Defaults
How DC default funds are adapting to diverse investment choices

Hybrid retirement products
Will hybrid products bridge the gap between annuities and drawdown?

Administration
How to simplify the process of changing administrators

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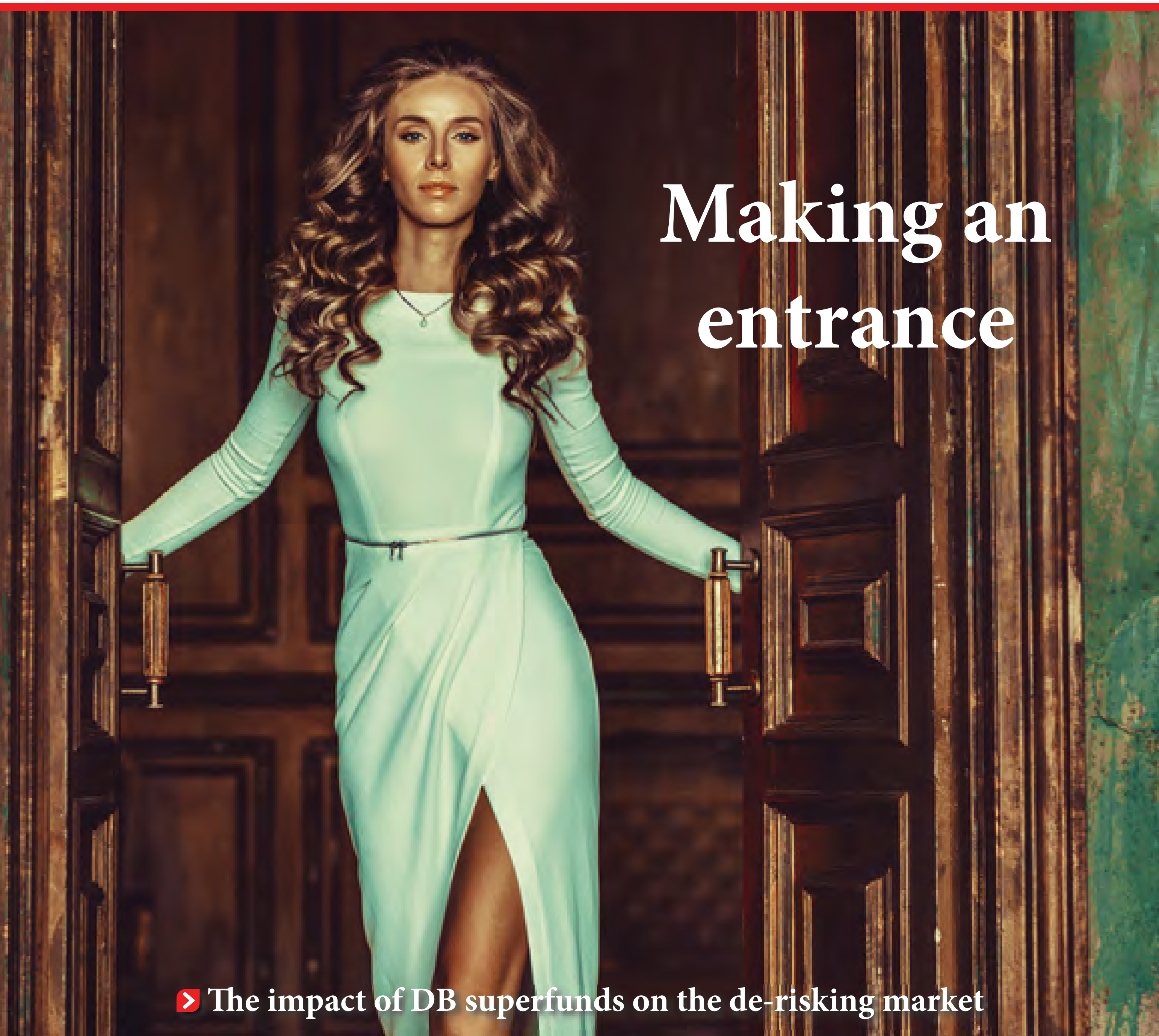
February 2019

PENSIONS*Age*

The leading pensions magazine

Insurers and DB consolidators: *How has the insurance market reacted to the emergence of superfunds?*

RPI/CPI: *The government has been criticised for still using RPI; should pensions make the switch?*



Making an entrance

The impact of DB superfunds on the de-risking market

Case study: How the Royal British Legion's pension scheme is working towards self-sufficiency

Editorial Comment

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

Oink oink. We've just gotten over one New Year and already another one is upon us. This time it's the Chinese year of the pig.

A quick google search has me firmly believing the retirement industry was 'born' in the year of the pig. As apparently, zodiac pigs do not stand out from the crowd, are realistic, not 'all talk, no action' flashy and are not wasteful spenders, but will let themselves enjoy life. They are energetic and always enthusiastic, even for so-called 'boring' jobs. Could there be a better description for the unassuming, yet dedicated pensions sector, which aims to make people realistic about their expected retirement, while doing all it can to help people enjoy later life?

However, the Chinese zodiac legend places the pig in last place, and taking the word of one auspiciously-timed press release, this year is actually considered unlucky for those born in the year of the pig.

Indeed, China's slowest expansion rate since 1990, coupled with US trade tensions, means that this little piggy may not be going to market. Plus, of course, in the UK we have the current concern that those in charge may be making a right pig's ear of Brexit.

There may be some who believe that we can't make a silk purse out of a sow's ear by leaving the EU, but really, how can a year that is akin to the industry's mascot – that of the piggy bank – bring bad luck to the pensions sector?

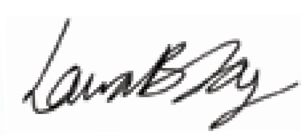
It's already gotten off to a (pork) crackling start, with the cold-calling ban now in force and a flurry of consultations delivered by the DWP igniting the industry's passion for debate. The recent closure of one such consultation, looking into DB consolidation and how they should be governed and regulated, seems to have received strong views about these 'superfunds' and their growth potential over the coming year/s, as this month's cover story *[see pg 32]* explores.

And after almost 30 years of complexity and confusion creating a pigsty of GMP equalisation, schemes are now starting to fully understand the implications of the recent High Court ruling on guaranteed minimum pensions. Our focus *[pg 39]* therefore reveals how the industry is finally managing to move forward.

Another feature this month explores that of behavioural bias within trustee boards *[pg 58]*. In a positive development, it seems there is a growing awareness on trustee boards of the biases that influence their decision making, and the steps that can be made to counter them. Meanwhile, for the individual saver, the newly-launched, if still yet-to-be-officially-named, Single Finance Guidance Body, coupled with the upcoming pensions dashboard, should help ensure that future retirees do not spend their pension pot on a pig in a poke.

Finally, the coming year should see the much-awaited pensions bill, covering topics such as DB consolidation, collective defined contribution and the pensions dashboard. Those that said pigs might fly before these major changes to the industry's structure would occur may find themselves looking up to the sky come May.

So the pensions industry should be bringing home the bacon with many positive developments expected in 2019. Assuming they all come to pass, we can then spend the year as happy as a pig in…. mud.



Laura Blows, Editor

*Unfortunately there was not room for the following pig phrases in this editorial comment: 'piggyback', 'pigs in blankets', 'hogwash', 'telling porkies', 'piggy in the middle', 'the whole hog', 'being a pig', 'pigtails'.

COVER FEATURE

Theme: Variety

30

Making an entrance

Commercial consolidators – aka superfunds – have entered the DB de-risking market to a flurry of interest, with the first schemes to join them expected to move soon, possibly once regulatory oversight is confirmed. Laura Blows explores these new entities and the considerations trustees should have when contemplating consolidation

Features & columns

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NEW circulation figures

Pensions Age now has its new circulation - figure from the Audit Bureau of Circulations (ABC). 15,000 (July –June 2018) print distribution this is 100% requested and/or copies sent as a member benefit (PLSA, PMI, SPC, AMNT). Pensions Age is also sent as a Tablet Edition to our 25,000+ online subscribers (source: Publishers Statement Sept 18). Our print circulation is nearly 300% higher than other titles in the market.

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Dateline - January 2019

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

2 January Nearly a quarter of a million (245,561) **NHS workers** have opted out of the NHS pension scheme in the past three years, according to a Freedom of Information request by the *Health Service Journal*. The opt-out rate of NHS workers is significantly higher than in other public-service schemes.

4 January The **Standard Life Staff Pension Scheme** is ordered by the Pensions Ombudsman to pay nearly £20,000 to one of its members for delaying his pension transfer, which led to investment losses. Its member, known as Mr L, complained to the ombudsman that he was provided with misleading information regarding his right to transfer, resulting in the losses. The ombudsman upheld his complaint and ordered the trustees of the scheme to pay £18,156 into Mr L's Standard Life pension plan within 21 days.

7 January Compensation payouts to members who have been wrongly advised to transfer out of DB schemes have doubled to £40m in two years, new data from the **Financial Services Compensation Scheme** (FSCS) reveals.

8 January Britons under the age of 32 are the most optimistic about the age at which they plan to retire, despite being the age group that is least financially prepared, research from **Navigate Wealth** finds. The study reveals that 33.3 per cent of respondents born in 1986 or later hope to retire between the ages of 61-65, compared to 31 per cent of those born in 1985 or earlier.

9 January The **pension cold-calling ban** takes effect, making it illegal for any member of the public to receive unsolicited calls about their pension. Companies who are caught making the nuisance phone calls could face enforcement action and fines of up to £500,000.

10 January An accounts manager admits to lying to investigators to try and conceal the fact that restaurants he oversees have not given their staff workplace pensions, **The Pensions Regulator** (TPR) reveals. Mansoor Nasir submitted false declarations of workplace pension compliance to TPR to claim that nine restaurants were giving their employees the correct benefits.

11 January Council workers' pension money totalling more than half a billion pounds has been invested by local councils in arms firms that have been linked to the war in Yemen. Originally reported by *The Guardian*, it has been revealed that 43 pension funds directly hold shares worth £566m in five companies.

14 January Twenty-two per cent of non-advised drawdown consumers are unaware of the **Money Purchase Annual Allowance** (MPAA), with Canada Life warning that savers could be faced with unexpected tax bills. Canada Life technical director, Andrew Tully, notes that while not everybody surveyed will still be paying into their pension, it is "nonetheless concerning that many people are unaware of the restrictions and potential tax implications if they continue to do so".

16 January The **Competition and Markets Authority** says it will consult on the draft order of its suggested remedies into the investment consultant and fiduciary management markets in mid-February. The regulator says it is currently working on drafting the order, which will require pension schemes to run a competitive tender before choosing a fiduciary manager, among other proposals.

17 January Pension Insurance Corporation (PIC) concludes a pension insurance buy-in with the trustee of the Somerfield Pension Scheme, insuring £425m of pension liabilities.

18 January The government should switch to using one single general measure in order to fix an error in the retail price index (RPI), in a move that

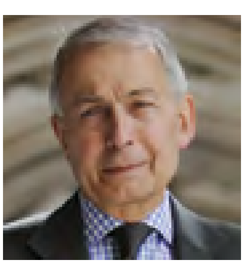
For more information on these stories, and daily breaking news from the pensions industry, visit **pensionsage.com**

could negatively affect private sector pension deficits. A report by the **House of Lords Economic Select Committee** says that the current position of the UK Statistics Authority (UKSA), which uses RPI as a legacy measure, is "untenable", particularly when used to uprate private sector pensions.

21 January The **Insolvency Service** reveals it has applied to wind-up 24 companies, connected to 3,750 pension-scam victims, for "pension misuse" since 2015, according to its latest figures. The Insolvency Service says people need to safeguard their pensions from investment scammers and negligent trustees, estimating that the total amount of contributions made by the victims could be £202m.

23 January Pensions provider **Now Pensions** blames its trustees' decision to currency hedge for its poor investment returns, after facing an awkward line of questioning from the Work and Pensions Select Committee. Giving evidence on the progress of auto-enrolment in front of the committee, Now Pensions director of policy, Adrian Boulding, defended his scheme's returns after Conservative MP for Amber Valley, Nigel Mills, singled out the provider.

24 January The cost of GMP equalisation could be less than 1 per cent of total scheme liabilities for more than half of all pension schemes, **XPS** finds. According to a survey of 90 clients with a 31 December year end, 57 per cent say they believe the total cost of equalisation was going to be less than 1 per cent.



25 January Work and Pensions Committee chair **Frank Field** writes to the Financial Services Compensation Scheme (FSCS) over concerns about the compensation offered to 'mis-advised' British Steel pensioners. The concerns, related to over £40m transferred out of the British Steel Pension Scheme (BSPS) to advice firm Active Wealth, were first expressed by the Financial Conduct Authority (FCA) after it queried how the way FSCS calculated the compensation.

28 January Some victims of pension scams have lost more than £1m in savings to fraudsters, **The Pensions Regulator** reveals. Data from Action Fraud, part of the multi-agency Project Bloom group, finds that two people had lost over £1m. However, TPR believes the overall figure is likely to be higher as a number of victims never contact the authorities.

29 January The **Equity Release Council** writes to the government arguing for 'housing wealth' to be included in the design of the pensions dashboard, so people are better able to see how it can support them in retirement. Responding to the Department for Work and Pensions consultation on the dashboard, Equity Release Council chairman, David Burrows, argues that people need a "complete overview" of their wealth in order to make the best decisions when funding their retirement.

31 January Defined contribution pension scheme contributions totalled £6.5bn in 2018, a 22 per cent increase from 2017, according to new data from **The Pensions Regulator**. Its annual report, *DC Trust*, also finds that £60bn has now been saved into DC schemes, with membership at 16.8 million people. This represents a 25 per cent increase in assets, while membership increased by 33 per cent over the past year, and by more than 640 per cent since the start of 2010. The rise in master-trust membership, from 10 million savers in 2017 to 13.4 million in 2018, was a major factor for this increase.

News focus

Average pension freedom withdrawal falls to record low

The news follows a consultation launched by the FCA on retirement outcomes for savers accessing the pension freedoms, which includes proposals such as investment pathways for those in drawdown and wake-up packs

The average value of pensions freedom withdrawals per person fell to a record low of £7,197 in Q4 2018, down from £7,597 in the previous quarter, according to new figures from HMRC.

The total value of payments also fell, by £60m from the previous quarter, to £1.9bn, while the number of individual withdrawals reached a record-equalling 264,000, up from 258,000. Commenting on the findings, AJ Bell senior analyst, Tom Selby, said: "While the popularity of the pension freedoms shows no signs of abating, the amount people are withdrawing from their funds per quarter has dipped to the lowest level on record.

"Although it is too early to draw firm conclusions about why this has happened, it could be a sign of people showing restraint in how they spend their hard-earned retirement pots."

In 2018, £7.8bn was withdrawn from 2.3 million payments, a significant increase on the £1.3bn in withdrawals from 614,000 payments in 2017. A total of £23.6bn has now been flexibly withdrawn from pension pots since the launch of pensions freedoms in April 2015.

Economic Secretary to the Treasury, John Glen, commented: "Pensioners should be able to control what they do with their own hard-earned pension savings, and that's exactly what the pension freedoms reforms did.

"Over £23bn of pension savings have been accessed by over a million savers since we introduced the reforms, and with free impartial advice available to everyone, pensioners across the country are now able to get the most out of their pension pot."

The news follows the publication of a consultation launched by the Financial Conduct Authority (FCA) on plans to introduce 'investment pathways', as well as introducing new rules on 'wake up packs', in order to stop 100,000 consumers a year losing out on pension income.

The proposals will target consumers who do not take advice as they approach retirement, and will aim to give them a "range of investment solutions" that will "broadly" meet their objectives, while also disclosing charges made by pension providers.

The measures were first recommended by the FCA in its *Retirement Outcomes Review* in June 2018, and they hope to ensure that consumers are better prepared when accessing pension freedoms.

Commenting on the proposals, FCA executive director of strategy and competition, Christopher Woolard, said: "The pension freedoms give consumers more flexibility in how and when they can access their pension savings; but that also means they have to make more complicated choices.

"Our *Retirement Outcomes Review* identified that many consumers are focused only on taking their tax-free cash and take the 'path of least resistance' when entering drawdown. This can often mean that the rest of their drawn-down pension pot is not invested in a way that meets their needs and intentions."

Furthermore, the FCA has suggested that consumers' pension investments are not defaulted into cash savings unless it is actively done so by the consumer.

According to Woolard, one in three consumers who have gone into drawdown are unaware of where their money is being invested.

"Our proposals on investment pathways will help non-advised drawdown consumers select from four relatively simple choices, designed to meet their broad retirement objectives so that they can maximise their income in retirement," he added.

As part of the "ready-made investment solutions", consumers will be offered four objectives for their retirement pot, and a solution based on their choice.

The regulator said it expects firms to "challenge themselves" on the level of charges they impose on the investment solutions, or it will move towards imposing a charge cap. Smaller drawdown providers will be able to refer investors to another provider, or the Single Financial Guidance Body's drawdown comparator tool.

Wake-up packs, retirement risk warnings, reminder requirements and the annuity prompt come into force from 1 November 2019. The more transparent rules around drawdown products will be applied from 6 April 2020.

Royal London director of policy, Steve Webb, added: "These FCA rules are a sensible response to the risk of savers sleepwalking into seeing their hard-earned savings eroded by sitting in low-return cash investments.

"But there is still a problem where people cash out the whole pot and transfer it into a cash ISA or current account. It is clear that reckless caution, not Lamborghinis, is the big outstanding challenge with pension freedoms."

However, the proposals could be welcome news to many savers, with recent research by Zurich finding that tens of thousands of savers risk a savings shortfall in later life due to neglecting their remaining pot after taking a tax-free cash lump sum.

Zurich and YouGov's research found that 44 per cent of people who had gone into drawdown to access tax-free cash but had not retired, would leave their remaining balance "untouched and unchanged" until they start taking a pension income.

There could be more than 115,000 consumers who have moved their pension into invest-and-drawdown to take tax-free cash who are unaware of what to do with their remaining pot.

Experts have warned that after moving their savings into drawdown, people need to actively manage their pot, or it could veer off track.

Zurich head of retail platform strategy, Alistair Wilson, commented: "After triggering drawdown, consumers need to monitor and adjust their portfolio to ensure market movements don't leave them exposed to too little, or too much investment risk – yet many are planning to leave their pot dormant until they retire.

"Drawdown gives people much greater freedom and flexibility in retirement, but it doesn't run on autopilot. With no one at the controls, there is a danger tens of thousands of people could see their pensions veer off course."

Written by Jack Gray and Theo Andrew

VIEW FROM THE ACA

In our response to the DWP consultation on DB consolidation, we welcomed the government's proposals to support the development of DB consolidators (or 'superfunds').

However, as set out in our recent paper with Royal London, *Benefit Simplification - is it time for the pensions pound?*, we believe that a stepping stone to achieving successful consolidation is through simplifying the manifestly complex DB environment, with significantly lower ongoing costs supporting improved benefit security for members.

Greater facilitation of benefit simplification in DB schemes could provide a significant improvement to member understanding and be a major catalyst for greater consolidation – whether that be in superfunds or other existing forms of pension scheme consolidation.

In terms of superfunds, it is right that there is appropriate regulation and protection for members, but this needs to be balanced with appropriate pricing and accessibility for schemes whose members could benefit from transferring to a superfund. In particular, the proposed superfund gateway is intended to remove the superfund option for those schemes that could fully buy out in the foreseeable future – the gateway should be set at a level where schemes that can benefit from the superfund option are not unnecessarily excluded.

Also, it would not be appropriate for funding rules applicable to superfunds to become a defacto standard for DB scheme funding, where the reliance on ongoing employer covenant should allow for much greater freedom where appropriate.

ACA chair Jenny Condron

ACA
ASSOCIATION OF CONSULTING ACTUARIES

VIEW FROM THE ABI

The DWP originally set out in its Green Paper on DB pension schemes to tackle a very real problem – the perilously-overlooked chasm between the Pension Protection Fund (PPF), and a gold standard insurer buyout. Sadly, the proposals in their consultation ignore much of this problem. Instead, the consolidation proposals seemingly only help employers to walk away from their obligations to their employees on the cheap.

This is evidenced by the superfunds who have come to the market, and have publicly stated that their intention is to only accept well-funded schemes. As a consequence, there is a clear risk of regulatory arbitrage, which puts member benefits at risk. Whilst the ABI recognises that the 'gateway' principles attempt to address this risk, we believe the proposals as they currently stand are insufficient and need strengthening.

This is because superfunds are profit-seeking financial institutions, and will be providing very similar services for employers and their DB scheme members to that of insurers. As such, these services require robust regulation, which will help ensure the financial sustainability of the scheme, and therefore the likelihood of scheme members receiving their pension in full. It is clear that the regulator of superfunds will need strong rule-making and supervisory powers – more like the Prudential Regulation Authority than The Pensions Regulator.

ABI policy adviser, long-term savings, Hetty Hughes

ABI

Lords Committee says govt must stick to single indexation measure

The House of Lords Economic Select Committee said the use of RPI is 'untenable', particularly when uprating private-sector pensions

Editorial credit: Drop of Light / Shutterstock.com

The government should switch to using one single general measure in order to fix an error in the retail price index (RPI), in a move that could negatively affect private-sector pension deficits.

A report by the House of Lords Economic Select Committee, published 17 January, suggested that the current position of the UK Statistics Authority (UKSA), which uses RPI as a legacy measure, is "untenable", particularly when used to uprate private-sector pensions.

Furthermore, the committee recommended a switch to using the consumer price index (CPI) in the interim, to prevent "shopping in the interim". In 2010, UKSA made a change that had the "unintended consequence" of creating a difference in the way price averages are calculated, widening the gap from around 0.5 per cent to 0.8 per cent.

UKSA has "refused repeatedly" to correct the problem, according to the committee. Committee chairman, Lord Forsyth of Drumlean, said: "The present position of the authority is untenable. Rather than pre-empting the decision of the chancellor, it should fulfil its statutory duty to promote and safeguard the quality of official statistics and to do that, it should request a fix to the clothing problem.

"The chancellor should approve this change regardless of the effects on index-linked gilt holders, holders of which before 2010 received an unwarranted windfall.

"Given RPI remains in widespread use, the authority should stop treating RPI as a legacy measure and resume a programme of periodic methodological improvements."

