Sackers

Finance & investment briefing

June 2024

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

Finance & investment briefing

June 2024

In this issue

Abbreviations

DB: Defined Benefit

DC: Defined Contribution

DWP: Department for Work and Pensions

ESG: Environmental, social and corporate governance

FCA: Financial Conduct Authority

F&I Strategy: Funding and investment strategy

FPC: Financial Policy Committee

IGC: Independent Governance Committee

LDI: Liability Driven Investment

LTAF: Long Term Asset Fund

OTC: Over the counter

PPF: Pension Protection Fund

PSA21: The Pension Schemes Act 2021

TPR: The Pensions Regulator

TSF: Taskforce on Social Factors

Electronic format

You can access electronic copies of all our publications at:

www.sackers.com/knowledge/publications

Sign up

Stay up to date with all the latest legal developments affecting pension and retirement savings by signing up to our free publications on www.sackers.com/knowledge/publications. These include 7 Days, our weekly round up, Alerts where topical issues in pensions are covered in depth and Briefings which summarise essential issues in pensions.

Finance & investment focus

"Welcome to our summer finance & investment briefing.

With a General Election looming, we are reflecting on the current trajectory of pensions policy. The current Government's Mansion House reforms' agenda pulls together a range of different aspirations. But even if there is a change at the top, many of these objectives are likely to remain on the agenda. This briefing summarises the current status of the key Mansion House investment themes: DB surplus assets, illiquid assets in DC and DC disclosure.

Of more immediate impact is the new trustee requirement to produce an F&I Strategy, which we also cover here. Underlying regulations are now in force, and these will impact triennial valuations with an effective date on or after 22 September 2024. Trustees will need to familiarise themselves with these new requirements, including a new DB funding code and revised covenant guidance. As we detail in this briefing, many of these supporting materials remain in consultation at the time of writing but, as ever, we will be actively monitoring these developments to keep you up to date."

Ralph McClelland
Partner

ralph.mcclelland@sackers.com

Environment

In line with our approach to corporate social responsibility (CSR), we monitor closely the number of copies printed of this publication. The paper and print manufacturing has been done in compliance with ISO14001 environmental management standards. Our paper, Revive 100% silk is derived from 100% pre and post-consumer waste, which is certified for FSC® chain of custody.

For more information on our CSR policy, please visit our website at www.sackers.com/about/csr

FSC www.fsc.org MIX Paper from responsible sources FSC® C105395

Productive finance – what's on the agenda for pension schemes?

"Productive finance" is a term that has become synonymous with the Chancellor's Mansion House speech in July 2023, and was perhaps little discussed outside the financial sphere before then. It is now a concept firmly on the Government's agenda, and it has featured considerably in the reforms, consultations and subsequent budgets that followed the Chancellor's speech. There is no legal definition to the term, but broadly it involves providing equity and funding to UK businesses in order to grow the economy.

> "...investment that expands productive capacity, furthers growth and can make an important contribution to the real economy.
>
> TPR (Private markets investment)

Mansion House reforms and more

The Mansion House speech led to a package of reforms focused on bolstering investment in the UK, with pension schemes playing a key role in achieving this aim. The reforms seek to "increase returns for pensioners, improve outcomes for investors and unlock capital for our growth businesses". The underlying question is how is more investment in productive finance going to materialise?

Eight pensions-related papers were published immediately following the speech with a strong emphasis on DC-related developments, together with some new proposals on the DB side. The Autumn Statement 2023 further built on the Mansion House reforms, announcing plans to "overhaul" the pensions landscape, with the aim of providing better outcomes for savers, driving a more consolidated market, and enabling pension funds to invest in a diverse portfolio (including productive finance). As part of these plans, the Government is exploring the use of surplus in DB schemes and whether there is a role for a public sector DB consolidator for schemes that are unattractive to commercial providers. Whilst it acknowledged the "lack of consensus" as to the path forward in the response to its 2023 call for evidence on such DB options, the Government has issued a further consultation to address these points in more detail (see below).

The Spring Budget 2024 also continued the productive finance theme, focusing on "boosting growth" and building further on the packages of reform already outlined in the Autumn Statement 2023.

Where are we now?

1

Surplus

On 23 February 2024, the DWP published a consultation seeking views on proposals to make it easier to make payments from DB scheme surplus to sponsors and scheme members, and a model for a public sector DB consolidator run by the PPF. The consultation put forward the possible introduction of a statutory override either allowing the refund of surplus to employers or providing a power to amend scheme rules to enable refunds of surplus.

The pensions landscape has changed significantly in the last decade or so, bringing us back to a position where more DB schemes now have permanent surpluses. The consultation discusses the treatment of surplus with the aim of removing both the practical barriers around surplus extraction in scheme rules and removing "behavioural barriers by bringing surplus extraction in line with trustees' duties". The hope is that these proposals will lead to more schemes investing in productive finance and for a longer time.

The consultation closed on 19 April 2024 and sits alongside the revised DB funding regulations which are intended to accommodate appropriate risk taking by DB schemes. No timing has been suggested for the reforms to the surplus framework and it will be interesting to see how, or if, the General Election affects the proposals. With Government policy very much looking to long term growth, changes have also been made to the new funding regime, with the aim of avoiding an overly risk-averse approach being taken by trustees. For further details please see our Alert.

Perhaps the bigger question is should DB schemes run on in order to create surplus or run off (buy-out)? Is buy-out still the ultimate intention? Any discussions about surplus will naturally lead to a closer examination of employer covenant strength, the long-term plan for the scheme, and the risks of moving to a buy-out versus the risks of running on. Of course, trustees' fiduciary duties should also be added to the mix, and whether the purpose of trustees' investment powers is to provide the benefits promised to members, or to invest for surplus for the possible benefit of the scheme's beneficiaries and/or employers.

2

Illiquidity

Another element of the Mansion House speech was the aim to increase investment in illiquid assets by DC pension schemes. The UK lags behind the global market, investing very little in illiquid assets. Recent developments, including the development of the LTAF, and the publication of various pieces of guidance from the Productive Finance Working Group, have sought to address the problem (see our Hot Topic). More recently, TPR published new guidance for occupational pension scheme trustees on investing in private markets with the intention to make illiquid investment more accessible to DC schemes.

At the time of the Chancellor's July 2023 speech, the Mansion House Compact was signed by nine of the UK's largest DC pension providers who voluntarily pledged to allocate 5% of assets in their default funds to unlisted equities by 2030. The Spring Budget 2023 built further upon the drive towards increasing the amount of investment by DC pension schemes in the UK, bringing forward the requirement for such schemes to disclose how much of their assets are invested in UK equity as compared to overseas businesses. Figures suggest that investment in UK equities across the pensions industry currently stands at around 6%. Improving data on UK equity holdings is intended to enable the Government to assess whether UK equity allocations are increasing and, if not, to "review what further action should be taken". Again, the intention is to enhance the Government's objective of increasing schemes' contributions to productive finance, improving outcomes for members through "value for money" requirements, and consolidating the pensions market. The Government also plans to continue building on the Mansion House reforms and establish vehicles to make it easier for pension funds to invest in UK growth assets.

3

Further investment disclosures for DC schemes

On 2 March 2024, the Chancellor announced additional pension fund reforms as a further step in the Government's push to boost British business. Under the plans:

- DC pension schemes across the market will need to disclose their levels of investment in British businesses, as well as their costs and net investment returns, by 2027
- pension schemes will be required to publicly compare their performance data against competitor schemes, including at least two schemes managing at least £10 billion in assets
- schemes performing poorly for savers won't be allowed to take on new business from employers, with TPR and the FCA having a full range of intervention powers.

The plans are subject to a future consultation by the FCA.

Where next?

Reform of the pensions market shows no sign of stopping, and there is likely to be much more to come this year and beyond. The upcoming General Election is highly anticipated and brings with it uncertainty as to what direction pensions reform might take next. Recent public statements by the Labour party have expressed interest in pursuing pensions reforms in the future should they be elected… we will wait and see!

Legal update

DB funding regulations

The PSA21 sets out the framework for a new requirement for DB schemes to have a funding and investment strategy ("F&I Strategy"), in which trustees will set out how they plan to reach low dependency funding by the time the scheme is significantly mature.

Following a consultation in 2022, the DWP published revised funding and investment regulations in January 2024, setting out the matters the trustees must take into account, and the principles they must follow, in determining or revising their scheme's F&I Strategy. The regulations also detail the supplementary issues that schemes will need to cover within the "statement of strategy".

The regulations are just one part of the funding package of reform:

- TPR's consultation on the **statement of strategy** closed recently. The statement will need to set out the F&I Strategy and certain "supplementary matters", including the trustees' assessment of the F&I Strategy, key implementation risks and mitigations, and information relating to investment, funding and covenant
- the **revised DB funding code** was consulted on in December 2022 and is expected to be laid in the summer, to be in force in September 2024. The code is designed to partner with the regulations, providing practical guidance on how trustees can comply with the requirements
- TPR's consultation on revised **covenant guidance** is expected in the summer 2024
- TPR's **Bespoke and Fast Track** regulatory approach was consulted on in December 2022 and we are awaiting TPR's response.

The regulations came into force on 6 April, however trustees will only be required to produce their first F&I Strategy within 15 months after the effective date of the first actuarial valuation **on or after 22 September 2024.**

Updates on TPR's progress in relation to the LDI crisis and financial stability

Increased resilience

On 27 March 2024, TPR published a letter dated 25 January 2024 updating the Bank of England's FPC on its progress and actions in relation to LDI and financial stability. TPR also published a press release welcoming a report by the FPC giving an update on the resilience of LDI funds following the volatility seen in September 2022. TPR's work to date includes publishing LDI guidance, increasing the number of its investment consultants and the recruitment of a senior economist to "better gather market intelligence". TPR considers that schemes are now more resilient to shocks.

Order to reduce tax charge on return of surplus published

Tax reduction

As announced in the Autumn Statement 2023, with effect from 6 April 2024, the tax due on an authorised surplus payment has been reduced from 35% to 25%.

Taskforce on Social Factors ("TSF") publishes guide

Following its 2023 consultation, the TSF has published its guide on incorporating social factors into trustee investment and stewardship decision-making. Accompanying publications are intended to "provide frameworks of good practice and allow for the assessment of materiality".

New guidance

These include:

- a "quick start" guide for pension trustees, to support trustees with activities to begin to identify and monitor social risks and opportunities of their scheme's investments
- case studies on considering social factors
- recommendations to improve the integration of social factors in pension scheme investment.

Sackers

Contact

Sackers is the UK's leading commercial law firm for pension scheme trustees, employers and providers. Over 70 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.

Paul Phillips
Partner
D +44 20 7615 9523
E paul.phillips@sackers.com

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

Ian Cormican
Partner
D +44 20 7615 9501
E ian.cormican@sackers.com

Key areas of expertise include: longevity transactions, funding negotiations, risk transfer transactions, LDI, fiduciary management and governance.

Stuart O'Brien
Partner
D +44 20 7615 9539
E stuart.obrien@sackers.com

Key areas of expertise include: risk transfer transactions, LDI, investment management agreements, ESG issues including fiduciary duties, policy, stewardship, climate change risk, responsible and impact investing.

Jacqui Reid
Partner
D +44 20 7615 9550
E jacqui.reid@sackers.com

Key areas of expertise include: DC investment strategy, regulation and industry best practice for IGCs and providers, member engagement and value for money.

Ralph McClelland
Partner
D +44 20 7615 9532
E ralph.mcclelland@sackers.com

Key areas of expertise include: risk transfer transactions including buy-ins and buy-outs, fiduciary management, custody arrangements, DB consolidators, asset transition, all types of pooled investment products and ESG.

Hugh Gittins
Senior counsel
D +44 20 7615 9549
E hugh.gittins@sackers.com

Key areas of expertise include: risk transfer transactions (acting for trustees, sponsors and insurers), LDI, fiduciary duties and corporate projects involving funding, investment and covenant support structures.

Polly Ehrman
Associate director
D +44 20 7615 9588
E polly.ehrman@sackers.com

Key areas of expertise include: risk transfer transactions, OTC derivatives, collateral and custody agreements, securities lending and repurchase agreements, funding and investing in alternative assets (including illiquid assets), and asset transition.

Lucy Swart-Mallett
Senior associate
D +44 20 7615 9040
E lucy.swart-mallett@sackers.com

Key areas of expertise include: ESG, including stewardship, climate change and fiduciary duty and risk transfer transactions, including buy-ins and buy-outs.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 20 7329 6699
E enquiries@sackers.com
www.sackers.com