

# Pension scheme investment: overview of the 2019/2020 changes

Updated September 2020

Pension briefing

## HIGHLIGHTS

Pension scheme investment and governance have been occupying policymakers and regulators both in the UK and in Europe. Pension trustees are faced with a challenging array of new requirements, recommendations, statements of good practice and consultation proposals coming from a wide range of sources.

This note, originally issued in September 2019, explains the new obligations on pension scheme trustees in relation to:

- Setting objectives for investment consultants
- Compulsory tendering for fiduciary managers
- Changes to the statement of investment principles (SIP)
- Changes to the annual report
- Requirements to publish certain information on a website
- Notifying members of information available on a website.

We have updated this note to take account of developments over the past year, in particular the delays to certain regulations and guidance following the Covid-19 pandemic.

**Trustees should note in particular the obligation to report compliance with the investment objectives and fiduciary management requirements to the Competition and Markets Authority by 6 January 2021, unless DWP regulations are brought into force before this date.**

We will cover the government's August 2020 proposals on climate-change risk, and the recent consultation paper on improving outcomes for DC members, in separate notes.

This note is aimed at trustees of occupational pension schemes. However, advisers and employers may find the information useful.



## INVESTMENT CONSULTANTS: SETTING OBJECTIVES

*Applies from 10 December 2019, although compliance only necessary before taking investment advice*

New requirements affecting trustees of almost all private sector occupational pension schemes came into effect on 10 December 2019. For background information, please see the box on the CMA market investigation below.

Broadly, trustees of occupational pension schemes are prohibited from taking investment advice, unless they have first set objectives for their investment consultant (the "IC requirement"). As trustees are required by statute to take investment advice before adopting or revising their statement of investment principles (SIP), the IC requirement has wide impact.

The Pensions Regulator (tPR) consulted in summer 2019 on draft guidance to assist trustees in complying with the new requirement.

Although the IC requirement came into force on 10 December 2019, trustees did not need to comply until they took investment advice after this date. Trustees of schemes whose circumstances made it appropriate not to take investment advice until a later date therefore had longer to meet the IC requirement.

### Which advisers fall within the IC requirement?

Trustees must set strategic objectives for providers of "investment consultancy services", which include advice on:

- making or retaining investments;
- matters the trustee must seek advice on before preparing or revising their SIP;
- strategic asset allocation; or
- manager selection.

tPR draft guidance points out that other types of advisers, who may not identify themselves as "investment consultants" could be providing you with investment consultancy services: for example, the scheme actuary if they advise on whether

your strategic asset allocation is appropriate for your scheme's liabilities. However, the CMA Order (please see the box below) specifically excludes *"high level commentary provided by the scheme actuary in or in respect of triennial valuation reports and with regard to the link between the investment approach and the pension scheme's funding objectives."* Trustees need to consider whether any comments provided their scheme by their scheme actuary on their investment approach are sufficiently "high level" to fall within this exemption.

The DWP has indicated that the provision of "high level commentary" by actuaries will not fall within the definition of investment consultancy services under draft regulations which had been due to come into force on 6 April 2020 (please see the box below).

### What about existing arrangements with investment consultants?

You must set objectives for both new and existing contracts with investment consultants, where you continue taking investment advice after 10 December 2019.

### How should trustees set objectives?

tPR's draft guidance suggests that a fair amount of detailed work is expected when setting your objectives for an investment consultant. The following steps are recommended:

- **decide the services to be covered by the objectives:** this may include advice on defining your investment beliefs; reviewing your investment strategy; risk modelling; setting targets; selecting investment managers; appointing investment managers; transition management; risk mitigation; monitoring investment performance; trustee training; and (for defined contribution (DC) schemes) reviewing your default fund and providing information for your chair's statement;
- **set objectives for your provider(s) of the above services:** which may include demonstration of added value, service delivery, proactivity of advice, and support with your governance and compliance; while making clear how each provider's objectives contributes to achieving your overall investment objectives; ensuring that your objectives are consistent with the services being provided and are realistic; and taking (and challenging) input from your investment consultant; and
- **monitor performance:** consider how you monitor your investment consultant's performance against your objectives; you should conduct performance reviews at least annually.

The objectives should be reviewed at least every three years and after any significant change to your scheme's investment strategy and objectives.

### Competition and Markets Authority (CMA) market investigation

On 12 December 2018, the CMA published the final report of its market investigation into the provision of investment consultancy and fiduciary management services to and by institutional investors and employers in the UK. Trustees of occupational pension schemes are some of the largest institutional investors that use these services in the UK and the CMA focussed on trustees as consumers in this market.

