Transparency
How the ability to compare different charges is improving

Deficits
Is it too soon to be celebrating the current stabilisation of pension deficits?

Buyouts
Why it will be a record-breaking year for bulk annuity deals

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March 2018

PENSIONS Age

The leading pensions magazine

Being ethical: *The growing focus on SRI, the question of whether to divest from or engage with companies, shareholder activism and the popularity of 'green' investments*

Distressed DB: *The actions needed to ensure future business failures do not overburden the PPF*

Vultures circling

Will DB-DC transfers become a future mis-selling scandal?

Case study: NGUKPS - how the National Grid's pension scheme implemented a new investment strategy and split into three

Editorial Comment

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

Time is money, and a precious commodity for the majority of us. Always stressed, always busy, trying to work through as much of the never-decreasing to-do lists as possible within the 24 hours of the day.

But time can also save money. Significant money. If savers could be convinced, if not to spend money on individually-tailored advice, at least to spend some time accessing the help and guidance from The Pensions Advisory Service, Pension Wise and other such outfits, it could result in an uptick in pounds during their retirement. At the very least, in the case of DB-DC transfers, it may protect them from unscrupulous vultures looking to prey on their funds *[see our cover story on p46 for more information]*.

"The pensions industry itself can be just as guilty *[as members]* at avoiding spending the time they need to on complex matters, even if it could result in money saved"

Efforts have been made to tempt people to spend more of their time on looking after their retirement. For instance the Financial Conduct Authority is currently introducing new measures to encourage consumers looking to buy a lifetime income through an annuity at the point of retirement to shop around.

These new measures will introduce quote comparison templates showing like-for-like rates, which are compulsory for all providers or advisers to produce when providing annuity illustrations.

However, when savers dream about retirement, they fantasise about how they will be spending their time, now that they have more of it at hand to do the things they love. It is not the literal pot of cash they are thinking about.

So maybe to increase the success of the efforts such as the FCA's initiative, communication messages should be about the value of time in retirement, and then highlighting how the funds required for this precious time can be increased.

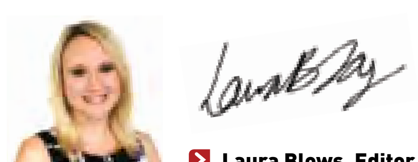
Convincing people to spend a little time now, in order to make the most of the time they have later in retirement can be a frustrating endeavour. However, the pensions industry itself can be just as guilty at avoiding spending the time they need to on complex matters, even if it could result in money saved.

For instance, spending the time to untangle the sometimes opaque nature of fees, and react accordingly as necessary, could result in sizeable cost savings. Even with all the time in the world though, it can be difficult to accurately compare charges, as our feature on p58 explains.

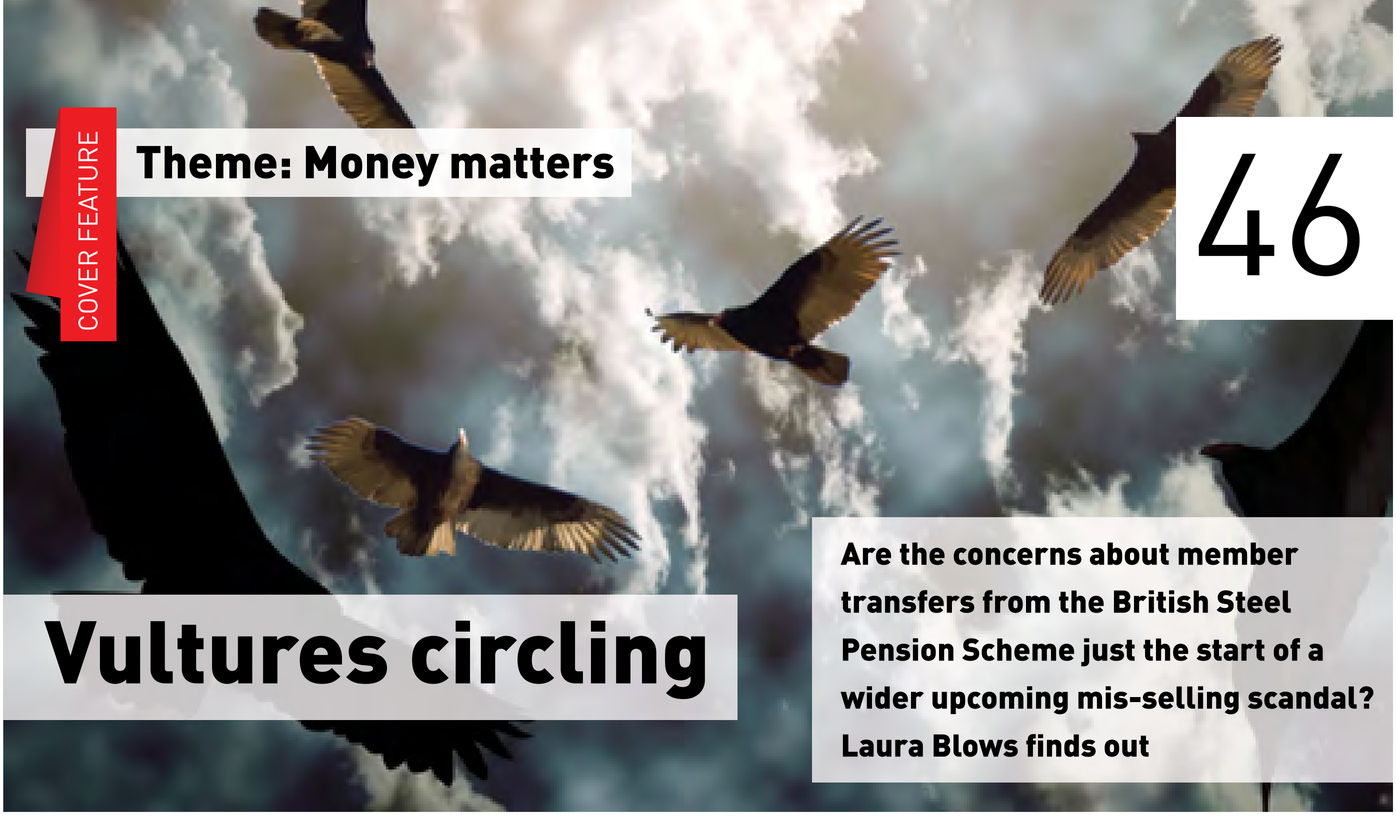
However the situation is improving, with regulations such as MiFID II and PRIIPS highlighting the need for cost transparency, the formation of the lobbying group the Transparency Task Force and industry calls for a standardised approach to charging structures across the industry.

Delving into the breakdown of charges may cost time – and sometimes money – but hopefully less so as these reforms bed in. But even so, the pensions industry, like no other, understands the value of patience, of investing time and money now for a greater payoff of both much later on.

Thank you for investing your precious minutes in reading this issue. I hope you find it to be time well spent.



Laura Blows, Editor



COVER FEATURE

Theme: Money matters

46

Vultures circling

Are the concerns about member transfers from the British Steel Pension Scheme just the start of a wider upcoming mis-selling scandal? Laura Blows finds out

Features & columns

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

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Pensions Age now has its new circulation figure from the Audit Bureau of Circulations (ABC). This is our BEST EVER circulation audit, and we would like to thank all our readers for their support. The average circulation July 2016 to June 2017 comes in at 15,023 print copies, near treble most of our competitors. This is 100% requested and/or copies sent as a member benefit (PLSA, PMI, SPC, AMNT). (source: ABC, see www.abc.org.uk). Pensions Age is also sent as a Tablet Edition to our 25,000+ online subscribers (source: Publishers Statement September 2017).

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DIVERSIFICATION
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Dateline - February 2018

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

1 February Total private pension wealth increases to £5.3trn between July 2014 and June 2016, up from £4.4trn between July 2012 and June 2014, the **Office for National Statistics** reveals. In its latest *Wealth in Great Britain* bulletin, the ONS reveals 49 per cent of individuals aged 16 to 64 had some form of active private pension that they were contributing into, up from 44 per cent in the previous period.

2 February One in five pensioners retiring this year will owe an average of £33,900 in debt, **Prudential** finds. According to Prudential's *Class of 2018* report, looking at the financial plans and aspirations of those looking to retire this year, 2018's retirees have debt that is nearly 40 per cent higher than their peers who retired in 2017.

5 February The UK has been ranked as the second-largest global market in terms of pension assets in 2017. According to **Willis Towers Watson**'s *Global Pension Assets Study*, the UK follows the US as the second-largest market when it comes to pension fund assets with 7.5 per cent. The UK was closely followed by Japan with 7.4 per cent. The ratio of UK pension fund assets to GDP now stands at 121 per cent, up from 108 per cent in 2016 and an increase of 33 per cent over the past decade.

6 February The Pensions Regulator fines the trustee of Now: Pensions a total of £70,000 and notifies the company of a deadline by which it must resolve its administrative failings. TPR has asked the master trust to settle its ongoing administrative problems for a number of years, which has led to some scheme members' pension savings not being collected from employers and invested by the scheme.

7 February The government's response to the Taylor Review offers "little hope" for improving the pensions of the self-employed, **Royal London** director of policy Steve Webb says. Commenting on the government's response to the review, former Pensions Minister Webb "welcomed measures on workers", but says it was worrying that the issue of gig economy pensions had again been "kicked into the long grass".

9 February The Pensions Ombudsman is investigating a group of over 150 complaints in relation to transfer values given to members of the British Steel Pension Scheme. A statement from the ombudsman says that it will also be undertaking another group investigation regarding early retirement factors, and said it continues to receive "new complaints and a high volume of enquiries".

8 February Removing the triple lock on state pensions could reduce the retirement income of a low-earning millennial by 5 per cent, according to research from the **Pensions Policy Institute** (PPI). The PPI's research says that a low earner's pension income, somebody earning £19,000 at the age of 40, would be 2 per cent lower by moving to a double lock and 5 per cent lower under an earnings linked state pension. The triple lock is expected to last until 2020 and Standard Life head of pensions strategy Jamie Jenkins believes it is inevitable that the triple lock will be replaced, as keeping it would be an "unrealistic benchmark against the way the economy works".

12 February Pension transfer values fell by £5,000 to £231,000 at the end of January, **Xafinity Punter Southall** reports. According to the Xafinity Transfer Value Index, values dropped from £236,000 at the end of December 2017 to £231,000 at the end of last month; the same figure recorded in October 2017.

13 February One million employers have enrolled their staff into a workplace pension, enabling over nine million employees to save for their retirement. According to figures from **The Pensions Regulator**, in the final stages of the policy launch, over 600,000 employers have complied with their duties in the past year alone. A further 150,000 small employers are due to enrol their staff by June this year.

The Pensions Regulator

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

14 February The Pensions Regulator says it is failing to measure the extent of pension scams and may have to "admit defeat", according to TPR Project Bloom chair Mike Broomfield. Broomfield says that collaboration on the issue is essential, but admits that they have not been able to put a price on the extent of scamming. Project Bloom, currently led by TPR, is a multi-agency taskforce that is working with government, the pensions industry, law enforcement agencies and other regulators to combat pension scams.

15 February The British Steel Pension Scheme has processed £1.1bn of defined benefit pension transfers since March 2017, with the **Work and Pensions Committee** stating that members have been "shamefully bamboozled". Publishing its latest damning report on the BSPS, the committee says that "dubious advisers exploited BSPS members for personal gain" with the help of "parasitical introducers", as it warns that another "major misselling scandal" is already erupting.

16 February The Sea Containers 1983 Pension Scheme secures a £187m bulk annuity buyout deal with **Aviva**. Aviva confirms that it has completed a deal with the scheme to insure its defined benefit pension liabilities and will enable trustees to secure benefits in excess of Pension Protection Fund compensation levels for the scheme's c750 members.

19 February Almost 80 per cent of pension savers have called for stricter checks to prevent scams, the **Pensions and Lifetime Savings Association** finds. According to new research from the PLSA, four-fifths, 79 per cent, of participants agree that there should be stronger checks to ensure pensions are protected. A lesser 28 per cent think these checks are unnecessary because people should be able to access their money when they choose and with ease.

20 February Work and Pensions Select Committee chair Frank Field is set to probe Arcadia owner Sir Philip Green on the company's pension schemes ahead of its potential sale. Following reports by *The Sunday Times* that Green is in talks with Chinese textiles company Shandong Ruyi to sell all or part of the company, Field confirms plans to write to Green to discuss this further. The committee chair has voiced that Green may have questions to answer on pension schemes at the retail empire.

Editorial credit: Featureflash Photo Agency / Shutterstock.com

21 February Lloyds Banking Group announces plans to increase its financial planning and retirement market by a million customers and increase its open book assets by £50bn in three years. Towards the end of 2017, Lloyds announced the acquisition of Zurich's workplace pensions and savings business, which has customer funds of £21bn and around 595,000 customers. In its full year report, it says the acquisition will enhance Scottish Widows' current offering, giving a strong platform on which to develop the next stage of its strategy in financial planning and retirement.

22 February Women are more likely to opt out of workplace pension schemes than men, according to a study by **Now: Pensions**. Analysis of Now: Pensions' members at the end of 2017 finds that women of all ages are more likely to opt out of their pensions than men. Nearly one in ten women (9 per cent) opted out, compared to 7 per cent of men. As women get older, their propensity to opt out also increases. Most likely to opt out are 60-64 year old women, as figures show only 62 per cent of this demographic remain in their workplace scheme, compared to 70 per cent of men.

23 February People who are divorced and planning to retire in 2018 face an annual retirement income that is on average £3,800 less that someone who has never divorced and retiring in the same year. **Prudential**'s latest annual study, which tracks the finances, future plans and aspirations of people planning to retire in the year ahead, finds that the expected annual income of a divorcee retiring in 2018 is £17,600. However, for people that have never divorced the figures rises to £21,400. The analysis is based on data from the Office for National Statistics.

News focus

'Shamefully bamboozled' members of BSPS transfer £1.1bn out of scheme

The criticism of the British Steel Pension Scheme by the Work and Pensions Committee in relation to defined benefit transfers is a "warning to all schemes"

The British Steel Pension Scheme has processed £1.1bn of defined benefit pension transfers since March 2017, with the Work and Pensions Committee stating that members have been "shamefully bamboozled".

Publishing its latest report on the BSPS, the committee said that "dubious advisers exploited BSPS members for personal gain" with the help of "parasitical introducers", as it warned that another "major mis-selling scandal" is already erupting. The report noted how unregulated introducers were incentivised to introduce as many steelworkers as possible to consider transfers. The advisers used contingent pricing, which means they will only take a fee if the transfer goes ahead. This led to them pushing the transfers, often against the interests of the members, the committee said.

"While doing so, they shamelessly bamboozled those members into signing up to ongoing adviser fees and unsuitable funds characterised by high investment risk, high management charges and punitive exit fees," the report added.

Since March 2017 the scheme has processed 2,600 pension transfers equating to £1.1bn, according to data revealed by the scheme's trustees to the committee on the 8 February 2018. The average value of BSPS pension benefits transferred out was £400,000; in around 20 cases the transfer value exceeded £1m. The committee heard of advice fees being typically around 2 per cent of the transfer value – and that the receiving funds sometimes imposed high annual charges and 'punitive' exit penalties, ranging from 5 per cent to as high as 10 per cent.

Furthermore, the report noted that research by the FCA showed that only half of DB transfer advice nationwide met its standards. This is far lower than typical rates for other forms of financial advice. For many people making a DB transfer, it is a huge and irreversible financial decision, the report said.

The report detailed how the circumstances surrounding the BSPS created the "perfect conditions for vultures to take advantage". It noted that many members had lost trust in the sponsor company and its pension pledges.

"The scheme was under-resourced and unable to provide basic facts to inform a complex choice. Its members were apparently neglected by the company, government, and TPR in their focus on the deal to keep the company going. A member communication plan sanctioned by TPR proved woefully inadequate. Against hard deadlines to choose one of two options worse than their promised pension, many members of working age were attracted to a third option.

"There was a surge in interest in DB transfers, seemingly unforeseen by all involved. Under pension freedoms, a transfer offered members control over a substantial sum of their own money. Foregoing a generous, indexed and secure retirement income is not, however, the right option for most people. Reputable local IFAs were overwhelmed by demand for advice."

Committee chair Frank Field said he struggles to fathom why contingent fees have ever been considered as an acceptable basis for providing impartial advice. "It is bad enough failing properly to enforce the rules there are, but when the rules are this weak? Our financial services regulator has been rejigged and rebranded but I can't see much evidence of it working better for the people it is meant to protect: individuals making life-changing financial decisions."

Field added that the outlines of a deal to save the sponsoring employer of the BSPS, Tata Steel UK, have been in place since May 2017. The scheme's members were "woefully under-supported" in making a decision: by the sponsor company, the government and The Pensions Regulator. It was the responsibility of TPR, who oversee trustees and signed off the deal to create a new pension scheme, to monitor the situation and ensure that members were not left in the dark. All this failed, the report said.

Within the report, TPR and FCA faced fresh criticism over their action in relation to the scheme. The committee has called on TPR to conduct a review, listen to BSPS members and learn the lessons of how they were let down. To prevent another BSPS happening again, TPR has also been urged to ensure all schemes in future are equipped to give members a full picture of the options they are choosing between.

Field said of the FCA that it has been "rejigged and rebranded" but he cannot see much evidence of it working better for the people it is meant to protect. He also questioned "whose side they're on" as he referenced the FCA's proposal to abandon the adviser presumption against transferring out of "gold-plated, stable, indexed pension schemes". As part of its report, it has suggested the FCA do not bring in these proposals, as it "looks reckless" in light of the BSPS case. The committee has also told the FCA to ban contingent charging, which it claims is a "key driver of poor advice".

Following the criticism, Hymans Robertson head of member options Ryan Markham has said that it should be seen "as a warning to all schemes". The company said the proportion of members requesting a quote to transfer out of their DB pension scheme has trebled over the past six months compared to pre 'pension freedoms' levels. The proportion of people actually transferring out is up four-fold compared to pre-April 2015.

Markham said that schemes need to "wake up and realise the pensions landscape has changed beyond recognition". He said those that don't support member decision making risk facing a scandal as big as some of the high-profile mis-selling ones of the past.

"The Work and Pensions Committee's report on BSPS brought the trustees under the spotlight about their approach to helping members with the transfer decisions they faced. Trustees made members aware of the need for advice and made sure this had been received before transfers were paid out. However, it is clear that much of the advice members found was poor and incredibly expensive. Despite trustees' warnings they were sitting targets for scammers and 'preyed upon' by some unscrupulous advisers." Markham noted that lessons can be learned from the situation for all pension schemes. He added that trustees have a moral duty to protect members.

Written by Natalie Tuck

NEWS IN BRIEF

Hymans Robertson has successfully completed the Pensions Administration Standards Association's reaccreditation process, PASA has revealed. Chair of PASA's accreditation committee Lorraine Harper, commented: "PASA accreditation is an outward demonstration that a pension service truly cares about the quality of service it provides to members."

The Pensions Regulator has begun carrying out spot checks in cities across the East Midlands to ensure employers are complying with their pension duties. Inspection teams are visiting dozens of businesses in Nottingham, Derby and Leicester to check that qualifying staff are being given the workplace pensions they are entitled to. It is part of a national campaign.

Dentons Pension Management has acquired the business of Sippchoice, the London-based bespoke SIPP provider, for an undisclosed amount. This acquisition will see Dentons add approximately 1,400 SIPPs to its existing book of business, bringing the total to over 6,000 SIPPs, along with 800 SSAS clients. It will take Dentons' assets under administration to over £4bn.

Scottish Widows and **Lloyd's Banking Group**'s wealth businesses have terminated over £100bn worth of partnership agreements with Standard Life Aberdeen. The contract, which the two signed after the sale of Scottish Widows Investment Partnership in 2014, held a clause that allows the Lloyds' businesses to terminate the contract "in the event that Aberdeen was subject to a change of control with a material competitor".

VIEW FROM TPR

In recent days there has been discussion about the government bringing forward its ban on pensions cold calling.

The cold-calling ban is in the interests of everyone except the scammers. A ban will not prevent fraudsters from trying to steal people's pensions but it will make it easier to prosecute offenders. More importantly, it will make it absolutely clear for potential victims that any cold call they receive about their pensions is coming direct from a criminal.

Cold-calling pension holders isn't illegal yet, but no reputable business does it. As far as we're concerned, cold calls about a pension – even ahead of the ban – are an attempt to steal someone's savings.

Yet unfortunately people are still being targeted.

We have launched an investigation with the police into a number of pension schemes that we suspect have been fed by cold calling.

While that investigation is continuing, we've appointed an independent trustee to manage one of the pension schemes and try to recover money that was taken from pension holders and invested in high-risk and illiquid investments overseas.

In January we persuaded the High Court to order four scammers to hand back £13.7m they took from their victims. Criminal charges are also being considered.

We and other agencies are working hard to tackle pension scams at the source. The cold-calling ban might not turn off the tap for fraudsters, but it should reduce the flow of potential victims.

TPR director of case management Mike Birch

The Pensions Regulator

Just 25% of self-employed save into a pension; govt criticised

The government's response to the Taylor Review has been criticised for offering "little hope" for improving the pensions of the self-employed

Just 25 per cent of the self-employed are actively contributing to a private pension, according to data from the Office for National Statistics.

The data revealed that the number of self-employed saving into a pension has dropped considerably since 2008, when the figure was 40 per cent. In addition, the ONS recently published another set of data on the self-employed, which revealed the clear divide between employees and the self-employed when it comes to private pension wealth.

Among the 35 to 54 age group, a large share of the self-employed do not have any private pension wealth (45.1 per cent) compared with employees that do not (16.4 per cent). This continues for ages 55 and above, with the highest share of the self-employed also having no private pension wealth. Despite the poor statistics on pensions and the self-employed there had been hope that the government's Taylor Review would begin a step-change, but Royal London director of policy Steve Webb has said the government's response offers "little hope" in improving pensions for the self-employed.

The former Pensions Minister "welcomed measures on workers", but said it was worrying that the issue of gig economy pensions had again been "kicked into the long grass". In its response, the government highlighted a number of key features for workers including enforcing vulnerable workers' holiday and sick pay entitlements, as well as stable contracts for zero-hours and agency workers, but made no reference to Taylor's recommendations on improving pensions for the self-employed.

In the 2017 Automatic Enrolment Review the government said it was going to take a "test and learn" approach to find the most effective way to encourage 4.8 million self-employed workers to save for a pension, admitting that the current framework is "not appropriate".

"Pension membership among employed workers has soared because of automatic enrolment, but it remains shockingly low for the self-employed. It is very worrying that this issue has again been kicked 'into the long grass', meaning that millions of self-employed people face an insecure retirement", Webb stated.

The Taylor Review, published in July 2017, welcomed the Conservative manifesto commitment to make auto-enrolment available to the self-employed and urged the government to "think creatively" about the issue. Auto-enrolment has meant that over nine million people are now saving into a workplace pension, but the government has come under pressure to help those in the gig economy, which as of 2017 made up 15.1 per cent of the labour force, according to the Office for National Statistics (ONS).

However, Pensions and Lifetime Savings Association policy lead, Tim Gosling, said that the government response will help prevent employers wrongly categorising people as self-employed and therefore not eligible to be enrolled into a workplace pension. Despite this, Gosling admits it does not address the self-employed issue and vows to continue working closely with the government and the industry to help tackle the issue.

Written by Theo Andrew and Natalie Tuck


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VIEW FROM THE PLSA

'A gangplank into thin air' was the dramatic phrase used recently by former Minister Lord Bridges to describe one of the scenarios for the Brexit negotiations.

Bridges, who served for a year as a Minister in the Department for Exiting the EU, was expressing his concern over what should follow the 'transitional' period of two years or so after Brexit Day on 29 March 2019.

The current media debate focuses very much on whether the transition and 'heads of terms' will be agreed, This is the easy bit.

The real challenge is the nitty-gritty sector-by-sector detail of how the new relationship will work in practice. Will the UK still participate in the EU Emissions Trading System? Will there be mutual recognition of standards for engineering equipment, medical instruments and all manner of manufactured goods? How will the new customs system work and how long will business get to prepare?

Pension schemes and their sponsoring employers will be directly affected by the answers to these questions. If economic disruption causes difficulty for a company, then the pension scheme's sponsor covenant will be affected as well. So the detail matters for pensions.

The PLSA's recent meetings with officials indicate that they understand the need for clarity and they grasp the potential impact on pension schemes.

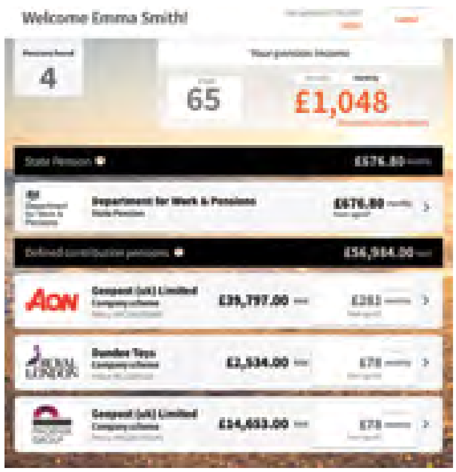
Lord Bridges also sketched out a more optimistic scenario, with the transitional period 'a bridge to a clear destination'. Turning the 'gangplank' into that 'bridge' will require both sides to focus on the substance of the issues – and quickly.

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

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

DWP confirms 'strong case for legislation' for pensions dashboard

Industry voices have said a phased approach to launching the pensions dashboard should look at gaining wide coverage and then depth later on



There is a "strong case for legislation" for the pensions dashboard, the Department for Work and Pensions has confirmed.

Speaking at the launch of the Which? dashboard report, DWP director Julie Gillis emphasised that there is a "strong case for legislation" for the progression of the pensions dashboard especially in relation to timing and collation of data.

Ahead of the DWP's feasibility study due at the end of March, the Which? report, titled *The pensions dashboard – How can we make sure it works for consumers,* outlined that the platform needs to be assembled to ensure it is fully functioning, tailored to the consumer and easy to understand.

To achieve this, therefore, the suggestion that legislation may be in the pipeline has been strongly supported. Former Pensions Minister and Royal London director of policy Steve Webb noted that he is "delighted" by the possibility of legal action.

Webb noted that although it may be years before an act of parliament could be passed and for providers to get their data in order, a timeframe following on from this could be beneficial. Once the act is passed, if clear communications are given to providers and those involved in the provision of information, then compliance is more likely to take place, he explained.

Signalling that the law is going to be passed could assist in the long run, Webb added. Amidst continued discussion on how to ensure that pension providers, trustees and administrators deliver necessary information to the dashboard, the industry group noted that a phased approach should look at gaining wide coverage and then depth later on.

