Investment regulation FAQs

These FAQs are intended to provide assistance to trustees in meeting their obligations under the Occupational Pensions Scheme (Investment) Regulations, 2005 (S.I. No. 593). References to articles are references to the articles of those regulations.

These FAQS update and replace the FAQs issued as part of Bulletin 3:2005 concerning the Occupational Pension Schemes (Investment) Regulations, 2005.

To what schemes to these regulations apply?

All schemes except small schemes (i.e. those with less than 100 active and deferred members) must prepare a Statement of Investment Policy Principles (SIPP). The remaining investment regulations apply to all schemes, except for single member schemes (see below). This includes defined benefit (DB) and defined contribution (DC), and both active and frozen schemes.

The investment regulations apply to all assets of a scheme, including those acquired before 23 September, 2005. Specific rules apply to borrowing, and these are discussed below.

These Regulations do not apply to PRSAs. PRSAs are not occupational pension schemes for the purposes of the Pensions Act 1990, as amended.

What is a single member scheme?

A single member schemes is a scheme whose rules limit membership to a single member (except where a Pension Adjustment Order applies), and where the member has discretion as to how the resources of the scheme are invested. The following comments may be of assistance in deciding whether or not a scheme qualifies:

(a) A scheme that has previously had more than one member can qualify as a single member scheme if there is currently only one member, and the current rules do not permit any additional members to join.

(b) For the purposes of deciding whether a scheme is a single member scheme, deferred members must be counted.

(c) It is considered that the requirement for member investment control is satisfied where the consent of the member is required for investments. The presence of a pensioneer trustee will not on its own disqualify a scheme from being a single member scheme. Similarly, investment in pooled funds will not disqualify a scheme from being a single member schemes as long as the choice of funds and/or fund manager requires the member's consent.

What borrowing is allowed?

Schemes (apart from single member schemes) may not borrow except for short term liquidity reasons.

The prohibition applies to borrowing made after 23 September, 2005. This includes borrowing approved before 23 September, 2005 but not drawn down until after that date. Refinancing of previous borrowing would not be considered as new borrowing, but additional borrowing (including interest roll-up) would not be permitted.

There is no specific definition of short-term liquidity, but the following comments may be of assistance to trustees. It should be noted that these comments are illustrative only, and are not an exhaustive definition.

(a) A scheme may occasionally need to borrow to meet a claim or benefit payment where liquidation of assets will take time. However, immediate steps should be taken to sell assets to redeem the borrowing. Trustees should note the requirements under article 7(3) of the regulations to ensure appropriate liquidity.

(b) It is the Board's view that borrowing in order to finance assets would not normally be permitted under these regulations.

(c) Even where schemes are permitted to borrow under the regulations, trustees are reminded of their overriding duty to invest the assets of the scheme appropriately and in the best interests of scheme members.

What information should be provided in a Statement of Investment Policy Principles?

The form and content of the SIPP are not prescribed in detail in the regulations or legislation. However, the regulations do set out minimum information that must be provided, and this is examined further below.

The SIPP requirements do not impose any specific investment practices on pension schemes: the SIPP is intended to be a description of the investment policies of the trustees. There is no minimum (or maximum) length of SIPP required. The information provided should be stated clearly and unambiguously, but it may be possible for an SIPP to be no more than a page or two long.

Some comments on the contents of the SIPP are as follows:

(a) Investment objectives – for DB schemes and for DC schemes where no member investment choice is available, the Board would expect this to include the objectives of meeting the liabilities and the attitude to risk. For other DC schemes, the Board would expect it to include a description of the rationale for the investment choice made available to members.

(b) Investment risk measurement methods – the Board would expect that this would identify the investment risks faced by the scheme and how these risks are measured. Different schemes use differing approaches toward measuring risk, and no one approach is prescribed here. DC schemes may choose to provide a separate response for each investment fund.

(c) Risk management processes to be used – the Board would expect this section to describe how the scheme trustees manage ongoing investment risk. There are many possible approaches, but for example, the SIPP may include the guidelines provided to the investment managers, and a policy statement relating to periodic review of investment performance and risk. Again, DC schemes may provide a separate description for each fund.

