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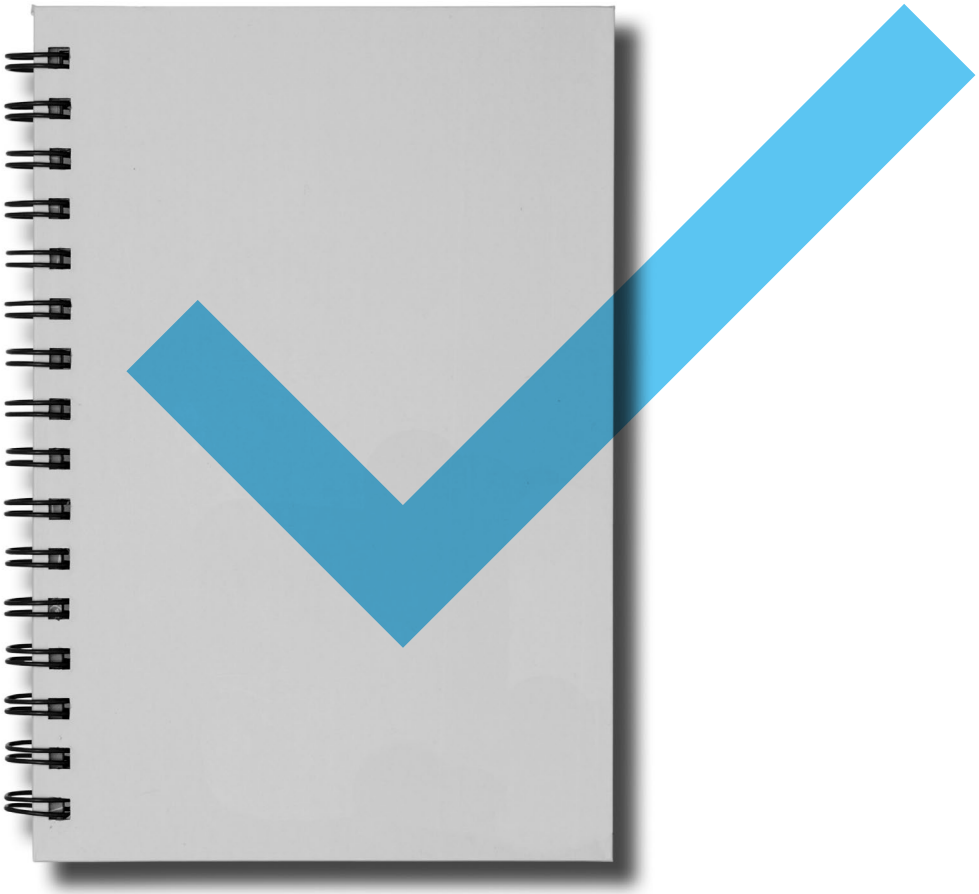


The right returns

Our pensions investment newsletter

Autumn 2021

Contents

Introduction

Welcome to our autumn 2021 edition of the Right Returns.

The rapid pace of change for pension schemes, particularly in relation to their obligations around ESG and climate related risks, continues. However, the Pensions Regulator is also consulting on its combined code of practice which will increase schemes' governance obligations in relation to their investments. All trustees should be looking now at their governance arrangements with a view to the single code of practice coming into force and with it, the requirement to maintain an effective system of governance.

Articles in this quarter's edition cover:

- why trustees need to take both investment and legal advice as part of the investment decision making process
- a round up of developments in relation to climate change rules including consultations by the Government and the FCA
- an update on the Association of Member Nominated Trustees' "Red Line" voting policies
- a look at whether failure to provide Sharia law compliant funds might be indirect discrimination
- a look at how long term asset funds (LTAFs) might affect investment by DC pension schemes

The proposals for the long term asset fund are intended to assist in allowing defined contribution pension schemes to access long term illiquid investments. We asked Jonathan Parker, Head of DC & Financial Wellbeing at Redington for his view on the new LTAF proposals and whether they may spark an investment "big bang". This edition of the Right Returns contains a guest article from Jonathan which is a great read.

We hope you enjoy this quarter's edition of our newsletter. As always we would be happy to discuss any of the areas of interest with you and we welcome your comments and feedback. Please feel free to get in touch with any of the authors of the articles to discuss.

Protecting your investments: understanding the legal risks associated with the scheme's investments

It is always slightly surprising the number of times we, as lawyers, hear about clients proceeding with investments without taking both investment advice and legal advice on the investments. Trustees have a duty to ensure that they understand the risks and security in connection with the investments they make on behalf of the scheme and those risks and the security of investments can vary greatly depending on the legal structure through which the investments are held and the protections attaching to them. In this article, we consider how your lawyers can add value to the investment decision process, help you comply with your legal obligations and protect you in the event something goes wrong.

