



Regulator ramps up “green” investment guidance for revised SIPs

Briefing

July 2019

Introduction

The Regulator has revised its guide to Investment Governance for DC schemes to reflect recent legislative changes requiring trustees of occupational pension schemes to set out their policies on environmental, social and governance (ESG) issues which may influence their investment decisions. The new guidance is long awaited and enables trustees to get to grips with their new disclosure obligations.

What’s the legal background to the disclosure changes?

Regulations¹ published in 2018 which come into force on October 1, 2019, make changes which govern the way occupational pension schemes prepare and revise their investment disclosure documents, including their Statement of Investment Principles (SIP) and introduce new requirements for an Implementation Statement to be prepared and made available.

In addition to the changes made under the 2018 Regulations, further Regulations² were necessary in 2019 as a result of the transposition into UK law on June 10, 2019 of the Shareholders’ Rights Directive II which encourages a longer-term focus on trustees’ investment strategies. The Directive urges both consideration of ESG factors and transparency on how trustees invest and engage as shareholders. This enhanced targeting of ESG factors and climate change closely aligns with the UK’s recent domestic agenda to improve the stewardship and governance of workplace pension schemes.

¹ The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 (the 2018 Regulations). The changes are implemented through amendments to the Occupational Pension Schemes (Investment) Regulations 2005 (the Investment Regulations) and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (the Disclosure Regulations)

² The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 (the 2019 Regulations)

The requirements under the 2018 Regulations were initially introduced for “relevant schemes” (that is, broadly DC schemes) but were extended to DB schemes under the 2019 Regulations.

What are the new disclosure requirements for the SIP?

From October 1, 2019, affected (principally DC) schemes must amend their SIP to include trustee policy on

- **The duty to take into account financially material considerations** – the current requirement is to take into account “environmental, social or ethical considerations” in the selection, retention and realisation of investments and will be replaced from October 1, 2019 with a wider reference to “financially material considerations over the appropriate time horizon”.

“Financially material considerations” encompass ESG issues, including climate change. The “appropriate time horizon” is the length of time that the trustees consider is needed for the funding of future benefits by the investments of the scheme.

- **Their stewardship obligations** – affected schemes must amend their SIP to reflect their policy on stewardship – that is, how rights relating to investments (including voting rights) are exercised.
- **The importance of non-financial matters** – affected pension schemes will have the option of including a reference in their SIP as to the extent (if at all) to which non-financial matters are considered in the selection, retention and realisation of investments.

Non-financial matters are “*the views of the 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 of the members and beneficiaries of the scheme*”. This has replaced the consultation proposal for the inclusion of a statement of members’ views.

What must be included in the Implementation Statement?

From October 1, 2020, for DC schemes with more than 100 members, the Implementation Statement must set out the following information³

- How, and the extent to which, in the opinion of the trustees, the SIP has been followed during the year.
- A description of any review of the SIP undertaken during the year (there is a legal requirement to review the SIP at least every three years and without delay after any significant change in investment policy). If a review has been done for any other reason that should be detailed.
- Where a review has been carried out, any change made to the SIP should be stated, giving the reason for the change.
- If no review has been carried out the date of the last review should be stated.

³ Schedule 3, paragraph 30(f), Disclosure Regulations

From October 1, 2020, for DC schemes with more than 100 members, the Implementation Statement must set out the following information⁴

- Confirmation of how, and the extent to which, in the opinion of the trustees, the policy (included in their SIP) on the exercise of the rights relating to the scheme's investments, and on undertaking engagement activities, has been followed during the year.
- A description of the voting behaviour by, or on behalf of, trustees (including the most significant votes cast by trustees or on their behalf) during the year and state any use of the services of a proxy voter during that year.

From October 1, 2021, trustees of DB schemes that are required to produce a SIP must also produce an annual Implementation Statement (that is available free of charge on a website) that contains the same information as required for DC schemes plus information relating to the capital structure of investee companies, and the management of actual or potential conflicts of interest on their part.⁵

A summary of the timeframe of the new requirements

The requirements for DC schemes are

- By October 1, 2019, publish the scheme's SIP on a publicly available free to access website.⁶
- By October 1, 2020, publish an Implementation Statement (a statement on the extent to which the SIP has been followed) on a publicly available free to access website.⁷

The requirements for DB schemes which are required to publish a SIP are

- By October 1, 2020, publish the scheme's SIP on a publicly available, free to access website.⁸
- By October 1, 2021, publish an Implementation Statement on
 - The extent to which the trustees' policy on the exercise of voting rights and stewardship (engagement and voting report) has been followed during the year.
 - Describing the voting behaviour by, or on behalf of, trustees (including the most significant votes cast during the year) and state any use of the services of a proxy voter during that year.⁹

⁴ Schedule 3, paragraph 30(ca), Disclosure Regulations

⁵ Regulation 29A(2B) and Schedule 3, paragraph 30(ca), Disclosure Regulations

⁶ Regulation 29A(2A)(a), Disclosure Regulations 2013, inserted by regulation 5(4)(b), 2018 Regulations

⁷ Regulation 29A(2A)(b), Disclosure Regulations 2013, inserted by regulation 5(4)(b), 2018 Regulations

⁸ Regulation 29A(2B)(a), Disclosure Regulations 2013, inserted by regulation 3(3)(b), 2019 Regulations

⁹ Regulation 29A(2B)(b), Disclosure Regulations 2013, inserted by regulation 3(3)(b), 2019 Regulations

The Regulator's updated guidance

The Regulator has updated its Investment Governance guidance for DC schemes to reflect the changes in legislation that we've outlined above. The revised guidance (which is described as one of six guides to be produced to support trustees in meeting the standards of the DC Code of Practice) provides further detail on what the Regulator expects trustees to be doing to fulfil their duties regarding stewardship and on the scope of financially material considerations.

The Regulator is keen to emphasise that trustees should not approach their disclosure obligations in a tick-box fashion, but should aim to produce for members an informative report.

The Guidance provides practical tips for trustees on how to formulate their policy on materially financial considerations. It highlights, for example, and how a relatively minor negative financial factor for the default fund may have an impact on a very high proportion of the scheme membership and may therefore be of material concern to the trustees.¹⁰

It also explains factors which may be considered non-financial and gives as an example members' potential ethical concerns about some individual investments held within the scheme's portfolio.¹¹

Stewardship in the context of a pension scheme is described as activities including monitoring assets and service providers and trustees are encouraged to become familiar with their managers' stewardship policies.¹²

The Implementation Statement is intended to illustrate to members how trustees have followed and acted upon the aims set out in their SIP, and should also detail any instances where decisions have diverted from those aims. Help is provided on what an Implementation Statement should cover, including: the relevance of investment beliefs underpinning voting and engagement policies; details of any sub-committees dedicated to the process; lessons learned in engaging with specific assets on specific issues; and the relative effectiveness of those actions in achieving their aims.¹³

What should trustees do next?

Some of the action points which trustees of affected schemes may wish to consider are set out below

- Use the Regulator's Guidance to help formulate policies on financially material and non-financial matters.
- Seek advice on how to formulate your policy on rights attaching to investments.
- Assess whether you are up to date in your investment skills training in accordance with the Regulator's expectations and address any gaps in knowledge.
- Check when the scheme's investment performance was last reviewed and ask questions of advisers, as suggested in the Guidance.
- Ensure that the scheme website is geared up to include the publication of the SIP and Implementation Statement by the required dates.

¹⁰ See pages 10-13 of the Guidance

¹¹ See pages 14-16 of the Guidance

¹² See pages 21-24 of the Guidance

¹³ See pages 30-31 of the Guidance

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