### The Investment Consultancy and Fiduciary Management Market Investigation Order 2019 (the "CMA Order")

The CMA found that features of the current markets for these services have an "adverse effect on competition (AEC)". It subsequently published the Order to remedy some of the AECs identified. The Order includes new obligations on occupational pension scheme trustees, in certain circumstances:

- to set objectives for investment consultants (the "IC requirement"); and
- to conduct competitive tenders for fiduciary managers (the "FM requirement").

The Order came into force on 10 June 2019, with provisions applicable to pension trustees having effect from 10 December 2019.

### Didn't the requirements apply only from 6 April 2020?

- The IC and FM requirements are contained in the Order, which is legally binding on trustees, with both requirements having effect from 10 December 2019.
- In summer 2019, the DWP consulted on draft regulations which (among other things) will bring the IC and FM requirements into pension legislation. The DWP regulations were expected to come in to force on 6 April 2020. However, presumably because of the Covid-19 pandemic, the regulations have not yet been finalised.
- When the DWP regulations come into force (it is not currently known when this will be), the IC and FM requirements in the CMA order will fall away. Until then, trustees remain subject to the provisions of the CMA Order.

### Reporting to the CMA?

- Under the CMA Order, trustees must report compliance to the CMA by 12 months and four weeks after 10 December 2019 (when the provisions came into force). This requirement would have been replaced by an obligation to report compliance to the Pensions Regulator under the new DWP regulations (which were expected in force on 6 April 2020 but which have been delayed).
- Unless final DWP regulations come into force before the end of 2020, trustees will need to report compliance to the CMA by 6 January 2021.

### Are there any exceptions?

The IC and FM requirements apply to "relevant trust schemes". Broadly, a relevant trust scheme is an occupational pension scheme established under trust, other than:

- a scheme which is not registrable on the Pensions Regulator's register of schemes;
- an executive pension scheme;
- a public service scheme;
- a relevant small scheme (a scheme with fewer than 12 members where all members are trustees and certain conditions apply);

- a scheme with fewer than two members; or
- a money purchase scheme with fewer than 100 members and which is not a registered scheme for tax purposes.

The requirements also do not apply where the IC or FM provider is:

- the principal employer or a controlling employer in respect of the scheme (or in the same corporate group); or
- a trustee of the scheme or is a company owned by the trustees.

### What are the sanctions for non-compliance?

Failure to comply with the Order, including the IC and FM requirements, must be reported to the CMA within 14 days of becoming aware of the non-compliance, and must include a brief description of the steps being taken to address the failure.

The CMA may enforce the order through directions, or by civil proceedings for an injunction or other relief. Once the DWP regulations are in force, the Pensions Regulator will be responsible for enforcing the IC requirement, and may issue civil penalties of up to £50,000 (£5,000 for individuals).

Trustees will be required to report their compliance to the Regulator via their scheme return. As explained above, because the DWP regulations are not in force, the current position is that trustees will have to report their compliance to the CMA by 6 January 2020.

## FIDUCIARY MANAGERS: COMPULSORY COMPETITIVE TENDERS

*If less than 20% of scheme assets are under FM: comply on first appointment of FM provider or allocation of increased assets to an existing FM provider on or after 10 December 2019*

*If 20% or more of scheme assets are under FM: comply by 9 June 2021 or, if later, five years from earliest appointment of FM provider*

Following the CMA market investigation (please see the box above), trustees are required to run a compulsory competitive tender before appointing a fiduciary manager, where the appointment (or increased allocation under an existing appointment) will result in more than 20% of the scheme's assets being under fiduciary management (the "FM requirement").

Trustees must confirm in writing to the successful FM provider that they were selected as a result of a competitive tender. FM providers are prohibited from accepting an appointment without such confirmation, or confirmation that the FM requirement did not apply.

### Which assets count for the 20% test?

Unhelpfully, the CMA and the DWP have adopted slightly different definitions for the assets to be considered when applying the 20% test:

- CMA: all scheme assets, excluding asset-backed contributions (ABCs) and buy-in policies;

- DWP: all scheme assets, excluding buy-in policies.

Where a scheme is sectionalised, the DWP intends the 20% threshold to apply to the whole of the scheme assets, not the assets within individual sections.

### Meaning of fiduciary management (FM) provider

A provider is an FM provider if it meets both conditions 1 and 2:

- Condition 1: the provider is appointed to manage the scheme assets by being:
  - a fund manager to whom the trustees have delegated investment powers under section 34 Pensions Act 1995, or
  - someone to whom the trustees have delegated any discretion to make investment decisions (including decisions about appointing a fund manager);
- Condition 2: the provider (or a person connected to the provider) provides investment consultancy services to the trustees at the time of the appointment to manage the scheme assets, or within 12 months prior or subsequent to the date of appointment.

### When must a competitive tender be held?

Again, unhelpfully, the requirements under the CMA Order and the draft DWP regulations are subtly different. Broadly, however, a competitive tender must be held as follows.

- **Scheme did not meet the 20% threshold on 10 December 2019:** run a competitive tender before appointing a new FM manager, or increasing your allocation to an existing FM manager, where the appointment or increase would result in the 20% threshold being met. You should also run a competitive tender for any existing FM managers at the same time.
- **Scheme met the 20% threshold on 10 December 2019:** hold a competitive tender for your existing FM managers by the end of the five year period starting with the earliest date of appointment of your existing FM managers, or 9 June 2021 if later.

### Qualifying tender process

To undertake a qualifying tender process, the trustees must:

- invite, and use reasonable endeavours to obtain, bids for the provision of FM services from at least three unconnected persons; and
- evaluate the bids which are obtained.

### Pensions Regulator guidance

In summer 2019 the Pensions Regulator issued a draft guide for trustees on tendering for fiduciary management services.

The guide sets out the Regulator's view on good practice for running a tender exercise. However, even where trustees are not subject to the legal requirement to tender, the Regulator will expect trustees to consider whether it would be in the scheme's best interests to run a competitive tender.

Steps the Regulator expects trustees to consider include:

- setting objectives for the tender exercise, to ensure that services expected from a fiduciary manager will meet the scheme's objectives;

- deciding the level of decision making to be delegated;
- deciding how to resource the tender process, possibly using a sub-committee or appointing a third party to help with the tender, plus any assistance the employer could provide, for example the services of its procurement team;
- the different approaches taken by providers of fiduciary management and the current range of options available in the market;
- the potential for conflicts of interest and how these may be identified, mitigated and managed;
- selecting a longlist of potential providers;
- agreeing selection criteria in advance, possibly including a scorecard;
- issuing invitations to tender, asking providers to recommend a bespoke investment and risk management solution (the Regulator suggests inviting as many providers as is reasonable, to increase the likelihood of obtaining at least three bids);
- assessing bids and creating a shortlist;
- inviting shortlisted providers to present to the trustees;
- site visits to shortlisted providers; and
- documenting the tender process undertaken, including the objectives and service standards expected of the fiduciary manager and a summary of the reasons for the manager's appointment.

## STATEMENT OF INVESTMENT PRINCIPLES (SIP): NEW REQUIREMENTS

As a reminder, the requirement to adopt a SIP does not apply to schemes with fewer than 100 members.

### Policy in relation to financially material considerations

#### *Compliance required by 1 October 2019*

The SIP must cover the trustees' policy 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. This follows from the Law Commission's conclusions that, where environmental, social or governance risks or opportunities are financially material, trustees should take account of them.

The reference to "financially material considerations" has replaced the previous requirement for the SIP to cover the extent (if at all) to which you took into account social, environmental or ethical considerations.

The DWP's response to consultation on the draft regulations explains that where concerns are not financially material, for example – concerns which are primarily ethical – trustees may only take the concerns into account where there is broad consensus. Where there are differing views around an investment issue, such as in relation to fossil fuels, trustees should focus exclusively on financially material risks and opportunities.

### Glossary: financial and non-financial considerations

**"Appropriate time horizon of the investments"**: the length of time that the trustees ...consider is needed for the funding of future benefits by the investments of the scheme. (The DWP intends this to act as a prompt to schemes which are approaching buy-out or winding-up to consider short-term financially material risks, while schemes with a longer time horizon should consider financial considerations over the longer term, regardless of whether some of the portfolio is turned over more rapidly).

**"Financially material considerations"**: includes (but is not limited to) environmental, social and governance considerations (specifically including climate change), which the trustees consider financially material.

**"Non-financial considerations"**: the views of members and beneficiaries including (but not limited to) their ethical views and their views in relation to social and environmental impact and present and future quality of life.

## Non-financial matters

### *Compliance required by 1 October 2019*

Your SIP must cover the extent (if at all) to which you take non-financial matters into account in the selection, retention and realisation of investments.

The DWP consultation response confirms that trustees are not required to invest in line with members' wishes, or in accordance with government policy objectives, nor are they required to survey members' views.

The government considers that trustees may only take account of non-financial matters, such as members' wishes, when a two stage test is met:

- the trustees have good reason to think the members hold the concern; and
- the decision does not involve a significant financial detriment.