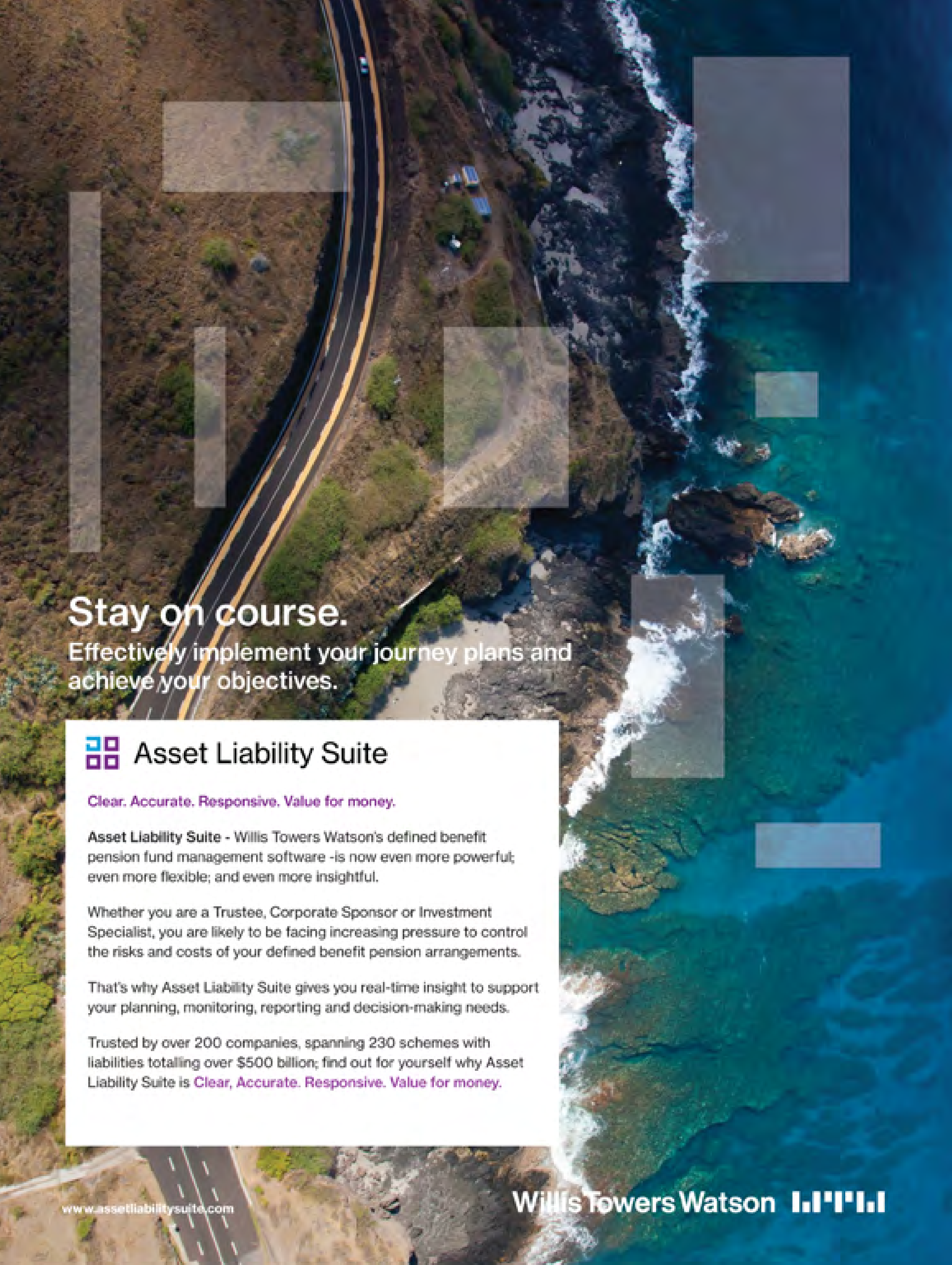
In providing data to the dashboard, Aviva strategy projects director James Ward stated that the industry should firstly focus on achieving "a wide coverage of schemes then go for depth of information".

For the platform(s) to be a success, therefore, ABI director of policy, long-term savings and protection Yvonne Braun voiced a shared view that an "appropriate phasing timeline" is needed.

In terms of governance and transparency, the report added that the dashboard could be operated by a single financial guidance body, independent of the industry and that information on the dashboard should include: charges, guarantees, benefits and which pensions provide contribution matching from employers.

The DWP's feasibility report on the dashboard is set to be published at the end of March, provided that it is not hindered by Brexit negotiations.

Written by Talya Misiri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VIEW FROM PPI

Automatic enrolment (AE) has now been with us for more than five years, and in April the minimum contribution level for employers and employees will increase.

It is tempting to try and judge the success of AE now, but in reality it will be many years before we know how well AE has performed. While undoubtedly beneficial to many people of working age, AE is designed to cover a full working life and retirement so it is those entering the workforce today that are likely to see the most benefit. How are they likely to fair?

Well the good news is that research by the PPI, sponsored by Standard Life, highlights that millennials – about 40 per cent of the target market for automatic enrolment – have seen participation in workplace pensions double between 2012 and 2017, up from 36 per cent to 72 per cent.

While coverage is important, how valuable will the resulting pension funds be?

While it is impossible to say for sure, simulated projections suggest that someone just entering AE now, who has median earnings for their age throughout working life until reaching state pension age and stays at the minimum contribution level, could expect a fund of over £100,000 in today's earnings terms.

If the recommendations of the AE review (starting from age 18 and removing the lower earnings threshold) are implemented, this could be over 40 per cent higher and approaching £150,000. And if they work for an employer with a good scheme with contributions at 16 per cent this could be almost £300,000. Definitely something worth having.

Chris Curry, director, PPI

PENSIONS POLICY INSTITUTE
PPI

UK ranked as second largest global market in terms of pension assets

The study also highlighted the growth of defined contribution assets, with them now accounting for 49 per cent of total assets across the seven largest pension markets

The UK has been ranked as the second largest global market in terms of pension assets in 2017, it has been reported.

According to Willis Towers Watson's *Global Pension Assets Study*, the UK followed the US as the second largest market when it comes to pension fund assets,with 7.5 per cent. The ratio of UK pension fund assets to GDP now stands at 121 per cent, up from 108 per cent in 2016 and an increase of 33 per cent in the past decade, it was found. In the past 10 years, UK pension assets also grew by 5.5 per cent per annum in sterling terms.

The UK was also one of the main markets that continues to be dominated by defined benefit pension assets, with a total of 81 per cent. The research added that defined contribution assets had grown from around 33 per cent in 1997 to 49 per cent of total pension assets in 2017. From these, Willis Towers Watson highlighted that UK pension funds represented 17 per cent of total UK pension fund assets in 2017. Overall, for the 22 largest pension markets total pension assets to GDP ratio was 67 per cent at the end of 2017 and pension fund assets managed by the top 100 alternative asset managers rose to $1,612bn, according to Willis Towers Watson's *Global Alternatives Survey*.

Home bias for equities were seen to be falling over the past two decades, changing from 68.7 per cent in 1998 to 41.1 per cent in 2017. The UK was among one of the 22 major markets in the study to have the lowest allocation to domestic equities. Willis Towers Watson global head of investment content Roger Urwin said: "While the short-term figures are positive these are due to unusually high market returns. Looking back at 20 years of

progress makes for encouraging reading. In particular, the improving position of pension assets as a proportion of GDP and the evolution of pension fund governance, which has risen up trustees' agendas and is certainly a lot stronger as a result."

Urwin added: "DC now accounts for 49 per cent of total assets across the seven largest pensions markets in the world as these funds continue to experience positive net cash flow and relatively lower levels of benefit withdrawals compared to their DB counterparts. As such we would expect DC assets to become larger than DB assets within the next two years. With DC models in the ascendancy, it is important that governance issues and the shift in risk on to the end-saver are closely monitored, without regulation becoming a burden and hindering the ability of DC plans to deliver optimal outcomes." The rise of DC, compared to DB, is also highlighted in a study by Hymans Robertson, which found DB schemes are set to reduce by more than 80 per cent over the next 25 years, from 5,500 to 1,000. The firm has predicted that DB schemes will begin to consolidate in a drive to reduce running costs, improve member security and manage risks, of which is "already happening".

Written by Talya Misiri and Theo Andrew

NEWS IN BRIEF

Removing the triple lock on state pensions could reduce the retirement income of a low-earning millennial by 5 per cent, according to research from the **Pensions Policy Institute** (PPI). The PPI's research, *The impact of the introduction of automatic enrolment on future generations*, said that a low earner's pension income, somebody earning £19,000 at the age of 40, would be 2 per cent lower by moving to a double lock and, 5 per cent lower under an earnings linked state pension.

Pension transfer values fell by £5,000 to £231,000 at the end of January, **Xafinity Punter Southall** has reported. According to the Xafinity Transfer Value Index, values dropped from £236,000 at the end of December 2017 to £231,000 at the end of last month; the same figure recorded in October 2017.

AXA IM has announced its intention to consolidate its European liability-driven investment (LDI) teams, bringing its capabilities under one unit covering the UK, France and the Netherlands. The merged team, which the company said will benefit both present and future clients through scale and expertise, will manage assets in excess of €18bn for third-party clients. The consolidated team consists of a solutions strategist team and a solutions portfolio management team.

Seven Investment Management has launched a retirement planning service to help advisers look after clients at or nearing retirement. The service aims to increase efficiency for advisory firms, helping advisers to deliver services and income to their clients throughout various life stages. The 7IM platform has the flexibility to accommodate different 'pots' for different financial priorities and risk profiles, to create an integrated service helping deliver the income clients need throughout various life stages.

KPMG defends role in Carillion pension scandal

In other pension fund news, Asda has been urged to rethink its pension cuts and Trinity Mirror has agreed to pay £41.2m into the Northern & Shell Pension Scheme in a takeover deal

KPMG has blamed the £725m actuarial loss of the Carillion pension scheme on the falling AA bond yields, as its reporting standards come under fire, it has emerged.

The information comes as the big four accounting firms, KPMG, EY, Deloitte and PwC, responded to questions raised by the Work and Pensions and the Business, Energy and Industrial Strategy (BEIS) committees.

Accounts of the big four show that combined, they earnt £71.6m for their work with Carillion, its pension schemes and the government. KPMG defended its role in the Carillion crisis and said that a fall in the discount rate applied to future liabilities from 3.95 per cent to 2.7 per cent, driven by historically low yields, had a "proportionally significant impact" on liability values.

According to KPMG, IAS 19 pension deficits for companies in the FTSE 350 increased from £50bn to £62bn in 2016, and that Carillion's liability valuation was "in line with other providers of defined benefit schemes". The firm has also come under fire in a Financial Reporting Council (FRC) audit quality inspection, which found that it needed to strengthen its "audit approach for corporate entities in relation to defined benefit pension scheme assets and membership data".

A joint committee statement said that KPMG will be pressed further on pensions and that the issue "was not addressed in any depth in their letter".

In other pension fund news, Asda is being urged to rethink proposed pension

Editorial credit: ricochet64 / Shutterstock.com

cuts by the trade union, Usdaw, after 2,000 staff signed a petition against the changes. Asda is currently undergoing a 60-day consultation on changes, which could mean staff have less choice about saving for their retirement, changes to the death in service provision, and their contributions not being matched by the firm.

Usdaw area organiser, Michala Lafferty, said: "Usdaw is the trade union for Asda staff in Northern Ireland, who are outraged by the company's proposals. Feelings are running high, which is demonstrated by us collecting so many petition signatures in just over a week."

In addition, Trinity Mirror has agreed to pay £41.2m upfront into the Northern & Shell Pension Schemes (NSPS) as part of its £126.7m acquisition of the publishing business. The £41.2m one-off payment into the scheme is part of an agreed recovery plan, which will also see payments totalling £29.2m enter the scheme up until 2027, amounting to £57.5m after tax.

According to the group, NSPS had a total deficit of £31.3m on an IAS19 basis at 31 December 2016, and a valuation deficit of £63.6m at their last actuarial valuation.

Written by Theo Andrew


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VIEW FROM THE ABI

The self-employed are a large and highly diverse group, representing around 15 per cent of the UK workforce.

What's worrying is that a large proportion of the self-employed population experience significant gaps in saving for life after retirement. A recent publication from the Office for National Statistics showed that some 45 per cent of self-employed workers between the age of 35 and 54 have no pension savings whatsoever.

"The long-term savings industry is determined to help create a behavioural shift among the self-employed"

As there is no employer to automatically enrol a self-employed person into saving, the government has rejected the idea that automatic enrolment could be simply extended to include this group. With no access to auto-enrolment and the possibility of this pension gap widening, this is an issue that needs addressing urgently.

The long-term savings industry is committed to supporting this growing group of the UK's workforce by making retirement saving easier for the self-employed and improving consumer outcomes.

As such, the ABI, with the DWP and HM Treasury are holding a two-day TechSprint on 26 & 27 March in London. The event will bring together pension providers, modern employers, payment system providers, banks and technology experts. These participants will be asked to develop an idea, a prototype or first iteration of a technology solution to make retirement saving easier for the self-employed.

The long-term savings industry is determined to help create a behavioural shift among the self-employed where regular pension saving is seen as both normal and affordable. Anyone else interested in taking part can request details of how to apply via tech-sprint2018@abi.org.uk.

ABI policy adviser, retirement and savings policy Anna Sharkey

Market commentary: Volatile assets

At the beginning of February the US stock market fell, causing volatility to spike higher than previous levels. With this, pension schemes have looked to shift their asset allocations to ensure they are not negatively affected.

Volatility among equities has been a key player in the current landscape. Looking at the year so far, Fulcrum Asset Management investment director Graham Neilson notes: "The sharp rise in equity volatility in February has been the standout feature of markets in 2018."

He explains that major global equity markets have fallen by almost 10 per cent from peak levels in late January. As a result, Neilson reminds investment managers that "irrespective of strong global economic backdrop, equity market volatility does not stay low forever".

Gatemore managing director Mark Hodgson echoes a similar warning: "Complacency is dangerous, and setting and forgetting can blow investors way off course." He observed that while pension fund trustees have become somewhat accustomed to sustained periods of strong equity markets, the bout of volatility "serves as a sharp reminder that markets can, and will, bite back".

"After a protracted period without any major drawdown, the equity market reaction has been sudden and severe. While other equity markets have also fallen sharply, the moves appear to have been most extreme in the US," UBS AM head of asset allocation Erin Browne adds.

However, Jones suggests that: "Reflationary assets such as equities still remain appropriate for pension scheme investment strategies."

Alongside the rise in equity volatility, an upsurge in global bond yields has been recorded in the year to date. Bond markets moved with interest rate rises in both the UK and US. "This has been welcome news for those UK pension schemes that haven't matched all of their liabilities with bonds," Schroders portfolio solutions strategist Alistair Jones says.

While this year has seen a considerable rise in global bond yields, Neilson notes: "With both bonds and equities down year to date, bonds don't always protect a portfolio in times of market sell offs," and so broader asset allocations may be a more sustainable option.

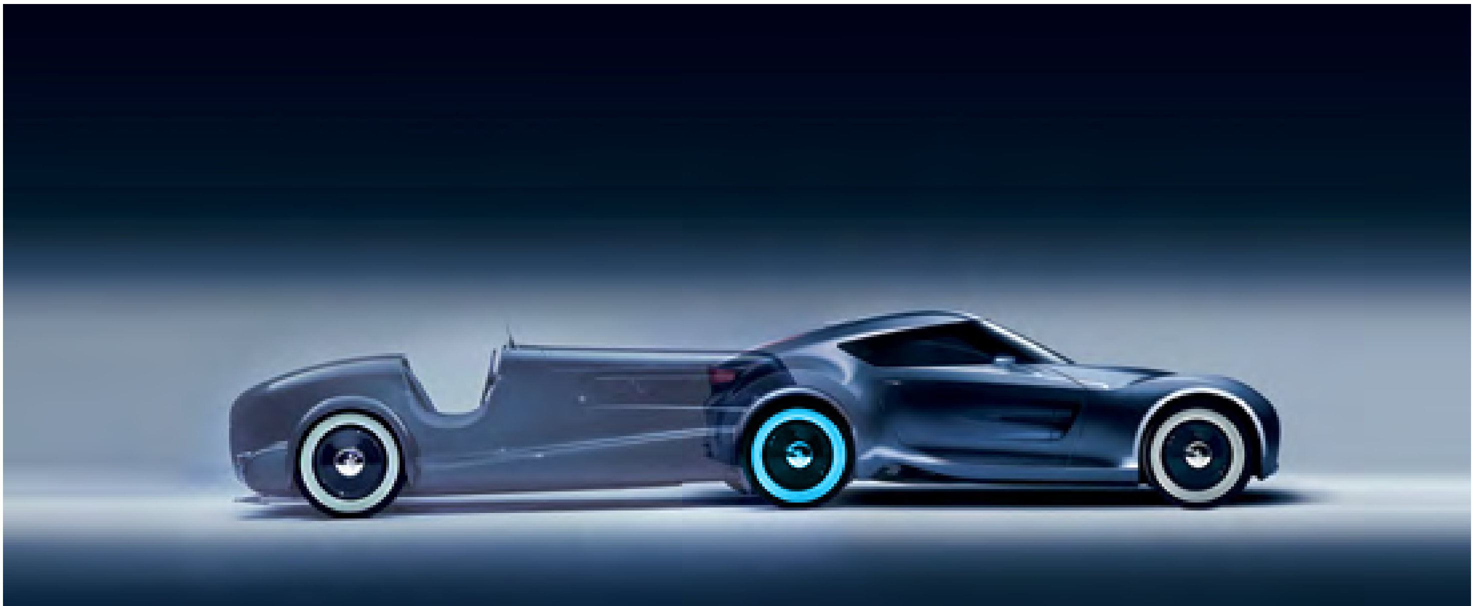
Considering other asset classes in the year so far, JLT EB senior investment consultant Aniket Bhaduri adds: "Credit has also remained fairly well behaved throughout this short period."

In summary, while US-driven volatility is anticipated to continue, this is not expected to be a long-term player. Royal London Asset Management head of multi asset Trevor Greetham comments: "We expect bouts of volatility like this to become more common now the Federal Reserve is in play, but expect stocks to recover over the coming weeks and months, making recent market moves look like an overreaction."

Hodgson advises: "Although this may not be the start of the next bear market, it is a warning that investing is not an easy game and there is no substitute for hard work and constant review in order to stay ahead of the pack."

To tackle overall investment volatility issues, Neilson concludes: "Diversification has to be an essential part of asset allocation for pension investing. There are alternative asset classes which are broadly unaffected by short term panics in traditional markets… to provide a smoother path to longer term returns."

Written by Talya Misiri



People on the move


Brenda Warrington

Greater Manchester's local government pension scheme has appointed councillor Brenda Warrington as the first female chair of the 95-year old fund.

Warrington's appointment was announced in an 'extraordinary' Tameside Council meeting on 31 January 2018. She replaces councillor Kieran Quinn, who recently passed away. In her acceptance speech, Warrington said she recognised the work that needs to be done for the £23bn pension scheme and named councillor Gerald Cooney as vice deputy to councillor Mike Smith.

She said: "I'm quite excited about the prospect, though I'm not here because I'm a woman – I'm a person who was elected to do the job and I happen to be a woman. I hope that more and more women are able to achieve senior positions and top jobs. I'm not afraid of hard work and to tackle the difficult issues and I care about people, particularly those who are more vulnerable."

Warrington will become the third female council leader in Greater Manchester.


Michael Abramson

Hymans Robertson has hired Michael Abramson as a partner and risk transfer specialist. Abramson has over 15 years in consulting and insurance and joins from Prudential, where he was director of wholesale transactions.

He was previously responsible for the firm's bulk annuity team, playing a role in both the largest buy-in and buyout deals. Prior to this, Abramson worked at Legal & General and Mercer.


Mark Stocker

Barnett Waddingham has appointed Mark Stocker to its corporate consulting team. Stocker will be responsible for delivering advice on pension scheme disputes, contentious matters and acting in an expert witness capacity. Previously he was a board director and chief actuary at Conduent HR Services and has also held senior positions at Mercer and Lane Clark & Peacock.


Natalie Flood

Redington has made two senior hires to its defined contribution and savings team. Natalie Flood and Jonathan Parker have joined the growing team and will be responsible for offering a "level of consultancy beyond investment". Flood joins having spent 10 years at Willis Towers Watson, where she led high-profile DC schemes. Parker has 15 years' experience across the industry, working for Dimensional Fund Advisors.


Chris Fagan

Muse Advisory has appointed Chris Fagan as an associate director. Fagan joins the independent pensions management consultancy having previously worked as an investment director in Willis Towers Watson's (WTW) fiduciary management team. In his new role, Fagan was also named a company-appointed trustee and an investment committee member of WTW Pension Scheme.


Karen Theobald

BESTrustees adds Karen Theobald to its team of trustee executives.

Theobald will be responsible for bringing her trustee and adviser experience to the company, having joined at the begining of February. Previously, she worked for Conduent, formerly Buck Consultants, where she chaired the trustee pension scheme since 2010 and developed a robust governance framework.


Clive Bannister

ABI has appointed Clive Bannister to its board.

Bannister is currently the group chief executive of Phoenix Group Holdings and before this was group managing director of insurance and asset management at HSBC Holdings. He worked at HSBC since 1994 and has extensive experience to provide strategic support to leading insurance companies. Bannister will be responsible for working with other board members to help "shape the future of the industry."

Bannister said: "I am very pleased to be joining the ABI Board at a time of great change, challenge and opportunity for our industry. The current environment makes it more important than ever that the industry speaks with a clear voice, and that the growing closed fund consolidator sector plays a full part in these conversations.

"I look forward to working with other board members to help shape the future of our world-leading industry."

Diary: March 2018 and beyond

PLSA Investment Conference
7-9 March 2018
EICC Edinburgh
The conference, titled 'Driving the Economic Machine', will consider ways to secure the role of investment as the engine of a prosperous, fair and sustainable economic model. Climate concerns are in the spotlight and increased regulatory focus on the pensions sector has the potential to affect great change in the industry. Sessions will offer insights on the geopolitical climate that has left capital markets open to a variety of risks.
For more information, visit:
Plsa.co.uk/Events-Investment-Conference

Pensions Age Data Seminar in association with ITM
16 March 2018
Hilton London, Tower Bridge
The 4th annual Pensions Age Data seminar – in conjunction with ITM – will be discussing what challenges of old world data and practices colliding with the requirements of new world data and efficiency means for pensions professionals throughout 2018 and beyond. Discussions will surround the looming Finance Bill, DWP's development of the pensions dashboard and the regulator's renewed focus on assessing the accuracy of data.
For more information, visit:
Pensionsage.com/itmseminar/

World Pensions Forum
22-23 March 2018
Paris
The seventh annual World Pensions and Investments Forum, organised by the World Pensions Council, will focus on 'Remarking long-term investment and board governance'. Planned sessions and topics will include long-term investment and risk management trends, empowering female trustees, modern DC, hybrid and alternative schemes and boardroom revolution.
For more information, visit:
Global-benefits-vision.com/world-pensions-investments-forum/

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

Visit www.pensionsage.com for more diary listings

Month in numbers

£1.1 billion
The British Steel Pension Scheme has processed £1.1bn of defined benefit pension transfers since March 2017, with the Work and Pensions Committee stating that members have been "shamefully bamboozled".
Publishing its latest damming report on the BSPS, the committee said that "dubious advisers exploited BSPS members for personal gain" with the help of "parasitical introducers", as it warned that another "major misselling scandal" is already erupting.

84%
A large majority, 84 per cent, of pension schemes are now focusing on their investment strategy to grow scheme assets, KGC has found.

One-quarter
Just 25 per cent of self-employed people are actively contributing to a private pension, according to the latest data from the Office for National Statistics.

VIEW FROM THE ACA

Responding to the Work & Pensions Select Committee Inquiry into CDC schemes, the ACA noted that CDC models can provide more stable outcomes than pure DC schemes, but their downside risks for scheme members (which may be less than DC but more than DB) do need to be recognised from the outset and communicated clearly to them.

We also believe that CDC models can provide better outcomes than pure DC schemes due to the pooling of investment risk, access to more investment opportunities and the likelihood of remaining in return-seeking investments for longer. However, given that the trustees will need to smooth investment returns over time when delivering benefits, similar concerns may arise in due course as led to the downfall of with-profit contracts.

CDC schemes may well need a certain scale in order to operate successfully, so they may only appeal to the largest of employers. As importantly there needs to be a shared mutual trust between those participating – i.e. everyone agrees to share the risk and accept the consequences. A CDC scheme also needs stability in the demographic make-up of its membership and through this a predictable flow of contributions. This may make such schemes unattractive as an employer-sponsored entity. It could be that only master-trust type structures will wish to develop CDC offerings. Parallels can then be drawn between the forthcoming regulation of DC master trusts and that of CDC offerings – with issues such as governance, strong capital reserving and endgame plans needing to come to the fore.

Bob Scott is chairman of the ACA

ACA
ASSOCIATION OF CONSULTING ACTUARIES

VIEW FROM THE SPP

We could be forgiven for thinking that from 29 March 2019, two years after triggering article 50, we shall be free from European 'interference' – including in the way we run our defined benefit pension schemes. However, there may be, at least, one more stressful encounter.

It seems increasingly likely that there will be a transitional period – possibly up to 2021. During this period, as a quid pro quo for single market access for financial services, it would seem likely that we shall have to accede to European financial services regulation.

EIOPA would like to be able to force UK schemes to provide it with detailed stress test results direct

Consequently, we may anticipate pension schemes having to carry out the EIOPA stress test in 2019. You may recall that we have done so in 2015 and 2017. No biggy, I hear you cry.

However, EIOPA has never liked the fact that to date most stress test data from the UK was provided by The Pensions Regulator – which shielded schemes from having to carry out EIOPA's undiluted onerous assessment. EIOPA would like to be able to force UK schemes to provide it with detailed stress test results direct. Well, under recent proposals, it may get its wish.

A consultation that closed in January proposes to give EIOPA this power and to impose a fine of up to €200,000 on any scheme that fails to comply. If in place for May 2019, a lot more DB schemes will experience the cost and effort involved in the stress test.

SPP European committee member Mark Dowsey

THE SOCIETY OF PENSION PROFESSIONALS
leading pension thinking

In my opinion

On TPR and FCA's plan to develop a shared pensions regulatory strategy
"The fact that the two regulators are proposing to look at how they can work better together to tackle key risks facing the pensions sector in the next five to 10 years is very welcome. There have been many significant changes in the pensions industry in recent years, which have generally been handled well, but it may require a more coordinated and holistic approach from the FCA and TPR in future."
Barnet Waddingham senior consultant Malcolm McLean

On Royal Mail and CWU's attempts to achieve CDC scheme legislation
"We believe that now is the time for the government to introduce the required legislation so that companies such as Royal Mail have the ability to offer CDC type schemes to their workforce... We believe that our proposed collective scheme will provide employees with significantly better benefit outcomes than a traditional DC scheme, without the company having to bear the balance sheet risks associated with a DB scheme."
Royal Mail Group HR director Jon Millidge, and CWU (Postal) deputy general secretary Terry Pullinger

On the increasing state pension age
"Successive governments have made appropriate but difficult decisions to equalise and increase the state pension age…. To increase costs for the working population would be unfair and unaffordable."
Undersecretary of State for Pensions and Financial Inclusion Guy Opperman

On 25% of the self-employed actively contributing to a private pension
"It's a worrying trend. If just one in four in self-employment are actively contributing to their pensions, around 3.5 million are missing out. While auto-enrolment is making it easier than ever for employed people to save for their retirement, many in self-employment put off saving into a pension in favour of investing in their own business."
NFU Mutual chartered financial planner Sean McCann

On building a closer relationship between trustees and administrators
"Scheme administrators often bridge the gap between trustee aspirations and genuine good governance. And occasionally even fill those gaps where trustees are not properly engaged with the process. We want trustees to better appreciate the value of a good administration and we would like them to develop a better dialogue with administrators. And we want them to appreciate the link between good governance and improved outcomes for members."
TPR acting executive director of regulatory policy Anthony Raymond

On awareness needed around the cold-calling ban
"The government can save pensioners, and itself, millions by running an awareness campaign highlighting the most common tricks used by fraudsters."
Liberal Democrat spokesperson for work and pensions Stephen Lloyd

Soapbox: Get serious on the self-employed

Auto-enrolment successes in some areas are undeniable. The party wagon was recently pulled out for hitting the one million employer mark – but as The Pensions Regulator pointed out, "auto-enrolment is not an option, it's the law".

