simply pensions
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Pensions Act 2004

investment, and borrowing and guarantees – update

Here we give further information for trustees of money purchase pension schemes about changes to investment, and borrowing and guarantees provisions which have been brought into force.

Background

In our May 2005 factsheet, investment, and borrowing and guarantees, we told you about changes that the Government intended to introduce under the Pensions Act 2004. We expected that the changes would become effective from 22 September 2005.

The Government has now published the final regulations dealing with the changes to investment, and borrowing and guarantees. This factsheet provides details of these final regulations.

Effective date of changes

The changes came into force on 30 December 2005.

Exemptions

In general, the requirements apply to occupational pension schemes. However, there are exemptions from most of the requirements for schemes with fewer than 100 members; and there are some reduced requirements for wholly insured schemes which have at least 100 members.

In particular, in our May 2005 factsheet we explained that the draft proposals issued by the Government would have resulted in many insured schemes losing their exemption from some of the investment rules unless a rule change was made to meet the new requirements. The Government did not carry those proposals through into the final regulations.

The sections below explain the exemptions that apply to each requirement.

Investment rules

The regulations set out the requirements that trustees of non-exempt schemes must meet in relation to the investment of scheme assets.

Exemptions from investment rules

Schemes with fewer than 100 members are exempt from the investment rules set out below, though they or their delegated fund managers must, when exercising their investment powers or discretions, have regard to the need for appropriate diversification of investments. (And trustees of pension schemes are always bound by trust law to act in the best interests of the scheme's members and beneficiaries and must also operate within the provisions of the scheme's governing documents.)

Requirements

Unless your scheme is exempt, you, or your delegated fund manager, must:

- invest scheme assets in the best interests of the members and beneficiaries. If there is a potential conflict of interest then the assets must be invested in the sole interest of the members and beneficiaries;
- exercise investment powers and discretions in such a way that ensures the security, quality, liquidity and profitability of the investment portfolio as a whole; but if the scheme is winding up this requirement need only be met to the extent that there is no conflict with Pensions Act requirements for winding up and as long as it is reasonably practical having regard to the winding-up circumstances;
- invest scheme assets predominantly on regulated markets (for this purpose, insurance policies are regarded as investments on regulated markets), keeping any other investments to prudent levels; but if the scheme is winding up this requirement need only be met to the extent that there is no conflict with Pensions Act requirements for winding up and as long as it is reasonably practical having regard to the winding-up circumstances;
- ensure scheme assets are properly diversified;
- invest in derivatives only if such investment contributes to a reduction in risks or to facilitate efficient portfolio management

As now, you will have to obtain 'proper advice' before investing (taking into account the new requirements).

Penalties for non-compliance

The Pensions Regulator can fine trustees who are legally required to comply with the investment rules but who fail to do so. This can be up to £5,000 for an individual, and up to £50,000 for a corporate trustee.

Statement of investment principles

Since 6 April 1997, trustees of certain money purchase occupational pension schemes have had to prepare and maintain a statement of investment principles, setting out in writing the principles that govern decisions about scheme investments. The new regulations make some changes to the requirements relating to statements of investment principles.

Exemptions from the requirement to prepare a statement of investment principles

Previous regulations

Under the previous regulations, there were exemptions from the requirement to prepare a statement of investment principles for:

- certain schemes with fewer than 12 members, and
- wholly insured schemes under which the trustees had no discretion as to how any of the scheme monies held by the insurance company (except monies related to voluntary contributions) were invested, nor any discretion as to whether any assets purchased with such monies are retained or disposed of by the insurance company

New regulations

Under the new regulations, schemes with fewer than 100 members do not have to prepare a statement of investment principles and there are reduced requirements for wholly insured schemes that have 100 members or more.

If you currently have to prepare a statement of investment principles and your scheme has fewer than 100 members, you will no longer have to meet this requirement.

However, if your scheme is wholly insured and has 100 members or more, you may previously have been exempt from the requirement to produce a statement of investment principles, but under the new regulations you will have to produce a simplified version.

Content of the statement of investment principles

The statement of investment principles has to be in writing and, as a minimum, cover the following:

- your policy for ensuring compliance with the requirements of rules relating to choosing investments
- except for wholly insured schemes, your policies on the following:
  - kinds of investments to be held
  - balance between types of investments
  - risks, including their measurement and management
  - expected return on investments
  - realisation of investments
  - the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments
- except for wholly insured schemes, your policy (if any) in relation to the exercise of rights (including voting rights) attaching to the investment
- for wholly insured schemes only, the reasons for the scheme being wholly insured

Actions to be taken before preparation/review of the statement of investment principles

Before preparing or revising the statement of investment principles, you must:

- obtain and consider the written advice of a suitably qualified person, and
- consult the employer

If your scheme has more than one participating employer, those employers can nominate a single nominee to act on their behalf, or they can tell you that you do not need to consult them at all. If neither of these apply, you will have to consult every participating employer.

Reviewing the statement of investment principles

The statement of investment principles must be reviewed, and if necessary amended, at least every three years and immediately after any significant change in investment policy.

Penalties for non-compliance

The Pensions Regulator can fine trustees who are legally required to prepare and maintain a statement of investment principles but who fail to do so. This can be up to £5,000 for an individual, and up to £50,000 for a corporate trustee.

New prohibition on borrowing and guarantees

Exemptions from the prohibition on borrowing and guarantees

Schemes with fewer than 100 members are exempt from the new prohibition on borrowing and guarantees.

Certain pre-existing employer-related loans, which might otherwise be caught by this new requirement, may be able to continue for a time under transitional provisions.

Requirements

Unless your scheme is exempt, you, or your delegated fund manager, will not be able to:

- borrow money, other than on a temporary basis for the purpose of providing liquidity, where the borrowing is liable to be repaid out of the scheme's assets, or
- act as a guarantor, where the liability under the guarantee is liable to be satisfied out of the scheme's assets

Employer-related investment rules

The regulations include some changes affecting employer-related investments.

These are more likely to affect small self-administered schemes. However, if you think your scheme will be affected by changes to the employer-related investment rules (for example, if your scheme is a small self-administered scheme), you should consult your financial adviser about these changes.

Schemes undertaking cross-border activities – dis-application of exemptions

UK occupational pension schemes that accept contributions from employers based in other parts of the European Union are carrying on 'cross-border activities'. These schemes do not benefit from the exemptions set out in this note which apply to UK occupational pension schemes that only take contributions from UK-based employers.

Action

You will need to determine if the new investment or borrowing rules apply to your scheme, and decide what action, if any, you need to take in order to comply with them. If your scheme has employer-related investments, you should consult your financial adviser to find out whether the changes to these types of investments have an impact on your scheme.

This note is based on Scottish Equitable's understanding of the legislation and regulations as at 31 December 2005. However, whilst every effort has been made to ensure its accuracy, Scottish Equitable cannot accept any legal responsibility for the information provided.

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