Administration
How trustees and administrators can effectively work together

Trusteeship
The pressures currently facing trustees, with yet more to come

Active vs passive investment
The debate between the two investment styles has intensified

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April 2018

PENSIONS Age

The leading pensions magazine

***Royal Mail case study**: The details of it potentially implementing the UK's first collective DC scheme*

***GDPR:** How schemes can prepare for the upcoming EU data regulation*

Changing time or wasting time?

Is collective DC the future for the UK pensions industry, or a distraction?

DC Guide 2018
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Editorial Comment

Sixth floor, 3 London Wall Buildings, London, EC2M 5PD

Causing a stir this past month has of course been the government's spring statement, as the pensions industry gets to grips with the latest barrage of reforms presented by Chancellor Philip Hammond.

Na, only kidding. The statement was refreshingly light – almost to the point of non-existence – on policies that would impact upon the pensions industry. It may have made for dull watching, but overall there was a collective sigh of relief across the industry that its already busy workload did not see anything new added to the pile.

This response was quite a contrast to how the industry responded to the real big news of the past month – the government's DB white paper *[See page 10 for more information]*.

Here, a whole host of changes were announced, from making an employer's 'wilful neglect' of its pension scheme a criminal matter, to its plans to consult on DB consolidation possibilities.

Despite all this, some in the industry cried out for more, describing the paper as a 'missed opportunity' not to address such issues as whether stressed DB schemes should be allowed to switch indexation from RPI to CPI.

The idea of breaking a 'promise' to DB members, effectively cutting the value of their defined benefit by switching to CPI, versus the idea that switching could protect members from a greater cut if the scheme went into the PPF has sparked strong views, so it's not wholly surprising that the government has dodged the matter.

But there is one industry discussion that the government has not been able to avoid – that of collective DC (CDC) *[see our cover story on page 61]*. Indeed its Work and Pensions Committee's focus on CDC is making it somewhat of a referee on the matter, and this, along with its upcoming response to Royal Mail and the Communication Workers Union lobbying for legislation for CDC to be implemented in the UK, will let the industry see which side of the debate the government falls on.

Those advocating CDC highlight the benefits of pooling investments, risk sharing of volatility and longevity, and the retirement income it provides.

However, those against it are concerned about its complexity resulting in a lack of member understanding and the reputational risk if retirement incomes have to be cut. CDC is also considered by some to be unnecessary, that it does not add any new solutions to the sector, and discussions around its implementation are simply distracting from tackling current problems.

Personally, I'm on the side of CDC. With the risk of funding retirement having swung from the employer to the employee – who, broadly speaking does not have the same level of financial knowledge and access to expertise as the employer had – a possibility of a 'third way', sharing the risk more equitably, is to be welcomed. Particularly as, in my view, DC members retiring in the future on drawdown and running out of money is the greatest risk the sector faces. Another product that enables them to access a regular retirement income – still with the choice of taking the cash if they so wish – must be beneficial. Yes, there is a chance this income will fluctuate, but even the set-income promise provided in DB is not 100 per cent certain – that's why we have the PPF and the current indexation debate. CDC offers those that would have been in standard DC a balance between the rigidity of purchasing an annuity and drawdown's flexibility risking funds running out.

Ok, CDC may not solve all the problems facing retirement saving, but so what? If new products can only be created if they solve ALL problems, we will never have any innovation. And elements of CDC may already be available within existing products, but the choice should be there to allow those who want to provide the particular mix of pros and cons CDC provides to their staff to do so. After all, aren't we all about 'freedom and choice' now?

Passions clearly run high with CDC, and it has certainly been subject to intense debate. Where this has been left currently reminds me of a TV drama series that has ended on a cliffhanger. The Work and Pensions Select Committee's period of gathering evidence regarding CDC's viability in the UK has finished – now it has all this juicy evidence, what will it decide to do? Will Royal Mail and the Communication Workers Union get their heart's desire – the opportunity to set up the UK's first CDC scheme? Who will ultimately be victorious, those calling for CDC's implementation, or those who rally against it? Tune in to find out more.

Laura Blows, Editor

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PENSIONS AND LIFETIME SAVINGS ASSOCIATION

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Dateline - March 2018

Rounding up the major pensions-related news from the past month

1 March The reduction to the rate at which life expectancy is increased is driven by "persistent influences' rather than short-term events such as the 2015 influenza outbreak, according to the **Continuous Mortality Investigation (CMI) Mortality Projections Committee**. Its analysis shows over the past six years, since 2011, mortality improvements were 0.5 per cent per year for males and 0.1 per cent for females.

2 March An average DC pension pot could grow by 30 per cent as the minimum auto-enrolment contribution rises to 5 per cent in April. According to analysis by **Aviva**, a person earning the average annual UK salary of £26,572 could add £840 to their pension pot over 2018, up from £600 in 2017. Furthermore, this could add up to £36,000 more to their pension pot when they reach retirement.

5 March The **Trinity Mirror** DB pension deficit fell by £88.4m to £377.6m during 2017, on an IAS19 accounting basis. In its full year results, the publisher reveals the group paid £38.7m into its DB schemes in 2017, which includes £2.5m in relation to a share buyback programme. However, it also attributes the drop in the deficit to strong asset returns and a fall in future mortality improvements, which more than offsets a reduction to the discount rate.

6 March DB transfer values remained stable throughout February, rising by just £1,000, according to the **Xafinity Transfer Value Index**. At the end of February transfer values were £232,000 compared to £231,000 at the end of January. The difference between maximum and minimum readings of the Xafinity Transfer Value Index over February 2018 was £4,000, equivalent to 1.6 per cent.

7 March A healthcare company and its managing director pleads guilty to misleading **The Pensions Regulator** about complying with its auto-enrolment duties. Birmingham-based Crest Healthcare and managing director Sheila Aluko admit recklessly providing false or misleading information to the regulator. They also admit wilfully failing to comply with their auto-enrolment duties.

9 March The CEO of **Anglian Water** tells unions to ballot for industrial action, as he is not prepared to attend any meetings with Acas over the closure of its defined benefit pension schemes. Trade unions GMB, Unite and Unison says that in a meeting with Anglian Water CEO Peter Simpson on 8 March, in which they sought to involve the mediation services of Acas into future meetings, CEO Peter Simpson refused the idea. The unions claim over 1,300 workers at Anglian Water are affected by the closure of the DB pension schemes, which could see some losing up to £100,000 should the new planned defined contribution pension scheme fail to deliver.

12 March The minimum auto-enrolment increase to 5 per cent next month will not lead to large-scale opt-outs by members, according to **Royal London**. Analysis by the firm finds that a number of factors will combine to keep pension scheme membership at a high level. These include increases to income tax personal allowances and national insurance contributions.

13 March The PPF 7800 deficit increased by £21.1bn over February, to £72.1bn up from £51bn in January, the **Pension Protection Fund** reveals. Despite this, the position is still an improvement from February 2017 when a deficit of £242bn was recorded. The funding level of schemes decreased over the

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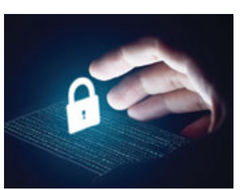
month from 96.9 per cent to 95.6 per cent at the end of February 2018.

15 March The bulk annuity market could hit £30bn in 2018 as providers overcome the "missed opportunities" of 2017, **Aon** says. According to the firm's *Risk Settlement: UK Market Update* for March, the market has not yet utilised the spare capacity for pensioner buy-ins and full scheme deals so far this year, but is still on course to match its £30bn prediction.

19 March The **Department for Work and Pensions** confirms its intention to legislate to introduce a criminal offence against those found to have committed "wilful or reckless behaviour" in relation to a pension scheme. In its white paper, *Protecting Defined Benefit Pension Schemes*, the DWP highlights that it will criminalise company directors and any concerned parties that have wilfully neglected their DB pension responsibilities. It will carry out a consultation over the coming months.



20 March The Pensions Regulator is to publish a guidance paper on pension scheme cyber resilience, it confirms. Speaking at Pensions Age's annual data seminar with ITM, **TPR** policy lead Lucy Stone highlights that in light of increasing cyber breaches, the regulator will be producing a guidance piece on how pension schemes can be resilient against cyber-attacks. "Pension schemes are very valuable targets to cyber criminals. Personal information are valuable, marketable commodities," Stone states.

21 March Work and Pensions Committee chair Frank Field questions the leadership of The Pensions Regulator after its chief executive gave evidence to the committee in the wake of the Carillion disaster. In correspondence between the committee and TPR released 21 March 2018, Field says that TPR chief executive Lesley Titcomb and her senior colleagues' performances did not give him assurances that they could achieve the "necessary cultural change" that the regulator needed.

22 March Forty per cent of default funds are still targeted to annuities, which could be leaving members exposed to "unintended investment risks", according to **Aon**. The introduction of the freedom and choice reforms in April 2015 has seen a huge drop in the number of people purchasing an annuity. Aon warns that pension schemes' default strategies, which in the past would move members about to retire into UK fixed income funds – targeting annuity purchase – are lagging behind this trend.

23 March The Financial Ombudsman agrees to hold an inquiry into allegations of bias against consumers and claims that its staff are inadequately trained amid fears that complaints may have been mishandled. Pressure has been rising for an inquiry into the service's 'failings' around 'mishandled complaints' after Channel 4's *Dispatches* programme showed an employee describing how investigators had been "churning" out decisions to meet targets.

26 March The **Financial Conduct Authority** backtracks on its proposal to remove the assumption for advisers that a defined benefit pension transfer is unsuitable, instead launching a consultation on whether a ban on contingent charging is needed. Publishing its policy statement on advising on pension transfers, the FCA says that it has decided not to proceed with the proposal on the starting assumption, noting that its recent supervisory work has shown "significant evidence of unsuitable advice being provided".

The Pensions Regulator

27 March The Pensions Regulator launches a consultation on its code of practice for master trust authorisation, after lobbying the government for "stricter rules". The consultation will outline what is expected of master trusts applying for authorisation, and with TPR confirming that new schemes will be subject to tighter supervision once authorised. It will run until the 8 May 2018 and from the 1 October existing schemes will have six months to apply to the regulator for authorisation.

News focus

Govt to make wilful pension scheme neglect a criminal offence

The new measure was confirmed in the long-awaited DB white paper alongside other plans to introduce a requirement for DB schemes to appoint a chair

The Department for Work and Pensions (DWP) has confirmed its intention to legislate to introduce a criminal offence against those found to have committed "wilful or reckless behaviour" in relation to a pension scheme.

In its white paper, *Protecting Defined Benefit Pension Schemes*, published 19 March 2018, the DWP said it will criminalise company directors and any concerned parties that have wilfully neglected their DB pension responsibilities.

"To ensure this power is proportionate, we will work with the relevant parties and carry out a consultation over the coming months so that all associated impacts are considered," the DWP stated.

In order to enable The Pensions Regulator to take a more proactive stance in the prevention of pension scheme neglect and reckless behaviour, it has been given greater powers. The white paper confirmed that it will strengthen the regulatory framework and TPR's powers as set out in the government's 2017 manifesto.

TPR will be able to allocate punitive fines for those who have deliberately put their scheme at risk and will see the introduction of legislation to introduce greater information-gathering powers, including the power to compel any person to submit to an interview, the power to issue civil sanctions for non-compliance and an inspection power.

Where employers, trustees and other parties may previously have not prepared to attend interviews with TPR, its new powers will see the extension and broadening of its interview requirements beyond this. The white paper stated that TPR will be given the power to inspect records, documents and electronic devises at premises for "purposes relevant to the regulator's functions". To do this, TPR would generally issue advance notice of an inspection, as long as notice works against the purpose of the inspection. Inspection powers for the purpose of 'compliance checks' already exist under section 73(2).

As an alternative to its power to impose criminal sanctions for non-compliance with a section 72 notice without a reasonable excuse, the government has also stated that it will legislate to give TPR the power to impose fixed and escalating civil sanctions.

Work and Pensions Secretary of State, Esther McVey, has said some fines may be issued retrospectively as legislation is not expected to be passed through parliament until the 2019/2020 parliamentary session. However, the Work and Pensions Committee critcised the government for not planning on introducing legislation earlier, as it means "pension rights are still at risk from unscrupulous businesses seeking to avoid their pension obligations".

Currently, TPR's main anti-avoidance power is the issuance of contribution notices, which require those involved in a detrimental act to pay an amount into the scheme. The payment can be up to a maximum amount of the scheme's section 75 deficit at the time the act took

place. It is hoped the additional powers will give the regulator the "ability to respond more quickly and decisively" where wrongdoing involving pension schemes have taken place, the DWP explained.

As a result of its earlier calls for the extension of its powers, TPR has "welcomed" the white paper's proposals. TPR chief executive Lesley Titcomb commented: "Planned improvements to our scheme funding, information-gathering and anti-avoidance powers will enable us to be clearer about what we expect from employers in relation to scheme funding and tougher where a scheme is not getting the funding it needs. Furthermore, strengthening the notifiable events framework will improve our regulatory grip and will ensure we are sighted sooner on planned transactions that could pose a risk to scheme members."

Pensions and Lifetime Savings Association director of external affairs Graham Vidler noted that the ability to impose significant fines, undertake enhanced information gathering exercises and introduce an increased oversight regime "can all play a role in safeguarding people's pensions".

However, he warned that while there is support for ensuring that TPR has the power to undertake its role, "our members are keen that they are proportional and practical".

In addition, the government will now require trustees of DB pension schemes to appoint a chair who will be required to report to the regulator in the form of a chair's statement, submitted with the scheme's triennial valuation. The DWP said its green paper on DB schemes identified that some schemes can suffer as a result of poor or uninformed decision-making by some trustees, which can increase the financial risk to the scheme or the sponsoring employer.

"We anticipate *[the requirement]* will encourage a greater focus on long-term thinking and sound risk management," the paper said.

The DWP explained that the chair's statement is intended to drive improved accountability and to demonstrate collaborative decision-making between the trustee and sponsoring employer. Trustees will be required to inform the regulator about their approach to managing risks to the scheme, including information on how the trustee is meeting the clearer funding standards and how the statutory funding objective (SFO) is being set in line with a long term funding objective. The chair will be required to submit the chair's statement with their triennial valuation.

One area of DB pensions that was left alone by the government, despite previous proposals, was the indexation of pension payments.

The government said it cannot accept any reduction in the value of member benefits. The government said the financial impacts of allowing schemes to switch to CPI would be significant, reducing some schemes' liabilities, possibly by as much as £90bn based on an aggregate DB deficit of £200bn. It noted that it would result in direct savings for employers, as scheme deficit repair contributions and on-going employer contributions would be reduced. However, supporting its decision not to make the change, it said reducing a scheme's liabilities would have a long-term effect on members' pension incomes.

Written by Natalie Tuck and Talya Misiri

NEWS IN BRIEF

Prudential Retirement and **Pension Insurance Corporation** have worked together to create a new approach to accelerate longevity reinsurance transactions for smaller pension buy-ins and buyouts. The process looks to combine an advance commitment of capital, known pricing and bundling of multiple transactions to enable PIC to address the risk transfer needs of small pensions more efficiently.

Moneyfarm has launched a self-invested personal pension. The pension is available to new and existing Moneyfarm customers and offers consolidation of existing investments. Engineering in the product will also bring a more personalised pension solution to individuals to reach their retirement goals. Target dates enable members to set a goal retirement date and as they near it, the portfolio asset allocation will adjust to ensure suitability.

Thesis AM has launched a decumulation portfolio service targeting the delivery of long-term income and lessening the risks of investing in the near term. The managed income service will be invested in lower risk defensive assets to achieve desired income and higher risk growth assets to increase the portfolio over time.

The Brunel Pension Partnership has responded to the Financial Reporting Council's consultation calling for input on the UK Corporate Governance Code, and the future direction of the UK Stewardship Code. Brunel believes that the duo of codes are hugely important to the future of investment, and welcome both the proposed amendments to the existing Corporate Governance Code and the new Stewardship Code.

VIEW FROM TPR

The phrase 'tick-box exercise' is often used as shorthand for a waste of time and effort. Few celebrate a job well done for rattling through paperwork that they don't think is worthwhile.

Our checks suggest a small minority of employers take the same approach to their automatic enrolment declaration of compliance. But while gathering the data for the form is vital for an employer, it also allows us to detect where employers are not doing the right thing for their staff.

Those who do consider the declaration to be a box-ticking exercise should take note of the case of Crest Healthcare and what can happen if you try to fob off The Pensions Regulator (TPR) with false information.

In March, the Birmingham-based company and its managing director, Sheila Aluko, appeared at Brighton Magistrates' Court and admitted having misled TPR by submitting false data on the form.

Both also admitted having wilfully failed to comply with their automatic enrolment duties.

Aluko falsely claimed that 25 staff had been automatically enrolled. She now has a criminal record and will discover her punishment and that of her company when the case returns to court for sentencing in May.

Completing your declaration of compliance accurately and on time is a legal requirement. Employers who think they can just tick the box without completing their duties should be prepared for us to take action against them.

TPR director of automatic enrolment Darren Ryder

The Pensions Regulator

FCA to keep 'unsuitable' starting point for DB transfers in U-turn

The FCA has also launched a consultation on banning contingent charging, and has published research on the pension freedoms that reveals 37% of drawdown products are sold on a non-advised basis

The Financial Conduct Authority has backtracked on its proposal to remove the assumption for advisers that a defined benefit pension transfer is unsuitable, instead launching a consultation on whether a ban on contingent charging is needed.

Originally proposed in June 2017, the FCA had considered replacing DB transfer guidance with a statement in its handbook, stating that for most people retaining safeguarded benefits will likely be in their best interests.

Publishing its policy statement on advising on pension transfers, the FCA said that it has decided not to proceed with the proposal on the starting assumption, noting that its recent supervisory work has shown "significant evidence of unsuitable advice being provided", including its work on the British Steel Pension Scheme. "Given our concerns about the significant proportion of unsuitable advice, we do not consider it is appropriate to change this assumption at the present time," it said.

Furthermore, the FCA has opened a discussion on charging structures for advising on pension transfers as it believes the existing starting assumption could be perceived as countering the incentive to give unsuitable advice created by a contingent charging model. In its consultation, *Improving the quality of pension transfer advice*, the regulator said it is considering whether a ban on contingent charging is necessary for pension transfer advice.

"While implementing a ban on contingent charging raises a number of issues such as access to advice, these need to be balanced against the potential

benefits of a ban on contingent charging, ie a reduction in unsuitable advice," the consultation said. Commenting on the decision, Aegon pensions director Steven Cameron said demand for advice on DB transfers has never been higher and the FCA has now set out clearly 'what good looks like' allowing advisers to meet demands from their clients with confidence".

In another update from the FCA, it has revealed that just over one in three (37 per cent) of all drawdown products are sold on a non-advised basis. According to latest research, firms are providing savers with relevant information and pointing them in the right direction, but unadvised individuals have often made their mind up about what they want to do before they approach a provider.

"Firms provided customers with written, oral and online information which was made available both at the point of accessing their retirement benefits, and afterwards, to help them make informed decisions," the report said. However, the regulator warned of "potential harm in the future" such as running out of money due to savers not engaging with the information provided or not taking financial advice.

Written by Natalie Tuck

TPR launches consultation on master trust code of practice

New schemes will be subject to tighter supervision under the regulator's plans to establish a market with "stronger safeguards" that pension savers can "have confidence in"

The Pensions Regulator has launched a consultation on its code of practice for master trust authorisation, after lobbying the government for "stricter rules".

The consultation outlines what is expected of master trusts applying for authorisation, and confirmed that new schemes will be subject to tighter supervision once authorised. It will run until the 8 May 2018, and from the 1 October 2018 existing schemes will have six months to apply to the regulator for authorisation.

TPR acting director of regulatory policy, Anthony Raymond, said: "As the master trust market grew we had concerns about the lack of regulation for these schemes and so we lobbied the government for stricter rules. The publication of our code of practice marks another important step towards establishing a market with stronger safeguards and which pension savers can have confidence in."

The master trust market has grown from 270,000 members in 2010 to almost 10 million people with £16bn of savings in 2018. The code outlines that trusts must continue to meet authorisation criteria on an ongoing basis, and TPR head of master trusts Kim Brown said that new master trusts will be subject to greater supervision.

The Department for Work and Pensions has also confirmed that master trusts must report their financial information to TPR, and finalised its decision for a split fee, with new master trusts charged £23,000 compared to £41,000 for those already in the market. This is lower than the £67,000 originally proposed for exisiting schemes, and £24,000 for new schemes. Commenting on the reduction, Pinset Masons pensions legal director, Mark Barker, said: "For some, the £67,000 fee would have been seen as a deterrent. Pension providers will welcome the lower fee."

Discussing whether a lower entry fee for new trusts means standards won't be upheld, Brown said: "The evidence they *[new master trusts]* will have to provide at authorisation may be less than existing schemes, but they will prove to us through supervision that they will achieve the authorisation standard on an ongoing basis. So what that means is there won't be any lower barriers, they will still have to meet the authorisation criteria, it just means our supervision will be tighter for new schemes."

Brown added that tighter supervision of new master trusts will be ongoing until the regulator is satisfied. The DWP expects that 56 schemes will remain in the market, down from the current 81 and calculate that the net annual costs to trusts will be £2.6m. In regards to the timeline for new and old schemes, Brown believes that trusts have had more than enough time to engage with the authorisation material and is "confident" that it will be a "smooth" process. TPR said it hopes to complete its assessment six months after receiving the application. If a master trust is initially rejected, it will have 28 days to gather additional information to support its submission, or withdraw its application.

Written by Theo Andrew

VIEW FROM THE AMNT

Having recently listened to Pensions Minister Guy Opperman at the AMNT Spring Conference I am on one hand encouraged by the impending changes to auto-enrolment but somewhat perturbed that little, or nothing is being done to deal with issues faced by those with mature pension pots.

We see far too many instances, such as British Steel, where pension savings are seen as an opportunity by the unscrupulous, scams and poor advice are too common. As trustees we can only do so much; provide information and warnings, and whilst the government has pledged to outlaw cold calling, I heard nothing as to when this would be.

So why are we putting so much emphasis on saving today whilst allowing savers to be fleeced at the other end by bad advice/temptation? If we want people to provide for their old age and not become a burden on the state why are we making it so easy for them to access the money early? Many are being tempted by the relatively large sums on offer and pension schemes are often only too keen to give transfers to ease pressure on the liabilities and potentially reducing employer deficit contributions. As a trustee it is extremely frustrating that we don't have the power to refuse transfers to suspicious schemes. Our only checks are to establish if the scheme is registered with HMRC and that IFA advice has been obtained; nothing about quality of advice or details of any scheme. Is it not time that we had a holistic and consistent approach that focused on what pensions are for, getting people a relatively secure retirement income?

Martin Giel, member-nominated director and AMNT member

VIEW FROM THE PLSA

After years of non-stop upheaval in pensions regulation, the consensus among PLSA members was that the Chancellor's Spring Statement was gratifyingly dull.

This lack of news gave commentators more time to dig into the accompanying documents. The 'Economic and Fiscal Outlook' produced by the Office of Budget Responsibility. A substantial part of this bill is, of course, the UK's share of future EU pension liabilities. Some newspapers managed to generate a 'shock, horror' headline from the OBR's 'revelation' that the UK would still be making annual payments to cover our share of Eurocrats' pensions for many decades to come – until 2064, in fact.

The OBR's analysis draws on research by Eurostat and a quick check of this document shows that the 2064 date arises simply because it marks the end of the standard 50-year actuarial forecast period on which the EU paper is based.

In fact, the UK's liability will continue for many years after that date (although the amounts will have declined to a relatively modest £50 million a year by then). Common sense supports this – a 30 year-old Briton who joined the EU services in the last year or two and who lives until his or her 90s could still be receiving a pension in the 2080s. If they have a surviving spouse who is significantly younger, then that person could still be receiving EU payments in the early years of the 22nd century.

Whatever your view of Brexit, it's clear that the costs of EU membership will rumble on for longer than even the media commentators imagine.

James Walsh, policy lead: engagement, EU and regulation, PLSA

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

New research finds 40% of DC funds are still targeted to annuities

A separate investigation has also found that those entering into drawdown products are losing thousands of pounds due to high investment charges

Forty per cent of default funds are still targeted to annuities, which could be leaving members exposed to "unintended investment risks", according to Aon.

The introduction of the freedom and choice reforms in April 2015 has seen a huge drop in the number of people purchasing an annuity, with people choosing other options such as drawdown. However, Aon has warned that pension schemes' default strategies, which in the past would move members about to retire into UK fixed income funds – targeting annuity purchase – are lagging behind this trend.

Commenting, Aon head of DC investment advisory Chris Inman said: "The change in preferences at retirement has introduced the need for pension schemes to re-think this approach. Traditional investment strategies that utilise passively-managed funds that invest solely in UK fixed income can now be exposing members to significant unintended risks."

Aon's *Defined Contribution Scheme Survey 2017* showed that 85 per cent of members are still using the default option and that 40 per cent of these default investment strategies target the purchase of an annuity at retirement. In the wake of freedom and choice, members should be aware that investing in fixed income has become much more risky, Inman said.

"Regardless of whether members take their benefits as cash or draw them down as flexible income, how we think about risk should change. We should focus on the absolute variability of outcomes, as well as the magnitude and duration of the capital loss. For DC members nearing retirement, investment strategies need to mitigate key risks including opportunity cost, longevity and inflation."

Despite the appetite for drawdown, *Which?* has warned that pension savers are losing thousands of pounds from their pension pots as a result of high investment charges on drawdown schemes.

According to research, shared exclusively with *The Times*, savers paid £12,000 more than others over 15 years. The *Which?* investigation found that someone who invested a £250,000 pension pot into a Standard Life Active Money Sipp would incur fees of £38,144 over 15 years. It was the most expensive of the nine pension companies and 13 investment broker schemes examined.

However, if a saver has chosen a Sipp from online service Interactive Investor, they would have paid £26,043-£12,101 less. *Which?* has called for transparency and comparability of charges.

"People should be able to make an informed decision, but it is extremely hard to compare fees when they are presented inconsistently. The FCA must introduce a charge cap on default products to ensure that consumers don't miss out on the savings they need for retirement," *Which?* author Paul Davies said.

Written by Talya Misiri and Adam Cadle

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VIEW FROM PPI

State pension aims have varied, from providing a basic level of income, to helping people maintain living standards, and back to a basic income under the new state pension (nSP). The nSP currently provides 24 per cent of average earnings; it is not clear whether this amount is expected to provide an adequate income, and how much the state expects people to be able to afford to pay privately.

The state pension currently increases each year by the greater of the rise in earnings, prices or 2.5 per cent (the triple lock) which makes up some of the value lost from when the state pension was price linked (1980-2010). However, it also will increase the cost of the state pension over time, though a large proportion of the expected costs are due to increases in the number of pensioners.

The government has pledged to maintain the triple lock during this Parliament, ending in 2022, but may then index the state pension to a double lock (the greater of earnings or prices) or to earnings. Removing the triple lock would save the state money but would increase the amount that people would need to save for a comfortable standard of living in retirement and would result in higher poverty. However, it is hard to properly assess the implications of choosing different indexation scenarios until the aim of the state pension is fully clarified.

Daniela Silcock, head of policy research, Pensions Policy Institute

Nortel UK pension scheme to exit PPF assessment following recoveries

In other pension fund news, the trustees of the GKN pension schemes have received commitments from new owners Melrose of £1bn, and BT confirms its DB scheme will close

The Nortel UK pension scheme is set to exit the Pension Protection Fund's assessment period following substantial recoveries from its sponsoring employer, which will allow the scheme to spend an additional £550m above PPF benefits.

Nortel Networks collapsed into insolvency in January 2009, with its European, US and Canadian entities making simultaneous insolvency filings in London, Delaware and Toronto. The business was hugely integrated, and there was significant difficulty associated with realising assets on a country-by-country basis. As a result, the various insolvency office-holders worked together to sell the key assets and business units on a joint, global basis, realising proceeds of more than $7bn. After several years of mediation, negotiation and litigation regarding the apportionment of these proceeds to the different global Nortel entities, a settlement was finalised in October 2016, and the $7bn proceeds were distributed in May-June 2017.

Trustees of the UK scheme have now recovered sufficient funds to exit the PPF assessment period, which is expected to be in October 2018. The pension scheme will receive an estimated £550m to spend on benefits above PPF level for members, some who have had their benefits cut to date. Total insolvency recoveries are now anticipated at around £1.2bn, with approximately £200m expected over the course of 2018 and 2019.

In addition, following GKN shareholder approval of Melrose's hostile takeover bid, the trustees of the GKN pension schemes have said they "look forward to working with Melrose Industries plc, the new sponsors of the schemes, to deliver the agreed package of mitigation measures". Prior to the announcement of Melrose's success, the GKN trustees confirmed they had reached an agreement with Melrose on a package of mitigation measures to support the schemes.

Melrose offered £1bn to the schemes, comprising of an initial contribution of £150m, of which c.£60m will be paid to the 2016 scheme to fund the 2016 scheme on a gilts+25bps discount rate basis. It has also been agreed to have a more prudent funding basis for the 2012 scheme using a discount rate of gilts+75bps, achieved by doubling annual contributions to £60m, an agreed formula for contributions on disposals. Payments to the schemes will be secured by Melrose Industries Plc guarantees.

The trustees said the contributions will mean that the schemes will be funded to a more prudent level and the enlarged Melrose Group would provide strong covenant support to the schemes following the proposed acquisition.

And finally, the DB scheme of BT will close and move to a 'hybrid' pension scheme, having reached an agreement with Communication Workers Union (CWU), it has been confirmed. BT announced that it will close its BT Pension Scheme (BTPS) and move members to the BT Retirement Saving Scheme (BTRSS), combining elements of DB and defined contribution for 20,000 non-management employees or 'team members'. Despite this, BT said that there are some "complex administration-related issues" that the trustee is working to resolve, on which it will provide a further update.

Written by Natalie Tuck and Theo Andrew

People on the move

John Ball

The Church of England Pensions Board has appointed John Ball as its new chief executive.
Ball is currently chief executive and diocesan secretary for the Diocese of Chelmsford and will take up his new role on 1 July.
In addition to his current CEO role, he is chair of the Church of England's National Procurement Group, a body that oversees and enables parishes to buy and save together. He is also a peer reviewer to other dioceses. Prior to joining the Diocese of Chelmsford in 2011, he spent 11 years at London Underground, part of Transport for London, where he was head of strategy and asset management. He graduated from Keble College, University of Oxford with a degree in Philosophy, Politics and Economics in 1999. Commenting on the appointment, Church of England Pensions Board chair Jonathan Spencer said: "I am delighted to welcome John. He brings with him a wealth of experience and a thorough understanding of the need and challenges faced by many of our key partners."

