of the AANA thresholds, and the rules for calculating AANA, differ between rule sets. Counterparties may be subject to rule sets other than EMIR

2 Under EMIR, AANA is to be calculated by reference to an observation window between March and May in the relevant year. Final determinations can only be made after May in the relevant year

Extension of remit of IGCs

IGCs currently provide independent oversight of value for money of workplace personal pensions in accumulation (ie. before pension savings are accessed).

Following recommendations by the Law Commission, the FCA is extending the remit of IGCs by requiring them to:

- consider and report on their firm's policies on ESG issues, member concerns and stewardship (for the products that the IGC oversees)
- oversee the value for money of investment pathway solutions for pension drawdown. (With effect from 1 August 2020, firms will be required to offer investment pathways to non-advised consumers entering drawdown.)

Legal update

The final rules and guidance were published on 17 December 2019 and will come into force on 6 April 2020.

IGCs must report on their firm's relevant policies, and on the value for money of their firm's (proposed) pathway solutions, in the first IGC annual report that covers a period including or after 6 April 2020, and in subsequent annual reports. The next IGC annual report (and those thereafter) must also include the IGC's report on their firm's implementation of its relevant policies.

DPO case examines disclosure of climate change information

Mr D complained to the PO that his occupational pension scheme's failure to disclose sufficient information about how it was dealing with environmental issues amounted to maladministration.

Before he brought his complaint, the trustees had provided Mr D with copies of the scheme's actuarial valuation and SIP. They also met with him to discuss his concerns regarding their management of the risks related to climate change.

New disclosure obligations in relation to climate change may be on the horizon

While the DPO found that there had been "no breach of a positive disclosure duty or maladministration", it should be noted that this case pre-dated the extension of investment disclosure requirements in October 2019 (see our briefing for details) and that we are likely to see additional obligations in relation to climate change risks in the relatively short-term.

In 2017, the TCFD published a framework through which exposure to climate-related financial risks can be assessed, reduced, managed and disclosed and we are expecting guidance for trustees to support them in complying with the 2022 requirements outlined in the Green Finance Strategy in the first half of this year.

EC Regulation on sustainability-related disclosures

The Regulation of the European Parliament and of the Council on sustainability-related disclosures in the financial services sector ("the Regulation") was adopted by the Council of the EU on 8 November 2019 and published in the Official Journal on 9 December 2019. It is intended to lay the foundation for an EU framework which puts ESG considerations at the heart of the financial system to help transform Europe's economy into a greener, more resilient and circular system. ESG factors should be considered when taking decisions on investments in order to make investments more sustainable.

Regulation intended to put ESG considerations at the heart of the financial system

The Regulation came into force on 29 December 2019, but the key provisions for pension schemes will apply from 10 March 2021, with certain requirements not in force until 1 January 2022.

Assuming the Regulation survives the Brexit agreement, we would expect its impact to be relatively minimal as, broadly, its requirements are already addressed in current disclosure regulations. However, trustees should be aware that, if they do not do so already, they may have to include details of their policy on the integration of sustainability risks in their investment decision-making process in future investment reports.

TPR's leverage and liquidity survey

On 17 December 2019, TPR published new research on leverage and liquidity. This work was undertaken to help TPR and the Bank of England to assess the potential for systemic risks to arise due to the use of leverage in DB pension schemes.

Research shows many schemes well diversified and actively monitoring risks

TPR's initial analysis of the data shows that many schemes are well-diversified and are actively monitoring the risks in their portfolios that may arise in relation to leverage and liquidity. However, in TPR's opinion, the data shows that some schemes are pursuing more risky investment strategies that seek extra returns, which could be damaging in the event of adverse economic shocks. TPR intends to analyse the survey responses in more detail and consider how it can use the findings to help trustees to improve their risk management practices further.

Buy-ins and buy-outs facts & figures

Transactions over £100m on which Sackers advised in 2019

Listed in order of size, client, date, insurer and transaction type

£4.7bn – GEC 1972 Plan (sponsored by telent), September 2019, Rothesay Life, Buy-out

£2.8bn – National Grid UK Pension Scheme, August 2019, Rothesay Life, Buy-in

£1.6bn – National Grid UK Pension Scheme, November 2019, Legal & General, Buy-in

£1.1bn – Undisclosed, December 2019, Legal & General, Innovative deferred premium annuity

£805m – Electricity North West Group, October 2019, Scottish Widows, Buy-in

£670m – SmithKline Beecham Senior Executive Pension Plan, May 2019, Aviva, Buy-out

£250m – Boehringer, April 2019, Legal & General, Buy-in/buy-out

£176m – Smiths Industries, June 2019, Canada Life, Buy-in

£164m – Undisclosed, December 2019, PIC, Buy-in

Some of our key highlights of 2019

£12.6bn+

We advised on deals totalling more than £12.6bn

We advised the Trustees of the National Grid UK Pension Scheme on two buy-ins, relating to Section A and B of the scheme, with Rothesay Life and Legal & General respectively, totalling £4.4bn. The National Grid UK Pension Scheme was the largest scheme to use buy-ins to manage risk in 2019

We advised on deals representing more than a quarter of the anticipated market value of around £40bn for 2019

We advised the Trustees of GEC 1972 Plan (sponsored by telent) on a £4.7bn buy-out with Rothesay Life, the largest full scheme buy-out ever undertaken in the UK

£1bn+

We advised on 13 transactions (4 over £1bn)

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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Key areas of expertise include: derisking, LDI, longevity transactions, OTC derivatives and repurchase agreements, investment management, transition and custody arrangements.

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