On this criteria, do we really need to bring the fanfare out for every milestone? While nudging over nine million workers into retirement saving is a solid return, we shouldn't forget how much still needs to be done for those who aren't covered by auto-enrolment, chiefly, the five million self-employed.

Stats from the Office for National Statistics revealed that just 25 per cent of the self-employed were saving into a private pension in 2017, compared to 40 per cent in 2008, and while the flexible workforce is growing, their savings aren't.

We can now more or less be sure that self-employed workers are not going to be auto-enrolled, but we have yet to see any concrete ideas from the government on how the growing workforce will be nudged into long-term saving.

The past few weeks have produced a number of disappointments for self-employed workers expecting to hear how they might be given that nudge.

The government's response to the Taylor Review failed to cast even a nod in the direction of Matthew Taylor's many recommendations on what to do for self-employed pension pots. Any mention of technological innovation, absolutely not, tax incentives, don't count on it!

Instead, the government proposed some further research and testing, which, in the words of ex-pensions minister Steve Webb, "is not up to the urgency of the problem".

Perhaps throwing this amount of shade at the government is a little unfair, Brexit means resources are low, and (slow) steps are being taken in the right direction. The Department of Work and Pensions, for instance, seem to have cottoned on that technology might be the prescription.

The Association of British Insurers, in partnership with the DWP and HM Treasury, have launched a two-day workshop, inviting tech experts, fintech service providers and banking representatives to come up with "practical solutions and interventions" for self-employed workers.

A step in the right direction, but the real proof of the pudding will be in the tasting, and it will be up to the DWP to find palatable answers. Given recommendations delivered in the Automatic Enrolment Review have a deadline of 'mid-2020s', prospects of a quick-fire solution for the self-employed are low.

The government has been far too reactive over the issue. While they have laid out their plans for ensuring the self-employed can be better supported in the workplace, as Webb alludes too, the opportunity for the self-employed to save for the long-term is passing them by.

Part of the problem is that there is no easy answer. The complexities of the issue can seem boundless, yet the enthusiasm to find workable initiatives isn't apparent.

There has been enough self-congratulation over auto-enrolment, we now need answers for those it has left behind. It's time to get serious on the self-employed.

Written by Theo Andrew

VIEW FROM THE PMI

I have written at length before about the governance challenges facing the pensions industry at times of perceived government distraction.

Now, however, there is finally some good news. The Financial Conduct Authority (FCA) and The Pensions Regulator (TPR) are working together on a pensions regulatory strategy, which will set out how they could collaborate in order to tackle the major risks facing the pensions industry over the next five to 10 years.

In the absence of an independent pension commission, this move could potentially bring about significant, positive change in our industry.

At a time when TPR is demonstrating greater scheme engagement and becoming increasingly involved in public service and master trust schemes, it is heartening to see that their ambitions now seek better alignment with the FCA. The FCA itself recently stepped up to the plate with its work on charging and hospitality, money laundering, and bribery within the asset management industry. However, despite this, a report issued by Share Action this February called for the FCA to take further action on IGCs' effectiveness. Following the indefinite postponement of a FCA review in 2017, the Share Action report calls for better VFM guidance, consistent standard reporting and improved assessment of contract-based schemes for members.

The aspirations of the FCA and TPR to acquire a collective view of the current pensions landscape and its respective regulatory remits should increase consistency across specific areas, such as VFM, for members.

Alongside input from the pensions industry, these plans should help sharpen the focus of the regulators so that their efforts are aimed in the right direction over the coming years.

Robert Branagh, president, Pensions Management Institute

Musings of a MNT

Why didn't they ask Evans?

"There are no experts, only varying degrees of ignorance."
- Amit Trivedi, *Riding the Roller Coaster: Lessons from financial market cycles we repeatedly forget*

The Pensions Regulator has been for some time undertaking research into what 21st century trusteeship should look like in the pension world and how they see that role evolving. Its review covered all pension funds and found that though there were many good trustees there were also, particularly in small- and medium-sized pension funds, the need for an improvement in standards; specifically the need for improvement in governance and administration.

These findings are hardly surprising given the time, costs and expertise needed to run schemes in the 21st century. Large funds, including my own, are able to afford the requisite administration, secretarial and advisory resources to enable the maintenance of not only good but excellent standards in running the fund. This does not mean that simply having the wherewithal guarantees high standards; trustees need to employ the right people at the right time for the right role and set up a rigorous monitoring process to ensure these standards are maintained. But having the money helps!

The regulator, having recognised the need to raise standards, is establishing a series of communications to make clear their expectations on those responsible for managing a scheme successfully. These include:

- Clear roles and responsibilities and clear strategic objectives
- A skilled, engaged and diverse board led by an effective chair
- Close relationships with employers, advisers and others involved in running the scheme
- Sound structures and processes focused on outcomes
- A robust risk management framework focused on key risks

[The Pensions Regulator Blog October 2017]

All of the above are commendable, and should be integral within trustee governance, but the resources needed to meet these requirements can prove the stumbling block. One possible resolution to this problem has been master trusts.

Master trusts offer employers the benefit of a governance function but with generally low operating costs and greater simplicity and expediency than a single employer scheme.

As a type of multi-employer pension scheme, master trusts have the potential to offer great advantages for members and employers, due to their scale, good governance and value for members.

The vast majority of employers have chosen to use a master trust pension scheme to meet their automatic enrolment obligations rather than set up and run their own workplace pension scheme. However the regulatory criteria for establishing and managing these funds are now only just catching up with their growth with new regulations coming into force in October 2018.

The regulator rightly monitors and enforces standards to ensure pension funds are run effectively but leaves the market to offer solutions to the resource issues raised by the increasing scrutiny.

What seemingly is missed in this interplay of cause and effect is the views of the very people who should be the main players in this arena; the members of the pension funds.

In Agatha Christie's book, *Why didn't they ask Evans*, published in 1934, the resolution of the murder mystery revolves around the simple fact that a key witness was not consulted, allowing the murderer to escape undetected until two amateur sleuths ask the right question.

There is an inherent danger that the opinions of the very people who are dependent on pension funds are drowned out in the cacophony of regulations and solutions.

Pension funds invariably have difficulties in gauging the opinions of their members. However there remains one resource that continues to be the focus for members; the member-nominated trustee. We should always remember to ask Evans!

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

Less talk more action

Talya Misiri talks to The Pensions Regulator's director of automatic enrolment Darren Ryder about his international career in pensions, life as a Kiwi and what motivates him

What is your pensions career CV?
My first involvement in the pensions world was through implementing the roll out of KiwiSaver in New Zealand, from 2005 to 2007 and then managing it until 2011. Like automatic enrolment, Kiwi Saver was introduced because people are living longer and not saving for their future.

Using my experience of implementing and managing KiwiSaver, I moved to the UK to help The Pensions Regulator and government design and implement workplace pension reforms. I've been able to bring my experiences and share lessons learnt from the New Zealand to help make the roll out of automatic enrolment a success.

What other areas have you worked in and what roles have you held prior to joining the pensions industry?
Prior to my work in pensions, I worked for the New Zealand tax office mainly in compliance roles across tax and social policies such as Student Loans and Child Maintenance. I was also involved in leading a national tax office transformation project, developing a new operating model across all of the NZ tax office sites.

What is your greatest work achievement so far?
I would say it is in the pensions arena. KiwiSaver is the largest programme delivery in New Zealand, the largest IT project and has achieved fantastic results in boosting the number of people now saving for their retirement.

In the UK, it's been an honour for me to help more than a million employers put more than nine million staff into a pension. We've worked hard to make automatic enrolment as straightforward as possible so it's business as usual for employers and that staff continue to save.

What do you still wish to achieve?
I want to see automatic enrolment continue to be a success so that more and more staff continue to benefit from workplace saving.

At TPR we're focused on the challenges ahead so that start-ups treat automatic enrolment as simply part of setting up a business and put staff into a pension as soon as they take them on.

We're also working to ensure employers understand their ongoing duties such as the increasing minimum contributions.

What is your biggest regret within your career?
No regrets. I've been very fortunate to have been involved in several major reforms that have real benefits for people.

Excluding your current role, what would be your dream (in or out of pensions) job?
I want to continue on and help other countries to bring in reform to get people saving. There are a lot of countries across the globe facing what some say is a pensions 'crisis', because people are living longer but saving less. I'd like to be involved in helping countries develop and deliver successful models like we have in the UK and New Zealand.

What was your dream job as a child?
I wanted to be a pro golfer when I was young, travelling the world playing lovely courses looking out over oceans, lakes and mountains.

What do you like to do in your spare time?
I spend a lot of time doing DIY and enjoy a house renovation project. I also love all sorts of water activities, anything from diving to fishing.

Any particular skills or party tricks?
Have to say I do a mean BBQ, but of course a lot of Kiwis will try and claim that too!

Who would be your ideal dinner party guests?
My family. Living 12,000 miles away from my family, I don't get much opportunity to see them, so it would be great to have a dinner party for all of us.

Do you have a particular phrase or quote that inspires you?
Mark Twain said: "The secret of getting ahead is getting started." For me this is a good motto. It says get on with it, stop talking about it and get started. Yes there will be some bumps and maybe mistakes, but that is all part of learning.

Written by Talya Misiri

Case law - changing from RPI to CPI

Matthew Swynnerton looks at a recent High Court judgment about whether a set of scheme rules permit a change from RPI to CPI

In recent years there have been a number of judgments from the courts considering whether particular scheme rules permit revaluation of deferred benefits or increases to pensions in payment to move from being calculated by reference to the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). Whilst the position for each scheme depends on the drafting of the particular rules, trustees and employers may nevertheless find it useful to see how this issue is approached by the courts and in this article we report on the most recent judgment from the High Court on this issue.

The court's recent judgment

This judgment concerned the rule on increases to pensions in payment in a particular section of the BT Pension Scheme. The rule provides for pensions to be increased by the increase in the cost of living and states that the cost of living "will be measured by the Government's published General (All Items) Index of Retail Prices or if this ceases to be published or becomes inappropriate, such other measure as the Principal Company, in consultation with the Trustees, decides". The question for the court was therefore whether RPI has "become inappropriate".

Issues of construction of the scheme rules arose, with the court concluding that whether RPI has become inappropriate is a question of objective fact and rejecting submissions that the rule should be construed as conferring

a power on the principal employer to determine whether RPI has become inappropriate. In relation to the meaning of the words "becomes inappropriate" the court's conclusions included that, for RPI to have become inappropriate, it must now be inappropriate (not merely less appropriate than any alternative index) for the purposes of calculating increases in pensions payable to members of the scheme to reflect the inflation experienced by those members.

In terms of whether RPI has in fact become inappropriate, the principal employer relied on a number of matters including the impact of a change in the collection and use of clothing prices in 2010, the decision by the UK Statistics Authority to 'freeze' RPI in January 2013 and the de-designation of RPI as a National Statistic in March 2013. The court concluded that these matters and events, whether by themselves or in combination, have not caused RPI to become inappropriate for the purposes of uprating pensions in the scheme. For example, looking in isolation at the decision to 'freeze' RPI, the court's reasoning included that this did not prevent RPI from remaining fit for purpose as it was maintained for legacy purposes. In relation to its decision about the cumulative effect of the matters relied on, the court considered that the following two factors were particularly important: the flaws which underlie the matters relied on by the principal employer were present in RPI in 2002 when this wording was first included in the rules; and the purpose of the rule is to provide protection for pensioners against increases in the real cost of living to which they are likely to be subjected.

Looking ahead

We expect trustees and employers to continue to watch developments on the issue of changing from RPI to CPI with interest. In terms of future case law developments, the employer in this case has stated that it intends to appeal this judgment, and a November 2016 Court of Appeal judgment (relating to a different scheme) which concerns the construction of the words "or any replacement adopted by the Trustees without prejudicing Approval" is expected to be considered by the Supreme Court this year.

It is also worth noting that the DWP's February 2017 Green Paper on defined benefit schemes noted that "the current arrangement where some schemes are prevented from moving to CPI by scheme rules is something of a lottery" and, in the context of a general question on whether there is a case for special arrangements for schemes and sponsors in certain circumstances, asked whether the government should consider a statutory override to allow schemes to move to a different index. It will therefore also be interesting to see whether the White Paper on defined benefit schemes, which is expected to be published this Spring, contains any proposals on this issue.

Written by Matthew Swynnerton, pensions partner at DLA Piper

Fine work

The number of fines imposed by The Pensions Regulator has ramped up in recent months, as it continues on its mission to be 'clearer, quicker and tougher'. But are punitive measures such as fines the most effective way to change behaviour and improve standards?

Yes

One might argue that the fines imposed to date have been relatively small in the context of the breaches – so perhaps not overly punitive. However, the purpose of a fine is two-fold 1) imposing a financial penalty and 2) imposing a reputational penalty. In some respects, 'naming and shaming' (as demonstrated by publishing a list of offenders) can be more damaging to a company than a financial penalty – particularly for high-profile offenders. TPR has typically undertaken its regulatory responsibilities with a 'comply or explain' approach. When it becomes aware of a potential breach, TPR tends to proactively engage with the relevant party to try and support rectifying the issue and only if this process fails, will it resort to more penal enforcement. So it's probably safe to assume that the fines imposed to date were after meaningful and repeated efforts by TPR to work with relevant parties in achieving compliance. Equally, it is understandable that breaches (and fines), particularly around auto-enrolment, could ramp up as the number of employers needing to comply has increased substantially.

P-Solve associate director Damon Hopkins

There's no doubt that TPR is living up to its new mantra of 'clearer, quicker, tougher', and fines are just one part of that. In isolation they would have limited effect, but combined with the various other actions that we're seeing they build a picture of a regulator who is standing up to be counted in a range of areas.

The regulator uses different tools for different issues. Fines tend to be focused on governance and compliance issues, with stronger action reserved for more substantial issues. The fines themselves are normally modest, and for most schemes will be more of an annoyance and an embarrassment than a financial deterrent. In many cases the fines will be passed on to advisers who haven't done what they should, and those advisers are likely to be hurt more by the reputational damage and impact on their client relationship than the amounts involved.

For schemes that accidentally fail minimum standards I think the fines will be effective. They provide a gentle but noticeable (and public) reminder that doing so has real consequences. For schemes or sponsors who are deliberately avoiding their duties, I suspect that stronger action will be required.

Aon retirement practice partner Paul McGlone

No

Few if any real-world issues can be answered neatly in this way; 'sometimes' might be better! If pushed though, I would have to say 'no', as a rule punishment generates resentment rather than reformed behaviour. If TPR wants to be appreciated rather than hated, it could make a good start on the right track to change behaviour and improve standards by appointing a named account manager to each scheme. Building a relationship is the key to successful engagement and co-operation. At the moment, TPR risks being perceived as 'all stick and no carrot'.

Aries Insight director Ian Neale

In the heavily regulated and complex environment of occupational pension schemes, structural and educational measures are far more effective to change behaviour and improve standards.

Indeed, improved communication and greater engagement with those in the pensions industry can be the most effective tool at The Pensions Regulator's disposal. And where necessary, The Pensions Regulator has a raft of statutory powers to reinforce and help shape behaviour and standards.

The theory is that fines punish wrongdoing, deter repetition and act as a warning to others. But other than in exceptional circumstances, I am not convinced of the merits of fines in the pensions environment.

Sackers partner Peter Murphy

Written by Laura Blows

How can trustees tackle their biggest pain points?

Aon's Susan Hoare identifies the issues pension trustees face, and explores tools that can help

What are the biggest concerns for trustees? We asked a range of trustees what kind of things keep them awake at night.

The issues they cited focused on a lack of time, insufficient resources, and concern that they lacked the knowledge and information to do their job well. Many trustees are worried about their collective ability to make informed and timely decisions – and then to implement them effectively.

Equipping your board to deliver on expectations

A trustee board has a wide range of stakeholders. Meeting the expectations of members, the scheme, the employer and the regulator can be a challenge.

The Pensions Regulator's 21st Century Trusteeship and Governance initiative sets out clear requirements for trustee boards. Among these, boards are expected to have:

- clear roles and responsibilities and clear strategic objectives
- a skilled, engaged and diverse board led by an effective chair
- sound structures and processes focused on outcomes

Achieve these, and you will be on the way to delivering for your scheme, your sponsor and, crucially, your members.

A toolkit for trustee success

Our research into – and work with – trustee boards has led us to identify five steps they can take to be more effective:

1. Review your current performance

Understanding your current position is the first step in making improvements. Review your board. A good review will assess your current structure and processes, as well as looking at your collective skills (both behavioural and technical) and decision-making ability.

2. Understand the balance of personalities

Get a feel for the characteristics within your board, and the personal attributes, skills and experience you collectively bring. Using a structured framework can help you to identify and take into account all the views within a diverse board. Aon's Governance Viewpoints is a four-step approach that has been proven to be highly effective in helping boards achieve better governance.

3. Improve your decision making

There is no shortage of behavioural biases that can impede good decision making. Understanding these and taking steps to avoid them helps trustees to make informed, well-rounded choices.

Aon's free Trustee Checklist enables you to spot and avoid the pitfalls that can hamper good decisions, while meeting chairs can use the Behavioural Checklist for Chairing Meetings to deliver best practice.

4. Make meetings (and non-meeting time) more effective

The way you organise trustee meetings can have a huge impact on their success. Structure your agenda to make the most of your time, taking into account recognised behavioural tendencies – like the inclination to make 'default' decisions when you are tired or hungry.

Aon's Trustee Meeting Framework has drawn on lessons from behavioural science to create the optimum meeting planner.

Because trustee meetings are often infrequent, it's also important that you make the most of the time in between to progress action items. Our Between Meetings Organiser helps trustees to achieve results even between formal sessions.

5. Challenge your advisers

If you are presented with choices by your advisers – do you go with their recommendation? Or do you challenge their assumptions, to ensure you're achieving the best outcome for your scheme? A list of 10 questions to help trustees challenge their advisers can help; use the questions to make a contribution, even when the topic is outside your area of expertise.

Take these five steps to address your pain points and you will be on your way to a more effective and efficient board. For more information, and to download any of the free tools from Aon's Trustee Effectiveness Toolkit, visit aon.com/trustee-effectivenessuk.

Written by Susan Hoare, principal consultant, Aon

A thoroughly modern trustee

Robert West and Hannah Moxon look at how 21st century trusteeship requires training, independence and added value

Who would want to be a trustee? It's a legitimate question, given the scrutiny the Carillion trustees have been receiving over the potential descent of their schemes into the Pension Protection Fund, following the problems engulfing their corporate sponsors.

Personal liability is a risk faced by trustees but, in a well-run and well-advised pension scheme, it is unlikely to be an issue. The perils are more likely to be reputational damage, uncomfortable encounters with The Pensions Regulator and the Pension Protection Fund (and possibly a select committee) and personal angst for scheme members facing substantial benefit reductions.

Who would want to be a regulator in these circumstances? Inevitably, there is a focus on the actions of the regulator and whether the regulator has adequate powers to prevent those problems. Although supervision and anti-avoidance powers are key, the issue also highlights the importance of the regulator's 21st Century Trusteeship and Governance Programme.

This programme, launched in 2016, is "designed to stimulate a dialogue about how government, regulatory bodies and the pensions industry can raise standards of trustee competence and improve the governance and administration of pension schemes". It was followed by the regulator's Raising the Standards of Governance campaign, introduced in September. The objective, as described by Anthony Raymond, the regulator's acting executive director for regulatory policy, is that "pension schemes should have a skilled and engaged board, led by an effective chair, have robust

risk management in place and good relationships with advisers and third parties".

The regulator has been keen to show an increase in its compliance and enforcement interventions, but its focus is on raising standards generally. So far, it has published guidance and checklists on governance, trustee responsibilities and strategic planning, with further content expected.

One particular aspect of the discussion is whether schemes should be required to have an independent or professional trustee and, on a related note, what should be expected of these trustees. The Professional Trustee Standards Working Group issued a consultation paper in December, which asks whether there should be a formal qualification, potentially with a requirement for continuing professional development.

Another question raised is whether a professional trustee, in the context of potential liability, should be judged by more exacting standards. Many pension schemes do tailor their liability provisions to render professional trustees potentially liable for 'negligent' actions and to be judged by the standards of a professional trustee.

To an extent, this reflects the Trustee Act 2000, under which a trustee's obligation to exercise reasonable care and skill is to be determined having regard to "special knowledge or experience that he has or holds himself out as having". Furthermore, this statutory duty provides that regard must be had, "if he acts as a trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession".

There is an interesting parallel here with the requirements imposed on trustees of master trusts under regulations made under the Pension Schemes Act 2017. Here, the regulator will decide whether trustees are 'fit and proper persons', taking into account completion of the regulator's online toolkit and the collective expertise and experience of the trustees.

So, what should trustees be doing at present to meet the standards expected of them? Training and paying attention to the regulator's campaign are clearly important. But so is adopting strong governance structures and a robust and questioning approach to trusteeship. Reliance may be placed on advisers, but trustees and advisers should develop a strong working relationship in which the important issues can be identified and addressed. Sometimes the experience of an independent or professional trustee can enhance this process and we anticipate an increase in such trustees over the next few years.

Written by Robert West, senior counsel and Hannah Moxon, associate, Baker McKenzie

In association with Baker McKenzie.

Engaging tactics

Laura Blows talks to Mark Rowlands, director of customer engagement at NEST, about how to increase member engagement

Member engagement is one of those terms that could mean different things to different people. So, for NEST, how do you define member engagement?
Engagement will mean different things to different people. Before we think about what it means for NEST, I think as an industry we need to start thinking about what the outcome of engagement is first, rather than engagement itself. So if you define the outcome, as in what behavioural change you are trying to achieve, that in turn can then inform how you want to achieve it and how you measure it.

If you go back a few years, engagement was framed as 'let's communicate through educational seminars with members'. Success was then measured by website hits or how many people were making active choices. It was all predicated on that belief that engagement led to active decision making.

Then more recently we've seen the arrival of auto-enrolment and scheme design, which not only thinks about automation for people joining, but also about automatic contribution increases, along with more innovation coming into default, lifestyle-type investments. So all of a sudden, the member doesn't have to make those decisions. Engagement can now be measured through different tactics. This is about how you combine education and automation. What best practice is looking like now, globally, is instead of that being perceived as a binary choice – that you either engage members through education or let the scheme do it through design – the two work very closely together.

From a NEST perspective, what we are trying to do is merge the best aspects of behavioural understanding, automation and auto-enrolment, with the best aspects of engagement, so members get the very best outcome they can.

You mentioned that automation means members do not have to be quite as actively engaged as was previously necessary. Does that mean the sole responsibility for engaging the members and determining the outcomes lies only with the employers and trustees now?
No, it's collaboration. The government sets the macro environment, in terms of the tax policies and regulatory policies to reward saving behaviour. However, the balance of responsibility, I would argue, falls on the trustee or the employer, but there is also a responsibility for the employee. But we know there are limits from the employee in terms of financial understanding.

But let's remember, if you put the scheme design in place, where you have auto-enrolment, auto-escalation of contribution, the very best investment ideas in the default fund, which is how NEST approaches it, some of those classic decisions have been taken care of. So then your engagement focus can be much more narrowly focused on the employee's understanding of what they have, so they then can tick the mental box that says their pension is covered.

If we go back a generation, how many DB members were actively engaged in understanding the DB environment? Hardly any. So if we take the best aspects of DB *[in terms of removing some decisions from the member]*, then the conversation can be about making schemes the best quality they can. We need the regulation to be empowering those schemes to deliver good outcomes for members. And that's why at NEST, we are calling for things like default pathways on retirement options as an example.

You said that previous generations weren't particularly engaged with pension saving. But we all know that the earlier somebody starts saving for retirement, the greater the impact on the eventual size of their pension pot. So how can we encourage younger people to start engaging and saving for their retirement?
The challenge is young people have lots of pressures on them. If they come out of university they have a debt of £40,000

on average. If they have moved to a city centre, probably half of their take-home pay goes to rent. So getting them to think about pensions, which is something their parents haven't even encountered yet, is a real challenge. Which is why we welcome some of the enhancements in the recently-announced automatic enrolment review about allowing people to join from 18.

The other thing we are doing at NEST is a piece of research with Harvard University around trying to think about how the pensions industry works with more liquid savings as a combined package. Because if we can get people into the savings habit, then, as an example, when their student loan has expired, they can move onto pensions saving. By running savings alongside pensions, we are starting to see some really interesting behavioural results and getting people to buy into savings at a younger age. We are in the stage of doing field trials with some larger employers who are testing this out and we will be publishing the results in due course.

How can those managing pension schemes help all the members they have? Is it a case of using member segmentation or personalisation, or do you have any other tips?

Segmentation can be really useful, as you can identify some broad buckets of colleagues within a scheme and you can tailor the messages to them. But we all know that one 50 year old, for example, is very different to another 50 year old. They can have different life events going in the background, and you as a scheme may only know so many things about them. So we have to use segmentation as a blunt instrument and then think about personalisation. If you can personalise the content, personalise the timing to coincide with a life event, and you personalise the call to action, that's how you can motivate all generations to do something differently.

A good example is a personalised video statement. Instead of producing a paper-based benefit statement, you produce it in a digital video format, personalised to the member, both with the content and in terms of the call to action. And because it's digital you can serve it at the time that makes the most sense to that employee so that they can be motivated to click on their smartphone to take the action, all within one statement. This closes the gap between awareness and action.

I imagine that increasing the call to action – not just raising awareness – is going to be of greater importance over the next couple of years, with auto-enrolment contribution rates rising and the potential risk of rising opt-out rates. How can we support members during this time?

It's no surprise that the contribution rises are choreographed to take place in April, when tax rates and the personal allowance changes, so that the impact on the take-home pay packet of the employee is negligible, depending on individual circumstances.

If you are an employer, you have to choose whether you want to be proactive and do something in advance, or reactive and respond to employees opting out. Irrespective of which route you choose, the key is about promoting the benefits. So the benefits can be promoted in current currencies. What I mean is saying, for example, for every £1 you as an individual put in, the employer is also putting in, plus tax relief, so you get £4 invested. Then if you project that forward with investment growth at the point of retirement, you can talk about thousands of pounds differential. So we need to be very benefit-orientated in terms of how we communicate.

Looking beyond the next couple of years, how may the way we help members engage with their retirement savings change? For instance, will it be through the changing way we use technology?