According to Aviva Investors head of LDI, Rakesh Girdharlal, the report could result in a lower RPI by 0.3 per cent per annum, leading to lower asset values and higher pension deficits.

"The report has significant implications for trustees and pension schemes, given its impact on the future measuring of scheme funding levels, as trustees typically match all inflation risk (RPI and CPI) with RPI-linked assets," he said.

"If the RPI flaws are fixed, this will result in lower asset values, which will worsen pension deficits.

"In light of the report, we would expect that future issuance of CPI-linked assets is likely to increase, as will demand from pension schemes. It will be important to monitor the levels of inflation linkage that could be available via these assets."

Written by Theo Andrew

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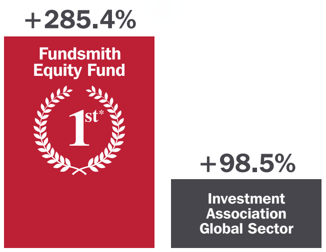

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*1st out of 178 Investment Association Global Funds (main units only).

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Year to end Jan	2019	2018	2017	2016	2015
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Investment Assoc. Global Sector	-2.0	+13.2	+32.2	-4.8	+12.6
Quartile Rank	1st	1st	3rd	1st	1st

1 Source: T Class Acc Shares, net of fees, priced at midday UK time.
Source: Financial Express Analytics.

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VIEW FROM TPR

Last year TPR launched a pension scams awareness campaign with the FCA and revealed that victims reported to Action Fraud an average loss of £91,000.

That is a huge sum to have ripped from your savings. But with some having estimated that to enjoy a comfortable retirement you will need a £260,000 pot, it is clear that many potential targets for criminals have far more than even £91,000 at stake.

New data that we published last month supports this concern. Two people contacted Action Fraud to report that they had lost more than £1,000,000 each to pension scammers. Given we believe that the majority of scam victims never contact the authorities, this total may only be a fraction of the total number of people who have handed over large pension pots.

It's vital that those who are considering transferring their pension are aware of the threat of scammers. As advisers may often be the first people to learn about a planned transfer, when a consumer contacts them, they are in a great position to halt a scam early if they give a clear warning about the dangers of suspicious-looking schemes and urge the consumer to visit fca.org.uk/ScamSmart immediately.

This is not about increasing the workload of advisers. This is about helping them to provide the best service possible to their clients, by keeping savers' funds in their pensions and out of the pockets of criminals.

TPR executive director of frontline regulation Nicola Parish

The Pensions Regulator

Insolvency Service winds up 24 companies for pension fraud

The Insolvency Service has warned people to safeguard their pensions from investment scammers and neglient trustees, and said that the total contributions made by victims could be £202m

The Insolvency Service has applied to wind up 24 companies, connected to 3,750 pension-scam victims, for 'pension misuse' since 2015, according to its latest figures.

The Insolvency Service has warned people to safeguard their pensions from investment scammers and negligent trustees, estimating that the total amount of contributions made by the victims could be £202m.

In August, The Pensions Regulator (TPR) and the Financial Conduct Authority (FCA) joined forces to launch a campaign urging people to be aware of scammers targeting their pension savings, as it was revealed an average £91,000 was lost per victim in 2017. The ScamSmart advertising campaign targets savers aged between 45 and 65, which the regulators say is the most at-risk group.

Consumer Minister Kelly Tolhurst said: "Our consumer protection regime is one of the strongest in the world and we are committed to making sure people know their rights. If you are approached to make an investment from your pension, always do your homework and seek independent advice, if necessary, to help you make an informed decision.

"Government continues to work closely with the Insolvency Service who are working to clamp down on rogue companies targeting vulnerable people."

In January, a ban on pensions cold calling came into effect, making it illegal for any member of the public to receive unsolicited calls about their pension.

The Insolvency Service highlighted cases including one where four directors were involved in the misuse of pension

funds of £57m, and subsequently banned for 34 years. In another case, Fast Pensions and five connected firms were wound up in May 2018, after 520 people were encouraged to transfer their pension savings into schemes where Fast Pensions was acting as the sponsoring employer.

The investigation found that £21m was transferred through various methods, including cold calls or through free pension reviews, where the advice was found to be inadequate.

Furthermore, TPR recently stated that data from Action Fraud, part of the multi-agency Project Bloom group, has found that two people have lost over £1m to scams. However, TPR believes the overall figure is likely to be higher as a number of victims never contact the authorities.

AJ Bell senior analyst, Tom Selby, believes the figures to be the tip of the iceberg. "Some victims will be unaware they have been duped for months or even years, while others will simply be too ashamed to come forward and report what has happened. Furthermore, it can take a long time for authorities – which are always limited by resource – to build a case against firms involved in scam activity."

Written by Theo Andrew

VIEW FROM THE PLSA

Since its launch in November, the Cost Transparency Initiative has been undertaking two important pieces of work.

The first of these – following the appointment of Mel Duffield as the initiative's chair – was to appoint members to its board from a wide range of backgrounds and experiences. This we've managed to do and I'm delighted we have so many experts on the board, and supporting the project to make sure it is a success.

The second piece of work is equally as vital. Since the launch of the initiative, we have been in the process of working with a number of pension providers and investors to test the Industry Disclosure Working Group (IDWG) templates.

This pilot phase has seen up to 20 organisations volunteer to take part and is due to conclude in March this year. Their time, hard work and feedback will help us fine tune the templates and guidance that go out for use in the marketplace to ensure they meet the needs of schemes, providers and professional advisers.

In the spring, following the pilot phase, we will begin to roll out the templates for adoption across asset owners and managers. This will, for the first time, provide trustees and providers with a clear and consistent means to compare or report costs for a given fund or mandates.

This year the Cost Transparency Initiative is resolute to help those responsible for savers' investments understand exactly where their money is being spent. In turn, and most importantly, we will contribute towards helping retirees achieve a good retirement income.

PLSA head of DB, LGPS and standards, Joe Dabrowski

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Whitbread to make one-off £380m payment to DB scheme

In other pension fund news, the LAPFF has written to mining company Vale following the Brazilian dam disaster, and BT's DB pension deficit has increased by £500m in Q3 2018

Whitbread has reached an agreement with the trustee of its DB scheme to make a one-off contribution of up to £380m to the Whitbread Group Pension Fund, following the sale of Costa to The Coca-Cola Company.

The sale was completed on 3 January and will release Costa, which is owned by Whitbread, from its obligations to the pension fund. The one-off contribution "will significantly de-risk the pension fund's investment strategy" and replace the previously agreed recovery plan, which would have required Whitbread to make total payments of £326m to the pension fund over the next four years.

The announcement also said: "As previously announced on 21 December 2018, Whitbread intends to start a share buyback programme, which is likely to commence following release of Whitbread's third quarter trading update on 17 January 2019."

In August, it was announced that Whitbread would be making a contribution to its pension fund as part of the £3.9bn sale, although at the time the amount was unspecified.

In other pension fund news, the Local Authority Pension Fund Forum (LAPFF) has written to Vale and its joint venture partner BHP Billiton over concerns regarding the Brazilian dam collapse, which is feared to have killed more than 300 people.

In a series of tweets, LAPFF said that it had raised responsibilities of senior partner companies for the actions of joint venture partnerships, particularly regarding Brazilian dam strategies. The

Editorial credit: Paul Daniels / Shutterstock.com

correspondence follows the collapse of a dam in Brumadinho on Friday, 25 January, which has led to the deaths of around 100 people, with approximately 260 people still missing.

The LAPFF said it holding meetings in order to review the responses. It follows moves from a number of European pension funds, including Danish fund MP Pension, which have placed Vale in quarantine after the disaster. This means that the fund is not allowed to invest further in Vale, owner of the burst dam, before a series of issues have been investigated and solved. At the moment, MP Pension has DKK 49m (£5.8m) invested in Vale.

And finally, BT's defined benefit pension deficit increased by half a billion pounds (£500m) in the three months to 31 December 2018, ending the year on £5bn (net of tax).

Publishing its third-quarter results, BT revealed that the estimated deficit has increased from £4.5bn to £5bn over the third quarter (net of tax) or £5.3bn to £6bn (gross of tax). It said the increase mainly reflects a fall in the real discount rate and a fall in assets.

In addition, with regards to the High Court ruling on the Lloyds Banking Group case, it said it expects the impact of the decision to cost around £100m.

Written by *Pensions Age* team

VIEW FROM THE PPI

The recent annual DC trust report from The Pensions Regulator is another indication of how, in a large part thanks to auto-enrolment, DC pensions are becoming the norm for today's pension savers.

The report contains a wealth of facts and figures. Ninety per cent of people now actively contributing to a pension are saving into a DC scheme. The number of scheme memberships grew by a third between 2017 and 2018. Thanks to auto-enrolment almost 10 million people are newly saving for retirement.

But the number of deferred memberships increased faster last year (45 per cent) than active memberships (24 per cent). This highlights the dynamic nature of the DC market, where a change in employer often means a new pension.

The fragmented nature of the market means it can be very difficult for policymakers to know what is really happening and how much pension saving individuals really have. How many pots with how many different providers? How much across all of the different pots? How many of these are 'small', and how much does it cost to maintain them all separately?

These questions – vital for considered policy evaluation and analysis – will need to be answered using a new approach to data analysis and collection. The PPI is looking at innovative ways of finding the answers, and we hope to publish results that shed further light on the real state of DC pensions in the UK later this year.

PPI director Chris Curry

PENSIONS POLICY INSTITUTE

PPI

People on the move

John Chilman

RPMI Limited has announced the appointment of John Chilman as chief executive officer (CEO).

He will be responsible for RPMI's pension admin business, which includes the Railways Pension Scheme (RPS) as one of its clients, as well as RPMI Railpen, which manages the £29bn of RPS assets.

Chilman brings over 25 years of pensions experience to his new role and joins RPMI from National Grid, where he was group head of pensions. He was previously group pensions director at FirstGroup and group head of reward at HBOS.

He is currently chair of the RPS Trustee, a position he has held since 2014, having been trustee director since 2007. He will be taking up his new role at RPMI in June.

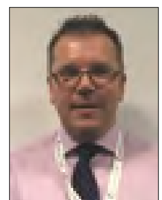
Commenting, RPMI chairman, Babloo Ramamurthy said: "John's past knowledge and experience of RPMI and his reputation as an innovative leader for many years in the pensions industry will be invaluable to ensure RPMI continues to deliver the trustee's mission of paying members' pensions securely affordably and sustainably."

Johan Cras

The Transparency Task Force (TTF) has appointed Johan Cras to the role of ambassador.

Cras is currently managing director at Kempen Capital Management, which he joined from Achmea Investment Management. Prior to that, he worked for Russell Investments for nearly 15 years.

TTF aims to drive up the levels of transparency and improve the quality of financial services.



Richard Beddall

Quantum Advisory has named Richard Beddall as senior benefits consultant.

Beddall joins the company with 12 years of experience in the flex and employee benefits industry. Previously, he spent three years as business project manager for National Express Group and held a range of flex roles with Benefex, Edenred and Lloyds TSB Group. His new role will be to develop and promote Quantum's flexible benefits proposition.

Clive Bolton

LV= has appointed Clive Bolton as managing director, life and pensions with immediate effect.

Bolton joins LV= after 11 years at Aviva Life UK, which included five years as managing director of retirement solutions. He is currently a consultant with the International Longevity Centre and a non-executive member of the Civil Service Pension Scheme Advisory Board. At LV=, Bolton will replace John Perks, who is leaving to join the Police Mutual Group as chief executive in April.

Commenting on the appointment, LV= chief executive, Richard Rowney said: "Clive Bolton is a hugely impressive business leader with a proven track record of growing and developing life businesses based around the needs of customers and advisers. He brings an extensive understanding of the life and pensions market and I'm confident that he'll contribute significantly to LV='s future success."

Commenting on the departure of John Perks, Rowney said: "John has played a key part in taking the life business from sales of £500 million a year to over £2 billion."

VIEW FROM THE AMNT

History studies of the world tend to classify Human advancement in the form of 'Ages'. So we have the 'Stone Age', 'Bronze Age', 'Iron Age', 'Industrial Age' and now the 'Information Age'.

The invention of the printing press in 15th century was the method by which new ideas spread throughout Europe and eventually the world, enabling the transformation of society through what we now term the 'Reformation'.

Similarly, the invention of the computer and subsequently the internet and the world wide web has enabled the Information Age. How this will be viewed by future historians is an open question, but what is clear is that it has shaped a knowledge based society based on personal needs.

Provision of that 'personal need' has seen the emergence of Google, Facebook, and a plethora of information-based services. In financial services the use of information (data) bases is now critical to investment decisions. With information a commercial product, knowledge is now closely guarded, however this conflicts with provision of personal need.

This conflict in the investment industry is seen in the arguments for transparency in fees, advice, governance, ESG and all issues affecting the ability of pension trustees to make considered informed decisions.

The AMNT in collaboration with UKSIF has produced a trustees guide *Holding Investments Consultants to Account* as part of this debate, for 'with great knowledge, comes great responsibility'.

AMNT member Stephen Fallowell

AMNT Association of Member Nominated Trustees

Market commentary: Brexit on sterling

On the day the result was revealed for the referendum on leaving the European Union, the value of sterling came crashing down.

Compared to the euro, for example, the value of the pound in the run up to the referendum was around €1.30. The day after the results it dropped down to around €1.22. Today (4 February) it sits much lower at £1 for around €1.14, having increased from around €1.10 at the beginning of 2019.

But in the two and a half years since the vote, sterling has never hit the pre-vote heights it reached, instead fluctuating between around £1 to €1.10 and €1.20. But what does this mean for pension funds?

State Street Global Advisers (SSGA), global head of currency, James Binny, believes that the vote has left sterling "significantly undervalued" against many currencies according to SSGA's measures, despite the rally in the past few weeks.

However, he says that the depreciation of sterling (therefore foreign currency appreciation) before and after the Brexit referendum led to a "significant windfall for pension funds who had not hedged their overseas exposure".

He says that it "makes sense" for pension funds to lock in that profit by having higher hedge ratios at this point, as currencies tend to revert to fair value in the long term. "The exception is the Japanese yen, which we believe is undervalued relative to sterling so we would suggest a lower hedge ratio – this will also help to provide some protection in the event of rising volatility as the yen tends to rise at such times," he explains.

With the outcome of the Brexit referendum still surrounded by a cloud of uncertainty, Binny says the shorter term is harder to predict. "However, given the undervaluation of sterling, a significant Brexit discount is built in we believe. This means that the risks are asymmetric – if the uncertainties are removed there is room for the currency to appreciate, and while it is always possible that the situation deteriorates further, a reasonably severe Brexit is already discounted, limiting the downside to an extent."

Currencies Direct chief market analyst, Phil McHugh, also notes that this continued uncertainty around Brexit makes it "very difficult to assess the future of the pound with any conviction". He adds that the value of sterling could easily spin 10 per cent lower or higher depending on the Brexit outcome, making any investment a very risky strategy.

"Longer-term investors such as pension funds will want to reduce the noise of foreign exchange market (FX) volatility impacting portfolios, especially when the market is implying higher volatility. With the outlook on Brexit still uncertain, funds should review their hedging positions to ensure they're as secure in their positioning as possible," he adds.

As the drama surrounding Brexit looks set to continue, possibly right up to the 29 March deadline, there will no doubt be more ups and downs for sterling. Pension funds should take note.

Written by Natalie Tuck

Soapbox: Are ICs pulling the wool over trustees' eyes?

It came to my attention last month that there was a possibility some trustees were being taken for a ride by investment consultants, regarding the remedies proposed by the Competition and Market Authority (CMA), after its investigation into investment consultants and fiduciary managers.

"Wake up and smell the coffee", trustees were told. The remedies were accused of being "spun so hard they have forgotten the key messages".

It was a clear warning for trustees, and the industry, that big players may feel they are allowed to flounce around the rules and regulations to which others abide.

While merely an accusation at this stage, if even remotely true, it is extremely worrying activity.

As well as highlighting that big firms may turn every which way they can to ensure the new proposals don't affect them, more generally speaking, it is not the only time in which investment consultants have been accused of pulling the wool over trustees' eyes.

According to many commentators, a blame game culture has been in play throughout the pensions industry for many years. Finger-pointing exercises were no more apparent than in the fallout from the major collapse of the outsourcing giant Carillion.

One thing that emerged was that trustees are often at the mercy of their advisers.

Most of the time it is a conflict of interest. It is of course possible that investment consultants may not want to actively advise people in another direction and say 'do not use all of our wonderful services', in spite of what the regulators might be pushing for.

More warning shots were fired recently when it was suggested that the CMA's requirement for trustees to tender for fiduciary managers should have a minimum standard in place, in order to avoid it being a 'box-ticking exercise'.

It begs the question, does the CMA's proposal requiring trustees to run a competitive tender before they choose a fiduciary manager for more than 20 per cent of its assets go far enough?

It is certainly a step in the right direction. Trustees will hold information that they will have previously not known will have existed, which could well lead to lower fees and improved performance. But this relies on the assumption that trustees will be taking this remedies verbatim. The above suggests they are not.

What it does do is highlight that trustees need help, or is it that the current system is fundamentally failing the lay trustee, who perhaps simply cannot cope with the layers of regulation it now finds itself wading through?

It is clear that some industry professionals do not hold the lay trustee in high esteem.

If a trustee cannot trust the best intentions of the advice being given, then where do they stand? Is more professional trustees the answer?

It is the closed loop of our industry. Advisers are often seen as the true power behind the running of pension schemes, with trustees often not being able to challenge. This has to change. We need to "wake up and smell the coffee".

Written by Theo Andrew

VIEW FROM THE PMI

In the past month we have seen a significant change in the way that information about pensions and other financial services is provided to the general public. The Money Advice Service, Pension Wise and the guidance function of The Pensions Advisory Service (TPAS) have come together to create the new Single Financial Guidance Body or SFGB as it is prosaically known (for now).

Whilst many within the pensions industry will mourn the loss of established and well-loved bodies, the case for bringing guidance services under the one roof is sound. In particular, splitting the delivery of Pension Wise between two separate bodies had potential for confusion. The public will now have a single point of contact for advice on financial matters, and this is surely a step forward.

The scale of the challenge facing the SFGB cannot be underestimated. A decade after the collapse of Lehman, millions continue to struggle with high levels of debt and the challenge of managing finances effectively from one payday to the next. Free, high-quality information about retirement is vital in an era when the public continues to face an unprecedented range of options for using money accrued in registered pension funds. With countless rogue agents competing with legitimate and appropriate investment propositions, the SFGB's role in the fight against pension scams and in helping people avoid these pitfalls will be pivotal.

We should wish Sir Hector Sants and his team well; the financial wellbeing of millions depends on their success.

PMI technical consultant Tim Middleton

VIEW FROM THE SPP

Up to about 20 years ago, if you joined a pension scheme in most cases it would pay you a pension after you retired. These days though, hardly anyone who's been auto-enrolled into a pension scheme is in line for a scheme pension.

They can still get an income for life from a money purchase pension scheme, by using their retirement pot to buy an annuity; but they've heard annuities are a bad deal, so they won't do that. The potential alternatives from an occupational DC scheme are to cash out, opt for income drawdown; or transfer to another DC provider.

Whichever option they choose, they won't be very happy when the money runs out – as it will do, unless they had a very large pot to start with. Not long ago, advisers would decline to recommend drawdown for pots less than £250,000. You need that kind of money to generate investment income to bolster withdrawal of capital.

There's a better solution on the horizon though, with collective defined contribution (CDC) schemes. CDC shouldn't cost a sponsoring employer any more than contributions to a master trust or personal pension scheme, but it will offer members a scheme pension for life with the likelihood of securing a higher target income. Investment and longevity risks are effectively pooled.

CDC isn't a magic wand. There are no guarantees, and scale is vital. Royal Mail will be the pioneer; other employers will see a potential advantage it gives them in the recruitment market. The DWP is consulting this month; we need legislation by the summer.

SPP DC Committee member, Ian Neale

THE SOCIETY OF PENSION PROFESSIONALS

In my opinion

On the potential increased public pension costs of around £4bn

"The government's attempts to reduce the cost of public-sector pensions, ensuring they remain sustainable for future generations in the face of people living and working longer, is facing a serious challenge. Pennies are tight in the Treasury, so finding a rather chunky £4bn every year will cause much head scratching. It could also pitch the public- and private-sector workers against one another, just as the current *[judges and firefighters]* case highlights inequalities across age groups."

Hargreaves Lansdown senior analyst, Nathan Long

On the DWP's consultation on defined benefit consolidation

"We have a rare window of opportunity to do something radical that would simplify pensions for millions of people. With a pensions bill expected in this year's Queen's Speech, legislation could remove barriers to simplifying member benefits, which would make it easier for members to understand their pension rights and cheaper for schemes and employers."

Royal London director of policy, Steve Webb

On the DWP's pension dashboard consultation

"The dashboard has the potential to reconnect people with their pensions. By providing a one-stop shop for viewing pensions, dashboards can help people plan for their retirement, leading to better decision making and outcomes. We very much support a non-commercial dashboard being offered by the SFGB. This will be an important pillar in establishing trust in the dashboard."

Smart Pension head of policy, Darren Philp

On the Work and Pension Committee's inquiry into contingent charging

"The FCA has confirmed to me that it shares many of the committee's concerns about the scourge of contingent charging. But to tackle this, and to protect consumers from the vultures circling around their pension pots, it needs more proof of what is really happening to people."

Work and Pension Committee chair, Frank Field

On the FCA's plans to introduce investment pathways for consumers

"The pension freedoms give consumers more flexibility in how and when they can access their pension savings; but that also means they have to make more complicated choices. Our *Retirement Outcomes Review* identified that many consumers are focused only on taking their tax-free cash and take the 'path of least resistance' when entering drawdown. This can often mean that the rest of their drawn down pension pot is not invested in a way that meets their needs and intentions."

FCA executive diretor of strategy and competition, Christopher Woolard

Understanding the risks at-retirement

Retirees now have more freedom and choice regarding their pension pot than ever before, but with that increased freedom comes increased risks. Jonathan Watts-Lay discusses these risks

There is no doubt that freedom and choice in pensions is liked by many individuals but it has also increased the risks and complexity for all. Employees and members now face a whole host of issues such as falling for a scam, paying more tax than necessary or not understanding the risks around defined benefit pension transfers, and ultimately not optimising their retirement income.

