ALLEN & OVERY

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The implementation statement: how to prepare for it

Trustee disclosure requirements on investment governance issues, stewardship and engagement are evolving rapidly. We expect additional requirements and guidance to emerge over the next few months in relation to environmental, social and governance issues – and in relation to climate change in particular.

However, the new disclosure requirements that apply from 1 October 2020 will affect some trustees within just a few months, so it's time to start preparing.

Overview of the key requirements

The headline requirements are:

- Trustees of most schemes with 100 or more members must include an implementation statement when they publish the scheme's annual report in the 12-month period starting on 1 October 2020.
- The implementation statement requirements differ between DC/hybrid schemes and pure DB schemes, but the statement must set out information about how the trustees have put their statement of investment principles (SIP) into practice, particularly in relation to stewardship and engagement.
- Trustees must also publish the implementation statement online and tell members about its availability.

The implementation statement is different from other forms of reporting that are required from trustees, in that it seeks qualitative narrative. Trustees are required to 'set out their opinion' on how their policy/the SIP has been followed; to 'describe' voting behaviour; and (in the case of 'relevant schemes' (see below)) to 'explain' any change to the SIP and the reason for it. The statement will vary from scheme to scheme and from year to year.

The government's intention is that 'requiring trustees to report on how they have followed their investment principles will ensure that the text [of the SIP] reflects what pension schemes aim to do, and that schemes act on the principles they set out'. The aim is to enable interested parties (members, campaign groups and others) to 'scrutinise and compare across the market. Trustees will be able to share best practice, and members and others will be more able to question poor policies or implementation.'[1]

Just as all SIPs are scheme-specific, all implementation statements will differ – so to help you get started, this guide sets out a list of questions to consider as you develop your first statement. This should also help you identify where there may be gaps in the information you receive (for example on voting and engagement activities) and discuss with your investment consultants and managers what you need them to provide. The content requirements are set out on page 5.

[1] Consultation response 'Clarifying and strengthening trustees' investment duties', September 2018.

What information is required?

Trustees of all schemes that are required to produce a SIP (that is, most DB, DC or hybrid schemes with 100+ members) must report on their stewardship and engagement activities, including voting behaviour, in the annual report. However, for 'relevant schemes' this is just one element of the implementation statement requirements. The implementation statement for relevant schemes must cover the SIP as a whole, including stewardship/engagement and voting, but also any other matters covered in the SIP. The key question is: what is a relevant scheme?

The key definition: what is a relevant scheme?

A 'relevant scheme' is, broadly, an occupational pension scheme with more than 12 members that provides money purchase benefits, but it excludes AVC-only arrangements, executive pension schemes and certain public service schemes.

Important note: this definition applies at scheme level – so a DB arrangement with 100+ members that provides AVC benefits is <u>not</u> a relevant scheme, but a scheme with 100+ members that comprises a DB arrangement, an AVC facility and also has one or more members with (non-AVC) DC benefits <u>is</u> a relevant scheme and must comply with the extended content requirements accordingly.

The differing content requirements for relevant and non-relevant schemes are summarised below.

Relevant schemes with 100+ members: a 'whole SIP' implementation statement

DB or DB+AVC schemes with 100+ members: an 'engagement policy' implementation statement

The statement must set out how, and the extent to which, in the opinion of the trustees

the SIP (including the policy on voting and engagement)

their policy on the exercise of rights (including voting rights) attaching to investments, and engagement activities

has been followed during the year, and also:

has been followed during the year, and also:

- Describe any review of the SIP and how it has been met.
- Explain any changes to the SIP during the year and the reason for them.
- If there has been no formal SIP review in-year, give the date of the last review.

Describe the voting behaviour by, or on behalf of, the trustees (including the most significant votes cast) during the year and state any use of the services of a proxy voter during that year.

When do these requirements take effect?

From 1 October 2020, the next scheme annual report to be published must include the implementation statement required by the regulations. That statement must be published at the same time as, or after, the annual report (the final deadline for publication is 30 September 2021). Generally speaking, most schemes will only produce one annual report during the 12 months to 1 October 2021, so even if the annual report is published shortly after 1 October 2020, the implementation statement within that report must include all the relevant information. For example, the trustees of a relevant scheme with a year end in June 2020 will have to ensure that the SIP is updated by 1 October 2020 and should draft an implementation statement for publication in the accounts by the end of January 2021, since they will not be publishing the scheme's next report (including the implementation statement) until after 1 October 2021.

The SIP of any relevant scheme is likely to need to be updated by 1 October 2020 to comply with the new requirements to provide details of the scheme's arrangements with asset managers (there are also extensions to the stewardship and engagement requirements that apply to all schemes). The narrative content of the implementation statement this year is likely to reflect the transitional stages in which these changes are being made, but trustees must comply with the requirement to state how they have followed the SIP during the applicable scheme year, and may wish to mention subsequent changes.

Points to consider before you get started:

TPR's guidance states that:

> 'The purpose of the report is to help ensure that 'action follows intent' as far as possible. The process of having to consider the content of the report will help to focus trustees' minds on how well their investment policies and stewardship arrangements are delivering against their scheme's agreed investment principles.'