In March 2021, TPR began its consultation on its new single code of practice. The single code of practice consolidates 10 of the existing 15 codes of practice into a single document. The code of practice sets out TPR's expectations of trustees and best practice and, in relation to investment matters, services as a good reminder for trustees to TPR's expectations that trustees:

- obtain advice and other inputs required to properly govern the scheme's investments (including considering what advice may be needed)
- review the investment managers' fund documentation, get appropriate legal and investment advice and put in place the right level of property for members, having considered that advice
- understand the types of protection available, such as indemnity insurance or the FSCS, for their different investments in the event of fraud, wrongdoing or other adverse events

Of course, none of what TPR has by way of expectation goes any further than what the law requires of trustees in any event. Regulation 4 of the Investment Regulations requires that trustees exercise their powers of investment in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole and assets must be invested in the bests interests of members and beneficiaries. A key feature of these requirements is that trustees understand the risks inherent in the structures through which they are investing and, as TPR says, the protections in place.

However the risks associated with an investment are not just the risks that the assets or the manager underperform, but also include the risks associated with manager insolvency or the terms of the investment affecting the trustee's access to its investment when it would otherwise want them.

Trustees access investment through a variety of structures, but the three most common structures, segregated mandates, pooled funds and investment-linked life policies all have unique legal risks associated with them which trustees ought to consider as part of their decision making process.

Segregated mandates involve the appointment of an investment manager to manage portfolio scheme assets on behalf of the trustee. As such, the assets being managed are typically securities held in the trustees' name by the schemes' custodian. The key contractual terms are set out in the investment management agreement, including the managers' liability to the trustee in the event of wrongdoing.

Pooled funds cover a wide variety of different fund structures from highly regulated UCITS funds to alternative investment funds. Under these structures, the trustee will invest the assets of the scheme in the fund and the manager manages that fund on behalf of all the investors in accordance with its terms. The trustees' asset is the units in the fund itself that may, depending on the terms of the fund, grant rights against the underlying assets being managed. Trustees will not typically have direct rights against the manager as its relationship will be with the fund itself.

Investment-linked life policies are life insurance policies which give trustees contractual access to the various investment funds "linked" to the policy. Under these structures, the trustee pays "premiums" to the insurer who undertakes to invest them in accordance with the terms of the policy. However, typically such policies do not grant the trustees rights to the underlying investments – they are just notionally linked in accordance with the contractual terms.

Key questions that trustees ought to be asking themselves before investing in any manner include:

- what is the structure through which my investment is held?
- what rights do I have in the event of manager insolvency? – Are the assets held separately from the balance sheet of the manager? Are there other protections in place?
- what control do I have over the terms of the investment? Can the manager unilaterally change the terms? Could other investors change the terms without consent?
- what liquidity restrictions could be placed on my investment (such as gating or suspensions)?
- is my recourse to the manager limited and are those limits appropriate given the risk profile?

Of course, some investments might involve combinations of the different investment structures, such as a segregated mandate which partially invests in investment-linked life policies or is made up of a series of pooled funds. In considering these structures, the trustees need to consider where their recourse lies and what protects their assets (within the layered structure) if things go wrong.

Trustees' legal advisors should have the experience and expertise in dealing with the various investment structures to provide them with the advice that they need to appropriately consider these risks as part of the investment decision making process. By taking legal advice on the risks and considering them as part of the investment decision making process, not only are trustees ensuring they are fulfilling their legal obligations and meeting TPR's expectations, but they are also protecting themselves against future claims. By taking advice from someone who trustees reasonably believe is qualified to give that advice, trustees will generally be deemed not to have been negligent in their decision making provided that they consider and understand that advice.

A really key point that flows from understanding these legal risks is that it allows trustees to make informed, risk based decisions in relation to the investment. Typically when assessing the risks of investment, trustees will put a great deal of emphasis on the risk that the investments or manager will underperform. However, it is fundamental to the decision making process that the security of the investments are also considered and this will typically require a detailed review of the terms of the investment by trustees' legal advisors.

The Eversheds Sutherland pensions insurance and investment team have been supporting trustees clients on their investments for a number of years and would be happy to discuss with you the way in which they can provide the tailored advice that trustees need to fulfil their legal obligations.

Mark Latimour
Partner

Round-up: new climate change rules and developments?

Update on Government consultations

On 8 June 2021, the UK Government published its **response** to its consultation on new climate change rules for pension schemes (the "**Response**").