Craig Cheyne

Momentum Pensions has promoted Craig Cheyne to UK managing director. Cheyne joined in the firm in 2013 and has built his international career in Singapore and South-East Asia with Royal Skandia International, and he has also worked for Zurich Life in the UK. He has over 25 years' experience as an independent financial adviser. Momentum Pensions group chairman Mark Gaywood said Craig is the ideal candidate.

Bart Kuijpers

BMO Global Asset Management has appointed Bart Kuijpers as head of fiduciary management. Kuijpers joins in April 2018 from the International Pensions Platform, which he founded in 2014 with Swiss Re and Credit Suisse. He has also held positions with Societe Generale and The Royal Bank of Scotland. Kuijpers will be responsible for expanding the firm's global platform, particularly across governance and sustainable investment.

Kathleen Gallagher

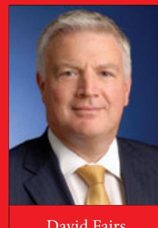
State Street Global Advisors has named Kathleen Gallagher as head of ETF model portfolios for EMEA and Asia Pacific. Gallagher will report to global head of SPDR ETFs and will be responsible for delivering the firm's investment capabilities to the intermediary market, based in London. Before joining SSGA she spent five years with institutions including BlackRock, where she was responsible for the research of multi-asset solutions.

Paige Willis

Sackers & Partners has hired Paige Willis as an associate. Willis joins the firm's alternative funding and contingent asset practice, as demand increases from trustees and employers for advice on defined benefit pension schemes. She will be responsible for working across a broad spectrum of funding and security solutions. Previously, Willis worked in Ashurst's securities and derivatives team.

Darren Philp

Smart Pensions has named Darren Philp as head of policy, effective September this year. He moves from director of policy and market engagement at The Peoples Pension. Philp joined B&CE in 2013 to build its media presence and ongoing policy work and has held directorships at the National Association of Pension Funds, now the Pensions and Lifetime Savings Association, and at the Pension Quality Mark before this.


David Fairs

The Pensions Regulator has appointed David Fairs as its executive director for regulatory policy, analysis and advice, effective July 2018. Fairs will be responsible for developing and implementing legislation relating to workplace pensions, Brexit, the 21st century trustee initiative and other pensions issues.
He joins from KPMG where he was responsible for helping clients deign, manage and communicate their pension benefits. Furthermore, Fairs has held external roles, including chairman of the Association of Consulting Actuaries and is the founding chairman of the Joint Industry Forum for Workplace Pensions. TPR chairman Mark Boyle said: "I am delighted David Fairs has been appointed to what is a pivotal role at TPR. The rapid pace of change in the pensions sector continues and David's strong background and deep understanding of pensions legislation will ensure we remain an active influencer and pragmatic implementer of government pensions policy, in line with our mandate to protect workplace pensions".

VIEW FROM THE ABI

In February, the ABI launched an industry framework to help find 'gone-away' pensions and insurance customers. Providers already go to great lengths to track down their lost customers, but the framework will encourage the most effective techniques across the entire sector. The framework was particularly timely with the government recently confirming its commitment to working with industry to expand the Dormant Accounts Scheme to contract-based pensions and insurance products. It also reiterated that customers should be able to reclaim their dormant assets at any time as a key principle of the existing scheme.

The Dormant Accounts Scheme distributes assets to really important causes, supporting charities and improving social mobility. It was established just under a decade ago and has been widely adopted by retail banks. By 2020 the total distribution from dormant accounts, which have been inactive for an extended period of time, will reach over half a billion pounds, with funds channelled towards causes such as housing vulnerable people and helping disadvantaged young people into work.

For firms considering whether to sign up to this voluntary initiative the primary concern, and one that is mirrored in the scheme's own principles, is ensuring that they have taken the necessary steps to reunite owners before funds are moved across. The ABI's 'Gone-Aways' framework will enable firms to volunteer for the scheme with the knowledge that they've done all that they can to reconnect people with their lost assets first.

Lucy Forgie, senior policy adviser at the Association of British Insurers

Market commentary: Volatility returns

It's bad news for pension schemes as volatility has returned to the markets.

News of further interest rate rises, US trade tariffs and the ongoing Brexit negotiations, combined with markets that are no longer supported by quantitative easing, has led to shakier funding levels for pension schemes with equity allocations, says Schroders portfolio solutions strategist Alistair Jones.

As well as these events, Aviva Investors senior portfolio manager James McAlevey believes the recent uptick in volatility reflects a deeper and more profound structural shift. McAlevey says the net result is the "removal of a hitherto reliable structural bond-buyer from the market, which changes the market dynamic drastically".

Unfortunately, he believes we are seeing the beginnings of a longer-term shift towards higher volatility. "As a base case, we expect volatility to normalise at structurally higher levels closer to its 1990s range, perhaps between 80 and 120 on the move index, following the extreme highs of the crisis and the extreme lows seen in the run up to the crash and thereafter. In this environment, investors need to ensure their portfolios will remain resilient in the face of market gyrations. First and foremost, they should be mindful of the duration of the government and corporate bonds they own."

This has had negative affects on the deficits of pension schemes; Hymans Robertson partner Alistair Russell-Smith notes that recently FTSE 350 DB deficits have increased by £15 billion, now reaching £90 billion. On a more positive note however, he says that deficits are "largely manageable" for 90 per cent of FTSE 350 companies, accounting for less than 10 per cent of their market cap.

"The impact of this recent volatility, particularly on schemes with low hedging levels, shows the benefit of taking a more measured approach to investment risk, even if this means having a longer deficit recovery period. This type of 'lower risk for longer' strategy will usually result in a better chance of the scheme paying its members' pensions while also avoiding placing the sponsoring employer into financial difficulty. We must remember that DB pension promises typically extend for the best part of a century and that trustees don't need to rush towards the exit only to risk tripping over the employer's own shoelaces," Russell-Smith adds.

However, BNY Mellon head of institutional distribution for Europe, Olivier Cassin, says schemes have already been proactive, as they want their assets to be protected in these turbulent times. "Recently, we have seen a lot of demand from large pension schemes, whether from the private or the public sector, for tail-risk hedging, absolute return and diversifying strategies. These include private debt, EMD, absolute return fixed income and long-short equities."

The volatility could also provide some opportunities for pension schemes, Aviva Investors senior portfolio manager John Dewey says. "Across a pension scheme portfolio, higher levels of volatility give greater opportunity to enhance returns. A diversified and risk-controlled approach with discretion to access a wide range of markets is desirable. This includes equities, fixed income, multi-asset and opportunistic investment in less liquid private assets. For schemes investing in overseas assets, cross-currency movements provide opportunities to enhance returns at a moderate risk profile. For example, changes in US monetary and fiscal policy have made dollar fixed income assets more favourable for an investor hedging back to sterling."

Written by Natalie Tuck

Diary: April 2018 and beyond

PMI Pensions Aspects Live
19 April 2018
County Hall, London
The conference will feature a number of prominent pensions industry speakers such as Alan Pickering (BESTrustees), Tom McPhail (Hargreaves Lansdown) and Mark Boyle (The Pensions Regulator). Speakers will engage in a number of discussions, debates and presentations throughout the event and there will be several networking opportunities throughout the course of the day.
For more information, visit:
Pensions-pmi.org.uk/events/upcoming-events/

Pensions Age Spring Conference
26 April 2018
De Vere Grand Connaught Rooms, London
Covering all aspects of pension provision, this key conference has become a must-attend pensions event and will help delegates to improve their pensions knowledge and understanding with a series of presentations from leading pension professionals and policymakers from across the industry. This one-day conference is open to pension scheme managers, trustees, FDs, advisers, pension and HR professionals.
For more information, visit:
Pensionsage.com/springconference/

PLSA Local Authority Conference
21-23 May 2018
De Vere Cotswold Water Park Hotel, Gloucestershite
The event is the largest of its kind dedicated to the Local Government Pension Scheme that has over 13,000 employers, over five million members and assets of over £225 billion. Attracting local authority officers, councillors and their advisers, the programme features senior government policymakers and influencers, high-profile industry figures and people from outside the pensions sector.
For more information, visit:
Plsa.co.uk/Events-Local-Authority-Conference

Pensions Age Northern Conference
14 June 2018
Leeds Marriott Hotel
Now in its third successful year, this one-day conference, which is open to pension scheme managers, trustees, FDs, advisers, pension and HR professionals, will offer delegates the up-to-date knowledge and guidance they need to help them run their pension schemes to the absolute best of their ability, and give them the tools they need to help them carry out their duties whether this is in relation to DB, DC or to schemes on a path to de-risk.
For more information, visit:
Pensionsage.com/northernconference/

Visit www.pensionsage.com for more diary listings

Month in numbers

53%
Over half, 53 per cent, of British businesses expect the government to remove the option for savers to opt-out of their auto-enrolled pensions and so make workplace pensions compulsory, Now: Pensions has said.

According to a recent survey of 691 British businesses, it is expected by over half that the government will make workplace pension saving compulsory at some point in the future.

71%
Over seven out of 10, 71 per cent, of defined contribution pension holders are unaware of the charges they are paying, the Financial Conduct Authority has found.

£1 billion
Melrose has pledged £1bn to GKN's pension scheme as part of its offer to take over the engineering firm.

VIEW FROM THE ACA

Responding to last month's white paper, *Protecting Defined Benefit Schemes*, I welcomed the proposals that would aim to help the simplification of benefits as a precursor to the consolidation of defined benefit schemes.

I also said that we look forward to a new funding code: which we hope will incorporate lessons learned from recent high-profile failures.

However, we are disappointed that no new relief to employers struggling with DB liabilities appears to be proposed. Our survey of employers conducted last year found this was needed if more employers are not to abandon DB provision. Eight out of ten schemes responding to our survey said the cost of defined benefit schemes was having a negative impact on intergenerational equity and – even more telling – 84 per cent of employers said the law should be changed so that defined benefit schemes can reduce pension increases if continuing to provide increases at the level of scheme rules will severely and adversely affect the employer, with the largest number favouring this being subject to an agreement with trustees.

Whilst our survey found employers generally support tougher rules and fines for directors not taking sufficient care in protecting scheme members' interests, we wonder whether these tougher rules – without any help for struggling employers with defined benefit liabilities – will again provide a further impetus for prudent directors to close schemes in favour of lower cost DC arrangements, with inferior pension outcomes.

Bob Scott is chairman of the ACA

VIEW FROM THE SPP

The Brexit countdown is on in earnest. The UK is currently set to leave the EU on 29 March next year. Time for a quick recap of the impact on our industry.

Gilt yields remain depressed following post-Brexit vote falls, which has put strain on the funding position of many schemes. How much of the continued downward pressure on gilt yields is down to Brexit uncertainties is debatable, but Brexit is only one thing in the mix.

There has not been any noticeable effect on the UK pensions law so far. We are still members of the EU and all existing EU legislation is to be enshrined in UK law by the Withdrawal Bill. Moreover, EU legislation in the pipeline is still being implemented. GDPR comes in next month and the Shareholder Rights Directive update and IORP II Directive are to be implemented before exit or during the 21-month transitional phase, assuming that there is a deal. All of these will have a significant impact. Currently there are no signs of a Brexit bonfire of pensions red tape but on the other hand Brexit may be blocking other legislation.

There are lots of potential risks to pension security associated with Brexit, for example funding, covenant and investment. These risks should be monitored as part of the integrated risk management framework which The Pensions Regulator is promoting. So, don't panic but keep a careful eye on the risks and have plans in place to mitigate them.

Tony Bacon, chair, Society of Pension Professionals' European Committee

In my opinion

On the extension of TPR's powers
"We called on government for more effective powers and so we welcome the proposals outlined in the DWP's white paper. Planned improvements to our scheme funding, information-gathering and anti-avoidance powers will enable us to be clearer about what we expect from employers in relation to scheme funding and tougher where a scheme is not getting the funding it needs."
TPR spokesperson

On the introduction of a DB Pension Superfund
"We know that many businesses are constrained by their pension liabilities and need to find a more affordable way to fulfil their promises to pension scheme members. The Pension Superfund is taking the lead in providing the opportunity to deliver better outcomes and improved security to pension scheme members, trustees and sponsoring employers."
The Pension Superfund CEO Alan Rubenstein

On TPR and FCA's closer working relationship
"It's essential that TPR and the FCA continue working closely together to identify and mitigate risks that are preventing pension savers from getting good value. One area they recognise is in need of scrutiny is the need to support good choices and outcomes at retirement. At the moment government policy is strong on encouraging pension saving but weak on ensuring savers take the guidance available to help them decide how best to use the money."
Just Group communications director Stephen Lowe

On the DB white paper
"I very much welcome the announcements of new powers called for by the committee. But for these measures to be an effective deterrent to the minority of employers wanting to shirk their pension obligations, there has to be a credible threat of them being deployed in full and at speed. This has been the problem with existing pension regulation powers, which laid largely dormant while the pension schemes at BHS and Carillion unravelled, with who knows how many more like them still waiting in the wings."
Work and Pensions Committee chair Frank Field

On Carillion pension scheme deferrals
"The decision to defer is not something I regret, nor the trustee regrets…We improved the ranking *[of the pension scheme]* in terms of the chain of insolvency so there was robust protection and a seat at the table going forward, which has saved the scheme multiple of millions of pounds."
PwC restructuring and pensions partner Gavin Stoner

On DC pension understanding
"Those who report a high level of knowledge about financial matters are three times as likely to have a high level of trust in their DC pension provider than those with lower knowledge."
Financial Conduct Authority

The greatest innovation of the 21st century?

Pensions Age speaks to CFM's Philippe Jordan about alternative beta and how pension funds can incorporate it into their portfolios

The greatest innovation in asset management of the 20th century? Systematic beta, so says CFM president Philippe Jordan. He acknowledges that active, discretionary management still holds the lion's share in portfolios, but "nonetheless, systematic beta really is one of the big innovations of the last century, due to it delivering on its promise of a decent Sharpe ratio of about 0.3-0.4 at very reasonable costs, and with relatively simple systematic implementation".

So while the greatest innovation of the 20th century is now widely adopted, what of the greatest innovation (so far) of the 21st century? For Jordan, this century's greatest development in asset management is alternative beta, which is the quantitative and systematic management of liquid alternative assets, sometimes referred to as alternative risk premia or hedge fund beta.

According to Jordan, there is a whole battery of alternative beta investment strategies that have made their way in the past 15 or 20 years from academia, into asset management and more recently into the public consciousness. They are scalable, persistent strategies delivering a significant Sharpe ratio between 0.5-0.7.

Its these characteristics, together with the industry's need for decorrelated returns to systematic beta but with greater capacity than pure alpha, which Jordan believes continues to make alternative beta attractive to pension funds. "I think it is going to continue to grow and become an increasingly significant component of pension fund portfolios. They either are using it to complement their exposures to traditional betas or they are using it as a completion strategy for their existing factor portfolios. Finally they are implementing them as a replacement strategy for hedge funds that are providing less value at a higher fee." Jordan explains.

The idea of using current alternative betas as a replacement for less efficient hedge funds is significant. "A lot of what we call alternative betas today was packaged as hedge funds 15, 20 years ago at a cost level and with governance structures that were unacceptable to many pension boards," Jordan says.

In contrast, since the mid-2000s, alternative beta has become available in a format that is now acceptable in terms of costs and governance package, he explains.

This change to an 'acceptable format' accelerated post-financial crisis. But while alternative betas would still be affected from a massive instantaneous shock such as another financial crisis, just as all investment products would be, they can protect investors against a protracted downturn in the equity and bond markets. This is due to the decorrelation benefits and diversifying effects alternative betas provide, Jordan explains.

However, the tricky part with achieving this is finding alternative betas that are truly persistent, "something we have committed decades of research to, as there are a lot to choose from, and within that there is a lot of noise", Jordan says.

There are certain factors that truly deliver exposures that are persistent over time and are decorrelated from traditional equity and fixed income markets, he assures, such as long-term trend following, or factor exposures such as value, momentum, quality, or risk premia.

So, in order to effectively implement alternative beta, a couple of ingredients are key. "One is being able to distinguish between persistent alternative beta from non-persistent," Jordan says, "and two, you need to be able to implement it in a fashion where you can control execution cost and control risk. Those two are particularly intertwined, in that the better you can control execution cost, the more you can risk manage, and vice versa – the less you can control execution cost, the less you can risk manage because you need to trade in order to risk manage and the more you trade the more cost you generate."

According to Jordan, to implement alternative beta into a pension fund portfolio properly, "you need to utilise technology globally and you need to accumulate a lot of know-how for how to use that technology to your benefit" – something that individual pension funds are generally reluctant to do alone.

This will lead investors to fewer than 20 firms worldwide that have the combination of rigorous, statistical science in order to distinguish what is the persistent from the non-persistent, coupled with implementation technology and know-how.

"So talking to firms that have these skillsets and have had these deployed in excess of a decade is probably the right thing to do," he concludes.

In association with

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested

Has income investing had its day in the sun?

Steven Andrew explains why pension funds are turning to multi-asset investments for their income needs

Income investing generated strong returns in the years following the financial crisis. However, today's low yields and the potential threat of rising interest rates could represent a challenge to many traditional income-generating assets. As UK DB pension schemes focus ever more on generating income from their assets, flexible income strategies that seek relative value from a wide range of assets globally should be best placed to adapt to the changing environment to meet these needs.

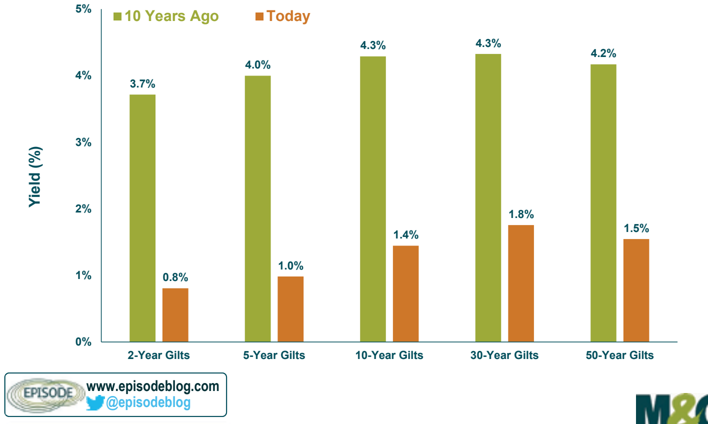
Income investing: A turning point?
In the aftermath of the financial crisis, traditional sources of income such as gilts, bonds and dividend-rich stocks generated strong capital returns against a background of falling interest rates. At the same time, pessimism about the growth outlook and an aversion to short-term volatility made near term return of capital a greater concern than longer-term return on capital.

However, the environment no longer looks supportive for delivering income via some traditional means. Falling interest rates have reduced the return available on many assets; even gilts with a maturity of 30 years and beyond are priced to deliver yields lower than 2 per cent (which, should CPI resemble most of recent history, would represent a negative real return).

A yield desert
Moreover, should the Western world begin to follow the US in meaningfully tightening policy, traditional income sources that have benefited from a low-rate environment could be vulnerable to material capital loss. Not only are low yielding bonds vulnerable, but rising rates can pressure a wide range of other assets.

In February 2018, threats of increasing US rates prompted material volatility in equity markets, while in the UK the underperformance of UK stocks with a history of growing dividends (as reflected in the S&P 'Aristocrats' index) began as UK yields began to rise in the latter part of 2017.

As rising rates pressured assets across the investment universe, correlation patterns changed during this phase. Government bonds, which had previously been seen as 'safer' sources of income, acted as a source of volatility, rather than a protection against it. Multi-asset income strategies can be flexible in responding to these dynamic diversification properties. For example, the volatility of February offered the opportunity to add exposure to US Treasuries at more attractive yields, and to areas of the equity market that should be less sensitive to interest rates over the longer term.



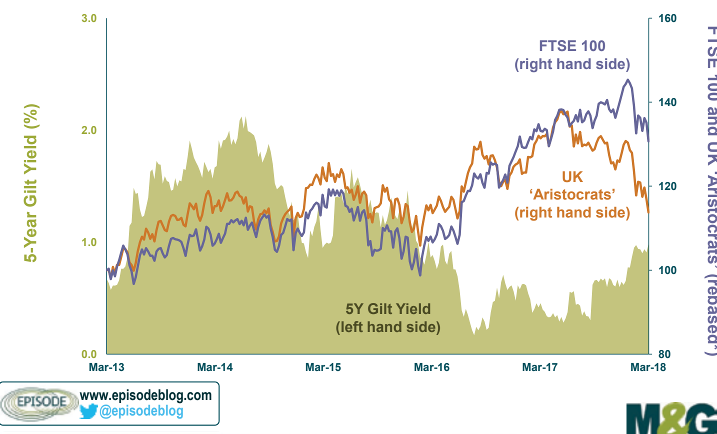
Pension funds' need for income
Pension schemes invest widely in asset classes ranging from equities and corporate bonds to real estate and infrastructure with the aim of generating diversified income as well as opportunities for capital growth. These assets complement their matching asset portfolios for contractual cashflow.

Maturing schemes need to meet increasing cashflow requirements:
Mercer's latest *European Asset Allocation Report* found that in 2017 for the first time over half of UK defined benefit schemes were cashflow negative (55 per cent of schemes versus 42 per cent the previous year) and this share is set to continue growing.

Regular income delivery can help pension schemes delay or even prevent having to liquidate assets in order to meet these cashflow needs – it can also partially mitigate the risks associated with forced liquidation. Divesting in periods of market stress can result in losses being crystallised (particularly when less liquid assets are involved) and could damage the prospects of an asset base delivering returns in line with long term expectations. Managing the process of

forced selling can also create administrative challenges, particularly for smaller schemes.

Pension fund trustees will need to consider the various trade-offs in achieving their income goals, or seek external actively managed portfolios whose objectives are compatible with the overall scheme. Multi-asset solutions are useful in this respect, offering a transparent means of delivering income in different market conditions.



enters a new phase in which asset prices may change significantly.

A regular, stable and growing income stream is a useful tool for schemes managing cashflows, while the commensurate need for stability and growth in the capital base of many income funds mirrors the requirements of schemes that need to improve funding levels.

We expect investors to have to look across a diverse investable universe for attractive income sources to support their goals. However, targeting a constant yield level should not incentivise chasing yields in ever riskier assets, simply because traditional sources are unavailable. Instead, taking advantage of the diversification benefits that come with a wider universe and considering risk management tools such as active currency and duration management allows multi asset approaches greater scope to deliver the return and volatility profiles that could once be expected from single assets.

This is especially important today, as a potential end to an era of ultra-easy policy in the developed world creates challenges to both prospective returns and correlation patterns across global assets, as demonstrated by market behaviour so far in 2018. Navigating such shifts will likely involve both selectivity and an ability to be dynamic as return and correlation patterns change.

Multi-asset solutions: Selectivity and dynamism

The clear benefit of multi-asset solutions for income delivery is that they are not bound to any single asset and are able to capture the best opportunities from around the world, while avoiding those areas where prospective returns are low.

Falling interest rates were a boon to a wide variety of assets, but the flipside of this is that many of the greatest beneficiaries could be the most vulnerable to a reversal in that trend. Selectivity therefore becomes increasingly important to avoid losses and manage short term volatility.

Fortunately, a growing global universe of income-bearing assets means that multi asset managers with an income objective have far more avenues to pursue today than in the past. The corporate bond market has become broader and deeper in the UK and overseas, more global companies are focusing on returning cash to shareholders via dividends and buybacks, and both alternative and emerging markets have also matured significantly.

This means that delivering income does not necessarily mean 'reaching for yields' in ever more risky assets, so long as investors are willing to look across financial markets to source assets offering attractive value. For example, although gilt yields are low, US treasuries offer more attractive yields of above 3 per cent from 10 year maturities out to the long-dated end of the curve and so offer the potential for diversification, which was less evident at lower yields.

Similarly, in equities, though 'bond proxy' stocks as described earlier have offered little value until recently, European banks have offered comparable income yields at far more competitive pricing. The ability to seek value across a far broader opportunity set can enable a manager to build a more resilient, diversified portfolio.

Multi-asset solutions also offer the advantage of being able to manage short-term volatility in capital and income payment by maximising diversification across a broader range of exposures. Single-asset income strategies on the other hand are likely to be more beholden to shorter-term swings in capital values, particularly if they are being relied upon to deliver a natural income.

Conclusion

Pension schemes' need for income is intensifying as if the market environment

For more information please visit www.mandg.co.uk/multiasset

Written by M&G fund manager Steven Andrew

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Musings of an MNT

Goodwill Hunting

Good Will Hunting is a 1997 American drama film. The film follows 20-year-old South Boston labourer (Matt Damon) an unrecognised mathematical genius who only through the intervention of a therapist (Robin Williams) realises his full potential and reconciles his personal life. Throughout the therapy sessions Williams attempts to, and finally succeeds in, getting Damon's cooperation by harnessing goodwill between them.

The dictionary definition of goodwill is 'friendly, helpful, or cooperative feelings or attitude', thus for Williams to help Damon there needed to the goodwill between them. In establishing goodwill between the two parties, not only is Damon's potential realised, but Williams is also able to come to terms with his own past. Goodwill provides mutual benefits to both parties in the relationship.

Goodwill is recognised in business terms as an intangible asset solely identified with that business. It cannot be separated, or divided, sold, transferred or exchanged: It is integral within that business. However, it can be damaged and destroyed.

Retail outlets particularly depend on the goodwill built up with their customers. In 1991 Gerald Ratner, head of the Ratner Group, delivered a speech to the Institute of Directors. This group of jewellery outlets whose shops and wares though widely regarded as 'tacky', were, nevertheless, extremely popular with the public, until Ratner said in that speech;

"We also do cut-glass sherry decanters complete with six glasses on a silver-plated tray that your butler can serve you drinks on, all for £4.95. People say, 'How can you sell this for such a low price?' I say, 'because it's total crap.'"

This act of bravado nearly saw the collapse of the group with £500 million wiped of its share price. Overnight he had lost the goodwill of his customers.

Goodwill is vital in the relationship between boards of trustees and the sponsoring business and between the trustees and members of the fund.

There needs to be a recognition by the trustees and the sponsor that establishing an open relationship is beneficial for both parties, particularly in time of pension deficits and when a sponsor is under financial pressure.

The Pensions Regulator in February 2009 issued guidelines that stated: "When the sponsor company is under pressure there is potential to renegotiate previously agreed plans to repair pension deficits (recovery plans). There is no reason why a pension scheme deficit should push an otherwise viable employer into insolvency. But the pension recovery plan should not suffer, for example, in order to enable companies to continue paying dividends to shareholders."

It also said: "Where an employer is facing more severe difficulties, it is in the interest of pension scheme trustees and the employer for information to be shared openly."

Openness can only come through establishing goodwill that enables both sides to provide reasonable solutions to difficult issues. Should one side have a hidden agenda then the results can only too readily be seen in the BHS and Carillion pension fund scandals.

Goodwill is established by the trustees with the fund's members by the tangible means of paying the correct pensions on time and meeting their requirements through efficient administration and by the intangible element of trust that is placed in the trustees that they will always act in the best interest of the members.

Indirect contact with members is normally through websites or communications like the annual funding statement. I have tried to reach out to members directly through seminars and group presentations, but there is a case, I believe, for consideration of an annual getting together similar to a company AGM.

Whatever approach is adopted the benefits of obtaining goodwill on all sides is immense, so good hunting.

Written by Stephen Fallowell, member-nominated trustee, Royal Bank of Scotland Group Pension Fund, writing in a personal capacity

A matter of time

Sam Roberts explains the importance of knowing your investment time horizon

All defined benefit pension scheme trustees should now be familiar with the concept of a flight/journey plan. It's a fairly complex calculation based on lots of assumptions to estimate how many years it could take for that scheme to no longer have to rely on either extra contributions from the sponsoring employer or achieving risky investment returns.

The flight plan is one way to think about how long trustees have to achieve their key objective of paying all members' benefits in full. Or, in other words, the trustees' investment time horizon.

Often the flight plan will be between five and 15 years. Most trustees might tweak it slightly and then accept it, but what else should be considered and what are the implications of a longer or shorter investment time horizon?

• Don't accept the first number calculated. Can the flight plan be shortened without increasing the overall investment risk, eg by using LDI or diversifying the growth assets more? Is the investment strategy's risk/return trade off really as good as it could be? The investment options available are much better and more cost effective than they used to be, especially for smaller schemes.

• The strength of the employer covenant. The stronger the covenant, the longer the investment time horizon can be. Can the covenant be strengthened to give more time for investment returns to be achieved? As we unfortunately see from time-to-time, covenant strength can weaken quickly without much warning (or is assumed to be stronger than it really is). Monitor regularly and be ready to move quickly if things change to help to protect members' benefits. If the employer becomes insolvent, the trustees' investment time horizon effectively goes to zero. Please don't fall into the trap of investing as if you have a long investment time horizon when you don't – a pension scheme is not automatically a long-term investor just because it is a pension scheme.

• The maturity of the scheme. How cashflow negative will the scheme be over the next few years and where will this cash come from? Try to avoid potentially having to sell equities just after they have crashed. A more mature scheme (eg one with more pensioners) will have a shorter investment time horizon than a less mature scheme as more cash will need to be disinvested and paid out sooner.

• Taking more investment risk means that the investment time horizon is less certain. So you might get there much quicker than you expect (or not)!

• Try to avoid stretching your investment time horizon to the maximum limit in normal market conditions. Give yourself a bit of a contingency margin – you may find you need it.

• Are there any likely future events that could change the investment time horizon? Eg extra cash available from the employer, more cash equivalent transfer values, or more early retirements than assumed?

The longer the trustees' investment time horizon the more they should/can consider:

• Defining a better long-term solvency target. This is likely to be lower than the immediate solvency premium estimated by the scheme actuary as some of the insurer's margins can be stripped out, although competition in the insurance market could change.

• Thinking harder about the potential impact of longer term risk factors, eg taking advantage of future asset volatility through triggers and/or being more aware of environmental, social and corporate governance issues.

• Choosing growth assets that focus more on the long term and take less notice of a benchmark index, eg active global equity and emerging market multi-asset funds. After all, it is more important for the growth assets to outperform the liability value over the trustees' investment time horizon than outperform a particular index.

• Including more exposure to less liquid assets, eg property, infrastructure or private equity.

So, what's your scheme's investment time horizon and how does it affect your investment strategy?

Written by Sam Roberts, head of investment consulting, Cartwright

In association with

VIEW FROM THE PMI

Another week, another news story about pensions administration. This time, the focus is on overpayments, though the headlines tell a somewhat different story to the details behind the scenes.

Work on GMP rectification continues across the UK pensions industry with diligent, detailed analysis of historical data, aiming to establish accuracy among member contributions records. Research can encompass decades worth of data across a wide range of archives, including microfiches (if you don't know what this means, ask a pensions professional over the age of 50 and they will tell you how record keeping has improved for the better).