At NEST right now, we are currently testing a number of techniques where we step back and see what is happening in the world of fintech and the world of consumer marketing.

We know the way pension schemes will communicate in the very near future will be fundamentally different. It will be much more about personalisation. It's unbelievable to think that we won't be personalising communication to members within a couple of years, because that's the pace of which technology goes.

Now the challenge is, if you are a trustee or employer, you only know a little bit about the member's life. How do you use that data to then communicate? You can reinforce that data with other data feeds, within the confines of GDPR, so you can build a picture of someone's life.

Employers increasingly will think about pensions as part of their reward package and will align pensions with their broader benefits. So the focus of communications will change. It will no longer be about things like joining a scheme, it will be about financial wellness, about the heuristics of getting people to feel engaged, getting people to feel savvy with their money. Also getting people to think about their pensions pot as a personalised asset.

The reason why this is important is because it is one of the trends that underpin transfers. People don't like the fact that they do not 'own' their pension. If we can build that sense of ownership it can stop irrational behaviours about transferring out of the pension and putting the money into an ISA, which could have exactly the same asset classes, but having gone from an institutional price to a retail price. So we have to think about the trust and brand of pensions.

To watch this interview in full, please visit pensionsage.com

In association with

The growing case for ESG in DC plans

Funds that consider environmental, social and governance factors can help members mitigate emerging risks and capture new drivers of long-term growth

Investors with long time horizons need to consider how the world may look tomorrow, not just what it looks like today. That can mean adopting new criteria to assess an investment's potential performance.

The World Economic Forum predicts that seven of the 10 greatest risks facing people, institutions and economies over the next decade come from threats outside of purely financial categories, such as extreme weather events, water and food crises, and the impact of climate change.[1] These risks create opportunities for companies that can adapt to the changing economic landscape.

Traditional investment analysis by itself may not adequately examine these non-traditional drivers of long-term performance. That's why more investors are considering the potential impact of environmental, social and governance (ESG) factors on a company's long-term growth potential.

At its core, ESG investing is based on the idea that environmentally efficient, socially responsible and well-governed firms are better positioned to withstand emerging risks and capitalise on new opportunities. As stewards of their members' assets, scheme sponsors and trustees should consider all the risks and opportunities that can affect long-term investment outcomes. Incorporating ESG into the scheme's investment strategy can help balance risk and potential returns.

The evolution of ESG investing

Although ESG strategies have roots in earlier generations of ethical or socially responsible investing, today's ESG investors may be less motivated by values than they are by ESG factors'

ability to mitigate risk, and to capture opportunities for innovation and growth.

For example, environmentally-efficient firms may consume fewer resources and produce less waste than competitors, helping them generate lower costs and higher returns on capital.

Social factors have emerged as important proxies for management quality, such as studies showing that management teams with greater gender diversity provide superior corporate performance.[2]

The value of good governance is clear as well, especially in light of recent corporate scandals related to auto emissions, food safety and labour issues. Effective, independent boards of directors and strong internal controls can reduce the likelihood of corporate malfeasance, fraud and other ethical breaches that damage shareholder value.

These trends suggest that ESG factors will only become more important to corporate health – and by extension, to shareholder returns – over time. That makes ESG investing especially relevant for long-term investors such as DC plan members.

How ESG can fit into a DC scheme

It has been common for DC schemes to offer an ethical fund for scheme members who wish to choose an investment fund consistent with their personal values. Typically, this would be a fund that screens out certain companies with business activities counter to those principles, for example involvement in the arms trade or tobacco. But the debate is now moving on to the default strategy, given that relatively few scheme members make active investment choices and reflecting the fact that the ESG debate now focuses more on long-term financial risks than on simply values themselves.

Equities form the majority of the growth phase of most default strategies, and most DC plans will have significant exposure to index funds benchmarked to market-capitalisation weighted equities. We expect to see these approaches evolve to reflect ESG principles; excluding some companies – for example, those producing controversial weapons—and tilting towards those that have better ESG credentials. Some early approaches have focused on climate change and tilting towards less carbon-intensive companies, but this can be extended to cover wider environmental issues (such as water and waste) and social issues (such as labour relations and diversity).

Schemes have an obligation to offer members appropriate and well-governed default investment strategies that deliver long-term value – and we believe that ESG has a key role to play in that effort.

Written by Alistair Byrne, head of European DC investment strategy, State Street Global Advisors

In association with STATE STREET GLOBAL ADVISORS

[1] The Global Risks Report 2017, World Economic Forum.
[2] Women on Boards: Global Trends in Gender Diversity on Corporate Boards, MSCI, November 2015.

Summary

- Headline accounting deficits are relatively benign.
- But experts warn investment risk and longevity still pose a risk.
- Alternative measures of DB deficits paint a much worse picture.
- The real deficit could lie between a buyout and a PPF calculation.
- Sponsors with a lower risk profile are well placed to face the challenge.

Too soon to celebrate

With pension deficits stabilising or even narrowing over the past year, Britain's DB sponsors could be forgiven for thinking the worst is behind them. But, discovers Stephen Bouvier, the twin challenges of investment risk and longevity are lurking in the shadows

A quick glance at the figures in the February JLT Employee Benefits monthly pension funding survey paints a picture of the new year kicking off to a relatively benign start for defined benefit (DB) schemes. The survey shows that based on the requirements of International Accounting Standard 19, Employee Benefits (IAS 19), the total DB deficit among FTSE 100 companies in January stood at £35 billion – a coverage ratio of 95 per cent, and up from 93 per cent this time last year.

Since then, however, the story has been one of how the FTSE 100 withstood the twin effect of a slide on equity markets and slightly better news from the bond markets. "For some schemes," says Lane Clark Peacock partner Tim Marklew, "those two opposing effects might broadly cancel out, but there will have been individual winners and losers."

Meanwhile, Hymans Robertson partner Alistair Russell-Smith broadly backs this analysis. "The one we most easily track is IAS 19 for the FTSE 350," he says. "It has been jumping around a bit recently, but we think it is around £100 billion deficit, compared with £85 billion at the start of the year. I agree that there are some bigger issues under the bonnet when looking at it at an individual company level."

Discerning the long-term trend

But whether this is a short-term improvement or a long-term trend is unclear, says Aon Hewitt principal consultant Simon Robinson. "I don't think we are going to see much of a change over the coming year. If you look at the past five years or so, the accounting ratio has probably gone from 93 to 97 per cent. Much of that change could be down to changes in the mortality assumption." According to his firm's data on the FTSE 100, total DB liabilities among Britain's top companies stood at £673 billion at the end of 2016 and nudged up slightly to £686 billion by the end of 2017.

Certainly, one feature of late is the apparent slowdown in the rate at which longevity is improving. However, Robinson urges caution: "Nonetheless, asset and interest rate volatility make it hard to break out those components. However, I think there is some evidence of an improvement of 3-4 per cent since 2013. The improvement in mortality assumption could be what is behind that improvement."

But as ever with pension deficit numbers, the devil is in the detail and Russell-Smith also cautions against celebrating too early: "Our Club Vita analysis of scheme mortality trends across more than 200 schemes shows that the improvement rates for more affluent members, who tend to be the ones with an occupational pension, have not slowed down as much as has been the case with less affluent members."

Marklew also notes that movements in the accounting numbers often reflect how sponsors have adapted to investment risk. He says: "Fifteen plus years ago, most schemes were invested in a broadly similar blend of equities and bonds, and reacted in a similar way to changes in markets. Now, however, schemes are using more sophisticated investment strategies with alternative investments and liability matching strategies, which means that recent movements in equity and bond markets have impacted different schemes very differently."

"The *[longevity]* improvement rates for more affluent members have not slowed down as much as less affluent members"

Which measure really counts?

Of course, the IAS 19 measure is simply a time point estimate for the purposes of reflecting in the accounts a snapshot of the total pension liability faced by a DB sponsor at the balance sheet date. Under EU law, companies with traded securities must report their results under IFRS. Within the IFRS reporting framework, the requirements for pensions accounting are set out in IAS 19. The standard requires a company to decide whether it has a DB or defined contribution (DC) plan.

DC accounting is simply a matter of expensing the annual payments to employees through the income statement. At the heart of DB accounting, however, lies the altogether more complex matter of the Projected Unit Credit method (PUC). At its simplest, IAS 19 requires you to project the benefit promise forward in line with assumptions about, for example, future salary growth, inflation and mortality and then discount back to reach a total net present value for the balance sheet liability.

But cautious though accountants are, sponsors are obliged to include an element of prudence in their approach. Typically, a scheme sponsor will agree a range of assumptions with the scheme's trustees on a range of factors such as salary growth and widow benefits. Essentially, the funding valuation is about estimating the cashflows in respect of liabilities over the life of the scheme on the one hand and taking account of plan assets on the other.

More cautious measures

Robinson is quick to point out the difference between a funding valuation and the superficially similar IAS 19 model: "Funding is different. Fundamentally, it is about what are you trying to achieve, and that is to smooth the cashflows that are payable from the company to the pension plan.

"You are saying, yes, we know we need to put money into the scheme, but it is almost like a cashflow smoothing exercise on an ongoing basis, with a little bit of prudence included, so it will more likely than not have enough money to pay the benefits as they fall due."

Yet more prudent then either of those models is the buyout rate. This approach is a market rate that adds up to the real-world figure that an insurer will accept to take over a DB sponsor's scheme risk. Ultimately, an insurer is in the business of making money, and so a buyout value will of necessity be less favourable to the sponsor than either the IAS 19 liability or the technical provision.

And whereas the funding approach assumes a sponsor will continue to meet its scheme's commitments, a buyout is about making sure that there will be sufficient resources to pay the scheme's liabilities. In fact, the apparently sudden leap in a firm's pension deficit when its sponsor collapses is really about the drop to a buyout basis, says Robinson: "Basically, it has appeared because you are measuring the liabilities in a different way for a different purpose."

Also in the news recently is the Pension Protection Fund's approach, or the s179 valuation. Although the starting point here is a buyout, the PPF deficit figure will vary. This is because the PPF only covers 90 per cent of the benefit promise for members who have not reached the scheme's normal retirement age when the scheme entered the PPF. This figure is also subject to an upper cap of just over £35,000.

Future cash calls on the cards?

Where sponsors go from here, says Russell-Smith, is largely down to how they have managed their investment strategy. "Companies that have already dialled down their investment risk are reasonably well placed. It is probably quite likely that they won't need to put more cash in, whereas companies that have taken more investment risk and not hedged as much are more likely to have to put more cash in.

"One of the issues with the regulatory focus on cash rather than risk is that it can sometimes lead to sub-optimal strategic decisions. So, for example, a push to fully fund schemes in a short time frame could lead to the taking of more investment risk than would otherwise be needed."

And, he warns: "There are still too many companies taking too much investment risk in their pension schemes. This is why we are seeing a lot of the volatility at the moment. Many schemes are taking significant levels of investment risk, sometimes to try and reach buyout in say 10 years.

"More often than not, we think a better approach is to take a lower level of investment risk and a longer period of time to reach full funding or buyout. This means taking less investment risk up front, which stabilises the funding position and improves the ability of the company to support the pension scheme."

Written by Stephen Bouvier, a freelance journalist

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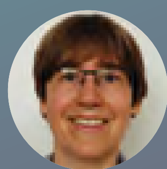

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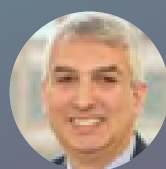

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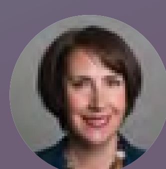

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#PMIPENSIONS

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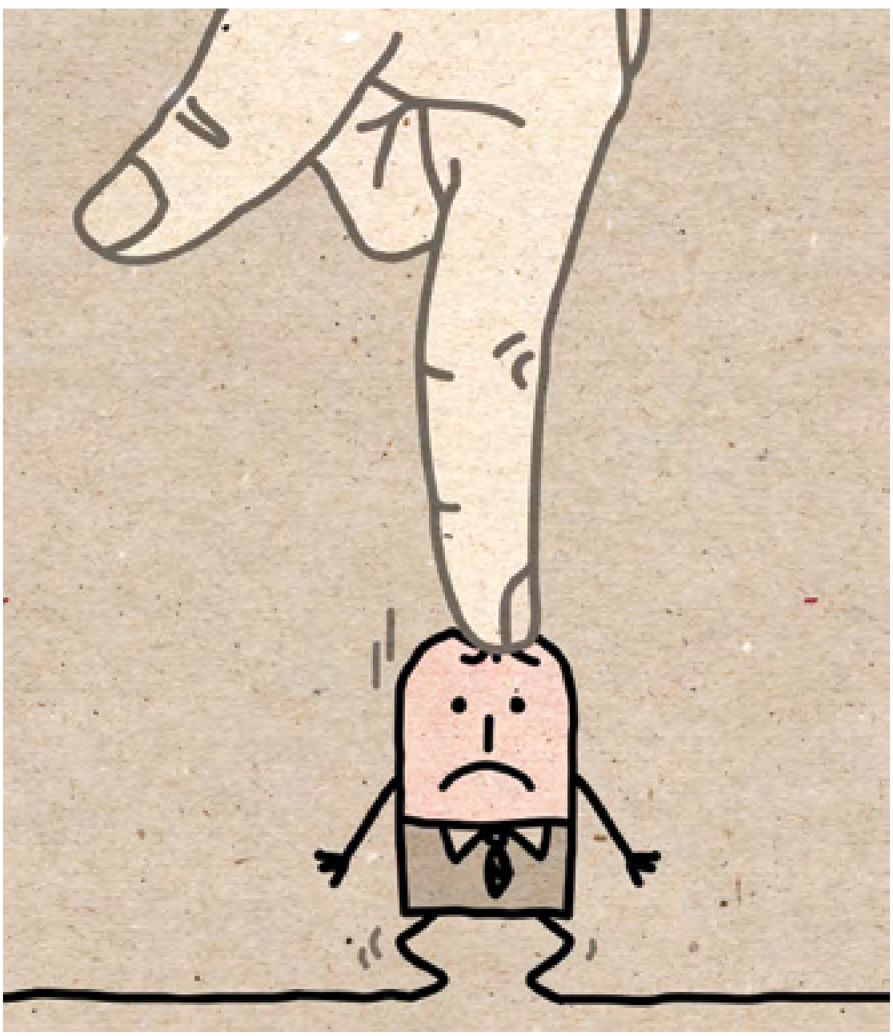
Summary
• The UK can expect to see further company collapses involving highly indebted DB schemes.
• The pressure this could put on the PPF may have been underestimated by the lifeboat.
• Getting back to basics and recalibrating DB risk management is the only way to fix the current malaise.

Easing the pressure

Recent high-profile company collapses have been accompanied by embattled DB schemes. Action needs to be taken to ensure that future business failures do not overburden the UK's safety net



Tata Steel, BHS, Monarch, Carillion: a sorry list of high-profile companies falling victim, in varying degrees, to global economic forces, poor management and simple old fashioned competition.

What linked their collapses was their sponsorship of struggling defined benefit (DB) schemes that hit the headlines and elicited inconsistent responses from the UK's pension regulatory system.

History affirms the inevitability of further company failures in the near future. And, as Redington's managing director of integrated actuarial, Marian Elliott, says, many of those will have chronically underfunded DB schemes.

"While many DB schemes are closed and therefore we might expect the problem to reduce over time, this is unlikely to happen any time soon," she explains. "The aggregate funding position of DB schemes is largely unchanged since 2008, despite the contributions that have been paid by companies to fund deficits over the past 10 years."

These contributions, amounting to some £20 billion a year according to the Pension Protection Fund (PPF), would appear – to an outsider looking in – to have simply disappeared into a vast black hole. As a result, if and when companies with DB schemes fold, they will be dumping yet more underfunded liabilities onto the PPF, leaving a number of questions that the pensions industry must face. Has regulation been up to scratch? Is there enough flexibility in the system? Have trustees used their powers to their full capacity? And have sponsors truly honoured their pension promises?

Another question is what the steady procession of abandoned DB schemes will have on the PPF.

The lifeboat fund has been resolute when questioned about its financial position. In its 2017 annual funding strategy update, it reported a 93 per cent probability of achieving its self-sufficiency funding target by 2030. The report also included modelling some worst-case scenarios, including a post-Brexit recession, global economic contraction, and collapse of large-scale employers with significant pension scheme deficits. Even under these circumstances, the PPF says that the probability of achieving self sufficiency is 74 per cent.

"The PPF does have some flexibility over the time within which they need to achieve this funding target," says Elliot. "While a corporate failure with significant pension deficit would undoubtedly impact the funding position of the PPF, and therefore levy payers, the PPF's funding strategy is reasonably resilient to these shocks."

However, Cardano's UK CEO, Kerrin Rosenberg, disagrees.

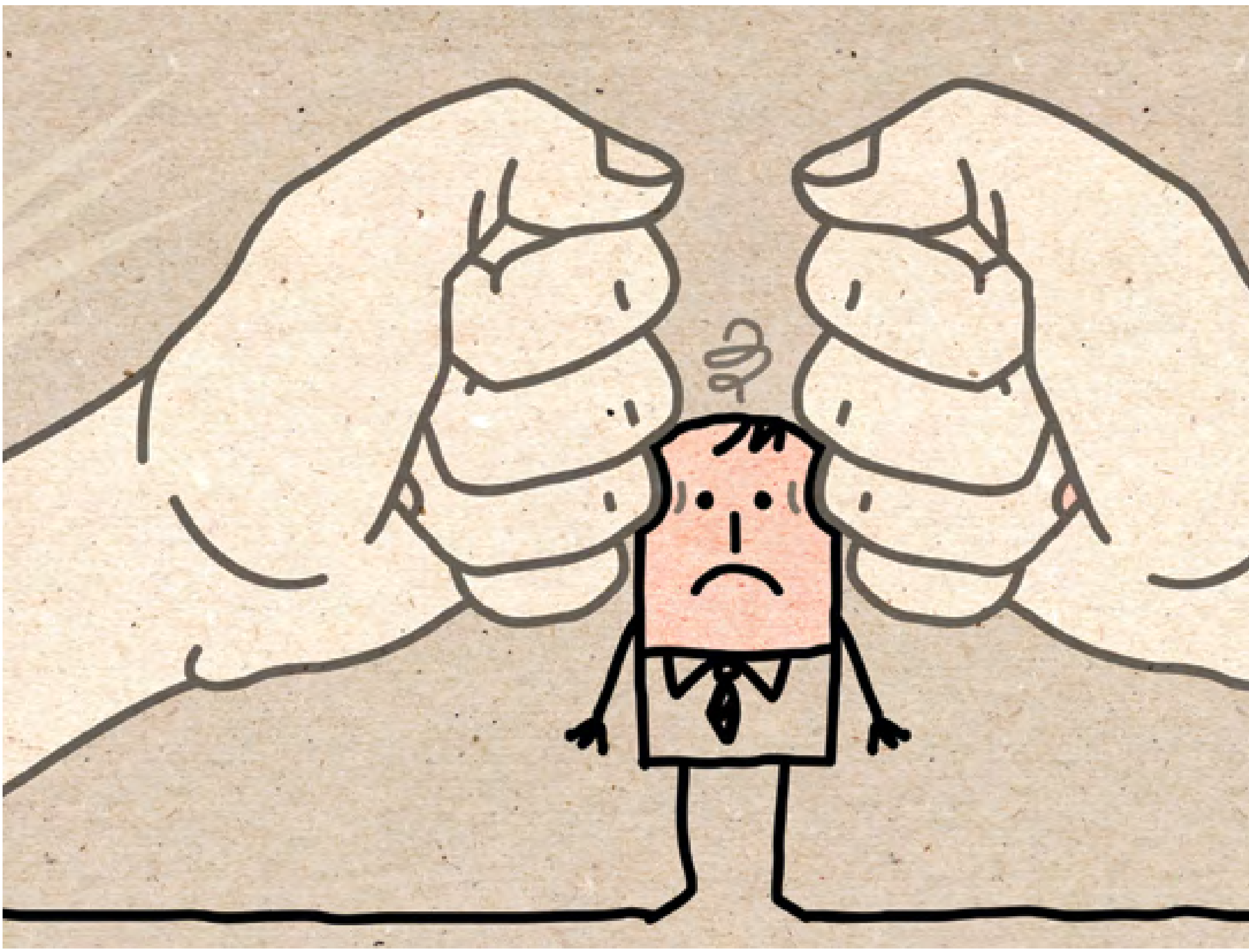
"If you listen to the PPF's story they'll tell you that they are in surplus and it's all hunky dory," he says.

"Our view is different. There have been quite a few people in the industry who feel a lot more worried about the overall health of the DB sector and the impact it would have on the PPF."

Rosenberg evidences separate reports by Cardano and Lincoln Pensions, the PLSA, as well as the Cass Business School and the Pensions Institute, which all lay out projected figures that lead to concern for the PPF's long-term health. These studies have predicted somewhere between 20 and 35 per cent of all current DB schemes ending up under the PPF's control.

"If you look at the PPF's projections, they're only projecting 5 per cent of DB pensions landing up with them. But if they're wrong, by, call it a factor of 6, meaning it's 30 per cent, then suddenly they're not looking so healthy and there will have to be dramatic increases in the PPF levy," warns Rosenberg.

"The Cass Business School has come

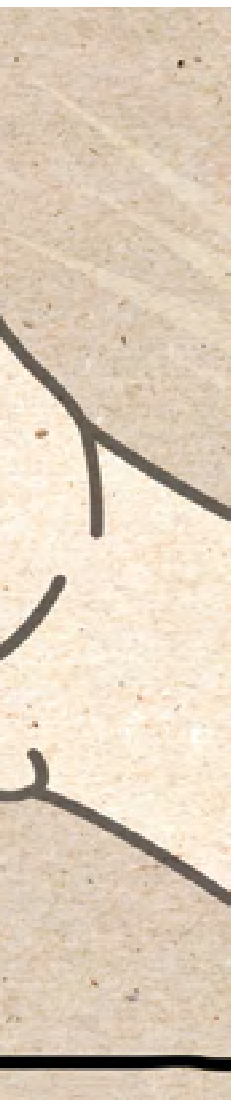


up with a one in six *[company]* failure rate, or even slightly higher. That's not a dramatic change from the historic run rate. If you look at the number of funds that have entered the PPF and assume it carries on at the same rate, then you do get that ratio.

"Our view is that the PPF have been perhaps a little too sanguine in their risk assessment and projections."

Restructuring

Pressure could be lifted off the PPF if companies had the freedom to restructure their pension benefits, argues Sackers partner Faith Dickson.



She has been a vocal advocate in recent years for changing legislation to enable schemes to have more scope to reshape pension benefits. If a sponsor is getting to the point of insolvency unless a level of restructuring can be carried out, then she believes that the ability to lower benefits, but still keep ones that are higher than PPF compensation, is in the members' best interests.

"Companies can restructure a lot of elements of their finances and liabilities but the scope for them to restructure their pension liabilities is incredibly limited. This is the final nail in the coffin, essentially for many of them," says Dickson.

This, could also, in turn, take some pressure off The Pensions Regulator. The watchdog came under fire in February from Work and Pensions Committee chair Frank Field for "sniffling" around Carillion, "clearly to no effect" as it collapsed.

But could the regulator have done more? The Merchant Navy officers' Pension fund chair of trustees, Rory Murphy, is unconvinced.

"The regulator may appear to have been found wanting. But they have a very difficult job," he says.

Murphy also doubts whether Frank Field and the committee truly understand the complexity and nuances of fiduciary responsibility. In response to Field's comments, Murphy is adamant that it is not the pension schemes that need regulating, but the companies.

"How can any company pay out dividends when it's in debt to its pension scheme? It's illogical. But we've got into that situation in the past 30 years; it's almost like bullying in the workplace.

"Companies say 'oh it's the pension, we can't afford it'. It becomes a very aggressive them-and-us scenario. And it isn't at all. The money should be put aside by the employer to pay the pension of their employees. And all trustees are doing is being guardians of that money. And I do sometimes think that we have to recalibrate how we view it."

Going back to basics

Recalibration is something that Elliot would also like to see. She believes that the whole system of pension scheme risk management is fundamentally flawed.

Elliot argues that the regulator, trustees, advisers and sponsors make decisions that get struggling schemes "over the line" when it comes to their valuations and result in set-in-stone contribution schedules for the next three years.

Although it is impossible to make all the right decisions and ensure that pension benefits are fully secure in advance of any corporate insolvencies, she says that the current system does allow for "a great deal of can kicking".

"As an industry, we should be brave enough to look in the mirror and recognise that we haven't gone far enough towards effective pension risk management," she says.

"Moving away from a three–year regulatory valuation cycle, and implementing a more joined–up and regular approach to risk monitoring and management would make it far easier for all stakeholders, including the regulator, to identify where action should be taken, and to be clear on the rationale behind any action."

The relationship between trustees and sponsoring companies also needs examination, says Murphy. His view is that trustees should take some responsibility for the poor state of some DB schemes, which in some cases, is due to employers treating them as a nuisance.

"Trustees have got power, but do they understand that power and how to deploy it?" he asks. "Do the employers understand it? They have to get the balance right of getting enough money and helping support the employer.

"Getting more transparency from companies is critical."

Reputational risk

Fixing some of DB's internal and regulatory maladies could prove fruitful across the retirement savings spectrum as well.

"If things continue as they are then there is a reputational risk," says Dickson.

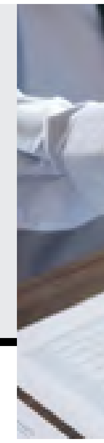
"People lose trust in the system and don't understand the difference between DC and DB schemes. Bad news stories are just another disincentive for people to save."

Rosenberg agrees: "If there's more willingness to acknowledge that there's a material problem here, then there's stronger credibility in the regulatory environment. And that can only help."

Written by Marek Handzel, a freelance journalist

Summary

• Predictions for pension scheme bulk annuity deals for the year ahead have proposed a 'record year' following the past few years of steady growth. The market has now got to a level where it is securing £10-15 billion of pension liabilities each year, with this year set to be even higher.
• For schemes considering a bulk annuity deal, full preparation is necessary to gain insurers' attention.
• When deciding whether to embark on a risk hedging deal, schemes must be wholly certain that they are making the right decision and that the agreement is well suited to them.
• Stakeholders, scheme members and scheme sponsors must be provided with adequate information to be aware of the transaction taking place and how it will affect them.



Getting the right deal

With many insurers predicting and preparing for record bulk annuity transactions this year, Talya Misiri asks what has caused this upsurge and what interested schemes, trustees and sponsors should do to prepare

In a volatile market, most industries look to remove and protect themselves from all possible risks to ensure that they are not harmed. This is certainly no different for pension schemes in the UK.

With many insurers predicting record bulk annuity transactions with pension funds this year, trustees and sponsors are being encouraged to ensure that they are wholly prepared to secure a desirable deal.

Record year

Predictions for pension scheme bulk annuity deals for the year ahead have proposed a 'record year' following the last few years of steady growth. The market has now got to a level where it is securing £10-15 billion of pension liabilities each year and this year is set to be no different, or even higher.

"The fact that this volume of members' benefits is being secured in this way is a fantastic result for the pensions industry," says Legal & General head of strategic pension risk transfer Pretty Sagoo. At present, "many scheme trustees and scheme sponsors are within touching distance" to longevity transactions, Willis Towers Watson senior director of bulk annuity and longevity hedging Shelly Beard adds.

But like all market upsurges, it is important to ask what factors are expected to cause increased bulk annuity transactions in 2018?

On a large scale, improved equity markets has been a key motivator for growth in the bulk annuity market. Beard points out that "equity markets have done well" in the past year and to date, which has essentially led to the strengthening of pension schemes' funding positions.

Aggregate funding levels across all defined benefit schemes, as measured by the PPF, are over 16 per cent higher than they were in the period immediately after the UK's Brexit vote 18 months ago. Schemes are now 95 per cent funded compared to 78 per cent in June 2016.

"The main factor we anticipate increasing *[buy-in/buyout]* demand in 2018…is the increase in pension plan funding," says LCP partner Charlie Finch. In particular, it is expected that buyout transactions, as opposed to pensioner buy-ins, are due to increase as a result of improved funding, he adds.

With stronger funding levels and falling deficits, schemes are in optimal positions to secure a well-priced deal. "As deficits have reduced, the cost of transferring risk to an insurer through a buy-in or buyout has become more affordable for increasing numbers of pension schemes and sponsoring companies," Sagoo says.

Looking at the types of schemes that are likely to pursue these deals in 2018, Sagoo notes that there is demand "right across the market from small to large schemes". She explains that while schemes differ in size, assets and liabilities, "pension debt is risky, volatile and tricky to manage," therefore, "the underlying motivations for wanting to transfer risk to an insurer remain the same" across most schemes.

Nonetheless, better pricing as a result of Brexit has been cited as a reason for increased buyouts among multinational companies this year. Finch explains that the UK's departure from the European Union could lead to more multinationals seeking to buy out their pension plans. This is due to falls in the sterling following the referendum, which further reduced the cost of buyouts, as well as "if some multinationals seek to relocate from the UK due to Brexit then buying out their pension plan would be a natural step in that process", Finch says.

Preparation is key

With increased demand for bulk annuity transactions from all angles therefore, insurers are inadvertently awarded with greater power over interested clients. For schemes considering a bulk annuity deal, preparation is necessary as: with increased demand, insurers are able to be "picky", Beard emphasises.

When it comes to embarking on a bulk annuity deal, "preparation is key", she says.

Finch agrees that: "In terms of preparing for a transaction, we would advise schemes to draw up a plan identifying and prioritising the work required."

In order to be fully ready for a de-risking transaction, key bases must be covered by schemes and their trustees, Beard outlines. To achieve good pricing from the insurer, trustees and the scheme sponsor must agree on the objectives of the deal, she highlights.

In addition, both Finch and Beard advise that member data must be organised to a sufficient level. "Data does not need to be perfect but almost all schemes should be able to identify key priority areas where it is worth spending time upfront before approaching the market," Finch says.

Beard adds that member data must be in order and trustees should have an exact idea of which benefits need to be insured. Further to this, schemes are encouraged to allocate some time to work with lawyers to draw up benefit specifications and "codify how any discretionary benefits should be applied", Finch notes.

It is also encouraged that undertaking a feasibility exercise before approaching the market is beneficial to present stakeholders with a clear view of what the deal aims to achieve.

Ultimately, the potential for increased strains on insurer capacity emphasises that schemes must be fully prepared to approach the market.

Making the right decision

When deciding whether to embark on a risk hedging deal, schemes must be wholly certain that they are making the right decision and that the agreement is well suited to them. The "due diligence" must be completed to "make sure it's the right decision for the scheme," Beard notes.

"Even if a scheme is not yet in a position to buy out, insurance does not have to be an all-or-nothing decision. We are increasingly seeing schemes de-risk gradually through a series of buy-ins, each making the scheme more secure and less reliant on the sponsor," Sagoo explains.

Alternatively, in recent years insurers have witnessed collective de-risking deals come to the market. One example involves collective deals whereby multiple schemes under the same sponsor work together to achieve a combined bulk annuity deal.

By taking this route, Beard comments that a collective effort is likely to lead to better pricing, a more desirable deal and more insurer interest. Sagoo adds that pension schemes are encouraged to "engage early and collaboratively in order to get the best result from insurers".

"Insurers are more likely to allocate resources, assets and capital to schemes that are willing to provide a pricing target and a commitment to transact at that target."

Clarity and communication

Stakeholders, scheme members and scheme sponsors must be provided with adequate information to be aware of the transaction taking place and how it will affect them. Gowling director Suzanne Mortimer explains that the level of communication expected of trustees with members is dependent on whether it is a buy-in or full buyout.

"If it is the former then members do not need to be told anything about the transaction as the buy-in is just another scheme investment. If however it is a full buyout, members will need to be told about the transaction," she says.

While members are generally informed after the deal has been agreed, trustees should inform members that they will receive an individual annuity in due course and that their pension payments will switch from trustees to the insurer.

"Some members may be concerned about what the buyout means for them so reassuring words that their pension will not change are helpful; trustees will also be keen to make sure that a consistent message is given to members from the insurer," Mortimer adds.

"Insurers also invest in really good communications", to maintain a clear understanding of the deal for all involved parties, Beard comments.

Ultimately, "planning and preparation *[in all areas]* remain the keys to success" when it comes to bulk annuity deals, Sagoo explains. Schemes must work from the deal's inception to prepare their scheme, its data, members and stakeholders for the transaction in order to gain insurer attention.

Sagoo concludes: "In a year where demand in the market is high, showing commitment in the early stages may prove to be vital."

Written by Talya Misiri

Summary
• Members of distressed DB schemes are being targeted for 'inappropriate' transfers into DC schemes with high fees.
• Work and Pensions Select Committee chair Frank Field warns that a "major mis-selling scandal" is emerging regarding DB-DC transfers, brought upon by scammers and insufficient advice to members.
• The advice industry would be the most affected by a scandal, but the pensions industry would also face a reputational risk.
• To help mitigate this risk, trustees and sponsors could help increase awareness of member retirement options and facilitate ways in which the member can access quality guidance and advice.

Vultures circling

Are the concerns about member transfers from the British Steel Pension Scheme just the start of a wider upcoming mis-selling scandal? Laura Blows finds out

Vultures have an impressive ability to hunt out dead or dying prey from over a mile away. It's little wonder then that they have already been circling around the injured British Steel Pension Scheme (BSPS), ready to devour its vulnerable – the scheme members.

The £15 billion BSPS recently

separated from its sponsor company, Tata Steel, in order to improve the 'viability' of its UK business. The Pensions Regulator (TPR) gave its approval for a regulated apportionment arrangement to be put in place. The arrangement means members of the BSPS had the option of switching to a new scheme, the New BSPS, or moving with the old BSPS into the Pension Protection Fund (PPF) – either way it was confirmed that both unretired and retired members of the original scheme will see lower pension payments.

It took over a year before the separation of the company and scheme was officially announced in autumn 2017, with the process of transferring members into the new schemes taking yet more months.

Amidst all these turmoil, over 2,600 members have taken flight, with £1.1 billion worth of pension transfers having been carried out since March 2017.

A recent Work and Pensions Select Committee report into how the events of the BSPS transpired states that the circumstances created the "perfect conditions for vultures to take advantage".

"Given a choice between two defined benefit options worse than what they had been promised, with precious little support in making that choice, many steelworkers were drawn to the superficially attractive third option [*of a DB-DC transfer*]," committee chair Frank Field notes.

The committee heard of advice fees of typically around 2 per cent of the transfer value – sometimes with high annual charges and 'punitive' exit penalties ranging from 5-10 per cent imposed. Unregulated "parasitical introducers" were used to get as many members as possible to consider transfers. The advisers used contingent pricing, meaning they only took a fee if the transfer went ahead. This led to them pushing for transfers, often against the interests of the members, the committee says.

"While doing so, they shamelessly bamboozled those members into signing up to ongoing adviser fees and unsuitable funds characterised by high investment risk, high management charges and punitive exit fees," the committee's report adds.

While the committee is still picking over the bones of the BSPS saga, the Pensions and Lifetime Savings Association (PLSA) has warned about scammers potentially circling members in other distressed schemes in the news lately, those of Carillion.

The company's pension schemes recorded a £587 million deficit in 2017, with a number of these schemes now due to enter the PPF.

"Following the collapse of Carillion, we have already seen warning signs that scammers may be seeking to exploit DB scheme members' fears about their future," PLSA head of governance and investment Joe Dabrowski reveals.

He notes that one in six pension holders in the UK generally have been contacted by a company – other than their provider – to discuss making changes or transferring their pension.

Field has been forthright in saying that a "major mis-selling scandal" is emerging in the case of the BSPS transfers. It also seems that other pension scheme members are being lined up as prey. So are these the warning signs of a broader mis-selling crisis emerging within DB-DC transfers?

Aegon's pension director Steven Cameron thinks not. "We don't believe we are facing a mis-selling scandal regarding people transferring from DB to DC schemes to access the pension freedoms," he says.

"The pension freedoms have proven very popular, with many people seeing them as a way of transitioning into a flexible retirement. This means there's a high demand from individuals seeking advice on whether to transfer from defined benefit schemes that don't offer the freedoms. This demand has been greater because of historically high transfer values and concerns over the funding position of certain DB schemes. Transferring certainly won't be right for everyone, but it will be suitable for some."

The popularity of DB-DC transfers has been such that they have been described as the 'new norm' post-freedom and choice reforms, with an estimated 200,000 people withdrawing £1.5 billion each quarter in 2017. However, the Work and Pensions Select Committee notes research by the Financial Conduct Authority (FCA) showing that only half of DB transfer advice nationwide meets its standards – far lower than typical rates for other forms of financial advice.

It is these record numbers that is all the more concerning, should concerns about a mis-selling scandal prove correct.

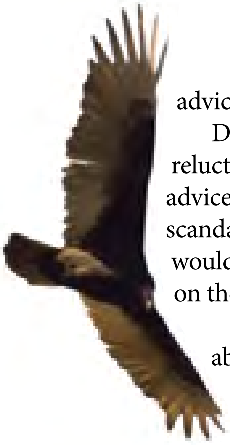
"Unfortunately, like any area of life, the financial services sector includes people who are prepared to take advantage of other people's weakness," Mercer partner and senior DB actuarial consultant Deborah Cooper states.

In the context of pensions freedom, this exploitation could range from providing poor quality advice, such as advising a risk-averse person to invest in risky assets, or advice given that is in the adviser's own, rather than the individual's, interest, she explains.

By removing the need to annuitise, pension freedoms made pension savings far more accessible, widening the range products they could be invested in, Cooper adds. "However, most people with pension savings do not have a deep understanding of how financial markets operate, or how financial products can be structured."

Advice

The counterpart to this is good, quality advice. However, "taking the individual's particular circumstances into account is not cheap and, unfortunately, people's lack of financial understanding extends to not understanding the value of good



advice", Cooper says.

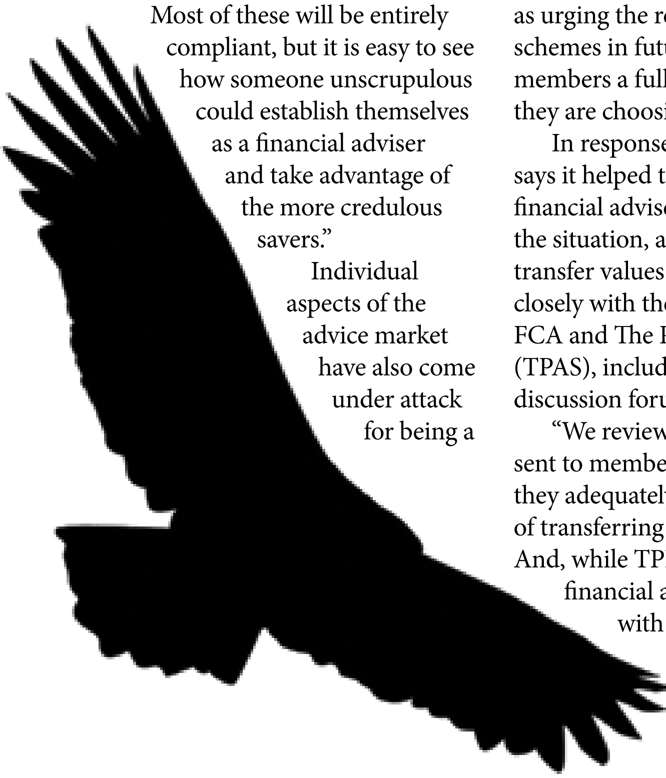
Despite individuals' general reluctance to obtain,and pay for, advice, if a transfer mis-selling scandal was to emerge, advisers would still see themselves first on the firing line.

Advisers are worried about this.

Momentum Pensions' September 2017 research found that 63 per cent of advisers state their biggest concern about DB business to be the risk of future liabilities from advice that is contested. Forty-eight per cent of advisers worry that customers do not understand the investment risks of moving DB into DC, with a similar percentage (47 per cent) of advisers seeing a rise in insistent DB pension transfer clients over the past year.

Large financial advice firms are conscious of their reputation, which makes it easy for the FCA to engage with them, Cooper says.

"However, there is a very large tail of small or lone traders where making these connections will be far harder. Most of these will be entirely compliant, but it is easy to see how someone unscrupulous could establish themselves as a financial adviser and take advantage of the more credulous savers."



Individual aspects of the advice market have also come under attack for being a conduit for poor advice and even potentially scams.

Field says that he struggles to fathom why contingent fees have ever been considered as an acceptable basis for providing impartial advice. The committee has even told the FCA to ban contingent charging, which it claims is a "key driver of poor advice". "Genuine independence is not compatible with a charging model that only rewards advisers for recommending a particular course of action," the committee states.

Regulators

However, it is not just advisers experiencing the committee's wrath. The two pensions regulating bodies, TPR and the FCA were both criticised by the committee for not adequately protecting members from poor advice.

In the case of the BSPS, the committee claims that a member communication plan sanctioned by TPR "proved woefully inadequate".

As a result, the committee has called on TPR to conduct a review to listen to BSPS members and learn how the members were let down, as well as urging the regulator to ensure all schemes in future are equipped to give members a full picture of the options they are choosing between.

In response, a TPR spokesperson says it helped tackle unscrupulous financial advisers who were exploiting the situation, and the current high transfer values available, by working closely with the scheme trustees, the FCA and The Pensions Advisory Service (TPAS), including particpating in a discussion forum with scheme members.

"We reviewed communications sent to members and were satisfied they adequately warned of the dangers of transferring out of a DB scheme. And, while TPR does not regulate financial advice, we wrote jointly with the FCA and TPAS to members to flag potential risks. We note the committee's recommendations and are continuing to work more closely with the FCA to protect pension savers," the spokesperson says.

The FCA that has also received fierce criticism from the committee. "Whose side are they on?", Field questions, referencing the FCA's proposal to abandon the adviser presumption against transferring out of "gold-plated, stable, indexed pension schemes". As part of its report, the committee suggests the FCA do not bring in these proposals, as it "looks reckless" in light of the BSPS case.

"From its intervention in this [*BSPS*] affair it seems clear that the FCA's actions still effectively protect these businesses' ability to make money out of pension funds, rather than protecting pension savers. They must take care they are not sleepwalking into yet another huge mis-selling scandal," Field states.

The FCA "fundamentally disagrees" with this statement, highlighting its joint TPR BSPS-dedicated helpline, its joint TPAS and TPR letter to around 12,000 BSPS members seeking a transfer quote, and a separate letter to BSPS members who have already transferred out about the complaints process should they have any queries with the transfer and advice.

In a January 2018 letter to the Work and Pensions Select Committee, the FCA says its initial investigation found some advice firms had 'industrialised' their DB transfer business so that they were no longer focused on their clients' individual circumstances and needs.

Furthermore, the FCA will be "collecting data from all firms who hold the pension transfer permission with the intention of assessing practices across the entire market to build a national picture".

According to Momentum Pensions' research, 48 per cent of advisers are concerned about the disconnect between the FCA and The Pensions Regulator on best practice regarding DB transfers.

"Recent issues demonstrate there is

not enough regulation, although the FCA is addressing the issue," Momentum Pensions group chairman Mark Gaywood says.

He recommends more focus and regulation on the qualifications of those providing transfer advice, and increased regulation of the underlying investments, with clearer guidelines on what is and is not acceptable, as well as what level of fees and incentives can be charged.

In contrast, both Cooper and Willis Towers Watson head of liability management Stewart Patterson, believe there is already enough regulation.

"There is already enough regulation, although a lot is in the form of guidance rather than rules," Cooper says. "The balance between rules and guidance should perhaps be re-considered."

However, the more important question, according to Cooper, is how regulation can be enforced in a way that "results in good behaviour across the board, rather than retrospective penalty". Extra regulation or controls likely results in higher costs though, she adds, "which could make it harder for some people to access financial advice, which might not be viewed as a desirable outcome".

Having advisers' recommendations peer reviewed could be a way around this, Cooper suggests.

Industry criticism

So far the responsibility of avoiding a mis-selling scandal seems to fall to the advice sector, not the pensions industry itself. However, if a "systematic problem" (to quote Cooper) is identified, the pensions industry would still find itself, rightly or wrongly, sharing the blame.

Some criticism will be directed at trustees who permitted the transfers to be paid, although, to all intents and purposes, their hands are tied, as the individual has the legal right to insist on a transfer, even if the trustees think a scam is occurring, Cooper says.

As pension saving is managed independently of the employer – either through trustees or an insurance company – individual employers may remain unscathed should a transfer crisis occur.

"However, we believe there have been pension scam cases where groups of employees working for a single employer have been targeted. In these cases, the employer might have an interest in supporting its pension provider in educating its employees about the risks they face," Cooper says.

She also recommends that where possible, an employer appoints a financial adviser for members contemplating transferring out of their DB scheme – the employer would also access small tax savings when providing employees with access to financial advice.

The greatest impact of a transfers mis-selling scandal for the pensions industry would be the reputational blow it would receive.

"Ultimately, any pensions mis-selling scandal damages the reputation of the whole industry and puts a question mark over the trust placed by individuals on any information put in front of them about pensions," Patterson says.

"That's a bad outcome for everyone, as it decreases the likelihood of individuals engaging in active decision making about their retirement income, which can only mean a decrease in the likelihood that the decisions they make are right for their particular circumstances."

Actions

So what can the pensions industry actually do to minimise this risk?

For Patterson, the more DB schemes adopt good practices, the better protection there will be for members to guard against poor outcomes, which could trigger a future scandal.

"Good practices centre around schemes ensuring members are aware of their options – both the pros and the cons of taking benefits as a DB pension or as more flexible retirement income via a transfer," he says.

He also recommends those managing DB schemes to direct individuals to a firm of financial advisers that has been through a robust selection process, and ideally make this advice available at no cost to the individual member.

It may be impossible to completely tame the vultures circling around DB-DC transfers, but with concerted effort, it is possible to prevent too many of them from picking off savers.

Written by Laura Blows

Preparing for the future

With 2017 being a record-breaking year for investments into UK funds, Natalie Tuck speaks to Investment Association CEO Chris Cummings on why the UK is so attractive, what influences pension funds' investment choices and how the IA is helping the industry to prepare for the future

2017 was a record-breaking year for investment into UK funds. What makes the UK attractive to investors, in particular for pension funds?

As the second-largest asset management centre in the world after the United States, the UK is recognised as a global centre of investment industry expertise. With a highly-skilled talent pool and robust regulatory environment, the UK is an extremely attractive location for investors. Pension funds are the largest client group and firms in the UK manage assets for pension schemes around the world. For defined benefit, the UK is a leading centre for liability-driven investment (LDI). Across both defined benefit and defined contribution, firms offer an increasingly wide range of investment services.

For the year ahead, what do you think will be popular asset classes for investors? Why?

The needs of pension schemes and savers in the UK and internationally are increasingly diverse. Defined benefit schemes in run off will invest very differently to cashflow positive auto-enrolment defined contribution default arrangements. Four themes are particularly notable in the investment debate at the moment. First, cost is an increasing driver of decision making, particularly in defined contribution. This is shaping innovation in a number of areas: for example, smart beta has evolved in response to clients wanting alternatives to purely passive exposure but at lower cost than traditional active products. Second, yield continues to be a major preoccupation, even as interest rates edge upwards, and this links to a third theme: the potential to access less liquid investments, such as infrastructure or private markets. Finally, socially-responsible investment is a growing theme, with particular strong flows in the UK retail fund market in 2017. All of this reinforces the central message that UK investment products and services are able to serve an evolving and often complex set of customer requirements.

The IA has previously said hidden fees may be the Loch Ness Monster of investments, finding no evidence that hidden fees affect fund returns. Does the IA still stand by its comments?

The press release that accompanied the report *Investment costs and performance, August 2016* has been removed from our website as it does not reflect the content of the report or the current views of our organisation. We remain wholly focused on delivering transparency of costs and charges in order to ensure that customers are able to feel confident in the full accountability of the industry for its delivery.

What else needs to be done to make investing more transparent, especially for the average pension fund member?

Investment managers need to work with pension schemes to help better explain three key things in accessible language: what the investment process aims to achieve, what it actually has achieved and what the costs are.

As part of this process, the IA is working closely and productively with transparency campaigner Chris Sier in his role as chair of a Financial Conduct Authority (FCA) independent working group to design a new template on cost disclosure, which will be rolled out later this year. This is likely to build on successful work previously undertaken by the Local Government Pension Scheme Advisory Board and the IA.

In your last annual report, the IA realigned its strategic priorities to reflect the changing environment. How has this been implemented in practice? What is on the agenda for 2018?

The IA has a busy agenda for 2018. We will be focusing heavily on customer communication and value delivery in the UK market as part of the follow up work to the FCA Asset Management Market Study. In addition to our ongoing work on Brexit and transparency, which will remain as priorities, we will be launching new initiatives on cybersecurity and fintech, and socially-responsible investing. Diversity is another key issue for our industry and we have been working for the past few months to help members prepare for the publication of the gender pay gap figures by April.

The IA said Brexit and cyber security were seen as key issues for the organisation. What impact has Brexit

had on the industry so far? How is the IA helping the industry to prepare for Brexit?
Two of the main objectives of the IA during the Brexit negotiations are to help protect the interests of savers and investors and to maintain an internationally competitive fund and investment management regime across Europe. This includes the need to preserve investor choice and a competitive products market, as well as a competitive regime that has the flexibility to delegate certain functions. These are key to ensuring the success of the wider European investment managements sector as a whole. We are actively engaged with our members and policymakers to provide a wide range of analysis on the asset management industry's priorities during the Brexit negotiations. However it is also important that global opportunities for growth outside the EU are not overlooked. The UK is at the centre of global investment allocation, with £1.2 trillion of investments managed in the UK coming from overseas, non-EU investors.

In relation to cyber security, what kind of cyber risks does the industry face? How is it working to protect itself from these risks?
Cybersecurity continues to be one of the greatest challenges for the financial services sector. In 2017, we saw a number of high-profile attacks, with notable examples including the WannaCry and NotPetya ransomware attacks, as well as large data breaches at Yahoo and Equifax.

The rise in increasingly sophisticated threats is set to continue. As part of our response to this, the IA will be launching an asset management security strategy to provide a coordinated industry response and to assist asset managers in assessing and establishing robust procedures to respond to cyber security risks. Cybersecurity is not just a challenge for 2018 but will require sustained long-term investment from asset managers to protect their business and customers.

And finally, in what way are technological developments changing the way the industry operates?
To remain globally competitive, the UK asset management industry must be restless in its quest for innovation and reinvention. We are seeing increasing numbers of fintech and regtech firms developing tailored solutions for the asset management industry and this is reflected in the growing numbers of fintech firms applying for IA membership.

Fintech firms are a key element in this process, driving innovation across the asset management industry to the benefit of its consumers. Speeding up the take up of new technology in the sector and ensure that fintech firms are embedded into the asset management ecosystem will be a key focus for the IA over 2018. As part of this drive we have just launched VeloCity, a fintech accelerator for the asset management industry.

Written by Natalie Tuck

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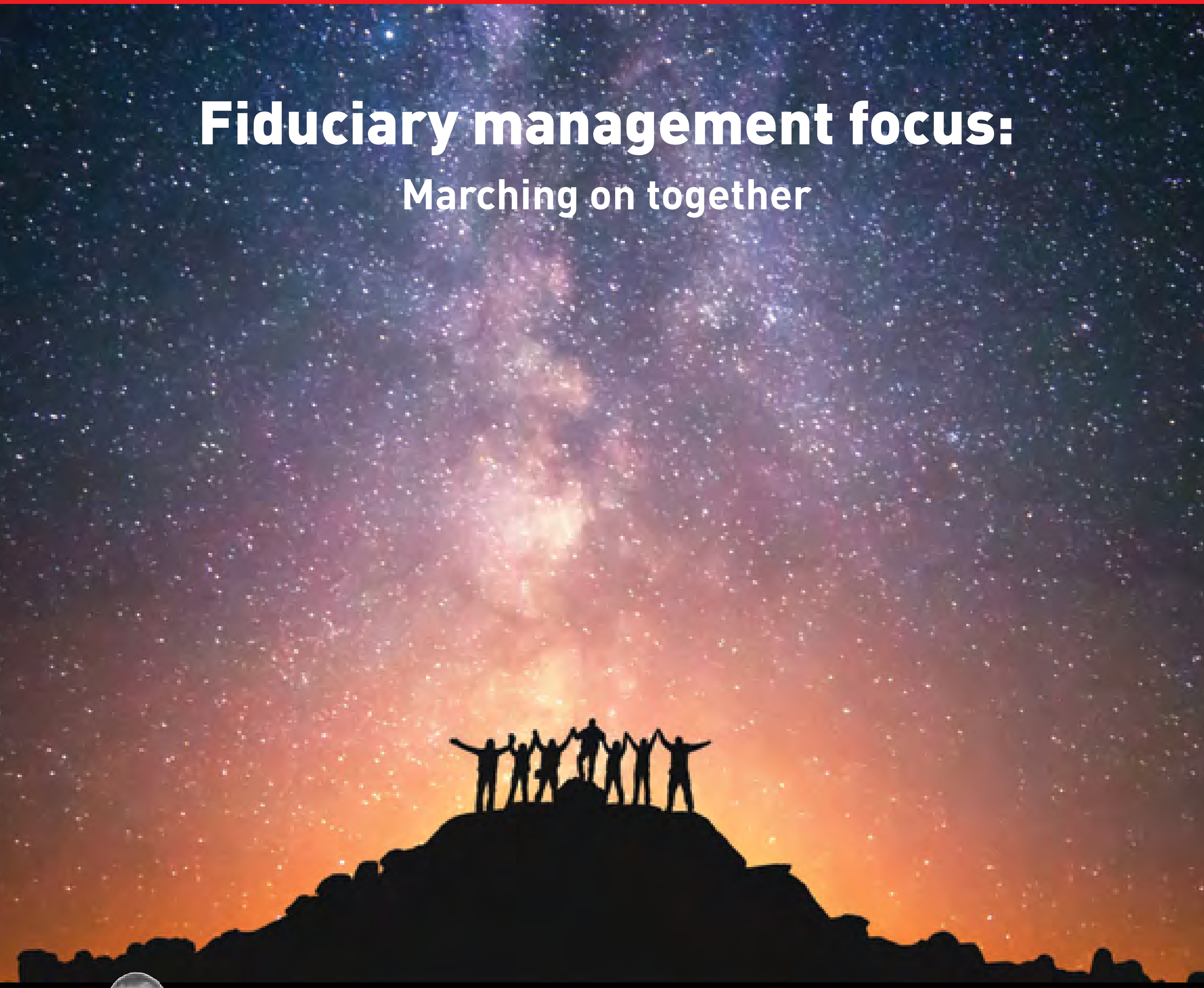
We've come a long, long way together – *David Rae looks back on the journey of fiduciary management and how it is adapting to meet the needs of pension funds today and for the future* **p54**

Sky's the limit? – *The number of pension schemes using a fiduciary manager is on the rise, helped by the option of partial mandates. Further growth seems assured, although opinion divides on how far and how fast the market will expand* **p56**

Fiduciary management focus:

Marching on together



Russell Investments head of strategic client solutions David Rae

Sponsored by Russell Investments

We've come a long, long way together

David Rae looks back on the journey of fiduciary management and how it is adapting to meet the needs of pension funds today and for the future

Fiduciary management has gained something of a Marmite status as an investment management approach. Many advocates cheer the simplified governance approach to an investment solution, while others bemoan the apparent one-size-fits-all nature of it. As the fiduciary management industry has matured and attracted greater scrutiny the true merits and differentiators across providers have and will become increasingly apparent.

It's hard to determine the exact origins of fiduciary management. If this fact stands for anything, there has been a Wikipedia entry since 31 March 2009. Our own experience of acting as a fully outsourced fiduciary manager in Europe definitely predates that, stretching back more than a decade.

Without doubt, since that time, markets have provided both the hard times and the good. Coming out of the financial crisis, equity markets and risk assets have generally been good. The FTSE 100 index is today flirting with a level of 7300 (as at 16 February 2018) – 86 per cent higher than its level at the end of March 2009 and that doesn't include dividends.

While this level of return is quite unprecedented, trustees and sponsors are acutely aware that the mark to market value of the liabilities have increased significantly as a result of the falls in long-term interest rate – a key component of almost all valuation methodologies.

Fiduciary management has served as a powerful force to increase the level of liability hedging, particularly amongst smaller and mid-sized pension schemes. Early fiduciary management solutions usually revolved around three core elements: the use of derivatives to hedge the key liability valuation risks, interest rates and inflation; more diversified and sophisticated growth portfolios that reduced the reliance on equities to generate returns; and de-risking strategies to create an evolutionary path towards a lower risk sustainable strategy. We may not know the counterfactual but fiduciary management solutions have clearly improved the funding position for the large number of pension schemes that have adopted this approach.

Defined benefit pension funds are continuing on a journey. The destination for all is to ensure that the retirement promises made to members are met as they fall due. The route to this destination can be different for different funds and we continue to witness increased variety in the long and short-term objectives of pension funds. Some are looking to immunise and lock down risk, accepting a higher funding cost to do so. Others are looking to longer-term return generation,

accepting this may lead to more volatile short-term outcomes. With greater input from corporate sponsors, regulators and other stakeholders, the range of potential investment solutions that meet everyone's needs is growing.

We're seeing a lot of evolution in the fiduciary management solutions to ensure that this approach keeps pace with the specific needs of each pension fund client. As pension funds continue to mature and demand for fiduciary management grows, we're building an array of fiduciary management solutions.

Striving for growth in a risk-controlled way

This was the starting point for many fiduciary management solutions. Generating strong investment returns to appease the costs of the pension promise in a risk-controlled fashion.

Fiduciary management provides an ideal platform to build a portfolio that achieves the required level of returns while managing risk relative to fund specific requirements. The combination of a well-diversified multi-asset portfolio coupled with fund specific liability valuation hedging has served our clients well over the last decade. By effectively managing the key liability valuation risks, our clients have been able to take advantage of the strong investment returns, progressively improving the funding position and de-risking.

Homing in on buyout

For many, the ideal end game is to transfer the pension liabilities to an insurance company at an acceptable cost or premium level. That will benefit the trustee and the sponsoring employer. Removing the reliance on the sponsor's covenant to serve as the backstop has benefits to trustees and employers alike. As funding positions have improved and insurance pricing has cheapened, we've been able to help clients execute both buy-in and buyout transactions.

Once again, the fiduciary management approach can play a critical role in delivering these outcomes.

Cashflow-driven investing

A big theme for pension funds over recent months has been the focus on cashflows. As cash outflows have increased for funds they have been increasingly prominent in trustees' thinking. The traditional investment industry has responded in time-honoured fashion, by pushing product.

My view is that cashflow-driven investing (CDI) is about so much more than this. It is about redefining the risk management framework to focus on the actual cashflows, rather than just the value of the liabilities. For me, CDI is a risk management approach, not a product.

Fiduciary management offers a robust means to build this risk management framework, to ensure that the appropriate risk measures are being monitored and managed towards. In time, portfolios can be reoriented towards greater cashflow generation as required. For some pension funds, this will include increased use of illiquid debt instruments. For others, particularly those looking to near-term buyout, liquid, Solvency II-friendly assets will continue to dominate.

Where next for fiduciary management?

Fiduciary management has never been about a one-size-fits-all solution for pension funds. As pension fund requirements have evolved over the past decade, we have seen our own solutions develop and evolve alongside our clients. Investment strategies have become more sophisticated in response to market conditions. Equity returns have been very strong but current valuation levels suggest it will be harder to generate similar levels of return going forward. The investment portfolios within our fiduciary management solutions have become more sophisticated, seeking out sustainable and repeatable sources of returns.

There has always been a strong focus on managing liability valuation risks within fiduciary management. This remains at the fore-front of fiduciary management and the evolution of risk management towards cashflows and insurance transactions will continue to develop.

Investors are taking their responsibilities seriously. The integration of ESG and sustainable development into fiduciary management solutions is critical to the future. As a signatory to the UNPRI since 2009, we're committed to evolving our investment solutions to integrating its six principles into our fiduciary management solutions.

Having proved itself adaptable to the changing needs of pension funds, the next 10 years will prove that not all fiduciary management solutions are built the same. It is now the time to objectively compare across providers, identify the best fit and switch if necessary.

Written by Russell Investments head of strategic client solutions David Rae

In association with Russell Investments

Summary
• A recent KPMG survey found that the number of DB schemes in the UK using a fiduciary manager has steadily grown over the past decade to 14 per cent. Further growth is widely expected, but projections vary as to whether it will reach 50 per cent by the end of the decade, or no more than 20 per cent.
• Governance, cost-effectiveness, performance and speedier decision making have all been among the drivers of growth to date.
• The Netherlands has been the pioneer of schemes using a fiduciary manager. The UK and the US (which prefers the term outsourced chief investment officer) are moving down the same path.

Sky's the limit?

The number of pension schemes using a fiduciary manager is on the rise, helped by the option of partial mandates. Further growth seems assured, although opinion divides on how far and how fast the market will expand

More defined benefit pension schemes are turning to fiduciary management. The latest industry survey by KPMG, released in November 2017, found that the UK market has steadily grown over the past decade and that a total of 805 DB schemes, around 14 per cent of the total, use fiduciary managers. Of these, 546 schemes delegated full control of their assets – and day-to-day management of the scheme – while the remaining 259 used a partial mandate.

There have been bullish – and fairly recent – forecasts that the impetus for more schemes to go down the fiduciary management road is accelerating. Bullish projections suggested the percentage could reach as much as 50 per cent by the start of the next decade. That forecast has begun to look overly optimistic – 20 per cent is now cited as a rather more realistic figure – with many keen to see what the Competition and Markets Authority's (CMA) ongoing investment consultants market investigation contains.

The Financial Conduct Authority (FCA) announced last September that it had asked the antitrust body to undertake a review of the entire investment consultancy and fiduciary management sector because of "serious concerns" about the industry – although these relate to issues such as transparency and value for money and not the validity of fiduciary management.

Among past concerns has been a tendency for smaller schemes to move from a consultant relationship to a fiduciary management relationship with the same provider, without involving any competitive tendering process involved. However, KPMG's survey found that 60 per cent of schemes appointing a fiduciary manager over the past year had received independent written advice on the selection and appointment process, against only 33 per cent in the 2016 survey.

The CMA's probe is scheduled to take a further 12 months and will deliver its assessment in March 2019.

Drivers of growth

The fiduciary management pioneer has been the Netherlands, where up to 90 per cent of scheme assets are managed –the figure admittedly helped by giant standalone pension funds such as ABP for government and education employees that regards itself as a fiduciary manager.

Across the Atlantic, US schemes of various sizes are also moving to fiduciary managers – although the preferred term is outsourced chief investment officer (OCIO) or outsourced CIO, which some believe more accurately summaries the role.

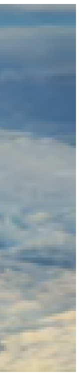
"The use of fiduciary managers by pension schemes is now fairly well established in the UK," says Russell Investments head of client strategy and research David Rae.

"Our industry has gone through the process of identifying cost-effective structures for managing funds and the two main options of either doing it yourself or outsourcing the task. If the latter, it needs to be cost-effective and offer the scheme value for money.

"It's a complicated decision and the FCA/CMA review has noted the morphing of traditional consulting assignments into fiduciary management assignments. The differences need to be clear for trustees on basics, such as the respective services and costs."

A major driver behind the increasing use of fiduciary managers is the issue of governance, says Kempen Capital Management UK head of investment strategy Nikesh Patel – in particular the amount of time that scheme trustees must devote to investment issues, including funding arrangements. "Governance is quite stretched when it has to consider investment," he adds.

"More recently, cost control has also become a major driver. Using a fiduciary manager gives a scheme access to greater



buying power. At the same time fees have typically reduced by 30-40 per cent over the past decade, which has made using a fiduciary manager more attractive."

For Cardano chief executive of investment consultant Kerrin Rosenberg, performance is the top consideration. "Over the past decade, the average pension fund has earned returns on its assets that have been 20-30 per cent below the increase in their liabilities," he notes.

"This underperformance has caused the large deficits we now see in the industry. It has forced those companies that can afford it to inject huge sums into their pension funds and left trustees vulnerable to sponsors who cannot afford large deficit repair contributions.

"Not only has the investment experience been disappointing, it's been incredibly volatile. As pension funds mature and they enter the decumulation phase, this volatility is increasingly hard to live with. We think fiduciary management offers trustees a more reliable improvement in their funding ratio – better returns but, crucially, better risk management as well."

Schroders head of fiduciary management Hannah Simons reports that many of their clients cite the speed of decision making as the main attraction of fiduciary management.

"Many scheme trustees met on a quarterly basis to decide the funding level they wish to target and over what time horizon," she says.

"However, this means that some opportunities may be missed. February's market correction underlined the need to be nimble and make adjustments. Many trustees have realised that quarterly meetings aren't conducive to changing behaviour and reacting swiftly, which supports the case for using a fiduciary manager."

Add to these drivers the fact that more DB schemes will mature over the coming years, says Simons. "Trustees are looking ahead to the end game, which in many cases will involve an insurance solution. Using a fiduciary manager along the pathway to an eventual buyout means that more decision making is delegated at an earlier stage, which is also likely to assist growth over the next five to 10 years."

Upcoming challenges

Alongside the traditional fiduciary management arrangement, under which the scheme trustees delegate control of the fund's assets, the past two to three years has seen a growing number opt for partial mandates, in which the fiduciary manager takes responsibility for only a portion of the assets. Patel says that the latter option is proving popular among larger schemes, with at least £1 billion in assets.

UK pension schemes collectively have an estimated £1.6 trillion in assets and the fiduciary management market has now reached around £150-160 billion. Patel believes that a number of very large schemes, collectively representing around £250 billion in assets, are unlikely to go down the fiduciary management route.

"At the other end of the scale, while outsourcing fiduciary management makes sense for smaller schemes, the fees are probably too high so that probably rules out a further £100 billion." That leaves just over £1 trillion, of which schemes making up around half the figure could ultimately give a full or partial mandate to a fiduciary manager, he suggests.

Stamford Associates head of fiduciary Carl Hitchman is optimistic on the outlook. "Trustees will have a greater range of options and individuals will become more comfortable with the concept of fiduciary management," he predicts. "The future performance of fiduciary managers will become more visible – and provided it is good, more schemes will be attracted.

"Investment returns over the next few years are likely to be more muted than previously, although this will be offset by the fact that the absolute returns needed by many schemes are likely to be less than before.

"As we've been reminded, the markets are susceptible to sharp corrections. If expectations aren't met, valuations are likely to come under threat. In particular, the staged withdrawal of quantitative easing (QE) could result in increased corporate insolvencies. Active fiduciary managers will need to start proving their worth in picking the best-performing companies and we'll start seeing a noticeable difference in returns."

Patel adds that the low to zero interest rate environment of recent years have already presented fiduciary managers with a challenge but also provided an opportunity to prove themselves. "Fiduciary managers were more focused on risk diversification and hedged far more against interest rates – meaning that they either suffered fewer losses or were able to make gains from the introduction of QE," he notes.

Having correctly deduced that interest rates would stay low for rather longer than many anticipated back in 2008-09, the industry's next challenge could lie in correctly determining when the next recession begins.

So are trustees seeking consulting or asset management skills when they appoint a fiduciary manager? Rosenberg believes that it's both. "At its heart, fiduciary management is a form of asset management, and trustees clearly need to be comfortable with the asset management capability of their preferred fiduciary manager," he explains.

"However, fiduciary management is more than a product, it's a solution. Trustees expect the fiduciary manager to understand and advise on their liabilities, journey plan and actuarial valuation, free from conflicts of interest and a desire to sell more 'product'."

Written by Graham Buck, a freelance journalist

Summary

- With the advent of auto-enrolment, charges are more important than ever.
- In a low return environment, charges take a bigger slice of the cake.
- Since 3 January 2018, transaction costs must be disclosed.
- There is still standardisation work to be done. Very often you are comparing 'apples with pears'.

Comparing apples and pears

Until now comparing charges has been difficult because there is no standardisation, but things are improving, writes Stephanie Hawthorne

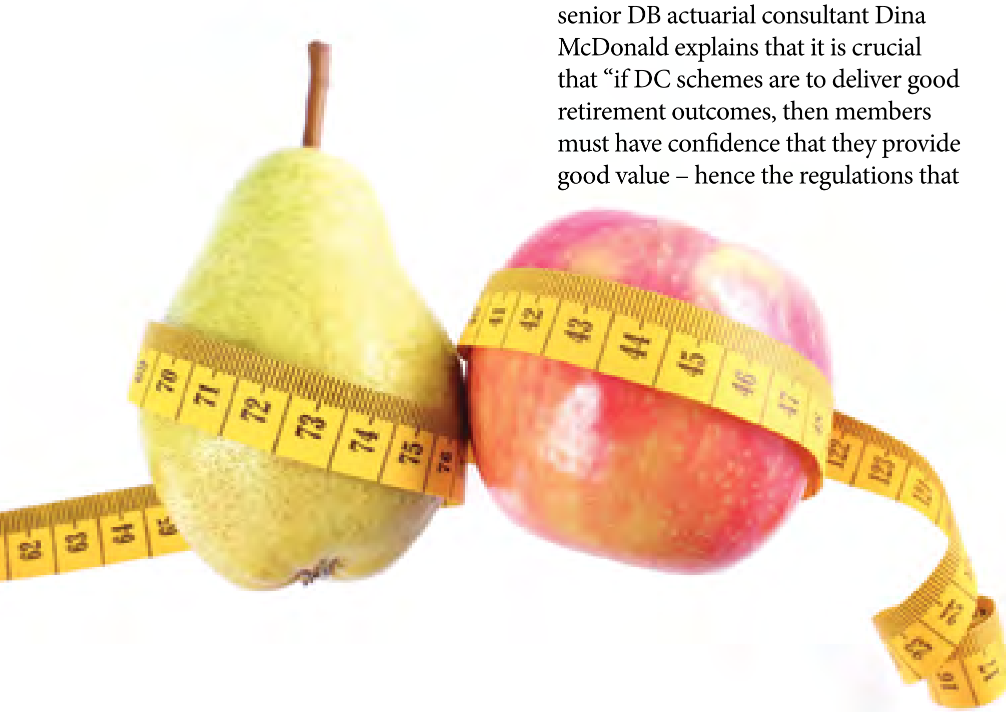
Since the arrival of auto-enrolment in 2012, millions of people are now in pension schemes they haven't chosen so it is more important than ever that charges are fair.

The effect of high charges can be dramatic. The Department for Work and Pensions estimated in 2013 that a 1.5 per cent annual charge would reduce the size of a pension pot by 34 per cent over a working life, whereas a 0.5 per cent charge would only reduce it by 13 per cent.

As Transparency Task Force chair Andy Agathangelou says: "It is desperately important that members get value for money or they will opt out and nobody wants that."

Low returns

Indeed, costs assume ever-more importance in a low return environment, as CEM Benchmarking principal John Simmonds explains: "Bond and equity returns over the past 30 years have exceeded long-term averages. Many of our clients believe the returns we have seen in recent years are unsustainable and that we are entering a lower return environment. Costs matter more when returns are low because those costs take a bigger slice of the return 'cake'. With that in mind, it's not surprising that attention turns to cost. This is happening all over the world."



DC schemes have had a bad press in the past with many legacy arrangements having outdated charging structures. Poor fee transparency led to suggestions that providers weren't always treating members fairly, which led to erosion of public trust in pensions. So Mercer senior DB actuarial consultant Dina McDonald explains that it is crucial that "if DC schemes are to deliver good retirement outcomes, then members must have confidence that they provide good value – hence the regulations that require governing boards to assess value annually".

The charge cap

In 2015, a charge cap on the annual amount that can be charged to savers in a pension scheme was imposed at 0.75 per cent of the fund held in the saver's pension account. The cap applies to all scheme administration and investment costs. It is currently still set at 0.75 per cent of the fund held in the saver's pension account. The cap applies to all scheme administration and investment costs.

Looking at the background, JLT Employee Benefits head of DC investment consulting Maria Nazarova-Doyle says: "For some time, there has been a requirement on trustees of DC pension schemes to disclose transaction costs and charges in the DC chair's statement, however, there has been no corresponding requirement on investment managers to provide these. In September 2017, the FCA evened out the position by publishing their policy statement, setting out the requirement for the firms managing DC money to fully disclose the transaction costs involved in managing the funds. This has taken effect from 3 January 2018."

KPMG head of DC consulting Richard Birkin says: "We now have FCA rules for fund managers on the disclosure of investment costs, including transition costs, using a common methodology ('slippage costs'). So from 3 January pension schemes and providers have at least been able to ask for these details. This is important in a DC context as it should allow trustees and governance committees to compare costs across all the funds they offer members. So far we have not seen much by way of data coming back."

Barnett Waddingham associate Sonia Kataora agrees: "Obtaining cost transparency in the past has been hindered by the lack of data on costs, particularly transaction/hidden costs, from service providers. Regulations imposed on DC providers will mean this data should be more forthcoming in future. But there is likely to remain difficulty initially in how the data will be presented, interpreted and ultimately what it means for value to members."

Reforms over the decades

People have been trying to reform this area for years, going back to the Myners Review in 2001, with a plethora of work in this area, as PLSA policy lead for investment and defined benefit Caroline Escott explains: "There have been many different regulatory developments on cost transparency at both the UK and EU levels. MiFID II placed new duties on investment managers in terms of cost disclosure; costs need to be aggregated and expressed both as a percentage amount and a monetary value, and disclosed both at point of sale and annually afterwards. 2018 has also seen the advent of PRIIPs, which requires investment product manufacturers to disclose information about transaction and other indirect costs to clients."

She adds: "In the UK, the programme of work that came out of the FCA's *Asset Management Market Study* has had a significant focus on better cost disclosure, building upon the work of others such as the LGPS Cost Transparency Code. The Institutional Disclosure Working Group (IDWG) was set up by the FCA to create a set of cost disclosure templates for use by trustees when comparing the costs of different products. The FCA has also recently referred the investment consultancy market to the Competition and Markets Authority (CMA) for investigation; should any evidence of anti-competitive practices be found in this market, one potential remedy under consideration by the FCA is improving consultants' approach to fee disclosure."

The People's Pension director of policy Darren Philp says this is not enough: "Fund managers should be required to follow a consistent set of assumptions, and present them to pension schemes in a coherent, standardised fashion. Such steps would allow scheme governance to compare and contrast, and really do their jobs in ensuring scheme value for the members."

He adds: "Although moves to require transparency of transaction costs are a positive and crucial step forward, costs can only be truly comparable if headline charging structures are standardised across the industry. At the moment it is too difficult to compare headline value. Regulators and the government need to sort this out."

Aon principal Neil Smith welcomes the greater transparency but does not believe that, "for those looking for an overall reduction in costs, this should be seen as a panacea. We have seen evidence in the early part of this century of cost disclosure resulting in an increase in average fee levels as those managers at the lower end of the scale take the opportunity 'to raise their fee levels to market averages".

But he expects "it to result in a culture where asset owners are paying for services that add-value, and not paying for those that don't. If this increased scrutiny results in an overall lower level of charges being paid with no adverse impact on the level of investment performance then that will be a clear benefit".

Simplitium head of product development for pensions Stewart Bevan says: "Managing costs and charges associated with a pension scheme is central to its operations, and can have a significant impact over the long term. Monitoring expenditure accurately is central to operating a scheme efficiently. With greater transparency, schemes gain greater insight, allowing them to improve their investment decision making and ultimately maximise outcomes for members, which is obviously the key aim."

He adds: "Only when you know and understand the full costs, can you manage the entity efficiently and begin discussions about value for money."

The pensions and investment sector is in a state of transformation. In conclusion, as Agathangelou says: "There is a close correlation between transparency, truthfulness and trustworthiness and the asset management and pension sectors desperately need to rebuild trust.

"The winners of the future will be those that don't see the demands for greater transparency and the resultant value for money as a threat, but as a commercial virtue. Now is the right time for all parts of the market to not just tolerate the change that is happening but to also embrace and welcome it. It's time for principles before profit, in the full knowledge that a more enlightened approach will maximise shareholder value in the long term; and also give is all the sense of pride that can only be achieved when you know you are doing all you can to give clients and scheme members the value for money they deserve."

Written by Stephanie Hawthorne, a freelance journalist

Plugging into change

Laura Blows finds out how the National Grid UK Pension Scheme managed not one, but two ambitious projects at the same time – outsourcing and overhauling its investment strategy, while also splitting the DB scheme into three autonomous sections

That moment of realisation when it dawns on you that you're no longer the dynamic, young whippersnapper you once were, but instead may actually be a bit old and set in your ways, can be a shock.

For those trustees managing the National Grid UK Pension Scheme (NGUKPS) that moment occurred when a number of new members joined the board.

The NGUKPS has four employer-nominated trustees, two independent trustees and six member-nominated trustees. In December 2014 three new member-nominated trustees, one new employer nominated trustee and a new chairman were appointed to the board.

At this time the contribution schedule with the sponsor regarding the March 2013 triennial valuation had only just been agreed, meaning the board was then moving onto reviewing its investment strategy, which had not been looked at since 2010.

What soon became apparent was the scheme's liability hedging of just 30 per cent being insufficient. "The new trustee board felt that inflation risk and interest rate risk was an unrewarded risk and they felt very uncomfortable that given the maturity of the scheme so little of that risk was hedged," NGUKPS chair Nigel Stapleton says.

The second issue noticed was the limited diversification of return-seeking assets. NGUKPS used an internal manager for £12 billion of its £17 billion worth of assets, "whom, although it had a skilled team, was unable to bring in people with the suitable skills to diversify the portfolio globally".

Finally, given the ongoing debate between active management and passive investment, all of NGUKPS' equities portfolio being actively managed was questioned.

Changing investments

As a result, in April 2015 it was decided that interest rates and inflation risk had to be hedged to a greater extent than was the case, and in order to get an appropriate risk profile (in terms of moving from an 80 per cent coverage on a Technical Provisions basis to 100 per cent without the sponsors paying a lot more money into the scheme), a more diversified, return-seeking portfolio was needed.

To achieve this aim, the decision was made in April 2015 to sell the internal investment management business, Aerion.

"When we looked at the skills within Aerion on liability-driven investment (LDI) we did not feel that a team of three could in any way have the comparable expertise of the really big external LDI players that dominate the UK institutional investment market," Stapleton explains.

Unlike the "salami slicing approach, where time is spent to select the best possible manager for each asset class, transferring the funds and then saying goodbye to the internal team", Stapleton says, Aerion was put up for sale "not as such to secure the highest price for Aerion but to get the least costly and most effective external management outcome and a buyer who was willing to take the staff and all the liabilities attached to Aerion, which included a long-term office lease as well as over 40 staff".

In August 2015 a deal was struck with LGIM to buy Aerion.

By December 2015, the £12 billion of assets under Aerion was transferred to LGIM (the remaining £5 billion already being with external managers), along with all Aerion's investment professionals, bar two who now form part of a newly-created NGUKPS CIO team.

LGIM since then has kept responsibility for NGUKPS' credit portfolio, and "has done a very accomplished job for us in moving that into a globally-diversified portfolio, and also moving some of it out of investment grade into alternative credit areas", Stapleton adds.

LGIM has also kept 25 per cent of the Aerion internally-managed equities portfolio that was transferred from active to passive. The other 50 per cent of the equity portfolio went to external global credit managers, including one focusing on emerging markets, and the final 25 per cent went to factor investment.

In parallel, the £5 billion that had already been outsourced was realigned, with 13 other external managers rationalised to seven.

The expectation was, as Aerion moved over to LGIM in December 2015, that the trustees would have a very considerable and demanding job, extending well into the next year, to complete a total rethink of what the return-seeking portfolio should look like.

Sectionalisation

However, the workload for 2016 became even more demanding, because in November 2015, a shock came the trustees' way. The sponsor informed the trustees that National Grid wanted to sell a majority stake in its UK gas distribution business. This area accounted for a third of the scheme's total liabilities, and the sponsor could only reasonably expect a buyer to pick up the pension assets and liabilities attributable to this part of their business, Stapleton explains.

Therefore National Grid proposed to the trustees to split the NGUKPS into three separate DB sections – one section for gas distribution, one section for gas transmission, and one section for the rest of the scheme members. This could only occur with trustee consent.

The deadline National Grid needed this sectionalisation to complete by was particularly tight, with the detailed terms by which it would be achieved needing to be confirmed by June 2016. "Our major objective was to ensure that the accrued benefits of every member were just as secure after the split," Stapleton explains.

The first significant hurdle was splitting the membership.

"There was no way we had a documentation for every person that clearly shows whether he or she should be a member of gas distribution or a member of gas transmission, for example," Stapleton explains. To overcome this problem, a bespoke process to allocate assets and liabilities to the three sections was devised. This included a carefully-developed and tested methodology by which to allocate members whose history was inadequate to determine their section.

The second biggest challenge was addressing the fact that each of the autonomous sections would have different covenants compared to NGUKPS being one single scheme. In this respect, the trustees took considerable legal and covenant advice, to reassure themselves that members would not be affected adversely, in either accrued benefits or security, following sectionalisation.

Despite all these complications, a mere seven months later, by June 2016, the trustees had successfully negotiated with National Grid a guarantee and funding structure, along with appropriate contingent asset support.

"A delay in doing so would have had implications for a strategic initiative that was vital for the company. So we had a pretty strong hand in negotiating terms." Stapleton says. "The discussions were tough but strong relationships were maintained throughout and I believe the outcome was a win-win for both the sponsors and our members."

The successful negotiations were aided by support from professional advisers, "because clearly our executive team had neither the skills nor the depth to be able to deal with issues of such complexity, which for most schemes don't come up in 50 years", Stapleton explains.

Implementation

The second half of 2016 was spent implementing the many changes necessary to effect sectionalisation. This included valuing the whole scheme assets and allocating these between the new sections.

Most importantly, a significant member engagement programme was launched with the help of a media communications consultant, using a mix of traditional methods, such as mailings and a dedicated telephone help line, alongside innovative methods, such as online videos and animations.

To implement both the new investment strategy and sectionalisation, 59 meetings of the trustee board were required during 2016, along with the formation of two ad hoc sub-committees and many more teleconferences and email exchanges.

Sectionalisation came into effect on 31 December 2016. However, more implementation work lay ahead. Major aspects of scheme governance and reporting, sectional investment strategies, member administration, communications and auditing required redesign.

The MNT representation was also deemed inappropriate because it had been based on geography and member type. The election process was revised and in February 2018 the members of each section voted for two members of that section to join the reconstituted board on 1 April.

For Stapleton the 'bitter/sweet' of all this is that the elections meant that at least two of the MNTs who helped implement the changes are leaving the board with the term for which they were elected in December 2014 less than two-thirds completed.

A worthwhile endeavour

The two projects may have required considerable effort to completely overhaul all aspects of the scheme, but the results already seem to prove its worth. The trustees can demonstrate that these initiatives have materially reduced the scheme deficit as compared with what it would have been had the pre-April 2015 investment strategy and governance remained in place.

Members also seem happy, as evidenced by the positive feedback and the statistically tiny number of queries that amounted to less than 0.1 per cent of the membership. And possibly best of all, "we would certainly take the view that the contingent asset and other sponsor support now in place for the three sections is in total stronger than it was before the scheme was sectionalised", Stapleton says.

Managing two ambitious, overlapping projects may have been a challenge for the trustees, but it has clearly sparked a new lease of life into the NGUKPS.

Written by Laura Blows

Summary
- DB schemes, especially the well-funded ones, are looking to insurance companies as portfolio role models.
- DB schemes are adopting a much more holistic investment approach and looking at a diverse source of returns.
- Equities are out of favour as different liquid and illiquid strategies become more popular.

An open mind

Lynn Strongin Dodds reveals how DB schemes are adopting a much more holistic investment approach to their investment strategies

As the years tick by on the defined benefit clock, schemes have become increasingly thoughtful about the way they structure portfolios for the end game. While the better-funded schemes are adopting more of an insurance mindset, others are looking at different blended approaches to meet their obligations.

Many of their challenges are not new. They have been grappling with low interest rates, quantitative easing, increasing longevity and scheme closures for some time. However, withdrawals are happening at a faster rate than expected as people take advantage of pension freedoms, which were introduced in 2015. They were designed to give over 55s in defined contributions greater choice beyond buying an annuity, but a swathe of DB members have followed suit and have relinquished their gold-plated guaranteed income in exchange for a lump sum.

Numbers crunched by consultancy Mercer show that 300,000 pension transfers, worth a weighty £85 billion, were made between April 2015 and the end of last year due to historic high values. "The mega trend is that schemes are maturing and are closed to new members," says Mercer investment consultant Adam Lane. "However, allied to this is that people are not waiting to reach retirement age to draw their benefits and are taking their benefits earlier than expected in the form of transfer values as a result of pension freedoms. The implications of pension freedoms are that members have greater flexibility but it also means that plans are becoming cash negative with existing asset portfolios not generating sufficient income to meet payments when they fall due."

The 2017 Mercer's annual *European Asset Allocation Report* reveals that 55 per cent of the UK's DB pension schemes are now cashflow negative, up from 42 per cent in 2016, with 85 per cent of the remainder expecting to be cashflow negative by 2027.

J.P. Morgan Asset Management's head of UK institutional Paul Farrell agrees that the speed of people pulling out of plans has become a huge challenge and that now schemes have the additional consideration of estimating the number of transfers. "For the first time, pension plans are becoming cash negative. They will have to think long and hard about what is their end game – is it buyout or self-sufficiency and can they change their mind along the pathway."

Structural changes within the industry are only one albeit important facet driving asset allocation. Market conditions are also changing. "The long-heralded turning of the monetary cycle is actually happening and in 2017 we saw big changes, led by the US, that we have not seen in a decade," says Aviva Investors head of investment strategy, global investment solutions John Dewey. "The expectation is that yields and potentially credit spreads will rise and there will be further significant volatility in the market."

M&G Investments director of global institutional distribution Annabel Gillard also notes that regulation around derivatives included in MiFID II and the European Market Infrastructure Regulation has also caused a shift in thinking about the best hedging strategies. "Derivatives are a big part of a liability driven-investment approach but collateral requirements may make them more expensive to implement," she adds.

Schemes are at different points on the de-risking journey, with the Mercer survey highlighting that 47 per cent of the UK DB pension looking at self-sufficiency as their long-term funding objective, while 36 per cent were focusing on their technical provisions liabilities and 17 per cent were targeting a buyout. The latter is growing at a clip and expected to break through the £15 billion mark this year but that is still relatively small considering that the UK's estimated aggregate buyout liabilities of over £2 trillion.

"The buyout market is constrained and will only be able to do a certain amount of business," says Royal London Asset Management (RLAM) Head of Institutional John Burke. "Those going for self-sufficiency will also want a lower risk approach to managing cashflow promises as they fall due, but if they are not as well funded they may need to consider a broader range of assets to generate extra yield, such as illiquid credit. A holistic solution would include overlaying an LDI strategy, which also protects schemes from interest and inflation changes."

Heading in the same direction

The overall direction of travel though has been similar, with a move away from equities and into bonds as well as alternative and assets. The Mercer survey reveals that since 2008, UK plans slashed equity allocations from 58 per cent to a new low of 29 per cent last year, while the average allocation to alternatives has been steadily climbing to 22 per cent from 4 per cent in 2008.

"We are seeing schemes act more like insurance companies as they mature and get to the end game," says Gilliard. "They are looking for a series of defined cashflows that is similar to an annuity-style portfolio. It has evolved slowly over time and schemes are moving at different rates. It will depend on their sponsor covenant, current default and funding ratios, cashflow positions and specific parameters."

The better-funded schemes are adopting more of an insurer mindset and are moving more to a cash-driven investment strategy, which places a higher emphasis on liquid and illiquid income generating strategies, according to Legal & General Investment Management head of portfolio solutions Graham Moles. "Broadly speaking this means assets with contractual cashflows and credit sensitivity and so it is not unusual to include corporate and government bonds as well as other fixed income strategies," he adds. "If the goal is to get to a buyout, the benefit is that this strategy is likely to move in the same way as an insurance company's portfolio and additionally it will be easier to transfer the portfolio over."

The difference is that DB pension schemes are not constrained by Solvency II and have a wider breadth of assets to choose from. "We are starting to see clients think about their fixed income portfolios more broadly. This includes coupling traditional fixed income exposures with integrated return seeking and income generating assets," says BlackRock head of UK institutional business, Andrew Stephens. "This fanning out includes asset-backed securities, absolute and total return strategies, buy and maintain credit, private-market debt and longer dated cashflow-generating assets like infrastructure debt and long-lease property. There is a realisation that schemes need to make their fixed income asset work harder and to develop a more integrated and holistic approach."

Other assets making the grade are those higher up the risk spectrum such as emerging-market debt, sub investment-grade credit and catastrophe bonds, which are typically insurance-linked and designed to raise money in case of a catastrophic weather-related events. Each comes with its own set of challenges but the returns can make it worthwhile.

"Catastrophe bonds currently offer a pocket of value – 7-8 per cent yields – even though 2017 was one of the worst hurricane seasons in 20 years with Irma and Harvey," says Schroders strategist Alistair Jones. "However, losses were only 0-5 per cent in many funds and the pick-up in yield may well now be worth the risk in a very diversified portfolio."

While fixed income is a key component, return-seeking assets will also need to be part of the picture for many. "In the past schemes would choose between return seeking or hedging liabilities but today we see a third option emerging, which includes growth assets such as equities and liability-matching assets," says Farrell. "In the middle sits those assets that do not provide a perfect hedge or maximise returns from a Sharpe Ratio perspective but instead offer cashflows with inflation linkage. Together they improve the overall efficiency and cashflow of the portfolio's profile."

Russell Investments head of LDI solutions, EMEA, David Rae also believes the lines are being blurred between growth and liability hedging. "It is no longer a barbell between low-risk government bonds and high-risk equities but there is a middle ground, which is becoming more mainstream, whereby schemes are looking at the different sources of risk in a more integrated way," he adds.

Written by Lynn Strongin Dodds, a freelance journalist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__Adding value__ – Paul Crosbie discusses how to enhance value in the UK real estate market __p66__

__The diversification game__ – Real estate investment in the UK has slowed somewhat over the past year, but for pension funds looking to diversify their portfolio, opportunities remain in regional and alternative asset classes, Theo Andrew explores __p68__

Real estate focus:

Location, location, location

Paul Crosbie, fund manager, M&G Real Estate

Adding value

Paul Crosbie discusses how to enhance value in the UK real estate market

UK real estate continues to trade at a historically high spread over bond yields and pricing remains favourable when compared to other global markets. This alone may be tempting enough for some investors, particularly those from overseas who are attracted by the liquid, transparent market, landlord-friendly leases, availability of large lot sizes, and of course the current relative weakness of sterling. Confidence in investing in UK real estate has been further underscored by the strength of the underlying occupational market. Construction levels across all sectors of the UK property market have still not fully recovered from the global financial crisis and the combination of muted levels of new supply coming to market and robust occupier demand for space is underpinning rental growth. Take up of office space in the UK in 2017 was above its five and 10-year average levels, with many occupiers now looking past the initial shock of the EU referendum result and adopting a 'business as usual' approach. This has resulted in vacancy rates on prime (the best quality) real estate falling to below 2 per cent in most of the core office and industrial markets.

Despite the relatively favourable occupational market dynamics, particularly outside prime central London, most investors have taken a 'flight to prime' approach in the wake of the Brexit vote. They have tended to focus on the best-quality core assets with relatively long leases; the definition of what is considered core has also narrowed during the past 18 months. This dynamic has created a divergence in pricing between core and non-core assets. Properties with perceived risk attached – whether it be vacancy, near-term lease expiry or imminent need of capital expenditure – are now on average at an 8 per cent discount to pre-referendum pricing. As a result, the net initial yield spread between core and non-core assets has increased by 50 basis points (bps) since March 2016 to stand at 300bps in December 2017.[1] At a time when the global real estate cycle is relatively well advanced, the UK stands out as offering relatively attractive value when considering long-run historic pricing, but also particular value, and therefore opportunity, in non-core assets.

Occupational market in focus

The combination of a shortage of quality accommodation and robust demand supports taking leasing risk, such as vacancy, which, when such risk is addressed through active asset management initiatives, should enhance a portfolio's income profile. Looking at the Investment Property Databank monthly index, rents at the all-property level have continued to grow every month since Brexit, but those sectors with tighter supply and demand dynamics have benefitted the most.

In the logistics sector, the supply and demand imbalance is particularly acute, especially for multi-let estates in London and the South East, and thus the sector has seen rents grow by more than double the average at 5 per cent p.a. in 2017. Strong appetite for space continues to be driven by structural changes related to e-commerce and competition from other land uses. Future returns are likely to be driven by rental income and rental growth, which can be enhanced through active asset management. However, investors are also likely to be well-compensated for taking development risk in particularly supply-constrained industrial markets.

Turning to the office sector, attractive income yields of above 5 per cent can be found in some of the key cities outside of London, including Manchester, Birmingham and Edinburgh. Such regional cities are set to benefit from transport infrastructure development, with £26 billion earmarked by the government for such purposes. In addition, the devolution of government powers to key regional cities should give them greater ability to unlock potential sites for urban regeneration. Coupled with the affordability of residing in the regions, this should encourage further migration from the capital to cities with high transport connectivity. Total employment growth in Manchester is following the same trajectory as that of London, with the city possessing the fourth largest tech company agglomeration in the UK. While in London development activity is more elevated, there are tighter supply and demand dynamics in the regions. Therefore, the relative shortage of quality commercial office stock in cities such as Manchester and Bristol gives us confidence to take on refurbishment and repositioning opportunities, transforming currently non-core assets to core.

So what do we expect the UK to look like post-Brexit? Over the next two to three years, we expect ongoing Brexit related uncertainty to weigh on GDP growth, but also on investor confidence, although both are anticipated to recover once the uncertainty starts to dissipate. This represents a compelling window of opportunity to acquire properties with strong underlying fundamentals at reduced prices, which are well-located and could benefit from capex or proactive leasing. Over the longer term, the UK is expected to see 2 per cent per annum GDP growth, the second highest G7 economy behind the US. [2]We anticipate that once the EU exit process

Non-core capital values have fallen since EU Referendum

CBRE PROPERTY VALUATION CAPITAL GROWTH, INDEX JUNE 16 = 100

Source: M&G Real Estate, CBRE (data to Dec' 2017)

has been completed, the UK economy and real estate markets will recover, leading to positive conditions to sell assets into a more favourable market.

Amidst improved business and consumer confidence, rental growth should accelerate as the occupational market strengthens on the back of an improving economy, further aided by the undersupply of 'Grade A' prime space across all sectors. Given the return of confidence, we anticipate the spread in risk premiums between non-core and core real estate assets will narrow, as occupier and investor risk aversion diminishes. On the capital growth side, a positive re-rating can be achieved from repositioning or refurbishing assets, which when combined with the timing of a market upswing can crystallise gains delivered through value enhancement. Delivering the best risk-adjusted returns from the property market requires expert delivery of active asset management initiatives to maximise the available returns from investing in attractive supply-constrained submarkets. Managers with access to the capital markets, significant experience of the UK market and asset management resources will be able to capture the opportunity and ultimately deliver better returns for investors.

Active management in action: 2 College Square, Bristol

Addressing leasing risk can contribute positive capital uplift to an asset. In September 2012, we acquired a 52,000 sq ft multi-let office building in Bristol city centre with a vacancy rate of just under 50 per cent, equating to 25,325 sq ft of space. The asset was fully let by December 2015. The size and flexibility of the floor plates, or the amount of rental area on each floor, were a key attraction of the asset, as there was a lack of quality large floor plates in Bristol's CBD, alongside strengthening occupational demand and diminishing 'Grade A' prime supply. The asset was bought for £13 million and sold for £22.8 million, representing a profit on cost of 65 per cent.

Written by Paul Crosbie, fund manager, M&G Real Estate

[1] *CBRE*
[2] *Consensus Economics*

This article presents the author's present opinions reflecting current market conditions. It has been written for informational and educational purposes only and should not be considered as investment advice or as a recommendation of any particular security, strategy or investment product.

Summary
- The search for a diversified portfolio has pushed pension funds towards real estate.
- Opportunities for higher long-term yields are an attraction.
- The private rented sector and ecommerce provide the best value deals for pension funds.

The diversification game

Real estate investment in the UK has slowed somewhat over the past year, but for pension funds looking to diversify their portfolio, opportunities remain in regional and alternative asset classes. Theo Andrew explores

Over the past year or two the number of and amount that pension funds have been looking to invest in the real estate market has been on the rise, but as economic headwinds become more volatile, the hunt for yield in the real estate market may be starting to wane.

Despite this, there are still a number of valuable reasons why pension funds look to grow their involvement in the real estate, most importantly, according to M&G head of capital solutions Martin Towns, providing an income stream that is "not only higher than many alternative asset classes, but also long-term and sustainable".

Although real estate is a viable investment option for pension funds, there remains a huge amount for investors to consider, from the nuances of alternative asset classes to the competitiveness of the mainstream office and residential properties.

While some may consider it a defensive asset, it is still important to know where to look and how to look for it, in order to achieve the right returns for your members.

Lay of the land

Market commentators are keen to emphasise the period of global political and economic uncertainty currently plaguing the market, but many in real estate feel that the industry can be somewhat of a safe haven for pension fund investors.

While much of the news around what effect Brexit is set to have on the UK economy isn't the most positive, a number of real estate firms believe that the UK real estate market has the potential to be one of the strongest, supported by "positive macro trends".

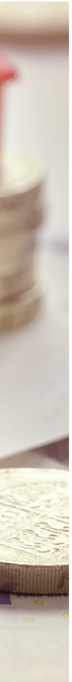
Towns says: "Despite the headwinds associated with the ongoing Brexit negotiations, the economy has remained relatively robust and occupiers – particularly in logistics and offices outside of central London – continue to take new space."

According to a JLL paper, *The UK Big Box Industrial and Logistics Market 2018,* while occupier take-up in 2017 was 36 per cent down on 2016 and 11 per cent down on the 10-year annual average, the investment market remains strong, with the logistics sector set to outperform both the office and retail markets over the next four years.

"The longer-term prospects for these markets are also supported by positive macro trends, for example ecommerce and increased urbanisation, coupled with a consensus expectation that the UK economy will again be one of the best performing of the G7 in years to come," Towns adds.

Another sector that has experienced a significant uptick over the past couple of years is the private rented sector (PRS), also known as build-to-rent.

It's an area of real estate that has capitalised on the unaffordability of house prices and in 2015 to 2016, 4.5 million, or 20 per cent, of households in England were renting in the private



sector, a number that is set to rise to 5.79 million, or 24 per cent, by 2021, according to Knight Frank research.

Furthermore, Knight Frank found that nearly 16,000 build-to-rent units have been completed across the UK, with another 20,600 under construction and nearly 50,000 with planning, as of August 2017, and is certainly an area pension funds are turning to.

In February, Hearthstone Investment Management's Residential Fund 1 (HRF1) raised £100 million of commitments from five local authority pension funds, which will invest in regions across the UK where there is anticipated to be string rental demand. The fund is targeting a 4 per cent return on a £200 million investment into housing.

Staffordshire Pensions Panel chair, Philip Atkins, says: "This is an opportunity for funds to make an investment that firstly meets our investment requirements, but also contributes in a small way to the housing need of the country.

"The growing demand and undersupply of quality housing, in particular in the private rented sector, makes residential property more resilient to economic downturns and attractive to long term investors. The HRF1 will provide a reliable income stream over the next decade while the underlying assets will act as a hedge against inflation."

Elsewhere, leading developer and operator of PRS, Platform_ , has revealed its plans to expand its housing portfolio to Exeter and Scotland with global investment giant, Invesco Real Estate.

The regional strength of this sector might make local pension schemes sit up and take note, and when you throw an attractive long-term yield into the mix then it starts to look like a good investment.

Rate of risk

While some areas of real estate can paint a rosy investment picture, there are a number of important factors for pension funds to consider and BlackRock's UK real estate team director, Paul Tebbit, holds a somewhat more apprehensive approach to the UK real estate holding a more mixed outlook.

"The UK real estate market outlook is somewhat mixed. On the one hand, political risk from Brexit looms large, the economy is lagging other developed markets and valuations are at an all-time high", Tebbit says.

"On the other hand, some markets remain supply-constrained and are experiencing strong tenant demand, but the UK remains popular with foreign investors, and low rates support high valuations."

While assessing the risk is the key component for any type of investment, Tebbit believes that for pension funds looking into real estate, risk factors include development, liquidity and leverage and investors need to measure these three factors accordingly.

It is this state of middle flux that has meant real estate has faced increased headwinds over the past year, but once Brexit has been taken out of the equation, the fundamental principles of the property market remains the same, which as UBS Asset Management head of real estate UK, Howard Meaney, points out, remains friendly for pension funds.

"Even taking Brexit uncertainty and the modest rental growth outlook of the UK aside, the principle of long-term secured income in the current environment presents an obvious draw for pension funds due to the structure of long leases, which enable them to use real estate income to meet distributions further into the future", Meaney says.

Part of the move towards real estate as an asset class is can be seen as traditional fixed-income investments fail to achieve adequate returns.

"With traditional fixed-income strategies not currently generating meaningful returns, the appeal of long-income property is attractive in that it provides stable income based on contractual real estate leases at a similar risk profile but offering a significant yield premium, circa 4.5 per cent versus circa 2.5 per cent from similar risk corporate bonds or 1.65 per cent from gilts", adds Meaney.

Bedding in

It is clear that there are asset classes out there that can provide opportunity for pension funds in the UK market, so for those willing to take the risk in the right way, the members will be the beneficiaries.

Towns says: "We believe that UK real estate will become an even more prominent choice for pension funds, adding greater diversification to portfolios and enabling funds to reap the benefits of sustainable, long-term income to help match their liabilities."

BMO Real Estate Partners head of business development, Angus Henderson, agrees that it is the hunt for diversification that is driving pension funds into the property market, as well as inflation-linked income streams, which offer an alternative to traditional bond portfolios.

"The UK is an obvious entry point for UK pension funds looking to increase their allocations to this sector, offering one of the world's most transparent legal frameworks and property ownership structures, which is particularly advantageous for long-term holders.

"A long-term investment horizon helps with both smoothing the impact of portfolio construction, transaction costs and ownership costs, which tend to be higher in real estate," Henderson says.

It is the alternative asset classes that are offering the most opportunity for investors, and technology is disrupting the traditional real estate game. For those that want to find it there are rewards to be had, it's just about knowing where to look.

Written by Theo Andrew

In association with M&G Real Estate

A turning point

A change in attitudes has fundamentally altered the way governments, regulators, businesses and investors view environmental, social and governance issues. Natalie Tuck explores the impact this has had on pension funds and their approach to ESG

In recent years there has been a fundamental shift in the way businesses and investors view environmental, social and governance issues (ESG).

The term is broad, encompassing a "huge range of topics", Schroders head of sustainable research Andy Howard says, "from climate change strategies to labour standards in supply chains". He adds that fundamentally, it is about understanding how companies interact with societies, and environments they belong to, and how they adapt to the changing pressures and expectations they face.

There is no clear trigger for what caused a turning point in investor attitudes, but rather several factors that have increased the importance of incorporating ESG issues. For pension funds, one that is often referenced is the Law Commission's report from 2014, which according to ARC Pensions Law partner Anna Copestake, clarifies that ESG factors should be taken into account, albeit when an investment is financially material.

Furthermore, TPT Retirement Solutions investment officer Jenny Anderson says that policy and the regulatory environment have become more prescriptive on trustees taking ESG issues into account. For example, The Pensions Regulator's Code for Trustees has a section on investment governance, which states that trustees should take ESG factors into account where they are financially significant.

In addition, the Department for Work and Pensions plans to review pension regulation for defined benefit and defined contribution schemes on fiduciary duty and ESG. "It is currently consulting on policy and it is expected that legislation will be brought forward to be approved by parliament in the second half of 2018," Anderson says.

A quick look at some statistics shows the significance of ESG for pension funds, with a study by Create Research finding that none of the 161 pension funds surveyed plan to cut their exposure to ESG assets. Just 14 per cent of the investors said they were either sceptical or did not believe in the logic behind the strategies.

AXA IM global head of responsible investment Matt Christensen notes that these statistics translate into an evolution of the industry where pension funds now demand proof of ESG analysis across asset classes and within the investment mandates as an industry standard. "It is no longer a box-ticking exercise to simply ask if an asset manager has signed the Principles for Responsible Investment, rather, pension funds now ask detailed questions of the portfolio managers about how ESG risks and opportunities are being identified and monitored."

Pension funds may be taking ESG more seriously, but Copestake notes that there is still work to be done. For example, she says that it is still relatively common for trustees to concentrate their efforts on one part of a portfolio, in particular defined contribution schemes that offer an ethical self-select fund for members.

"Those trustees should consider how the default option, and other funds on offer, fit with their ESG strategy, and check that the ethical fund does not risk significant financial detriment. This would mean it shouldn't be offered even if members would agree with its objectives," she adds.

For those that ignore ESG issues or don't get it right, there are risks. Lombard Odier Investment Managers global head of solutions Carolina Minio-Paluello says since 2015, we have entered a "new paradigm" in which global governmental and regulatory policy has shifted towards a more socially and environmentally inclusive agenda. "A shift on this scale can transform economies and capital markets over the long term, which creates both risk and opportunity[…]Ignoring ESG issues means potentially ignoring the significant risks and opportunities resulting from the global shift in policy."

In addition, Christensen explains that ignoring ESG issues can create risks of missing signals that may directly or indirectly contribute to an enlarged understanding of entire sectors or companies. He highlights the automobile industry, where ESG analysis has been helpful to monitor companies that were investing in new technologies around engines in anticipation of a design shift from fossil fuel independence, to battery and hybrids.

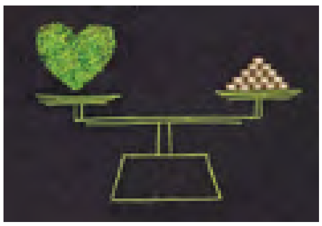
"A case like the Volkswagen scandal which ultimately is a fraud situation, cannot have been anticipated purely through an ESG focus, but without an ESG lens, it would have been difficult to see that the reliance on diesel was inhibiting innovation in other potential energy sources/design that are now becoming a part of the product mix within the industry."

Written by Natalie Tuck

Engagement vs divestment

When it comes to ethical investing, pension schemes have the choice to either divest completely or engage with the companies, in order to try to make a difference. Natalie Tuck looks at the pros and cons to both

Environmental, social and governance issues may be rising up the agenda but, ultimately, a pension fund's first priority is its fiduciary duty. This no doubt impacts a pension fund's decision on whether to divest, or stay invested and try to make a positive difference.



As BMO Global Asset Management director of governance and sustainable investment Vicki Bakhshi notes, historically there had been legal uncertainty over whether divestment decisions may be contrary to this duty. There is now more clarity, Bakhshi says, given the Law Commission's report that said there should not be any financial detriment when considering ethical investments.

More favourably, however, is that multiple studies have shown that ethically-screened funds do not systematically underperform their unscreened peers. "On the contrary, some studies show superior characteristics particularly around risk and volatility," Bakhshi adds.

If it is possible for a pension fund to meet its fiduciary duty, and ethically screen, then what determines whether a fund should engage or divest? There are sometimes apparent cases for divestment, such as pension schemes in the healthcare industry choosing to divest from tobacco completely.

Members' opinions are "the most important factor to take into account", when it comes to deciding on what to do, says Bakhshi. For those in certain sectors, such as healthcare, an opinion may be obvious, but for others, those preferences may be harder to find out. Bakhshi recommends using stakeholder meetings and online surveys to gauge members' beliefs.

With member opinions holding weight, a recent YouGov survey would explain why so many funds have taken to divesting from fossil fuels. Fifty seven per cent of the UK public believe that it is the responsibility of investment managers to ensure that savings are managed in a way that is positive for the environment and society.

In the UK, trade union Unison is the latest organisation to launch a campaign calling for the divestment of fossil fuels, targeted at local authority pension funds. In the past year Hackney Council's pension fund has committed to going carbon free, along with Waltham Forest and the Avon pension fund.

The campaign against fossil fuels is not just formed on member opinion, however. Since the announcement of the Paris Climate Agreement there has been increasing awareness about climate change on their portfolios. In the past trustees may have avoided ethical investments in order to comply with their fiduciary duty; this has been turned on its head.

"We argue that the risk is not climate change itself but the risk that governments around the world will introduce significantly stricter regulation to reduce greenhouse gas emissions, most likely by the imposition of carbon taxes or carbon pricing," says Impax Asset Management director Scott Thompson.

Despite the increased momentum building around divestments, Bakhshi points out that a disadvantage to omitting something completely from a portfolio is the loss of opportunity to engage directly. But, she says, divestment "sends a strong signal to companies".

Where there is an ethical or values-driven investment policy, exclusion is an easy and common approach, says First State Investments global head of responsible investment Will Oulton. "However, where material corporate change is an objective, engagement plays a critical role of not only holding companies to account for their behaviours and environmental and societal impacts, but also in improving their long-term business performance. In such instances, both shareholders and wider society benefit."

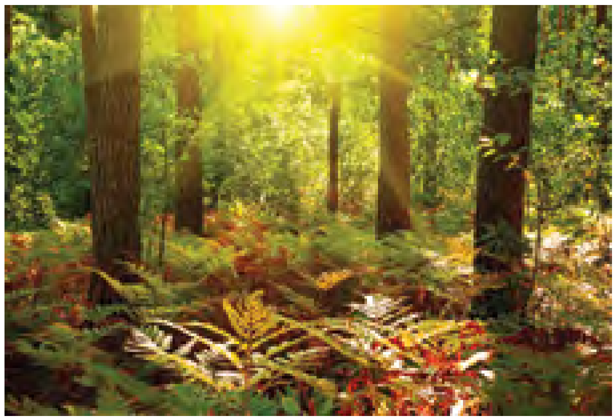
Another argument in favour of engagement over divestment comes from Barnett Waddingham partner Neil Davies, who notes that completely divesting form certain sectors has an immediate impact of reducing the opportunity set of investments available to managers, and so there is still a risk than an exclusionary approach may impact return opportunities.

"Even for those investors with a moral objection to certain investments, there is an argument that engagement can be a more positive way of addressing that concern. For example, for those that oppose the use of fossil fuels, it may well be those companies that currently exist as a result of those fuels who are best placed from a technological and business perspective to develop alternative energy sources."

Written by Natalie Tuck

Making an impact

As the campaign against fossil fuel investments gains momentum, the case for exposure to green investments is building, with attitudes towards their financial value shifting. Natalie Tuck looks at the opportunities available



There was a time when green investments were left largely for those with a vested interest in the cause, but as global views among world leaders and governments change, the idea of greener investing has gained pace, no longer being seen as niche.

"There's no doubt that the popularity of green investments to pension funds is growing rapidly," KBI Global Investors chief economist Eoin Fahy says, referring to both statistical and anecdotal evidence. He notes a survey by Eurosif that showed huge growth in impact investing. "Of all SRI/ESG strategies, green investing showed the strongest growth, rising by almost 400 per cent in just two years," he adds.

Anecdotally, he says a quick browse of asset owner searches reveals that many of the largest asset owners in Europe, and the US, have been allocating substantial mandates in this area. Conferences and webinars on the topic are also numerous and well attended, he says.

Typically we think of green investments as renewable energy, sustainable forests and clean forests, pollution control and waste management but there are other less obvious areas to invest in. For example, Xafinity Punter Southall head of investment north Ben Gold notes the redevelopment of brownfield sites, and Fahy says energy efficiency and sustainable infrastructure, such as water pipes needed to bring clean water to emerging economies also have their place.

"Most evidence suggests that while wind turbines and solar cells get most public attention, the development of new technologies or materials to reduce energy consumption can have just as much impact on reducing emissions. It's less glamorous but just as important," Fahy says.

The benefits and motivations for such investments include helping to mitigate climate change, to improve the long-term sustainability of society and the economy, says Fahy. "As pension plans usually have a long investment time horizon, for obvious reasons, they have a clear interest in promoting a healthy global economy.

"If the global economy within the reasonably foreseeable future faces severe growth constraints due to the physical impact of climate change or due to a lack of clean, safe, water food or energy, the financial damage to pension plans could be severe. So investing in green investment strategies that seek to provide solutions to these problems can very readily be said to be in the best financial interests of its members, even leaving aside the fact that such investments could also be very profitable in their own right."

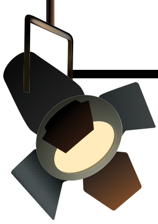
For many trustees, such investments will appeal to their own set of moral beliefs, but Gold notes that a scheme's fiduciary duty should always come first, and moral views on green investing should be secondary. But as Fahy notes the profitability of impact investing, is there a way to satisfy both?

UBS Asset Management head of sustainable impact investing Michael Baldinger states that as transparency has increased, so too has research into the consequences for portfolio returns. "Academic studies suggest that by incorporating sustainable investing in the investment process, returns are not harmed. On the contrary, it may help lower the cost of capital and limit downside risks."

Gold is less convinced, believing from a pure return perspective, "the case is somewhat mixed", noting that there is "limited evidence of higher returns from green investments or SRI". Nonetheless, he says that a "forward-looking case certainly be made that some green investments have a good chance of being successful over the long term, especially with government intervention in favour of green practices".

Regardless, all the experts agree that the trend of green investing is set to grow, with Gold adding that so too will the size of the green investment universe. "The characteristics are appealing. As green investing becomes more accessible and the governance burden of accessing it becomes lighter, many more schemes will likely dedicate a specific 'green' allocation," he adds.

Written by Natalie Tuck



Making your vote count

The PLSA's Luke Hildyard explores how pension funds can engage in shareholder activism to influence the governance, strategy and culture of the companies they invest in

Pension funds are responsible for about £2.2 trillion of investments managed in the UK. This equates to about two-thirds of the money managed on behalf of institutional investors. The Pensions and Lifetime Savings Association's (PLSA) annual survey suggests that around one third of this money is invested in listed companies. Therefore the performance of these companies is of critical importance to pension fund investors.

It is therefore beholden on pension funds to engage with these companies – either directly, or through their asset managers – and to ensure they are account for their governance, strategy, culture and other factors that are likely to affect their performance.

Annual general meeting (AGM) voting rights are amongst the most important tools available to investors for holding their investee companies to account. For pension funds, these can be used directly when investing in the companies themselves. When they outsource investment decisions to an external asset manager, the manager's voting policies and practices should be a consideration when awarding, monitoring and reviewing mandates.

Typical AGM resolutions relate to the approval of the annual report and the accounts; the appointment of the auditor; the re-election of the company directors; and the company directors' pay. Though not all the AGM voting resolutions are binding, significant levels of shareholder dissent can put the spotlight on particular practices and represents a powerful means of exerting influence.

The PLSA's research found that in 2017, around one-fifth of FTSE 350 companies experienced 'significant' dissent of over 20 per cent of shareholders either voting against management's recommendation or abstaining on at least one resolution at their AGM. The most common resolutions to attract dissent relate to executive pay and the re-election of directors to the board. Of the 117 resolutions attracting significant dissent in 2017, 49 related to executive pay and 35 to the re-election of directors.

Very high executive pay packages raise questions about the corporate culture and governance of the company – a large pay package could suggest that the company is overly-dependent on a single individual executive, or create intra-company resentment toward the executives from lower-paid workers.

A PLSA survey of pension funds views on executive pay, found that 87 per cent of respondents said executive pay was too high and 85 per cent felt that pay gaps within companies were a concern for them as investors. Despite this, the PLSA's hidden talent research on corporate reporting of employment models and working practices found that just 7 per cent of FTSE 100 companies currently report on their pay ratio between their chair and their median worker.

The re-election of company directors may reflect concerns about the individual in question, their qualification and their perceived commitment or independence. They can also act as a proxy for wider issues with the running of the company. For example, a large numbers of shareholders at Sports Direct have opposed the re-election of the company chair in recent years, in response to controversial employment practices at the company. The PLSA's recent guidance on the risk posed to pension funds by climate change suggested that a vote against the re-election of the chair may be appropriate at companies that fail to explain how their business models are compatible with international greenhouse gas emissions reduction targets.

Whatever the resolution, AGM votes are a useful tool for investors who have failed to achieve a satisfactory response to attempted engagements with a company on a particular issue, yet do not (or cannot, for those funds investing via an index) divest from the company altogether.

The PLSA's Corporate Governance Policy and Voting Guidelines set out specific recommendations for circumstances under which shareholders should consider voting against management. We encourage our members to examine their asset managers' approach to AGM voting, how they have applied that approach in practice and concrete examples of where their AGM votes have successfully influenced an investee company. We also recommend that pension funds report on how the shares they own have been voted to members, and seek to understand their members' values and interests, in order to bear these in mind when directing their own votes or those their asset managers.

Written by PLSA policy lead for stewardship and corporate governance Luke Hildyard

Summary
• A fifth of 2018 retirees will do so in debt. The average amount owed has grown by 40 per cent since 2017, to £33,900. The debt is mainly the result of credit cards and mortgages.
• Longer-term mortgages, continuing past the age of 65, is likely to increase the number of people entering retirement in debt, as will university debt, a growing number of people renting in retirement and the rising cost of living.
• The pensions industry can assist people approaching retirement with debt by signposting them to financial advice bodies.

The price of debt

The number of people entering retiremen in debt is set to grow rapidly. Laura Blows explores why this is the case and what the industry can do to help these retirees

£33,900. While the pensions industry is understandably concerned about matters like how to ensure auto-enrolment contributions provide a sufficient retirement income, or whether DB scheme pensioners should be protected from the risk of its scheme falling into distress by changing the inflation link from RPI to CPI, there are many people – a fifth this year – beginning their retired life on a minus figure greater than the UK's average annual salary.

So finds Prudential's annual research into people entering retirement.

Its *The Class of 2018* report shows that one in five people planning to retire this year will do so with debt. Of those retiring in debt, the average amount owed is £33,900, 40 per cent higher than those retiring last year on £24,300, and 80 per cent higher than the low of £18,800 recorded in 2016.

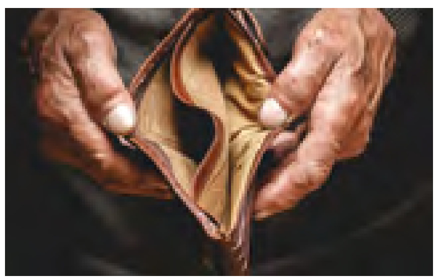
The figure for 2018 is a record high, surpassing the average £38,200 retiree debt recorded by Prudential in 2012. Since then the amount owed had steadily declined, but has been rising back up again from 2016.

Delving into the figures, men were found to owe substantially more debt than women, owing £43,600 on average, compared to the average £19,200 owed by women. Regional differences also shone through, with those retiring in the North West most likely to retire in debt, with 24 per cent of respondents there doing so. Wales is the least likely area to see retirees in debt, at 14 per cent.

Reasons for debt

Society of Pension Professionals president and Spence & Partners director Hugh Nolan sees how easy it is for retirees to fall into debt.

"Lots of pensioners in the UK struggle to make ends meet each week. Those without a private pension to top up their state pension can only afford a very basic standard of living and usually have little or no savings to deal with



unexpected one-off expenses, however vital they may be," he says. "They end up in debt paying high interest charges, which eat further into their meagre incomes, and can only repay minimal amounts so that the interest just keeps on coming. Other people who fall into debt can hope to get a new job, promotion or pay rise to ease the pressure but pensioners can't even see this possible light at the end of the tunnel."

At a time when the base rate is expected to rise, it is worrying to see the rapid increase of a pensioner's average debt, Prudential retirement income expert Vince Smith-Hughes says.

"Given forthcoming retirees' expected income has increased for the fifth year in a row, it's possible that some people feel more comfortable about servicing debt and are borrowing more," he explains.

"Meanwhile, more and more grandparents are helping their grandkids with university fees and children with house deposits."

According to Prudential's research, credit cards and mortgages account for the biggest proportion of debt. Over half of those retiring in debt owe money to credit card firms, with 38 per cent still paying off mortgages, its research finds.

This is backed up by StepChange Debt Charity's findings. Its financial solutions manager Andrew Kerry says: "Those approaching retirement can be cash poor but have assets, with the main reasons our retired clients borrow money being clearing outstanding mortgages or paying off debts."

More2life's 2017 research, *The size of the retirement lending market,* also finds that 9 per cent of 65-74 year olds are still repaying their mortgage, as are 4 per cent of over-75s. The average mortgage debt for 65-74 year olds has increased from £5,400 in 2006-2008, to £9,500 in 2012-2014.

As the average amount of debt has increased in the past year, so has retirees' repayments. Prudential finds that 2018 indebted new-retirees will pay an average of £285 a month, up nearly a quarter on the £230 a month being paid on average by those retiring in debt in 2017.

Of those retiring in debt in 2018, 14

per cent expect to take over seven years to pay off their debts and 6 per cent fear they will never clear the money they owe.

"Debt repayments will take a substantial slice of monthly retirement income, which will make budgeting tougher at a time when most people will see their income drop as they stop work," Smith-Hughes says.

However, the problem of pensioners in debt may be "less acute than it might seem", Nolan says, as the biggest debts may be new retirees who haven't quite finished paying off their mortgage. "Some of these have private pensions or are not yet able to draw their state pension and can therefore look forward to a decent retirement even after settling their debts," he explains.

Since Prudential started researching the number of people retiring in debt in 2011, the proportion has remained pretty consistent, hovering around the 20 per cent mark. However, the number of people retiring in debt decreased this year, from a quarter in 2017 to 19 per cent this year. This Prudential retirement expert Stan Russell attributes to the pensions freedom and choice reforms, as many may have used their newly-freed pensions to pay off debts, reducing the percentage of people still with debt in retirement.

A growing problem

Yet the numbers look set to explode. More2life's research forecasts the total debt held by over-65s to grow from £65 billion in 2017 to £142 billion by 2027. This it attributes to the rising number of over-65s in employment, increases in the state pension age and increasing household incomes for the over-65s increasing the ease in which this demographic can access credit.

Currently, its research states, 65-74 year olds hold an average of £12,500 of debt, which is forecast to increase to a £22,700 average by 2027. Those aged between 75-84 currently hold £4,100 of debt , which is expected to rise to £8,200 by 2027, while over-85s are expected to increase from £2,400 of debt to £6,000 within a decade. Growth in average unsecured debt among the over 75s was higher than any other age group, More2life adds.

According to the International Longevity Centre-UK (ILC)'s 2017 report, *Lengthening the Ladder: The future of borrowing in older age*, the amount of mortgage debt held by over-65s is set to increase by more than £19 billion by 2030 – from £20.1 billion to £39.9 billion.

More2Life's research explains this expected growth. The average first-time home buyer is now over 30 years old, and with the number of longer-term mortgages increasing, they can expect to still be in debt in retirement. In 2016, 28 per cent of all first-time buyers opted for a 30-35 year mortgage, an increase from 11 per cent doing so in 2006.

Mortgages may not be the only reason why future generations can expect to spend later life with bills still to pay. Russell thinks that the cost of university tuition may also play a part, as even though the university debt is wiped after a certain number of years, while it is still being paid for it adversely affects people's financial ability to save for a mortgage or pay into a pension, increasing the likelihood of mortgage debt and a smaller pension at retirement.

The increasing number of people not buying a home at all, but permanently renting may also cause financial strain in retirement. They run the risk of high rent increases, while those owning homes benefit from having much lower expenditure, as well as having a capital asset to fall back on if needed, through equity release or downsizing for example, Nolan explains.

Industry help

Despite pensioner debt likely to become a growing issue, "sadly the people most in need of help are largely ignored by the pensions industry as they aren't in our schemes and don't buy our products," Nolan says.

However, the success of auto-enrolment means an increasing number of retirees should have some additional savings in the future.

"The industry must do all it can to support AE, including designing inexpensive products for people with small pots to invest and withdraw their savings without facing disproportionate charges," Nolan adds.

The People's Pension director of policy Darren Philp agrees that "much more needs to be done across the industry" to help people understand the options and support available to them in preparation for life after work.

"It's important to remember that how people live their lives is changing. The days of collecting your pension at 60 or 65, having paid off your 25-year mortgage, are a thing of the past. And how people plan their financial lives and the role that pensions play in that needs to evolve," he adds.

To assist with this, Kerry says: It's important that *[retirees in debt]* seek a full range of advice and do not make hasty decisions such as cashing in their pensions to clear the debts. Pensioners will have a slightly different set of concerns and could be recommended different debt solutions more suitable to their circumstances and could greatly benefit from free debt advice."

Tackling the issue of older people in debt needs to begin well before they retire, Russell says, by signposting people to bodies such as Pension Wise, Citizens Advice and Money Advice Service before retirement to help find out how they could manage their debts.

People retiring in debt may be the individual's own concern, but if the number doing so rises significantly, and the amount owed increases rapidly, the pensions industry will be one of the sectors paying the reputational price.

Written by Laura Blows

Balancing act

It's generally accepted that the 8 per cent auto-enrolment contribution level will be inadequate to create a sufficient retirement income. *Pensions Age* asks: What should the optimum AE contribution rate be for members to obtain a decently-sized pension pot, but without being so high as to significantly increase opt-out rates?

Our 2016 DC survey suggested that a typical 25 year old needs to save 18 per cent of salary to maintain their standard of living in retirement if they expect to get a full state pension and want to retire at age 65. This shows how big a gap there is between legal minimum and best practice and so by providing the minimum there is a significant risk of a mismatch of expectations. Some employers have also recognised the adequacy issue that is looming and are taking action by using automation (either auto-escalation or defaulting members in at higher rates), often requiring employee contributions of up to 8 per cent. Our experience is that generally over 80 per cent of members stay in at the higher rates, which shows that apathy works in our favour, even at this level.

Aon partner and head of DC consulting Sophia Singleton

We don't believe there is a magic rate for all – it depends on your age and how early you start saving. One marker though could be the age-old rule of thumb that to be able to retire on 50 per cent of salary contributions you should look to save at a rate of half of the persons age. Eg if you are 22 you should be looking to save 11 per cent, if you're 50, 25 per cent.

Salvus Master Trust managing director Graham Peacock

The problem with having a relatively low minimum AE contribution rate (such as 8 per cent of qualifying earnings) is the risk people perceive this amount to have been set by the 'powers that be' on the basis that it will provide a sufficient retirement income. General consensus (based on various industry bodies/sources, including our own research) is that a rate of over 15 per cent, starting at age 22 is needed to provide an adequate retirement income – nearly double the AE minimum. So, what's the solution? Materially increasing AE rates could be an unpopular political decision – it would increase the cost of employment for employers and/or erode already frugal employee disposable incomes. This may increase opt-out rates and be, at least partially, counterproductive. The solution is potentially a combination of things; a small, incremental increase in minimum AE contributions to say, 9-10 per cent, increasing awareness amongst members of what an insufficient retirement income will mean, ie working longer or lifestyle compromises, encouraging members to voluntarily contribute more; and ensuring investment strategies are appropriately designed to take account of specifically targeted member outcomes in a risk-adjusted way to help plug the gap.

P-Solve associate director Damon Hopkins

Contribution rates sufficient to achieve what in former times would have been regarded as a decent pot, ie big enough to fund a two-thirds pension, are impossibly high to even contemplate in the short term: the stuff of dreams. For some years now, probably the great majority of new GPP arrangements have been set up on a salary sacrifice basis, by which the pension contributions are treated as employer contributions. By building on this, the impact of auto-enrolment on employers will be lessened and the NIC advantage for employees retained. Once established, this principle of 'what you've never had, you don't miss' might be extended each year.

Aries Insight director Ian Neale

The government must look at the impact that the increase in contributions both this year and next year has, to decide what level of contributions we need to reach, how quickly we can get there, and whether it's employers or employees who should pay more. This would also be an opportunity to consider if tax relief could be better targeted to support auto-enrolment savers.

It's widely agreed that in the medium term, contribution levels of between 12 and 16 per cent are needed, but the reality is that household budgets are stretched and there's a balancing act between increasing contributions and keeping opt outs low. If we push auto-enrolment contributions too far, too fast, it could falter and let down the people it's there to help.

The People's Pension director of policy Darren Philp

There are three options to encourage workplace savings that could help ensure adequate, ideal and comfortable retirements. 'Auto-escalation' has been suggested as a means of overcoming the issue of low contribution rates. Also, with the introduction of the Lifetime Individual Savings Account (LISA) in April 2017, many commentators believe that, for those eligible to make contributions, this option could be more attractive than contributions to a pension plan, especially with the younger savers. In addition to flexible workplace pension savings, the UK could revisit the idea of allowing early access to pension savings in prescribed circumstances, as is already in private pension systems in other countries.

JLT Employee Benefits head of technical John Wilson

Contribution rates will rise to 8 per cent next year and there is every chance opt-out rates will increase – how much will depend on the industry's ability to engage members to take control of their retirement and of course, affordability. However, increasing minimum contribution rates further at this stage may prove counterproductive. In time, policymakers can look towards measures such as auto-escalation to boost the level of savings, as has proved successful in the US.

Columbia Threadneedle Investments institutional business director, EMEA, Andrew Brown

Irrespective of how one defines a decent-sized retirement pot, 8 per cent will almost certainly fall short of the mark. In Australia, for instance, the current rate of contributions is 9.5 per cent, rising to 12 per cent by 2025. Australia abandoned an 8 per cent contribution rate in 2002 and if it didn't work for Australia then, it is unlikely to do so for the UK today.

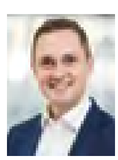
It is also noteworthy that in Australia the burden of contribution rests with the employer. And if we were to follow this example in the UK it would alleviate concerns over opt outs. Legislating for this, however, would be politically bold.

The solution might be more nuanced as highlighted in the Auto Enrolment Review last year. Leaving contribution rates as they are while integrating additional elements of income into the calculation would see an increase in contribution levels for many. Reducing the age at which AE bites would also lengthen the investment period for savings, adding still further to the pot.

SEI managing director of defined contribution EMEA and Asia Steve Charlton

Recently the PLSA called for lifetime average contributions on all earnings of 12 per cent a year and we would support that. Whilst AE has been a great success in getting people to save into pensions, if the member gets used to paying at 8 per cent they may believe this is the 'right' number and not consider paying more. Often employers will match to higher levels yet their default contribution is in line with AE requirements and members will and do miss out. Our experience is that there are many schemes where employees could take advantage of more 'free money' but don't understand the benefits on offer.

WEALTH at work director Jonathan Watts-Lay



The fundamental problem with any contribution rate is that it ends with the start, whereas we should be starting with the end – what do you want and need and then what do you need to contribute to achieve it? The reason why this doesn't happen is that it takes an investment of time and effort and the result is often too unpalatable to act upon. Any significant rise in contribution rates, which is really what is now required, needs to accommodate and acknowledge certain personal financial circumstance. A solution could be introducing lifestyle-based contribution triggers that reference age, salary and financial drag factors such as children or dependents.

Trafalgar House client director Daniel Taylor

Pensions history

Relief from income tax for superannuation funds campaign

In *Pensions Age* July 2017, I wrote about the Conference of Superannuation Funds held in July 1917, which established a standing committee to form a register of Pension & Widows Funds. The idea was to meet periodically to discuss matters of mutual interest. One of the main topics of mutual interest, at that time, was obtaining relief from income tax on superannuation funds. This month I report on the progress made 100 years ago to achieve this aim.

At a meeting held on 4 March 1918 it was reported that 41 funds representing 41,845 members with total assets of £4,915,903 was to be enter the register.

The minutes record that the chairman of the committee should take an early opportunity of seeing an officer at the Board of Inland Revenue with a proposal to establish an agreement to deal with income tax questions in connection with Funds on a routine basis. The chairman also reported that a bill to consolidate the income tax laws had been introduced in the House of Lords. It was agreed that he should communicate with the Chancellor of the Exchequer on the position of funds in relation to the bill.

At the next meeting on 27 June 1918 the chairman reported he had definitely ascertained that the superannuation funds of certain railway companies were entirely tax free. The other issue that arose was the Trade Boards bill before Parliament. This would prevent a deduction from wages for contributions if the deduction reduced the amount of the wage below the minimum for that trade.

The conference convened for 2 July 1918 recommended amendments to the bill and the following resolution was passed: That the expression "deductions" referred to in Clause 5 sub section 4 should not apply to funds to which employees contribute and which are certified by Board of Trade to be for the benefit of employees.

Written by Alan Herbert, chairman, The Pensions Archive Trust

Fun and games

Wordsearch

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DEBT
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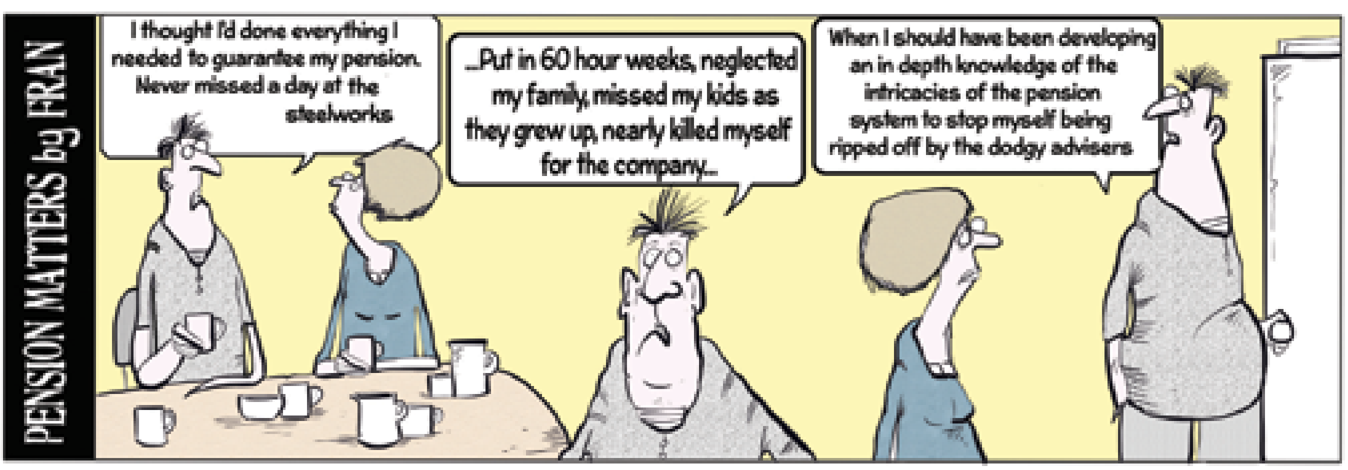
INVESTMENT
LIQUIDATION
TRANSFERS
TRANSPARENCY

I know that face...

Answer at bottom of page



I know that face... Answer: PLSA chair Richard Butcher

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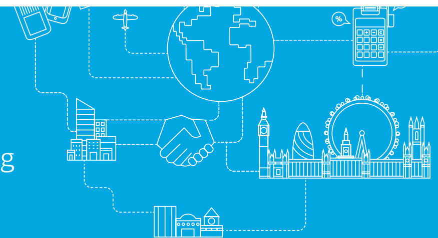

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