By way of recap, these rules will require trustees of larger occupational pension schemes, authorised master trusts and collective money purchase schemes to:

- adopt governance and risk management systems
- consider climate-related risks and opportunities as part of the scheme's investment strategy and (if applicable) its funding strategy
- prepare and publish a report on a publicly available website in line with the recommendations of the Task Force on Climate-related Financial Disclosures ("**TCFD**")

Although some clarifications were made to the draft rules (see below), which will apply from 1 October 2021, few changes were made to the proposals released in January (as summarised in our **Speedbrief: Greater clarity on mandatory climate change governance and reporting standards for pension schemes)**.

Two weeks later, on 22 June, the Financial Conduct Authority ("**FCA**") published two consultations on proposed rules requiring listed companies, asset managers, life insurers and FCA-regulated pension providers to report in line with the TCFD recommendations.

This article outlines:

- the clarifications made to the climate change regulations
- the FCA's proposals on climate-related disclosure rules
- two recent developments showing how climate change risk can arise, and affect trustee decisions, in practice

Clarifications to the climate change regulations

The Government has clarified the following points in its draft climate change regulations and updated statutory guidance for in-scope occupational pension schemes. It intends to issue these in final form in the summer:

- **Timing:**
  - **Scope of TCFD report:** We noted in our response to the January consultation that it would be helpful if the rules could be amended to make it clear that the first report due from trustees will only relate to so much of the scheme year that falls after the relevant 1 October (i.e. when the rules start to apply to the scheme). The revised regulations now clarify that, where trustees are subject to the requirements for part of a scheme year only, their climate change report need only cover that part scheme year (i.e. the part falling after 1 October).
  - **Scenario analysis:** The new rules require trustees to analyse the resilience of the scheme's assets and liabilities and investment and funding strategies in at least two scenarios where there is an increase in the global average temperatures. Trustees need to do this in the first year they are subject to the requirements and then at least every three scheme years thereafter. The Response clarifies that:

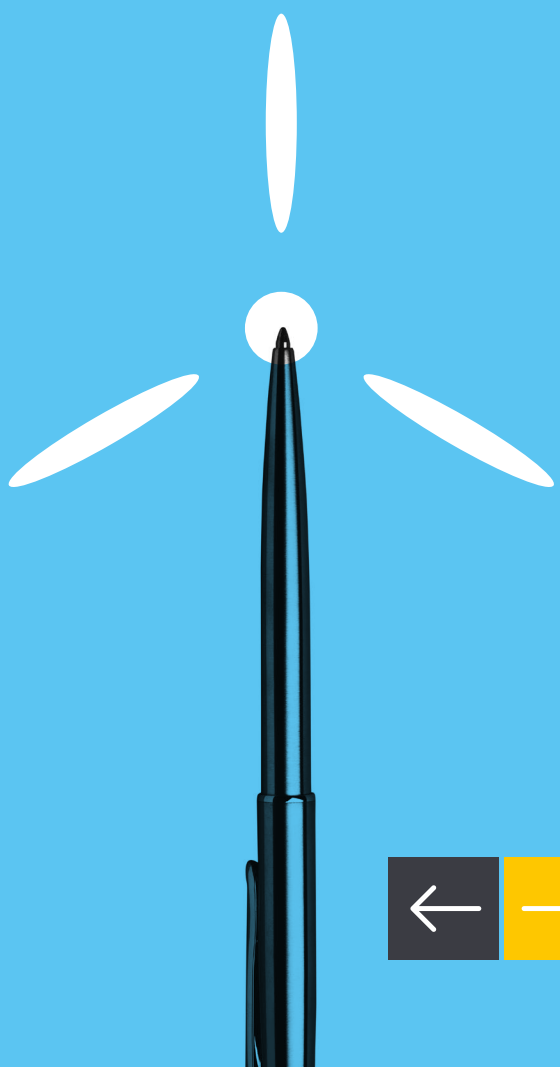
  - Trustees may rely on scenario analysis done before the regulations first apply to them (but in the same scheme year). Similarly, in relation to the metrics that trustees are required to assess, where the first year of application is a part scheme year, activities carried out within that scheme year may be relied upon to meet the requirements.
  - Whenever trustees undertake fresh scenario analysis the triennial cycle is automatically re-set to three scheme years thereafter.
- **Targets:** The Government has clarified the requirement to set targets to make it clear that they need to be set during the first scheme year in which the regulations apply, not on the first day.
- **Metrics:** Trustees will not have to collect and report on Scope 3 emissions (being indirect greenhouse gas emissions, which occur from sources that they do not directly control, other than from purchased electricity) in the first scheme year that they are subject to the requirements.