## Stewardship and engagement

### *Compliance required by 1 October 2019 (1 October 2020 in relation to capital structure, management of actual or potential conflicts of interest and person with an interest in the issuer of debt or equity)*

Your SIP must cover your policy on undertaking engagement activities in respect of your investments, including how and when you will monitor and engage with **"relevant persons"** about **"relevant matters"** (please see the glossary of new terms below).

You should expand your SIP to cover your policy on undertaking engagement activities in respect of your investments, including how and when you will monitor and engage with "relevant persons" about "relevant matters" (please see the glossary of new terms below).

This new requirement is in addition to the existing requirement to state your policy, if any, in relation to the exercise of rights, including voting rights.

Where a relevant scheme has more than 100 members, the SIP for the scheme's default arrangement(s) must cover the trustees' policy on engagement activities.

### Glossary: new stewardship and engagement terms

**"Relevant person"**: includes an investee company, an investment manager, a shareholder of an investee company, and an issuer or a holder of debt. From 1 October 2020, the definition of relevant persons is extended to include a person (or group of persons) with an interest in the issuer of debt or equity.

**"Relevant matters"**: includes the performance, strategy, risks, social and environmental impact and corporate governance of an investee company or issuer of debt. From 1 October 2020, it also includes a relevant person's capital structure and management of actual or potential conflicts of interest;

**"Relevant scheme"**: broadly, a scheme providing money purchase benefits other than additional voluntary contributions (AVCs), whether or not the scheme also provides defined benefit (DB) benefits. This means that DB schemes which have a DC (non-AVC) section, however small relative to the DB section, will have to comply with the relevant scheme requirements.

The DWP acknowledges that smaller schemes have less direct influence over companies in which they invest, but it considers that a stewardship policy is still feasible, even if it is limited to the recruitment, retention or replacement of investment managers. It also comments that there does not seem to be any intrinsic or insurmountable reason preventing trustees from influencing or exercising votes in pooled funds.

### Policy on asset managers

#### Comply by 1 October 2020

Your SIP must include details of your arrangement with any asset manager, including the following:

- how the arrangement with the asset manager incentivises the manager to align its investment strategy and decisions with your investment policies;
- how the arrangement incentivises the asset manager to base decisions on assessments of the medium to long-term financial and non-financial performance of an issuer of debt or equity, and to engage with those issuers to improve their medium to long-term performance;
- how the method and timescale for evaluating the asset manager's performance and fees are in line with your investment policies;
- how you monitor turnover costs incurred by the asset manager, and how you define and monitor targeted turnover; and
- the length of the arrangement with the asset manager.

If the SIP does not include the above matters, you should explain the reasons for the omission.

Where a relevant scheme (please see the glossary) has more than 100 members the SIP for the scheme's default arrangement(s) must cover the trustees' policy in relation to their arrangement with any asset manager.

## ANNUAL REPORT: NEW REQUIREMENTS

### Policies to be included in the annual report

#### Compliance required for annual reports for scheme years ending on or after 1 October 2019

The requirements for the annual report were extended to include the trustees' policies in relation to:

- financially material considerations;
- the extent (if at all) to which you take non-financial matters into account; and
- engagement activities and exercising rights.

### Report of exercise of rights, engagement and voting behaviour in past year and policy on asset managers

#### Comply for annual reports for scheme years ending on or after 1 October 2020

The annual report must also include your policy on asset managers. In addition, the requirements for the investment report to be included in your annual report will be extended to include:

- a statement setting out how, and the extent to which, in your opinion, your policy on the exercise of rights attaching to investments and engagement activities in relation to investments has been followed during the year; and
- a description of the voting behaviour by or on behalf of the trustees (including the most significant votes cast) during the year and stating any use of a proxy voter.

### Implementation statement: relevant schemes (including some DB schemes)

#### Comply for annual reports for scheme years ending on or after 1 October 2020

Where your scheme is a "relevant scheme" (please see the glossary), your annual report must include an implementation statement which:

- sets out how, and the extent to which, you consider that the SIP has been followed during the year;
- describes any review of the SIP undertaken during the year;
- explains any change to the SIP during the year and the reason for any change;
- where no review of the SIP was taken in the year, gives the date of the most recent review; and
- describes the voting behaviour by you, or on your behalf, during the year.

## PUBLICATION ON A WEBSITE

### Relevant schemes (including some DB schemes)

*Compliance required by: 1 October 2019 (SIP); implementation statement (1 October 2020)*

Trustees of a "relevant scheme" (please see the glossary) must make the following documents publicly available free of charge on a website:

- the latest SIP, with a link to this in the members' annual money purchase benefit statement (applicable from 1 October 2019); and
- the implementation statement, with a link to this in the members' annual money purchase benefit statement (applicable from 1 October 2020).

