

September 2019

ESG, stewardship and transparency in pension scheme investing

The trustees of most UK pension schemes have a range of new compliance requirements to meet, affecting statements of investment principles (SIPs), arrangements with investment consultants and asset managers, the content of the scheme's annual report and the publication of implementation statements.

From 1 October 2019, the SIP must set out trustees' policies on taking financially material considerations (broadly, environmental, social and governance issues) into account in investment decisions, any policy on non-financial (e.g. ethical) considerations, and their policy on stewardship matters. From 1 October 2020, the content requirements will be extended to cover arrangements with asset managers and to widen certain definitions in the stewardship and engagement requirements.

In addition, schemes will be required to publish their SIP from October 2019 (DC) or October 2020 (DB schemes with 100 or more members) and to publish an implementation statement online by October 2020/2021 respectively.

Separately, trustees must ensure that they have set appropriate objectives for their investment consultants in line with rules set by the Competition and Markets Authority (by 10 December 2019) and/or forthcoming regulations (by 6 April 2020).

This guide provides an overview of the requirements and deadlines, together with a compliance checklist.

What content should your SIP include, and when?

Most UK pension schemes have reviewed and/or updated their SIP during 2019, to comply with updated requirements relating to environmental, social and governance issues, and stewardship matters. A further review will be required before 1 October 2020 to ensure that the SIP covers the trustees' arrangements with asset managers, including how those arrangements promote alignment with the scheme's investment strategy, and information about remuneration and monitoring of asset managers. The underlying trigger for these changes is the government's implementation of the revised Shareholder Rights Directive.

Before updating a SIP, trustees must:

- obtain and consider the written advice of a person who is reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of the investments of such schemes; and
- consult the employer.

Schemes should ensure that their business plan for 2020 allows sufficient time to review and update asset manager arrangements as appropriate, and to settle new content for the SIP. The table below summarises SIP content requirements and deadlines.

SIP content requirements and deadlines

	Content requirement	Deadline for inclusion
A	The trustees' policy for selection/retention of investments and ensuring continued suitability (based on proper advice, obtained in writing)	Already in place
B	The trustees' policies in relation to: <ul style="list-style-type: none"> i) the kinds of investments to be held; ii) the balance between different kinds of investments; iii) risks, including the ways in which risks are to be measured and managed; iv) the expected return on investments; v) the realisation of investments; vi) 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; and vii) the extent (if at all) to which non-financial matters are taken into account in the selection, retention and realisation of investments 	(i) to (v): already in place (vi) and (vii) must be included from 1 October 2019 (replacing the requirement to state the policy in relation to 'the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments'). See definitions section below
C	The trustees' policy in relation to: <ul style="list-style-type: none"> i) the exercise of the rights (including voting rights) attaching to the investments; and ii) undertaking engagement activities in respect of the investments (including the methods by which, and the circumstances under which, trustees would monitor and engage with relevant persons about relevant matters) 	Applies from 1 October 2019, but note that the definitions of relevant persons and relevant matters have been extended; the deadline for preparing policies covering the extended requirements is 1 October 2020. See definitions section below
D	The trustees' policy in relation to their arrangement with any asset manager, setting out the following matters or explaining the reasons why any of the following matters are not set out: <ul style="list-style-type: none"> i) how the arrangement incentivises the asset manager to align its investment strategy and decisions with the trustees' policies mentioned in B; ii) how the arrangement incentivises the asset manager to make decisions based on assessments about medium- to long-term financial and non-financial performance of an issuer of debt or equity and to engage with issuers of debt or equity in order to improve their performance in the medium to long term; iii) how the method (and time horizon) of the evaluation of the asset manager's performance and the remuneration for asset management services are in line with the trustees' policies mentioned in B; iv) how the trustees monitor portfolio turnover costs incurred by the asset manager, and how they define and monitor targeted portfolio turnover or turnover range; and v) the duration of the arrangement with the asset manager 	First policies must be in place from 1 October 2020 (but schemes can comply earlier if appropriate). See definitions section below

Additional requirements for default arrangements

Trustees of relevant DC schemes¹ must comply with additional requirements in relation to default arrangements. Note that the recently announced changes only affect schemes with 100 or more members.

Content requirement	Deadline for inclusion
1. Their aims and objectives in respect of such investments	Already in place
2. Their policies in relation to the matters mentioned in B AND if the scheme has 100 or more members, C and D above	B(i) to (v): already in place; B(vi) and (vii) must be included from 1 October 2019 (see above) Schemes with 100 or more members must include policies relating to C (stewardship and engagement issues) from 1 October 2019. By 1 October 2020, these policies must cover additional matters (see above) The first policies relating to D (asset manager arrangements) must be in place by 1 October 2020
3. An explanation of how aims and objectives (row 1) plus policies in row 2 ('the default strategy') are intended to ensure investment in best interests of members/beneficiaries	Already in place

Annual reports: new content requirements

The next annual report published on or after 1 October 2019 for a DB or DC scheme with 100+ members must include the trustees' policies on taking financially material considerations into account in investment decision-making, any policy on non-financial considerations, and their stewardship and engagement policies. For annual reports published on or after 1 October 2020, the annual report must include the policy in relation to arrangements with asset managers (and extended stewardship/engagement definitions).

For annual reports published on or after 1 October 2020, the following requirements also apply:

DB and DC schemes with 100+ members	The annual report must include a statement that: <ul style="list-style-type: none"> – sets out how, and the extent to which, the policy required under C above (engagement/stewardship issues) has been followed during the year – describes 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 states any use of the services of a proxy voter during that year
Relevant DC schemes ² with 100+ members	The statement in the annual report must also cover: <ul style="list-style-type: none"> – how, and the extent to which, the SIP has been followed during the year – any review of the SIP undertaken or changes made to the SIP during the year and the reason for any change, and the date of the previous review if there was no review during the year – the voting behaviour by, or on behalf of, trustees (including the most significant votes cast) during the year, and any use of the services of a proxy voter during that year

¹ 'Relevant DC schemes' means, broadly, DC schemes with more than 12 members but excluding AVC-only arrangements and public service schemes.

² DC schemes which are excluded from the definition of 'relevant DC schemes', such as AVC-only schemes, could fall within this category if they have more than 100 members.

Implementation statements

As well as publishing the information in the scheme accounts, schemes must make implementation statements available on a website.

- **DB schemes with more than 100 members** (and potentially some DC arrangements) must publish an implementation statement setting out the information summarised below, as per the most recent scheme accounts, by 1 October 2021.
- For most relevant DC schemes, the current implementation statement, published alongside the Chair’s statement for scheme years ending on/after 6 April 2018, must set out costs/charges information, an explanation of trustees’ assessment of value for members and an illustrative example of the cumulative effect of charges etc. For **relevant DC schemes with 100 or more members**, from 1 October 2020 the implementation statement must include the information summarised below, as per the most recent scheme accounts.³

Summary

	Schemes that are required to produce a SIP (except relevant DC schemes)	Relevant DC schemes that are required to produce a SIP
SIP content requirement	SIP must include policies covering matters in B(vi), B(vii) and C above by 1 October 2019; plus D (and extended elements of C) by 1 October 2020	SIP and default SIP must include matters in B(vi), B(vii) and C above by 1 October 2019; plus D (and extended elements of C) by 1 October 2020
SIP publication deadline	Publish the latest SIP on a website by 1 October 2020	Publish SIP and default SIP on a website by 1 October 2019
Implementation statement requirements	State how the policy on engagement/stewardship issues has been followed during the year; and describe voting behaviour by, or on behalf of, trustees (including proxy votes), as per the most recent scheme accounts Deadline: 1 October 2021	State how the SIP has been followed during the year and describe any review, reason for any changes etc; and describe voting behaviour by, or on behalf of, trustees (including proxy votes), as per the most recent scheme accounts Deadline: 1 October 2020 (but see footnote below)

³ Except that for information relating to voting behaviour/proxy votes and the extended definitions of ‘relevant persons’ and ‘relevant matters’ (see C in the first table above), the implementation statement deadline is 1 October 2021.

Objectives for investment consultants

In a separate development, trustees will be prohibited under rules made by the Competition and Markets Authority (CMA) with effect from 10 December 2019, from entering into a contract with an investment consultancy (IC) provider for IC services (or continuing to obtain these services) unless they have set strategic objectives for the provider. The CMA expects that the objectives will be closely linked to the scheme's investment objectives in most cases and should include a clear definition of the expected outcome and the timescale for delivery. There is a carve-out from the CMA rules for certain in-house providers of IC services; but there is no equivalent carve-out proposed in forthcoming regulations which are expected to replace the CMA rules from 6 April 2020.

The regulations are expected to include requirements to set objectives and to review the provider's performance against those objectives annually. Trustees should therefore review current arrangements with IC providers and ensure that their arrangements will be compliant by the date applicable to their scheme. The Pensions Regulator will produce guidance to assist trustees with this process.

Arrangements with asset managers

As set out in the table above, SIP requirements will be further extended from 1 October 2020 to include a statement of trustees' policy in relation to their arrangements with asset managers, setting out various matters or explaining why any of the specified matters are not set out.

The issues include how their arrangement incentivises the asset manager to: (a) align its investment strategy and decisions with the trustees' policy on various investment considerations (including risk/return and financially material factors); and (b) make decisions/engage with investee companies based on an assessment of their medium- to long-term performance. Other matters such as asset manager performance, remuneration, duration of appointment and monitoring of portfolio turnover costs are also included.

Relevant DC schemes (not AVC-only schemes) with 100 or more members will also need to comply with these requirements in relation to the SIP for default arrangement(s).

Increased disclosure by life insurers and asset managers

From 10 June 2019, life insurers and asset managers have been subject to new Financial Conduct Authority (FCA) rules requiring them to develop and publicly disclose an engagement policy that meets specific requirements, and then publicly 'comply or explain' on an annual basis. The engagement policy must cover:

- how shareholder engagement is integrated into the investment strategy;
- how voting and other rights are exercised; and
- how investee companies are monitored on issues including financial and non-financial performance and risk, and social and environmental impact and corporate governance.

In addition, life insurers are required to make disclosures about their arrangements with asset managers, and both life insurers and asset managers are required to make disclosures about how their strategies contribute to the medium- to long-term performance of the assets of the asset owner or fund. The matters that must be reported on include:

- key material medium- to long-term risks and portfolio composition;
- conflicts of interest in relation to engagement activities; and
- whether/how investment decisions are made based on the medium- to long-term performance of an investee company.

These new requirements should provide increased transparency for trustees in provider and asset manager selection processes and ongoing monitoring.

Definitions

Appropriate time horizon means the length of time that the trustees consider is needed for the funding of future benefits by the investments of the scheme

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

Non-financial matters means 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

Portfolio turnover costs means the costs incurred as a result of the buying, selling, lending or borrowing of investments

Relevant matters includes (but is not limited to) matters concerning an issuer of debt or equity, including their performance, strategy, capital structure, management of actual or potential conflicts of interest, risks, social and environmental impact and corporate governance*

Relevant persons includes (but is not limited to) an issuer of debt or equity, an investment manager, another stakeholder or another holder of debt or equity*

Stakeholder means a person or a group of persons who has an interest in the issuer of debt or equity

Targeted portfolio turnover means the frequency within which the assets of the scheme are expected to be bought or sold

Time horizon means the time period over which the trustees evaluate the performance of the asset manager

Turnover range means the minimum and maximum frequency within which the assets of the scheme are expected to be bought or sold

* The deadline for the SIP to include trustee policies relating to the underlined text is 1 October 2020.

Checklist of requirements

By/from date	Requirement	Applies to	Complete?
By 1 October 2019	SIP updated (ESG and stewardship/engagement content) Note: additional requirements apply in relation to default arrangements	All schemes required to produce a SIP	
By 1 October 2019	Publish SIP online	Relevant DC	
From 1 October 2019	Next annual report must include policies on ESG, stewardship and engagement	All schemes required to produce a SIP	
By 10 December 2019	Set strategic objectives for investment consultants (CMA rules – carve-out for in-house IC providers)	See CMA rules	
By 6 April 2020	Set objectives for investment consultants (DWP regulations – includes in-house IC providers)	See regulations	
Q4 2019 – Q3 2020	Review current arrangements with asset managers against future SIP content requirements and identify/close any gaps. Ensure processes are in place to meet future implementation statement requirements (e.g. relating to voting behaviour)	All schemes required to produce a SIP	
By 1 October 2020	Review and update SIP (asset manager arrangements and extended stewardship/engagement definitions); publish online Note: additional requirements apply in relation to DC default arrangements	All schemes required to produce a SIP	
From 1 October 2020	Next annual report must include policies on asset manager arrangements and extended stewardship/engagement definitions plus implementation statement (see below)	All schemes required to produce a SIP	
From 1 October 2020	Next implementation statement must state how SIP has been followed during year, including policy on stewardship/engagement and explanation of voting behaviour by/on behalf of trustees; publish online. Extended publication deadline for extensions to stewardship policy and for voting behaviour elements is 1 October 2021	Relevant DC	
By 1 October 2021	Implementation statement must set out how policy on stewardship/engagement has been followed during year and explanation of voting behaviour by/on behalf of trustees; publish online by 1 October 2021	Schemes that are required to produce a SIP but are not relevant DC	

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