The Trustee toolkit downloadable

An introduction to investment

Tutorial one: Investment in a pension scheme

By the end of this tutorial you will better understand:

- what a Statement of Investment Principles (SIP) is
- what should be included in the SIP
- how often the SIP should be reviewed

This tutorial is part of **Scenario one**.

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at **www.trusteetoolkit.com**

The Pensions Regulator

The importance of good investment

Good investment is a key element in any well-run pension scheme. Trustees are responsible for investment governance and are accountable for any investment decisions they take. They also have a duty to act in the best financial interests of beneficiaries.

Trustees of both DB and DC schemes should retain appropriately qualified investment advisers who can provide them with professional advice and assistance. Trustees should also ensure that they, or their advisers, have obtained sufficient information from their investment managers. Trustees need to be satisfied that they have demonstrated that they have understood the types and ranges of investments they are making and the implications of making that particular investment.

What do pension schemes typically invest in?

These are the basic forms of pension scheme investment.

Equities

Equities are shares in a company. Owning shares makes you a 'shareholder', a part owner of the company and you share in its profits.

Property

To invest in property you don't need to own a building. Instead you can buy units in a property fund.

Cash

Trustees can invest in cash funds which are invested in a range of liquid financial products.

Bonds and gilts

Buying bonds means lending money to a government (gilts) or a company (bonds).

You will find more detail on these in the Tutorial: 'Types of asset: Common assets.'

Hedging and derivatives

There are many different types of hedge fund and they aim to exploit anomalies and trends across the investment market. Derivatives include forward contracts, futures, options and swaps.

You will find more detail in the Tutorial: 'Types of asset: Alternative assets.'

How do trustees make investment decisions?

Trustees have a very wide power to invest scheme assets. Subject to any restrictions imposed by the scheme rules, trustees have the same power to make investments as if they were absolutely entitled to the assets of the scheme. There are five areas to consider.

- Statement of Investment Principles (SIP).
- The requirement for advice.
- Financial services requirements.
- Delegation to a sub-committee.
- Stewardship

We will now look at these five areas in turn before focusing on investment restrictions.

1. Statement of Investment Principles (SIP)

Under the Pensions Act 1995 (subject to a limited number of exceptions and modifications), schemes must draw up, maintain and review a written SIP. This sets out the trustees' investment objectives for the scheme and the investment principles governing how decisions about investments must be made.

What should the SIP include?

A SIP must be in writing and cover the trustees' policy on at least:

- securing compliance with the requirements of Section 36 of the Pensions Act 1995 around choosing investments. You will learn more about this later in this module
- the kinds of investments to be held
- the balance between different kinds of investment and investment funds
- risks, including ways in which risks are to be measured and managed
- the expected return on investments
- realisation of investments
- financially material considerations (which include environmental, social and governance considerations, including climate change) over the appropriate time horizon of the investments, including how those considerations are taken into account in the selection, retention and realisation of investments
- the extent (if at all) to the views of members and beneficiaries (including their ethical views, and views on social and environmental impact and present and future quality of life for members and beneficiaries) are taken into account in the selection, retention and realisation of investments

- the exercise of rights (including voting rights) attaching to investments, and undertaking certain engagement activities
- any arrangement with any asset manager (setting out a number of specified details / matters).

Implementation statement

Trustees must also include in their scheme's annual report an implementation statement setting out how, and the extent to which, policies in their SIP have been followed during the scheme year.

If you are a trustee of a scheme that provides money purchase benefits, the implementation statement must cover all policies in the SIP and other information about any changes to, or reviews of, the SIP.

For other schemes, the implementation statement only has to cover the trustees' policies on the exercise of rights (including voting rights) attaching to investments, and undertaking certain engagement activities.

The Law Commission 'Fiduciary duties of investment intermediaries' report

The Law Commission published their report in July 2014 (viewable at **http://bit.ly/FidDutiesReport**). The report concludes that trustees should take into account factors which are financially material to the performance of an investment. Where trustees think environmental, social or governance (ESG) issues are financially material they should take them into account.

However, whilst the pursuit of a financial return should be the predominant concern of pension trustees, the law is sufficiently flexible to allow other, subordinate, concerns to be taken into account. The Law Commission concludes that the law permits trustees to make investment decisions that are influenced by non-financial factors, provided that:

- they have a good reason to think that scheme members share the concern
- there is no risk of significant detriment to the fund

Financial Reporting Council codes

The Financial Reporting Council provides two codes that trustees may find useful. Sight of compliance with the 'UK Corporate Governance Code' may be one of the due diligence items trustees view when considering investing in a particular corporate.

The 'Stewardship Code' may help trustees consider their approach to corporate scrutiny. More information can be found at **https://www.frc.org.uk/investors/uk-stewardship-code**.

How often should the SIP be reviewed?

Trustees must review the SIP regularly, at least once every three years and without delay after any significant change in investment policy.

Who needs to be involved in preparing a SIP?

