Sackers

Finance & investment briefing

June 2023

Sackers finance and investment experts take a look at current issues of interest to pension scheme investors

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Abbreviations

AA: Annual Allowance

DB: Defined Benefit

DC: Defined Contribution

DWP: Department for Work and Pensions

ESG: Environmental, social and corporate governance

FCA: Financial Conduct Authority

FRC: Financial Reporting Council

HMRC: HM Revenue & Customs

IA: Investment Association

IGC: Independent Governance Committee

LDI: Liability-driven investment

LTA: Lifetime Allowance

OTC: Over the counter

PA 1995: The Pensions Act 1995

PCLS: Pension commencement lump sum

PLSA: Pensions and Lifetime Savings Association

SIP: Statement of Investment Principles

SRD II: Directive (EU) 2017/828 (which amended the previous EU Shareholder Rights Directive (2007/36/EC)

TCFD: Task Force on Climate-related Financial Disclosures

TPR: The Pensions Regulator

TPSVI: Taskforce on Pension Scheme Voting Implementation

Finance & investment focus

"Welcome to our second finance & investment briefing of 2023.

So far, 2023 has been dominated by work on risk transfer transactions, including the biggest deal in the market to date where Sackers advised on a £6.5bn buy-in for RSA's UK pension schemes. But while attention is so often focused on the big, new transactions, there are many schemes with one or more buy-in transactions, who will also be working hard to transition to buy out. In this issue, on page 5, we start the first in a series of articles focusing on the process of turning a buy-in into a buy-out. This briefing will outline the legal basics; future issues will focus on more specific issues, and some potential traps for the unwary.

On page 3, we provide an overview of our latest ESG guide, taking stock of how the industry and legislative environment on ESG and climate change has developed in the preceding years, and what we can expect in 2023. The guide includes links back to our previous publications where topics are covered in further detail, as well as referencing numerous other resources for those looking to get deeper into particular issues. We catch up on the latest legal developments on page 4, with ESG remaining a strong theme.

We look forward to seeing many of our clients and pensions industry colleagues at the Pensions and Lifetime Savings Association's Investment Conference in Edinburgh at the start of June."

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ESG: where are we now and where are we going?

Since the launch of our first ESG guide in 2016, the industry and regulatory environment on ESG and climate change has moved on apace. The landscape that trustees must now navigate is significantly different and the latest requirements and legal thinking continue to develop. So, where are we now and what does 2023 hold?

A snapshot of where we are now...

Pensions regulation

The Investment Regulations introduced new requirements in relation to SIPs and, by October 2019, trustees were required to update and prepare their SIP in relation to "financially material considerations" over appropriate time horizons and their engagement activities in respect of investments. Within a year, further changes to the regulations, implementing aspects of the SRD II in the UK, required trustees to set out more details in respect of asset managers. Similarly, from 1 October 2020, the Disclosure Regulations require trustees to produce an implementation statement setting out how they have acted on policies in the SIP. The DWP then produced guidance in June 2022 outlining additional recommendations.

Fiduciary duty

Fiduciary duty has been a subject of considerable discussion for many years and continues to develop. In our view, there is no doubt that trustees can take account of ESG issues as financial factors in their investment decision making and as part of their trust law and fiduciary duties. As trustees get used to ESG becoming mainstream, further issues such as net zero, impact investment, systemic market risk and beneficiary quality of life are requiring trustees, and lawyers, to think more deeply about their fiduciary trustee duties.

TCFD reporting

Climate reporting obligations were introduced in 2021 under the Pensions Schemes Act 2021 via the Climate Change Governance Regulations. The requirements were phased in with schemes in scope required to put in place appropriate governance arrangements to manage climate-related risks and produce, and publish, an annual report. Schemes with £1bn or more assets are the latest group to be in scope of the regulations, since 1 October 2022, and should be well on the way to publishing their respective reports. Recent amendments to the obligations also require trustees, since last October, to calculate a new "portfolio alignment" metric setting out the extent to which the scheme's investments are aligned with the Paris Agreement goal of limiting global warming to well below 2°C. This year we are expecting the "second tranche" of TCFD reports to be published and, in light of these extended reporting obligations for climate-related metrics, lots of schemes are likely to be grappling with issues of data availability.

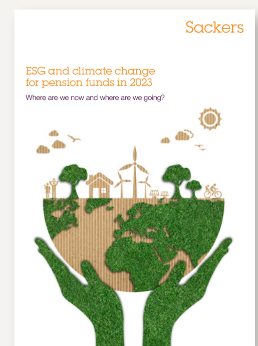
Stewardship

Trustees have clearly defined obligations to articulate their policies on stewardship. Schemes are being increasingly encouraged to improve their stewardship activities as part of a global response to climate change and sustainability issues. Recent reports from the TPSVI and IA have provided recommendations for giving pension savers a voice on how their savings are invested, as well as embedding stewardship into the relationship between investment managers and pension funds. In addition, the FRC's Stewardship Code and the PLSA's stewardship toolkit provide practical options for trustees to further their stewardship endeavours.

Where are we going?

ESG issues, and the related regulations, continue to have an impact across the economy. It is anticipated that 2023 will see movement in relation to the Government's Greening Finance Roadmap (see legal update), and in particular the new sustainable disclosure requirements for asset managers, which, over the longer term, are expected to filter down to pension schemes.

Our 2023 guide takes stock of where we are and what we anticipate for 2023 in further detail, providing links back to our previous publications where topics are covered in further depth. ESG and climate change issues only continue to grow on both a national and global level, and there is no doubt there are more requirements and obligations to come…



Legal update

Government publishes updated green finance strategy

Further reviews expected in late 2023

On 31 March 2023, the Government published a 2023 Green Finance Strategy. As part of the pensions-related measures in the strategy, the Government will "engage with interested stakeholders" during 2023 on clarifying trustees' fiduciary duties in the context of the net-zero transition, and will provide "further information and clarity" on these duties by reviewing the DWP's Stewardship Guidance in late 2023. The FRC, working with the FCA, the Government and TPR, will review the regulatory framework for effective stewardship, including the Stewardship Code, in the last quarter of 2023.

Alongside the strategy, the Government published a consultation on whether ESG ratings providers should be brought into the FCA's regulatory perimeter and how this could be done. The consultation closes on 30 June 2023.

PLSA publishes its annual stewardship and voting guidelines

PLSA provides a framework for trustees

The PLSA has published its latest annual Stewardship and Voting Guidelines, intended to provide a framework for trustees, and investors generally, to ensure that companies are held to account on key issues. Three themes are identified as particularly relevant for 2023:

- the cost-of-living crisis
- climate change and the environment, and
- the impact of company operations on its workforce and the wider society.

Finance (No.2) Bill 2023 published

Guidance updated to reflect tax changes

Setting out measures intended to implement the Spring Budget proposals, the Finance (No.2) Bill 2023 ("the Bill") was published on 23 March 2023. The Bill will make changes to the pensions tax system so as to:

- increase the standard, money purchase and tapered AAs with effect from 6 April 2023
- remove the LTA charge with effect from 6 April 2023
- generally freeze the maximum PCLS at £268,275 (being 25% of the current LTA)
- grandfather existing rights to higher PCLSs for those with certain tax protections.

The abolition of the LTA will be dealt with by a separate Finance Bill. See our Alert for further details. The Bill is making its way through Parliament and is expected to receive Royal Assent before the summer recess.

On 6 April 2023, HMRC updated its pension scheme administration guidance to reflect the tax changes announced in the Spring Budget. The updates include new pages on taking higher tax-free lump sums with LTA protection, and losing LTA protection.