With this in mind, let's take a look at some of the risks.

Tax

Over a quarter (27 per cent) of individuals over the age of 55 didn't realise that they have to pay tax on their pensions if they take the whole fund as a cash lump sum. This perhaps suggests why The Office for Budget Responsibility recently reported that the revenues raised from the pension freedoms in 2018 would be 50 per cent more than forecast and indicates that individuals are often paying tax when it could have been avoided with careful planning.

Scams

The FCA estimated that victims of pension fraud lost on average £91,000 each in 2017. Many are hoping that the new legislation making pension cold calling illegal will help the situation. However, individuals will still need to be alert as it's not going to stop all fraudsters, including those who are calling from overseas. Taking regulated advice and getting the additional consumer protection it offers should not be underestimated.

Defaults at-retirement

Some in the pensions industry believe that default retirement pathways protect individuals from making poor decumulation choices. However, I don't believe that anyone should be defaulted at-retirement without receiving financial guidance and making a proactive decision first.

This view is supported by a recent poll by WEALTH at work, which found that 86 per cent of respondents believe that employees should not be defaulted into a decumulation pathway at-retirement without financial guidance.

Defaulting individuals into something without a positive choice being made raises questions over if it's within the pension providers or the member's best interest and the effects could be costly. After all, it discourages shopping around and risks destroying freedom and choice in pensions. Additionally, if those with more than one pension default based on individual pots rather than the collective value the likely outcome will be sub-optimal.

DB pension transfers

Defined benefit (DB) pension transfers have hit the headlines over recent times bringing member support under the spotlight.

Even though regulated advice must be sought to transfer a DB pension if its value is £30,000 or above, there is no requirement to take ongoing advice and no guarantees that future income needs will be met.

Offering partial transfers can be an efficient way for schemes to manage liabilities and can also help members avoid the cliff edge of total transfer or no transfer. Only about 15 per cent of schemes provide this option now but our poll found that 85 per cent trustees and employers were in favour of all DB schemes offering it.

Guiding the way

Individuals really need to understand their options at-retirement, including the generic advantages and disadvantages of these, as well as considering associated risks such as tax inefficiency, longevity or losing money to scams.

Financial education and guidance at-retirement can help with this and will enable individuals to make informed choices, including being able to decide if they need further support such as regulated advice.

Although there are concerns over the take up of Pension Wise, nine in ten customers who received guidance were satisfied with the service. Our experience is that following financial education and guidance, employees emerge more confident, knowledgeable and more able to make informed decisions.

Employers and trustees are perfectly placed to facilitate access to a breadth of services including financial education, guidance and regulated advice, to help employees and members fully understand their options. However, there are still big gaps in the support available which is why we are calling for this provision to be made the norm.

Written by Jonathan Watts-Lay, director, WEALTH at work

In association with WEALTH at work

Lesley Carline, PMI President

Laura Blows, Editor, Pensions Age

All change

Laura Blows speaks to PMI president Lesley Carline about how the institute is continuously adapting to cater to evolving industry requirements

You became PMI president in July 2018 and since then there has been a number of developments, both within the pensions industry and beyond. What do you think will be the main issues you need to address during your time as president?
You'll have noticed there's been one or two consultations, coming thick and fast before the end of 2018, all gearing up to the pensions bill in 2019. So I think, if we ever get a pensions bill in 2019, we'll have a lot of work to do.

The pensions bill is looking to cover DB consolidation, which is a very interesting concept and one that I do think has wings for certain parts of the industry. We also have the pensions dashboard and hopefully that is another step towards the pensions nirvana of people being able to do their retirement planning by seeing everything with their pensions, wherever they are, but also eventually with links to open banking, seeing their other investments. So I am very hopeful around that.

CDC – will it or won't it take off? That's a big question. There are parts of the industry who think it is a little too late, particularly for the private sector, but it might have some application in the public sector, where they still have very large DB arrangements.

And there are the governance aspects and a lot of the fallout that we saw with BHS and Carillion and the lessons learnt from the governance we have seen coming into DC, such as the chair's statement, moving across to DB. Also some of the governance aspects of master trusts going into single-trust DC. So we have got a little bit to be getting on with if we ever get past Brexit.

The PMI is well known for providing education and training across all aspects of the pensions industry. I understand it's recently been undergoing a review of its education programme. Could you tell me what that entails?
The PMI has at its core professional pension qualifications that we do across the board, from people entering the industry, with vocational-type qualifications for if they want to be an administrator, but we also provide skills for those that want to go into scheme management, or for those who work in different areas that are aligned to pensions, which they need to know about. So we do have a broad brush of qualifications.

One of the things that came out of the review was that we needed to look at the delivery mechanisms, making qualifications more accessible and easier to sit – but definitely not easier to take.

Last October we trialled online qualifications for the first time and it was very successful, so come March we will roll it out across the board. Eventually you should be able to sit your qualifications anytime, anywhere.

We are also making a concerted effort to push our 'fab five' qualifications. The first one is our award in pensions trusteeship, which is quite timely because TPR is going to be announcing the accreditation programme for professional trustees, which the PMI is heavily involved with, and we will be the accrediting body.

There is also our certificate in scheme guidance for members. A lot of providers are now using call centres, so through this qualification, they are teaching their administrators how to talk people through their retirement process.

The international diploma in employee benefits is always very popular for those who have worked their way up their career and are now looking after international benefits and not just UK ones.

The RPC – Retirement Provisions Certificate – is a good all round one for people who are new to the industry. And then the one I'm particularly interested in is the certificate in DC governance. That's a standalone qualification and it's good for trustees or for people who have already got pensions qualifications but want to brush up on how to look after DC.

You mentioned DC governance being of particular interest to you. Why is that?

I've been in the pensions industry for 20-something years, and most of that has been in DC. The changes I have seen over the years have been immense. The days where you had a few people in a nursery scheme are long gone and we see millions of people who are going to be relying on DC as their sole pension in retirement so I think it is important that we get it right. No longer can we give trustees five minutes to look at DC. It needs an entire day looking at it.

There are so many things that can go wrong with DC. There is this perception that DC is easy because it's all automated. I can tell you it is not easy. It is particularly not easy when it does go wrong, so part of the governance aspect is looking for the pitfalls and making sure the risks are mitigated. So I'm all for trustees looking at this certificate.

We can't talk about DC without mentioning master trusts. I believe the PMI recently revealed its report looking at good service delivery for master trusts?

The master trust working party is one of our first specialist interest groups – we will also be launching one on the DB end game, one on employer covenant and one on ESG. We got together around a year ago with a group representing master trusts and their suppliers. The master trusts themselves want to deliver good service so decided to look at what may be preventing good service.

We surveyed the larger and smaller master trusts and we launched our report in December 2018 about the things they felt got in their way. As a result of this we are creating a body within the PMI to give them a platform for overcoming the issues they have encountered.

These were things like them being supportive of the master trust authorisation process but then there were concerns that the law of unintended consequences would apply. So they didn't want it to be too prescriptive.

They also expressed concerns that as master trusts grow and develop, there will be this different area of conflicts that trustees have to look at because master trusts are a commercial entity, as opposed to running a single trust, so there are different conflicts to think about. They are already used to managing conflicts; they just want some guidance on how to do it.

The PMI has also been working with NextGen, the industry body that is helping younger people both enter and progress within the pensions industry. What advice would you give the industry to help younger people join – and actively join, not just fall into the sector as we so often hear?

It is an area that I'm particularly passionate about. I wouldn't be where I was if people hadn't helped me throughout my career. There used to be a tradition of people falling into the pensions industry by accident – I know I did – but providers are now 'growing their own' by taking on graduates and school leavers.

The PMI is helping them by providing the apprenticeship framework. We have been appointed as assessor for level three apprenticeship and that is for people coming from school, maybe going to one of the large EBCs, and becoming an administrator. So they can do their pensions qualification through the apprenticeship network.

Also for those who are a bit older and want to do a degree level qualification, we are looking to launch a level six apprenticeship qualification, and that would be the advanced diploma in retirement pensions, for people who maybe want to go onto be scheme managers or consultants.

Moving on from people starting their career in pensions, to career highlights, what would you like to achieve during your time as PMI president?

What I would like to see by the end of my time is the PMI being in a position where it continues to deliver to meet the needs of the members. The members' needs have changed, as the pensions landscape has changed so I want to ensure that the PMI is in a healthy position, that it's dynamic and that it's flexible enough to deliver what our membership wants, for now and for the future.

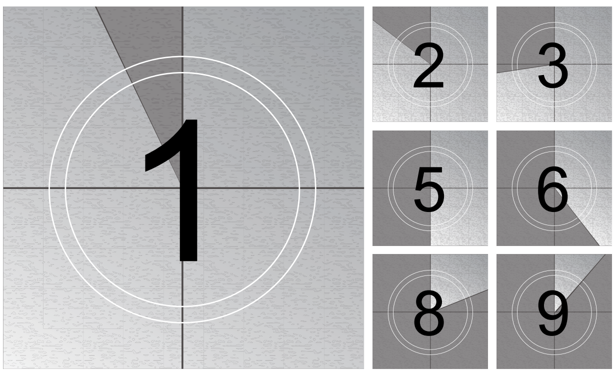
To view this video, visit pensionsage.com

Written by Laura Blows

In association with Pensions Management Institute

The final countdown: Master trust authorisation

Duncan Howorth discusses the important role of data in the master trust authorisation process and beyond…



How important is data to the authorisation process?
The Pensions Regulator (TPR)'s 51 page questionnaire on systems and processes centres around a scheme's ability to receive, protect, process, evaluate, report and act on its data. With key administration tasks such as; processing core financial transactions, contribution reconciliations and investment, membership movement statistics, annual benefit statements, transfers in and out, investment switches and member online access all underpinned by data, processing and systems – data is, quite rightly, an essential component of authorisation. That's without the potential future requirements for dashboard or anything else that might come along.

What about those not looking to go for authorisation, what should they be thinking about in terms of data?
It's important to understand the overall picture when delving into these areas. Once a scheme notifies TPR of a triggering event, the trustees must either transfer out all members and wind up (continuity option one), or resolve the triggering event to continue operating (continuity option two). There is then a number of actions to undertake within a three-month window; before the start of the implementation phase of continuity option one. They must notify employers in the scheme within 14 days, prepare and submit their implementation strategy within 28 days as well as determine what the default scheme will be.

Back to data, during the implementation phase there are a number of member notifications that must happen, followed by the transfer of members. Reconciled and clean data will be essential to ensuring these happen as smoothly and efficiently as possible. If a scheme is on the cusp of financial viability – time will be of the essence, being 'data ready' for member transfer will save significant time and aid the due diligence process when looking for a default scheme.

The other obvious point to call out here is data migration. Taking member records, transfer values and contribution history from one database to another, needs to be done in a controlled, robust and secure way – and may well need external expertise.

What sort of timescales are we looking at here?
At the beginning of January TPR confirmed 90 master trusts in the market. Six have applied for authorisation; 29 schemes have decided not to apply for authorisation and six schemes have wound up. Leaving a further 49 schemes to either apply for authorisation or trigger their exit from the market by 31 March 2019.

That's a substantial volume of consolidation in potentially short timescales. Preparation is key to success; scoping the size and scale of work required will help with project planning and implementing continuity option one. Well-considered sequencing is key to any data project. Some tasks can be started immediately – data analysis and cleansing; this can take anything from eight weeks to eight months. Once a default scheme and platform, or system, has been agreed, the next phase is the mapping requirements. This has a multitude of dependencies and can range from a few weeks to several months and iterations. Finally, there will be a controlled migration, usually iterative, to reduce risk and taking place over a period of weeks.

What are the ongoing data impacts?
Trustees are ultimately accountable for their scheme's administration – even if it is outsourced. They must understand the data controls and quality checks that are in place and review these. This may result in an amendment to procedures to improve the management (and quality) of data. Ultimately data is the lynchpin to operational efficiency. If we loop back to the first question and all those key administrative tasks that rely on data, add to that the requirement to include common and scheme-specific data scores as part of the scheme return, the importance of data is only increasing.

Written by ITM executive chairman Duncan Howarth

In association with

itm
Solution delivered…

Small spaces

Jack Gray ponders whether there's any space for small defined benefit schemes in today's market

As the DB pensions landscape gradually shifts towards consolidation, smaller DB schemes could become a thing of the past. Larger vehicles may represent a more stable and less expensive option to smaller employers who wish to try and minimise insolvency risk by becoming part of a consolidated scheme.

However, some smaller DB schemes are effective at meeting the needs of stakeholders. Every employer is different, and smaller schemes could offer a more tailored and personal service that a large master trust would find it more difficult to provide.

Relevance

With the industry focused on DB scheme consolidation, it could be argued that the relevance of the smaller schemes is waning. However, smaller DB schemes are currently very commonplace, and although master trusts could be the future, it is impossible to say how long it will be before they are widely adopted.

"Around 4,000 DB schemes have assets below £100 million, which represents a massive 74 per cent of all DB schemes in the UK," says Hymans Robertson partner and head of trustee DB, Susan McIlvogue. "Therefore, small schemes are very relevant in the current market."

Barnett Waddingham associate, Tom Hargreaves adds: "Schemes with less than 1,000 members make up 80 per cent of the UK's DB schemes by number, but only represent around 10 per cent of the total liabilities. A lot of focus is therefore placed on the larger schemes which make up the majority of the liabilities."

Small issues

Despite this, McIlvogue admits that smaller DB schemes are "facing significant challenges that need to be addressed in order to improve the security of peoples' retirement income".

"The regulatory burden on trustees is immense and shows no sign of reducing," begins TPT Retirement Solutions head of direct distribution, Adrian Cooper. "This at a time when replacing trustees is becoming more difficult year-on-year as the candidate pool diminishes. Smaller schemes are also unable to access sophisticated funding and investment strategies."

Due to their size and funding, some smaller DB schemes find it difficult to keep up with the ever-increasing regulations and requirements.

"Increased complexity changes in legislation, regulation and governance have made the maintenance of small DB scheme less attractive or viable," says Citrus DB Master Trust employer nominated trustee, Michael Penny, "DB schemes are declining and so is employer priority, especially for employers where the DB scheme is closed and where attention is needed to ensure successful outcomes of DC schemes that are acquiring new members."

Consolidation

The perceived poor value for money offered by smaller schemes is compounded by a recent study from Citrus, which reveals that smaller DB schemes could save up to £700,000 in costs, if they group together when targeting full buyout. It finds that schemes with assets under £10 million could expect to save around £400,000, while schemes with assets under £50 million could save up to £700,000.

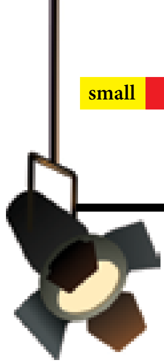
"Key advantages associated with DB consolidation include much lower operating costs. Many schemes have multiple advisers and cost per member scheme charges can be disproportionate," adds Cooper. "Other advantages include time saved by the finance director and executive team managing the scheme – our small schemes survey showed that financial directors were spending as much as 45 days per year on their scheme – at huge opportunity cost."

So is there anything smaller DB schemes can do to stay relevant?

"The key task is managing liabilities and ensuring pensions are paid," says SSGA head of pensions and retirement strategy, Alistair Byrne, "Larger schemes have significantly adopted liability-driven investing approaches, often on a segregated basis. Smaller schemes can adopt similar strategies using LDI pooled funds.

"Often these funds have been less efficient or flexible than segregated approaches, but new strategies that are more capital and collateral efficient are becoming available."

Written by Jack Gray



Sink or swim

Jack Gray explores the future of smaller defined contribution schemes and whether they provide good value for members

DC pensions are becoming more commonplace as the industry moves away from DB pensions, but the future of smaller DC schemes could be under threat. Higher governance, increasing costs and consolidation are casting doubt on the viability of smaller DC schemes.

Member value

In September 2018, The Pensions Regulator (TPR) released its annual DC survey. It found that the trustees of just one in 10 'small' schemes and one in three 'medium' schemes are doing "everything which TPR believes is essential to assess value for members". This includes having good knowledge and understanding of member costs and charges, and completing a yearly assessment of the value the scheme provides.

The same study also found that just 41 per cent of trustees are researching what members value and taking it into account.

Governance

Improved governance for pension schemes could also present a threat to the future of smaller DC schemes. Although more stringent regulations could improve member experience and outcomes, the increased costs and time taken can have a negative impact on smaller schemes as they don't have the funds or manpower of the bigger schemes.

Increasing governance will also require trustees to plan ahead to deal with the changes, as Hymans Robertson partner and senior investment consultant Rona Train explains: "Pension scheme governance is becoming an increasing priority for smaller DC schemes, as ramped up Chair's Statement requirements come into force this year.

"This will be a significant change and by now even the smaller schemes should be making plans on how they will deal with the additional costs and charges disclosure requirements it will bring."

Consolidation

One of the possible solutions to dealing with increased governance and satisfying members' needs could be consolidating DC schemes into master trusts. The current debate on the merits of master trusts will most likely rage on until they have been tested in the real world.

Train suggests that they could be a positive change for the industry, saying: "For every well-governed smaller DC scheme there are likely to be more schemes struggling under the burden of increased regulation and governance requirements. For these schemes, moving to a master-trust arrangement may not only be a viable option, but could also lead to better retirement outcomes for their members."

Despite this, River and Mercantile Solutions head of DC solutions, Niall Alexander, says that consolidation isn't for everyone and small DC schemes still have a role to play.

He says: "There is a place for smaller schemes in today's DC landscape, and we are having lots of conversations with trustees who are telling us they are very happy not consolidating.

"This is primarily driven by paternalism: employers want to be able to demonstrate they are looking after their employees by appointing best of breed advisers and suppliers to get the best possible outcomes for members, and this is best done by keeping the pension scheme in house rather than relying on one provider."

However, this may not be the case with all smaller DC pensions, as TPR's annual DC survey found, but Alexander insists there are other reasons small DC schemes may not want to consolidate into a master trust.

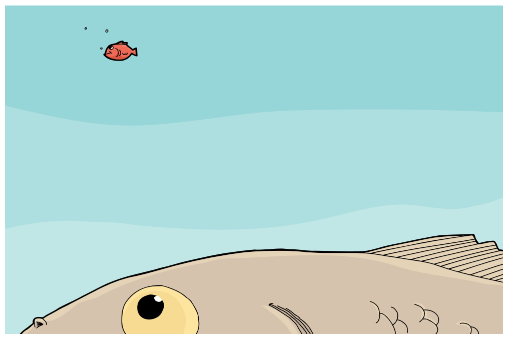
"A small scheme can often pay the same investment fees as a larger scheme. It can access the same suite of investment funds: from passive index-tracking funds or ETFs, through to more actively managed strategies or non-daily dealt funds," he explains. "And crucially, this means we as investment advisers can give the same investment advice to all schemes – size is not an impediment to small scheme success."

It seems as if the jury is still out on the way to make the most of a smaller DC scheme, and it may take some real-world experimenting before we know what future role they have to play.

Written by Jack Gray

A small fish in a big pond

Consolidation and member uncertainty could pose threats to small pension providers. Jack Gray examines whether they have any influence in today's market



Smaller pension providers could face an uncertain future as the market shifts towards consolidation and greater emphasis is placed on member security. It seems as if it is difficult for small providers to ensure members have the same level of stability as they would have with the larger providers, but it does not necessarily mean that they are irrelevant.

Obstacles

In order to compete, smaller providers need to be able to convince employers that they can provide the same, if not better, value to their members than the larger providers. However, this could be easier said than done as smaller providers' resources are often dwarfed by those of, for example, Nest or Aviva. With members likely to be more interested in having a scheme that presents little risk, we could see the influence of smaller providers on the market starting to wane.

This, in part, has led to the industry moving towards consolidation, which could spell bad news for the smaller pension providers, as it is typically the large providers that are able to establish and run master trusts.

Furthermore, master trusts could help the bigger providers become even bigger, potentially squeezing small schemes out of the market. Barnett Waddingham partner, Paul Leandro, explains: "As more and more small schemes transition to larger master trusts, and the master trust consolidates, we will have less market competition. Then we could have the scenario, like in Australia, where the larger schemes will not have to put in much effort to secure members' contributions.

"This could naturally stem the spend on innovation, as the argument could be that from the providers' perspective, 'there is no reward for innovation.'"

A recent study from Lincoln Pensions finds that more than half (52 per cent) of pension professionals believe that superfunds will become 'more commonplace', which could be bad news for small providers. However, the same survey finds that 35 per cent believe it will become a 'highly unusual approach applicable to only a very small number of schemes'.

Lincoln Pensions director, Adolfo Aponte says: "While superfund consolidation is not going to be right for everyone, it is clear that pension professionals believe it could be right for a number of schemes, if an appropriate regulatory framework can be put in place."

Potential solutions

Despite the issues, smaller providers could offer flexibility and a more personal experience that many of the larger providers cannot. In order to remain relevant, smaller providers may have to stand out amongst the bigger providers. Barnet Waddingham partner, Mark Futcher, insists that this is possible through offering unique benefits.

"Small pension providers will have to offer something different and enhance value over the stability, efficiency and economies of scale that larger providers offer," he says. "This is likely to be in the form of bespoke niche services, or having taken advantage of new technology on a more 'start up' basis."

Smaller providers could entice employers and employees by offering services that focus on issues that the member may be passionate about, such as responsible investing, prioritising environmental, social and governance factors or favouring high risk, high reward strategies.

Influence

In order to remain influential in the pensions landscape, smaller providers may have to become experts in creating bespoke services that will set them apart from the competition. However, some schemes seem to have already realised this. Futcher says: "There is clear evidence that smaller pension providers are influencing the market. Some are technology heavy and aimed at small and medium-sized enterprises, which had to comply with auto-enrolment, and are now becoming mainstream, with ideas and technology filtering into the major providers."

This could quell some of the fears consumers have, as they may be willing to sacrifice stability to get the pension that is perfect for them. Futcher concludes: "The ability to be nimble, innovative and change old ways of working is vital in the DC pensions market."

Written by Jack Gray

Making an entrance

Commercial consolidators – aka superfunds – have entered the DB de-risking market to a flurry of interest, with the first schemes to join them expected to move soon, possibly once regulatory oversight is confirmed. Laura Blows explores these new entities and the considerations trustees should have when contemplating consolidation

Summary

- Interest in DB consolidation has occurred in recent years due to rising deficit contributions, high-profile pension scheme failures, such as BHS and Carillion, and government consultations into its feasibility.
- A new model of DB consolidation has emerged, that of superfunds. With these, the entire responsibility for the scheme is passed to the consolidator to manage for a lower cost compared to an insurance buyout. However the level of security for the members' benefits is higher with a buyout than in a superfund.
- So far two superfunds have entered the market - Clara Pensions, which manages each scheme's money in separate sections until buyout is achieved, and the Pension SuperFund, which works on a self-sufficiency model with all its schemes' assets and liabilities combined.
- Trustees have to determine the level of control they are willing to relinquish when deciding on which of the various consolidation options, such as asset pooling, DB master trusts, commercial consolidators or buyout, to undertake.
- Despite the regulatory structure of superfunds still being determined, commercial consolidators are expected to have a key role within the DB de-risking market.

When someone new enters the room, it's only natural to take a look. If, as they enter the room, murmurs spread that the entrant may just spark new life into the party, excitement and anticipation builds.

So it is with the emergence of a completely new type of DB scheme solution – that of the commercial consolidator, also known as superfunds. For the first time, trustees can move their DB scheme into one of these models and sever the sponsor's ties to the scheme, without it having to be sufficiently distressed to fall into the PPF or having to pay the higher costs of an insurance buyout.

Growing need

It is therefore no wonder this new middle ground option is turning heads. But their walk into the pensions 'room' has been gathering pace over recent years.

Hymans Robertson partner and head of corporate DB Alistair Russell-Smith points out that of the 5,500 DB schemes in the UK, around 4,000 are under £100 million. "It costs around £8 billion per annum in adviser fees and asset management fees to run these schemes. Economically it cannot be efficient to carry on like this."

It may not be efficient, but these costs are nothing new. Attention on the matter increased recently due to greater awareness of the amount of covenant risk faced by DB schemes, as demonstrated by recent high-profile corporate failures such as BHS and Carillon, Lincoln Pensions director Adolfo Aponte states, along with "a desire to show that the UK is open for business against the backdrop of Brexit and a record amount of deficit contributions paid by UK companies".

Also spurred on by the PLSA's work highlighting the benefits of DB consolidation, the government swung into action with the Department for Work and Pensions (DWP) White Paper, *Protecting Defined Benefit Pension Schemes*, published in March last year, which proposed a consultation into DB consolidation. Submissions for the consultation closed earlier this month, with expectations that DB consolidation will be included within the upcoming pensions bill this year.

With this, the political and industry opinion has shifted, Society of Pension Professionals (SPP) president Paul McGlone says. "With so many companies collapsing with a pension scheme left behind, it has become more widely accepted that consolidators making money out of running legacy schemes is reasonable if it allows UK plc to better honour its pension obligations."

So far, two commercial consolidators have entered the arena, each offering a different version of consolidation.

The superfunds

Clara Pensions is one of the new superfunds. Its model is to serve as a bridge between the pension scheme and insurance buyout.

Instead of cross-pooling, Clara Pensions works on a sectionalised model, whereby the assets and liabilities of each pension scheme consolidated into Clara's scheme will become their own section, supported by their own ring-fenced and funded capital. This capital will remain available to that section until all members' benefits are secured through a buyout. Only once every member in a section has had their full benefits will Clara's investors receive a return on capital.

Its CEO, Adam Saron, describes this as a 'member first' model. "We want to take on responsibility for pension schemes today and provide them with a safer and more efficient journey to

buyouts in the future," he says.

Instead of aiming for buyouts, the other commercial consolidator on the scene, The Pension SuperFund, has a 'run off' model akin to scheme self sufficiency. Also in contrast to Clara, The Pension SuperFund is non-sectionalised, so all the transferring schemes' assets and liabilities are blurred.

Each year, it says, one-third of any improvement in The Pension SuperFund's funding level above 100 per cent will be paid into a separate members' trust, which The Pension SuperFund determines will either be used as a one-off payment to members or held in reserve.

This is unusual, The Pension SuperFund managing director, asset and liability management and solutions, Antony Barker, states, as "one discussion I can be pretty sure that has never been had when the FD meets the trustees is 'you know all those deferred pensioners, is there any way we can make their benefits bigger'?"

Suitability

Neither Clara Pensions or The Pension SuperFund claim to be a solution for every type of scheme and scheme circumstance.

According to Aponte, superfunds will be looking for schemes that are closed to future accrual and have a meaningful population of deferred members. Distressed schemes are unlikely to be of interest, as "consolidators are commercial entities and will look to take schemes that can afford their entry requirements", Pensions Management Institute (PMI) president Lesley Carline explains.

So it seems the individual scheme's circumstances would be a major factor in determining whether to enter into a commercial consolidator, and if so, which one would be most appropriate.

"A scheme that is a few years away from buyout may find there is less risk spending those final years within a consolidator targeting buyout than working alongside its own sponsor," McGlone says. "A scheme going through wind up with benefits higher than PPF levels but lower than 100 per cent may conclude that a better option is to pass the benefit to a consolidator who can use outperformance to fill some of the gap in member benefits."

According to Russell-Smith, Clara appears to be an easier structure for trustees to agree to. "The sectionalisation means the health of the rest of the fund is not a concern, and the security of members' benefits appears higher than The Pension SuperFund," he states.

"However, in practice there may not be many situations where trustees face this choice. As an example, if The Pension SuperFund is cheaper than Clara, the sponsor may only be willing or able to fund a transfer to the Pension SuperFund. The decision for the trustees would then be The Pension Superfund versus the status quo, rather than The Pension Superfund versus Clara," he adds.

Trustee considerations

Trustees have a number of factors to consider when weighing up the pros and cons of consolidation. These include the cost, employer covenant, the consolidator's ethics and philosophy, member benefits, governance structure and the overall endgame for the scheme.

Moving the scheme into a commercial consolidator, where it can benefit from economies of scale and remove the sponsor from any further obligation following this last payment to the superfund – at a lower cost than handing over the scheme to an insurer through a buyout – seems likely to be beneficial to many.

"A buyout is never really going to be on the radar for very many schemes and employers," Pensions and Lifetime Savings (PLSA) head of DB Joe Dabrowski says. "They're in a position where they have to either run on or they all end up in the PPF. Giving them something that's a little bit more in their reach, that is also very secure and robust, is very welcome."

An additional benefit, Carline adds, is that the commercial consolidators are likely to offer DC level of member communications, such as financial education tools, along with online services.

But ultimately, trustees must weigh up the loss of the employer covenant against the upfront cash injection and subsequent financial covenant from the capital buffer in the commercial consolidator and decide whether their members will be better off and their benefits safer in or out of the consolidator.

Member benefits within a consolidator do seem broadly safe, as their higher funding level requirements and lower risk investment strategy increased the probability of all member benefits being paid out in one case from 56 per cent to over 99 per cent in Clara, research from Hymans Robertson found.

There are no legal barriers for schemes to move into a commercial consolidator, Hogan Lovells partner Duncan Buchanan says, but "there is risk for both trustees and more importantly, for members because the business model of the commercial consolidators is yet to be tested".

But according to Sackers, there are barriers to full-on consolidation, such as considerable upfront costs, covenant information and confidentiality, and the difficulties involved in consolidating schemes with different benefit structures. "Whether these are all legal barriers is a moot point but there is certainly a need for the new market consolidators to prove themselves and show their business models will work if there are adverse events," Sackers partner Janet Brown says.

For the Association of Member-Nominated Trustees (AMNT) committee member Bill Trythall, this, along with the lack member representation within the management structure of commercial consolidators, is a cause for concern.

"There has been great focus on superfunds' authorisation structure but less so on the supervision side," Trythall states, "which we believe is slightly worrying as to whether they will be monitored once they are up and running, particularly without anybody whose role it is to blow the whistle."

As there's a certain amount of political weight behind it, another worry is if commercial consolidators do not work out well, things may be altered so to improve the consolidators' lot, "meaning the risk to the members is correspondingly increased", he adds.

At some stage it is "almost inevitable" that a consolidator will fail, McGlone says. "Trustees will have to accept that risk going in, and the test will be how that is managed. But to point back to the sponsor at that time and say 'the sponsor is still solvent' would be flawed, as a key reason that the sponsor survived may be because it was able to pass the pension scheme to the consolidator."

Spectrum

Pension Insurance Corporation (PIC) chief origination officer Jay Shah warns that trustees will come under "immense pressure" to transfer to a superfund rather than to an insurer because it is cheaper. "It is cheaper precisely because it is less secure *[than a buyout]*," he states.

The commercial consolidators themselves agree that well-funded schemes should not be considering this solution, and instead should aim for

buyout. "We estimate that 12 per cent of the FTSE350 are already sufficiently well funded to buy out," Russell-Smith says. "However, commercial consolidators are likely to take off for the next tranche of schemes where buyout is still over five years away, and the cash injection required to transfer to a consolidator is very material to the prospects of the scheme."

But superfunds and buyouts are not the only options available for trustees looking at de-risking their scheme through consolidation. Instead, there is a broad spectrum of possibilities.

The choices depend on the amount of scheme control the trustees are willing to sacrifice. On the one side is the pooling of investments or administration services in order to achieve cost efficiencies through economies of scale. Here the trustees still maintain control of the scheme. On the other side are insurance buyouts, whereby the trustees and sponsor can hand over the entire responsibility of a scheme to an insurer for a fixed cost. The insurer then guarantees member benefits will be paid in full.

Commercial consolidators sit just below buyouts, whereby the trustees and sponsor still hand over responsibility for the scheme, but for a cheaper cost than a buyout. However, there is still the risk that the consolidator now running the scheme may itself fail, and member benefits not paid out in full (which would have been guaranteed under a buyout).

Below commercial consolidators is that of DB master trusts, which provide some of the benefits of consolidation in terms of governance and operational efficiencies, while not 'cutting the cord' with the sponsor relationship – unlike superfunds that replace the existing sponsor covenant, Employer Covenant Working Group chair Donald Fleming says.

"In principle, a DB master trust can accommodate any type of scheme, such as very small to very large, closed and open to accrual. However, the advantages of a DB master trust are probably most obvious for smaller schemes, where the scale of a DB master trust offers the prospect of lower running costs and access to a wider range of asset classes, plus improved governance," Citrus DB Master Trust trustee Michael Penny says.

A DB master trust can provide a scheme with savings of around 30 per cent typically, TPT Retirement Solutions head of direct distribution Adrian Cooper states.

"Another reason why schemes may use a DB master trust may be due to succession planning issues with trustees on the scheme," he adds.

Taking action

But what should those schemes whose trustees have decided upon a commercial consolidator do to prepare for the move?

The Pensions Regulator (TPR) provides guidance for schemes in this situation, but according to Russell-Smith, those wanting to move should ensure they have clean data to speed up the transaction. They should also engage early with the consolidator to avoid pitfalls such as spending a large amount on consulting, to only then find out that the move is not possible.

Many are not yet at this stage. Most trustees are interested in this topic but "for the majority it is just window shopping at the moment rather than serious interest", McGlone says.

Recent research from Lincoln Pensions found 46 per cent of respondents recognise consolidation as a potential endgame they may consider in the future, but just 11 per cent said they were currently considering this option. Increased security was considered its biggest benefit by 71 per cent, with 42 per cent citing improved funding and 21 per cent improved governance. The biggest disadvantage was the risk of consolidator failure, followed by an uncertain regulatory regime.

The future of the nascent superfund market will depend on DWP's next move, Aponte warns, as some of the proposals included in the DWP's recent consultation could limit the pool of potential candidates for consolidation.

"In that case, it is questionable whether it would be worth the effort of introducing a new regulatory regime where a close analogue already exists with insurance solutions." However, there are more than a handful of schemes and sponsors already actively evaluating superfund consolidation, Aponte notes.

"Once the first deal is done, which it will be, there will be no going back," Gatemore Capital Management partner Mark Hodgson states. "The concept will have been proven and there is more capital looking to swallow up pension funds for a healthy return. If those returns really are attractive, there may well be rush of consolidators to market who have been waiting in the wings."

Indeed, there are already a handful other providers that have superfund products waiting in the wings. Recently, Legal & General stepped out with its Insured Self-Sufficiency (ISS) product, which works in a similar way to a commercial consolidator, but without severing the sponsor link.

However, it appears that TPR has learnt from the rise of multiple DC master trusts, which led to unsustainable numbers, Carline says, so it will ensure there are just a few DB consolidators, so that oversupply doesn't lead to problems.

K3 Advisory managing director Adam Davis is hopeful that superfunds could provide much-needed capacity to small pension schemes who struggle to get traction in the buyout market. Shah agrees, highlighting that bringing together small schemes was the "original purpose" of superfunds.

This hope could come true, as Barker states that The Pension SuperFund's ultimate end game is to develop a 'cookie cutter' approach for onboarding sub-£1 million schemes – "but this is something for 2025 rather than today's challenge".

It seems that now commercial consolidators have entered the room, they will be making themselves at home within the DB consolidation landscape.

Written by Laura Blows

Summary
- Insurers have expressed concerns over the emergence of superfunds.
- There are debates as to whether superfunds should be regulated akin to insurers or pension funds.
- The DB de-risking market should be large enough for both insurers and commercial consolidators to co-exist.
- There are opportunities for superfunds and insurers to work together.

Friend or foe?

Superfunds, the new DB consolidation options available to schemes looking to de-risk, have been compared and contrasted against insurance buyouts. Laura Blows looks at the relationship between insurers and commercial consolidators

There are always concerns when you get a new neighbour. Will you get on, will they leave you be, will they be intrusive? Will you end up having fights over land boundaries?

The latter seems to be the case for pension scheme insurers. The arrival of commercial consolidators, also known as superfunds, has caused some concern that these new entrants may have pitched up uncomfortably close to insurers' bulk annuity offerings.

When a buyout is purchased for a pension scheme, the insurer takes on the assets and liabilities of that scheme, including the responsibility of paying the members' pensions, from the employer. A commercial consolidator also takes over the running of the scheme, and also frees the employer from any further responsibility, but at a cheaper cost and with lower member benefit security than the pretty-much-guaranteed security a buyout brings.

So far, two commercial consolidators have entered the market – Clara Pensions, which sectionalises the assets and liabilities of each scheme entered and aims to bring each to buyout, and The Pension SuperFund, which blends all together in a 'run off' model and plans to use a proportion of the profits to increase member benefits.

Insurer concerns

Insurers have expressed concerns about their arrival.

According to Pension Insurance Corporation chief origination officer Jay Shah, many – including insurers' regulatory body, the Prudential Regulatory Authority (PRA) – are seriously questioning whether superfunds "should be allowed to offer the same product as insurers but based on lighter regulation and less capital".

"Clearly, there has been a lot of, shall we say, concern expressed *[by insurers],*" Clara Pensions CEO Adam Saron tells *Pensions Age*. "If we are a quarter as successful as the insurers appear to be worried, I'm a happy guy."

The Pension SuperFund has stated that insurers' concerns "stem from incomplete or incorrect understanding of our and similar proposals".

Working together

Indeed, The Pension SuperFund managing director, asset and liability management and solutions, Antony Barker, says that the insurance companies it has engaged with have seen the advent of consolidation as "primarily a good thing".

The fund claims to have already encountered instances where trustees have considered consolidation, only to conclude that they can afford buyout.

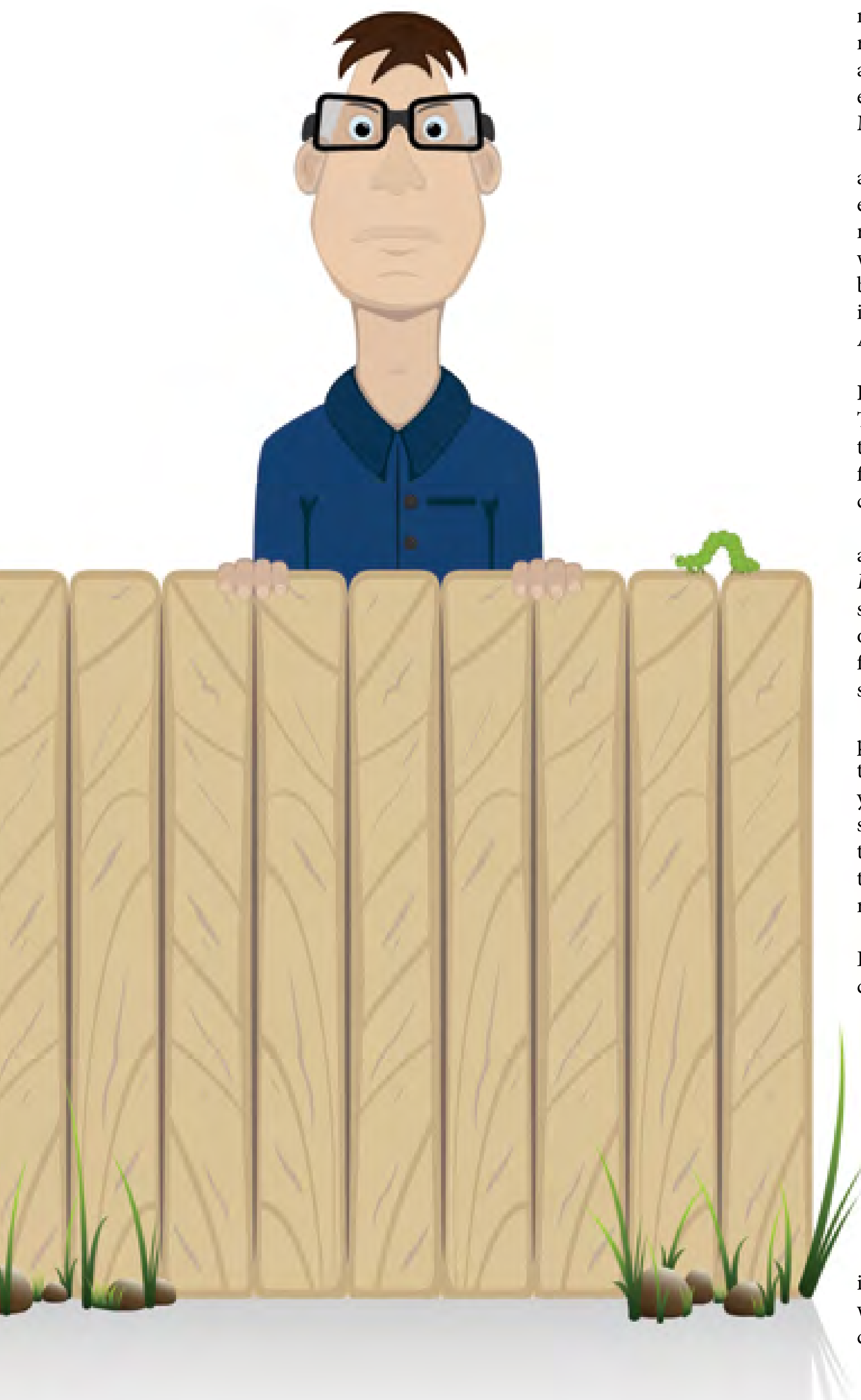
Insurers and consolidators can also work together, Barker states. For instance, The Pension SuperFund has quoted on a joint basis with some insurers or offered deferred-only quotes. It can also partner with an insurance company, with The Pension Superfund absorbing the more illiquid assets as part of the deal. The superfund itself may also seek partial buyouts or buy-ins from insurers.

Clara also highlights its own positive dialogues with insurers. "Clearly, in our model, the future health of the insured market is crucial for us, because our model will only work if there is a future healthy insurance market for us to ultimately deliver our members to," Saron explains.

Pensions Management Institute (PMI) president Lesley Carline suggests this could also be beneficial for insurers, as for those whose resources for new buyouts are constrained "will see some consolidators as a helpful screen, effectively acting as a funnel for the right type of scheme and giving them breathing space".

There is also the possibility of insurers effectively cutting out the middle man and creating these precursors to buyouts themselves.

While still at a preliminary stage, Legal & General is the first insurer to announce its intention to offer its own insured self-sufficiency product. In this, the scheme's assets, along with any employer contribution required to reach the initial funding requirement, are passed to Legal & General and invested to reach buyout over time. An insurance wrapper is also included, whereby the insurer covers a fall in funding in all but the worst 1-in-



200 year event.

This was conceived "as an innovative means by which pension schemes can reduce their long-term risks, while allowing the sponsor to remain fully engaged", Legal & General head of DB Mark Johnson says.

However, for insurers to create a superfund model that breaks the employer link would be tricky. The regulatory regime that insurers operate within is incredibly stringent, so it would be down to the PRA to decide whether insurers could operate a superfund, the ABI warns.

Regulation and authorisation

To what extent may be under debate, but there seems to be some blurring of lines for where insurers start and commercial consolidators begin.

However, the Department for Work and Pensions (DWP)'s *Consolidation of Defined Benefit Schemes* consultation seeked to define those edges. It requested opinion on a new legislative framework for authorising and regulating superfunds.

One of its proposals was a 'gateway', preventing any schemes that seem likely to be able to buyout within the next five years from entering a consolidator, to stop "any employers who may be tempted to seek to discharge their responsibilities through a superfund, when buyout is a realistic prospect".

This does not go far enough for the Employer Covenant Working Group. Its chair Donald Fleming states that external covenant advice should be a mandatory requirement of the process, "and we propose that the threshold should be set higher, to help reduce the moral hazard risk of a sponsor contriving the conditions for entry".

While the Society of Pension Professionals (SPP) president Paul McGlone acknowledges the gateway as an understandable way to encourage insurance when it can be afforded, he warns the gateway could have adverse consequences.

"If a scheme is 95 per cent funded on a buyout basis, has no access to contributions, and is expected to move towards buyout over five years, the question will be whether it is safer to spend that five years with its own sponsor or within a consolidator targeting buyout. With a weak sponsor at risk of insolvency the sensible choice may be the consolidator, but the gateway may prevent this," he explains.

Or, as Saron succinctly states: "If you're a high street retailer, five Christmases is a hell of a long time."

Instead of a gateway, Pensions and Lifetime Savings Association (PLSA) head of DB Joe Dabrowski recommends schemes having to identify its endgame – be it buyout, consolidation, self-sufficiency, etc. "So if a scheme changes path, say from buyout to consolidation, it would have to justify to The Pensions Regulator why," he explains.

Another contentious issue is capital adequacy. As schemes no longer have the ongoing support of an employer covenant, should commercial consolidators be subject to the same Solvency II-style level of funding as insurers?

The DWP's consultation suggests superfunds should operate on a 99 per cent probability of paying benefits in full.

However, with insurers using a 99.5 per cent probability of paying full member benefits, K3 Advisory managing director Adam Davis says that this too-slight difference "will exclude schemes who need the solution the most, i.e. those that are poorly funded and with a weak covenant".

In contrast, the PLSA's DB Taskforce considered 95 per cent to be more appropriate.

In its consultation response, The Pension SuperFund stated that "since superfunds are firmly intended to be pension fund solutions, it does not seem reasonable that they should be subject to additional constraints modelled on insurance, which do not apply to other pension schemes. In fact, this increases the blurring of lines and risks creating confusion".

Superfunds may consider it unreasonable, but it would be completely understandable if a consolidator is more lightly regulated and requires less capital, that an insurance company cries foul, Gatemore Capital Management partner Mark Hodgson says. "In that instance the consolidator is playing regulatory arbitrage, which would be unfair."

Despite their pleas to be treated like a pension fund, the PRA believes that commercial consolidators should be required to publish an annual balance sheet using market valuations and including liabilities valued on a buyout basis, together with a buffer fund based on the Solvency II approach.

The PRA may have its strong views, but it is The Pensions Regulator (TPR) that is to authorise commercial consolidators, and give approval to schemes looking to move into one.

According to Asspociation of British Insurers (ABI) policy adviser, long-term savings, Hetty Hughes, the regulator of superfunds will need strong rule-making and supervisory powers, which is "more like the PRA than TPR".

Shah agrees, saying: "This requires a large, experienced and expert regulatory infrastructure. The TPR does not have this. That is a real concern if TPR is to be the superfund regulator. Many (including PIC) are saying that superfunds need to be regulated by the PRA rather than creating a new mirror regulatory system within TPR."

Ultimately it needs to be decided which these new superfunds are more akin to – a pension fund or an insurance product.

Hughes says that, as profit-seeking financial institutions, superfunds will be providing very similar services for employers and their DB scheme members to that of insurers. However, both The Pension SuperFund and Clara Pensions are adamant that they are pension funds, not insurers, and should be treated so accordingly.

Room for all

A sense of scale is needed, Saron states, because "as successful as the insurers have been, taking on about £85 billion of liabilities over the past 13 years, there's still about £2 trillion *[of UK DB liabilities]* left".

Within that £2 trillion are often small schemes, or ones looking to buy out deferreds, which struggle to gain insurer interest.

"Over a third of the DB schemes in the UK will struggle to insure their benefits even if they can afford it. That is almost 2,000 small- and medium-sized businesses that cannot shift the burden of a DB pension scheme from their balance sheet even if they have the means to do so," Davis says.

Therefore, it shouldn't be a 'turf war' between insurers and superfunds, Barker states, "as we can easily be in two very different and very large fields, working together over the hedge when sensible to do so".

Insurers and superfunds should be able to operate in a wide enough area to not bump into each other. The new entrants could be beneficial to the insurance marketplace, or they could end up treading on insurers' toes. Much depends on both the result of the consultation and how the dust settles after the initial disappointment it will undoubtedly cause for some. It remains to be seen whether these neighbours will become good friends.

Written by Laura Blows

CPI-way or the highway?

Following the switch of public-sector schemes to CPI from RPI in 2011, and the recent report from the House of Lords that slammed the government for continuing to use RPI, Elizabeth Pfeuti looks at whether private-sector schemes can, and should, make the switch

Summary

• The Retail Price Index has been discredited by peers, but vast numbers of pension schemes use it to measure inflation.

• How can trustees negotiate to maintain promises to members while keeping on good terms with the sponsoring employer?

• Does the sector still have to wait for CPI-linked gilts – or has the starting gun just been fired?

In January, The House of Lords' Economic Affairs Committee slammed the UK Statistics Agency for continuing to publish a monthly figure it knew to be inaccurate – and admonished the government for using it only when it was beneficial to the public purse.

The figure was the Retail Price Index (RPI) and the rebuke could reignite the embers of an argument that has been smouldering in the pension sector since the turn of the decade.

In 2011, the UK's public-sector employers were told by the government to change the inflation-linking part of their pension provision to follow the uplift in the Consumer Price Index (CPI) rather than the RPI measure they had been traditionally using.

CPI, unlike RPI, excluded housing costs such as rent and mortgages, which it was assumed pensioners would no longer be paying, making it a more accurate reflection of their monthly outgoings.

Importantly, the new measure had also risen more slowly. At the time of the change in legislation, the Bank of England and the Department for Work and Pensions estimated RPI would increase around 2.7 per cent each year, with CPI rising just 2 per cent.

This point was not missed by unions who strongly challenged the change but were ultimately unsuccessful. CPI had, after all, been the UK's official inflation measure since 2003, so this was just bringing pensions into line, the government said.

The move, set by statute, saw hundreds of millions of pounds in liabilities shaved off the public-sector pension bill. In a submission to the House of Lords' consultation at the end of last year, KPMG estimated that public-sector defined-benefit pensions liabilities linked to CPI were worth £200 billion.

Going private

The next step looked to be moving the private sector across to the same calculation. It would have been welcome, too, as companies were struggling with desperate underfunding after more than two years of the financial crisis – but there was a problem.

Each corporate defined benefit scheme had documents written explicitly for itself. To enable each scheme to switch from RPI to CPI automatically would

need further, intricate legislation.

Despite the original measure becoming increasingly discredited, the government was not keen to restart the battle with the unions and potentially millions of employees over whom they had no control.

Instead, each scheme was left to fend for itself.

Ever since, corporate pensions have had to examine their internal documents to scope out the potential for switching. They fall into four main categories, according to Addleshaw Goddard legal director, pensions, Judith Donnelly.

First, benefits must be increased in line with the statutory minimum, making a switch to CPI possible; second, the rules require increases to be specifically in line with RPI, meaning no switch is possible. Third, the rules require an increase in line with RPI, but allow a different measure to be used in clear, distinct circumstances; lastly, the increase should be in line with RPI or potentially another index, but the mechanisms for allowing the change is not clear.

Over the past couple of years, the cases that have hit the headlines have fallen into the latter two categories, in which there is significant ambiguity. Household names have been dragged before judges – Barnardo's, Arcadia and BT – to ask for permission to switch to the lower rate.

Some have been successful in switching, others have not. Donnelly says the way in which the government changed the legislation had created a "lottery" and handed responsibility to the courts.

"There are numerous ways in which scheme rules can be drafted," says Donnelly. "The Barnardo's case confirmed that a judge might not look just at the scheme wording as it pertained to the clause about indexation, but the whole document to see whether there is a meaning implied elsewhere."

Stick or twist?

There has been a lot of activity with companies switching across to CPI, but not all have publicised their decision, according to KPMG director John Hodgson, noting that the process was not always an easy one.

In its submission to the House of Lords, KPMG estimated of the £2 trillion private-sector, defined-benefit pension liabilities, £1.1 trillion are still linked to RPI, with just £300 billion linked to CPI. A further £600 billion are not inflation linked.

As part of their risk management obligations, companies are looking at the potential to switch, says Hodgson. This did not guarantee they would move, "but the financial impacts mean it should be looked at".

For Hodgson, companies need to consider the switch as a business decision – a corporate obligation to pay the intended benefits, rather than a moral one. For the trustees, the decision is more complex.

"Despite having the power to switch to CPI, trustees sometimes feel a moral duty to uphold the use of the inflationary measure members were told would apply at the time of joining the scheme," Womble Bond Dickinson managing associate director, Gavin Ellison, says.

Any change to CPI cannot affect benefits already paid out, but it can impact what members are paid in future. Additionally, employers are under no obligation to consult with pensioners already in receipt of their pension that their benefits are set to change. Most do tell them, but it is a wrinkle that needs ironing out.

"In practice, a balance needs to be struck between protection of member interests and avoiding additional liabilities being imposed on the company," Ellison says. "Cost-saving alone is not sufficient. A more nuanced balancing of the relevant factors is needed. Is it the right and proper thing to do? Should they be using this power? Or simply is CPI actually the more appropriate measure?"

Association of Member Nominated Trustees co-chair, David Weeks, says, in his experience, most trustees were not in favour of making such changes. "Trust rules have obligations and they should be honoured," he says. "Some schemes might have a shortfall but switching inflation measures is a bit of a blunt instrument – there must be more considered ways to a solution."

For Weeks, despite the rhetoric about more appropriate measures, for trustees, "the net effect is that CPI is 1 per cent lower. Why not just come out and say the employer wants to reduce inflation linkage by 1 per cent?"

Deal making

Ellison says that employers should be aware that they are unlikely to get a straight 'yes' from trustees, even if they agree that the switch is appropriate.

"Typically, there will be a negotiation about whether to augment members' benefits and how the savings made from the switch may be recycled back into the scheme to improve the funding position," he says.

"In some cases, we have found that where employers have told trustees that they want to reduce benefits, the trustees have indicated that they will only exercise their power to consent if the employer gives them something else of value in return," Donnelly says.

There is a lot of work involved and realistically, it can take months from getting the legal opinion to agreeing – and the process takes time, effort and money.

"Employers need to talk to trustees," LCP head of the pensions research team, David Everett, notes. "Some might be waiting to put any plans into action, in case there is a governmental reaction to the House of Lords report, and they end up having to do it anyway."

Everett warns that, as it stood, CPI-linked assets were not available in such numbers for so many schemes to switch, but there are signs within the House of Lords report that could change.

"The government should begin to issue CPI-linked gilts and stop issuing RPI-linked gilts," the report said, citing evidence from the Bank of England that suggested there was enough demand to make a viable market.

"It is tricky for trustees, who are likely to be beneficiaries, with friends and colleagues who are, too," Hodgson says. "But there is a direction of travel for away from RPI and the rest of the world is moving on – so why should those pension funds with flexible rules be stuck using it?"

Written by Elizabeth Pfeuti, a freelance journalist

PENSIONSAge

100 days later – GMP equalisation – 3 February marked 100 days since the ruling in the Lloyds Bank GMP equalisation case, affecting thousands of UK DB pension schemes and millions of members. Tom Yorath, an expert witness in the Lloyds case, shares his views on how the industry has moved forward since the judgment date following almost 30 years of legal uncertainty *p40*

Tip of the iceberg – As schemes start to fully understand the implications of the High Court ruling on guaranteed minimum pensions (GMP), what, apart from the harrowing complexity, are the issues we should be focusing on? Theo Andrew investigates *p42*

GMP equalisation focus:

Stepping up

Thomas Yorath, principal consultant, Aon

100 days later – GMP equalisation

3 February marked 100 days since the ruling in the Lloyds Bank GMP equalisation case, affecting thousands of UK DB pension schemes and millions of members. Tom Yorath, an expert witness in the Lloyds case, shares his views on how the industry has moved forward since the judgment date following almost 30 years of legal uncertainty

Scheme sponsors

With the financial impact of GMP equalisation directly impacting the profits reported in company accounts, it should come as no surprise that the largest immediate reaction to the judgment was from scheme sponsors.

While many sponsors were aware in advance of the potential for a hit to company profits, the timing of the judgment so close to calendar year ends meant that some were blindsided and were left with both a nasty financial surprise and a mad rush to calculate numbers.

The analysis conducted by Aon on more than 250 schemes suggests that the expected cost for two-thirds of schemes is less than 1 per cent of their overall liabilities and while 1 per cent of liabilities is easily lost in noise on most company balance sheets, a reduction in profits of 1 per cent of scheme liabilities can be hugely significant and concerning for sponsors.

What's more, the submission of equalisation costs in company accounts is by no means the end of the involvement of sponsors in equalisation.

The judgment from the High Court put much of the power over which method to use in the hands of sponsors. With the overall costs and merits of the various court-approved methods so different, it should not come as a huge surprise that many sponsors are keen to take an active part in this project rather than leaving the work solely to the trustees.

Scheme trustees

Following the judgment, trustees found a number of burning platforms that needed to be addressed.

However, for the most part, we saw most trustees adopting a 'keep calm and carry on' attitude as far as possible. The majority felt that it was disproportionate to put projects and business as usual on hold indefinitely, preferring pragmatic workarounds, particularly given that equalising GMPs is unlikely to be a quick fix. There are workarounds suitable for member option exercises, risk settlement projects and ill health retirement. Practical solutions regarding the communication around transfer values have been developed. The exceptions have been small pots and trivial commutation, where most have either needed to quickly update their process or put the projects on hold until there is guidance from HMRC that they would not be unauthorised payments.

Over the past month, trustee attention is now beginning to turn to two main areas:

• Preparation – in particular sourcing and cleaning scheme data, and reviewing and understanding benefit practices.
• Method – in particular whether there is a preference towards converting benefits or running a dual record approach.

While some schemes have excellent historic data, many are finding that significantly more data is needed for the purposes of equalising than to administer the pension scheme. The good news is that this preparation work is not a wasted endeavour and will stand schemes in good stead regardless of which method they choose, as well as making them well-prepared for any future settlement activity.

Although schemes have started the job of preparing and considering their options on solutions, the vast majority are rightly waiting for further guidance – whether that be from industry bodies or subsequent court hearings. Many trustees are concerned that implementing too quickly risks falling on the wrong side of industry norms before they are even formed, with very limited upside.

Members

Despite the case making the front page of a national newspaper, for the most part the response from members has been quite muted. In practice this may be a combination of factors:

• It is hard for members to work out whether they are affected
• The issue is horribly complicated
• The financial impact for many is small

The most member noise has been made in response to those cases where members have had their retirement plans directly impacted by the case; for example, those members who had been expecting or relying on a trivial commutation lump sum and who now face a delay to their payment while the trustees decide how best to adjust their processes for equalisation. Remember that, despite the name, these trivial commutation lump sums may not be trivial to the recipient.

IFAs

IFAs want to make sure they are giving best advice to members and their biggest concern is that they are making a fair comparison between options. So, typically, they are comfortable advising on a transfer value that has not been adjusted for GMP equalisation, against a benefit that also has not been altered for GMP equalisation, accepting that there may be a top-up payment at some point. This complexity again emphasises the need to have an IFA who really understands DB pensions, and the challenge that members face if they are trying to seek an IFA of their own without trustee or company support.

Insurers

Q4 2018 did not see any slackening in the pace of risk settlement project completion, despite the GMP equalisation issue. Although many schemes are at the early stage of decision making on their GMP equalisation method when considering a transaction, it is worth understanding the insurer view. Insurers have an obvious preference for the standardisation and simplification provided by GMP conversion.

But this does not mean that schemes should hold off from pursuing a buy-in or buyout while addressing GMP equalisation. For schemes looking to reduce risk using buy-ins and buyouts – and at a time when pricing is attractive – being flexible has become important to capture the best pricing. GMP equalisation is another area where flexibility from schemes is likely to increase insurer engagement. It is therefore even more important to ensure you have an experienced adviser who has a clear understanding of the solutions available and who can help you navigate through the current busy market.

Government and industry bodies

There is still a need for further guidance from the courts, government, TPR and industry bodies. They need to tackle areas questions such as

• Will there be a de-minimus threshold?
• What is the impact on annual and lifetime allowances?
• What about transfers out?
• How will GMP conversion work in practice – for example, is it aiming for minimum interference or maximum administration simplification?
• Will there be best practice codes (similar to the Code of Good Practice in Incentive Exercises)?

To continue to facilitate a competitive administration, market standardisation of the details of implementation will be beneficial and the Pensions Administration Standards Association (PASA) are taking a look at that to bring clarity to the market. Building industry norms will help manage the costs of this complex exercise for the entire industry.

Next steps

There is plenty of work to be done, even before all this guidance is available. You need to analyse gaps in your data, understand your administration practices, and consider interaction with GMP reconciliation projects. In practice, we expect that schemes are still some way off a decision on what GMP equalisation method to use and while schemes may want to quickly address member event processes such as trivial commutations and transfer calculations, for most, full implementation of pensions is likely to be mid-2020 at the earliest.

If you'd like more detail on this please email talktous@aon.com for a copy of our technical summary on the topic.

Written by Thomas Yorath, principal consultant, Aon

Summary
• In October, the High Court ruled that Lloyds must start the process of equalising GMP, which has had huge consequences for thousands of pension schemes.
• Schemes are now getting to grips with the ruling, which could cost them anywhere between 1 to 3.3 per cent of liabilities, but are still awaiting guidance from the Department for Work and Pensions on the best method to apply.
• The complexity of the equalisation process has highlighted issues around insufficient data and general lack of human resource to deal with demand.

Tip of the iceberg

As schemes start to fully understand the implications of the High Court ruling on guaranteed minimum pensions (GMP), what, apart from the harrowing complexity, are the issues we should be focusing on? Theo Andrew investigates

For many pension schemes, it is the iceberg they saw coming. A clear danger away in the distance, but one they were anticipating. Others, despite the warnings, have not readied themselves for what lies beneath.

In October, the High Court ruled that Lloyds must equalise pensions benefits related to guaranteed minimum pensions (GMP) for men and women. Since then, the industry has been in somewhat of a frenzy to find an adequate, cost effective, solution.

In the month after the ruling, a Herbert Smith Freehills survey found that despite 78 per cent of schemes agreeing with the verdict, 61 per cent said that they had insufficient data to equalise.

First introduced in 1978, GMP were a means of allowing schemes to contract out of State Earnings Related Pension Schemes (SERPS), as good as the statutory amount, which were allowed to be calculated differently for men and women.

For now, schemes have been doing their best to estimate what effect it will have on their liabilities. Compass Group estimated a cost of 1-2 per cent of liabilities, while Haynes Group say it could range from anywhere between 2-3.3 per cent.

Recent research from XPS Pension Group painted a brighter picture for schemes, when it said it could cost less than 1 per cent of total liabilities.

What though, for schemes who have yet to be provided with guidance, can trustees be doing now?

The data crunch

It's the question that pension schemes will have been asking themselves from the off. Do we have sufficient data to carry out the process of GMP equalisation, and what do we do if we don't?

For starters, Premier head of administration, Girish Menezes, believes pension schemes shouldn't be getting ahead of themselves: "My view would be it is key that we do not run before we can walk. We don't quite know exactly the route forward, there are people saying we need to do C2 and then D2 but is that what people are going to do?"

Aon principal consultant, Tom Yorath, agrees that before they concentrate on the data issues, schemes need to be addressing their burning platforms. A process he believes many have already achieved.

"For those schemes where they have a large bulk exercise underway, transfer value exercises or annuity purchases, then trustee sponsors are having to make a decision on how to proceed," he says.

"It's not putting a handbrake on those exercises, it's just an extra consideration. Most schemes are through the burning platform stage, or have at least made a decision on how they will tackle it."

Currently, pension schemes are awaiting guidance from the Department for Work and Pensions on the best method to take, which according Yorath, is leaving trustees in a catch-22 scenario.

"The big problem is people don't have the data, and where they do have the data, they don't have clarity on implementation."

In December, the judge on the case

ruled that schemes can go directly to D2, without going through C2, and confirmed that for schemes going back to rectify GMPs, they will need the salary information for those years.

A move Menezes believes could be troublesome: "You need the salary information from those years, which a lot of schemes don't have. GDPR also means a lot of scheme sponsors may have actually deleted the information. So what does one do?"

Depending on the circumstance of the schemes, trustees may be able to make certain assumptions about the data they are missing, which they can then use to calculate members' equalised benefits.

"We need to do far more analysis in what we are going to have to do to move schemes from where they are now to a fully equalised state, before we take on what effort is going to be required and what skills are needed going forward," Menezes adds.

The capacity crunch

The amount of work that is likely to be placed on administrators, legal firms and actuaries, could see the industry faced with a capacity crunch when working through equalisation, let alone getting on with the day-to-day running of the schemes.

A number of initiatives are already underway to mitigate this risk and stop schemes moving at a glacial pace.

In January, the Pensions Administration Standards Association (Pasa) formed a working group to advice trustees on 'best practice' throughout the process. It will be overseen by The Pensions Regulator, to ensure standards align with 'regulatory expectations'.

Pasa board member and chair of the GMP working group, Geraldine Brassett, says: "It's just the sheer amount of work this is going to be put on the industry.

"Until we actually understand what equalisation means, we are going to have an awful lot of pension schemes going through it at the same time. So being as prepared as you can is a really good thing."

Furthermore, a number of consultancies are rumoured to have 'beefed up' their GMP practices.

Sackers partner, Faith Dickson, believes that while there could be a capacity crunch, not all schemes will go through the process together, meaning it could almost be three years before some have completed the process.

"Most schemes are struggling with finalising GMP reconciliation as well, and until they have done that, they can't do the equalisation process. If all schemes are going to take a year to do it, they can't all do it at once, so you could see it dragging on."

Aon partner, Mike Edwards, agrees that not all schemes will be ready to equalise at the same time.

"We wouldn't expect all schemes to be going through equalisation at the same time, in the same way we don't see every scheme implement buy-ins at the same time. Practically speaking, there will almost have to be some staggering of the process because of the bandwidth of administrators."

"There will be a challenge keeping up with the day-to-day activities as well as this project," Dickson adds.

Bergy bits

The way schemes are likely to approach the ruling will be dependent on the size and complexity of their scheme, so it will come as no surprise that trustees themselves are split on how to equalise.

And what for the DWP guidance that we are expecting?

According to Yorath, this is likely to be focused on conversion – following on from the basis used in the DWP's previous consultation. At the time of writing, the DWP said guidance will be delivered "shortly".

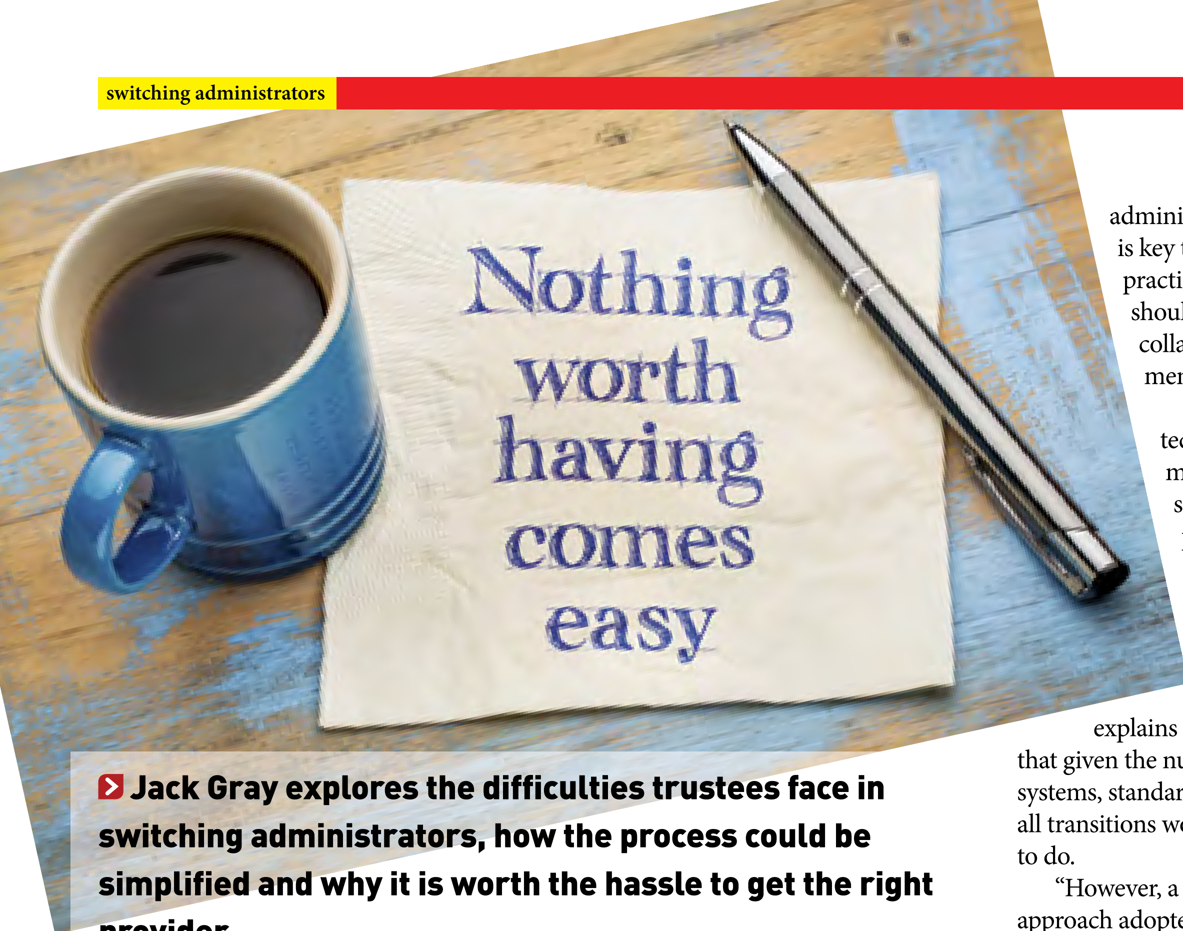
"The big upside in conversion is it can actually result in savings for schemes, while the simplification will bring down the cost of materially of passing the scheme off to an insurer. Some are seeing conversion as a gateway to full settlement," he says.

Schemes will no doubt be a lot more attractive to an insurer having been through the process, but trustees will have to weigh up the decision to go for the most costly conversion process, which will lead them closer to buyout, or the more cost effective dual record method which may not have as a desirable outcome.

One thing is for certain, schemes are also being urged to think about the post-equalisation landscape, and the dangers ahead, but first they must navigate themselves through the tricky bergy bits.

Written by Theo Andrew

In association with Aon Empower Results®



Jack Gray explores the difficulties trustees face in switching administrators, how the process could be simplified and why it is worth the hassle to get the right provider

Now well into 2019, people all around the country are trying to still stick to their New Year's resolutions. Whether it is losing weight, cutting down on alcohol or quitting smoking, it is never easy but always worth it in the long run. Trustees face a similar challenge when tasked with switching pension administrators. Currently, the process seems long winded and complex, but it appears to be worth it to ensure that schemes have the right administrator for their members.

The lengthy process

As things stand, switching administration provider can be considered a convoluted and unapproachable challenge that helps breed poor administrative practises, leading to members not receiving the best service possible.

"Switching administrators is seen as a painful process and that makes trustees reluctant to change," Trafalgar House business development manager, Joe Anderson explains. "However, this leads to schemes putting up with appalling levels of service for much longer that would be the case in any other service industry."

XPS Pension Group principal, Damian Magee, echoes Anderson's message, but also insists that trustees should not be put off by the process: "Often trustees are turned off by the thought of changing administrators – they view it as a labour intensive, difficult and somewhat messy piece of work to undertake, but really what they should have in mind is that their members receive the best possible service."

"It is not uncommon for schemes to have been with their administrator for well over a decade without having performed a review," Anderson continues. "This isn't necessarily an issue but familiarity breeds contempt, and trustees should be mindful that they, and their members, could benefit from a change that leads to higher levels of automation, introduces online tools and leads to greater efficiency," he adds.

Simplification

Technological improvements, including automation, should help simplify and streamline the process of switching administrators. Accurate data is key to best administrative practice and technology should make it easier to collate and store up-to-date member data.

Despite the improving technology, industry members concede that simplifying the switching process is just not an easy task.

"A common approach, segmented by scheme size, could simplify the process," explains Magee. "The reality is that given the numerous providers and systems, standardising processes across all transitions would be very difficult to do.

"However, a standard common approach adopted by the exiting provider would be a step in the right direction. For example, a central point of contact at the incumbent administrator, industry agreed timescales, data formats, charging structure and reporting."

Furthermore, as the industry has had to adopt higher levels of governance, the process has slowed as a result. Of course, strong governance is not a bad thing and is necessary for improving standards within the pension industry, but it can put trustees off reviewing the administration services used by their schemes.

"Long gone are the days when a strong personal relationship was enough to win an admin contract," Anderson states. "With governance high on the agenda and every decision subject to scrutiny, trustees have to be able to evidence the reasons for their choice of provider. This inevitably means a thorough and detailed Request for Proposal (RfP), followed by a presentation and then a site visit, narrowing down the field of potential providers along the way.

"When you factor in contract negotiations, once a preferred provider has been chosen, the whole process takes

Summary
• Some trustees feel that the process of switching administrators is more hassle than it is worth.
• Industry members are calling for the process to be simplified in order to make switching administrators a more appealing prospect.
• Trustees should assess their administration provider more regularly to help minimise bad practise and poor service.
• Greater care in choosing administration providers should lead to better member outcomes.

months, and that's before you start the transition itself."

Not easy but rewarding

Although the process is long winded and making it simpler does not seem like an easy undertaking, Premier head of administration, Girish Menezes, insists that it is worth the effort if trustees are not getting the best from their administration provider: "Switching administrators is not easy, but very rewarding.

"The quality of pension administration in the market is varied. If your current experience is that of poor service-level agreements, delayed projects, opaque member communications and member complaints, there are far better options in the market and switching is a more than worthwhile effort."

Menezes says that the most difficult part of switching administrators is "identifying a new provider with a good functional and cultural fit", but he believes that there are a number of ways to streamline this process.

"Having the support of a procurement consultant with experience of pensions administration" is one of the ways to simplify the process, says Menezes, along with "leveraging the experience of your independent trustee, limiting the length of the RfP and limiting the number of providers invited to bid for your administration".

If identifying the right provider is the most significant factor in improving the member's administrative experience, what should trustees look out for when finding a new administrator?

"A provider who can demonstrate a track record of servicing schemes of a similar scale and complexity," suggests Magee. One that provides "case studies and references from existing clients they have transitioned from the incumbent administrator and software, and propose an experienced, qualified team that is adequately resourced".

Transition frequency

What seems clear is that, when deciding on a new administrator, trustees should consider their options carefully and take their time to ensure the best outcome for their members. As previously discussed by Anderson, just the process of finding the right administrator for the scheme can take months, so trustees should ensure that they are not adding unnecessary time on to an already lengthy procedure.

The complexity of the situation is highlighted by disagreement amongst experts on how regularly trustees should consider switching provider: "The decision to change administration provider requires full and informed consideration. There isn't really a fixed timeframe after which trustees should consider switching administrators," says Magee.

However, Anderson believes that reviews should be undertaken relatively regularly: "Provider reviews should be a part of annual trustee business plans.

"As long as your administrator is performing well, you might think there's no need for change. However, it won't hurt to perform regular benchmarking on fees and services to make sure your current administrator isn't falling behind on the latest service developments, technology, online services and member communications."

Although the provider should be reviewed regularly, Menezes warns against switching providers too often: "An actual switch should only be undertaken if the lack of service suggests that this is required and the relationship has broken down."

He continues: "Trustees who flip administrators regularly are usually the ones who are driven by price, do not invest in cleaning their data and often create additional sub-optimal processes. These clients drive poor behaviour from their pension administrators."

Anderson has seen some improvements in the amount of attention trustees have been giving to the efficiency of their administration providers. The number of professional trustees on boards has increased in recent years and this "has led to more and more frequent reviews".

Anderson adds: "They usually sit on multiple boards, meaning they have first-hand experience of a number of providers and up-to-date knowledge of how they are performing. They also have a wide network, so will hear quickly about providers that are performing well or are struggling."

Conclusion

Although there are still question marks over the complexity of understanding administration and how trustees should go about ensuring that they secure the best outcomes for their scheme members, the rising number of professional trustees and increased guidance from organisations such as The Pensions Regulator are helping create greater understanding for if and when to switch providers.

Like New Year's resolutions, switching pension administrators takes time, effort and commitment to get the desired outcome, but it is almost certainly worth the effort.

Written by Jack Gray

About turn

Having transitioned from being the Royal British Legion's finance director to its pension trustee, John Graham tells Natalie Tuck why the scheme is keeping its growth assets while working towards self-sufficiency, rather than the popular option of de-risking

With so many pension scheme buy-ins and buyouts making the headlines, and talk of 2018 as yet another record-breaking year for that sector, it's rare to hear from a pension scheme that has made an 'about turn' from the fashionable de-risking options, and is instead keeping its growth assets while working towards self-sufficiency.

The Royal British Legion's (Legion) pension scheme, however, is one of those schemes. John Graham, who was appointed as the charity's finance director in 2008, but now represents the charity on its pension fund trustee board, set out to "radically change" the scheme when he joined the charity.

"I felt that when I joined the Legion, the fund was too much in the hands of the advisers, so I wanted, as an organisation, to take more control of it, to take charge of the decisions. One of those decisions was to close it to future accrual, which we did in 2010, and set up a defined contribution scheme, which is with Standard Life," he explains.

Having previously closed to new members in 2002, Graham's radical change began in 2010. Despite the fund closing to future accrual, the active members in the Legion didn't become normal deferred members.

Instead, they became known as 'employed deferred' members, so that any future pay rises during their time at the Legion are reflected in their future pension. At the moment there are around 1,600 employees working for the Legion, and fewer than 100 are still members of the DB scheme.

In terms of the scheme's membership, it had 1,224 total members as of 31 March 2018; Graham notes that the number stays quite static, dropping by around 30 members a year. He says this is because of members' spouses' eligibility for a pension if the member passes away before their partner.

When the scheme closed, Graham says that it became apparent that the pension scheme was becoming "divorced" from the operations of the charity. For example, it was no longer promoted to new employees, nor was it an incentive for people to stay at the organisation.

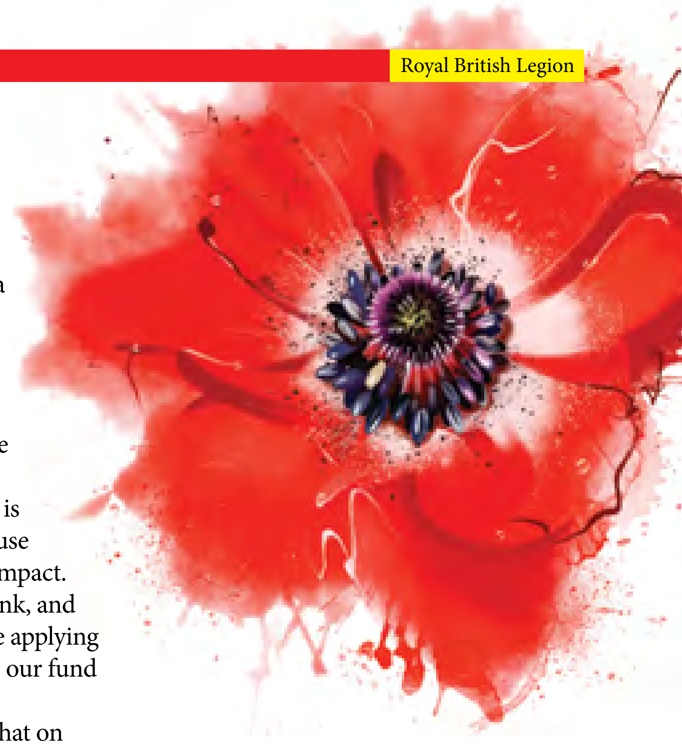
"It went off the HR agenda and it came very much firmly onto the finance agenda; it became a question of honouring the commitment that had been made to the pensioners as part of the DB scheme. That's where the principle of self-sufficiency came from," he says.

Self-sufficiency

Graham explains that the Legion, likely due to it being a charity, has very strong cash reserves – of around £100 million. This value is greater than the amount of assets that the pension scheme has, worth £91 million. The scheme's most recent actuarial valuation revealed a deficit of £10 million (compared to £5 million in 2014), with the increase being a reflection of the scheme's strategy to work towards self-sufficiency. However, under the latest recovery plan, the Legion is not currently required to pay any deficit contributions and only contributes around £300,000 a year to the scheme to cover the expenses of running the scheme.

Buyout, or any sort of de-risking, is not on the cards for the scheme for the foreseeable future. This is because the Legion's covenant is so strong that it doesn't want to pay a premium that would be required to go to buyout, Graham explains. Therefore, the goal for self-sufficiency, Graham says, is to get to a situation over the next 10-15 years whereby the pension scheme is in a strong enough position to meet its liabilities without going back to the charity.

In order to achieve this, the scheme has reviewed its investment portfolio and recognises that in time, it will be geared towards bonds. "If we want to be self-sufficient, we have to have a lower



risk portfolio," Graham states, adding that this was the reason for the deficit increase.

"When we decided to target self-sufficiency, we think that up to 80 per cent of our portfolio will need to be in matching assets. The classic matching assets are investment in gilts. At the moment, we are in a mixture of funds, some of which are very vanilla, but some that are trying to do bond plus. They are using investment techniques to make a greater return that you get from straightforward bonds. Our investment consultant is Aon."

Graham says that the Legion has told the trustee board that, for now, it would like the scheme's investments to remain at 50 per cent in matching and 50 per cent in growth assets, and the charity is prepared to put its covenant behind that.

"Although we have a target of 10-15 years of being somewhere like 80 per cent of matching assets, we aren't going in a linear line there. We are seeking to take opportunities up from the growth assets. We have done a Monte Carlo scenario analysis that shows that if the growth assets perform, we'll get there sooner, and if they don't perform well we'll get there later, hence the 10-15 year time frame," he notes.

However, the Legion very much lets the trustee get on with the running of the scheme, Graham says. It gets involved every three years for the actuarial valuation, and is updated annually by the trustees.

"What we have set out with the Legion is our target of where we want to be. That target is self-sufficiency and we have a map of how we get from where we are now to where we want to be. We are essentially reporting back against that map but that map is on a 10-15 year time horizon," he says.

ESG

As well as incorporating a strategy that targets self-sufficiency, the trustees are in the process of developing an environmental, social and governance policy (ESG), following warnings from The Pensions Regulator that not doing so could have a detrimental financial impact.

"We are working on our ESG policy at the moment in the Legion. I was very taken at the *Pensions Age* conference in September 2018, when the regulator stood up and said it is paying attention to ESG because it believes ESG has financial impact. That has woken us all up I think, and on the pension scheme we are applying ESG, and we get reports from our fund managers," he states.

However, Graham notes that on a member level, the pension scheme isn't facing any pressures to take up a particular ESG policy. "If you look at what they stand for, they are ex armed forces, so you wouldn't exclude arms manufacturers from it...And in the past smoking was encouraged in the armed forces."

As a result, the current debate the trustees are having is on striking the right balance of taking on board the regulator's warnings on ESG, whilst also keeping the members' preferences in mind.

Behind the scenes

Graham credits his actuary, First Actuarial founder, Peter Shellswell, and fellow trustee, Punter Southall Governance Services (PSGS) client director, Mark Fletcher, with getting the fund to its current position. "They have played a major part in getting the fund to where it is today, and we couldn't have got there without them," Graham states.

Fletcher joined the scheme in 2010, when Graham, as finance director, and the chairman of the Legion, were both trustees. When they sought to close the scheme to future accrual the member trustees were concerned that they had a conflict of interest.

"The chairman and I were removed from the pension scheme, and Mark Fletcher was brought in as an independent chairman to oversee the closure. He has stayed with us the help us reformulate the governance. We are down to three trustees now. I represent the Legion, there is a member-nominated trustee and there is *[Fletcher]* as a professional trustee," he notes.

But what was it like making the switch from finance director to pension trustee? "I've had a few chuckles with my fellow trustees," Graham says. "As finance director my job was to try get the liabilities as the lowest figure on the accounts. As a pension trustee, my responsibility is now very clearly to do the best for the scheme members. I do wear a different hat, but at the same time I still have a commitment to the charity."

Written by Natalie Tuck

THE ROYAL BRITISH LEGION

Summary
- Pension freedoms have left default funds with an uncertain target.
- TDFs are slowly replacing the lifestyle approach.
- Default funds are set to start investing in illiquid assets and apply ESG criteria.

It's nobody's default

Almost four years on from the introduction of the pension freedoms, Alastair O'Dell looks at how DC default funds are adapting to increasingly diverse retirement choices

Structuring defined contribution (DC) default funds appears to be a simple task, given their universal aim and strict control on costs, with a universal solution. But while they all share a growth stage followed by a de-risking stage, there are a huge variety of approaches and outcomes.

Freedom and choice has left default funds chasing an uncertain target and rival approaches have emerged. Since 2015/16 members can take lump sums, drawdown and/or the traditional annuity, with access from 55. As it is too early to determine the 'new normal', default funds need to accommodate all likely member choices.

The underlying assumptions have a big impact. Fidelity International, head of UK DC investment, Hugh Skinner, says: "Providers work out a non-standardised model for each client. Each has its views about capital markets, the investable period and universe, inflation, contribution growth and likely retirement dates. Little variations mean they will not deliver the same experience."

As the vast majority of members will enter a default fund – for instance, in excess of 99 per cent of Nest's members are in its default target-date funds (TDFs) – so it is essential to concentrate efforts on its selection or construction.

Abandoning annuities

The aim of de-risking is to end up with a pre-retirement portfolio that mirrors the post-retirement strategy as closely as possible. The high price of annuities, due to low gilt yields and increased longevity, has left the traditional solution as the least popular choice.

"Providers are no longer targeting annuities – less than 20 per cent of our clients still have annuity purchase as their default," says Hymans Robertson, head of DC investment, Raj Shah. This has a big implication for the investment strategy: "Long-dated bonds can be volatile and you would not want to see a big swing your pot size just before you cash out."

Nest's at-retirement TDF portfolios maturing 2021 and beyond will have a CPI+ target. Nest, head of private markets and investment proposition, Stephen O'Neill, says: "We knew evidence would not be in about how people are decumulating, but it at least keeps pace with inflation. It's kept in constant review."

PLSA policy lead: investment and stewardship Caroline Escott says: "Schemes are looking at default pathways but the market is continuing to evolve and will do so more rapidly once the *Retirement Outcomes Review* follows through."

Scheme membership analysis can be used to shape the strategy. Small pots are usually taken as cash while larger ones are more likely to enter drawdown, where a proportion can remain return-seeking for longer.

Barnett Waddingham head of DC investment Sophia Kataora says: "There is no industry standard – it very much depends on the membership. If DC members also have big defined benefit (DB) benefits we can be relatively sure they will take a tax-free lump sum. That shapes the derisking profile."

Skinner adds: "It's difficult at this point. People are electing to do things with their DC pots that are not necessarily reflective of what DC retirees will do in the future. We can't say in any way that we have the blueprint."

Fidelity offers a strategy that aims to preserve the option to annuitise, cash out or drawdown within one lifestyle solution. "We could offer three options, but then one of them would be the actual default. The natural tendency would be to go for that, for a significant majority.

"An individual needs to have elected a glidepath many years before retirement, as it has an impact on investment for the preceding period. People are not engaging at that early point."

Trending to target-date funds

Lifestyle and TDF approaches both effectively aim for the same outcome but via different structures. PLSA found in 2017 (it plans a survey for 2019) that 80 per cent of main default funds were lifestyle. Only 14 per cent were TDFs, although this was rapidly increasing and "it's fair to say that trend has continued", Escott says.

As TDFs are less expensive and easier to administer, at scale, some are surprised they have not been adopted more rapidly, as has been witnessed in the US.

TDFs allow members to take full advantage of the freedoms; one could take a lump sum at 60, work part time with a small drawdown to 65, then retire completely and enter full drawdown, before purchasing an annuity at 75. While this would require an uncommon degree of foresight the market may well mature in this direction.

"The beauty of TDFs is you can invest in different funds that target different outcomes at different points," Kataora says. "It's very difficult to do that through a traditional lifestyle strategy with its administration constraints."

In lifestyle funds, each member has their own fund and the administrator trades according to a matrix-based strategy, an intensive process with the potential for error. In TDFs, members are pooled so the fund manager trades within a single fund.

Nest was an early adopter of TDFs, benefitting from being able to start with a blank-sheet design and anticipating sufficient scale to run its own TDFs. A standalone pension fund may have to choose off-the-shelf products, albeit from a wide range of automated or tactically allocating products.

JLT Employee Benefits, DC investment consulting, Maria Nazarova-Doyle, says: "You must have confidence the TDF manager can deliver for all asset classes and de-risk appropriately. You must really understand the product and know it fits your membership. In lifestyle you can pick all the components and managers, so there is a lot more input from trustees.

"TDFs are less expensive, but I do not yet see a trend. Trustees are used to being in control. But as the market consolidates into bigger master trusts or DC super funds it will potentially all go towards TDFs."

The change cannot happen very quickly, according to Skinner. "There are regulatory challenges around construction and delivery using a TDF structure that need to be thought through properly."