With proper investment in data verification, it inevitably comes to light that many people have been over or underpaid throughout the course of their career. Unfortunately, this can trigger a blame game targeted at administrators and past processes. The truth of the matter is that a common failure across bodies of professionals responsible for correct data, as well as a failure among employers to recognise the importance of data accuracy around contributions and earnings, has led to the current predicament.

While there may well be instances in which incorrect payments have been made, they are generally rare occurrences due to improved, robust checking and control systems among administrators, and pledges to clean up data from sponsors and trustees. This newfound mindset is not only in the interest of GMP or de-risking preparation, but also an example of the much-awaited, industry-wide recognition that high-quality, clean data is in fact the bedrock of successful pension schemes.

Robert Branagh, president, Pensions Management Institute

Soapbox: My pension is invested in...

The pensions landscape is quickly changing and the industry has an obligation to ensure that the thinking that accompanies this is adapted also.

In discussion with industry experts recently, I was reminded of the widely-held view among those in the industry (and unfortunately not their peers outside of it), that pensions are a 'young persons issue'. This points to the fact that it is largely the duty of the young, of whom are currently in employment, to ensure that they save for their pension up to their pensionable age to achieve a desired lifestyle in retirement.

In addition, the evolving landscape, whereby the number of savers with defined contribution pensions are quickly overtaking those in defined benefit schemes, naturally calls for increased, clearer communications. Essentially, as pensions are becoming more of a responsibility for the individualas opposed to the employer or government, there is a need to promote retirement savings in a way we haven't previously.

With auto-enrolment being a considerable success in enrolling the majority of the UK workforce into pension saving, it is time that the reliance on inertia is replaced with active engagement. While many industry speakers have argued this, however, few have proposed how it can be achieved.

It is clear that a key reason many become disengaged from their pension savings is due to the lack of ownership they feel over it. The introduction of savings products such as stocks and shares ISAs and even the more recent emergence of cryptocurrency investing has grasped the interest of considerable numbers of young workers.

But why these and not pensions? When it comes to these other savings, it is because savers can physically see their funds growing and are able to influence rates of growth and returns through putting in more or less.

So surely, the solution is make pension savings more accessible. My answer, market pensions in terms of investments.

It can be argued that the pensions dashboard, that aims to present all of an individual's pension pots in one place will aid in making pensions more accessible. But, we also need to make members aware of their ability to actively make investment decisions.

Increasing numbers of tech-savvy millennials and their peers are much more likely to pay more interest to their pensions if they are made aware of what their funds are invested in and if they are informed of their ability to actively decide where and what their capital is supporting.

By marketing pensions as a personal investment product, as well as highlighting the additional tax relief and employer contributions, saving for retirement in this way almost becomes a no-brainer.

It is this that I believe will encourage members to pay more attention to their pensions, as well as providing them with a greater sense of control.

So, the next time pensions are discussed in the workplace or down the pub with friends, we shouldn't be asking "are you saving for a pension?", but "what is your pension invested in?"

Written by Talya Misiri

Opportunities after the storm

Market turbulence has created new opportunities, says Andrew Cole

The storm that swept the markets in February rattled nerves, but it ended up changing very little in the investment landscape. The global economic expansion has further to run. Corporate profits are still rising. And while central banks – led by the US Federal Reserve – are still tightening monetary policy, they are doing so gently.

Over the medium term, that's a combination that should favour equities over bonds – any short-run bouts of volatility notwithstanding. In fact, such turbulence can prove useful.

With some of the froth having been swept out of the market in recent weeks, we actually feel more comfortable investing in equities now than we did at the start of the year, particularly in cyclical sectors.

Emerging markets are particularly well-placed to benefit from the surge in global exports, which rose 4.4 per cent in 2017 – their fastest pace in six years. According to Pictet Asset Management's economics team, a 1 per cent increase in international cross-border goods flows lifts EM economic output by 0.26 percentage points.

Within the developed world, Japan's stock market tends to do especially well in times like these, as its exporters thrive when trade is buoyant. Not only is the country's economy in good health – unemployment is at its lowest in a quarter of a century – its equity market also looks attractively valued, compared to both US and European counterparts.

In contrast, we are more cautious on Europe. This view isn't so much based on its economic data (which is still solid, if possibly starting to plateau), nor on the valuations of its stock markets (which have improved markedly in recent weeks). The problem is that European equities continue to be a source of volatility. Indeed, they were among the worst hit during the recent sell off. The ongoing political uncertainty engulfing much of the continent – amplified by populists' strong showing in Italy's general election – has left corporations and international investors wary.

Therefore, until we can see a clear catalyst for sustainable outperformance of European stocks, we will focus our attentions elsewhere.

Banks and techs

When it comes to sectors, we prefer stocks in cyclical industries such as materials, energy, financial and techs. The last two should fare well if interest rates rise. For financials, higher rates is an advantage – banks' borrowing tends to be more short term than their lending. So when yield curves steepen, their lending margins improve. Techs, meanwhile, have low borrowing levels and large cash piles. That means they should be more insulated from the negative impact of higher rates than companies that have taken on more debt.

Defensive utilities and consumer stocks will probably prove the most vulnerable to higher rates and rising inflation, as they have limited ability to pass on any cost increases to their customers.

In fixed income markets, bond yields are gradually grinding higher, and attractive investment opportunities are harder to find than in equities. But that doesn't mean that they don't exist – and sometimes in quite surprising places.

The US, for example, is now one of the few developed markets which offer a positive real return on 10-year government paper. Inflation-linked bonds there look particularly attractive.

The risk would be if the fixed income market suddenly started to discount much higher levels of inflation than are currently expected. That could lead to a sharp steepening of the yield curve, hurting investors in longer-dated bonds.

Another risk is that credit growth may not be strong enough to offset the monetary tightening deployed by the Fed and other major central banks, which would lead to an abrupt deterioration in financing conditions worldwide. A 2007-style credit crunch certainly does not look likely right now, but we should remain alert to any signs of stress.

The third threat to our portfolio is China. There, economic growth is slowing as authorities in Beijing make yet another attempt to deflate the country's credit bubble. So far, thanks to healthy demand for Chinese exports, the tightening of monetary policy has not done too much damage. But if, as seems likely, the pace of credit growth slows further and US President Donald Trump enacts additional protectionist measures against China, the prospects for emerging markets and the rest of the global economy will look less rosy than they did a few months ago.

Written by Andrew Cole head of multi asset London, Pictet Asset Management

In association with

Source of all data: Pictet Asset Management, Thomson Reuters Datastream, March 2018.

GDPR: The difficult questions about data

It's now little over a month until GDPR comes into effect on 25 May 2018. If you haven't yet started addressing GDPR don't panic: put a plan in place and prioritise the key actions. In this article we try to address a few of the difficult questions

How long can I keep pension data?
Under GDPR, data must be kept only as long as necessary. But what does this really mean? There is no clear cut answer but what is clear is the need to have a transparent data retention policy setting out how long each category of pension scheme data is to be kept.

Historically many pension schemes have simply kept all their data forever. We certainly find this approach helpful for benefit rectification work when reconstructing and recalculating individuals' benefits. Conversely some pension schemes have deleted or lost data along the way, sometimes due to records being closed to reduce licence fees. This can lead to difficulties, particualrly when tying up the membership for GMP reconciliations. There will no doubt be exercises in future when further benefit rectification work may be required, for example GMP equalisation. There is therefore good justification to keep the majority of pension data for the long term.

There are however some data items that are only needed for shorter periods, e.g. medical records for the purpose for making a decision on ill-health retirement (unless the member's health is periodically reviewed).

Also consider how long to keep data for 'no liability' members such as those who transfer out. You will want to keep at least skeletal data to prove that they had a benefit in the scheme and subsequently left, but it may be possible to delete some of the detail. Don't get carried away though – it's theoretically possible that you will want to do a benefit rectification exercise and recalculate their transfer value at some point in the future.

How do I minimise the data held?
Under GDPR, the data kept must be limited to what is necessary for the purposes for which it is processed. Start by considering the personal data you're currently collecting. You need to strike a balance between gathering the information you need and not having more personal data than required. Once you have ensured that your current processes are compliant, you can then get on with the much bigger challenge of reviewing the data you have already amassed.

You may well hold data that is no longer current such as historic addresses, out-of-date nomination forms (which may implicitly infer a member's sexual orientation, which is classed as sensitive) and old bank account details. Much of this can certainly be deleted. There may also be data that has never been needed and acquired inadvertently, for example the employer providing too much information when a member joins the scheme.

You also need to consider data held by other organisations processing data on your behalf. Check what data these organisations are holding, consider whether it is still required and if not request that they delete the data.

How do I identify and delete the unwanted data?
Deleting data is easier said than done. Historic data may be on microfiche, in which case start by scanning it but doing so intelligently, i.e. scanning in such a way so that you can firstly find data and then secondly delete selected data items. The same principle applies to scanning paper records. For data that isn't required on a daily basis but which you'd like to keep 'just in case', consider securely archiving such data and document your approach.

Data may be stored in a multitude of places on computer networks, databases, cloud storage and more. There are various data discovery tools on the market that you can deploy to search for personal data and it's worth engaging your IT specialists in these areas.

There may be some areas where the cost is prohibitive and disproportionate to the attached risk in which case you may decide to take a pragmatic course of action. In this case make sure you have documented your approach and reasoning.

In summary, review what personal data you hold, determine whether or not you need it and if so how long to keep it for, delete any data that is no longer required and document everything.

Written by Rebecca Morgan, senior technical consultant, ITM

In association with

Old meets new

Administrators strive for automation.
Trustees demand value for money.
Members expect real-time information.

It is a world moving at a furious pace. In order to keep up, it is essential to harness the power of data and the capabilities of technology. ITM remains at the forefront in this space, having improved data quality and efficiency for hundreds of UK pension Schemes, helping to translate old world record keeping into reliable, accurate Scheme data for the new world of pensions.

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Legacy systems	*meets*	Leading edge platforms
Problematic and inadequate data	*meets*	Flexible and functional records
Fragmented system interaction	*meets*	Universal automated solutions
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Collective thought

A *Pensions Age* survey in association with SimCorp

Over the last few years, the traditional arrangements between pension funds and their managers have come under increasing scrutiny. Pressures on performance, pricing and transparency have all been questioned. Whilst outsourcing is still a functional need for many, a steady insourcing drive has seen players like RailPen and the Pension Protection Fund increasingly turn to in-house asset management.

More recently, with the creation of Collective Investment Vehicles (CIVs), funds such as Local Government Pension Schemes (LGPSs) have had the opportunity to pool resources, cutting operational costs and driving performance. **The challenge for pension funds, particularly those deciding on CIVs, remains cutting through the noise to really understand the potential benefits of insourced management, and the operating model that will best deliver the returns sought**.

Attitudes on pensions administration

In order to understand this trend, this survey takes a step back to look at the general thinking, when it comes to fund management and administration. Carried out in early 2018, it engaged with over a hundred funds, ranging in size from under a billion pounds to over ten billion and responsibilities of participants - mainly Trustees and Investment Committee Members/CIOs.

The survey presents the sentiment, decision-making and position of pension funds in relation to their present and future arrangements, especially the ongoing impact of alternative methods for managing assets.

Will you be consolidating your trading and administration data?

Chart 1

An overwhelming 49% are unsure of their strategy when it comes to consolidation of trading and back-office administration. Regulation has provided many pension funds with an added conundrum, when it comes the decision to insource portfolios. On the one hand, they've lifted the lid on the complex operations of asset management firms, raising questions on the ability to implement regulatory compliance in a timely manner. But also, and particularly in the case of MiFID II, clarified previously opaque processes, such as pricing of fees, giving pension funds better transparency of their externally managed assets. This has left many asset owners in a half-way house predicament.

A small sub set (11%) have chosen a fully in-house solution. Cost is certainly a major element, with a recent CEM Benchmarking survey reporting up to 38 basis points saved by bringing asset management in-house. However, there is another driver, that of control, which can be improved by deploying investment management solutions that deliver timely positions and exposure.

In stark contrast, the next largest category (24%), many of whom include the funds considering a move to a CIV, stand in favour of outsourcing. The challenge of garnering in-house resources and talent acquisition could be a key factor for this decision. An important point to bear in mind here for pension funds and ultimately the CIVs themselves, is whether they have the ability to maintain an underlying view of the externally managed assets and in cases where management is a composite of external and internal, whether their investment operations can incorporate data for externally and internally managed assets into one system. Thereby, tackling the issue of cost when it comes to maintaining systems, but more importantly, of transparency and governance.

Will you be managing a portion of your pension fund through a collective investment vehicle (CIV) structure?

Chart 2

Surprisingly, despite much of the recent attention around CIVs, it appears the majority of pension funds are sticking with traditional arrangements, or are unaware of the options. Given this information, there is still much education required around the structure and more importantly, the investment operations of the CIVs, to help the decision process of those pension funds already in flux but also those defaulting to current arrangements out of pure inertia. Much of this can be overcome by understanding the potential benefits CIVs bring, when it comes to economies of scale, lower costs and the added advantage of a master trustee/executor at the helm of a shared investment strategy. For example, accessing a single transparent, real-time view into what the fund owns, what it is worth, and its exposure across the investment book, will provide the operational efficiency many funds are seeking, whilst keeping cost and risk low.

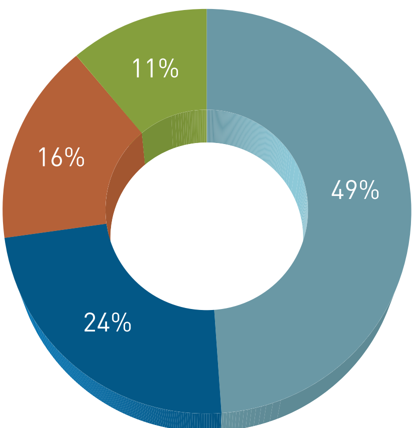
Reasons for using CIVs

Chart 3

When asked the reasons for using a CIV, there appeared to be no correlation between the size of the pension funds surveyed and the reasons given, with access to a wider asset class base forming the main rationale (41%). This is synonymous with the continued market direction towards multi-asset class investment strategies and the rapid growth of alternatives, such private debt and infrastructure, offering promising returns. It also unveils a more interesting point, one which resonates with

Chart 1

Will you be consolidating your trading and admin data



49% not sure
24% outsource
16% still defining strategy
11% in-house solution

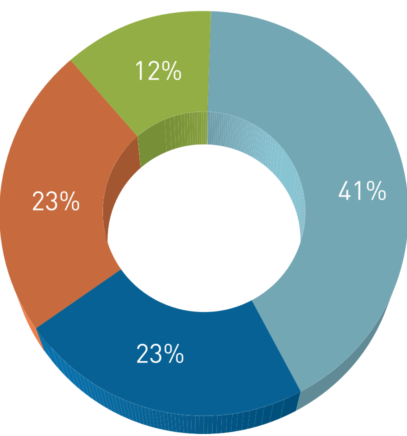
Chart 2

Will you be managing a portion of your pension fund through a collective investment vehicle (CIV) structure

84% Not considering moving to CIV
8% Considering moving to CIV
5% Decided on particular CIVs
3% Will positively name CIVs

Chart 3

Reasons for using a CIV



23% Better bargaining power
23% Change of investment policy
12% Lower cost of investment
41% Access to a wider asset class base

wider market research. This includes the CEM Benchmarking survey, which found ease of implementation and capacity constraints of external managers, where alternatives were concerned, were one of the key concerns aside from cost, motivating the re-direction of assets in-house.

Whilst the management of traditional asset classes is a highly automated workflow across key functions from performance, settlement and reporting to accounting, finding the same level of automation and integration for growing illiquid, alternative investments, like Private Equity, Real Estate and Infrastructure, has been a challenge for asset management. To date, asset management firms have spent significant money on niche or unicorn systems to overcome lack of integration, which in turn has made their management challenging and costly. By making the time and capital investment towards a consolidated operating model, pension funds and CIVs can eliminate this challenge and run multi-asset class strategies in one system. Further, a solution that incorporates an Investment Book of Record (IBOR) to provide granular performance data and analytics, will enable pension funds to tighten risk management.

Conclusions

- The advantages of collective investment means one might expect their use to be more widely contemplated. The reality is that there is an education process required when it comes to truly understanding of CIVs.
- This lack of clarity, on the benefits of CIVs and the various approaches to insourced management, may mean asset owners remain inert, continuing with a default position of outsourcing. Furthermore, those considering CIVs are still undefined in their choice.
- It is important that funds can make more informed decisions on their asset management options. Not doing so is a risk, given the lack of access to newer alternative instruments, as evidenced by funds stating wider asset class access as the key reason to move assets to a CIV.
- Both pension funds and CIVs need to consider a consolidated operating model for their investment operations, to achieve the most operationally efficient investment management. This approach provides the most transparent foundation to drive performance, explore new asset classes and retain governance, whilst keeping both cost and risk low.

A Pensions Age survey

In association with

Is the bulk annuity pricing boon here to stay?

Buy-in and buyout pricing was widely reported to have improved significantly over 2017 with the most attractive pricing seen in the market for a number of years. In this article Gavin Smith from Legal & General provides an insurer's insight as he considers if these pricing levels can be maintained in 2018

2017 proved to be a good year to purchase a bulk annuity for many schemes. A number of factors came together that led to outstanding pricing in the market despite a backdrop of continued historically low yields across the gilt and bond markets that, all else being equal, one would expect to lead to more expensive pricing.

One of the factors widely cited for the attractive pricing seen in 2017 was the level of competition, with as many as eight insurers actively quoting on transactions.

How much can competition drive down pricing?

To answer that question we need to understand the factors that drive insurer pricing.

Pricing a buy-in or buyout is a complicated affair. Each time we provide a scheme with a quote we are making assumptions about cashflows and investment returns long into the future, in some cases potentially for the next 60 years and beyond. Relatively small changes in those assumptions can have a material impact on the price we are able to offer. As markets become increasingly competitive, insurers need to remain on their toes to ensure that their pricing assumptions remain up to date and that any opportunities to improve pricing are taken into account where appropriate. Examples of this might be changes in mortality trends or investment opportunities.

Insurers investing directly in the UK economy

One of the biggest factors affecting pricing in recent years has been insurers' willingness and ability to invest in new ways. At Legal & General we are particularly passionate about investing in UK infrastructure and urban regeneration projects. These investments not only benefit our wider society by creating jobs and supporting the UK's economic growth, but they are also an excellent match to pension liabilities in that they generate long-term, stable and often inflation-linked cashflows. It is these kinds of investments that have played a key role in allowing us to offer pension schemes the attractive pricing seen over 2017.

However these direct investments are not a free lunch. Insurers must ensure that their investments continue to offer the security that is required. The Solvency II framework and PRA oversight help to ensure that insurers hold enough capital to maintain security over the investments that we make and the risks that we take on in buy-ins and buyouts.

So whilst competition will continue to play a part, it is the availability of suitable investments and how insurers decide to allocate them to transactions that will be the biggest factor driving pricing over 2018.

What does this mean for pension schemes looking to de-risk in 2018?

It is still relatively early in 2018 but initial signs suggest that pricing remains attractive. Those schemes that have approached the market early would seem well placed to benefit from pricing levels comparable to those seen in 2017 as insurers look to secure early transactions.

Insurers will want to ensure that they have a sufficient pipeline of investments to support the volume of bulk annuity business that they wish to target this year. These early signs would seem to suggest insurers are happy that they can continue to do that at 2017 pricing levels but only time will tell what size of market can be supported at those levels.

Buy-ins and buyouts are ultimately about certainty. For trustees, the prize is certainty over your liabilities and the security of your members' benefits. This means not only ensuring that your long-term objectives are aligned with your sponsoring company but having a clear idea about what you are looking for in an insurance partner.

Insurers also value certainty. If insurers have a degree of certainty that a transaction will take place, there are often levers we can pull, such as the allocation of resources, assets and capital that can help to make it a reality. In a year where demand in the market is high, engaging us early and showing commitment to your objectives will go a long way to helping you deliver the outcome you want for your scheme and members.

Written by Gavin Smith, director, core transactions, Legal & General

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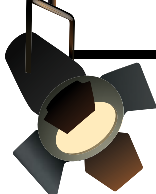


AE: Moving on up

This month sees auto-enrolment contributions rise for the first time since the policy was introduced in 2012. Natalie Tuck looks at what this means for employers, members and the future of workplace pension saving

Playing on the concept of inertia, auto-enrolment has overcome its initial challenge of enrolling millions of UK workers into a workplace pension.

Opt-out rates have been low at around 10 per cent, but right from the start there has always been calls to increase contribution rates. Currently at just 2 per cent, many in the industry have warned that such a low contribution rate will bring disappointment to many members at retirement.

From this month, however, contributions have increased, now at 5 per cent, made up of a 3 per cent employee contribution and a 2 per cent employer contribution; this will increase further to 8 per cent in April 2019, when employers will have to contribute 3 per cent, and employees 5 per cent.

On the increase, Pension Monster director Peter Bradshaw notes that auto-enrolment has achieved a significant take-up, with nine million UK employees enrolled into schemes since 2012, but it now faces a big challenge.

This is because, despite numerous calls for contribution increases, there is concern that such a rise will leave a hole in members' take home pay, which could lead to more people opting out of their pension. There is no line of agreement on this, with research from Royal London suggesting that opt-out rates will stay low due to income tax and national insurance allowance increases, and that in April millions of workers are given pay rises.

At the other side of the debate, Aviva published a survey in December 2017 that found one in eight employees might opt out when their contributions start to rise. Even the Pensions Minister Guy Opperman is concerned about the contribution rise, stating that it is his "biggest hurdle".

There is no doubt about the fact that for those who remain in their pension schemes at the higher rate, bigger pots will be seen at retirement. Based on current contribution levels, an employee earning the average UK salary, who began saving into a workplace pension when auto-enrolment started in October 2012, could have a total of £30,000 in their pension fund at retirement, according to Aviva. However, with increased minimum contributions of 5 per cent they could benefit from a £36,000 boost, more than doubling their total pension fund to £66,000 when they retire.

Aviva predicts that once the 2019 contribution rate is implemented, the same saver could have a pot of £101,000 at retirement, representing an additional £35,000 in their pension pot and more than triple the amount they would have under current contribution levels.

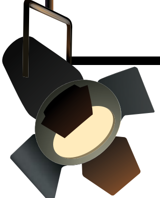
Of course, the change will also have a significant impact on employers. Hargreaves Lansdown head of retirement policy Tom McPhail notes that employers "don't get a choice in the matter".

"For some businesses operating on very tight margins this could even have an impact on their overall staffing numbers. The best value the company can get out of this unavoidable overhead is to make sure their employees are aware of their pensions and the contribution their employer is making towards their future," he said.

Others in the industry are urging employers to make sure employees are aware of the changes, in order to minimise opt-outs. Sanlam UK head of commercial Elliott Silk says: "What we don't want to see is people waking up and questioning why their pay cheque is less than last month without having prior knowledge of the increase. If we provide people with information ahead of the deadline, we can help them realise the value of these contributions and the impact they could have on their future lives in retirement."

This is really only the beginning for auto-enrolment, with demand for contributions to rise to 12 per cent at least, to help workers save enough for retirement. Despite the government's auto-enrolment review, published in 2017, nothing has yet been decided on the future of contributions. The results will be seen in time, with Opperman holding his breath until then.

Written by Natalie Tuck



Time for transparency

New rules to make defined contribution pension fees more transparent come into effect this month. Natalie Tuck takes a look at the changes and what trustees need to do to meet the new requirements

The government has taken action to make defined contribution pension fees more transparent for millions of savers by updating regulations on cost disclosure rules.

The new rules come into effect this month and the government says the changes will benefit more than 10 million savers. The regulations were laid before parliament in February, and the update means occupational defined contribution schemes will need to publish information about the fees they charge members.

The plans, initially announced last autumn, will allow savers to access online information about their scheme charges and investment costs. By the end of 2019, every occupational defined contribution pension scheme member can expect to receive an annual benefit statement from their provider, with a link to where they can obtain these details, and an illustration of the compounding effect of these costs and charges and how their schemes assess the value for money of their pension funds.

The measures will also require schemes to give members information about where their contributions are invested, on request. Failure to provide this information could cost occupational workplace pension scheme trustees up to £50,000. The changes were described by Minister for Pensions and Financial Inclusion Guy Opperman as the "final step" on an "important journey to building an open and transparent costs and charges system which supports consumers to make well informed decisions".

"Membership of workplace pension schemes is at an all-time high and it is right that people are able to access all of the information that they need about their scheme in a meaningful way. My priority as Minister for Pensions and Financial Inclusion is to ensure that all the new savers we are bringing in through automatic enrolment are able to engage with their options and understand the true value of their funds. These changes combined with future developments such as the pensions dashboard and formation of the single financial guidance body will do just that," Opperman says.

Typically, occupational pension scheme members face two broad types of cost from their pension schemes. Firstly, charges that include marketing, communication, administration, legal and consultancy fees, and regular payments to investment managers. These are normally expressed as an annual percentage of funds under management. So for example, a 0.5 per cent charge could be levied on the value of the pension pot each year until the member retires. In pension schemes used for auto-enrolment, the default fund (into which 90-95 per cent of members save) is capped at 0.75 per cent.

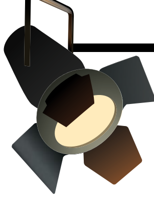
Members also face transaction costs, which are the trading fees incurred by managers of the pension scheme's investments, from buying and selling shares and bonds, for example. They are often referred to as 'hidden costs' as they have not traditionally been reported to anyone, and there has been no agreed way of calculating these until the Financial Conduct Authority published final rules last year. They are usually lower than pension scheme charges, but excluded from the charge cap.

Sackers partner Georgina Jones says that shouldn't be difficult for trustees to capture the additional information on member-borne charges for the chair's statement and, stated that with FCA-regulated firms now required to provide information on transaction costs on request, gathering this data may be less problematic than in previous years. "The new requirement for an illustration of the cumulative effect the costs and charges have on a member's benefits over time probably presents the greatest challenge. While the supporting statutory guidance is clear on the basic elements, trustees must determine how best to present the information to their members and must manage messages carefully."

A scheme with higher transaction costs is not necessarily worse than a comparable scheme with lower transaction costs, if those transaction costs relate to investment changes that result in a higher rate of return for members, she says. Jones adds that the changes will also necessitate revision of administration processes to ensure that benefit statements are amended to flag the web address for the online information at the correct time, and not before, and to ensure that trustees are ready to publish when the time comes.

"Depending on a scheme's year end, trustees may not have that long to adapt and there is no extension for schemes which do not have a readily available website. The first schemes affected (those whose scheme year runs from 7 April 2017 to 6 April 2018) only have until 6 November 2018."

Written by Natalie Tuck



Meeting the deadline: LGPS pooling

With the deadline for local government pension schemes to pool their assets this month, Natalie Tuck looks at how local authority schemes have changed since the requirement and the next steps for the funds

It's almost three years since former Chancellor George Osborne asked the 89 local government pension funds to pool their assets, in the hope of achieving six British sovereign wealth funds.

The government said that setting up the six funds would cost an estimated £20 million and £11 million in annual running costs. Speaking in December 2017, Parliamentary Under-Secretary for Housing, Communities and Local Government, Rishi Sunak, said that the costs were necessary in order to achieve total net savings of between £1 billion and £2 billion by 2033.

At the time, Osborne dreamed the six funds would have a minimum size of £25 billion, but with the deadline this month, has his dream become a reality? The Pensions and Lifetime Savings Association's policy lead Tiffany Tsang says the funds have put "enormous effort", during a short amount of time, to establish eight LGPS pools across England and Wales. Not quite six, but close.

According to information submitted in LGPS pool submissions in July 2016, and the most recent data on the funds' sites, five of the eight funds have achieved Osborne's dream of having assets over £25 billion, the biggest being the Border to Coast fund with £43 billion. A sixth fund, the Brunel Pension Partnership, has just under the minimum with £23 billion, and the Local Pensions Partnership has just £13 billion, along with the Welsh pool, which the government acknowledged was in a "special position", due to the possibility of "eventual devolution".

"A great deal has been achieved," says Tsang, including the pools leading the way on issues such as cost transparency. She adds that the April 2018 deadline that has just passed, was only the end of the beginning, as the pools begin to consider the implementation phase of next steps. "This will include developing a balanced score card of both quantitative and qualitative measures to help determine what good performance looks like, as well as putting the pools' money to work for the best returns possible," she notes.

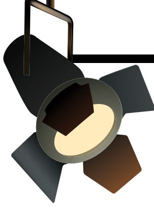
Furthermore, Robeco UK head Peter Walsh says that with the April deadline having passed, LGPS investment teams are looking ahead and starting to re-engage on their investment needs. "Many of these are doing it with a dual hat (as employees of a fund and a pool) as the individuals involved transition from one to the other but the trend is clear that the thinking about the required investment needs of the new pools is gathering steam. Once the staffing of the pools is complete, there will be a flurry of activity in procuring new investment solutions," he says.

There have been several benefits for local authority schemes pooling their assets, and one is already becoming evident, notes Walsh. "One clear trend is that the better resourcing of the pools means that sustainability can be taken into account more seriously and this will ensure that sustainability integration moves from a nice to have to a must have. The scalability required in a pooling world means that the focus on systematic (factor) based strategies is strong. Transparency, lower fees and more predictable outcomes are the types of benefits the pools will require," he explains.

Walsh adds that there is still much deliberation around whether each pool will build or rent their authorised contractual scheme (ACS), with the end result likely to be mixed with both options being utilised.

"The end result of pooling will definitely be in the interest of members, and therefore a positive outcome. The scale of the pools will ensure better-resourced teams, which should lead to better investment outcomes for members. The size of the investment allocations will also ensure lower investment management charges and, of course, the improved focus on sustainability will benefit members with better long-term returns and will also benefit society," Walsh concludes.

Written by Natalie Tuck



A simpler process: DC bulk transfers

In February 2018, the government published its response to a consultation on amending the process for DC bulk transfers. Natalie Tuck looks at what changes have been made and how this will affect schemes

Following a consultation in autumn 2017, the government published its response on simplifying the process of defined contribution pension scheme consolidation, whilst maintaining member protections, in February this year.

The government listened to the consultation's responses, making some amendments to its original proposals. For example, the Department for Work and Pensions (DWP) said many respondents believed proposals on how advisers could be judged to be independent were too stringent given the relatively consolidated nature of the industry, which also sees some advisers frequently moving between companies.

Therefore, the DWP has amended the requirements so that the advisers must not have provided advisory, administration or investment services (rather than any work) to the receiving scheme, service provider or sponsoring employer (or a connected firm) in the past year (rather than the past five years).

In relation to bulk transfers between connected schemes, for example, as a result of corporate restructurings, the DWP said that risk here from conflicts of interest seems minimal. As a result, it has removed the requirement to seek independent advice in such types of transfer.