(d) Strategic asset allocation with respect to the nature and duration of the pension liabilities – for DB schemes the Board would expect a statement of the asset allocation strategy and how the nature of the liabilities of the scheme have been taken into account in setting it. For DC schemes, the Board would expect this section to include a description of the investment funds made available, along with any restriction on member investment choice.

What, if any, additional requirements are imposed by article 7(3)?

Article 7(3) imposes a general responsibility on scheme trustees to invest the assets of the scheme in a manner appropriate to the circumstances of the scheme. It is the view of the Pensions Board that the requirements of this regulation are similar to the obligations imposed on trustees under trust law, i.e. to invest the assets prudently and in the interests of the scheme members.

What restrictions are imposed by the obligation to invest in regulated markets?

Article 7(4) states that the scheme assets must be invested 'predominantly' in regulated markets. Regulated markets are defined in article 2. It is the Board's view that 'predominantly' means more than 50% of the assets of the scheme. Article 7(4) further requires that investment in markets that are not regulated should nonetheless be kept to prudent levels. This may mean that the liabilities of the scheme are such that a lower level of investment in unregulated markets would be appropriate.

The Board considers that monies on deposit with a regulated financial institution comprise investment in a regulated market. Note that property investment is not a regulated market. This applies even when the investment is made through a collective investment arrangement (see below).

If, as a result of market movements, a scheme finds itself with more than the permitted proportion of unregulated investments, the trustees should take immediate steps to make the scheme compliant. It may be prudent to allow sufficient margins to ensure that small market movements will not oblige the trustees to make investment changes.

Is investment in derivatives permitted?

Investment in derivatives is only permitted to reduce investment risks or to facilitate efficient management of the portfolio. The Board will expect trustees to satisfy themselves that any investment in derivatives can be justified on these grounds before the investment is made, and to be in a position to provide documentation of their decision to the Board if required.

How do the regulations apply to schemes invested in insurance policies or pooled investments?

Investments in insurance policies are governed by article 7(7)(b), (c) and (d). There are different rules for unit linked and non-linked insurance policies.

For unit linked policies, compliance will depend on the underlying assets of the funds to which the policy proceeds are linked. Where a policy is invested in unit trusts or a fund of funds, it is the ultimate assets and not the trusts that will determine the scheme's compliance with the regulations. So long as the assets that underly these funds comply with the diversification and regulated market requirements, the investment in the insurance policy will be deemed to satisfy those same requirements. Thus, for instance, a typical managed fund is well diversified and primarily invested in equities and bonds. A policy linked to such a fund would satisfy the regulations. On the other hand, were a policy wholly linked to a fund invested in unregulated shares, or in a single property, this investment would not satisfy the investment regulation unless it comprised only a reasonable proportion of the scheme's investments.

For non-linked policies, including with profit policies, the investment in the insurance policy will be deemed to satisfy the regulated market and diversification obligations if the policy proceeds are guaranteed at maturity to be at least equal to the sum of all the premiums.

Any annuity policies held by a scheme will be deemed to satisfy the regulations.

Note that the prohibition on borrowing applies only to direct borrowing by scheme trustees: it does not apply to borrowing undertaken within a pooled fund or insurance policy.

How will these regulations affect defined contribution schemes?

As stated above, these regulations apply to all schemes, including DC schemes. Therefore the trustees must abide by the regulations in choosing the investments to be made available to scheme members, even where the members can choose from a number of investment alternatives. In particular:

(a) Trustees of DC schemes with more that 100 active and deferred members must prepare and maintain an SIPP.

(b) Trustees of all DC schemes must choose scheme investments that are appropriate to the liabilities of the members.

(c) Trustees of all DC schemes must ensure that the investments of each member comply with the regulations governing regulated markets, diversification, etc. Thus, for instance, no member may invest more than 50% of his or her funds in unregulated market assets.

How quickly must schemes apply the new regulations?

The new regulations applied with effect from 23 September, 2005, and there is no provision for any changeover period.

All schemes should take immediate steps to comply with the new regulations. The Board would not consider it reasonable were this process to be unduly prolonged.

If any scheme has particular issues which may delay its compliance with the regulations, the trustees or their advisers should contact the Board immediately.

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