In relation to hybrid schemes offering both defined benefit (DB) and money purchase (non-AVC) benefits, the consultation response confirms that the requirement to publish the SIP applies in relation to both the DB and the money purchase benefits from 1 October 2019.

DB members who do not receive an annual money purchase benefit statement must nevertheless be notified that the SIP and implementation statement are publicly available on a website. The legislation does not specify a time period within which the notification must be sent, and trustees may find it convenient to notify members at the same time as issuing the annual funding statement or other regular member communication.

### Other DB schemes

*Comply by 1 October 2020 (SIP); 1 October 2021 (report on rights, engagement and voting)*

Trustees of defined benefit (DB) schemes which are not relevant schemes must make the following documents publicly available free of charge on a website:

- the latest SIP (applicable from 1 October 2020); and
- their report on the exercise of rights, engagement and voting behaviour (applicable from 1 October 2021).

## PUBLICATION TO MEMBERS

### Relevant schemes (including some DB schemes): additional requirements

*Compliance required for first annual benefit statement produced on or after 1 October 2019 (SIP) and 1 October 2020 (implementation statement)*

From 6 April 2018, trustees of relevant schemes have had to notify members in their annual benefit statement that the following information is available on a website:

- the default fund SIP and information about any review of the default SIP;
- information about charges and transaction costs during the year; and
- an illustration of the effect of charges.

The requirements to inform members of the availability of information have been extended, to include:

- the scheme's SIP (from 1 October 2019); and
- the implementation statement (from 1 October 2020).

The consultation response explains that the requirement to include links in members' annual benefit statements may be satisfied by including a single link to a location where the SIP, the implementation statement and the costs and charges information may be found.

## ACTIONS FOR TRUSTEES TO TAKE NOW

### Statement of Investment Principles (SIP)

You may already have updated your SIP to cover your policy on asset managers and to extend your policy on monitoring and engagement. If not, speak to your investment consultant to ensure you comply by 1 October 2020.

### Annual report

Remember to include the following in your annual reports for years ending on or after 1 October 2020:

- Your policy on asset managers;
- A statement on compliance with your policy on rights and engagement;
- A description of your voting behaviour (or voting on your behalf) during the year; and
- for relevant schemes (including some DB schemes): an "implementation statement" reporting on: compliance with the SIP; any review of the SIP; and your voting behaviour during the previous year.

### Publication of SIP and implementation statement

- Relevant schemes (including some DB schemes): publish your implementation statement when available on a publicly accessible website, and check that your administrator will include a link to the statement in members' annual benefit statements; and
- Other DB schemes: ensure you publish your SIP on a publicly accessible website by 1 October 2020.

## APPENDIX: SOURCES

### Competition and Markets Authority (CMA)

**CMA Order:** The Investment Consultancy and Fiduciary Management Market Investigation Order 2019 and Explanatory note, in force on 10 June 2019.

**CMA Report:** Investment Consultancy and Fiduciary Management Market Investigation Final Report, issued on 12 December 2018.

### Legislation

**Disclosure Regulations:** the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013/2734.

**Investment Regulations:** the Occupational Pension Schemes (Investment) Regulations 2005/3378.

**IORP II Regulations:** the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018/1103, in force on 13 January 2019. The IORP II Regulations transpose some requirements of the second European Directive on occupational pensions schemes ([IORP II](#)) into UK law.

**2018 Modification Regulations:** the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018/988.

**2019 Regulations:** the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019/982, issued to implement parts of the Shareholders' Rights Directive II which relate to the encouragement of long-term shareholder engagement by occupational pension schemes.

### Department for Work and Pensions (DWP)

**Clarifying and strengthening trustees' investment duties:** consultation response issued 11 September 2018, with the final 2018 Modification Regulations.

**IC and FM Requirements:** The draft Occupational Pension Schemes (Governance and Registration) (Amendment) Regulations 2019, issued for consultation on 29 July 2019.

**Investment innovation and future consolidation:** consultation issued on 5 February 2019.

### Pensions Regulator

**Investment consultancy / fiduciary management:** draft guides to deliver the CMA's recommendation to produce guidance to trustees of occupational pension schemes on engaging with investment consultants and fiduciary managers issued on 31 July 2019.

**Future of trusteeship and governance:** consultation issued on 2 July 2019.

**DB investment guidance:** updated guidance issued in September 2019.

**DC investment guidance:** updated guidance issued on 27 June 2019.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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