In addition, the DWP has said it will be removing the option to use the current process, but this will be from October 2019, so that schemes have a full 18 months to complete any transfers that are underway. The DWP plans to work with stakeholders and The Pensions Regulator to produce high-level guidance for pension scheme trustees, expected no later than the end of April 2018.

CMS senior associate Mark Jenkins believes the new rules are a "welcome change" to a requirement that was "generally acknowledged not to work in the context of a pure DC to DC bulk transfer and caused significant headaches for actuaries and legal advisers trying to establish the scope of what the certification required". However, he warns that with the government expected to publish further guidance at the end of April, those schemes keen to take advantage of the new regulations may wish to hold off for a few weeks pending clarification on these points.

With regards to charge cap constraints, the government said some respondents expressed concern about how the legislation treats self-selectors – members who previously made an active choice to contribute to a particular arrangement, which is currently uncapped.

"Under current legislation, where such members did not actively confirm, prior to a transfer between schemes or within a scheme, that they wish to be moved into an arrangement which is not a default, then where the scheme was being used for automatic enrolment by their employer, they would need to be moved into an arrangement which could be offered within the cap," the DWP said.

"To help address concerns whilst maintaining member protection, we have amended the draft regulations to provide additional latitude in respect of recent self-selectors by introducing a time-based trigger. This would allow a transfer without active member consent from a non-default arrangement to a new non-default arrangement without triggering the cap restrictions, where the member has, in the five years ending with the date of the transfer, expressed a choice as to where his or her contributions were allocated."

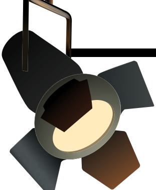
Arc legal director Max Ballad notes that DC transfers without member consent have always been tricky because you have to think about the likely output of the investments. "It's different from comparing two sets of benefit promises in the defined benefit environment and needs a different approach. It's not an actuarial or legal question. Now we have some open doors, especially for master trusts," he adds.

Ballad says the problem has been that those conditions were drawn up with defined benefit schemes in mind. "The requirement for the actuary to certify that the transfer credits to be provided in the receiving scheme will be broadly no less favourable was not very meaningful in a DC context."

He notes that most bulk transfers will be prompted by proposals from the employer and trustees will still need to consider whether a bulk transfer is a proper exercise of their powers. If the proposed transfer will not be to a master trust, the trustees may need to obtain and consider written advice from an "appropriate adviser".

"The key point here is that the adviser must be independent from the receiving scheme or any of its advisers. There is a lack of detail about the advice to be given which may be a good thing in that it gives the trustees some flexibility," Ballad adds.

Written by Natalie Tuck



Small change

With the lifetime allowance set to increase by CPI inflation, Natalie Tuck looks at the impact it could have, how previous cuts have affected pension saving and whether the next Budget will bring good news for pension savers

Savers have faced relentless cuts to the lifetime allowance (LTA) over the past several years, but this year they can benefit from a £30,000 increase, a small amount, but an increase nonetheless.

It was announced in the Autumn Budget in 2017 that the LTA will rise by CPI inflation, 3 per cent, rising from £1 million to £1.03 million. Unfortunately, the annual allowance will remain the same at £40,000, along with the money purchase annual allowance, which was cut down to £4,000 in 2017. Although disappointing for savers, the fact that the Treasury has resisted tinkering with the allowances this year will be welcome news for many.

The government last cut the LTA in 2016 from £1.25 million to £1 million, but it has seen significant cuts since 2010/11 when the allowance stood at £1.8 million. Recent research by Old Mutual Wealth revealed that the drop in the LTA has led to a 2,100 per cent increase in the government's tax take in the 2016/17 year, compared to the 2006/07 tax year, when the allowance was £1.5 million.

Good news for the Treasury, but for savers the impact of so many cuts is felt by more than just the top 1 per cent. Old Mutual Wealth pension specialist Ian Browne says that when people hear such a large figure they are likely to tune out, convinced it will have nothing to do with them. "This underestimates the power of compounding interest, investment, tax-free growth and continual pension contributions," he notes.

"As a long-term investment, what might seem like a modest amount, could exceed the allowance by the time you start to withdraw. People should not mistake that the lifetime allowance is just a concern for the top 1 per cent. In fact, the allowance would need to go up to over £4.5 million if it were just to impact the top 1 per cent of the population," Browne adds.

That is why he recommends planning ahead to ensure savers can get the most out of their pension, without having to pay undue tax. For example, using other allowances such as the capital gains tax allowance, the dividend allowance and maxing out ISAs.

However, Browne notes for those who are already approaching the LTA, they should check if they are eligible for fixed or individual protection 2016. Individual protection is only for those who had savings of at least £1 million in April 2016, when the allowance was lowered from £1.25 million to £1 million. The protection allows savers to retain the lower of their pension value at April 2016 or £1.25 million. There is no minimum pension value required for fixed protection, which also allows savers to keep the £1.25 million allowance.

Pension savers may be in for a break this year, but Barnett Waddingham senior consultant Malcolm McLean thinks that unless the Chancellor receives an unexpected windfall over the coming year it seems odds-on that he will be looking to find some fairly substantial savings in public expenditure costs in his Autumn Budget. Pension tax reliefs, he notes, are an "obvious target".

However, he predicts that it won't be the LTA that will see a reduction in the next Budget, which he thinks will likely see another inflation rise. Instead, McLean expects to see further reductions to the annual allowance, down to £30,000. He also thinks the higher earners annual allowance threshold could be cut by £20,000, down to £130,000, as well as the possibility of an increase to the taper rate; currently anyone earning over £150,000 has their annual allowance cut by £1 for every £2 they earn over the threshold. McLean thinks we could also see the carry forward allowances for unused reliefs reduced from three to two years. All these would likely not be implemented until April 2019, so savers should make the most of it while they can.

Written by Natalie Tuck

Old meets new

The *Pensions Age*/ ITM half day seminar looked at the challenges of old world data and practices colliding with the requirements of new world data and efficiency; considering GDPR, cyber security and new data management approaches

"Data is not something we can pass the buck on. Without good data, you can't do the basic job: paying the right person at the right time. You absolutely have to prioritise administration," The Pensions Regulator policy lead Lucy Stone stated at this year's *Pensions Age* annual data seminar with ITM.

It is evident that while the importance of maintaining good data is not a new thing to the pensions industry, many schemes are still reluctant to ensure that the right processes are in place to deliver desired outcomes, comply with regulations and prevent data from security breaches.

With the introduction of the General Data Protection Regulation fast approaching, the likely possibility of compulsory data provision to the pensions dashboard and increased data threats and vulnerability, it is crucial that pension schemes are doing all they can to be prepared.

GDPR

The European Union's GDPR is set to be introduced on 25 May 2018 and will involve more specific rules around personal information, how it is used, the consent needed, how long data can be kept for and stricter penalties for abusing or breaching the rules of the regulation.

The regulation will replace the previous EU 1995 Data Protection Directive and will apply to all 28 European Union member states and increase the scope of the 1998 UK Data Protection Act.

Kicking off the day's proceedings, Stone highlighted to attendees that if schemes are already complying with the Data Protection Act and have an "effective" data governance programme in place, they are "most of the way there" in terms of meeting the new requirements.

However, a number of schemes are still delaying the necessary preparations for the regulation, ARC partner Rosalind Connor argued.

With Article 50 set to make Brexit official in just under a year and the Data Protection Bill passing through parliament, GDPR compliance is still compulsory in the UK, Connor explained.

"The regulation comes in automatically and it's worth understanding that, because it means that it doesn't really matter whether the Data Protection Bill becomes an act of parliament by the 25 May, it's *[GDPR]* coming in anyway."

As a result, GDPR "shows that data still needs to be held safely, securely," as well as being accessible for schemes and their members, ITM director of HR consulting Colin Hamilton commented.

Cyber security

In addition to greater rules around data transparency via the new regulation, pension schemes are more likely to come under cyber security threats. "Pension schemes are valuable to cyber criminals so it is worth putting protections in place," TPR non-executive director and seminar chair Margaret Snowdon said.

Furthermore, Stone highlighted that in light of increasing cyber breaches, TPR will be producing a guidance piece on how pension schemes can be resilient against cyber attacks.

"Pension schemes are very valuable targets to cyber criminals, as personal information are valuable, marketable commodities," she said.

In order to change the way data is protected, Stone noted that the regulator "wants to change the dialogue" around administration. She emphasised that when it comes to the protection of scheme information, it is not just about administrators, but also trustees, advisers and employers who need to be responsible. Schemes need to "look at the whole footprint", Stone added.

Furthermore, it was highlighted that schemes shouldn't "just talk about cyber security, but also cyber resilience" and should ensure that they have effective plans in place, in order to be prepared for

itm
Solution delivered...

when "things go wrong".

Stone detailed recent research by the regulator that looked at different types of schemes' consideration of admin issues. The study found that 90 per cent of large DC schemes assign a focus on administration issues at board meetings, while only 14 per cent of small schemes do this. DB schemes were more likely to measure their data than DC schemes.

"Data is a corporate priority for the regulator to drive up standards of record keeping… and we are working with the administration industry to increase standards," Stone said.

A TPR spokesperson explained that: "TPR has been working with industry to identify good practice and this will be set out in new guidance shortly."

Data management

Regardless, to ensure pension schemes operate effectively and efficiently, it is essential that strong data management processes are in place.

Emphasising the need for this, the regulator now requires trustees to report on record-keeping in the scheme return to help improve standards. "We want to see improvements over time and we can then produce more guidance where required," Stone said.

"If you have bad data going in, you will almost certainly have incorrect benefits being paid," Firefighters' pension adviser Clair Alcock added.

Alcock noted that where bulk transfers have taken place, particularly in the private sector, with bulk batched data, identifying data for individual members has also become increasingly difficult. In addition, historic paper files that have been scanned into new computerised programs are likely to have some inconsistencies and errors.

While systems such as internet banking have become the norm, the pensions industry's delayed pace with entering digitalisation of information is "still causing bad data to enter the system", Alcock emphasised. This is partly due to a lack of accountability and ownership when it comes to data management of pension schemes, she suggested.

EDF Energy pensions operations manager Clive Pothecary agreed that in order to efficiently manage scheme data, "clear ownership and responsibilities, regular reporting and clear communications" are necessary. ITM director Matt Dodds added that schemes must "stop the finger pointing" and essentially move on from the "blame game" whereby individual parties are burdened with data errors, to a position of shared responsibility for data management.

In order to improve the way data is managed, a number of speakers made reference to the implementation of long-term data improvement plans. Schemes are encouraged to have plans that are forward-looking to ensure that data is prepared for what may come in the near and long-term future.

Cabinet Office head of data improvement Adam Howell detailed how the department embarked on a two-year data cleanse project for the Civil Service Pension Scheme, with ITM. The two-stage process worked to reduce DVFs by 2.5 million to 1.2 million and then a further data correction phase.

ITM program manager Shaun Bigg explained that in order to streamline data improvement systems, there are four key success factors. These being: validate and report data problems, root cause analysis, engage and communicate and control and cleanse data.

Similarly, Alcock discussed effective data improvement practices including data profiling, where data is understood and scanned for problems; data cleansing; good data governance around key objectives and prevention of bad data. "Preventing bad data entering in the first place is a real driver for improvement," she said. To achieve this, it is essential that members have access to their data and the necessary communications are had so schemes are informed when information changes.

Moreover, MorganAsh founder and managing director Andrew Gething also provided a new method of medical underwriting to improve schemes' valuations. Using processes from life insurance and the annuity sphere, the firm uses current data and medical underwriting to predict life expectancy.

This alternative process highlights that "health and life data" is a far better indicator of life expectancy and therefore pension liabilities than individuals' postcodes, Gething suggested.

Nonetheless Alcock noted that there is not a "one size fits all" process when it comes to data improvement plans. Instead, she emphasised that it is crucial to understand that "challenges are drivers to improvement processes" and that schemes must recognise that "data improvement is a continual improvement process with cycles, so you need to have that clear understanding of your goal."

Pothecary agreed that schemes "must be clear on the end game… big or small the project, careful control and understanding of data is key."

With the ever-changing pensions and data landscape, a key takeaway from the event was the reminder that data improvement is a continual process and not a one-stop solution. Administrators, trustees, employers and members, alike, are all responsible to ensure that information held by schemes is continually up-to-date and managed to lead to desired outcomes.

Written by Talya Misiri

Getting ready for GDPR

Maggie Williams reveals how pension schemes are to prepare for the General Data Protection Regulation (GDPR), which comes into force on 25 May 2018

While some aspects of GDPR are an evolution of current Data Protection Act practices, and others simply reflect good scheme governance, there is still plenty that trustees need to do to make sure their schemes are compliant.

Know your scheme data – and who uses it
The first step towards GDPR compliance is for schemes to understand their data, and who has access to it. Key questions are:
- what personal data they hold
- who they hold it in relation to
- how long they have held it for
- who they share it with, and
- if any of that information is used outside the UK.

GDPR defines two roles within data management: the data controller (who is responsible for ensuring compliance with GDPR) and data processors (who handle data and, under GDPR, also have statutory obligations). In many businesses, both the data controller and data processors might be employees within the same company – but for pension schemes, the situation is often quite different. The trustees will be a data controller, but most data processors will be third parties, others, including the sponsoring employer in this context. Some of those third parties will also be data controllers in their own right.

Trustees need to identify all of their data processors, and how data flows between them. While some of these will be obvious – such as the sponsor and scheme administrator – there are others to consider as well. "More of a challenge is to identify less obvious data flows and data processors," says Willis Towers Watson associate director Helen Nicholas. "What about the printers who print and distribute member newsletters? What about the doctor who assesses ill-health retirement cases?"

What to do now? Carry out a data mapping, or data audit, exercise to identify the types of data that the scheme (and its third parties) hold, who its data processors are, and how they interact.

Update contractual arrangements
Once trustees know who their data processors are, they will need to update any contract arrangements to reflect GDPR rules. This is particularly important if a third party is also a data controller in their own right (such as the scheme sponsor). "Another data controller will have their own obligations under GDPR, so the contract should specify exactly what the other party can use scheme information for," says Sackers partner Claire Carey.

In some instances, data will be managed by joint controllers who need to work together to decide how it will be used. "This is particularly important when it comes to individuals' rights," says Carey. "You will need to decide together who is responsible for responding, should an individual want to know what information is held about them."

What to do now: Contractual updates are one of the most important and time-consuming aspects of GDPR preparation. But, most of the work is a one-off exercise. Reviewing contracts over time should then be less onerous.

Update privacy notices
Although most schemes will already have a privacy notice, the information that needs to be included under GDPR is wide-ranging and must be broad enough to cover all the ways in which a scheme might want to use an individual's data. These include the legal basis for processing information, explaining an individual's right to access his or her data and to withdraw consent for its use, the source of any third-party data, and the right to rectify or erase data held about an individual.

This all needs to be included in a single notice, which is available to scheme members and potential members.

What to do now: Make sure that all members have access to the full privacy notice. "There is an option to signpost the full privacy notice from a shorter format document," explains Carey. If the scheme usually sends out printed information to scheme members, the full privacy notice must also be available as a printed document.

Understand individuals' rights

Any member can ask about the information the scheme holds about them and ask to see it (termed a subject access request). They can also ask for out-of-date information to be corrected without undue delay or deleted altogether.

Once GDPR becomes law, members will also be able to object to data processing. "Make sure you have genuine legal grounds for processing information," cautions Carey. Grounds could include the legal requirement to comply with the terms of the trust, pensions legislation, or a legitimate interest on the part of the trustees to make sure the scheme is run properly. Trustees will need to make it clear exactly what their 'legitimate interests' are, however: "Paying the right benefits to the right people is a pretty compelling legitimate reason for holding data," adds Carey.

What to do now: Trustees will need to think about how they apply individuals' rights, and how they and third parties respond promptly to requests for information.

Be breach-ready

Trustees will need to make sure that they (and the third parties they work with) have a clear, documented plan of action, in the event of a data breach. It will also need to document how the scheme protects personal data in the first instance - for example, policies for using data on laptops, or storing information online 'in the cloud'. "Pension schemes hold a goldmine of personal and financial data," says RSM head of pensions Ian Bell. "Trustees need to take their obligations seriously, particularly under GDPR." There are significant fines for not doing so - failure to notify authorities of a data breach carries a fine of up to €10 million or 2 per cent of annual turnover, in addition to the €20 million or 4 per cent of annual turnover fine for breaching the regulations.

What to do now: Schemes will need to make sure they have a clear policy in place that explains what happens if there is a data breach, and how this will be reported within the required 72 hours turnaround time.

Written by Maggie Williams, a freelance journalist

Case study: The MNOPF

With over 25,000 members and 80 years of history behind it, the Merchant Navy Officer's Pension Fund (MNOPF) had its work cut out when it came to preparing for GDPR. MNOPF pensions director Ivan Laws explains how the scheme approached it.

What have been the major challenges involved in preparing for GDPR, and how have you addressed them?

The principle issue we faced (and are facing), was initial industry-wide inertia. Only when headlines about the magnitude of potential fines began to surface, did panic set in across pensions as a whole.

The Information Commissioner's Office (ICO) has provided a level of reassurance (without being too specific) by stating that it will take a pragmatic approach to GDPR implementation on and after 25 May.

However, the ICO has not given any industry-specific advice to pension schemes. Even at this stage there is uncertainty about how certain areas of the GDPR will be applied in a pensions context. This may be because pension schemes are not the primary target of the regulations, but sadly that is not a view our industry can sensibly take!

Is there anything that you would do differently if you were starting the process again?

If you think about the hundreds of pension schemes that are individually consulting their legal advisers and the attendant costs, it would be good to think that the pensions industry could adopt a more collective approach to regulations such as GDPR. That way, general principles (such as grounds for processing being a legitimate interest) could be established quickly and cost effectively, with individual scheme advice then being required on a much smaller scale, at much less cost.

What guidance would you give to a scheme that is still working on its approach to GDPR at this stage?

I suspect that the majority of schemes will still be working on GDPR. The advice I would give is to do what we have done, and that is to put together a comprehensive list of tasks in the form of a plan to fully implement the provisions of GDPR. This will go beyond 25 May. Give emphasis to the tasks that carry the greatest risk. They will be those directly related to members, such as data processing permissions and data retention policies. It's time to find out what is in all those old boxes!

A changing landscape

Pensions Age speaks to The Pensions Regulator (TPR) non-executive chairman Mark Boyle on how the organisation is adapting to the evolving challenges of regulating pension schemes

***Pensions Age* (PA):** Congratulations on being awarded a second three-year term as non-executive chairman. How have you noticed TPR change over the past four years?

Mark Boyle: Without it wishing to appear personal, I think the calibre of the leadership of the organisation is significantly stronger and this has been demonstrated with the results that we've achieved.

However, TPR has the same starting point today as it had three years ago. The starting point for us is our six statutory objectives that have been set by Parliament. So from that we as a board then have to derive what our corporate priorities are.

There are eight corporate priorities and the corporate priorities for 2018-19 are going to be pretty consistent with the corporate priorities for 2017-18. What is going to change is the way that we go about it, which is where TPR Future comes into play.

TPR Future is at a really exciting stage now because it has completed what I call the first phase, which is the diagnostic work that concluded last summer. We're just in the process of concluding the second phase, which is the design phase that finished in Q1 this year, and then we move into the implementation phase. That's about fundamentally changing the way that we deploy our resources, the way that we scan our horizons, the way that we interact with our regulated entities. So the direction of travel will be broadly the same, but the way we go about it is going to get sharper.

PA: Could you provide specific examples of how you'll be sharper?

Boyle: I think you need to look at what's happened over the past 12 months as to how we're going to be sharper. Our efforts to be clearer, quicker and tougher does accurately describe the way that we're changing. So let me give you some examples. So 'clearer' – one of the things that was changed by the regulator over the past few years is we have more voice. We've seen that both with our regulated entities and more broadly as we seek to feed into and assist the wider agenda.

Another area we have been clearer is with the role of trustees. Our 21st Century Trustee programme is about making our expectations of them clearer, for instance how we've begun to differentiate between professional trustees and lay trustees.

Being quicker is about the way our processes work internally and how quickly we realise there's a situation out there, scanning horizons. The regulator is in a different place from four or five years ago in terms of the speed at which we act. Is it yet the finished article, no. But TPR Future will help us sharpen that up. So that's quicker.

Tougher – I think you just need to look back over the past 12 months and see that on a number of different areas we have become tougher in calling out where we think it's appropriate. So for instance, the results we've achieved in terms of our avoidance powers or the negotiations we did with BHS. That's a headline case, but there's always more going on that doesn't get into the headlines, which is the general administration, data standards and the way that schemes are managed. But you've seen us fine schemes that are not getting the basics right and you will have also noted the criminal prosecutions that we've made for the first time.

PA: Is the clearer, quicker, tougher intention a direct response to the criticism TPR has faced with BHS, Carillion etc?

Boyle: Absolutely not. This change was already happening. It was already happening frankly since Lesley *[Titcomb, TPR chief executive]* arrived. She's been the catalyst for change. So this hasn't happened overnight. An awful lot of what has come together as TPR Future predates the BHS discussions and Carillion. So no, it's absolutely not a knee-jerk reaction. It's part of a long and consistent move that we've been trying to make with the agreement of the board and with the agreement of our stakeholder DWP.

PA: What is your response to criticism TPR reacted too late to the Carillion crisis?

Boyle: The vast majority of what we do – the same with Carillion as it was in any other case – happens behind the scenes. I think in terms of the way the Carillion story has played out, it's actually quite a difficult environment to put the full picture across within

the select committee environment. The problem with it is that you only get to answer the questions that are posed of you. What that can mean is that sometimes an incomplete picture is given. Lesley *[Titcomb]* did say that in retrospect, we could have moved faster to make a decision on whether to use our powers or not. I would echo her comments on that. But we do need to emphasise, that was four, five, up to 10 years ago. That wasn't related to what's happened since July when Carillion issued its profits warning.

PA: Please could you highlight some of TPR's success stories from recent years?

Boyle: Well let's talk about automatic enrolment. Almost half of our budget is spent in implementing automatic enrolment and automatic enrolment has been a huge success, not just for TPR but for all those involved in it. By any stretch of the imagination, over one million employers nine million members newly part of a pension saving is a staggering success. I think we sometimes forget just how successful that's been.

PA: How will your efforts with auto-enrolment evolve now that the first stage of auto-enrolment will be completed by July for all employers?

Boyle: Our efforts have evolved throughout the piece. It's not been static. So at first the legislative phase was about getting the large employers to comply. There was then a very different challenge in getting medium and smaller employers to comply. So we had to spend a huge amount of time thinking about the messaging. I think we used quite a lot of behavioural science to inform the way that we approached that.

Clearly the next significant milestone is going to be the increasing contributions to take place in April this year and then April next year and we need to make sure that that is a success.

PA: You've also been very good at trying to crack down on the employers that don't comply. How big an issue is that, especially with the smaller sized firms? It's more difficult to keep an eye on so many firms. Do you think you have the capacity at TPR to effectively do so?

"The calibre of the leadership of the organisation is significantly stronger and this has been demonstrated with the results that we've achieved"

Boyle: We had to skill up for it. We have arrangements in place including an outsourcing contract that enables us to have the bandwidth to do it. We have to do that with a very data driven approach. So in the case of AE we take a lot of data from HMRC and integrate that with our own data in order to work out where to focus. If we have to intervene, there's an increasing ratchet of things that we can do, from a compliance notice through the various levels of penalty. So actually taking someone to court is something we will only do as an extreme response.

However, the levels of non-compliance at the smaller micro end in percentage terms have been no worse than we saw at the large end. Clearly the numbers are lot higher, but there is no difference in percentage terms. So that is pleasing.

PA: Are there any other areas of success that you would like to highlight?

Boyle: The master trust authorisation regime we're now bringing in came about as a result of lobbying, which we did behind the scenes. Out of this we believe will come a stronger segment of schemes that are managing people's funds. Of course it's the master trusts that are getting the lion's share of the AE contributions so we need to make sure that that works. I think that – as with anything – we can't draw the line and say, that's success, move on. We now need to deliver this in the autumn and thereafter when we move from authorisation into a supervision regime. But so far, that has been a success and it's one that we've played quite a significant role in as the catalyst.

PA: How is TPR tackling pension scams?

Boyle: The people who are looking to exploit these opportunities will continually look for new ways to exploit and we have to adapt our approaches accordingly. We recently got significant praise for a fairly straightforward statement saying, if you get cold-called about your pension, it could well be somebody trying to steal it. So we can be clearer and more explicit in a way that actually will get through to individual members and the public. There was a case recently where some trustees are being forced to restitution of funds that the court held was inappropriately obtained. So we need to take examples like that and make sure that they are visible.

The cross-government body to prevent pension scams, Project Bloom, currently has its chairmanship with TPR. With this, one of the things we're trying to do is to take a fresh look at the way scams are measured, the evidence base for it, what is being done, along with establishing the messaging that works, the messaging that doesn't work. What if anything can be changed and improved.

PA: What are your concerns about DB to DC transfers following the freedom and choice reforms, and the increased risk of scams they may generate?

Boyle: Well I think that's exactly an example of the way the landscape changes. Freedom and choice means we need to be collaborating closely with the Financial Conduct Authority (FCA) as it has the responsibility to regulate the adviser community. This is something that's changed a lot over the four years that I've been there. We now have much more regular dialogue with the FCA at lots of different levels. Following our recent joint publication there is going to be a period of engagement, with the aim is to follow that up with another joint document with the FCA later in the year.

Written by Laura Blows

A crushing weight?

Louise Farrand considers the increasing pressures facing trustees, with yet more challenges to come

Summary
• Trustees are under more pressure than ever before. In the defined benefit world, concerns are growing about the sustainability of previously made pensions promises, leading the government and The Pensions Regulator to toughen their approach. Meanwhile, defined contribution regulation is growing to better protect members' interests, as this area evolves.
• The Pensions Regulator is trying to help by producing clearer guidance for trustees. The revised DC code and the 21st century trustee initiative are two examples of new resources that are designed to support trustees.
• However, the fact remains that the regulatory burden has increased exponentially, but trustees' resources haven't. This is calling some to question whether the trustee model is still fit for purpose. We are likely to see more professionalisation of trusteeship, as well as consolidation of DB pension schemes.

Once upon a time, trustee boards met four times a year. The meetings lasted a few hours and were largely spent reviewing investment growth (usually satisfactory), addressing member enquiries and perhaps having a training session with their advisers. Afterwards, many such boards went out for a nice lunch.

These days, life is very different for trustees. Members are living for longer. Investment strategies are more complex, markets uncertain and strong performance by no means assured. Pension scams are an ever-present worry. Defined benefit (DB) schemes are underfunded and encouraging members to engage with and save enough into their defined contribution (DC) counterparts is a struggle.

Regulation, which is designed to address some of these issues, has increased exponentially. The four meeting a year model is a distant memory for many pension trustees.

"The regulation on pension scheme trustees is now massive," summarises PAN Trustees managing director Steve Delo. He adds: "Whilst some of it is necessary, a bit of it is welcome and pretty much all of it is well meaning, the compound impact on boards is excessive."

"The burden of regulation has increased exponentially, but the resources at trustees' disposal haven't," agrees Independent Trustee Services' director, Peter Askins.

Regulation, regulation, regulation

Consultancy Broadstone's technical director, David Brooks, witnesses the extent of trustees' workloads regularly. "An agenda I was looking at for next week had a list of issues to cover – sponsor covenant, legal update, actuarial valuation, the investment adviser talking about fund performance – at this point, we are nearly at two hours already. Then the administrator comes in, and then we have to cover governance, GDPR, business plan, conflicts of interest policy, training policies – it's just layer upon layer upon layer. So, I am not surprised that trustees are flat out."

The Department for Work and Pensions' white paper, *Protecting Defined Benefit Pension Schemes*, is a bid to tighten up governance in the wake of high-profile scheme collapses like Carillion and BHS, as well as encouraging poorly-run schemes to consolidate.

Brooks says: "Anyone hoping for a lighter regulatory regime following the recent issues experienced by DB schemes will be in for disappointing read. The government clearly sees TPR as the body to provide the answers to any issues in the DB funding area. We shall soon see a more interventionist and proactive regulator with more powers to punish employer and trustee transgression."

The Pensions Regulator welcomes the DB white paper. Its policy manager, Louise Sivyer, told *Pensions Age*: "The planned improvements to anti-avoidance and information powers will allow us to provide more clarity on what is and isn't acceptable."

In response to high-profile pension

scheme collapses, the regulator has already become more interventionist, says Brooks. Last year they picked 100 small schemes, planning to audit 50 prior to their valuation, and 50 afterwards, to test whether an interventionist approach is effective.

"We have had six letters about this," says Brooks. "Trustees should expect to receive a letter from the regulator more than they ever have before."

GDPR is another piece of regulation at the top of trustees' priority lists. "GDPR is a massive issue for pension schemes," says Askins. "I have asked seven lots of lawyers, what's the penalty if a pension scheme is noncompliant? And no one knows. It's all right saying a company can be fined a certain percentage of its turnover, but what about a pension scheme?"

Sivyer adds: "We think there is probably a large chunk of schemes where they haven't addressed this as well as they ought to. If trustees are in a space where they are already compliant with the existing data protection regulations, they are in a really good space to be compliant with GDPR. Our main message to trustees is you really ought to have started this quite a while ago and at the earliest opportunity, you need to be having conversations with all the advisers who hold your data and have a clear view of the controls in place. It's not just a case of trustees holding data correctly, it's about them being accountable for all their providers' data – they need to be confident that third parties are also compliant with GDPR."

GDPR and the DB white paper are just the tip of the iceberg when it comes to the expectations that rest on trustees. Any expectation that a swathe of Brexit-related legislation might stem the flow of pensions guidance and regulation has so far proved unfounded. What can trustees do to manage the burden?

Down to business

Well-run pension schemes are more and more closely resembling businesses. The regulator's 21st century trustee initiative encourages trustee boards to take steps in this direction. "They want trustees to take more of a strategic view of their pension scheme," says Brooks. "What the regulator wants is for them to look five or ten years ahead: where is the scheme and how are we getting there?"

Sub-committees are one way to make trustee boards more efficient. "Trustee boards typically meet four times a year, with bigger schemes having sub committees. However, recent compliance pressures mean even smaller schemes boards are having to set up working groups or sub committees to drive forward projects between meetings. Lots more are having regular conference calls," reports Delo.

Using advisers effectively is another way trustee boards can manage the burdens on their time. However, great advisers are not a panacea. As Sivyer says: "It is important that trustees have high quality advice provided to them so that they make well informed decisions, but the accountability of these decisions lies with the trustees, so they can't delegate a lot of their decision making. However, some things can be delegated – individual member issues, for instance."