Diversity in default

DC funds have followed DB funds into ever more esoteric asset classes in pursuit of diversification and returns. "Since 2015 there has been access to an increasing range of asset classes in the DC market," Shah says.

One major focus is on illiquid asset classes, such as infrastructure and corporate loans, which exchange a long-term commitment for premium returns. O'Neill says private markets are the "natural evolution" for Nest and notes this is the route taken by similar US funds.

The major problem is illiquid assets are intrinsically unsuitable for the daily-priced, unitised DC world. However, the Treasury's *Patient Capital Review* is shedding light on how DC capital can be invested.

Nest is working with the British Business Bank on accessing growth stage private equity and venture capital. "It's challenging to say the least but there is a lot of political investment in the programme and the early signals suggest the market is innovating," O'Neill says.

Despite booming institutional demand there seems to be sufficient supply. Shah says: "In the next few years the global need for infrastructure will go up. There is a massive deficit and trillions are needed. It's the same for patient capital – supply will keep on coming. At the moment limited supply may be driving up pricing – but this is a long-term thing."

Skinner says illiquid assets "certainly have a role to play" but cost is an issue with the ongoing charges figure (OCF) capped at 0.75 per cent. "True illiquid assets – not securitised ones – would undoubtedly bring additional charges that would probably have to be offset elsewhere."

He also notes an operational hurdle. Money needs to shift between asset classes – but the illiquid manager cannot guarantee timely entry or exit. "Everyone wants this done fluidly, transparently and with great control and automation. Automation and scalability are the key factors in driving down costs and making sure you can run broad market solutions."

Another major trend is for environmental, social and governance (ESG) investing. "I see this really changing this year," Escott says. "A lot of schemes are looking at ESG investment regulations and the duties being placed on them. Schemes are aware of the benefits that ESG can bring to investment strategies, including default funds."

Trustees have become a lot more conscious of non-financial factors, according to Shah. "There is a lot of product development, such as for multi-factor investing with an ESG tilt."

Skinner says the industry is evaluating how ESG can be incorporated: "What is appropriate for the membership? How should it be deployed and assessed? How do you achieve the right balance with fees? What is the most appropriate timeline?"

Written by Alastair O'Dell, a freelance journalist

The battle for savers' retirement pots

Despite industry warnings, consumers are still abandoning annuities in droves. Could hybrid products bridge the gap between flexibility and security? Sara Benwell explores

Summary
- The take up of annuities has continued to fall since 'freedom and choice'.
- However, some retirees are working with advisers to blend products in retirement.
- Hybrid products are failing to gain traction due to cost and complexity, but may become more popular as fewer retirees have DB savings to fall back on.

Pension savers are continuing to embrace freedoms, with more people cashing out or going into drawdown than ever before.

A Financial Conduct Authority (FCA) sector report finds that in 2017, 55 per cent of people took full cash withdrawals, 30 per cent went into drawdown and only 15 per cent bought annuities.

These figures aren't particularly shocking. The consumer trend towards abandoning annuities has steadily increased since the pension freedoms were introduced, leading many large insurers to withdraw from the insurance market altogether.

It's been more a flood than a trickle, and one driven by low interest rates, Solvency II requirements and most critically 'freedom and choice'.

Part of the driver is a demand for flexibility. Aegon pensions director, Steven Cameron, comments: "The sharp increase in transfers from defined benefit to defined contribution schemes, coupled with an ongoing preference for income drawdown over annuity, points to a desire for flexibility over how to draw retirement income.

"This is consistent with Aegon's latest research, which found that half of over 50s want a fluid transition from work into retirement, which requires greater flexibility over how and when to draw pension income, often alongside reduced earnings."

However, the industry remains deeply concerned by fears that consumers are making poor decisions and could run out of money.

These fears are not totally unfounded. Of the 55 per cent of people taking all their pots as cash, over half are putting the money into cash, investments in ISAs, savings or bank accounts.

Clearly the lack of trust and understanding in pensions remains. After all, it is rare situation where taking money from a workplace pension only to stash it in a bank account or ISA is a good decision, either from an investment or a tax perspective.

Balancing flexibility with security

When you ask people what they want from their retirement income, the answer tends to be unequivocal – if conflicted.

They say they want flexibility but also that they want a secure and guaranteed income for life – or in other words, an annuity.

One way to achieve this balance is to combine different products (sometimes from different providers) in order to get elements of both stability and flexibility.

Standard Life head of global savings policy, Jamie Jenkins, says: "There is a great deal of merit in considering a combination of flexible and fixed income products for retirement planning, particularly given the uncertainty of future needs, health and life expectancy.

State Street Global Advisors head of pensions and retirement savings strategy, Alistair Byrne, adds: "Those with a financial adviser can have the adviser structure a mix of savings, drawdown, and annuity income for them. In addition, a number of products exist that put drawdown side by side with annuity, and enable future tranches to be annuitised. As it stands, the annuity element tends to be relatively underused."

That's borne out by the figures, annuity take up remains poor, even for it to be used as security against poverty in later life.

This may be because retirement decisions are complex enough, without having to go to providers and get two products, with two sets of fees.

Intelligent Pensions technical director, Fiona Tait, says: "The potential downside of a mix of retirement products is complexity and cost, whether that be an increase in the cost of advice or additional product costs. If one element of the mix, particularly if it's drawdown, is relatively small, costs can become prohibitive."

Barnett Waddingham self-invested technical specialist, James Jones-Tinsley, adds: "The cost of effecting two or more arrangements as part of an individual's overall retirement planning strategy could be more expensive than effecting one arrangement… and may involve using two or more different providers, which may increase the complexity and ongoing administration of the overall strategy."

One alternative is a hybrid product that combines annuities and drawdown in a one-stop-shop product for retirees, a solution that is gaining enthusiasm among providers.

But even though the industry has appetite for hybrid products, consumer demand for these innovations remains low.

Jenkins says: "All of this flexibility can be achieved within the current framework of products. While hybrid products may appear attractive, they haven't proved popular in practice."

One reason for the low take up of hybrid products may be that a large majority of people retiring today have DB pensions.

For anyone with a substantial DB pot, this can provide the stability and security one needs, and means that smaller DC pots can be used for discretionary and flexible spending.

And for those on lower incomes, the state pension should provider a sensible replacement rate and guaranteed income for life – again leaving any DC savings to be used as one wishes.

Looking to the future

The lack of appetite for blended products, or indeed mixing and matching drawdown and annuities, makes sense against a backdrop of DB-led pensions.

But as we see the next cohorts retiring, who have the vast majority of their savings in DC, is this likely to change?

Byrne argues that deferred annuities could play a role in helping retirees secure income throughout later life.

He says: "So far there is a limited supply of deferred annuities in UK, but that may change with greater demand. In the US, we are working on implementing such a model for a large client, and initially the supply of annuities was limited but insurers are now becoming more interested."

However, JLT Employee Benefits head of pension decision service, Richard Williams, argues that cost may mean that hybrids never reach their full potential.

He explains: "Many hybrid products come with extremely high fees. These hybrid products are also especially complicated, and many clients are not capable of understanding all of their technical features or limitations.

"This becomes a vicious cycle, as higher costs put advisers and clients off, which in turn stops providers from reaching a critical mass where they can reduce the costs."

And some advisers are questioning whether annuities have any role to play at all in a sensible income strategy.

Portafina managing director, Jamie Smith-Thompson, says: "We believe in many scenarios annuities currently offer really poor value and have done for some time. A big part of this is down to year-on-year increases in life expectancy.

"Depending on your circumstances, they may only guarantee a 3 per cent return if you chose to add other benefits such as inflation protection, guaranteed periods or spouse benefits.

"You could look at a hybrid option of a guaranteed annuity and pension drawdown but why would you if annuities are such poor value?"

Even where savers do want to add in an insurance-based solution, there are questions as to whether a hybrid is the right way to go.

Williams argues that a mix and match DIY approach might make more sense. He explains: "The hybrid's ability to combine two complete products into one vehicle is their greatest selling point, but the jury is still out on whether they are genuinely able to provide a level of benefits that cannot be matched by their traditional alternatives." And while a hybrid might make it easier for a consumer, in that they only have to decide on one product, the increased cost and complexity may be off-putting.

Tait adds: "Combination products are simpler to set up as there is only one application form and one income payment, even if money is effectively withdrawn from both parts of the plan.

"The downside is that the underlying product is more complicated to understand and usually more expensive to cover the cost of the guarantee."

But DIY solutions are usually the result of independent financial advice, something for which many people are unable or unwilling to pay.

This suggests there may still be a role for hybrid products, in meeting the needs of middle-income savers. Those people for whom the state pension is too low to provide enough security, but who feel that their pots are not large enough to warrant advice.

Tait concludes: "Combination products can be more effective for smaller pot sizes where the cost of having a separate annuity and drawdown product are harder to justify."

Written by Sara Benwell, a freelance journalist

Summary

- Alternative asset classes remain popular due to diversification, income generation and better risk-adjusted returns.
- Private credit is still high on the list, although the market is getting crowded and investors have to be more discerning due to the end of the cycle.
- Infrastructure and real estate are also favourites although investors are moving more towards core assets.
- Alternatives would be beneficial to defined contribution schemes, but the structures are not in place, although this will change in time.

The new alternative

Alternatives have been popular with pension funds for several years, but with increased market volatility, pension funds are having to broaden the range of alternatives that they turn to. Lynn Strongin Dodds investigates

Alternative or real asset classes have been a regular feature in UK defined benefit schemes for the past few years, with allocations comprising roughly 20 per cent. Lower-risk, high-yielding assets have been a favourite but as volatility has spiked thanks to changing macro-economic conditions, funds are having to look more closely at the best opportunities.

The drivers behind the trend though remain the same – the low return outlook for traditional asset classes and the steady depletion of the coffers. It has been well documented that UK DB plans are heading into negative territory with a recent study by PWC predicting that 80 per cent are expected to be cashflow negative within five years. The doors of many are not only firmly shut to new entrants, but the workforce is ageing and the rate of transfers have been faster than predicted.

The benefits of alternatives, according to BlackRock head of UK institutional business, Andrew Stephens, is that they provide differentiated sources of return, diversify the scheme's investment risks and offer access to illiquidity and complexity premia that can improve portfolio outcomes.

"Increasingly, we are seeing DB schemes also thinking about illiquid asset classes that can provide income in excess of what is available in the public markets," he says. In general, "alternatives are a very broad term that covers liquid investments such as alternative risk premia, hedge funds and absolute return strategies, as well as illiquid investments like infrastructure, private credit and property."

Each pension fund of course has their own risk and return characteristics and constraints that will dictate the type of assets to be slotted in. "There is no one-size-fits-all solutions but exposure to alternatives continues to rise and the definition is broader than in the past," says Goldman Sachs Asset Management head of UK and Irish institutional business David Curtis.

The opportunities in credit though may not be as vast as the recent past as economists are predicting slowing global growth, tightening of monetary policy and a bumpier ride. While these soothsayers have been warning that the end of the bull run is nigh, the axe is expected to fall this year. This can be a difficult time for credit investors as spreads tend to widen and schemes need to be much more vigilant of the downside risk for individual credit holdings.

"Private credit has been hugely popular and in the second half of 2018, we had a lot of conversations that did not lead to investments because of fears over the end of the cycle," says Mercer senior consultant and UK alternatives leader David Willers. "However, defined benefit schemes have to spend money somewhere to generate returns and private markets still offer some of the most attractive opportunities."

Curtis adds: "We have seen large allocations to private credit over the years and while it may seem crowded it is still a sizeable market at $600 billion, with the US accounting for two thirds. He says while investors have to be more discerning there are opportunities in, for example, senior secured loans, which have the same credit quality as for example high yield but are floating-rate notes and also offer more investor protection, in that borrowers must repay senior loan debt before other types of debt if the company runs into trouble."

Looking farther afield, interesting prospects can be unearthed in the less fashionable, harder to enter areas of the market, according to Cardano investment manager Ben Cooper. These range from middle market distressed debt to China-A and other emerging-market debt strategies.

Although these require greater due diligence, LGIM head of institutional clients Mark Johnson believes that, in general, DB schemes are adopting a more granular approach and looking carefully at sector exposure, the ratings and credit quality of the holdings. Their mindset has also changed as to its role. "There have been three stages," he adds. "Five years ago, public credit was seen as a stand-alone allocation alongside equity but as schemes have de-risked and turned cashflow negative, they looked at more buy and maintain strategies to meet cash outflows. Now, private credit is also seen as part of the matching element of the portfolio, with a number of our clients having all three strategies in place."

A more conservative tone has also been struck with infrastructure and real-estate debt, which provide uncorrelated returns, as well as stable and predictable cashflows. "As we are at the end of the cycle, we are seeing a greater demand for core infrastructure and property than value add, speculative assets," says J.P. Morgan Asset Management's head of Emea pension solutions and advisory group Sorca Kelly-Scholte. "They are looking more at the stability of the income rather than the capital gains. We also recommend sector and international diversification to protect against political risks."

UBS Asset Management lead real estate strategist, real estate and private markets, Paul Guest, sees value in student and senior housing as well as medical offices. However, he also believes schemes should look to investigate the potential of data storage centres that cross the property and infrastructure divide.

There are different routes, such as buy and build or shell and core, which each have their own disadvantages and advantages. On the whole though they can offer long-term income, a dependable tenet base and a greater yield than industrial," he adds.

Aviva Investors investment strategist, Boris Mikhailov, would add long lease and commercial ground rents to the real estate list because "they produce long-term, high-quality streams of income and are inflation linked. Beyond real estate, certain types of infrastructure projects, if financed on an unlevered basis, could also have similar attributes, such as wind farms, solar panels and high-speed fibre broadband. Outside of real estate and infrastructure equity financing, I also think there are a number of opportunities in the structured finance space, such as swap repacks, fund or trade financing that can provide attractive risk-adjusted returns to investors."

On the more liquid end of the alternative spectrum, some fund managers are advising smart beta type of product, while others such as Redington Investment consulting director, Nick Lewis likes "high-quality structured credit such as asset-backed securities in the US and Europe or globally. A blend of senior investment grade tranches can generate Libor plus 2 whilst benefiting from high liquidity. In addition, strategies focused on riskier parts of the securitisations (below BBB) aim to return Libor + 3.5-4 per cent whilst giving up some liquidity."

As to other asset classes, there is a debate as to whether gold and currencies could be slotted into the alternatives bucket. World Gold Council director, John Mulligan, argues that gold is not just a safe haven but has a place in alternatives because it produces reasonably attractive long-term returns, offers diversification and a hedge against downside risk. "Gold is not as volatile as other commodities and if you look at the long term it is a growth market – over the past 30 years, it has doubled in volume and quadrupled in value," he adds.

In terms of currencies, Record Currency Management CEO, James Wood-Collins, says there has been more interest over the past four to five years in return seeking currency strategies, as well as the ability to manage currency risk in other alternatives, especially in credit. "Pension funds are looking more at how the risk premia can be exploited instead of currency as a discretionary trading strategy. This is not unique to currencies but can be found in other alternative risk premia such as smart beta in equities."

While many of these solutions are well-trodden ground for DB schemes, they are new territory for defined contribution plans. The products are far and few between but as DC grows in scale and maturity, alternatives are likely to be more prominent. "One of the biggest problems with DC schemes is the need for daily liquidity," says M&G investments director, global institutional distribution Annabel Gillard. "It is not a legal but defacto requirement by the operating systems that manage the flows of the different payrolls. However, the sooner we can crack this technological problem the better. It has gained more attention and there have been a few asset managers who have launched alternative type of products with daily liquidity. However, they do not give investors the full alternative experience."

Written by Lynn Strongin Dodds, a freelance journalist

The Pension Protection Fund chief actuary, Lisa Mccory, sits down with Theo Andrew to discuss her greatest work achievement, how she wanted to be a doctor and the values passed on from her father

What is your pensions career CV?
I started working as a trainee actuary in 1998. My first role was in the DB section of a life insurance company, which was then acquired by Aegon. After qualification in 2003 I joined a small consultancy as a scheme actuary specialising in restructuring and winding up DB schemes. I left in 2009 to join the PPF, where I have had numerous roles.

What other areas have you worked in and what roles have you held prior to joining the pensions industry?
I had a brief spell in IT as part of the actuarial rotation programme at Aegon, but even then I was working on DB calculations.

What is your greatest work achievement so far?
My appointment as chief actuary at the PPF and being responsible for the production of our most recent annual valuation of the fund. We now have assets of around £30 billion, making us one of the biggest funds.

What do you still wish to achieve?
I am looking forward to working on our funding strategy and helping the board reach our objective. We are progressing well but there is a lot of risk out there and part of my job is analysing the risks and helping the board understand them and how they might change.

What is your biggest regret within your career?
None! Even when things haven't gone quite as I had planned, I have always come away feeling like I have learnt something new.

Excluding your current role, what would be your dream job, in or out of pensions?
I love my job so if I was going to change I think it would need to be into something very different. Perhaps a teacher; I enjoy working with our trainees and seeing them grow and develop.

What was your dream job as a child?
I always wanted to be a doctor. I spent a lot of time operating on my dolls when I was young.

What do you like to do in your spare time?
I have two girls aged three and six and love spending time with them and my partner. We all enjoy the seaside, musical theatre and theme parks.

Any particular skills or party tricks?
I am currently training for my third half marathon in 18 months. I am slowly improving and I am hoping to knock another 10 minutes off my time to finish in under two hours next time round.

Who would be your ideal dinner party guests?
Mo Mowlam. I grew up in Northern Ireland and have great respect for what she achieved there. It would have been great to hear her story and I am sure I would have learnt a lot on how to get a consensus view.

Do you have a particular phrase or quote that inspires you?
"Do right. Do your best. Treat others as you want to be treated." It reminds me of my dad and is also very similar to our values here at the PPF.

Written by Theo Andrew

Diversity – the key to overcoming groupthink

Outgoing TPR CEO Lesley Titcomb once stated that the pensions industry was "behind the game" when it came to trustee board diversity, but is this still the case? Natalie Tuck investigates

Many in the pensions industry will be familiar with the 'elevator groupthink' psychological experiment from the 1960s, where a man copies his peers (who are unbeknown to him, actors) and faces away from the doors whilst riding in the lift. The clip, often played to audiences of pension conferences, illustrates the idea of groupthink.

It's an issue that particularly impacts pension trustee boards, but could diversity be a potential solution? As part of its guidance on defined contribution schemes, The Pensions Regulator notes that "as far as possible" trustee boards should be diverse and well-balanced.

This includes those typical to the pensions industry, such as employer-appointed, member-nominated and professional trustees. But its guidance also notes factors such as the experience and skills of trustees – for example, education, professional, voluntary – and lists societal demographics, such as race, sex, age, disability and orientation.

However, despite such guidance from the regulator, its outgoing chief executive, Lesley Titcomb, at the Pension Lifetime Savings Association's Investment Conference in 2017, said the pensions industry is "behind the game" when it comes to diversity. In a more recent speech at the Eversheds conference in December 2018, she noted TPR's continued interest in the composition of trustee boards.

"Diverse boards bring better decision-making and governance. They have a closer connection and better represent the members they are there to serve," she said. It is apparent that the regulator is convinced of the benefits of trustee diversity, but is the rest of the industry following suit?

The statistics would say no, with research from the University of Leeds revealing that around 81 per cent are male, and have an average age of 54; the majority are aged between 50 and 70. However, Association of Member-Nominated Trustees (AMNT) co-chair, David Weeks, notes that in recent years the view that having a diverse trustee board has spread across the industry. "The question is what you do to increase diversity," he says.

"The key task now, and we certainly at the AMNT are doing, is to spread the net. I think the biggest gap we have is that we're so thin on the ground in terms of younger trustees," he says, adding that a significant trend amongst young people is that they have a much more developed perception of what investments are being used for, such as valuable societal projects.

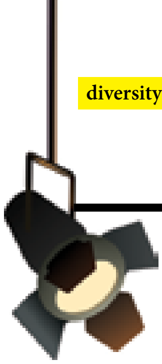
Backing up Week's comments is the view of ShareAction investor engagement manager Anne-Marie Williams, who has previously argued that a lack of younger representatives on trustee boards pushes issues such as climate change into the future. She believes that a lack of age diversity on trustee boards means that there are very few young savers who are really in touch with environmental risks.

Asked whether the problem is that pension schemes aren't approaching young people to join, or whether young people don't want to join, Weeks said the picture is a mixed one. However, he notes that most schemes do need to focus more on outreach work in terms of recruiting younger trustees. Weeks explains that recruiting younger trustees for closed defined benefit schemes is "quite difficult", and there is much more potential for diversity for defined contribution schemes.

As a believer of the importance of diversity in decision making, Weeks notes that all the actors of diversity are important, and it's not just about bringing on younger trustees, or more women. "If the people on the board are all too much of the same way of thinking then they will be good at addressing some issues but not others," he explains.

For example, in the case of integrated risk management, he says that if the trustees are all involved in groupthink it is less easy to spot all the risks that there may be, whereas with a diverse trustee board, the risks are much easier identified due to the different perspectives.

Written by Natalie Tuck



Who's listening?

Pension scheme members are a diverse group of people, with different needs and understanding when it comes to their pensions. So how do schemes communicate to such a varied group of members? Natalie Tuck explores

If there's one area where the pensions industry ticks all (most) of the boxes when it comes to diversity, it is with pension scheme members. This has always been the case but the government's auto-enrolment policy has brought in a wider set of people, with around 10 million people enrolled that weren't previously members of pension schemes.

"Schemes can have a huge array of member types, all with different financial needs and ambitions and levels of understanding around pension savings," notes Local Pension Partnership (LPP) head of client delivery Taryn Mutter. Her colleague, head of business development, James Wilday, adds that at LPP, pension administration services are provided to LGPS, police and firefighters' pension schemes, with members ranging in age from 16 and above.

This, as LifeSight master trust director, David Bird, notes, makes it all the more crucial that communications are personalised, rather than generic. "Generally, schemes will issue an annual report, an annual benefit statement and, increasingly, some form of online experience," he says.

With these types of communications, Quietroom director of strategy, Rhys Williams explains, at a basic level, tailoring is about addressing someone by their name, instead of 'dear member'. "The next tier up from that is information that is relevant just for you," he says. "Within the pensions space it would be, are they in DB or DC, which sections of the scheme are they in, what is their contribution level, what investment choices have they made, have they nominated a beneficiary etc."

