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Dear Colleagues,

FOR YOUR CONSIDERATION: DWP RESPONSE TO QUESTIONS ABOUT THE NEW INVESTMENT REGULATIONS

DWP has responded to our questions about the new Investment Regulations.

The response is below.

Regards

John Mortimer
Secretary

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SPP QUESTIONS ON NEW INVESTMENT REQUIREMENTS

I need to caveat this response that DWP does not give legal advice or interpret its own legislation. The latter is a matter for the courts alone. It is for trustees to ensure that they comply with their legal duties, and should obtain their own legal advice on the requirements of S.I. 2019/982 ("the 2019 regulations) and S.I. 2018/988 ("the 2018 regulations").

Timing of the new implementation statement for relevant schemes

Q - The new 2018 investment regulations amend regulation 29A of the Disclosure regulations (SI 2013/2734) to require that for "relevant schemes" the specified information in paragraph 30(f) of Schedule 3 must be made publicly available on a website. This requirement is sometimes referred to as the implementation statement.

The amended regulations are ambiguous about how the requirements relating to the implementation statement come into force. Our understanding of the policy intent (see for example page 32 in last year's consultation is that they apply to the first annual report produced on or after 1 October 2020. Hence, for example, the first implementation statement for a scheme which reports on a calendar year basis would be expected to cover the year ending 31 December 2020 and be published online once the annual report is finalised (so no later than 31 July 2021). But it is possible to read the regulations so that an implementation statement must be published from 1 October 2020 regardless of the scheme's annual reporting cycle. We also note that the Shareholders' Rights Directive II fact sheet published on 11 September 2019 contains wording that also supports this alternative interpretation. However we understand that this is not the policy intention and therefore ask you to please confirm that the policy intention remains as stated last year? If that is the case, please also arrange for the fact sheet to be amended since having alternative interpretations in the public domain will lead to confusion.

Further, if our interpretation of the policy is correct, please could you also confirm that the pivotal date for determining when an annual report is "produced" is the scheme year end. Hence, the first schemes that need to prepare an implementation statement will be those "relevant" schemes with a 30 September 2020 year end.

1. The intention of the 2018 Regulations is that the requirement that the implementation statement information (except the information in relation to capital structure, management of actual and potential of conflicts of interest and another stakeholder in the stewardship policy and the information on asset managers ("the additional information")) is included in any annual report produced on 1 October 2020, which is the coming into force date, or after that date and published online once produced.
2. The policy intention is that the annual report is "produced" on the date it is signed, not the scheme end date. As trustees have 7 months to produce an annual report, a report produced on 1 October 2020 could have a scheme year end date not earlier than 1 March 2020.

3. As regards including the additional information in the annual report, it is the intention of the 2019 Regulations that schemes can include their first report against this additional information in an annual report which is produced no later than 1 October 2021 and publish that information online by that date.

Hybrid schemes

Q - The new 2018 investment regulations insert the required content of the implementation statement for relevant schemes as specified in paragraph 30(f) Schedule 3 of the Disclosure regulations. For schemes that are not relevant schemes less extensive content is specified in paragraph 30(ca) (as inserted by the new 2019 investment regulations).

The way that relevant scheme has been defined (within the Scheme Administration regulations as amended (SI 1996/1715)) may lead to perverse consequences. If the policy intention is for "DB" to be subject to more limited reporting than "DC" this may not be achieved. It seems odd for a scheme that provides mostly DB benefits but has, say, a very small number of members with non-AVC DC benefits to be subject to the same implementation statement requirements as a DC scheme (and different to a DB scheme without such benefits). But this is what the regulations appear to provide for. Can you confirm both that our reading is correct and that it is reflective of the policy intention?

On a related point, we note that the recent Shareholders' Rights Directive II fact sheet refers only to "DC Schemes" and "DB Schemes", which perpetuates the impression that there is a clear boundary between the two types of scheme. Please could future versions of this fact sheet and other documents reflect the reality that there are a significant number of hybrid schemes that provide both DB and DC benefits and that the technical dividing line is between schemes which are "relevant schemes" and those which are not.