The regulator is sympathetic to the burden on trustees and is trying to support them. Sivyer says: "We completely rewrote our code of practice for trustees of DC schemes, which we launched last year … We aimed to produce something that provided them with a lot more clarity around what we expect of them as a DC trustee and practical steps for them to do that."

Similarly, with the 21st century trustee initiative, Sivyer explains: "What this aims to do is not introduce any new standards or messages, but to break down the guidance and expectations we have set previously into clearer and more digestible chunks, so that trustees can see quite easily, without having to read through lots of guidance, what it is we expect of them in certain areas and how we can go about achieving that."

However, the fact remains that many trustees are struggling to keep up. Askins questions whether the model is fit for purpose, particularly member-nominated trusteeship. He says: "I am thoroughly wedded to the democratisation of trustee boards. But we are in a position where – if you were an ordinary person working for a firm, bearing in mind the legacy is mostly small, industrial firms – given your day job, are you really going to want to get involved with all of this?"

A changing landscape

Consolidation might well make sense for trustees of smaller schemes who are struggling to find the time, or lack the expertise, to meet their responsibilities.

Sivyer says: "In the DC space, the DWP are introducing regulations from this April which mean that DC schemes should be more easily able to consolidate and undertake bulk transfers. If trustees feel they are in a space where they are not able to carry out their duties in a way that meets our expectations and provides value for money, we do think there are a large number of schemes that need to be seriously considering whether their position is sustainable and whether they ought to be considering consolidation."

The trend towards using professional trustees is likely to continue. Sivyer says: "We think that professional trustees are going to have an increasing role in the landscape and that role is a very important one."

It's no wonder that the future pension governance landscape looks set to change. Value for members and transaction costs are next on the DC regulatory agenda, as UK DC continues to mature. Meanwhile, with high street retailers suffering, the public's gaze is increasingly focused on the sustainability of DB schemes. The pressure on trustees is unlikely to relent any time soon.

Written by Louise Farrand, a freelance journalist

An uphill cycle

Talya Misiri talks to Just director of defined benefit solutions Tim Coulson about his career history in DB insurance and how he came to represent GB at cycling championships

What is your pensions career CV?
I studied Mechanical Engineering at Leicester University and qualified as an actuary in 1998. In 2000 I joined Prudential and started work on DB and six years later I joined Paternoster. It was an exciting time as Prudential and L&G were the dominant players and we brought something different to the market.

I joined UBS in 2010 and secured approvals to write a couple of billion pounds of longevity business.

Rodney Cook (Group CEO at Just) and I have shadowed each other's careers. He got to Just 12 months before me and approached me to join in 2012. It offered me a blank canvas to work on. Since then I've built the team and service we have today.

What roles have you held prior to joining the pensions industry?
Apart from a period working for the engineering firm that sponsored me through university I have always worked in insurance. Why would anyone want to work anywhere else!

What is your greatest work achievement?
Without doubt, it's establishing the DB team at Just – we've built a modern and flexible capability from scratch and now have a strong track record of completing over 120 transactions, valued in excess of £3 billion.

We introduced a new approach to the sector, offering better value to trustees through post-deal medical underwriting and we continue to innovate. We always start by ensuring we have a clear understanding of what the trustee is looking to achieve – and then we get creative to develop a competitive solution.

What do you still wish to achieve?
DB schemes are in the headlines every other day and public perception is shifting. We offer an important part of the solution to the intense challenges facing DB schemes and their sponsors. We can help trustees meet their fiduciary duties, offer scheme members security and solutions to employers. I'd like to see this story told more widely. I'd also like us to become closer to trustees and move from transactional support to a service partnership.

What is your biggest career regret?
No regrets. Even with the benefit of hindsight, I'd still do what I did because it's given me the opportunity to create and lead the team at Just.

That said, I sometimes wonder what might have been if I'd got into cycling when I was younger. I didn't start until my 30s following a football injury. I love it and now compete for GB as an amateur.

Excluding your current role, what would be your ideal job (in or out of pensions)?
This one's easy – managing a professional cycling team. There are plenty of parallels with managing the team at Just. A lot comes down to how you get on with people, then there's the competitive element and the variety.

What was your dream job as a child?
I loved football and dreamed of playing for Manchester United. I had a fascination with Lego and Meccano which is probably why I studied engineering at university. But football was my passion.

What do you do in your spare time?
Cycling and family. At the weekends you'll find me pedalling around the lanes of Hertfordshire with club mates. I was chuffed to represent GB as a senior at the UCI amateur championships last summer. I met my wife Kath when we competed in a triathlon so we share a passion for sport and now have two sons aged seven and six.

Any particular skills or party tricks?
I think I'm good at DIY and cooking but you'd better ask Kath!

Who would be your ideal dinner party guests?
Kath, Warren Buffett, Richie McCaw, Peter Kay and Winston Churchill.

Do you have a particular phrase or quote that inspires you?
"A bicycle ride around the world begins with a single pedal stroke" – Scott Stoll.

Written by Talya Misiri

DC Guide 2018:

Navigating changes

Featuring:

- The challenges facing DC scheme trustees
- When trustees should encourage members to make decisions, or lead them into defaults
- Governance best practice
- The increase in master trust regulation

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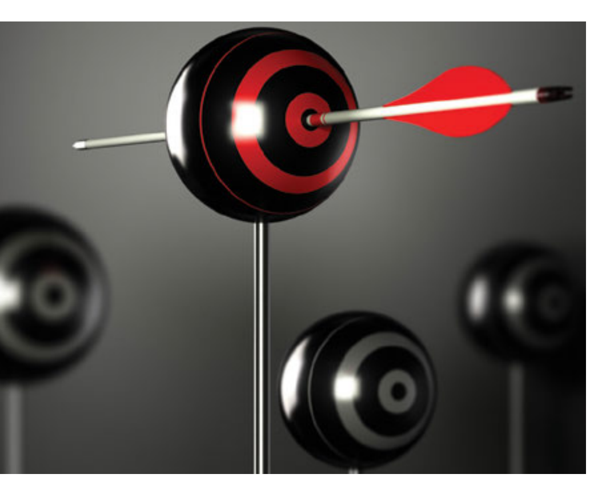
Summary
• A perennial question for DC scheme trustees – how much information needs to be shared and how much does the average scheme member genuinely want to know?
• New rules requiring disclosure of pension scheme investment costs take effect this month.
• The DWP's recent green light for regulations easing the bulk transfer of DC members without their consent is likely to drive scheme consolidation; helping up to one in three of the UK's 2,180 trust-based DC schemes close and transfer members into an arrangement with greater scale.
• Master trusts that don't meet the minimum standards set out in the new authorisation process will need to be wound up in 2019.

Raising the bar

Keeping it simple and straightforward to keep members engaged, while keeping them informed of ever-more complex regulations, is among the many challenges for DC scheme trustees



In the new pension freedoms era, the challenges faced by DC scheme trustees range from effectively communicating and engaging with their members to ensuring they are being offered the best available options for maximising retirement income.

One imminent test will be that of retaining scheme members as two sizeable hikes in auto-enrolment contribution rates kick in. They rise this month from 2 per cent to a minimum of 5 per cent, with employees now contributing 3 per cent of earnings and the employer adding 2 per cent. A further increase, from 5 per cent to 8 per cent, will follow in April 2019 when the employee contribution will be 5 per cent.

"Most scheme trustees I speak to worry most about the issue of member engagement," says Legal & General Investment Management (LGIM) head of DC solutions Emma Douglas. "Auto-enrolment has got many employees into schemes, but has relied too much on apathy and inertia.

"It's admittedly difficult to engage millennials and younger scheme members, who have competing calls on their money, such as paying off student loans and attempting to climb on the housing ladder. However, auto-enrolment does mean that they are saving early on in their careers and contributions are being increased to a more realistic level to ensure they have a decent DC pension pot to look forward to."

For Xafinity Punter Southall head of DC solutions Ken Anderson, the need for scheme flexibility and helping members make sensible decisions are major challenges for those running a DC scheme. He also cites concerns about the efficiency of the independent governance committees (IGCs), whose remit is to represent the interests of members in contract-based rather than trust-based schemes.

In 2015, the Financial Conduct Authority (FCA) stipulated that contract-based pension providers should appoint IGCs to represent scheme members' interests and ensure they get the best possible value for money. However, Anderson says that recent press articles have questioned their performance. Following delays in the FCA's own review, ShareAction recently compiled its own league table ranking the effectiveness of individual IGCs.

The responsible investment charity suggested that many don't adequately report the value for money provided by their respective provider, while its ratings awarded fewer than 10 points out of a maximum of 19 to the majority of IGCs.

Anderson also questions whether changes in regulation are always effectively communicated. "Over the past year, we've been sitting down with clients to ask whether they are keeping scheme members fully up to date with the very latest revisions to auto-enrolment regulation," he says. "The regulator has responded with fines for some schemes that have failed to update members.

"Also is the scheme still fit for purpose? In some cases, investment policy may still be focused on annuity purchase, despite the pension freedom changes introduced three years ago."

Top priorities

Aon's DC investment advisory service leader, Chris Inman, says that the group's most recent employee engagement workshop carried the tagline 'engagement is easy'. It suggested five basic decisions that DC scheme members should consider, based on the changing priorities that will apply at various stages during

their working life and in retirement:

- Should you enrol in the scheme, or leave?
- How much should you contribute?
- Where should you invest?
- What's your planned age of retirement (which will determine an appropriate investment strategy)?
- How will you take your benefits?

Aon has also published the first of three research papers that focuses on defining the stages of a DC member's lifestyle strategy, linking these to investment objectives and reviewing ways of improving the equity allocation for DC savers.

The second and third papers, which appear this month, have as their respective topics the use of diversified growth funds (DGFs) and how to evolve fixed-income investing nearing retirement. "The second paper focuses on whether DGFs still have a place in DC schemes," says Inman.

"We believe they do but clearly defined and realistic objectives need to be set so we don't suffer from the same 'failure of expectations' as has been the case recently. There are many different types of DGF, each with a number of different objectives – performance is just one of them. We found that when each type of DGF is evaluated against its actual risk and return targets, these funds still have a valuable role to play for DC savers."

"Freedom of choice has turned investment on its head," says Douglas. "People often don't know exactly when they'll retire, or what they'll do with their money. The idea of a long, slow slide into retirement and de-risking ahead of it has been replaced by more radical thinking about investment. People tend to invest for longer; indeed their investment should ideally last for as long as possible.

"The recent low-interest rate environment has had the effect of making annuities look particularly poor value and individuals fear being 'ripped off' if they die early. However, higher interest rates could restore to them a measure of attractiveness; particularly for individuals in later life."

Responses to regulation

Royal London head of investment solutions Lorna Blyth reports that the group has made three recent changes in response to scheme member needs and regulation. "The investment default changed in February to target a drawdown outcome," she says. "We've been monitoring customer behaviour since pension freedoms were introduced; initially there was a rush to cash, however over the past year we've seen a steady trend towards drawdown and have changed our default to align with this move.

"We will change all existing schemes in the third quarter this year after writing to advisers, employers and members to explain the shift and give them the option of remaining in their current default which targets annuity."

Royal London is accompanying the change by launching new retirement engagement packs, which will be sent annually to members from five years before their chosen retirement age. "By connecting with members earlier than the government requirement of six months, we believe this will help highlight their choices at retirement and also help align their retirement target with a suitable investment choice," says Blyth.

"The third area is around costs and charges where we have captured and aggregated transaction cost data for members in the default. These have been calculated in line with the FCA template." The group has moved ahead of this month's requirement that all DC scheme trustees publish charge and transaction cost information for investment options in the chair's statement and on a publicly-available website. Disclosure must also include an illustration of the compounding effect of the costs and charges.

Among other changes, the Department for Work and Pensions' (DWP) recent green light for regulations easing the bulk transfer of DC members without their consent is likely to drive scheme consolidation; helping up to one in three of the UK's 2,180 trust-based DC schemes close and transfer members into an arrangement with greater scale.

Regulation is also being introduced for master trusts, which have increased in number since auto-enrolment, with only a handful carrying both the Pensions Quality Mark (PQM) and the Retirement Quality Mark RQM) as well as meeting the master trust assurance framework. DWP plan for a new authorisation process will require master trusts to meet criteria set in five areas.

"The bar could be set fairly high, although as the draft code hasn't yet been issued it's not possible to be certain," says Sackers partner and head of DC Helen Ball. "There will need to be an orderly wind-up process for those master trusts that don't meet the new minimum standards. The law comes into force in October 2018 and trusts have six months in which to make their application, so in 2019 it should be clear which of them doesn't make the grade."

To this already crowded agenda can be added the issue of collective defined contribution (CDC) schemes. This follows the recent agreement between Royal Mail and the Communication Workers Union (CWU) that set a CDC pension benchmark.

"CDCs are likely to be the 'canary in the coalmine'," suggests Inman. "The pooling of assets is certainly a good idea and it will be fantastic if they can make the concept work. But it's unlikely that too many others will be joining Royal Mail until we have a lot more detail."

Written by Graham Buck, a freelance journalist

Decision or default?

Lynda Whitney discusses how and when those managing DC schemes should help members make their own decisions

There are only five decisions a member needs to make about their defined contribution (DC) pension. In this article, we explore whether you should educate the member to make the decision or default them into a scheme solution. By recognising your limited resources, this approach can help you decide where to focus.

The five member decisions

STAY

Employer matching of contributions, along with tax relief, mean it is usually in an employee's best interest to stay in the scheme, unless they are a low earner and struggle to afford contributions, or a high earner if there are Annual Allowance or Lifetime Allowance issues. Your responsibility as an employer is to pick a scheme that offers the best value for your employees; not necessarily the cheapest – but the right balance between cost effectiveness and good service. We can help you benchmark your scheme against more than 300 others with data from Aon's *DC Scheme Survey 2017*.

PAY

The decision on how much to pay in will arguably have the biggest impact, so it is worth investing the time and resources to get this right. Take steps to understand what the typical retirement outcome looks like – is this enough or are changes needed? Educate the member about the benefits of matching (if available), the power of compound returns over time and make it personal by showing them what difference an extra contribution may make. Keep the communications upbeat, as research shows that people take more action in response to aspiration than threats of bad outcomes.

If the employer is really committed to pensions, default members in at the top contribution rate but allow an option to opt-down.

INVEST

Most members do not want to become investment experts. Typically they will follow the scheme default, so spend your time and resources on getting this default right. Keep the other investment choices simple. Where you educate, pick your moments wisely. A member entering a lifestyling phase is more likely to benefit from making a decision about their target outcome.

RETIRE

When a member wants to retire is clearly a personal decision. However, you can help by educating them about what they will get from the state pension and when, as well as from your scheme. The best schemes allow members to picture their future self and to consider what outgoings they might have in retirement. This allows a considered decision about when they might be able to afford to retire comfortably.

SPEND

Whether a member is better off with cash, an annuity or income drawdown will depend on personal circumstances. The scheme needs to educate them about the options available, allowing them to explore areas including tax, inflation, their risk tolerance and whether they need benefits for a dependant. The best tools allow side-by-side comparison of annuities (including reflecting their health conditions) with income drawdown. However, once the member has decided on the shape of the retirement income they want, they often still need help. Schemes can assist by negotiating bulk deals with an independent financial adviser or an income drawdown provider.

So focus your communications strategy – and the precious interest of your members – on the decisions where their input will have the biggest impact. For example what they PAY in, when they want to RETIRE and how they want to SPEND their retirement savings.

For a copy of Aon's latest DC Scheme Survey visit aon.com/dcpensionsuk

Written by Lynda Whitney, partner, Aon

Choosing the best risk reduction strategy can prove challenging. Our experts help trustees and sponsors understand their motivation for risk reduction.
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DC governance: Best practice

DC governance should focus on appropriate due diligence to ensure the best chance of delivering optimal outcomes for members. But it's not all about processes; sound governance includes taking practical steps to reduce the risk of adverse outcomes

We focus on four governance factors that we believe are instrumental in helping to deliver your scheme objectives.

Following the DC code

The direction of travel from The Pensions Regulator is clear: higher expectations for trustees and scheme managers are on the way. This is to help support members in a post-freedom and choice world.

The DC code has four key messages for trustees. They must:
1) Act with integrity and competence
2) Act in the interests of scheme members and beneficiaries
3) Be financially sound (professional trustees)
4) Have appropriate levels of knowledge

Value for money is a key area of focus for DC schemes, so how can you ensure this? Of course, it can mean offering low-cost solutions, but it's important to remember that low cost does not always equal good value. From our experience, engaging member communications, high quality service to members and an effective at-retirement solution are now top of the agenda for many trustees and sponsoring employers.

What's your investment strategy?

With continued high numbers of members using default investments, having a default that is appropriate for the majority is crucial in improving overall member outcomes.

A 'default default' that is still popular is one designed to smooth the path towards an annuity purchase. However, this seems at odds with member behaviour, particularly since income drawdown is expected to become the most common method of post-retirement income.

If a scheme offers multiple solutions, some form of guided journey could be offered to help members understand the potential opportunities and risks of each choice. It's also essential that trustees understand member demographics and behaviour, and tailor solutions accordingly.

Questions for discussions with advisers and service providers

In many cases, advisers and providers have been in place for some time, so it's important to evaluate whether they continue to help you meet your objectives.

A good provider should offer value for money, performance that meets agreed targets, engaging communications, funds that meet members' future needs and at-retirement solutions that seek to minimise 'out-of-market' cost and risk.

Where a third-party administrator is in place, it's important to evaluate how adaptable their service is to meet changing member needs. Is pension administration a core part of their business and is there a demonstrable commitment to the DC market?

Where an adviser solution is in place, questions should also focus on conflicts of interest. Ask how the charging structure works and what benefits these bring. Ultimately, if advisers and service providers are not performing as expected, trustees or sponsoring employers should push them to improve the situation as quickly as possible or replace them.

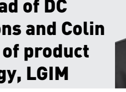
Could delegating the governance be a better solution?

As the immediate challenges of day-to-day governance and administration take centre stage, other initiatives, especially member engagement, can be compromised.

A master trust allows employers to fully outsource the governance, investment and administration of their DC scheme. Not only are the investments designed and managed by experts, but the whole delivery of retirement savings is entrusted to those whose expertise and resources are focused on ensuring the best experience for members and employers. Master trusts also have the benefit of strong, independent governance from designated professional trustees.

Taken together, this can free up resources for other key factors that are crucial in helping to achieve better member outcomes and a better return on investment.

Written by Simon Chinnery, head of DC client solutions and Colin Clarke, head of product policy strategy, LGIM



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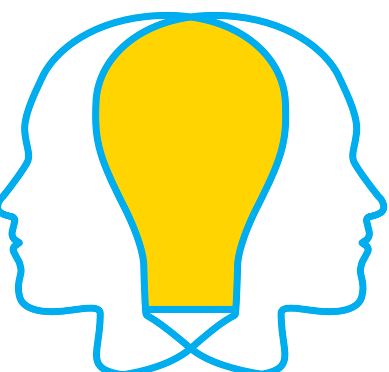

We think that the most effective client relationships aren't just based on mutual interest, they're based on a genuinely shared agenda.

Take the example of a major UK pension scheme. The pension fund needed something that could give their members better returns while sheltering them from the long-term financial risks of climate change. Knowing LGIM's values and working practices were aligned with their own they asked us to build a brand new fund to power their pension scheme. So we put our heads together with FTSE Russell and between us we developed the Future World Fund, a ground-breaking, multi-factor fund that tackles climate change risks head on.

By actively engaging with companies who hold the key to a low carbon future and selectively divesting companies that fail to meet the necessary standards, we have created a light bulb product that has the potential to provide thousands of scheme members with a future proofed pension. Why? Because, in all our heads, it's the right thing to do.

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Master trusts: What next?

Roy Porter looks at the impact of increasing regulation on the master trust market

There's no denying that master trusts have played a crucial role in implementing auto-enrolment, offering real economies of scale and a professional level of governance that would be hard to find cost effectively, had many smaller schemes gone it alone.

Regulation hasn't always kept pace with the level of growth in this sector of the market, but the introduction of the Pensions Schemes Act 2017 changed all of that. Worries about the financial stability of some master trusts, alongside calls from many within the industry itself for more robust regulation, eventually led to the government's decision to introduce a specific authorisation and supervisory regime.

Historically there had been very few quality criteria required to launch a master trust and The Pensions Regulator had few powers to intervene after they had been set up. Whilst the vast majority of people saving in master trusts are doing so with the largest few, this lack of regulation meant some were saving with smaller providers with little or no capital reserves and inadequate business plans.

When the industry is ultimately striving for the best possible retirement outcomes for the greatest number of members, this simply had to change.

From 1 October 2018, there will now be a requirement for master trusts to apply for authorisation to continue operating, which is a welcome move that we'd long lobbied for. Any existing schemes that do not receive authorisation, or fail to comply with the five criteria outlined by The Pension Regulator on an ongoing basis – that the scheme must be run by fit and proper persons; that it must have sufficient and effective system and processes; that it must be financially sustainable; it must have scheme funders who meet specific requirements; and that it must have an adequate continuity strategy – will be required to wind up and transfer their members to another authorised scheme.

The Department for Work and Pensions have just confirmed that existing master trusts will have to pay £41,000 to apply, and any new entrants to the market will be faced with a £23,000 application charge. We are concerned to see that the government is pressing ahead with its proposal to charge different application costs, depending on whether the applicant is an established master trust or a new one. We would argue that the same rigour and assessment needs to be in place on both existing and new master trusts. We would be concerned if this were symptomatic of there being a lower bar in practice for review for new entrants, as, after all, the political impetus behind the Pension Schemes Act was driven by the entrance of low quality, under-capitalised schemes.

There will be a number of hurdles to overcome when applying for authorisation – along with the cost, time, resources required, and the rigorous nature of the authorisation process will force some master trusts to review whether they can continue operating, or whether it makes business sense for them to continue trading.

For those that do decide to cease trading, there are master trusts intending on applying for authorisation this Autumn that are ready to acquire.

At The People's Pension, we recently completed a major master trust merger, in collaboration with JLT Employee Benefits, with around £20 million funds under management transferred to us from Your Workplace Pension master trust, on behalf of almost 9,000 members.

So what does increased regulation mean for the market? Simply put, we expect the rigorous nature of the authorisation regime will naturally create market consolidation, which will leave a smaller number of larger, financially robust master trusts with better governance structures.

Ultimately, proper regulation and authorisation of master trusts will ensure members are appropriately protected, and as an industry, there's no denying that can only be a good thing.

Written by Roy Porter, group director of sales and marketing, The People's Pension

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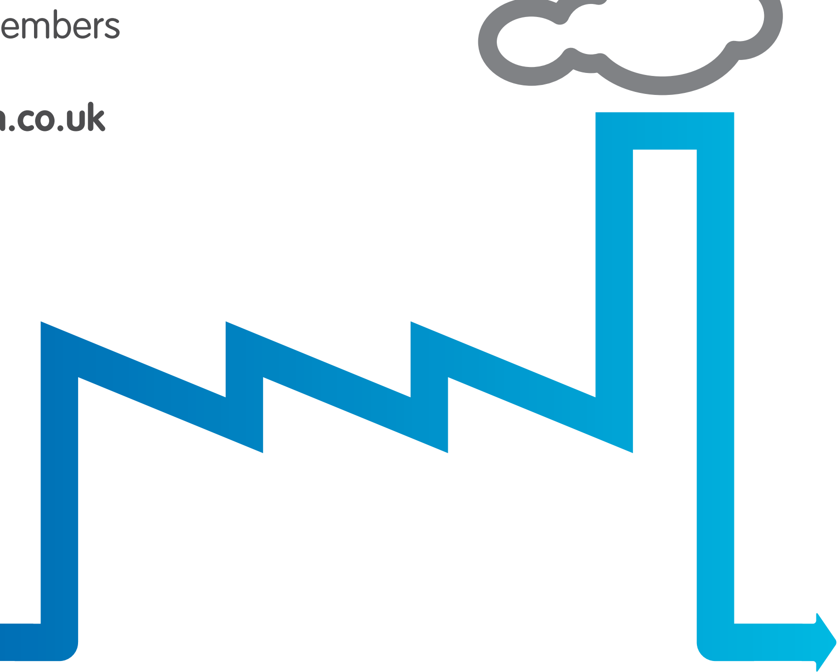

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Company Profiles

Aon

Discover better DC built on insight. Aon's expertise in DC pensions is built on our wealth of market data, renowned consultancy services and range of innovative DC solutions. Our dedicated team of DC consultants in the UK form a core part of our retirement business.

We cover DC investments, communications and design, and strongly believe that good governance and improved member outcomes should underpin all aspects of our advice. We think hard about the issues that affect our clients and always use bespoke, highly-appropriate approaches to address them. We recognise the challenge of providing more for your members, while still achieving value for money.

Our technology, products and propositions position us as a leading advisor in the DC market, with over 1,500 DC clients across Aon's businesses. We advise on, design and manage trust-based occupational pension schemes, group personal pension schemes and The Aon MasterTrust, our own master trust solution. So we can offer the complete range of DC services for employers or trustees, helping you find the right solutions to deliver better outcomes for your members.

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Legal & General Investment Management (LGIM) is one of Europe's largest asset managers and a major global investor, with total assets under management of £983.3 billion*. We work with a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

Throughout the past 45 years we have built our business through understanding what matters most to our clients and transforming this insight into valuable, accessible investment products and solutions. We provide investment expertise across the full spectrum of asset classes including fixed income, equities, multi-asset, commercial property and cash. Our capabilities range from index-tracking and active strategies to liquidity management and liability-based risk management solutions.

We are one of the world's leading providers of index fund management and a major investor in global fixed income markets. We are at the forefront of developments in liability-driven risk management solutions for defined benefit pension schemes and offer a large variety of strategies to help our clients manage their investment objectives. LGIM is also a leading provider of defined contribution solutions and we continue to innovate as the market evolves, building strong relationships with clients and their consultants.

More than 80% of our new business comes from established clients – a record that demonstrates our belief in growing with our clients and serving them well. Industry-leading client service means being accessible and delivering investment expertise consistently. Whether that means reliably providing a market return through our index funds, or establishing a bespoke actively managed solution that fits a client's needs, we have one key focus – to provide what our clients tell us they need most.

**as at 31 December 2017, including derivative positions. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor.*

The People's Pension

The People's Pension is the UK's largest private sector DC master trust with more than 3.5 million members and over 70,000 employers of all sizes from a wide variety of sectors signed up. It's a flexible and portable workplace pension, designed for people, not profit. With no shareholders, any surpluses are used for the benefit of our members.

Run by not-for-profit provider B&CE, which recently celebrated its 75th year, our values of creating simplicity, showing compassion and keeping promises drive everything we do.

The People's Pension is a multi-employer scheme with independent trustees and it's a hassle-free, flexible and portable workplace pension suitable for any organisation, large or small, in any sector.

Pension Quality Mark (PQM) READY is designed to help employers identify a good multi-employer pension scheme or master trust and aims to promote best practice around charges and scheme governance.

The People's Pension has gained the PQM READY standard in recognition of its low charges, clear communications and strong governance.

The People's Pension was the first master trust to report on its governance and administration arrangements in accordance with the Institute of Chartered Accountants of England and Wales' (ICAEW) new assurance framework for master trusts.

Earlier this year, we also led the way in public disclosure of the underlying transaction costs of our investment funds. Transparency in transaction costs is crucial in helping consumers assess value for money, and it's important to us that this information is scrutinised as part of effective scheme governance.

And we're striving to achieve excellence in our communications. We've become a corporate member of the Plain Language Commission and are extremely pleased that some of our member and employer facing publications have achieved their Clear English Standard accreditation. We pride ourselves on the simple, stripped back language we use to communicate to our clients and members – pensions shouldn't be complicated.

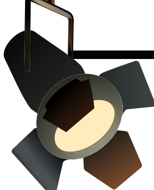
Pensions Age

Pensions Age is the leading title targeting UK pension funds and their consultants. Published monthly in print since 1996, and daily online, we invest heavily in our circulation and content to ensure we are the clear market leading title. Our in-house editorial team of Francesca Fabrizi (Editor in Chief), Laura Blows (Editor), Natalie Tuck (News Editor) Talya Misiri (Senior Reporter) and Theo Andrew (Reporter) ensure we cover the latest news and topical industry issues to help our readers make the best informed decisions.

www.pensionsage.com is the leading website for pension funds, and we look to cover the breaking stories as they happen. With over 24,000 subscribers to our email newsletter service; we offer our readers an unrivalled service. At the core of this is high quality, news-breaking journalism combined with in-depth knowledge of the target market and heavy research into data.

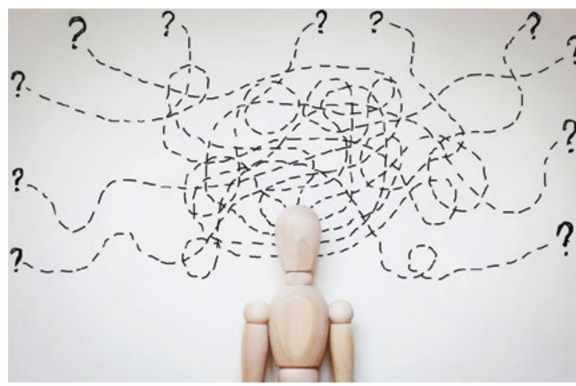
Pensions Age also runs highly successful conferences, and the Pensions Age Awards.

We also publish *European Pensions*, which targets pensions funds across Europe, as well as running the European Pensions Awards, Irish Pensions Awards, and Pensioni & Welfare Italia Awards. We also run an Italian language e-newsletter and website, and run an annual Nordics roundtable.



Overload

Stephanie Hawthorne shows how pension administrators are handling ever-increasing workloads



Ever since the introduction of the new freedoms in 2015, a huge bow wave of pension transfer requests from defined benefit schemes has place enormous pressure on pension scheme administrators.

Indeed, alongside other freedom and choice costs, transfer value activity is adding between 10-20 per cent to scheme administration costs over previous years, according to the Association of Consulting Actuaries (ACA). One of the problems is there is no standard process for requesting a cash equivalent transfer value (CETV).

ACA chairman Bob Scott says: "Where IFAs are providing transfer advice, the questions they pose during the transfer process are varied and time consuming. The quantum of enquiries and differences in approaches is posing difficulties for administrators and pushing up administration costs. Standardisation in the questions asked would seem to be a sensible step and this may be an area where the FCA could act swiftly to help all concerned."

PASA executive director Fergus Clarke agrees: "We are definitely seeing an increase in volumes. While the focus has been on DB, in our experience we are also seeing an increase in DC."

Some trustees are being more proactive in terms of routinely providing CETV figures, either at retirement or on annual deferred benefits statements or online. Clarke explains: "This brings its own challenges as, typically, actuaries provide CETV modellers so these are often not fully automated solutions and therefore can be costly and time consuming to implement. Administrators and actuaries need to find a way to better work together to solve this issue."

