Finance & investment briefing

December 2024

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

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Abbreviations

DB: Defined Benefit

DC: Defined Contribution

EEA: European Economic Area

ESG: Environmental, social and corporate governance

FCA: Financial Conduct Authority

FSCS: Financial Services Compensation Scheme

IGC: Independent Governance Committee

LDI: Liability Driven Investment

LGPS: Local Government Pension Scheme

OTC: Over the counter

PRA: The Prudential Regulation Authority

SPP: Society of Pension Professionals

SSPE: Securitisation special purpose entity

TPR: The Pensions Regulator

VFM: Value for Money

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Finance & investment focus

“Welcome to the final finance & investment briefing of 2024.

Somehow, we find ourselves already in November with the end of the year fast approaching. Over the last 12 months we have seen a change in direction with a new Government, and the recent Budget has pensions back in the frame with proposed changes to the inheritance tax treatment of “unused pension funds and death benefits”. Alongside this, we’re expecting further development and implementation of the Mansion House reforms, now set against a stronger policy stance on net zero and further evidence of the physical impacts of climate change becoming more severe.

In this briefing, we summarise the key provisions of the new UK Securitisation Regulations that applied from 1 November this year, explaining how these apply to occupational pension schemes and what differs from the EU legislation.

In the legal update section, we provide our usual update including a reminder on the FSCS protection of overseas members in risk transfer transactions.

In the meantime, we wish you all a restful holiday period and look forward to seeing you in 2025.”

Stuart O’Brien
Partner

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New UK securitisation rules

On 30 April 2024, the FCA and PRA published their new rules relating to UK securitisation. These, together with the new Securitisation Regulations 2024 (as amended), replaced the UK's on-shored version of the EU Securitisation Regulation (Regulation (EU) 2017/2402, as amended), from 1 November 2024. These final rules are part of the Government's "Smarter Regulatory Framework" initiative, whereby previously retained or assimilated EU law relating to financial services is replaced by rules set by the UK's financial regulators, the PRA and FCA.

The original securitisation rules and framework are predominantly being preserved with very few changes from the EU regulations that have been in place since 2019.

Background

The EU Securitisation Regulation originally applied to the UK as part of EU law, and came into effect on 1 January 2019. It is a comprehensive framework designed to regulate the securitisation market across the EU. Following Brexit, the EU Securitisation Regulations were on-shored and retained in UK law under the European Union (Withdrawal) Act 2018, making it part of the UK's domestic legislation (the "UK Securitisation Regulation"). The FCA and PRA oversaw compliance with the UK Securitisation Regulation, taking on the role previously played by EU bodies. The UK is in the process of modifying the rules to a model that better fits the UK market, and the FCA and PRA published their new rules in relation to the UK framework earlier this year.

The new rules

The new UK securitisation framework repealed and replaced the UK Securitisation Regulation on 1 November 2024 and comprises the Securitisation Regulations 2024 (as amended), rules contained in the FCA's rulebooks (see annexes to FCA's Policy Statement PS24/4) and rules contained in the PRA's rulebooks (see appendices to Policy Statement PS7/24).

The Securitisation Regulations 2024 include provisions which specify acting as an original lender, originator, sponsor or SSPE of a securitisation, or selling a securitisation position to a retail client in the UK, as designated activities under the new designated activities regime. This ensures that the FCA's rules will apply to unauthorised manufactures of securitisations.

New rules apply from 1 November 2024

Like the original EU securitisation regulation, the Securitisation Regulations 2024 include due diligence requirements for institutional investors, including occupational pension schemes. However, the Securitisation Regulations 2024 have been amended to make clear that TPR, rather than the FCA, will monitor and enforce the regulations so far as they relate to occupational pension schemes. Consequently, because the FCA and PRA rules will not apply to occupational pension schemes, the new regulations themselves set out the requirements for such schemes.

Not included in the new UK securitisation rules are EU non-legislative materials (guidelines etc) as they were not assimilated into UK law after Brexit. Nevertheless, both the FCA and PRA have confirmed that market participants may continue to refer to relevant pre-Brexit EU guidance to help interpret new UK securitisation rules, unless such guidance has been withdrawn or suspended.

New UK securitisation rules cont.

What is changing?

The original UK rules (as on-shored) are predominantly being preserved. The new rules contain some relatively small policy changes from the sell-side perspective that are not addressed in this article.

Provisions in the new regulations that apply specifically to institutional investors (including pension schemes) include:

Principles-based due diligence

- ✓ Due diligence for institutional investors: a more principles-based approach has been adopted for the disclosures institutional investors must obtain from securitisation manufacturers. UK institutional investors are now only required to obtain sufficient information to assess the legal structure and the risks of holding a securitisation position, regardless of the format of reporting. While disclosures must include certain types of information as outlined in the rules and be provided within specified timeframes, they are no longer required to be in a specific template. This change should facilitate easier investment by UK institutional investors in non-UK securitisations.

Clarification on delegation

- ✓ Delegation of due diligence: it has been clarified that UK institutional investors can delegate their due diligence obligations to another party. If the delegate is also a UK institutional investor, that party assumes responsibility for any compliance failures. If the delegate is not a UK institutional investor, the responsibility for compliance remains with the delegating investor.

A new clause 8A(2) to the Securitisation Regulations 2024 states that institutional investors "must not invest in a securitisation carried out by means of a securitisation special purpose entity that is established in a country or territory outside the United Kingdom" that is for the time being listed by the Financial Action Task Force as a high-risk jurisdiction subject to (a) a call on members to apply proportionate enhanced due diligence measures or (b) a call on members and other jurisdictions to apply countermeasures.