- **Insurance contracts:** As mentioned in our earlier **Speedbrief**, the January consultation confirmed that bulk and individual annuities would be excluded from the scope of the thresholds for assessing scheme assets. This reflects a comment we made during the first consultation that the costs of compliance are likely to be disproportionate to the benefits for scheme beneficiaries (particularly given that insurers are subject to separate TCFD requirements). The Response clarifies the definition of a relevant contract of insurance, so that it does not require:
  - an exact matching of the level of benefits specified in the contract and those payable under the scheme rules
  - the intention to meet the costs of specified benefits in all circumstances, or
  - the insurer to have unfettered discretion in relation to the investment policy of the assets used to meet its liabilities under the contract
- **TKU:** In relation to the new requirements for trustee knowledge and understanding both opportunities and risks, the Government has clarified that it intends trustees to have sufficient knowledge and understanding to enable them to meet the climate governance requirements.
- **Popular arrangements:** The Government recognised that default arrangements with limited assets, which exist largely as a result of bulk transfer or because of administration and mapping, should not be included within scope for reporting if they have a relatively small number of members. The final statutory guidance now states that trustees should carry out scenario analysis in relation to any arrangement in which £100m or more is invested, or in which 10% or more of the assets are invested – rather than when the arrangements apply to 250 or more members.

The Response stressed that trustees of in-scope schemes should now focus on implementing the measures, stating that:

"This will ensure that the vast majority of pension schemes members' savings will be invested in schemes whose trustees have a specific legal duty to actively consider the risks that a transition to a low carbon economy brings."

"**Recent developments: managing climate change risk in practice**" (below) outlines a couple of recent events in the energy sector showing how these risks can arise, and how investors may seek to manage them, in practice.



FCA consults on climate-related disclosure rules

FCA is consulting on two sets of rules which would require listed companies, asset managers, life insurers and FCA-regulated pension providers to report in line with the TCFD.

These proposals are intended to ensure that more (and more usable) information is available throughout the investment chain. Sheldon Mills, executive director of consumer and competition at the FCA, **observed** that the "new rules will help markets, investors and ultimately consumers better understand the impact of climate change and make more informed decisions."

Both consultations close on 10 September 2021 and the FCA intends to confirm its final policy on climate-related disclosures before the end of 2021.

Listed companies

In December 2020, the FCA implemented new disclosure rules and guidance for commercial companies with a UK premium listing, based on the TCFD recommendations. The FCA now proposes to apply these requirements to issuers of standard listed equity shares. This would require these companies to set out in their annual report whether they have made disclosures consistent with the TCFD's recommendations and explain where they had not done so.

The FCA is also seeking views on other topical environmental, social and governance ("**ESG**") issues in capital markets, including on green and sustainable debt markets and the increasingly prominent role of ESG data and rating providers.

Asset managers and pension providers

The FCA also **proposes** to introduce new disclosure rules which would apply to 98% of assets under management ("**AuM**") in both the UK asset management market and held by UK asset owners. Life insurers (including reinsurers) providing insurance-based investment products and defined contribution pension products are also in scope, together with certain platform providers and self-invested personal pension (SIPP) operators.

The rules will not apply to asset managers and providers that have less than £5bn in AuM.

The FCA proposes that in-scope asset managers and providers would be required to make disclosures at two levels:

- Entity-level disclosures: Firms would need to report annually on how they take climate-related risks and opportunities into account in managing or administering investments on behalf of clients. These must be published in a prominent place on the firm's main website.
- Product or portfolio-level disclosures: Firms would need to report annually, in a consistent and comparable way, on the individual products or portfolio management services they offer. These include a core set of metrics on carbon emissions. Depending on the firm, product or portfolio, these must be published in a prominent place on the firm's main website or be available upon request by eligible clients.

The FCA proposes to introduce the rules in two phases:

- The rules for the largest firms (including assets managers with more than £50bn in assets under management and providers that have more than £25bn) would come into force from January 2022, with a publication deadline of 30 June 30 2023.
- The rules would apply to the remaining in-scope firms from January 2023, with a publication deadline of 30 June 2024.

In both cases, these deadlines will fall after 1 October 2021, when the climate change regulations will start to apply to the largest in-scope occupational pension schemes.

Recent developments: managing climate change risk in practice

The climate changes regulations are intended to improve how in-scope trustees identify, assess, manage and disclose climate-related risks and opportunities relevant to their scheme.

The Government's **statutory guidance** breaks these risks down into three categories:

- **physical risks** which relate to the physical impacts that occur as the global average temperature rises (e.g. flooding caused by rising sea levels)
- **transition risks** which arise as governments seek to realign their economic system towards low-carbon, climate-resilient solutions (e.g. following changes in industry regulation, consumer preferences and technology)
- **litigation risks** which result where businesses and investors fail to account for the physical or transition risks of climate change

Two recent developments in the energy sector demonstrate ways in which transition and litigation risks could arise in practice and how investors could seek to manage them.

The first concerns a judgement from the District Court of the Hague, which ordered Royal Dutch Shell to reduce its CO2 emissions by 45% by 2030 (compared with 2019 levels). The case was brough by several NGOs and more than 17,000 individuals. It demonstrates that companies and investors should not only be considering how governments might set regulations to meet the net-zero targets set out in the Paris Agreement, but also how courts could enforce a duty of care for companies to meet certain targets. It is a further example of a global trend of companies and funds facing liability and reputation damage, if they fail to manage climate change risks appropriately. It follows last year's Australian case of *McVeigh v Retail Employees Superannuation Trust* ("**Rest**"), in which a beneficiary claimed that the trustee of an industry-wide superannuation scheme had failed to provide sufficient information on the fund exposure to climate change, and had breached statutory duties to act with reasonable care and skill in managing scheme investments (see out **Winter 2020 edition of the Right Returns** for further detail on this case).

Simon Daniel
Partner

The second development concerned a shareholder vote on 26 May, which resulted in two new directors being appointed to ExxonMobil's board, with the aim of facilitating a transition to a lower-carbon strategy. The vote was led by Engine No.1, an activist hedge fund, and supported by two Californian pension funds (CalPERS and CalSTRS), proxy voters (Institutional Shareholder Services and Glass Lewis) and institutional asset managers. It is almost six years since Mark Carney, then governor of the Bank of England, **warned** that investors could face "potentially huge" losses as a result of the transition to a low-carbon economy – for instance, if the assets of fossil fuel companies were left "stranded" as a result of tougher climate change regulation. The ExxonMobil vote indicates a growing willingness among investors (including pension schemes) to seek to manage those risks through active stewardship.

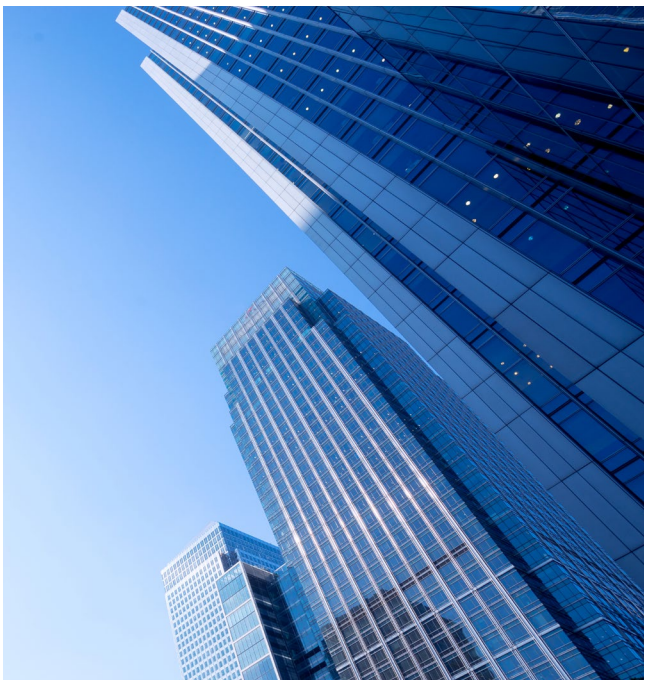
Update to Association of MNT's Red Line Voting Policies

The Association of Member Nominated Trustees (AMNT), an organisation with membership of around 500 trustees from about 400 schemes, launched its red line voting initiative in 2016 to encourage schemes to become more active, responsible investors and to encourage good stewardship in relation to the companies they are invested in. The now-familiar rationale is that better run companies display superior performance, which will ultimately benefit their investors (including pension schemes). The red lines identify a number of poor practices which should be opposed by schemes and their investment managers – examples include environmental matters, and social issues.

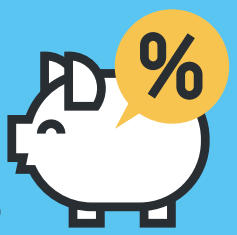
The AMNT has now updated its red line voting policies, to include a number of new items, including some that follow the new Taskforce on Climate-related Financial Disclosure (TCFD) recommendations. In particular, the policies now:

- provide that investee companies should report in relation to the TCFD requirements
- state that corporate lobbying should be done in alignment with the Paris Agreement
- specify that schemes should consider the Modern Slavery Act and human rights considerations
- set out additional requirements in relation to gender diversity on company boards
- include a number of new parameters for executive remuneration

The AMNT has expressed hope that these red line voting policies will play an important role in helping trustees fulfil their new regulatory responsibility, particularly those who don't yet have a voting policy.



Tom Meyrick
Senior Associate



Investment into LTAFs by DC pension schemes

Overview

The long term asset fund ("**LTAF**") is proposed to be a new category of authorised open-ended fund intended to enable efficient investment by professional investors and sophisticated retail investors in long-term, illiquid assets. The provision of appropriately designed and managed investment vehicles for investing in illiquid assets is key to supporting the UK government's plans for greater investment in infrastructure and the transition to a low carbon economy.

The Financial Conduct Authority (the "**FCA**") set out its draft rules for the LTAF in its consultation paper CP21/12 "**A new authorised fund regime for investing in long term assets**" which has now closed.

Whilst the draft rules are helpful in many places, not least in respect of permitted links, as set out below, if investors were hoping that the LTAF would be a UK answer to the Irish qualifying investor alternative investment fund (QIAIF) and the Luxembourg reserved alternative investment fund (RAIF), offering the same kind of flexible investment in long term assets with limited restrictions and regulation, they will be disappointed.

The form of LTAF contemplated by the FCA is highly regulated and in some respects arguably more regulated than a UCITS or a non-UCITS retail scheme ("**NURS**"). While described by the FCA as being based on the qualified investor scheme ("**QIS**"), in many ways the LTAF is a hybrid of a QIS and a NURS.

The LTAF will be able to invest in all those classes of assets in which QIS are permitted to invest, but in addition will be able to invest in loans, including direct lending.

The limitations of existing UK fund structures for investing in illiquid assets were thrown into sharp relief by the collapse of the Woodford patient capital funds. The FCA's cautious approach to the LTAF may in part be informed by the FCA's understandable sensitivity to public criticism of its role as Woodford's regulator.

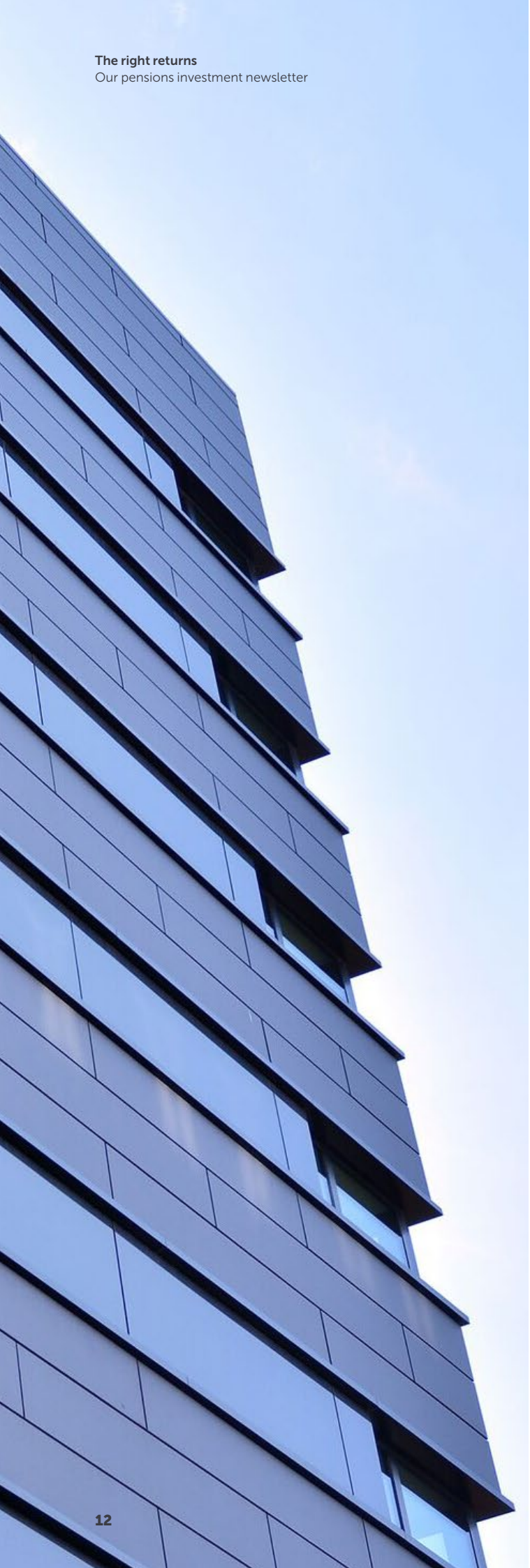
Permitted Links

One of the key issues that industry participants have been flagging is the need to ensure that the permitted links rules contained in Chapter 21 of the FCA's Conduct of Business Sourcebook ("**COBS**") are amended so that an LTAF will be an eligible investment for as many investors as possible and, in particular, defined contribution ("**DC**") pension schemes.