The actual amount of extra work varies from scheme to scheme, but as Dalriada Trustees trustee representative Chris Roberts points out: "The average age is increasing in closed *[DB]* schemes (which are now the vast majority of schemes). This means more members will be engaging with the administrator and the scheme will be reaching peak cashflow. But following peak cashflow, the demand should calm as the balance shifts from deferred to pensioner. The administration team (in particular, in-house) must consider this evolution and be staffed accordingly."

There is also more activity arising from scamming checks, governance, GMP reconciliations, de-risking exercises and pension sharing on divorce.

Digitisation of data

Clarke says: "There are things the industry can do to help themselves, for example data quality and the digitisation of data. If data is in a digital and clean format it increases the opportunity for automation and for members to self-serve. Trustees will need to invest in cleansing data but the results will be an improved service for members, increased accuracy and greater timeliness."

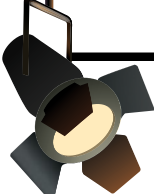
Willis Towers Watson head of business development, technology and administration solutions, Clive Witherington, says his firm tackled the problem of the bulging workflow by rapidly "expanding all resources in frontline roles working with dealing with members' queries. Since 2015 a number of more considered initiatives have been deployed, including online transfer quotations to aid self-service, better communications and educational material to help members make better choices and occasionally agreeing with trustees a temporary relaxation or extension to non-urgent SLAs to enable resources to focus on benefit quotations and settlements."

Other administrators are also investing in technology, as Hymans Robertson senior technical consultant Stuart Reid explains, with one option being to upgrade. He recommends web portals to allow members to obtain benefit projections and estimated transfer values through a self-service route.

Roberts adds: "The automation of calculations should speed up the processing of most member movements. We also find administration teams in larger firms can flex resource from other teams to cope with peak demand."

He concludes: "There is no real excuse for bottlenecks and backlogs of member enquiries. The majority of administrative spikes will follow the issue of communications, or as part of targeted exercises. These spikes can be planned, with communications issued at appropriate times of the year and appropriate staffing considered. With a well-planned communication structure and properly resourced team, the administrative calendar can be actively managed."

Written by Stephanie Hawthorne, a freelance journalist



At your service

Stephanie Hawthorne advises trustees on implementing SLAs with their administrators

Many pension schemes use third-party administrators and have in place service level agreements (SLAs). The Pensions and Administartion Standards Association (PASA) provides templates and standards for these.

"The key is that the agreement clearly states who will do what and when, how much they will be paid, how performance will be measured and what happens if things go wrong," says Dalriada Trustees' trustee representative Greig McGuinness.

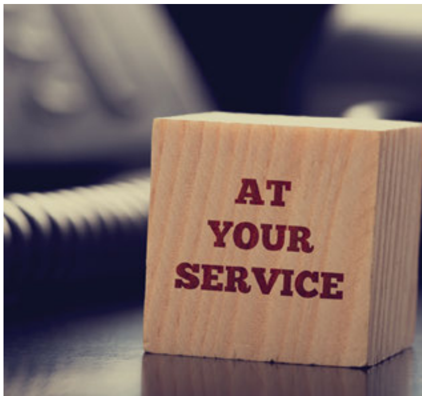
KPMG's head of administration consulting Samantha Coombes has seen very poor examples of contractual SLAs on both sides, which can push an administrator to try to deliver the impossible, or TPAs effectively abdicating responsibility for delivery. She says: "Being honest and open about client expectations and the art of the possible upfront are crucial to getting the right outcome."

The critical factors

SLAs should ideally be focused on the desired outcomes for the trustees, what is critical for them to have done correctly and without error. What are they trying to measure and why? PASA executive director Fergus Clarke explains: "If in a mature DB scheme, the payment of regular pensions is the most critical issue then this should be a prime focus of the measures."

He adds: "Similarly, for a DC scheme the investment of contributions and reconciliation of all investment movements might be considered to be a critical issue, so this should be measured and reported upon."

Willis Towers Watson head of



business development, technology and administration solutions, Clive Witherington, says: "The majority of SLAs are time based and expressed as completion of a particular activity or transaction within a specified number of working days – typically five working days for most member-related activities. SLAs probably should also reflect some measurement of accuracy and quality but equally the members' understanding of the information being provided but these 'softer' criteria are very difficult to define as a contractual undertaking."

Barnett Waddingham associate Julie Walker agrees: "Turnover of cases is easy to measure but we need to make sure we pay attention to the experience as well as the statistics."

The only measurement of success that really matters is whether members' (reasonable) expectations were managed and met and whether the communications from the trustees and administrator provide a full explanation to aid members' understanding of their choices. Witherington explains: "SLAs are a tool but if the ultimate customer is not getting the service and information needed, it is academic whether the activity was completed 'in time'."

Regular reviews

Taking a different tack, Trafalgar House client relationship manager Karla Bradstock, advises: "There should never be a single measure of the success of an administration SLA. The requirements of service delivery vary significantly between one scheme and the next. Trying to adopt a universal standard or range of measures for every scheme simply won't work."

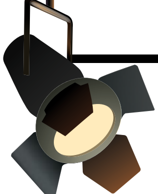
She adds: "Don't wait until things fall apart or a critical event causes you to review the SLA. Many SLAs do not get reviewed for years, even though service standards and member requirements evolve. Do it regularly and often."

Keeping the members at the forefront of everything is recommended. Trustees and administrators can become fixated on reducing the SLA working days targets but Witherington says: "In reality members' are generally 'happy' as long as they know when and what is going to be delivered and that 'promise' is met."

Care should be taken that an emphasis on meeting target timescales doesn't drive down the quality of the work being produced, as Hymans Robertson senior technical consultant Stuart Reid explains: "Trustees and scheme managers should consider whether it's more important to them that everything is done to an agreed timescale or that the administrator is able to spend 15 minutes talking a member through the retirement quote they have been issued and helping them to understand the options available and the decisions they have to make."

McGuinness concludes: "The key to a successful agreement is that you know what to expect; you receive the services that you need, want and are paying for and don't pay for things you don't need or want."

Written by Stephanie Hawthorne, a freelance journalist



A switch in time

Changing administrators is far from easy, says Stephanie Hawthorne

Switching third-party administrators is a daunting task as the process involves much work for the new and outgoing administrators, as well as for the trustees and participating employers.

Day-to-day administration doesn't stop just because a scheme is getting ready to transfer – throughout the transfer process the scheme still needs to be administered, pensions still need to be paid, members will still be joining, leaving, transferring and retiring.

"The key to making the switch as smooth and easy as possible lies in the project planning and management of the switch," Hymans Robertson senior technical consultant Stuart Reid suggests.

Trafalgar House client project manager, Gillian Hickey, advises trustees and sponsors to "make sure they have a seat at the table on the project steering group to remain fully informed on progress".

There is also PASA Code of conduct that acts as a guide to good practice.

Exit agreements

Willis Towers Watson head of business development, technology and administration solutions Clive Witherington advises: "Always ensure as trustees you have a very clear exit agreement in place with your current administrator so that if you wish to terminate the service it is crystal clear what the trustees can expect by way of hard deliverables, timescale and support. Many transitions are delayed or disrupted because the trustees only begin the dialogue on exit arrangements at the point they have elected to move administration to a new supplier."

He adds: "Commission analysis of the members' data, to share with any new supplier, before you bake in transition timescales and expectations, as going into the transition without a clear and mutual understanding of the quality of members' data is a fundamental mistake."

Barnett Waddingham associate Juliette Walker says: "Most typically, trustees set out a pathway to administration transfer assuming they're going into the exercise with all the leverage and goodwill they're used to having. Depending on where the outgoing administrator sits on the scale of 'we are or are not about to hold your scheme to ransom', the outgoing administrator then comes up with a scale of exit charges that pushes the trustees to such extremes of outrage that the first two months of a three month transition are hijacked by a conversation that's totally focused on costs."

Typical timescales for transition can range from three to nine months, depending on the complexity of the scheme being transitioned and the volume of any issues identified during the handover process.

Some areas can be problematic if they're not managed effectively during the transition project, says Xafinity Punter Southall Administration senior consultant Damian Magee. "The knowledge of the existing administration team needs to be captured and documented," he explains. "A thorough scheme manual and process guide must be developed during the transition project. Other issues revolve around the inherited backlog, which can increase workload for new administration team. Payroll deadlines are important – ensuring that there isn't a disruption to the payment of pensioners and clear communications."

It is also recommended trustees take the opportunity to revisit the quality of scheme data, understand the benefit calculations and ensure that the appropriate governance around administration is in place.

KPMG head of administration consulting Samantha Coombes says: "Capturing historic practices and practical application of the scheme's rules (for example: commutation order, rounding, equalisation methodology and practical use of retirement factors) are typical issues that often present problems during a transition period, as well as poor quality historic recordkeeping."

In conclusion, Magee has five tips for making switching third-party administrators easy:

- Engage with a specialist administration provider with a proven track record.
- Take references from their clients – recent transitions and long-standing clients.
- Value for money is more important than the lowest price.
- Participation on project boards, effective communication with the administrator.
- Choose an administrator with a robust, tested transition process and experience and expertise of transitioning schemes similar to yours.

Written by Stephanie Hawthorne, a freelance journalist

Summary
- Collective DC (CDC) has been described as a 'third way', blending elements of DB and DC.
- Its benefits include risk sharing of investment and longevity and providing a retirement income. However potential intergenerational unfairness and member understanding of potential cuts to income are concern.
- There is debate as to whether CDC is suitable for modern work and retirement.
- So far CDC interest has been low, but it is expected to be used by large employers as a DB replacement, and by DC providers wanting to offer a retirement income.

Changing time or wasting time?

Laura Blows considers whether collective DC will be the future of UK pension provision, or whether discussions around its implementation are simply distracting from efforts to solve other industry issues

The argument last erupted in 2015. It was never resolved; merely overtaken by other events. But now it's back. The past year has seen the debate about the merits of collective DC (CDC) return with a vengeance. Will CDC revolutionise the pensions industry, or will it once again be a case of all talk, no action?

A third way

CDC is a pension product currently unseen in the UK. While people's DC retirement savings are invested individually, CDC groups these together in order to pool investment risk and smooth volatility. And instead of the individual being left to make their own retirement income decisions, as is the case with DC, CDC provides an income in retirement. But while DB has its retirement income 'promise', CDC offers no such guarantees; pension payments can be cut if needed.

"If CDC schemes were enabled in the UK, this would be a fundamental change to the pensions landscape, offering corporates a 'third option' for employee retirement benefit provision," Willis Towers Watson director Simon Eagle says.

While always having its supporters, CDC has been little discussed since then-Pensions Minister Steve Webb advocated his CDC-type proposal of 'defined ambition' three years ago, with it included in the 2015 Pensions Act. However, a general election that year brought about political change, with Webb's successor, Ros Altmann, confirming that secondary legislation to enable CDC had been put on hold in order to introduce the freedom and choice reforms and bed in auto-enrolment.

Webb may have been 2015's biggest advocate of CDC, but now that accolade belongs to the Royal Mail and the Communication Workers Union (CWU) *[see page 65 for an interview with Royal Mail about CDC]*. Earlier this year it reached an agreement to replace its DB scheme with CDC, featuring a guaranteed cash lump sum, subject to government passing the necessary legislation to make this possible. Since then, both organisations have been lobbying the Department for Work and Pensions for this to occur.

Meanwhile, the Work and Pensions Select Committee opened an inquiry into CDC in November 2017, with calls for evidence closing on 31 January 2018. The inquiry is considering the merits of CDC, the role it could play within the pensions landscape, the potential benefits to savers and the regulatory framework that would be required to be successfully implemented.

Defining CDC

However, exactly 'what' is being requested is the first of many CDC debates. As Cardano head of DC Ralph Frank states: "If you were to ask 10 pension professionals what CDC is, you are likely to get at least 11 different definitions."

While considering the structure of CDC, eyes have understandably turned to the Netherlands, which established CDC as a replacement for DB in 2000.

According to Barnett Waddingham partner Paul Hamilton, the CDC form in the Netherlands is actually very close to a DB scheme, with a very similar formula effectively used to allocate the pooled assets to members, but with members' benefits reduced, on some form of 'share of fund' basis, when the scheme has a 'deficit' compared to the target benefits.

"That form of CDC would almost certainly need legislative changes to be done *[in the UK]* within a tax-approved vehicle, but I am not convinced this form of CDC would work well here," he adds.

Benefits

However, there are many in the industry who believe CDC could provide benefits to the UK.

"The main potential attractions of CDC would be scale (if it can be attained) and long-termism – if money is invested over a period of decades and smoothed between and within groups of workers

then there might be the potential for better returns," former Pensions Minister and now Royal London director of policy and external communications Webb explains.

Aon's CDC scheme modelling finds that CDC can improve standard DC outcomes by a third to double. The PPI's CDC model found that in the long term, once CDC schemes are mature and the scheme population is stable, a relatively low contribution rate of around 10 per cent results in better outcomes than DC.

For its evidence to the select committee, the PMI conducted a member survey into CDC, which found that 54 per cent of respondents think that CDC would improve the standard of workplace pension provision, with its main benefits being higher pensioner incomes and members being free of investment decisions.

Member involvement

However, this lack of individual involvement could also be considered a downside to CDC. After all, the freedom and choice reforms were a success because they allowed people to engage with and make decisions as to what they want to do with their retirement savings. Any new product that takes away this choice is unlikely to be popular.

The PLSA is sceptical that CDC fits with freedom and choice, "given that CDC aims to provide an income in retirement and the pension freedoms provide options for people to take their money as lump sum".

ABI head of retirement policy Rob Yuille believes that CDC and freedom and choice can coexist, "but it's not a comfortable fit".

"Savers who value the flexibility of DC and are coming round to the idea of owning their own pension may regard CDC as a backward step," he warns.

For Hargreaves Lansdown senior analyst Nathan Long, there are also concerns about how CDC would suit today's flexible workforce.

The CDC modellings that have found collective investing over a long period of time, generating better returns and therefore income payouts assumes people stay in the pension scheme from the point of joining through to the day that they die, he says.

"The reality is that with modern working patterns, pensions need to be flexible to cope with the retire-as-you-go needs of people as they reduce hours, require lump sums and potentially change their work entirely. Our experience is that people will want to keep control of their circumstances as they traverse through their later years, mindful that retirement can last for many years and their circumstances will change."

Therefore any new pension product, such as CDC, must allow people to transfer out and take their funds, if it is to have any hope of success.

This, according to Simplitium head of pensions business development Tom Hibbard, is not a problem.

"CDC allows you to invest collectively, but still own a slice of the total assets," he explains. "This 'equitable interest' can be valued at any point, giving members an instant transfer value that they can take under freedom and choice without having any effect on the value of other members' pensions."

However, this would need to be designed in such a way as to reduce the risk of 'system gaming', Slaughter and May partner Sandeep Maudgil warns.

Along with the level of member engagement required, the extent of member understanding could also be an issue. Indeed, it was considered CDC's biggest risk according to the PMI's survey.

The PLSA acknowledges that some people may find it hard to understand the intricacies of CDC. "That said, it is also hard to understand how DB or DC works," it points out.

The repercussions of this lack of understanding in CDC are less far-reaching than in DC however, Hibbard states, as the member does not have to make a decision at retirement if they do not want to, "which means there is a lesser need for financial knowledge".

The biggest problem with low member engagement would occur if/when pension payments were to be cut. A reputational risk to CDC, and pension saving more widely, could occur if members did not adequately realise this could happen.

Frank notes that the five largest Dutch CDC schemes, which account for more than half of the assets in the Dutch pension system, have failed to deliver the much-needed increases to pensions over the past 10 years.

"Not only have the increases granted by these Dutch pension schemes fallen short of price inflation over the period but three of the five also cut pensions in payment at different times. In other words, some scheme members have not only experienced a real-term loss in income but also in nominal terms. A large part of this was due to poor

risk management, notably in this case a lack of interest-rate hedging during a period when long-term interest rates fell sharply," he explains.

For Hibbard, cuts are certain to occur in cases of prolonged market downturns, but as long as they are understood to be a natural part of pension saving and that it is widely understood that overall people are still better off on average than in any alternative, then it shouldn't be an issue.

"In the 07/08 recession, across all Dutch CDC structures, only 25 per cent made cuts and on average the level of these cuts was 1.9 per cent. Compare this to market downturns of 40 per cent, which would directly hit DC fund structures," he says.

Aon backs this up, finding that cuts are rare, with its CDC modelling suggesting only after world wars. "Failure to cut is more of a risk than cuts," its partner Matthew Arends adds.

However, understanding when cuts may occur would be difficult.

"Within CDC someone is taking some decision about how assets are being allocated to individuals, which is by definition a much more opaque situation from the members' points of view," Hamilton finds.

Governance

To alleviate this issue, a strong CDC governance system would need to be established. A trust-based arrangement is considered the most likely solution.

Maudgil points out that as the assets are entirely the members', there will need to be clear controls on the use of assets for anything other than benefit provision.

In its select committee evidence, Cardano expressed concern that CDC members will lose out compared to a DC arrangement, due to the higher costs of administering the risk-sharing and the greater volumes of member communications required to explain this.

"In the interests of transparency, would the scheme need to tell members that, for example, 'your fund achieved a return of 8 per cent this year, but has been increased by 4 per cent'? It's not difficult to imagine the issues this could cause, particularly for members who had not been through a time when negative returns had been smoothed upwards for their benefit," PTL director Alison Bostock says.

"I expect that these decisions, together with those about cutting back or reducing increases to pensions in payment, would rest with the trustees. This would be a totally new kind of duty and responsibility. Whilst trustees currently make financial decisions that affect the profitability and sustainability of the employer, the balance of power is somewhat different as the employer can take its own professional advice and is equipped to provide meaningful debate and challenge. In CDC, trustees would effectively be in the position of balancing the interests of different cohorts of current and future members, who could not all be properly represented in a debate," she adds.

Intergenerational fairness

Ensuring intergenerational fairness would also be a challenge. According to Eagle, trustees would need to perform a delicate balancing act across generations of members when setting benefit levels.

Some select committee respondents, such as the ABI and Cardano, have expressed concern that CDC either relies upon new entrants to continue to join the scheme, or for the scheme to reserve sufficient funds to wind up over a very long period.

However, the PLSA states that the need for a continual flow of younger members would not be an issue, provided that contributions from existing members were sufficient to keep the scheme's funding ratio stable.

Hibbard agrees that the risk of intergenerational unfairness is not an issue. "If the scheme ever got to the point where it was too small to efficiently continue, the assets could be transferred instantly to another CDC structure or be wound up and put back into a DC type pension," he states.

Attention

Clearly, successfully establishing CDC would require more than the government just generating the secondary legislation. It would also require a great deal of time and dedication spent to its structure.

"It doesn't follow that just because something is new and difficult, we should not try it," Bostock says, "but arguably we have tried *[CDC]* and it doesn't always work as everyone hopes – remember with-profits endowment policies?"

For some, spending time on CDC is diverting attention from solving issues currently facing the UK pensions industry. Especially as, they argue, CDC does not offer unique solutions to these problems, which instead could be achieved through existing structures – eg auto-escalation to increase contributions, and annuities for a retirement income, while CDC's much-heralded benefit of investment pooling could be achieved through GPPs or master trusts.

However, B&CE, provider of The People's Pension master trust, states in its evidence to the select committee that CDC would be a beneficial addition to current products available to providers.

According to the the PLSA, CDC may have a useful role to play in providing a decumulation option for master trusts.

Level of interest

Yet CDC needs to be of interest to more than just master trusts to justify its establishment.

So far, Royal Mail has been the only provider to have come to government seeking the implementation of CDC, current Pensions Minister Guy Opperman informed the select committee. Despite this, any potential CDC legislation would need to "accommodate everybody", not just the needs of Royal Mail, he added.

There have been rumblings of more interest though. While not described as a CDC scheme, last month the CWU agreed a deal with BT that saw its DB scheme close and members moved into a 'hybrid' scheme, combining elements of DB and DC.

However, March also saw university strikes resume as members of the University and College Union rejected an agreement between the union and Universities UK that would have included a promise to look at CDC in the future.

Yet current low interest in CDC may not always be the case.

"Right now demand is low as those managing pensions have so many other things to think about," Hibbard says.

"Unless they feel that they can influence policy, there is no need to do anything but sit and wait to see what happens. The effect on the employer between DC and CDC is effectively nothing, so there will be no vested interests on the employer side acting against it – alternatively, if it is advocated as a better form of pension provision, many will seek to adopt it as an additional means of enticing the top talent to work at their company."

Maudgil notes that the first cohort of pure DC retirees have not occurred yet, and if it turns out that they cannot afford to retire, then employers, as well as members, may appreciate the more predictable retirement income expectations that CDC provides over DC.

Figures back this up. In the PMI's survey, 53 per cent saw employer appetite for CDC schemes as either a long-term replacement for other schemes designs, or in addition to existing designs.

Some appetite for CDC may need to be limited, as many respondents to the select committee's call for evidence stressed that CDC cannot be used as a 'dumping ground' for employers struggling with DB. It would not be suitable for this purpose anyway, Cardano's committee evidence points out, as "CDC will not resolve the issues faced by seriously underfunded DB schemes as it cannot create assets that do not exist".

Future

So, if a framework for CDC were to be established, would it be used by the many, or the few?

Predicting a 'niche offering' is the PLSA, which, barring a large AE provider implementing CDC, expects only a small number of employers moving from DB and wanting to offer something more than DC. "Whilst a minority, these employers still make up an important part of the pensions landscape in the UK, who are generally ignored by current policy makers so anything that can be done to help their position is to be supported," Hamilton says. Large DC providers wanting to provide a CDC decumulation option to their offerings is also expected to add to CDC's popularity.

Meanwhile, Webb is cautious, stating that while it is perfectly reasonable for CDC to be part of the pensions landscape, it does require employers to be willing to make a stronger commitment than under individual DC. "Employers who have been stung by large and volatile DB costs are likely to be very wary of standing behind anything that 'looks and smells' like a guarantee, even if it is only an aspiration," he warns.

In contrast, Hibbard predicts there to be mass take up of CDC, with traditional DC becoming the niche product "for the super-rich who can accept a degree of uncertainty, have a good understanding of finance and want to manage both their investments before and in retirement more personally".

So who's right? The only thing that can be agreed upon with CDC is that every aspect of it is subject to intense debate. Will it become the 'saviour' of freedom and choice, generating the desired regular income in retirement currently lacking, or will it at best be a niche product for a few large, still paternalistic, employers who cannot continue with DB but want to provide more security than DC? Is CDC the answer to key problems within the UK pensions industry, providing a fair 'middle ground' of risk sharing between DB and DC, or would it simply add complexity to an already complicated pensions structure?

Only time will tell.

Written by Laura Blows

CDC or CIDC?

Cass Business School's Pension Institute Director David Blake recently stated that collective individual defined contribution (CIDC) schemes are 'better' than CDC, being the only form of collective pension scheme that is feasible in the short term.

"CIDC schemes maintain individual accounts, they are better able to deal with sudden cash withdrawals than CDC schemes, yet are still able to exploit economies of scale to the full, which lowers costs, eg through automatic enrolment and the pooling of investment and longevity risks," he said.

However, Simplitium head of pensions business development Tom Hibbard disagrees, stating that as CIDC maintains individual pension accounts, it removes the element of risk sharing.

"*[CIDC]* would be quicker to implement, but it takes away most of the benefits of CDC (longer-term saving horizon, risk sharing and not being required to have pensions knowledge at retirement), all of which contribute to a better outcome in the majority of cases," he says.

CDC - a first class idea

Laura Blows speaks to Richard Poole, legal director, pensions and employee benefits, Royal Mail Group, about its collective DC proposal

The proposal to create a collective DC (CDC) scheme for Royal Mail members follows months of negotiations with the Communication Workers Union (CWU). How did the decision to create a CDC scheme – something that has yet to exist in the UK – occur?

We had frank and detailed discussions with the CWU about our future pension arrangements. They had to be sustainable, affordable and secure, for both members and the company. Over many months we explored a number of different pension design options, but for various reasons none of them met our needs. After a helpful mediation process and further talks, we agreed that CDC was a progressive option that would meet our objectives, providing the best outcome for members and the company. Royal Mail and the CWU committed in principle to the future introduction of a CDC scheme and agreed to jointly lobby government to make the necessary legislative and regulatory changes so a CDC scheme can be established.

Please could you describe the proposed new CDC scheme to me – its structure and how it will work? How does it differ to the DB/DC/cash balance schemes provided by Royal Mail?

Our proposal – assuming the relevant legislative changes can be made – is for future pension arrangements that combine a CDC scheme with a defined benefit lump sum scheme (DBLSS) sitting alongside it.

Royal Mail's proposed arrangements would target, although not guarantee, providing a similar level of member benefits as the Royal Mail Pension Plan – the defined benefit scheme that closed to future accrual in its current form on 31 March 2018.

The CDC scheme would provide members with a target income during retirement, with the DBLSS providing a guaranteed lump sum at the point of retirement.

Under the arrangements we are proposing, risk would be shared between members and the company. The CDC scheme would pool risk amongst its members, while the company would guarantee a minimum lump sum at the point of retirement through the lump sum scheme.

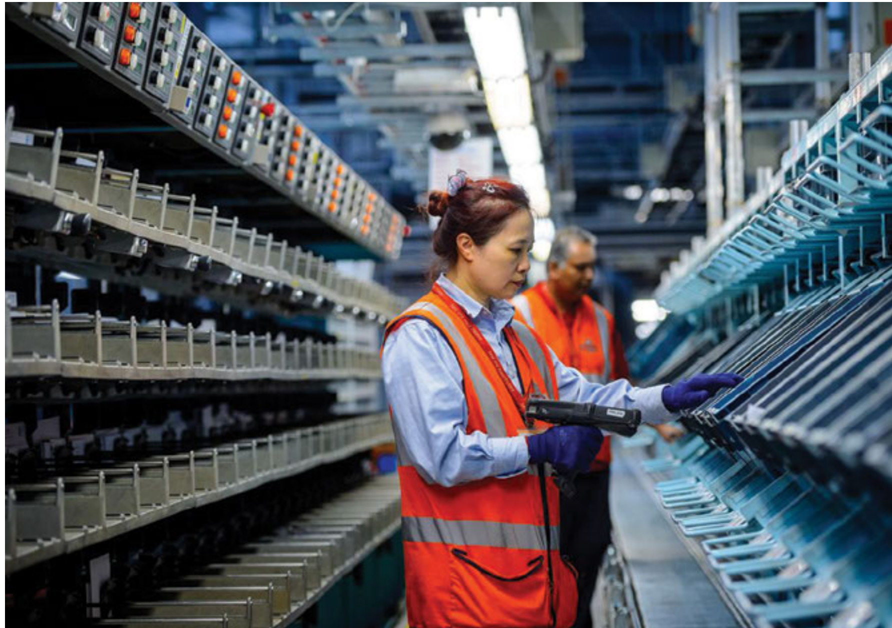
Had we not made changes to the Royal Mail Pension Plan – our defined benefit scheme – contributions were expected to increase to around £1.2 billion, which was simply unaffordable. Under our proposed arrangements, the ongoing annual cash cost of pensions will continue to be around £400 million.

What are the barriers that are still to be overcome for the CDC scheme to be implemented – e.g. government secondary legislation required or legal technicalities, members voting in favour etc?

Royal Mail and the CWU have started to assess what legislative changes would be required to enable a CDC scheme to be introduced. We have recently shared our initial thinking with the Department for Work and Pensions (DWP). Clearly, it would be for the government and the DWP to decide what legislative changes, if any, would actually be introduced.

Assuming it does become possible, what would be the next stages to get the CDC scheme up and running? What are the practicalities involved with this? When would you ideally want it to be operational?

We want to introduce the CDC scheme as soon as possible, but it is too early to put timings on it at this stage. It is the early stage of discussions with government. We think we have a strong case and are hopeful that the legislative and regulatory changes we seek will be made. While we seek the necessary changes, there is lots of work to do. We have agreed the key features of the proposed scheme, and are working through the detailed scheme design. From there, the rules must be written – in line with legislative and regulatory changes – including a clear governance and disclosure framework. And there will be work to do to link the scheme with



our existing HR and payroll systems.

In the meantime, transitional arrangements are in place for our colleagues. From 1 April 2018, they now either participate in our new defined benefit cash balance scheme – which sits within the old Royal Mail Pension Plan and provides a lump sum on retirement – or in our improved defined contribution plan.

What would be the governance structure of the CDC scheme?
We envisage offering a CDC scheme under similar governance arrangements to those currently used for defined benefit schemes. That is, a trust-based model where the board of trustees are responsible for running the scheme and administering its benefits, managing its investments and communicating actively with members. Under any pension scheme, communication and transparency are key. This is particularly important for CDC schemes, where the target nature of the benefits, the specific way in which benefits are calculated from the available assets of the scheme and how risks are shared between the members of the scheme, must be communicated very clearly. We are committed to doing this, in collaboration with the trustees appointed to oversee the scheme and our unions.

What will be the benefits of a CDC scheme – for both Royal Mail and its pension scheme members?
We see several advantages that CDC schemes can offer members. Importantly, such schemes can take a less conservative investment strategy in members' later years, allowing higher potential returns. Unlike individual DC schemes, they do not require members to purchase an annuity if they want to receive an income for life in retirement, and they can benefit from an overall reduction in costs through economies of scale. CDC schemes can also be simpler for members, who are not faced with making decisions about investments or what to do with their benefits at retirement. The combination of these features makes for a more efficient design for members when compared with a pure defined contribution scheme, but with no benefit guarantees to be underwritten by the company.

Under our proposed arrangements, risk would be shared between members and Royal Mail, with the risks associated with the target pension being borne by members collectively, but the company guaranteeing a set lump sum at retirement.

How will you be communicating the changes to members?
We have already sent a letter and booklet to members to explain our proposed pension arrangements. Both Royal Mail and the CWU have been communicating widely to help our workforce understand CDC. As well as our internal communications channels such as our in-house TV programme and magazine, we offer a pensions helpline to help our workforce better understand what our pensions agreement means for them. Of course, assuming the legislative changes can be made, and when we have clarity over implementation timescales, we will develop a detailed and comprehensive communications programme in the run up to the launch of the new arrangements.

What are your thoughts on hopefully being the first employer in the UK to provide a CDC scheme to its staff? Do you think CDC will have a significant role in the future of the UK pensions industry?
We are very keen – as are the CWU – to see CDC become a reality in the UK. We believe CDC is right for our workforce and our business. We also see CDC schemes as an important third option in the UK pensions landscape, complementing those currently available.