But where it gets interesting, Williams adds, is when schemes extend beyond the personalisation, in terms of names, and start giving people different messages. Quietroom was involved in the 'Time to Choose' consultation for the British Steel Pension Scheme (BSPS), where members were given the choice to remain in the existing scheme, which would fall into the Pension Protection Fund, join the new BSPS scheme, or transfer out.

"There were over 25 different versions of the option packs sent out to members, and it was based on every little nuance, the choices they have made in the past, their circumstances, whether they'd be better off going down one route or another route," Williams states.

This is something that has also been put into practice by LifeSight, which Bird says has led to far greater online engagement rates (80 per cent among active members, almost 50 per cent among deferred members), and he adds, far fewer queries coming through the helpline.

Taking tailored communication a step further on from that is targeting a specific message to members that schemes think would benefit from intervention. Williams says that all the schemes Quietroom is working with are working towards this method.

Mutter and Wilday believe that we are at a "critical juncture in the pensions industry", and tailored communications are an increasingly vital solution. "Built around individual member needs, these will go a long way to promoting awareness and understanding, which ultimately drives engagement and a better financial future for members."

Aside from tailoring the content of communications sent to members, providers can also tailor the way in which they communicate to members. Mutter and Wilday add that "ultimately, it's up to the scheme to ensure that members have the option to receive communications in a way that suits their needs".

This can range from face-to-face sessions, group meetings, post, email, and as some of the master trusts are already doing, creating smartphone applications. Aviva has gone beyond that, creating an Alexa skill, giving people the option to access their pension information through their own Amazon voice-controlled device.

But as Williams notes, the medium used is not the main point; it is rather that schemes should be thinking about the member. "Make it as easy as possible for them to do the things they need to do, because everything that puts friction into the process…people will just get off the bus, because they're looking for reasons not to think about their pension."

Written by Natalie Tuck

Room for improvement

When it comes to diversity within the pensions industry, the phrase 'male, pale and stale' is often bandied around, but is that a fair reflection?

The pensions industry – it's no Gap advert is it? That was one of the responses as to whether those within the pensions industry believe it to be diverse.

The clothing retailer is famously known for its diverse advertising campaigns that champion diversity and inclusivity. But, according to State Street Global Advisers (SSGA), senior managing director, Nigel Aston, the pensions industry is far from that.

The general consensus from those within the industry is that diversity is improving, but as Pensions for Purpose head, Karen Shackleton, notes: "I still go into meetings where I am the only woman present."

However, Next Gen (which promotes younger voices within the industry), chair, Michael Watkins, believes that the industry is diverse, and is "full of intelligent people that represent a wide range of demographics and ages". Instead, he says the problem is that that diversity isn't evenly distributed where it ultimately matters, "which is on decision making and trustee boards".

"For all of the diversification that there is in the pensions industry, what impact can be made if those diverse minds aren't empowered with a voice? Whether it be generational, gender or race, in order to provide positive member outcomes and solutions that are designed to meet the needs of an ever-changing working population, we have an obligation, as an industry to provide a platform that promotes and encourages diversification of thought," he says.

Next Gen, which was launched at the Pensions and Lifetime Savings Association's Annual Conference last year, has already gained close to 300 members. This, Watkins notes, shows how great the appetite is. He adds that a career in the pensions industry is often spoken about in a derogatory way, despite the industry being of great importance to society. Next Gen, he says, wants to change the perception of those that have recently begun a career in the industry.

If the pensions industry, and those within it, has a desire to bring in a wider range of people, and perhaps give those already in the industry a platform, then it must get to work in making that change. Shackleton says that pension funds can play an important role in encouraging diversity.

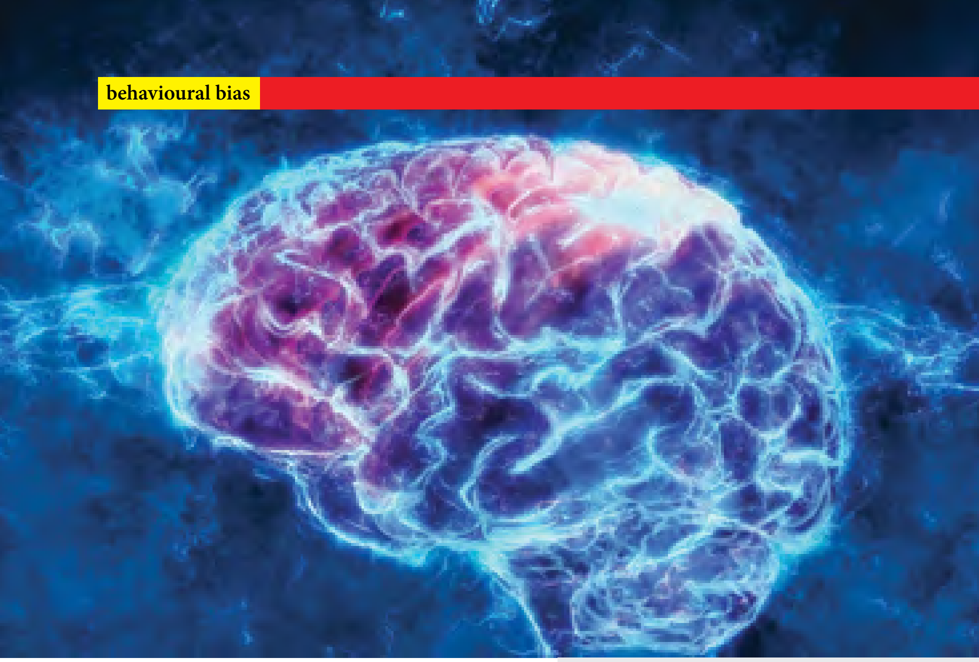
"One of my LGPS clients asks each and every asset manager that he meets why they don't have more women in their investment teams. He has just requested an annual report on the gender pay gap for each of them. I've watched managers get quite hot under the collar answering his questions."

She adds that firms should also reflect on how they advertise jobs, for example, whether they use adjectives that appeal to men or women, and what ethnic minorities would think. This approach has paid off for SSGA; Aston notes that since the launch of its 'Fearless Girl' campaign, in which a statue of a Fearless Girl was dropped on Wall Street in New York to mark International Women's Day 2017, SSGA has seen a "noticeable uptick in the number of women applying to work for us in all positions".

There are obviously areas within the industry that have made more progress than others, with the consensus being that asset management is further ahead. However, as Gresham House, head of institutional business, Heather Fleming says, the very technical roles within pensions tend to attract males who dominate roles in this area. "I think work needs to be done to encourage younger women to consider the technical roles and give them confidence that they are suitable for them."

All in all, the pensions industry appears to be heading in the right direction, but as Watkins notes: "Our industry has some way to go to ensure that we share the cognitive load. The beauty of the challenge is that it never ends."

Written by Natalie Tuck



Bias on the board

Trustee board members can be subjected to large amounts of technical information and are under pressure to make the right decisions. Whether they know it or not, behavioural biases could easily impact their choices. Andy Knaggs looks at how the risks of this can be mitigated

Summary

- There is little research into the effect of behavioural biases within pension scheme trustee boards, but it is well recognised that it exists.
- Resources such as checklists and meeting frameworks have been developed to help trustees feel more confident about decision making.
- The role of the chair is critical to helping mitigate the risks of behavioural biases affecting trustee board decisions.
- Board diversity and an awareness of behavioural bias issues among all types of trustee can also help.

A great deal of time has been spent on researching the issue of how behavioural biases can affect the financial decision making of individuals. Much less has been devoted to institutional investors and, in particular, the way that behavioural biases such as groupthink, loss aversion and authority effect can affect the decisions made by pension scheme trustee boards.

Is it generally recognised and accepted in the industry that these behavioural biases can, and do, play a part in the group decisions that trustee boards make? Yes, says Association of Member Nominated Trustees (AMNT) co-chair David Weeks. "It's not creeping up and not being noticed; it's very much there and has been noticed," he says. "It's a field of activity that is beginning to be probed for the first time."

Further evidence that the industry has woken up to this as an issue is provided by the work of professional services firm Aon, in collaboration with the behavioural science specialists Behave London. Between them, they have provided a set of 'trustee effectiveness tools and techniques', that they claim will allow trustees to make decisions with greater confidence. Among these resources is a trustee checklist to help with group decision making *[see boxout]*.

According to Aon principal Susan Hoare, trustees do not always feel equipped to ask challenging questions of investment advisers on every topic presented to them at a board meeting. "The research undertaken with Behave London has helped us to identify the decision-making biases we are looking to overcome," she says.

Anyone can download these trustee resources, which also includes a trustee meeting framework, from Aon's website. Behave London founder Hannah Lewis says that the checklist has already been downloaded thousands of times, suggesting that many trustees have already leaped the first hurdle in overcoming behavioural bias, which is being aware of its existence in the first place. Awareness is key, she says, although that does not make biases disappear. Accepting that it can happen to you is another key stage to get past.

"One bias I see consistently rear its head among boards is that they have a bias blind spot," says Lewis. "It's very hard to spot bias in ourselves, and very easy to spot it in others. You'll hear a board of white men in their 50s state that diversity is important, yet justify their own lack of board diversity by saying that they have 'cognitive diversity'."

The behavioural specialists draws upon a motoring analogy to demonstrate how 'cognitive biases' can be fought: "Think of it like being in a car going too fast. We can put speed bumps in the way to slow us down – which is an overt measure. So, having a checklist in place to make us think about decisions is useful.

"We can also use covert measures – like painting the road markings closer together, which makes us feel like we're going too fast, and we naturally slow down. In this case, it's putting processes in place to make sure we make decisions well. Have a lunch break or a coffee break before voting on a big decision, so that your brain is refuelled. Make sure you address strategy first thing in the morning when you are fresh. Don't waste valuable brain juice going over the minutes of the last meeting."

Chair necessities

Organisational factors can help to mitigate the possibility of behavioural biases affecting trustee board decisions. This is the viewpoint of both Weeks and PTL managing director Richard Butcher.

Both men stress the important role of the chair of the trustee board. "The first thing is the role of the chair in making sure that the board directs the attention it needs to the correct issues," says Weeks. "Most boards meet quarterly, and meetings can last for most of the day. It is important to concentrate on the issues that are significant.

"Trustees vary in how forthcoming they are and, likewise, some chairs can be a bit over-dominant in dictating things. One of the skills that the chair ought to have is nurturing the trustees that may have something valuable to say, but are not too forthcoming, and limiting the contribution of the ones that might talk too readily. All trustees should have the TKU (trustee knowledge and understanding), so they are expected to have a basic understanding. My view is that you should not have too many people that are investment experts. There needs to be a spread of commercial expertise, and the skill of the chair is achieving a balance among those interests."

Butcher says the three key things that can mitigate behavioural bias are an effective chair, a diverse board of trustees and the acceptance that you can be susceptible to such biases. The chair should "make sure that everyone has sufficient information to give their view on a decision", while it is the "duty of a trustee to tell the chair if they feel they are being pushed too quickly" into a decision. Time should be built into a meeting agenda to debate and explore important decisions.

Many trustees are 'lay' trustees, for whom the work is a part-time addition to their main jobs. They are not specialists and so might be considered more likely to fall victim to biases such as groupthink or authority effect than a professional trustee. However, as a long-time professional trustee himself, Butcher says it is vital that these also accept that they are not immune to behavioural bias. "It can be a touchy subject for professional trustees," he said. "Most will say they are above it and, in a sense, that's a weakness too."

The best way to mitigate behavioural bias is to encourage more diversity among the trustees, according to the PLSA, whose policy lead for investment and stewardship, Caroline Escott, says: "It's a well-established fact that diverse boards make better decisions and are less prone to groupthink. Encouraging the creation of diverse trustee boards will help ensure schemes are well-placed to take the best possible decisions."

Another way to mitigate the risks may be to seek several different opinions before making a decision, says Pensions Policy Institute head of policy research Daniela Silcock. Meanwhile, Butcher recommends getting everyone to write their decision on a slip of paper, so they are not influenced by the views of the rest of the board.

It may not be fashionable to say so as the UK prepares to leave the EU, but we could also learn something from the continent, says Silcock.

"We are way behind the rest of Europe on this. It's much more a matter of form there, with indexes of social and environmental credentials. It's not going away there, and it won't be going away here either."

Written by Andy Knaggs, a freelance journalist

Pension decision making in trustee meetings

Decision making in a group

1. Authority

I am not allowing a person's experience from a different domain to unduly influence me in this domain.

2. Herding and groupthink

I have listened to my 'gut', and spoken without censoring

Evaluation of assets, investments, and strategy

3. Loss aversion

I evaluate loss and gain by using calculations and logic – my feelings about either are not important.

4. Status quo

Should I wish to leave an option as it is, I make an active choice to do so – nothing I do is 'by default'.

5. Endowment

I have made this decision 'as if' I were not involved previously, 'as if' I were giving advice on someone else's problem.

6. Reputation and responsibility

I have made a choice in favour of the best outcome, irrespective of what others may think of me.

Source: Aon Trustee Checklist

Higher deficits

Unite has warned that more must be done to prevent companies from legally prioritising executive pay over pension deficit recovery payments, else more 'Carillions' may happen. *Pensions Age* asks: Do you agree that there is still a risk and if so, what more needs to be done to make companies prioritise pension deficit recovery payments?

There is still more to be done to secure improvements in stewardship and corporate governance to avoid other situations where companies go bust leaving large unfunded deficits. This has to start with the setting of realistic recovery plans to get pensions back on track where large deficits exist.

The interactions between remuneration, dividends and recovery payments are complex ones and no single approach will be right for all companies. However, the regulator needs to build on its recent approach by continuing to be tougher in making sure recovery plans are realistic and not overly long to ensure members get the benefits they were promised. Promises should not be made on the never never.

Smart Pension head of policy Darren Philp

Whilst there is always scope for improvement, the current legal and regulatory framework does genuinely influence the behaviour of such companies (increasingly so since Carillion and BHS) and in any case the gains may be marginal if trustees find themselves fighting for a bigger slice of a very small cake.

For companies that aren't in financial trouble, it's all about finding an appropriate balance, and what's appropriate depends heavily on the individual circumstances of the scheme and its sponsor. It's therefore much harder to make generalisations about prioritising one thing over another.

For example, taking money out of executives' pockets in favour of higher deficit contributions sounds like good news, but taken too far it may leave the company unable to recruit and retain the right leadership. Similarly, restricting dividends can have potentially disastrous consequences for a company's cost of capital.

Attitudes have already changed to some extent. There may be further to go in some quarters, but we must be careful to target this carefully and maintain the right balance. In most cases, it isn't appropriate for the pensions tail to wag the corporate dog.

Sackers associate director Tom Jackman

It's entirely possible that Unite have over simplified the challenge here. There will always be corporate failures – they are a necessary function of a capital market – and it's bound to be the case that a few of these will have been sponsors of defined benefit pension schemes. The challenge for trustees is to seek to mitigate the impact of a failure on their beneficiaries as best they can. This isn't foolproof and never could it be because for it to be otherwise would require trustees to make the decision on whether a company should survive or not – a decision they are very rarely qualified to make. The key must be to ensure trustees have access to a flow of data in relation to the sponsors covenant – it should be a timely flow and to ensure they have the resources and power to do something with this data if they need to. The real trick for trustees is to spot the iceberg while it's still on the horizon and not just before they hit it.

PTL managing director Richard Butcher

The Pensions Regulator (TPR) has correctly recognised the need to achieve the right balance between dividends and deficit recovery payments: one cannot be prioritised to the exclusion of the other. Dividend income is important for schemes invested in equities. Maintaining the dividend rate is also important for investor confidence in the company. TPR can require companies to pay more to the pension scheme and may need to use this power in cases where pressure on the share price is creating a demand for dividends. The forthcoming revised DB funding code is expected to clarify TPR's expectations. Companies are likely to find it harder to obtain TPR agreement to extending recovery periods; reductions instead are what TPR is looking for, especially where the company already has 10 years or more.

Excessive executive pay, especially bonuses and performance-related deals, attract greater public opprobrium but are usually not so impactful as dividend payments on a company's ability to make pension contributions.

Aries Insight director Ian Neale

While Unite raises a valid point over executive pay, of greater concern to most DB scheme trustees is the growing disparity between dividends and deficit-repair contributions (DRCs) – the ratio of FTSE 350 dividend payouts to DRCs standing at almost 15 times. Indeed, dividends being prioritised at the expense of higher DRCs is of increasing concern to The Pensions Regulator (TPR) who, while, "not against companies paying out dividends" has cautioned scheme sponsors against not striking the right balance between shareholders and the pension scheme. Although TPR is unwilling to explicitly set the parameters within which scheme sponsors should operate, it has shown that it is willing to act when dividends are blatantly being prioritised over DRCs, as in the case of Southern Water in December.

Of course, recent triennial valuations have, in the main, been disappointing in that despite three years of DRCs having been paid, with only around half of DB schemes having comprehensively hedged their interest rate risk against the backdrop of historically low real interest rates, little improvement in many scheme deficits has been evident, to the obvious frustration of the scheme sponsor. After all, for many companies, the DB deficit represents the biggest risk on company balance sheets.

Columbia Threadneedle Investments head of pensions and investment education Chris Wagstaff

Pensions history

The common sense of the common stock

Fifty years ago, 3 February 1969, found George Ross Goobey making one of his many speeches on pension fund investment to a local charitable club in Bristol.

He explained that one of the greatest investment trends in recent years had been that of the change from fixed interest securities to equities as the more attractive investment for trustee and other funds. He went onto say that the fund for which he had the privilege of managing the investments had been one of the forerunners in this trend and that others may still be able to learn something from the arguments put forward to his trustees, which prompted them to take this step.

He indicated that he was not happy with the popular description of this change, which is generally referred to as 'the cult of the equity'.

"I thoroughly dislike this description", he said. "A 'cult' conveys the idea of some temporary fashion that has no real justification for its existence and will therefore soon pass away. I hope to endeavour to establish during the course of my address that there are still reasons why one should invest in equities rather than fixed interest securities and moreover this situation is likely to continue. If you must have a catchphrase for this philosophy might I suggest as being more appropriate, 'the common sense of the common stock' (if I might borrow an Amercanism)," he added.

Despite George Ross Goobey's suggestion and making the same point in speeches during the 1960s and 1970s 'the cult of the equity' catchphrase still survives.

The full text of George Ross Goobey's speech can be found in the Pensions Archive website; www.pensionsarchive.org.uk under "Collections" – "The George Ross Goobey Collection" reference LMA_4481_F_07_077

An extended list of George Ross Goobey's speeches and papers are now available to view online.

Written by The Pensions Archive Trust, chairman, Alan Herbert

Fun and games

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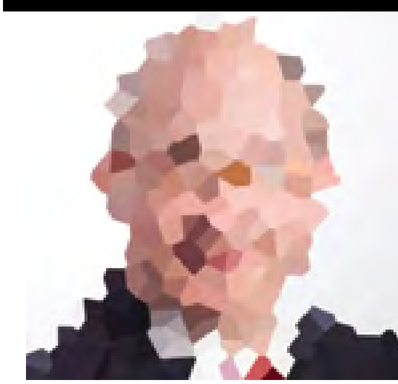

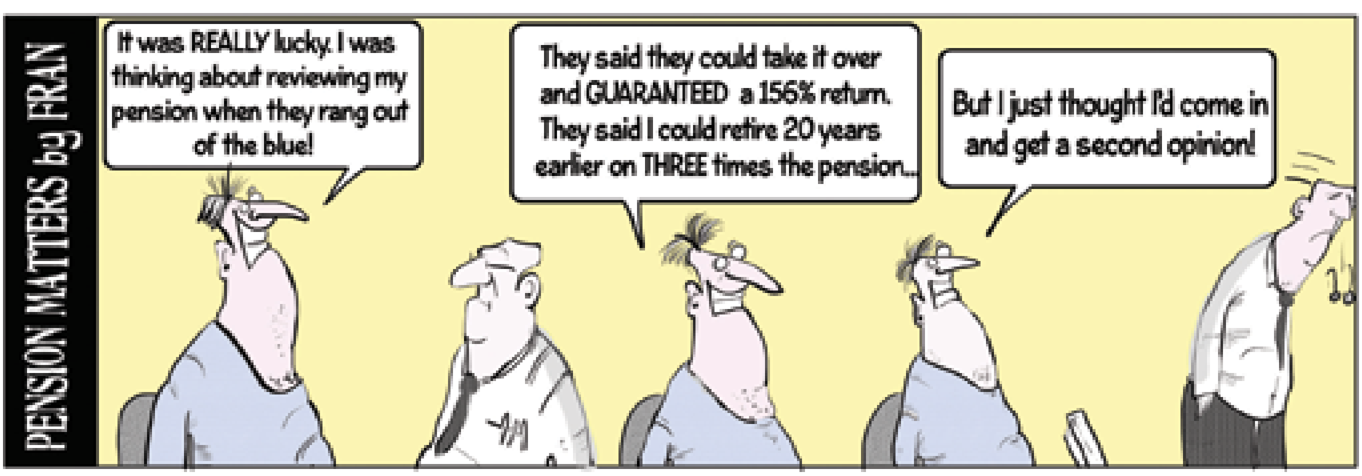

I know that face... Answer: RPMI CEO John Chilman

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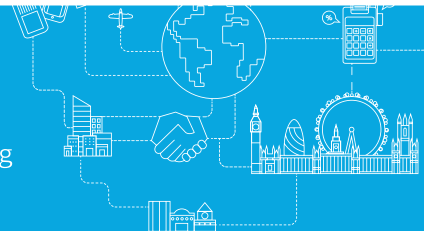

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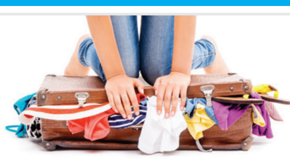

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DB Pension Consultant
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Ref: CB17279 W.Yorkshire **To £38,000 pa**
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christine@branwellford.co.uk

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Ref: HB17309 London **To £55,000pa**
You will be ACCA qualified with direct experience of accounting for UK occupational pension schemes, strong financial accounting skills, evidence of producing and reporting on year end and management accounts up to Board level.

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Ref: HB17313 Kent **To £34,000 pa**
Reporting directly to the Pensions manager, you will be responsible for providing a full pensions administration service to the in house scheme. Typical duties will include mentoring the Administrators, allocating workload, checking calculations and scheme events.

hayley@branwellford.co.uk

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