While some DC pension schemes (principally those which are trust-based) can access QIS directly as professional clients, it is not common for them to do so. From an operational and administrative perspective, many trust-based DC pension schemes still access their investments by using a life wrapper, which is subject to the permitted links rules. Other DC pension schemes (eg contract-based schemes) may not be able to access a QIS directly due to their regulatory classification, and may only be able to do so through a life wrapper.

It is permissible for a unitised policy to be linked to a UCITS or NURS without the life company concerned having to undertake any investigation itself of the underlying portfolio. Under the current rules, if they link to a QIS they need to check the underlying portfolio for acceptability under the permitted links rules, a requirement which is largely impractical.

The look-through obligation will make an investment into an LTAF extremely difficult. Specifically, it will be very difficult to be certain that every asset of the target fund will comply on a look-through basis, particularly over the life of that investment. If the LTAF is a third party managed fund, life companies will face challenges accessing sufficient data to get comfortable on a look-through basis.



Acknowledging the recent flexibilities added to the permitted links rules, the look-through obligations and constraints on instrument types in the permitted links rules will remain a barrier to access if left unamended. The FCA seeks to facilitate this by:

- removing the 35% limit on illiquid investments if an LTAF forms part of the default arrangement of a DC pension scheme. This is achieved by excluding the LTAF from the definition of a QIS in COBS 21.3, which will make an LTAF a conditional permitted link for default arrangements only, and
- including guidance that an insurer must consider the concentration risk of including an LTAF as part of the default option when considering investment in an LTAF

It appears that the FCA intends that the look-through obligation will not apply where the LTAF is included in default arrangements, which will be extremely helpful.

It is worth considering whether permitting investment into an LTAF only by the default arrangements of a DC pension scheme is sufficient. There is an argument to say that this is suitable because, while the default strategy is held by an underlying retail customer, it is constructed by professionals and thus subject to professional scrutiny. This prevents the risk of retail investors self-selecting illiquid strategies and, therefore, being subject to market events which prevent or restrict liquidity. Conversely, this carves out a large proportion of DC assets which would otherwise be available for investment into LTAF, for example through funds of funds or balanced funds which can be self-selected or self-invested.

Another question to consider in this context is whether it is necessary for an LTAF to be open-ended. Arguably the DC market is looking to match its strategies to the underlying assets. This strikes us as a reason why the LTAF would benefit from the flexibility to be structured as either open- or closed-ended, which would provide true flexibility to mirror underlying assets.

How can Eversheds Sutherland help?

Our team have been advising on regulatory interpretation and product development for the fund management industry since the 1980s and we have been at the forefront of new products under European and UK regulation in the period since then. Our in depth understanding of the sector and experience with the practical implementation of new product categories mean that we are very well placed to guide you in complying with the changing product and regulatory environment.

Stefanie Sahla-Jones
Principal Associate

Will the LTAF spark an Investment Big Bang?

With the Prime Minister and Chancellor of the Exchequer's clarion call ringing in our ears, is now finally the time for DC pension schemes to rise to the challenge and allocate more of their assets to 'long-term' investment opportunities? I, for one, hope the answer is a resounding 'YES'!

I'll use the phrase 'long-term' to describe these assets, but for those who have followed the sometimes circuitous path to the birth of the LTAF, a number of other labels have been used over the course of multiple government & industry reviews including 'productive', 'illiquid' and 'patient'.

So, why am I such an advocate? Over the last few years, a number of distinct but interconnected issues have come together to create what should be ideal conditions for DC schemes to take advantage of a once-in-a-lifetime opportunity to improve outcomes for members. These can be grouped into three categories:

1. An alignment of stakeholder interests
2. A desire and need to make a difference
3. Scale

Within any investment ecosystem there are multiple actors. For DC pensions, this includes governance bodies (i.e. trustees, IGCs, pension providers), regulators, fund managers, the government and most importantly, the end beneficiaries. Often these actors have slightly different goals, depending on the prevailing political, regulatory and economic climate. Until recently, the primary focus for governments, regulators and governance bodies has been more on creating the right structural (policy) and compliance (regulatory) conditions to support the smooth running of the DC workplace pensions. By this, I mean getting auto enrolment implemented, establishing IGCs, authorising master trusts etc.

All of these of course will be ongoing endeavours, but much of the heavy lifting is done. Attention has now shifted to how to turn the dial on improving member outcomes. In an economic environment where money is tight and therefore it is unlikely that employers and members will be required to (or voluntarily) contribute more, the only lever to pull that will make a material difference is investment. And with many DC schemes already maxed out on listed equities (at a time of declining public markets), the clearest opportunity to improve returns is in long-term assets. Pension schemes have always been providers of long-term capital and although the government's intent for pushing this agenda may not solely be better member outcomes, they are correct that UK DC schemes have to date underinvested in these assets, in contrast to DC schemes in other countries.