Written by Laura Blows

Allianz Global Investors

In association with

Resilient Credit roundtable

Resilient Credit – a new opportunity

Our investment panel reflects on what Resilient Credit entails and what it can offer pension funds in today's environment

Medium-term infrastructure credit or Resilient Credit was the focus of a recent *Pensions Age* investment roundtable, which saw thought-leaders in the space – Allianz Global Investors – come together with key stakeholders in pensions and insurance to discuss the merits of this dynamic new strategy.

For institutional investors today, finding new opportunities to meet their varying needs is an ongoing challenge, especially given the current environment. Among the plethora of asset classes out there, infrastructure debt has already gained momentum, regarded as one way of gaining long-term stable and predictable cash-flows. Resilient Credit can offer similar benefits but with a more medium-term timeframe.

Margaret Frost, Head of Institutional UK at Allianz Global Investors, explained to the panel: "In recent years, there has been huge interest in all things private as investors seek opportunity and diversification away from public markets, specifically for institutions looking for reliable, long-dated cash-flows, some of which have inflation protection.

"We feel that the long-dated core infrastructure debt area has become well known to many market participants. Today, however, we want to talk to you about a new area, which is more of a medium-term opportunity in what we call Resilient Credit."

Resilient Credit, in simple terms, involves investing in directly sourced medium-term secured private debt; more specifically, infrastructure-like/asset-heavy companies with monopolistic/oligopolistic characteristics and high barriers to entry. These include car parks, power generation, motorway services and telecom towers, all of which offer a stable medium-term outlook. These businesses sit adjacent to the type of assets that would be within the scope of investment for longer-dated core infrastructure strategies.

Emmanuel Deblanc, Head of Resilient Credit at Allianz Global Investors, went on to explain the term in more detail, using a series of examples to describe how the strategy aims to provide investors with enhanced returns and reduced risk relative to the public debt market. The assets involved are characterised by strong gross margins and deliver a service with predictable revenue over the term of the investment, and would all be entities with an existence of five to ten years minimum.

"We look at the EBITDA evolution over the economic cycle. We can pretty much always look at how borrowers fared during the recent financial crisis, from peak to trough, in terms of volumes, stability and level of correlation to GDP – that's helpful."

Risk management

The discussion moved naturally onto risk management, with the panel keen to understand more about how risk is kept at bay.

Deblanc explained first how the background of the Resilient Credit team helps ensure risk is naturally kept at a minimum: "One thing that's paramount is that all of us on this platform are debt people. We don't come from an equity background. As such, we are risk averse culturally – risk management is part of our DNA and you just don't change your DNA.

"As a result, we do not invest with the expectation that 'excess return' will

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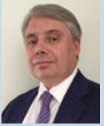
CHAIR

Margaret Frost, Head of Institutional UK, Allianz Global Investors
Margaret is head of UK Institutional Business at Allianz Global Investors. Previously, Margaret headed the generalist portfolio management team for Rogge Global Partners (RGP), the London-based global fixed income specialist acquired by Allianz Global Investors in June 2016. Before joining RGP, she was global head of bond manager research at Towers Watson for six years and prior to that she was a global fixed income portfolio manager at the Kuwait Investment Office.

PANEL

Purna Bhudia, Head of Credit, Pension Protection Fund (PPF)
Purna joined the PPF as head of credit in 2017. She's responsible for further developing the PPF's GBP investment grade credit capabilities and for delivering both public and private market strategies, the continued resilient performance of the PPF investment portfolio and the designing and delivering of PPF's credit target operating model. Purna is a highly experienced fund manager and analyst, with extensive technical knowledge obtained through over 15 years of experience within credit.

Emmanuel Deblanc, Head of Resilient Credit, Allianz Global Investors
Emmanuel is head of resilient credit at Allianz Global Investors. Before joining Allianz Global Investors, he was a managing director at BNP Paribas, co-heading a debt advisory and financing team. He was responsible for origination and execution of advisory and arranging mandates across a broad range of sectors. Emmanuel has been involved in the infrastructure and energy sectors since 1997. Prior to joining BNP Paribas, he was part of MBIA's public finance team led by Deborah Zurkow.



Bob Hymas, Trustee Executive, BESTrustees
Bob has worked with pension schemes for nearly twenty years. He currently has two appointments with BESTrustees, one to a scheme with assets of less than £100 million and the other to a scheme with in excess of £1 billion of assets. Bob is chairman of the smaller scheme and on the larger he sits on the Investment Committee and the Administration and Discretionary Benefits Committee. As well as fulfilling a trustee role, he has been a pension scheme adviser and auditor.

Keir Macdonald, Associate in Manager Research, Redington
Keir is an associate in manager research at Redington. He joined Redington in 2014 after completing an internship in 2013. His research initially focused on infrastructure, but has since expanded to include coverage of real assets strategies across infrastructure and property markets. Prior to Redington, Keir attended the University of Oxford, graduating in 2014 with a BA in Classics. He is a regular contributor to the pensions press.

Chris Parrott, Head of Pensions, Heathrow Airport
Chris is head of pensions for Heathrow Airport Holdings Limited (formerly the British Airports Authority), responsible for the operation of all group pension arrangements and insured benefits. He has been working in occupational pensions since 1982, holding management positions for the operation of both public and private sector pension schemes. Chris is a fellow of the Pensions Management Institute and in 2013 was elected to the Institute's Council.

Erik Vynckier, Non-Executive Director, Foresters Friendly
Erik is a non-executive director at Foresters Friendly Society. He was elected to the Board in 2016. He is a partner of InsurTech Venture Partners and Chief Investment Officer (Europe) of Eli Global LLC, following a career in banking, insurance, asset management and petrochemical industry. He co-founded EU initiatives on high performance computing and big data in finance. Erik is also chairman of the investment committee and a member of the audit, risk and compliance committee.

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compensate for any loss in the portfolio – each investment carries as little risk as possible from our perspective."

The risk management process, he continued, follows an extensive due diligence process, coupled with a thorough screening process to assess the acceptability of the credit, which happens early on.

Linked to this, the point of duration was raised, with Deblanc explaining how the strategy lends for the medium-term, with a weighted average duration of 7 years, as part of its risk management strategy. It structures debt in both the senior and junior parts of the capital structure depending on the risk profile of the underlying asset.

Deblanc was also keen to highlight not only the team's low appetite for risk, but also how the size of the firm puts it at an advantage as they are able to take full investment stakes: "We believe we are the largest in the space which is a massive advantage because we can take the whole deal ourselves. We've got no issue with that. You do make a difference in some auctions if you can do the whole thing yourself, compared to taking, say, 10 per cent."

Similarly, the team's experience puts them ahead of the pack when it comes to trust: "Having spoken to people in the market, we don't think there are many people who do this. We can't really find a direct competitor, an obvious name, and that means people can trust us. If you've been at it for many years and you've got people who are trusted in the market, that makes a real difference."

Comparisons

The next question posed was how Resilient Credit compares to other opportunities of a similar make-up, and how it stands out in terms of return or risk.

Deblanc used leveraged loans and core infrastructure investment strategies as comparisons. "The two pockets of money I'd say which are the most obvious to benchmark it are leveraged loans and core infrastructure. If you look at leveraged loans first, they're looking for low double B, or single B. They're looking for a higher-risk, higher-return profile than we are. Our perception is that there is much more appetite for risk with them. They make more money and they have an acceptance for default. They also don't mind restructuring stories. We like clean stories.

"The second comparison I would make is to core infrastructure – we are taking more risk than in core. We are in a world where we are a notch below in terms of visibility of cash-flow. So, for me these are the two obvious benchmarks."

Asked whether Resilient Credit offers a better return, potentially, than core, Deblanc responded: "It aims to give you a return that's commensurate with a core strategy. However, relative to the core strategy, the investor obtains more of this return by way of the risk component and less of it through duration".

Frost expanded: "In core infrastructure we're lending money for 20 years plus. In Resilient Credit it's a much shorter maturity – it's seven to 12 years on average. It's a more attractive spread, but it's also slightly lower credit quality."

Asked whether something like a Carillion story would impact on a fund such as this, Deblanc reassured the panel: "In Resilient Credit it's extremely unlikely that we'd have any relationship with a Carillion story, because we're limited in terms of greenfield risk."

Competition

The subject of competition was next to be addressed, the panel asking if other direct lending funds were likely to encroach on this space.

Deblanc commented that it was unlikely. Competition exists, he explained, in the form of the banks, but players like Allianz Global Investors can bring something more than the banks – specifically, duration: "The banks are liquid right now, but they're liquid in the three to five-year bucket, which is an issue from a borrower's perspective, because that is very short - it means that the borrower is taking credit market risk."

He used the example of a network of broadcasting towers in Northern Europe that Allianz Global Investors is looking to lend to. "It's a monopolistic type business and, because technology will change in terrestrial television, you wouldn't go 30 years on something like this. But on the next 15-20 years, it's a viable option. They've got a contract with robust counter-parties and so, for all those reasons, we're happy going eight years on that deal. The banks by comparison are stopping at five. They don't want to go any longer. So, we're doing a deal 50/50. We're being remunerated roughly 50 bps above what the banks are getting.

"That means we're bringing duration – for the owner that's very attractive. They're diversifying. For us it's great, because we also have the comfort of having shorter duration paper next to us,

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which means that we can reset conditions when it comes to re-discussing that.

"Banks right now have much more capital than they used to post-crisis, but they are not extending duration."

Defaults

The topic of defaults was then raised, with a question being asked on where Allianz Global Investors would sit relative to the bank if there were to be a default scenario. Deblanc said that everybody's rights would be the same, but he added a caveat: "The reality of the infrastructure world, and that's whether you look at core or resilient, is that there are extremely few defaults. Where defaults do happen, they always happen in the same bucket. In infrastructure it's greenfield toll roads. Very few have ever got that right.

"The reason why there are very few defaults in infrastructure, broadly speaking, is you've got patient capital. If you're patient and you're cash generative, even if you're not generating as much as expected, with time you will generate enough to de-gear and to actually find someone to do the trade and to look after it. So that sorts it out."

Continuing on the topic of defaults, it was suggested by the panel that perhaps a bigger risk than default was the sustainability risk.

Deblanc responded: "It's an interesting thought. Probably the way one could get it wrong is a change in paradigm that's happening faster than expected – that's what we're looking at mostly in terms of risk – is it possible that things will change faster than we thought?"

Insurance companies

The conversation then progressed to how insurance companies view this strategy, especially given the ratings issue and the fact that insurance companies often have to see an A-rating in order to invest.

This was highlighted as a key issue for some of the more mature pension funds today that are perhaps approaching full funding and are looking to buyout – might they have difficulty finding insurance companies that are willing to take these kinds of assets?

Deblanc responded: "I can tell you about the way Allianz Insurance Group views this – we've got our in-house views of the rating, which is very defensive. We also don't want to call non-investment grade, investment grade. We have no appetite for trying to stretch this investment grade definition – this is really a no-go area from our perspective."

Frost added: "One of the reasons in our core strategy that we have always wanted to have all of the deals rated by a rating agency is that it's much easier to have a buyout, it's much easier to find someone 10 years down the line who is willing to take those assets if they have an S&P or Moody's official investment grade rating; because if they don't, a secondary market becomes less reliable."

European deals

Deblanc moved on to give an insightful overview of where opportunities in this sector lie geographically: "You need to look at this on an 18-36 month basis to see where the deal-flow will come out – you might have six months, for example, when nothing happens in the Nordics, then in the next six months you get three big deals. So it can be a bit lumpy in some regions. One deal gets delayed, and then they all happen at once.

"What we are seeing is, I'd say, a third of the European deal-flow is in the UK. We are also seeing more activity in Southern Europe because confidence there has returned. First, the sovereigns are improving materially, as is the economy, and overall there is just a very positive momentum around the Iberian Peninsula. Italy, however, is a bit of a black spot. We are struggling there in the way things are done.

"France is always an active market in infrastructure. There is quite a lot happening on the M&A side. Germany we find very expensive, whether it's equity or debt. There is a huge amount of liquidity there and we are well positioned, however we need to remain disciplined. The Netherlands is always producing interesting situations and in the Nordics, Finland in particular is offering a lot of assets."

Smaller pension schemes

The discussion then moved to the needs of the smaller pension scheme investor, with one panellist asking what sort of investment size would best suit the strategy. Would an allocation of £2.5 million from a pension fund be feasible?

Frost explained that the minimum investment size would more likely be around the £15 million mark.

Asked whether in due course the strategy may be made available to the smaller schemes, that quite often struggle to get access to some of the more interesting investment opportunities in the market, Frost responded: "We would

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certainly love that to be so. The devil in this is always about how you make sure the product is suitable for as large an audience as you can, but realising you have to start somewhere. So, we would certainly love to see that in time. At the moment it's probably premature to think that the allocations could be quite as small as that. But it's certainly something that we'd like to see evolve over time."

The question was then raised about whether it could also work in a co-investment scenario.

Frost replied: "I don't see why not. Those are still discussions that would need to be had in terms of size of client and what the client's specific situations are. But I don't see why that wouldn't eventually be the case."

The panel was also interested to understand how big the investment universe was.

Deblanc explained: "Our view is that we can source about €1 billion equivalent per annum in this. Now, that's on average over a two to three year period. There will be years where we'll do more, and others we'll do less. It's quite a lumpy market in general. For example, in core, 2014 was very busy. In 2015 we passed on every deal, then 2016 was very busy.

"And you do not want to be active just for the sake of being active. It's really the wrong way to go about this. But there is enough volume. The issue is, how do you access it best? Do you do it with the right people? So, accessibility is paramount."

The final leg of the discussion was a reflection by the panel on whether a proposition like resilient credit would meet the current needs of the pensions market.

It was primarily noted that the less well funded pension funds generally have more risk budget and are looking for a slightly higher return; therefore, they are often looking at opportunistic illiquid credit – funds or strategy managers who are able to look across the lower end of the credit spectrum in the illiquid space.

At the other end, the more mature schemes look for cash-flow generation, with low default to no default. They're generally looking at the purely investment grade end of the spectrum, such as senior real estate debt, senior infrastructure debt, investment-grade private placements, and so on. They're often targeting buyout, or they're getting to the stage where they're starting to think about it.

Resilient Credit, it was argued, could be interesting for those pension funds looking for the stability of cash-flow, for a largely investment-grade product, but who also want a little bit more pick-up.

Smaller pension schemes, it was said, are looking to do what the larger schemes are already doing and tick the boxes on diversification. They're also looking potentially at what the end game will be, but the starting point at the moment is diversification. Cash-flow was also flagged as an increasing priority for smaller pension schemes. As such, a strategy like Allianz Resilient Credit ticks a lot of boxes for what schemes large or small are looking for. Access for the smaller scheme is likely to be a challenge going forward but potentially one that can be overcome in time.

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Sustainability Summit conference review: the tools to tackle ESG

Attendees braved the blizzard-like conditions to discuss the hot topic of sustainable investment, talking about what ESG means to them, how data can drive investment and achieving positive returns. Theo Andrew reports

As sustainability continues to be one of the hottest topics in investment at the moment, not even the 'Beast from the East' could stop the industry coming out in droves to discuss their latest thoughts and feelings on the current environmental, social and governance (ESG) issues facing pension schemes.

Having braved the glacial-like conditions, and once in the safe haven of London's De Vere Grand Connaught Rooms, attendees got straight down to business, focusing on the impact of sustainable investments.

Never a simple topic however, and it was clear that the industry was grappling with the definition of ESG. Some seem to think the 'G' is the most important, while others will focus on the 'E' or the 'S', while the concept of 'sustainable' can mean many different things to people.

One way this could be sorted is by the use of data. Quality data-driven investment, it has been argued, will be able to deliver a holistic approach to ESG investing, allowing you to see where your money will have the most impact towards your ESG goals. This in turn can deliver positive financial returns, an argument that is gaining more and more credence as we amble towards the 2 degree target.

The tone was set by keynote speaker, United Nations Environment's Principles for Sustainable Insurance Initiative programme leader, Butch Bacani, who through the UN's 17 sustainable development goals is leading the way in the development of a sustainable financial system.

Bacani argued that the issues facing the pensions and insurance industries are multi-faceted, and that the industry and investors must follow a strict set of principles to ensure that they are managing their investments and their assets in the right way.

So, while the UN's global sustainability goals point investors in the right direction, Hermes senior portfolio manager for global equities, Lewis Grant, highlighted that across the investment landscape there appears to be a lack of consensus on the definition of ESG, and how investors can successfully implement sustainable strategies.

Grant said: "The problem is there is no universal definition, I notice at the start we did the sustainability goals, we have ESG and responsible impact, but what do these words actually mean?

"This is not about ethics … it's about finding companies that are sustainable, that keep delivering strong cashflows. The problem with ethics is that it lacks a single definition, we are talking to investors all over the world and they have completely different standards of being ethical."

One way, in which UBS managing director Bruno Bertocci sought to define sustainable investment, is by accessing the impact through a unique science-based approach. However, even here, Bertocci would not consider this ESG.

He said: "Impact investing is quite separate from ESG. ESG is mainly about corporate housekeeping. It's about things that management has a control over, conditions in the factory, how a company supervises the supply chain and the energy sufficiently of a manufacturing project. Things that are largely close to the business model."

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Bertocci argues that through pinpointing an area you can have an impact, and then specifically estimating what your product does when it leaves the factory and having a way to measure return expectation, you can achieve a positive impact.

Despite this, ESG, as well as impact investing, requires a solid data set that can help you understand the lay of the sustainable investment land.

Data driven

One firm helping lead the way on providing a useful benchmark to rate the ESG perspectives of their managers is Mercer. The firm has evaluated more than 5,000 investment manager strategies on their integration of ESG factors, including their idea generation, portfolio construction, implementation and commitment in the manager's firm.

Speaking at the conference, Mercer senior researcher for the responsible investment team, Sarika Goel, said: "We have come a long way … today it is about a more innovative and holistic approach to ESG ownership and impact measurement."

The holistic approach described by Goel will help both defined contribution and defined benefit schemes consider the risks when investing the schemes money, she said.

Speaking on a panel at the conference, Sustainalytics associate director, Doug Morrow, gave a global research preview into its work with Oxford University and Aberdeen Standard Investments aimed at understanding how investors are incorporating smart beta strategies into their investment.

Morrow said that smart beta investing is a growing trend in the asset management world, which sits in between two important trends, ESG and data, but rued the lack of data made available by asset managers.

"The obvious challenge is the dearth of corporate disclosure. We estimate that

3 per cent of the world's publicly-traded equities now are disclosing. It's things like greenhouse gas use or total water usage that aren't best disclosed, so clearly there is lots to do on that front, but the supply of ESG data is certainly on the increase."

One other way the issue has been approached is by simply buying data. Deutsche Asset Management ESG thematic research strategist, Murray Birt, who argued that the only way to get a "holistic view" on your investment strategy was to purchase it from a number of suppliers.

Grant agrees: "We try to get as many viewpoints as we can, we try to get as much data and information and we can combined that with our own knowledge and expertise."

Sustainable divestment

Another strategy that was widely discussed at the conference was sustainable divestment. The act of pulling your money out of portfolios that you now know might be invested in the likes of arms or tobacco.

Newton Investment Management responsible investment management, Victoria Barron, believes that a key way to do this is through the engagement of millennials, giving them "ownership over protecting the environment".

Barron said that this increasing demographic is more likely to have a growing influence over multi-nationals than governments and advocated "red line investing", where companies not doing the basic fundamentals will not be invested in.

UK Sustainable Investment Finance Association (UKSIF) chief executive, Simon Howard, also agreed and said that millennials must be engaged with driving change.

Through proper engagement, making millennials aware of where their pension funds are being invested, attendees heard how some investors could be drawn out of the dark ages through people power.

Growing returns

The tide has been seen to be turning in the minds of investors who used to believe that investing in sustainably would negatively affect returns. Almost all the conference speakers alluded to the fact that investing smartly in ESG would now deliver strong returns.

Howard said: "If you get sustainability right it will change the structure of the financial system, banks will start losing money through bad loans and if insurers start having to pay out more on bad investments then we have problems."

Royal London head of sustainable investments, Mike Fox, agreed: "If you have a strong financial and ESG identity, you can get good investment returns … my standpoint is an investment concern, not particularly a moralistic standpoint, but if we do this and do this well we will get better outcomes for our investors."

Getting it right is easier said than done and there was a feeling that the 'G' in ESG must be done correctly in order for anything to change. Good governance, it might be plain to see, is the driver of ESG.

Written by Theo Andrew

Summary
- Active investment involves higher charges and has not always produced higher returns.
- Passive funds track markets and work well in bull markets.
- When times are tough, an active, bottom-up approach can help improve performance.
- Fixed income can be passive or active too.
- Passive bond funds give a broad spread of access at low cost.
- Active bond funds can navigate the very complicated waters around the bond market.
- All investment – equity, fixed income, active or passive, involves an active decision-making process on the part of investors.

Active versus passive investment: Is there a clear winner?

The debate around active and passive investment continues within pension investment. Sandra Haurant finds out where the experts think the smart money should go

Every now and again research comes out that makes investors stop and think. In January, the *Financial Times* published the results of one such report: according to analysis carried out by CEM Benchmarking for the *FT*, active funds had only beaten the markets by 16 pence for every £100 invested.

The results naturally challenge received wisdom – if active managers cost more and don't make more money, then where is the value in using them? Indeed, the *FT* quoted CEM principal John Simmonds, saying: "A lot of value that is being created has been returned to the asset management industry rather than to the pension funds and their members."

It is a familiar argument. By and large, active fund managers charge more than passive funds because. Which, of course, makes sense: while passive funds follow a market benchmark, actively-managed funds employ teams of people who make, as the title suggests, active decisions about the investments that are held within their fund. But for pensions, as for all other investors, it is important to get what you pay for – and when performance on higher-fee funds is all but equivalent to those lower-cost passive funds, it becomes hard to justify the choice.

"In a world of low expected nominal returns, in theory the 'alpha' from active equity should be more valuable to pension schemes compared to earlier periods when equity market beta was expected to be higher," explains PiRho Investment Consulting's director Phil Irvine. "However, the reality is that 'alpha' from active equity investing in mainstream markets has been difficult to access in any consistent manner."

The place for passive

Indeed, there are certain areas in which passive investment delivers fairly consistently for pension investors, says Irvine, creating that necessary imbalance between charges and returns. "Within equities, investing in large, efficient markets such as mainstream US equities, which can be accessed very cheaply and are highly liquid, is highly suitable to pension schemes," he says.

Indeed, says JLT Employee Benefits senior investment consultant, Aniket Bhaduri, there is plenty of evidence to suggest that passive investment should and can deliver returns at a lower cost and therefore with greater efficiency

than active funds: "There has been a lot of research and empirical evidence to suggest that developed equity markets are generally efficient in most cases. It is therefore difficult to add value through active management in these markets," he says. "This has been evidenced in the current bull market where tracker funds have provided robust returns, and often, higher than average actively-managed funds on a net of fee basis."

Nonetheless, there are, as ever, caveats. While Bhaduri agrees that this view holds up in so-called 'normal conditions', there are other matters to take into consideration, he argues: "For instance, we prefer active management in emerging markets as we see opportunities in country, sector and stock selection away from the traditional benchmark."

Indeed, the capacity that active managers have to zoom in on specific markets and sectors, and then to stock pick within that focused scope in response to whatever political or economic conditions are in the wider atmosphere is, arguably, what should give active investment an edge. And it is this that strengthens arguments in favour of an active approach.

A hands-on approach

For Cardano's senior investment strategist Tom Rivers, the current conditions point towards a renewed need for just the kind of bottom-up approach that active management can deliver: "Market conditions over the past five years or so have been characterised by ever-lower volatility and asset price reflation. During this period, passive investors have been able to harvest solid risk-adjusted returns, at low cost," he says. "We believe we are entering a phase of likely increased divergence between economies, asset classes and bottom-up corporate fundamentals; all of which can drive an increase in volatility. This provides an attractive landscape for active management."

What's more, while cost and underwhelming performance are often highlighted as weaknesses for active funds in today's landscape, there are other factors to take into account in passive investment. "It has been difficult to outperform indices in the current bull market," says Bhaduri. "However, exposure to passive funds can result in a different type of risk. As more and more allocation to passive funds are being made, it is driving up the prices of the benchmark components and hence may result in taking overvalued positions."

The bond question

And of course, equities are only part of the story. A similar debate is also taking place within the fixed income space, too. Passive fixed income funds are often seen as a way to gain access to this important sphere at relatively low costs. However, there are limitations to this strategy, argues Irvine: "One of the main purposes of investing in fixed income, for a pension scheme, is to match liabilities – but bond indices are by definition not tailored to the individual scheme," he says. What's more, Irvine adds: "For fixed income, generally, companies or countries that are doing poorly have more need to issue debt. As a result, the country weightings in global equity indices are very different to global bond indices."

For Payden & Rygel (London)'s managing principal Robin Creswell, the differences between equity and bond indices makes this a very different decision: "Bond indices can typically have 2,000 or more bonds in their composition, compared to 100 to 500 stocks in a typical stock index," he explains. "A petroleum company with one class of stock can have 100 bonds outstanding to its name." As such, a hands-on approach in expert understanding of the sector is crucial to navigating the waters of the bond market. "An active fixed income manager must weigh the value and characteristics of each of 100 bonds of an issuer versus the single analysis of the single share classes. Within an institution's guidelines, duration, maturity, credit quality, convexity, position in the capital structure must be weighed, and availability of bonds is also an issue when selecting."

For equities, it does appear that the markets, to an extent, dictate whether the time is right for active or passive funds. But in all cases, there are choices to be made. Selecting a manager – equity or fixed income, passive or active – will always involve a level of active engagement on the part of the investor. So how do you make the choice?

Creswell says: "Pension funds are best served identifying managers and manager style, expertise and process that most closely match their needs. Managers should be able to demonstrate best fit through an evidence-based due diligence process." What's more, he adds, needs can change and when that happens, so might relationships with managers. "It is our experience that an institution's requirements flex over time as liabilities, the environment, equity valuations, the interest rate environment and many other factors change. An active relationship reflects these changes to a client with opportunities to increase or decrease risk and portfolio sensitivity in line with need and appetite."

So while debate continues over the whether active or passive investment is the best fit for pension funds in today's economic environment, there is perhaps a wider and more philosophical matter to ponder. As Rivers points out: "Passive investing still requires you to make an active choice, for example on index and whether you want to take currency risk or not. These can lead to quite different outcomes." Which begs the question, is there really such a thing as passive investment?

Written by Sandra Haurant, a freelance journalist

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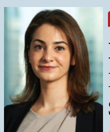
CHAIR

Antoine Lesné, Head of SPDR ETFs Strategy & Research EMEA
Antoine is head of SPDR ETF research and strategy for EMEA at State Street Global Advisors. Prior to SPDR, Antoine was a fixed income portfolio strategist for SSGA and global fixed income beta strategies. Antoine joined SSGA in 2006 from SunGard Reech where he was responsible for selling advanced pricing and risk analytics with a focus on structured fixed income derivatives. He started his career at Société Générale on the fixed income & FX structured products sales desk.

PANEL

Gerard Fitzpatrick, Chief Investment Officer, Fixed Income & EMEA, Russell Investments
Gerard is CIO for fixed income and EMEA for Russell Investments. He assumed the CIO of fixed income position in 2013. Fitzpatrick also currently co-manages Russell Investments' flagship strategic bond fund. Gerard assumed the CIO of EMEA role in 2016, assuming responsibility for several governance functions, including becoming a member of Russell Investments European Executive Committee and a director for Russell Investments Limited.



Rima Haddad, Head of UK Institutional, SPDR ETFs
Rima is a vice president at State Street Global Advisors and leads the coverage of asset managers, hedge funds, pension funds, insurance companies and consultants for the UK SPDR ETF business. She joined SSGA in January 2017. Rima previously led the UK institutional business at ETF Securities, having joined the company in 2009 to develop their pan-European distribution capabilities in UCITS. She also led their Swiss and Middle East distribution from 2010-2014. Prior to this she spent four years at Bloomberg L.P.

Abhishek Kumar, Lead Portfolio Manager, Emerging Markets Debt, SPDR ETFs
Abhishek is a managing director and the lead portfolio manager for emerging markets within the fixed income beta team. He leads the emerging market debt team, managing both hard currency and local currency EM funds, and also works to develop new strategies and solutions for clients in EM debt. He joined SSGA in September 2010. Prior to joining the investment management team, Abhishek spent three years at ICICI Bank UK PLC managing global credit portfolios.

Andrew McDougall, Head of Fixed Income Portfolio Management, Mercer
Andrew is a portfolio manager within the fiduciary management team at Mercer. He specialises in investment manager selection, portfolio construction and asset allocation within fixed income asset classes and has over 11 years investment experience. Prior to joining the fiduciary management team, Andrew was a consultant in the fixed income manager research team. Before that, he was part of the firm's Quantitative Research Group.

Robert McElvanney, Senior Portfolio Strategist, Santander
Robert has over 25 years in financial services and leads the strategic investment solutions team at Santander Asset Management, part of the wider multi strategy solutions offering. He joined Santander from Aon Hewitt where he was a principal consultant and lead advisor to a portfolio of corporate and trustee clients on all aspects of investment strategy. Whilst there, he was cofounder of the corporate advisory and insurance solutions groups.

Ian Scott, Head of Investment Strategy, Pension Protection Fund (PPF)
The PPF appointed Ian in the newly created role of head of investment strategy in September 2016. Ian previously worked for over 20 years on the sell-side at Lehman Brothers, Nomura and Barclays. Before Lehman, he worked on the buy-side, initially in fixed income and subsequently in multi-asset strategy. Most recently he led the multi-centred and multi-disciplinary global equity strategy team at Barclays where he was head of global and European equity strategy.

Nigel Stapleton, Chair, National Grid UK Pension Scheme (NGUKPS)
Nigel has been chair of the National Grid UK Pension Scheme since November 2014. For 9 years until June 2017 he was also chair of the Mineworkers Pension Scheme. He is a Cambridge Economics graduate who subsequently pursued a career in finance and in general management. He was CFO of Reed Elsevier (now RELX), the global business publisher, and later its co-chairman. More recently, he has held a portfolio of non-executive roles, including at the London Stock Exchange and the Postal Services Commission.

Paul Whelan, Fixed Income Manager Researcher, Aon Hewitt
Paul is UK head of fixed income manager research for Aon Hewitt and heads up the UK transition management team. He covers the full spectrum of fixed income asset classes. Paul is an active member of the UK fixed income views team, working to expand the breadth of the team's output, formulating appropriate scheme hedging levels and informing the advice given to clients on managing their liabilities. Paul also works closely with the fiduciary business, Delegated Consulting Services.

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Evaluating ETFs

Our panel of experts reflect on the investment needs of pension funds today and debate what fixed income ETFs can offer portfolios in the current environment

Chair: Fixed income is a key element of a pension fund's asset allocation and our primary aim today is to think about fixed income in the context of the current environment and the likely outlook going forward, as well as what we expect in terms of inflation and how we can position for that.

Second, we want to explore the different types of instruments that are being used in fixed income portfolios today, given the macro-environment, in terms of both the matching element and the growth element. SPDR is a large provider of ETFs, fixed-income ETFs in particular, and it will be interesting to discuss how pension funds in the UK are using fixed-income ETFs, what sort of exposure they have, and how this compares to the rest of Europe and indeed across the globe.

To start with, does anyone have any thoughts about where inflation is headed?

Fitzpatrick: I'll begin with my thoughts on the US. I think US inflation is rising, and there are three reasons why.

The Phillips curve is a big one – unemployment has come down and at some stage, employers will have to pay their staff somewhat more to be competitive. We are seeing that particularly in the West Coast of the US. There is a lot of wage inflation with the aim of attracting the best quality people especially on the tech side.

The second point I'd make is that the central banks seem pretty hesitant and I think they're enjoying that – the ECB in particular is enjoying it and the Fed has enjoyed the boost that it's given the economy and the financial markets. So, I think they'll be hesitant in, let's call it, tapering or hiking too much.

The third point is, we've got this interesting scenario with what seems to be a hike-ish environment from central banks, but against that you've got one foot on the break, one foot on the gas, the gas being fiscal stimulus, and I think that will feed through towards higher inflation.

They are the reasons I'd see for higher inflation.

Against that I'd say late cycle. We are in a strange environment of super low interest rates and a hiking, towards probably a recession risk rising – we are perhaps less than two/three years away from a recession. Against that I'd expect inflation to start coming down from there.

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premium over where central banks allege their targets are, with the assumption those targets will remain unchanged over the longer-term.

A lot of hedging activity has also been done on inflation over the last 18 to 36 months by UK schemes.

So it's reasonably well priced-in, I would say, at the long-end. It certainly doesn't look cheap, given where the market concerns are. Obviously, there are various political developments in the UK that could derail that and, again, that's part of the reason why it's less of a perceived valuation argument than it might be for other asset classes.

McElvanney: I'm just wondering about the impact that the change of Chair at the Fed might have. The markets are anticipating roughly three one quarter point rises this year, and if it goes beyond that it might be a challenge. The risk is that they go too far and then the US economy starts to derail, and it falls back again. The US economy seems to be well-supported without the tax changes just by corporates investing to keep driving that economy at the moment.

So, with the tax stimulus, inflation potentially going higher – not necessarily out of control, but higher – will the Fed hold back and just let it play out, so it isn't risking the economy contracting? Then, does that have a consequence for US to sterling? Because if the US depreciates relative to sterling, then we're not going to be importing inflation as we did, and therefore there will be less pressure on the Bank of England to raise rates, and there should be less pressure on the curve as well. It's a tangled web.

So, I think we are in the early stages of a spike in inflation – a big one just happened – but with some slight tempering ahead.

Chair: We agree with those views. The Phillips curve is an interesting framework – it tends to lie dormant for a while, until it wakes up, and reacts very quickly. Average hourly earnings are still volatile. A strong number in March may trigger the next phase of the sell-off in bonds. But at the same time the long end may flatten reflecting expectation a partial slow-down, if not a recession, further down the line.

McDougall: There's always going to be a bit of a tension between the inflation side and the economic side, versus the demand side. Certainly in the UK a lot of DB pension schemes are structurally still under-hedged. Therefore, for every rise in gilt yields, at least from our experience and how we position, you have structural buying opportunities to help close off some of that risk position.

I'm not sure if that's the same in the US, but what happens next in terms of the Fed's steps is going to be crucial.

Whelan: Longer-term inflation expectations in the UK are commensurately higher than they are in the US, if one compares to a reasonable

Asset allocation

Chair: In terms of asset allocation, because pension funds can take a long-term view, they arguably have the chance to squeeze different types of illiquidity opportunities. Are you seeing any trends on the asset allocation side, particularly given that everyone is slightly more bullish on credit?

Scott: We would argue that most assets are fully priced here. If you look out beyond the very short-term prospects over, say, a three-year horizon for asset returns, they're not very attractive.

One way of trying to gain some prospects of returns in an environment where asset classes are fully priced is to look within those asset classes at relative value and absolute return strategies. I think there are opportunities to do those things within asset classes, to eke out returns in an environment where it's going to be quite difficult.

Also, we've had many years of very strong asset returns in an economy which hasn't really been performing to the extent that asset prices have been moving. So, while I don't think we're likely to have a recession in the very near term, I think there is scope for returns to be lower, even if the economy continues to grow.

Chair: So, there's a catch-up to be done somewhere.

Following on from that, one may argue that one of the key struggles for pension funds is how to construct a fixed income portfolio in 2018 in a rising rate/normalisation environment and where should you position yourselves? Some investors, from a flow standpoint, continue to favour riskier exposures – such as diversifying into emerging

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market debt local currency – as a source of absolute return.

We've also started to see a change in the way pension fund investors are using emerging market debt. Having once been considered as a kind of tactical position that was used from time to time, it is now for some becoming part of the standard strategic asset allocation. EM debt is then being viewed as an asset class that can generate returns from a growth portfolio standpoint.

Fitzpatrick: It's a very interesting point that some investors are looking at absolute return or relative value strategies, or looking at other asset classes such as emerging market debt, rather than just considering the purely traditional asset classes. Our view would be that, on the betas within fixed-income, it certainly looks very expensive from a credit perspective. Our tactical management process has led us to be the most defensive we've ever been, in terms of credit allocations.

The question then is, where do we go from that view, given that we have de-risked on the credit side? On the one hand, we think being defensive is not such a bad thing. You may miss some potential up-side, but a lot of fixed-income clients are clearly looking for us to protect money, pursue the principles of capital preservation with some additional return. So, taking a little bit of time out, rather than chasing the last buck, makes a decent amount of sense.

Saying that, there are other decent strategies out there, whether it's relative value or absolute return. Going long volatility as well, in the unconstrained bond funds, for example, can be a decent strategy. But my main point there is, either be defensive and/or look for some incremental return but be careful where you would look for that return.

Be very careful when you invest in something new in fixed-income, in absolute return, relative value, other types of strategies – currency for example – to make sure you get positive expected return and good diversifiers. When these things go wrong, it feels really bad.

Chair: Yes, it is important for us as providers of strategies and solutions, and for some of you as advisers, to ensure that, with any strategy or any asset class, all the risks are understood by the investor, and that it is being implemented or bought for the right reasons. That is something that we have always felt extremely strongly about.

McDougall: I would add that in a low-yield, low-return world, we as advisers and implementers are constantly looking for the most cost-effective outcome for clients, and therefore in the efficient markets, where there's less evidence of persistent value creation from active management, we will be looking to go down the passive route.

Conversely, where there is significant alpha potential, we will look to adopt the active approach, and pay for active management where it makes sense to do so. Antoine *[Lesné]*, you mentioned local currency or emerging market debt – that is, I would say, somewhere in the middle. It's had its own little cycle of alpha – structurally we've seen very strong alphas post '08/'09, then some poor alphas in '11, '12, '13, as managers got whipsawed, or maybe didn't stick to their process, or focused on the flow side, to now really coming and picking up those alphas again.

So, clients should always be looking for the best value and where there is no value creation to be had, they should stick to that passive or ETF route as structural investors and then perhaps barbell that with the more alpha-oriented strategies, whether it's unconstrained, or absolute return, or indeed, multi-asset credit.

Whelan: I think analysing the sources of alphas that one might expect from the managers as well is key going forward, because a lot of the alpha of late isn't actually alpha in its purest form of uncorrelated idiosyncratic added value. It's been sourced typically from long beta or long carry.

We would also argue that you'd expect greater idiosyncratic dispersion within indices now. Intra-asset class correlations are, and have been, very high, but I think we would view that as coming to an end as volatility and valuations appear to normalise.

McElvanney: We have found that, when it comes to asset classes like investment-grade credit, if they're not fully valued, they're pretty close to it. So, in order to get value out of them, we're reliant on the skill of the investment manager to identify the right securities to hold, rather than have a blanket approach.

We've also found it tough to get

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comfortable with a fixed-income approach where you're reliant on a manager to be able to spot the opportunities and be nimble enough to take advantage, absolute return for example. We found in the last few years that we were not very satisfied with the level of returns, and so we have tended to now go for more predictable, more of a contractual cash-flow type arrangement, so loans for example and the private markets.

We're happy to take illiquidity, where we can commit for seven, maybe 10 years, where there is a strong contractual cash-flow, no leverage required, and after fees we can get a good expected return. Also, it always comes back to having the ability to spot the manager who can source it, knows what to do if something goes wrong, and can manage that whole process.

We're finding that we can get attractive returns that way without having to really dial up the risk.

Emerging market debt

Haddad: Coming back to the point on emerging market debt, we've done a lot of analysis on how active managers perform during those volatile markets, and a lot of investors say, "okay, EM debt is quite a small market, or an illiquid market, so for this we will tend to go to active". But in fact, when we looked at it, over 85 per cent of active managers had underperformed over the last three years, and you tend to see a lot of that underperformance when you have those big risk-off events in the EM space.

Kumar: Yes, it has already been mentioned that everything is fully priced, and investors will tend to go for the cheaper-to-implement options in the fully priced strategies, and go for alpha strategies where there is value to be extracted.

In that sense, what we are starting to see is that EM is now an asset class which has started to become cost-efficient, our bid offer for buying and selling is down to 15 basis points, which is really efficient, because if you compare that to the cost of euro corporates or euro treasuries, it's not that far off.

The second point comes to fully valued, and is there alpha to be extracted in this space? What we did is look at the Morningstar data for the top 30 largest active funds as at the end of December '16.

What we found was that 87 per cent of the managers had underperformed on a five-year basis. Obviously, this year has been a good year, because 2017 was a year where you rarely had blips. You had a rare blip in the year when there was some political turbulence in Brazil. You had the blip in Turkey when there was a coup. But apart from that, it was a fairly straightforward period.

So, active managers have tended to underperform in this space on a long-term basis, and that is because fundamental analysis doesn't really work in fixed-income emerging markets.

I would just give the example of Russia invading the Ukraine. No one had actually anticipated that happening or that the Ukraine crisis would happen. Then the market sold off. But the reality is that Russia has strong fundamentals, and is still one of the best in class, and if you had stuck to your guns from that time on, from December '15 to now, you would have made money. But the markets have been irrational for longer than you could ever have been liquid, and that is true in this market. The markets are so irrational that, eventually, you would have to cut down a position before your strategies come to materialise.

Whelan: I would say though, with Russia, it was more a question of willingness to pay, rather than an ability to pay issue, wasn't it? We could easily be in a different situation now, where Russia is zero per cent of any index?

Kumar: Russia is a difficult one, in terms of whether its sanctions are going to be tightened, or whether they're going to be relaxed. No one knows for sure.

My point is, it's very difficult to anticipate what's going to happen in these emerging markets, and therefore, what we see is the long-term drivers of returns in emerging markets are the carry, and fundamental analysis doesn't really suit this asset class given the nuances.

Use of ETFs

Haddad: Another interesting trend, and this is something that we talk to a lot of investors about, is that ETFs can be used in conjunction with active managers as well. We talk to a lot of funds that are using active managers that perhaps want to tilt duration in their portfolios; we also know of active fixed-income managers that are using ETFs for liquidity reasons, so to manage creations and redemptions in their own funds. Rather than selling their underlying securities, they have an ETF overlay to do that.

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So, we have conversations where they're used strategically, tactically, or as that overlay solution as well. The flexible nature of the product allows for that to happen, given that they can trade intra-day, costs have come down significantly and bid-offer spreads have come in as well. That's been a big reason as to why a lot of the markets have migrated to these sorts of vehicles.

McDougall: I have spoken to a number of European peers who say that there's a stigma attached to active managers using ETFs, because if they go out to their clients and say, "I'm using an ETF", there's an automatic negative – not around the ETFs, but around the fact that you're paying them active management fees, and they're implementing some of the portfolio through ETFs.

Therefore advisors, fiduciaries and the like need to do a better job of articulating some of the benefits that come with ETFs. Ultimately, lots of clients only focus on the top-line cost, when actually the execution costs, or the all-in cost, is as important. Therefore, some of the things that we have been discussing with clients and with managers is around the fact that for flows in any given day, ETFs can be actually quite a helpful tool to aid not just execution itself, but good execution, given some of the lower bid-offer costs, particularly in EM, but also in the sub-investment grade parts of the market. We just need to raise the profile of that.

Chair: A question I would like to put to the table, do you currently use ETFs in your portfolio? If not, is it something you have considered?

Scott: We do. We have used emerging market local debt ETFs, essentially to get exposure to the asset class because the managers we have in that space, we give them an absolute return mandate, so they give us the alpha, and then we manage the asset class risk through an ETF.

Chair: Do you outsource everything, from a portfolio management standpoint? Or do you have internal management as well?

Scott: It depends on which part of the portfolio we're talking about. On the growth side the portfolios are mainly outsourced, but we have discretion to implement overlays on that, and we can use ETFs there.

Stapleton: At National Grid we have considered using ETFs, but at this point in time we are not. But all our fixed interest is outsourced.

Fitzpatrick: We use an open architecture approach, so there's some access to active managers and we regard the use of ETFs as an opportunity that we haven't used as yet, but we are considering doing so. Then there are also some other customised exposures – we called them factor exposures – to areas of the EMD market that we think offer us the best risk-adjusted returns.

But I think the ETF market is interesting. Costs of course always have to be considered. But having a choice of ETFs, active managers, some sort of customised exposure can be a decent way to get the best value for your costs, recognising that clients have a limited fee budget out there.

But this is an asset class with potentially a decent high expected return versus the likes of, say, US treasuries or investment grade.

Even a small allocation to an area like EMD could be quite attractive; it arguably might be better value for money than a higher allocation to, say, an active investment grade manager.

McElvanney: At the moment there's no use of ETFs in either listed equity or fixed income for us. Within the fixed income, everything is outsourced, same for the equity, and it's all active managers who are stock pickers to one degree or another.

Fees

Chair: Just picking up on the topic of fees and fee budgets, that's something that is obviously making headlines in the press – is that something that is changing your attitudes towards investing?

McDougall: This is a topic that we are encouraging more debate on. I'm not making the statement that retail and institutional should have different fees. Maybe they should, maybe they shouldn't, but there's definitely scale in institutional which typically gets reflected in how that's charged in the active management world, and in the passive management world. But we haven't seen the ETF world join that club, or at least I haven't seen that.

So, I think there could or should be increased education or further dialogue around what institutional investors should be paying given our scale.

Haddad: But there is also an argument, and something that we have

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picked up conversations on, that revolve around how you can generate revenue as well by using particular instruments in your portfolio. So, there are some pension funds we talked to that lend their ETFs. If they can lend stocks or bonds, they can also lend an ETF, whereas you can't lend other pooled funds.

That's a really big phenomenon in the US, while in the UK it's starting to catch on. There is big demand for borrowing ETFs in the European space as well. That's an educational point that we're trying to talk to investors about as one would typically look at the headline fee, the TER, maybe your transaction cost, but not consider the possibility of using that as a revenue generator.

Whelan: That's the one area where we've seen strategic uses of ETF often talked about.

Chair: It is an interesting area. While you can't really lend a lot of the securities within the EMD portfolio, you can lend ETFs, and you can get paid for that and it can be substantial. Obviously, as the market gets more developed, you're probably going to see a gradual compression of these revenues, but at the moment there is an interesting opportunity there.

Fitzpatrick: It's a nice feature, given that the theme of value for money is an important one. Paying up for, say, an ETF, and then recouping some of that on a lending basis, depending on where the numbers are, certainly is an attractive idea.

McDougall: It's a good opportunity for institutional investors who have the right governance framework. So again, that's something we need to make the industry more aware of.

Chair: Yes, governance is key – the lending proposition is an interesting one, but of course it's important to understand the risks associated.

Coming back to the point around fees – and where you price yourself if you're referring to retail versus institutional investors – if you are looking at fees charged on a TER basis, when you're looking at an ETF, it always includes everything. Sometimes when you buy a fund from an active manager, you have a discussion on the investment management fee. The other part is non-negotiable. So, it is important to compare fully charged TERs and not investment fee on the one hand vs TER on the other hand.

For ETF issuers, as we look to develop a product, part of the question is about where to price? A lot of investors, at least in the European ETF market, are very much institutional ones. The numbers quoted vary but I would say between 70 per cent and 85 per cent of the total assets are actually being invested by what we would qualify as institutional. So, that would be pension funds, insurance companies, sovereign wealth funds, central banks as well as asset managers and discretionary wealth managers.

Kumar: In terms of the costs, as managers of ETFs, we try to get the best holding costs for the ETF. To give an example in the EM debt space, even though the bid offers in bonds have started to come down, the cost of holding EM bonds is still quite high. That's because it's still dominated by a few local custodians in some countries, such as Citibank in Columbia. That's where the next level of cost-efficiency needs to come down.

In one case we were able to reduce the cost of our total holding, our total custody costs, by as much as 50 per cent just by being aware of the cheapest locations to hold the ETFs.

Looking ahead

Chair: How do you see your future in terms of the asset allocation, strategies and processes you are using?

Fitzpatrick: We are doing a review of our strategic allocation – we currently have an overweight towards credit and we will revise that again just to check in on the point. The sense, possibly, is to increase credit versus treasuries on a longer-term basis. The point then is how we implement that, be that via an ETF, an active manager, or whether it's via some sort of customised exposure. Everything is under consideration.

Ultimately, people want to get paid and I think there are good-quality premia out there versus the likes of treasury. It would be interesting to see what others think but I think, particularly if we get past the next "crash", as such, there will be a move back into credit, so long as the downside isn't so bad; then the question will be around the best way to implement it.

Stapleton: Can I ask for views on a high-level question that we're always asking in terms of whether to increase our allocation to fixed interest, and that

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relates to the fact that default levels have been very low for a long period of time. Obviously, you have to factor that in to your expectations of future returns. Is the general view that this low level of defaults is going to continue given the economic environment we're facing at the moment, or should we be factoring in a higher allowance for default?

Fitzpatrick: From here, I would certainly factor in a higher allowance for default. If you look at where we are in terms of approaching a likely recession, I think credit provision will start to reduce, and default risk will rise from relatively low levels.

So, from a tactical perspective, I would be cautious about increasing credit given the environment right now. But if you want to look at it on a more strategic basis – and it depends on where you currently are of course – potentially there could be more of an allocation there versus, say, treasuries. But on a short-term basis, I can see default rates rising.

Stapleton: So, when you said earlier that your credit allocation was the most defensive it had ever been, was that primarily related to duration, or was it primarily related to rating?

Fitzpatrick: More so valuations, because spreads have got so expensive. So, when that gets more expensive, to back away is the primary driver. The second one is on the cyclical fundamental side, whereby we see that we're in the latter stages of the credit cycle. Leverage rates have gone up higher, probability of default indicators would be somewhat higher. So, there are two reasons, valuation and fundamentals, moving towards fundamentals, to bring it right back.

Stapleton: There's very little evidence at the moment that an expectation of higher default rates is priced in.

Fitzpatrick: Agreed. We don't know exactly when we are going to see the problem, but being a little early on the defensive side I think is the way to go.

Stapleton: That's a very useful perspective.

Scott: I would add a third reason for being on the cautious side – in credit, we've got plenty of examples of what tends to get called disruptive technology, where industries are being disrupted by technological change, and typically the losers in that process can often be companies with large credit weightings.

Stapleton: That's why we have avoided going into the retail sector.

Chair: Indeed, some of the more established businesses tend to have been growing these higher debt levels, and they appear in the benchmarks, and as a result you do hear discussions around whether the benchmark is actually a safe reflection of where investors should be putting their money.

We have started to discuss this point more and more. We have discussed that in the past with pension funds more on a segregated mandate basis, but this is something that continues to pop up.

Whelan: Do you see many institutional clients looking to use ETFs for an interim holding period to get a more liquid exposure to asset classes?

Chair: That's exactly what we see. They are used in different ways by different investors, but that's one way we've started to see investors using them, pension funds and insurance companies as well. So instead of doing it via futures, you implement this strategy via an ETF.

Kumar: ETFs have a number of different uses, and every day it's a new revelation. Many managers who have asset class allocations to, for example, high yield, but want to move allocations to, say, emerging markets – so from an active manager in high yield to an active manager in emerging markets – will find that doing this switch can be quite expensive on its own because it is quite difficult to sell bonds or to buy bonds.

As a result, we have seen some managers go via an ETF to help them do this – because of the easy nature of ETFs, going via an ETF does tend to be a lot cheaper than a blanket switch from high yield to emerging market, for example. So, ETFs have started to be applied in a number of interesting ways.

Whelan: We have seen that when, for example, funding level triggers have been hit – ETFs can be a relatively cost-effective and quick way to implement a transition at that trigger point.

Chair: As Abishek [Kumar] said, there are many different uses for ETFs and, going forwards, education is key in order to help investors understand all these different uses. There is more work to be done to help investors to understand that ETFs are more liquid, more transparent and indeed more cost effective than they are sometimes perceived.

A missed opportunity?

The government recently published the long-awaited defined benefit white paper, revealing its plans to make it a criminal offence for employers to 'wilfully neglect' pension schemes. However, the white paper showed that proposals to give The Pensions Regulator mandatory clearance powers had been dropped, as had a suggested shake-up of the Regulated Apportionment Arrangement system, and to indexation, with some criticising the paper as a 'missed opportunity'. *Pensions Age* asks: Is this the case, and if so, what else should the paper have addressed?

The government ducked two issues. Firstly, new moral hazard powers for the regulator won't achieve anything unless they are seen to be used successfully. A good guard dog needs to be expected to bite. The regulator has hardly used the moral hazard powers it already has, and the tests being proposed (eg 'wilful or grossly reckless behaviour in relation to a pension scheme') will be hard to prove, particularly if the consequences are "punitive". What's needed is clearer and swifter use of its existing powers.

Second, the government asked about rationalising indexation, but all its response said was that RPI is expected to rise faster than CPI – we already knew that. The substance of pension increase promises was to link them to 'inflation' – that is what everyone understood, with the financial consequences of the government's change of practice down to the luck of legal drafting. The ONS has been blunt about RPI, discouraging its use, saying it "is a very poor measure of general inflation" and "likely to overstate inflation". So let's fix our pensions. What we have at the moment is a second National Lottery that jeopardises some members' security to give others a windfall."

Mercer policy, professionalism and research partner Deborah Cooper

We support the strengthening of the voluntary clearance regime – if The Pensions Regulator has adequate resources. The original voluntary process, started over a decade ago, was initially welcomed but quickly fell to very limited use, because at that time TPR did not have adequate resources.

Waiting for legislative space risks missing opportunities over the next two to three years and The Pensions Regulator should move on best practice ahead of receiving the White Paper's legislative sticks. For example, they could provide a checklist of good corporate behaviour (i.e. what is well clear of 'wilful neglect'), guidance on when trustees should challenge corporate dividend policy, guidance for trustees where the sponsor is not paying dividends eg not-for-profit, partnerships etc. and an early adoption route for a principles-based DB Chair's Statement.

On RPI vs CPI, we do not believe it is good policy that what members get is simply historical luck. RPI has been discredited statistically. We call for a final resolution of this issue, which will need to deal with the thorny issues of both benefits and the introduction of CPI gilts to really make progress.

Overall, we are keen to see the changes in the White Paper come to fruition effectively, and creating a DB regime that can last for the next decade.

Aon partner Lynda Whitney

The main message of this white paper is that TPR is the lead character, being given greater powers to strengthen the existing pensions system, for the first time since it replaced OPRA in April 2005. But nothing is said about whether TPR will also be given sufficient resources to utilise these strengthened powers. Their impact will also be highly dependent on the clarity with which they are drafted and TPR's appetite to use them. Although the white paper talks tough, it is perhaps trying to manage expectations through discussion of proportionate use of powers and potential actions, and the use of the new sanctions being proportionate with the breach. This is just the first step and there is a lot more to come in consultations as the year develops. The paper does include some good stuff in amongst the background noise of strengthened powers, though there are missed opportunities to introduce a statutory override on RPI/CPI (with member protections) and to beef up the powers trustees may have, but it still begs the question: will TPR have the right resource at the right time, to do the right thing?

Sackers partner Janet Brown

We are supportive of the extra powers to be given to The Pensions Regulator, including the ability to fine company bosses. Although the powers may prove difficult to apply in practice and could be subject to legal challenge, they will hopefully at least have a deterrent effect in sounding a warning to those employers who may be disposed to wilfully neglect providing the necessary support expected of them in relation to their pension schemes.

Forcing companies to gain clearance ahead of all corporate transactions would be a step too far, leaving the regulator exposed to accusations of interfering in, or even jeopardising, legitimate business activities. Similarly, we understand the reasons why the government may be reluctant to implement alterations to the Regulated Apportionment Arrangement system at this stage or to sanction changes in indexation requirements – in the latter case which could materially reduce members' pension incomes for the full length of their retirement.

The white paper was a missed opportunity in the sense that at the end of the day it did little or nothing to improve the sustainability of DB schemes and/or encourage current corporate sponsors to persist with them.

Barnett Waddingham senior consultant Malcolm McLean

Pensions history

Looking back 20 years

Last month we looked back 100 years to March 1918. This month we look back just 20 years to see what was happening in pensions then.

Martin Slack, the chairman of the Association of Consulting Actuaries, writing in the annual review of the association for 1998, indicated that over the previous 12 months some of the most volatile investment conditions for many years had been experienced in the behaviour of the UK equity market. This had required consulting actuaries to reconsider some of their traditional techniques and to call on their consulting skills to help their clients make financial sense of the future.

He went onto say that pension provision remained dogged by excessive regulation and complexity, which had, understandably, deterred many individuals and employers from making adequate provision for their own or their employees' retirement. The survey of small companies that the association had carried out during the year provided stark confirmation of the attitude of such companies to pension provision. The continuing drift away from defined benefit schemes to less valuable money purchase schemes did not bode well for the future.

He warned that whilst the concept of pension provision (providing income in retirement out of income saved during employment) was very simple but this simplicity was being lost under the regulatory requirements. At best it made it difficult to identify the correct choices and at worst, deterred the making of any provision at all. He confirmed the association would continue to work for further simplification. Reflecting on the position he was left wondering whether the only way to achieve real simplification would be to make no further changes to pension's legislation and to let some of the historic anomalies simply fall away over time.

The Association of Consulting Actuaries' archive collection can be viewed on line at, http://www.pensionsarchive.org.uk/ click "Our Collections".
You can contact us through the website or via: alanherbert@btconnect.com

Written by Alan Herbert, chairman, The Pensions Archive Trust

Fun and games

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ACTIVE PASSIVE
ADMINISTRATION
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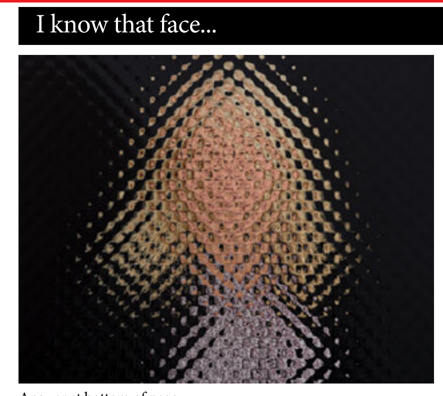

Answer at bottom of page

I know that face... Answer: TPR executive chair Nicola Parish

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WE ARE DELIGHTED TO ANNOUNCE THE FOLLOWING SPEAKERS WILL BE JOINING US ON THE DAY:

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/ The Pensions Regulator

Sarah Levy
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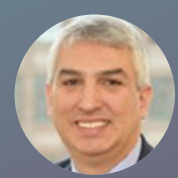

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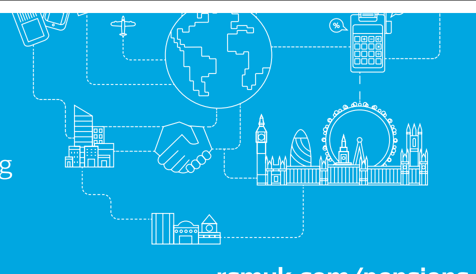

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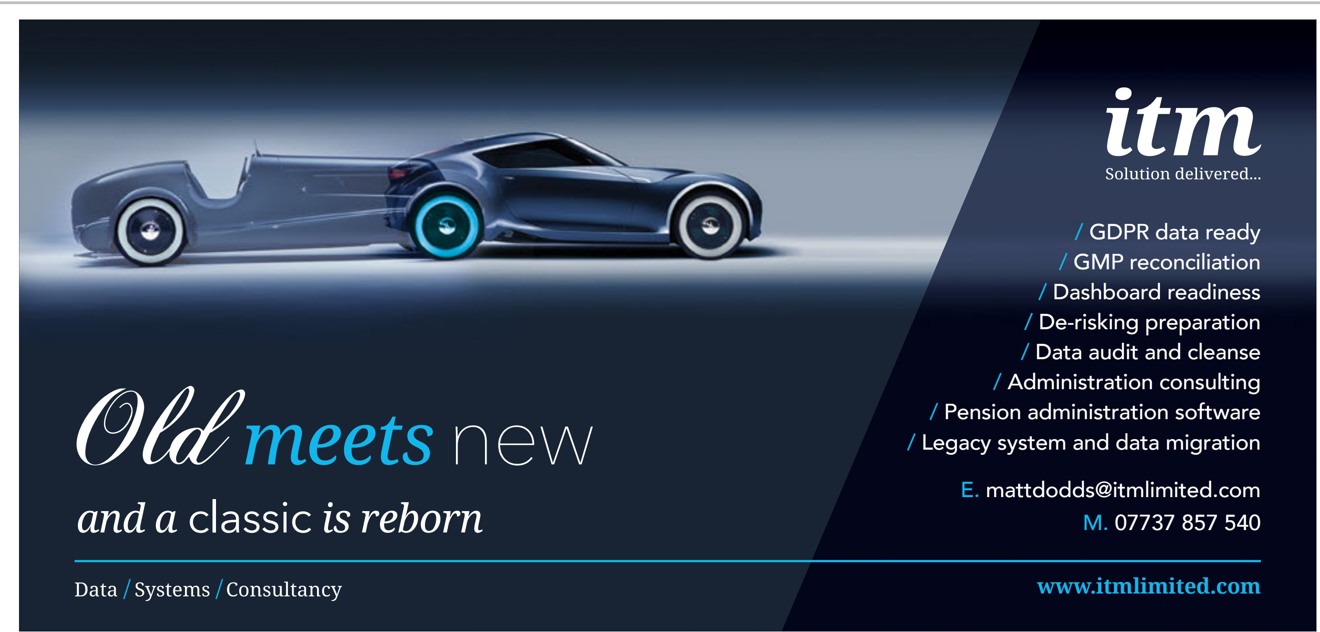

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