

The investment issues that pension trustees will need to think about, and have a policy on, are expanding. Here, we explain the new requirements. The deadlines for implementing the new requirements are set out in the table at the end of this communication.

Where the period for implementing the new requirements has been extended by transitional provisions for existing schemes, we have stated in this communication the extended period as being the effective date from which action must be taken.

Changes to the Statement of Investment Principles

There have been four significant changes to the contents of the Statement of Investment Principles (SIP), which broadly relate to (1) financially material considerations, (2) stewardship, (3) non-financial matters (including members' views on social impact investments) and (4) transparency of arrangements with investment managers.

From 1 October 2019:

- Trustees must state in their SIP their policy in relation to **financially material considerations**, including how those considerations are taken into account in the selection, retention and realisation of investments.

The definition of "financially material considerations" includes, but is not limited to, ESG considerations that the trustees of the scheme consider financially material. Trustees should remember that "environment" in ESG expressly includes climate change, but can also include other risks and opportunities such as air quality, water stress, soil and waste.

- Trustees must expand their policy in relation to **stewardship**. Trustees will be required to state in their SIP (1) their policy in relation to the exercise of the rights (including voting rights) attaching to the scheme's investments and (2) their policy in relation to undertaking engagement activities in respect of the scheme's investments (including the methods by which, and the circumstances under which, the trustees would monitor and engage with **relevant persons** about **relevant matters**).

"Relevant persons" include (but are not limited to) an issuer of debt or equity, an investment manager and (from 1 October 2020) another stakeholder or another holder of debt or equity.

"Relevant matters" include (but are not limited to) matters concerning an issuer of debt or equity, including their performance, strategy, risks, social and environmental impact, and corporate governance. From 1 October 2020, the definition also includes their capital structure and management of actual or potential conflicts of interest.

The new requirement clarifies that stewardship does not just relate to how votes are cast, but can include engaging with management of entities in which a fund is invested on matters such as strategy, performance, risk, capital structure and corporate governance.

- Trustees must state in their SIP their policy in relation to the extent (if at all) to which **non-financial matters** are taken into account in the selection, retention and realisation of investments.

"Non-financial matters" means the views of the members and beneficiaries of the scheme, 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.

There is no statutory requirement for trustees to ascertain and take account of members' views. If they do so (which is permitted), they must also have a policy on the extent to which they take account of members' views. Trustees should bear in mind that they should only take account of non-financial matters such as members' views where there is no risk of financial detriment to the scheme (even though this requirement has not been specified in statute).



From 1 October 2020:

- Trustees must state in their SIP their policy in relation to any **arrangements with asset managers** (not defined in the legislation). The policy must set out on a comply or explain basis:
 - How the arrangement incentivises the asset manager to align its investment strategy and decisions with the trustees' policies in the SIP
 - 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
 - How the method and time horizon of the evaluation of the asset manager's performance and related remuneration are in line with the trustees' policies in their SIP
 - How the trustees monitor portfolio turnover costs and how they define and monitor targeted portfolio turnover or turnover range
 - The duration of the arrangement with the asset manager

The above requirements flow from observations made in the Law Commission's report on pension funds and social investment¹. Very few SIPs currently contain this type of information or detail.

These changes to the SIP affect defined contribution (DC) schemes, defined benefit (DB) schemes and hybrid schemes.

Changes to a Scheme's Default Fund SIP

With certain exceptions, the changes to the scheme SIP also apply to the SIP that is required to be prepared in respect of a default fund of a scheme providing DC benefits (excluding those schemes where the only DC benefits are additional voluntary contributions [AVCs]). Further information is set out in the table at the end of this communication.

These changes to a scheme's default fund SIP affect DC schemes and hybrid schemes.

Implementation Reports

From 1 October 2020, a scheme providing DC benefits (excluding schemes with AVCs only) will be required to produce an implementation report, with trustees proactively considering and setting out how they have implemented the policies in their SIP. The report will also need to describe 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. This report is to be incorporated into the scheme's annual report and accounts.

From 1 October 2020, the trustees of a DB scheme will also be required to produce an implementation report (but in a shorter form) covering stewardship issues and describing 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. This report is to be incorporated into the annual report and accounts.

The requirements to produce an implementation report affect DC schemes, DB schemes and hybrid schemes.

Publication Requirements

SIP

From 1 October 2019, trustees of schemes providing DC benefits (excluding schemes with AVCs only) will be required to publish their SIP online in a freely available format. Note that where a scheme is a hybrid scheme providing both DB and DC benefits, the full SIP must be published, including the part relating to DB assets.

From 1 October 2020, trustees of pure DB schemes will also be required to publish their SIP online in a freely available format.

Implementation Report

From 1 October 2020, trustees of schemes providing DC benefits (excluding schemes with AVCs only) will be required to publish their implementation report online in a freely available format, although the part relating to voting behaviours does not need to be published until 1 October 2021.

From 1 October 2021, trustees of DB schemes will also be required to publish their (shorter form) implementation report online in a freely available format.

Benefit Statements

Annual DC benefits statements issued on or after 1 October 2019 should direct members to published documents.

These publication requirements affect DC schemes, DB schemes and hybrid schemes.

Recommended Actions

We set out some recommended actions in Part 2 of this communication, which can be accessed [here](#).

¹ See, for example, paragraph 6.30 of Law Commission report 374.

Deadlines for New Requirements

New Requirement	Schemes Affected	Effective Date (Taking Account of Any Transitional Provisions)
Policies relating to financially material considerations, non-financial matters and stewardship to be included in the SIP ² .	DB, DC, Hybrid, Default fund	1 October 2019
Schemes providing DC benefits (other than AVCs only) must publish their SIP online in a publicly available format.	DC, Hybrid	1 October 2019
Schemes providing DC benefits (other than AVCs only) must prepare and publish an implementation report and include it in the annual report.	DC, Hybrid	1 October 2020
Policy relating to arrangements with asset managers to be included in the SIP ³ .	DB, DC, Hybrid, Default fund	1 October 2020
The definitions of “relevant persons” and “relevant matters” are expanded. These terms are used in relation to the stewardship policy requirements for trustees.	DB, DC, Hybrid	1 October 2020 Information reflecting the expanded definitions does not need to be included in the implementation report published on a website until 1 October 2021.
Schemes providing pure DB benefits must publish their SIP online in a publicly available format.	DB	1 October 2020
DB trustees must produce and make publicly available on a website a mini implementation report (and include it in the annual report) on how their policy in the SIP in relation to exercise of voting rights has been followed. They must also describe in the implementation report 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.	DB	1 October 2020, although it does not need to be published on a website until 1 October 2021.
The implementation report for schemes providing DC benefits must include 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 a statement on any use of the services of a proxy voter during the year.	DC, Hybrid	1 October 2020, although this extended reporting requirement does not need to be published on a website until 1 October 2021.

If you wish to discuss any of the issues raised in this communication, please get in touch with your usual firm contact.

Contact



Clifford Sims

Partner, London

T +44 20 7655 1193

E clifford.sims@squirepb.com

² The stewardship requirements only apply in relation to a default fund SIP if the scheme has 100 or more members.

³ The requirements relating to asset managers only apply in relation to a default fund SIP if the scheme has 100 or more members.