TPR publishes review of climate reports

Data availability remains a challenge

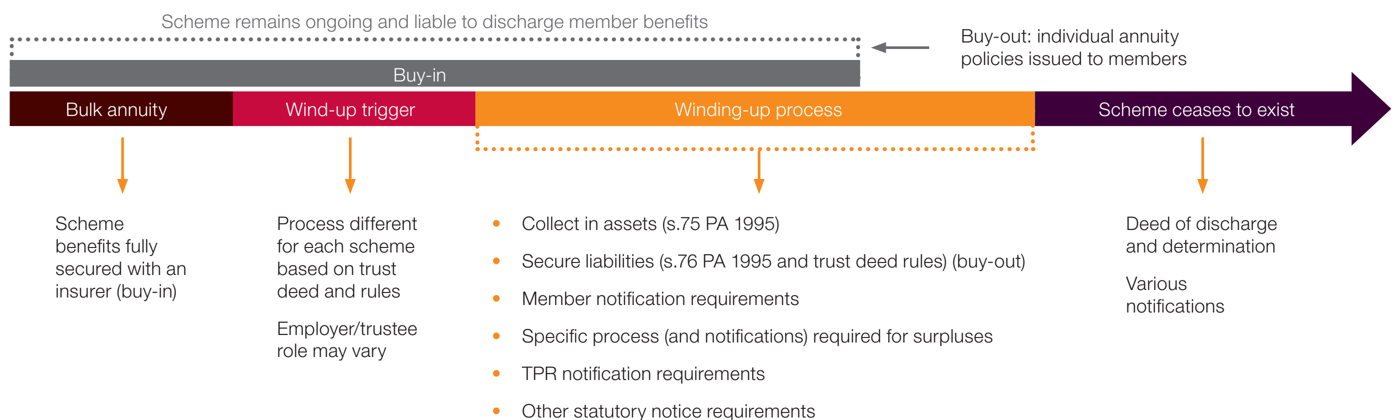
TPR published the results of its review of a selection of schemes' annual climate reports on 23 March 2023, highlighting areas of improvements and emerging good practice. TPR found that almost all reports were published on time, and the reports showed an "encouraging level of trustee engagement" with the requirements. Some reports included helpful non-technical summaries for savers. Data quality and coverage "remain a challenge", but TPR thinks this is likely to improve over time.

TPR asks trustees to consider some areas for improvement when preparing their next report, including providing sufficient background information on the scheme, and ensuring reports are fully accessible to savers with different needs (for example being compatible with accessibility software and capable of being printed).

Moving from buy-in to buy-out

A buy-in can be a relatively straightforward transaction – a buy-out is rarely without issues. Once a buy-in is complete it can be far too easy to think that the hard part is over. However, if you are ultimately looking to buy out, there may still be a substantial amount to do once a buy-in is finalised. Any "tricky issues" you parked at the buy-in stage in the interests of locking in a good price will need to be dusted off and resolved. In practice, discussing and preparing for a buy-out ahead of a buy-in can smooth out some bumps in the road. It is never too soon to start discussions with insurers to plan for the next step and to make the scheme "buy-out ready".

Below we provide a brief overview of the legal processes involved in moving from a buy-in to a buy-out. We will use later briefings to hone in on tricky issues you may face along the way and how to overcome them, including those steps that can be taken pre buy-in.



Legal process

A buy-out is the ultimate "end game" for a scheme. The scheme will be wound up and members will have individual annuity policies issued by the insurer.

The trigger for winding-up will depend on specific mechanics in the scheme rules. The process will be different for each scheme and the trustees' and employer roles may vary depending on what the rules dictate. Once wind-up is triggered, the trustees must follow the scheme rules and relevant legislation to make arrangements to secure members' benefits. Various statutory notices must be provided to both scheme members and TPR. Trustees will also need to check the specific requirements of their buy-in policies on moving to buy-out. Each insurer has its own provisions, which need to be considered as part of the project planning.

Notifying members

The key statutory disclosure obligations during winding-up are to notify members:

- of their benefit options
- within one month of the start of the winding-up, that it has begun
- three months before the date when their benefits are due to be secured
- of the latest position on the winding-up on at least an annual basis (communications may be issued more regularly)
- of proposals to refund surplus to the employer (we will consider this in more detail in future briefings).

Reports to TPR

The trustees must submit various reports to TPR in relation to the progress of winding-up, with the first report due in the first quarter that follows two years after the date winding-up commenced. TPR generally expects wind-ups to be completed within two years – another reason to be well prepared! Trustees are also obliged to provide TPR with annual progress reports providing details of any factors which are delaying winding-up, and a timetable setting out the likely completion date and the steps to achieve it.

Notifications after the event

Once all member benefits have been secured outside the scheme, trustees have to go through a number of tidying up exercises to make sure that the relevant bodies have been notified, that the scheme is fully wound-up, and that all loose ends have been tied up.

Sackers

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Sackers is the UK's leading commercial law firm for pension scheme trustees, employers and providers. 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 on all aspects of pension scheme finance and investment.

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