– As a starting point, review the SIP and ensure that it is an accurate reflection of your intentions – for example, if it says that voting policies of asset managers or member retirement practices are reviewed 'regularly', what does that mean? If they are reviewed annually, does that happen in practice? The implementation statement will have to set out whether or not you have carried out the review in the relevant year, how you did it and what you found – so it's worth ensuring that commitments in the SIP to review/monitor particular issues reflect your intentions and practice and are also built into your business plan.
– How lengthy/detailed should the statement be? Part of the intention is to help members understand why decisions are being made in the way that they are, and too much detail is likely to be off-putting. The statement originates in the annual report and needs to be proportionate in length in that context. Relevant schemes will publish some of the same information as part of their charges and governance statement (in relation to the default arrangement); we would expect the narrative of the implementation statement to be longer than that of the charges and governance statement (ignoring the illustrative example of costs and charges) because more content is required.
– TPR suggests that the process of trustee review is an important element of the requirement, so we believe that there should be a degree of flexibility to provide summarised explanations in the published statement, provided that trustees have evidence that they have considered matters fully, should TPR wish to dig deeper. However, this needs to be balanced against TPR's comment that the statement should not be a 'tick box' exercise and should include 'relevant useful information' for members.

Setting a framework: questions to help you with your first draft

As the statement is intended to be scheme-specific, it is not possible to provide a rigid model to follow. Here's our suggested approach to producing the first draft (this may evolve over time and/or in line with further TPR commentary):

Suggested content	Relevant schemes	Other schemes
Some members will read the implementation statement as a stand-alone document – do you need to provide contextual information, e.g. about governance structures, as part of showing how you implement the relevant SIP policies?	Possible	Possible
Pick out all the actions set out in the SIP to which timeframes are attached (e.g. commitments to review mandates/monitor providers/gather members' views). Have you done what you said you would? If not, why not?	Y	Relates to voting/ engagement policy only
Look at the investment objectives set out in the SIP. Have they been met? If not, what did/will you do as a result?	Y	N
Has there been a review during the year of the SIP or of investment activity against the SIP? This might be the regular formal review or a more informal assessment. Describe that review. If there has been no such review, give the date of the last review.	Y	N
You need to explain not only 'how' the SIP was followed but also the 'extent' to which it was followed and its objectives were achieved. If your investment decisions have deviated from policy during the year, what was the reason, and what do you intend to do to address this?	Y	Relates to voting/ engagement policy only
Have any changes been made to the SIP during the year? Explain the changes and the reason for them.	Y	N
Have there been any specific events during the year that would be relevant useful information for members? For example, you might describe the selection process and the criteria used to select a new investment manager (showing how the trustees' policy influenced that decision).	Y	Relates to voting/ engagement policy only
If voting is delegated to investment managers, is this in line with each manager's 'house' policy or on a scheme-specific basis? If the former, how is it monitored? Talk to your managers about obtaining quantitative information such as the number of opportunities the scheme had to vote, how many times the scheme voted and high level information on the voting approach.	Y	Y
The regulations don't prescribe how to identify 'significant votes' for reporting – this could refer to a significant shareholding, or issues that are significant to the issuer or the scheme because of the subject-matter. Investment managers may be able to assist with the identification of key votes, or you could look at the issues identified in the PLSA Stewardship Guide and Voting Guidelines.	Y	Y
Proxy voting services – you must state any use of these services during the year.	Y	Y

Content requirements

Relevant schemes with 100+ members	'Pure DB' schemes with 100+ members
'Whole SIP' implementation statement	**'Engagement policy' implementation statement**
The statement must: (i) set out how, and the extent to which, in the opinion of the trustees, the statement of investment principles has been followed during the year,[2] (ii) describe any review of the statement of investment principles undertaken during the year in accordance with regulation 2(1) of the Investment Regulations[3] and any other review of how the statement of investment principles has been met, (iii) explain any change made to the statement of investment principles during the year and the reason for the change, (iv) where no such review was undertaken during the year in accordance with regulation 2(1) of the Investment Regulations, give the date of the last review; and (v) 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.	The statement must: (i) set out how, and the extent to which, in the opinion of the trustees, [their policy in relation to: – the exercise of the rights (including voting rights) attaching to the investments; and – undertaking engagement activities in respect of the investments (including the methods by which, and the circumstances under which, trustees would monitor and engage with relevant persons about relevant matters)] has been followed during the year, and (ii) 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.

Final points

The Regulator's guidance includes a number of suggestions for other material that could be included: for example, how the trustees' policies were developed, the time and resource dedicated to voting and engagement, and whether the trustees have signed up to or participate in any wider initiatives. This is similar to some of the issues covered in Stewardship Code compliance statements; it is voluntary in this context. TPR has also suggested including 'lessons learned' content about specific assets/issues, presumably to document trustees' evolving approach and focus on investment issues. Again, this is voluntary and we expect that scheme approaches may evolve over time.

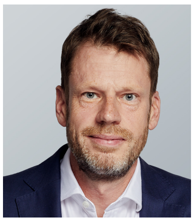
The implementation statement must be made publicly available free of charge on a website and must be accessible, searchable and downloadable. Relevant schemes must give details of the web address to members in the annual benefit statement in the same way as for the charges and governance statement. Other schemes must provide a notification about the provision of new information on a website in the normal way.

Unlike the Chair's Statement penalty regime, penalties for breach of the implementation statement requirements are not mandatory. However, just as disclosure of SIPs has enabled public comparison and commentary, the same is likely to be true of the content of implementation statements in due course.

[2] This refers to the SIP as a whole, i.e. including, but not limited to, the policy on voting and engagement as described in the right hand column paragraph (i).
[3] This is the formal SIP review that must take place at least every three years and without delay after any significant change in investment policy.

Contacts

For more information, contact one of our experts



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