Those affected by the new UK securitisation regime are likely to appreciate the fact that the new regime is not that far removed from the previous one and not hugely different from the EU regulation. Those amendments that have been made will in parallel be welcomed by some – particularly the more principles-based approach to due diligence.

What next?

There are some changes that have not been addressed in the new rules. No distinction has been made between "private" and "public" securitisations or reporting requirements – the regulators have reserved this topic for future change, to be consulted on later in 2024 or 2025. FCA and PRA have acknowledged that other changes would be considered in future rounds of policy change. As these rules are now in the regulators' rulebooks, it should be easier for the changes to be made going forward.

Future consultations by the FCA and PRA are awaited, though it is likely that the UK regime will continue to diverge from the EU regime.

Legal update

Reminder on FSCS protection of overseas members in risk transfer transactions

The FSCS is a statutory compensation fund for customers of financial services firms authorised by the FCA or PRA. It may pay compensation to eligible customers of a financial services firm if that firm is unable, or likely to be unable, to pay claims against it. Generally, the FSCS applies to any "contracts of long-term insurance" which generally include bulk annuity (buy-in) policies held by trustees and individual annuity (buy-out) policies held by members. Should the insurer become insolvent or otherwise unable to meet its liabilities, pensioners drawing a pension would receive 100% of the retirement income the member was drawing as a benefit falling due (including pension increases). Any member not yet in receipt of a pension would have 100% of their insured pension protected.

FSCS protection may not necessarily apply to members who are resident outside the UK, the EEA, the Channel Islands or the Isle of Man. This is a technical area that has been subject to considerable discussion, further complicated by the impact of Brexit in recent years. However, it will generally be determined by the location in which the policy holder resides at the time the insurance contract commenced (either at buy-in stage, pre buy-out, or afterwards at the date the buy-in is converted to a buy-out) and the location of the insurer at that time (whether this is outside the UK or the EEA), as well as the particular terms of the buy-in/buy-out contract. There is therefore a risk that members living outside the UK, the EEA, the Channel Islands and the Isle of Man would not be covered and compensation from the FSCS would not be payable in the event of insurer failure.

To deal with this potential issue (and a possible lack of cover for overseas resident members following a scheme buy-out), an industry practice has emerged whereby trustees will take out the individual policies on buy-out and immediately assign them into individual members' names. This two stage buy-out process is thought to mitigate the problem since the policy-holder at the time of issue of the individual annuity policy will be the (UK resident) trustee and therefore ought to meet the FSCS eligibility requirements. This has, however, not been tested with the FSCS in circumstances of an actual insurer failure.

The Bank of England launched a consultation in April 2024 to address this concern by proposing amendments to the PRA handbook. In general terms, the amendments point to a member's place of residence at the time they joined the scheme as the determining factor to qualify for the FSCS. Subsequent feedback from the industry has voiced considerable concerns over this point, referencing that evidencing such residency may be very difficult if not impossible to prove and also seeking comfort that the well practiced method of assignment is blessed by the PRA. The consultation closed in May and we are awaiting a response from the Bank of England.

Further details of Government's pensions review published

On 16 August 2024, the Government published terms of reference for phase one of its pensions review to "boost investment, increase saver returns and tackle waste in the pensions system". The first phase of the review will focus on developing policy in four areas:

1. "driving scale and consolidation" of DC workplace schemes
2. "tackling fragmentation and inefficiency" in the LGPS through consolidation and improved governance
3. the "structure of the pensions ecosystem" and "achieving a greater focus on value" rather than cost, and
4. "encouraging further pension investment into UK assets to boost growth across the country".

The terms set out various factors that the review will have regard to, including implications for wider financial stability policy objectives (such as with respect to the gilt market), and the progress already made on in-train policy initiatives such as the VFM framework.

Subsequently, on 4 September 2024, the Government published a call for evidence inviting input to inform the first phase of the review. The call for evidence asks a range of questions relating to scale and consolidation, costs vs value and investing in the UK. It closed on 25 September 2024.

SPP issues paper on productive finance

The SPP has published a paper on "solving the UK investment puzzle", looking at the challenges in ensuring UK pension schemes invest more in the domestic market and how those challenges might be overcome. It discusses the different issues faced by DB and DC schemes and the LGPS. The paper is intended to feed into the Government's review of the UK pensions landscape.

TPR publishes speech on transparency in investment performance

On 11 September 2024, TPR published a speech on investment performance disclosure and improving outcomes for members. TPR is increasing its focus on investments, including through using greater numbers of investment consultants and changing its structure to be more market-facing and outcome-focused.

TPR believes that "sound investment in diverse assets can not only improve outcomes for savers but could also generate growth for the UK economy". However, for there to be "meaningful changes" in investment strategies, there needs to be greater transparency in the industry around performance and costs. The "first step" is to bring greater transparency on value through the forthcoming value for money framework which will require schemes to publish consistent, comparable metrics.

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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.

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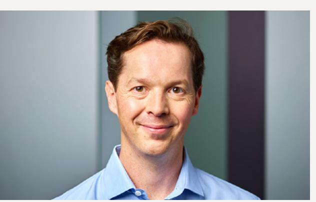

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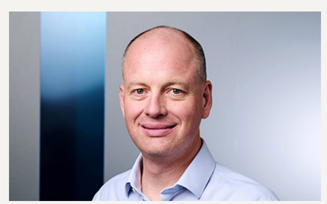

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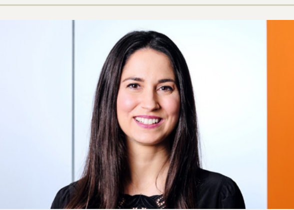

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