Finally, fund managers would love to see more flows into their products and have started to think more deeply about how they could structure and price them to be better aligned for DC asset owners.

The second of my overlapping issues is perhaps the most important. There has been a fundamental shift over a relatively short period of time in how asset owners make investment decisions. Alongside strategic asset allocation, ESG factors are now the primary driver. Successfully addressing the climate crisis, which is often the main consideration within ESG investing, will require nothing short of a total rewiring of the global economy. This presents huge risks but also possibly the single largest investment opportunity in history. Again, whatever you think of the government's motives, the legal commitment to net zero coupled with a desire to rebalance the economy means that money needs to be put to work. It is possible both to support this agenda and deliver great returns.

The third leg of my argument is the most straightforward. Money talks, and lots of money shouts! The UK DC market has only recently gotten to a scale and structure (i.e. a relatively small number of schemes/providers with most of the money) where it can make a meaningful investment in these long term opportunities.

So, everything is in place. This should be simple? Unfortunately, there is one remaining barrier which cannot be easily removed.

Fees

The DC industry in the UK is the most competitive in the world from a fee perspective. According to a 2017 Pension Policy Institute report into international DC asset pooling, average UK fees were 0.46% (and for larger schemes they are much lower), whereas in Australia – a much bigger market - they are 0.63%. Lower fees have benefitted many DC members, but this could have come at the cost of limiting the investment opportunities now open to these schemes. These long-term assets are likely to be more expensive than current investments, albeit with the prospect of higher returns and better outcomes. Although there are no actual barriers to putting DC money in higher charging funds (current fees are mostly well below the charge cap), there is a clear psychological hurdle for trustees to overcome in delivering a message to members that their fees are going up.

A consequence of years where the drumbeat has been that value goes hand-in-hand with low cost, is that fees have been driven so low that reversing this trend has become almost impossible. The minutes from the June meeting of the Productive Finance Working Group (the latest body to try and dismantle the remaining hurdles to investing in long-term assets) confirms that this remains a real barrier to demand.

I am certainly not advocating for a relaxing of requirements for fiduciaries to consider value to members, and the decision to increase fees should never be taken lightly. However, if DC schemes are to take advantage of the full range of investment opportunities now available, it will require a concerted effort on behalf of both policy-makers and regulators to use the tools at their disposal (possibly backed-up by written guidance) to give governance bodies the space to properly consider long-term assets.

Jonathan Parker
Head of DC & Financial Wellbeing at Redington

Sharia law DC investment options

Sharia law investment funds invest in a way that is compliant with Islamic principles on finance.

These principles include:

- **ethical investing** – restricting or excluding investments in what are deemed to be unethical businesses, including alcohol and tobacco, and
- **not charging or paying interest** – Sharia law says that financially benefiting from lending, receiving or exchanging money is unfair and can create inequality

Over recent years there has been an increasing focus from the Government on trustees to invest responsibly according to environmental, social and governance standards. However, whilst this may cater for people who feel strongly in relation to issues such as climate change, ethical funds are not normally Sharia law compliant. In fact, many DC schemes do not provide members with any access to Sharia compliant investment options. This makes it very difficult for individuals who wish to build up pension savings in line with Islamic principles on finance, as they are either forced to (i) invest in funds that are contrary to their beliefs or (ii) opt-out of their employer's pension scheme.

In May this year, we understand that Islamic Finance Guru instructed Paul Newman QC (from Wilberforce Chambers) to give an opinion in relation to whether DC workplace pension schemes are required to offer halal investment funds. Paul Newman QC opined that failure to provide these funds is likely to be discrimination under the Equality Act 2010. His view is that not providing halal funds constitutes "indirect discrimination" because providing a range of funds which does not include Sharia compliant options puts Muslim employees at a disadvantage compared to non-Muslim employees, as it ultimately discourages them from joining their employer's pension scheme (and therefore from accruing pension savings).

Whilst indirect discrimination can be "objectively justified" under the Equality Act 2010, Paul Newman QC is of the view that ***"the only plausibly-arguable justification for not offering members the option of halal investment funds is likely to be where it is not practically possible for the trustees to locate such funds which would also comply with the legal and regulatory requirements of pension scheme investments, including the maintenance of the security, quality, reasonable liquidity and profitability of the portfolio as a whole"***.

Whilst the opinion from Paul Newman QC has not been tested in the courts, we expect that the provision of Sharia law compliant investment funds is an issue that will start to come on the agenda for many DC workplace schemes that are not yet providing access to these options.

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