4. Hybrid schemes (like 'pure' DC schemes) are covered by Schedule 3(30)(f) of the Disclosure Regulations. The decision not to modify the policy to limit the publication requirements to just the money purchase benefits offered by the scheme was made after formal consultation[1] – paragraphs 100 and 101 refer.
5. We will amend the factsheet to reference 'relevant schemes' and 'non-relevant schemes' as both terms are used in the legislation.

Exemption for wholly-insured schemes

Q - Regulation 8 of the Investment regulations (SI 2005/3378) contains a long-standing exemption for wholly-insured schemes from sub-paragraphs (b) and (c) of regulation 2(3) of these regulations. As you will know, sub-paragraph (b) requires that a Statement of Investment Principles (SIP) must state the

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739331/response-clarifying-and-strengthening-trustees-investment-duties.pdf

trustees' policies in relation to various investment matters and sub-paragraph (c) requires the trustees' policy regarding voting rights and engagement activities to be covered.

However, the new 2019 investment regulations add a new sub-paragraph (d) to regulation 2(3) requiring trustees to set out their policies in relation to their arrangement with any asset manager – including references to matters covered in sub-paragraph (b).

The problem is that regulation 8 has not been amended to extend the exemption for wholly-insured schemes to this new sub-paragraph (d). Consequently, as matters currently stand, the SIP for a wholly insured scheme will not need to include any information on the trustees' policies on matters such as choosing investments, the kinds of investments held and the exercise of voting rights. But it will need to include their policy in relation to asset managers (including a reference to policies in sub-paragraph (b)). Please confirm that this is an oversight in the latest amending regulations, and that regulation 8(1)(a) of the 2005 regulations will also be amended to extend the exemption to regulation 2(3)(d).

6. The intention is that wholly-insured schemes should be excluded from the requirement to produce the SIP policy on asset managers in sub-paragraph (d) of regulation 2(3) of the Investment Regulations, in addition to such schemes being excluded from the requirement to produce the SIP policies in sub-paragraphs (b) and (c) of regulation 2(3) of the Investment Regulations. We intend to amend the Investment Regulations accordingly in due course.
7. However any default arrangement of a wholly-insured scheme will be required to include the information in 2(3)(b) and, if that scheme has at least 100 members, 2(3)(c) and 2(3)(d) in the default SIP prepared under regulation 2A.

Wholly-insured schemes and the SIP for default arrangements

Q - We would also like to raise a further matter, indirectly related to the new 2019 investment regulations.

Regulation 8 of the Investment regulations (SI 2005/3378) only provides exemptions for wholly-insured schemes from regulation 2 but not regulation 2A – Additional requirements in relation to default arrangements.

Regulation 2A(1)(b) refers back to regulation 2(3)(b) and (c) and now also (d).

This default arrangement will be provided under a contract of insurance in the same way as the other funds and therefore the information in regulation 2A(1)(b) above is irrelevant. Whilst this has been a requirement since 2015, we believe it is an anomaly, as – by virtue of the exemptions in regulation 8 – DWP has previously acknowledged that, if there is no default arrangement, this information can be excluded for wholly-insured schemes. This anomaly has been made worse by the requirement under the new 2019 investment regulations to include further details.

We should be grateful if you would confirm that DWP's position remains that this information can be excluded for wholly-insured schemes and that the exemption in regulation 8 can be read as also applying to regulation 2A.

We look forward to your earliest reply given that some of these matters are pressing. We are happy to discuss further if that would be helpful.

8. Regulation 2A of the Investment Regulations applies to those wholly-insured schemes with a default arrangement. Trustees of wholly-insured schemes still have a fiduciary duty to their members. When they choose between providers of long-term contracts of insurance, they have the opportunity to set the terms of stewardship carried out on their behalf. Excluding such wholly-insured schemes would undermine the policy intent, which is to guide trustees who can carry out a stewardship role to state their policy on it.