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Pensions Finance Legal Update

Legal Update Contents

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This is the first of an occasional series of updates on investment and pensions finance issues.

Securities lending: guidance for trustees

Summary. The Pensions Regulator (the Regulator) has issued a guidance note for trustees about securities lending.

Background. Securities lending involves the lending of securities by their owner to a borrower for a fixed period in exchange for a fee. Although described as "lending", normally the legal ownership of the securities passes from the borrower to the lender. Collateral is provided by the borrower to protect against the risk of the borrower being unable to return the securities; for example, because of insolvency.

The Regulator's guidance is a useful reminder of key issues that arise in relation to securities lending.

Facts. The Regulator recommends that trustees should:

- Identify and control the risks associated with securities lending (for example, the risk that the borrower becomes insolvent).
- Ensure that they know whether securities lending is being carried out with the scheme's assets, including by pooled funds in which they invest.
- Understand the proportion of their assets that may be lent out.
- Understand the proportion of securities lending fees that benefit the scheme and the proportion that benefit their fund manager or custodian.
- Understand the arrangements in place between the trustees, the fund manager or custodian and the borrower.
- Be aware of the level of collateral which is provided to protect against the risk of insolvency by the borrower.
- Ensure that there are appropriate legal agreements in place to record the obligations of the borrower and the lender.
- Ensure that there are monitoring arrangements in place.
- **Comment.** The Regulator's guidance is a useful reminder of key issues that arise in relation to securities lending. Most pension trustees will have considered the terms on which securities lending is carried out where they have authorised this for a segregated portfolio. However, they may not know whether securities lending is carried out by pooled funds in which they invest.

Source: Understanding and managing the risks of securities lending – Pensions Regulator note, 12 January 2010, www.thepensionsregulator.gov.uk/pdf/stock-lending-statement-Jan2010.pdf.

Myners principles

Summary. The Investment Governance Group (IGG) is consulting on a draft best practice framework for investment of defined contribution (DC) schemes (the framework).

The principles and code of best practice are not legally binding. However, the intention is that they should be adopted on a "comply or explain" basis

Background. The Myners principles are a voluntary code of good practice for occupational pension scheme investment. They were originally published in 2001 and updated in 2008. The IGG is a government sponsored group of experienced individuals from the pensions and investment industries whose aims include encouraging the spread of best practice in investment decision-making and governance.

Facts. The framework includes:

- Principles providing a code of best practice for decision-makers.
- Best practice guidance to assist in meeting the obligations of the principles.
- A table of accountabilities, setting out who is responsible for the key activities involved in establishing and running the investments of a DC scheme.

The six principles are:

- Clear roles and responsibilities. Roles and responsibilities in relation to investment decision-making and governance are clearly defined and communicated to interested parties.
- Effective decision-making. Decisions relating to investment governance are taken on a fully informed basis and the investment governance processes are sound.
- Appropriate investment options. The investment options provided take account of a range of member-risk profiles and needs and are designed appropriately.
- Appropriate default strategy. An investment strategy which is offered for members who prefer not to make a choice is designed appropriately.
- Effective performance assessment. The performance of investment options is monitored.
- Clear and relevant communication. Clear information on the investment options and their characteristics that will allow members to make informed choices is provided.

The principles and code of best practice are not legally binding. However, the intention is that they should be adopted on a "comply or explain" basis; that is, comply, or explain to members why compliance is inappropriate.

Source: IGG Consultation paper – Investment governance of defined contribution pension schemes, February 2010, www.thepensionsregulator.gov.uk/pdf/igg-con-doc-2010.pdf. Responses are requested by 5 May 2010.

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