Before preparing or revising a SIP, trustees must obtain and consider written investment advice. They must also consult with the scheme's sponsoring employers, or where the scheme has more than one sponsoring employer, a person nominated by the employers to act as their representative.

Exemptions and modifications

In general schemes which have fewer than 100 members and are not being used for automatic enrolment, or schemes established under an enactment and are guaranteed by a public authority, are not required to prepare a SIP.

However, the trustees of schemes that offer a default arrangement subject to the Occupational Pension Schemes (Investment) Regulations 2005, because they are qualifying schemes for automatic enrolment purposes, must produce a SIP for this arrangement, even where there are fewer than 100 members.

For wholly insured schemes, the SIP requirements are modified so that they only have to record the trustees' policy for securing compliance with section 36 of the Pensions Act 1995 around choosing investments and the reasons for the scheme being a wholly insured scheme.

2. Requirement for advice

Before making any investments, trustees must obtain and consider 'proper advice'. This is essentially:

- advice made or confirmed in writing by (in most cases) a person authorised to carry on investment business in the UK (or exempt from authorisation requirements) or, in other cases,
- from someone who the trustees believe has appropriate knowledge and experience of the management of investments

3. Financial services requirements

Under the Financial Services and Markets Act 2000, trustees are deemed to carry on investment business. However, they are not required to be authorised to do so as long as they delegate all their day-to-day investment decisions to a person who is authorised under financial services legislation.

In addition, under the Pensions Act 1995, decisions must be delegated to an authorised person or to an unauthorised person where the decisions do not involve day to day investment business.

These restrictions mean in practice that trustees must appoint an investment manager and delegate day to day investment decisions to them (or invest in insurance policies or pooled funds). Trustees can take strategic investment decisions or delegate strategic decisions to an unauthorised person, for example an investment sub-committee of the main trustee board.

4. Delegation to a sub-committee

Trustees can delegate strategic investment decisions to an investment sub-committee or to a fund or investment manager.

An investment sub-committee is usually responsible for tasks such as monitoring the fund investment performance and making recommendations to the trustee board. However, it's the board as a whole that remains responsible for the decisions made by the investment sub-committee.

Even if you are not a member of your scheme's investment sub-committee, you still need to have an understanding of investment matters and how they relate to your own scheme. You need to know enough to be able to challenge your sub-committee and/or your investment advisers and show that you have understood the types and ranges of investments the scheme is making.

5. Stewardship

Stewardship is defined in the Financial Reporting Council's Stewardship Code as the responsible allocation, management and oversight of capital to create long-term value for investors and sustainable benefits for the economy, the envrionment and society.

Stewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities. It is up to the trustees to exercice stewardship and ensure, as far as they are able, that this is done through the whole length of the investment chain. This is particularly relevant for the management of macro-economic, systemic risks such as climate change, which cannot be sufficiently hedged through portfolio construction and asset allocation alone.

For many pension schemes, stewardship activities, including engagement, are likely to be undertaken by the investment manager on the trustee board's behalf. This especially applies where investments are made via pooled funds.

We would encourage you to become familar with your managers' stewardship policies. Where you consider it appropriate, seek to influence them, and use stewardship as a criterion when shortlisting and selecting managers. For wholly insured schemes, it is unlikely to be possible to enagage directly with your provider's fund managers, but you should ask your provider for information about the fund manager's stewardhsip policies.

Stewardship also includes the exercising of rights attaching to investments, such as the voting rights attaching to shares. Where practicable, you may wish to agree specific voting criteria when selecting investment managers or consider potential managers' willingness to abide by your preferred voting criteria when selecting investment managers.

DB and DC schemes with 100 or more members are required to include in their SIP details of the trustees' policy in relation to the exercise of rights (including voting rights) attaching to investments, and undertaking certain engagement activities.

While there is no requirement for schemes with fewer than 100 members to have a policy on stewardship, and smaller schemes will have more limited influence over firms in whom they invest, you should be mindful of your duty to act in the best financial interests of members and beneficiaries.

A stewardship policy for a smaller scheme might set out:

- its policy for the appointment, monitoring and where necessary switching of investment managers
- how the trustees will monitor and publicise how:
  - their scheme's investment policies, for example in relation to ESG and climate change; and
  - member preferences;

  and reflected in the voting behaviours of their investment managers.

In relation to climate change, stewardship can form an effective part of trustees' risk management activities and can help to reduce the impact of climate change on scheme investments. Trustees of schemes in scope of the Occupational Pensions Schemes (Climate Change Governance and Reporting) Regulations 2021, should include information in their scheme's TCFD report on how, if at all, they have used stewardship to help manage climate-related risks to the scheme.

Useful links

DC schemes
https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/investment-guide-for-dc-pension-schemes-

DB schemes
https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/db-investment/db-investment-governance#4615aa729c5443cf9c7766be3a8b2445

Financial Reporting Council - UK Stewardship Code
https://www.frc.org.uk/getattchment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf