DB-DC transfers
Transfer values reached record highs – was there a surge in members moving their money?

Ethical investing
The pressure for pension schemes to invest responsibly

Contributions
How to sustainably increase pension contributions

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March 2017

PENSIONS Age

The leading pensions magazine

Deficits: *The difficulties in accurately determining deficits*

RPI/CPI: *Will schemes now be able to switch from RPI to CPI?*

The battle to reduce pension scheme deficits

UPP Unchaining Pensions from Politics

Thomson Reuters case study - how it is providing an in-scheme drawdown service to members

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Editorial Comment

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

A bacon and egg sandwich. It's a pretty simple thing; its sole ability to provide a delicious snack, you would think. Wrong. A bacon and egg sandwich was able to lose a man his job recently.

The trade union for hospital workers, GMB, was all set to mobile an angry protest group outside Ilford's King George Hospital because of the instant dismissal of hospital porter Aldren Tomlinson over the 'theft' of his £4 breakfast sandwich – despite having left his wallet at home and asking to pay for the food later, which staff claim to not have heard. Thankfully common sense prevailed and Tomlinson was reinstated hours before the protest was to take place.

This story ended well, but it should not have taken media exposure and public uproar for the employer, Sodexo, to realise its over-reaction. It should have been clear that a rigid interpretation of its 'employee theft' rules were hardly required in this instance.

The same seems true of a major pensions story to have hit headlines this past month: that of the Supreme Court ruling that an unmarried woman is eligible to receive a survivor's pension from her deceased partner's pension.

Denise Brewster had lived with her partner William McCullan for 10 years in December 2009 when he died two days after their engagement.

At the time, McCullan had worked for Translink, a public transport operator in Northern Ireland, for around 15 years and had been contributing to the local government pension scheme.

While Brewster stated that McCullan had nominated her to be eligible for a survivor's pension, the administrators of the scheme had apparently not received the form and therefore refused to pay her a survivor's pension.

Under regulations passed in 2009, the LGPS required that unmarried co-habiting partners be nominated by their pension scheme member partner in order to be eligible for a survivor's pension. The survivor must also show that he or she has been a cohabitant for two years before the date on which the member sent the nomination and has been in that position for two years before the date of death.

However, the Supreme Court "unanimously" ruled that Brewster should be allowed to receive a survivor's pension, as a surviving unmarried cohabiting partner should receive a similar status to a surviving married partner or civil partner. It ruled that the requirement of nominating a longstanding cohabitant was a "discriminatory" effect that "cannot be justified".

Just like Tomlinson wanted recognition of his 15-year service from his employer when Sodexo was considering whether to interpret his taking of the bacon and egg sandwich as a misunderstanding or deliberate theft, so Brewster desired acknowledgement of her 10-year committed relationship with McCullan, regardless of whether there was a wedding during that time.

That's all anybody wants, be it when dealing with those managing their retirement savings or anything else, to be treated like an individual with their own point of view and circumstances acknowledged.

The pensions industry has been making great strides with this. Personalised communications, timed with key stages of the member's life, is becoming more commonplace, while the upcoming pensions dashboard puts assisting the saver first and foremost in its application, by helping them see a clear picture of their total retirement savings.

However there is still more work to be done. For instance, a softening of the difference between 'advice' and 'guidance' would be welcomed, both by companies keen to help employees make the best retirement saving choices and by individuals who are not interested in discussions about the technical differences between two similar words, but simply want to ask for help regarding their own financial situation.

Rules and regulations are of course needed to ensure the well running of pension schemes. But let's make sure there's enough flexibility within their governance structures to consider individuals' own circumstances when required, and most of all, to apply some good old-fashioned common sense.

Laura Blows, Editor

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Dateline - February 2017

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

1 February Over 12 million private sector workers will be "outside the auto-enrolment tent" by 2018 if the government does not lower the earnings trigger or find a way to include to self-employed, according to the **Association of Consulting Actuaries**. The ACA notes that over 40 per cent of employees of micro employers (fewer than five workers) are paid under £10,000 a year, meaning that although these companies are due to reach their staging dates in the next 12 months, many will be ineligible.

2 February The concept and education around pensions should be introduced as early as childhood when there are "few behavioural biases", the **Pensions Policy Institute** says. Speaking at the Trades Union Congress People and Pensions Conference, PPI head of policy research Daniela Silcock discusses what information people should have on pension saving based on their age.

3 February The **government** confirms that people will be able to withdraw up to £1,500 tax-free to pay for pensions advice from April 2017. The Pensions Advice Allowance was first mooted by the government in the Autumn Statement in 2016. Under the new plans people will be able to withdraw £500 up to three times to pay for financial advice.

6 February The official costs of the new pension promises for the UK public sector is understated by £15bn a year, independent pension consultant **John Ralfe** tells the *Financial Times*. Ralfe explains that public sector DB pensions cost considerably less than private sector pensions because the government "fiddles" how it calculates yearly costs.

lazyllama / Shutterstock.com

8 February The **Supreme Court** rules that an unmarried woman is eligible to receive a survivor's pension from her deceased partner's pension.

Denise Brewster had lived with her partner William McCullan for 10 years up to December 2009. On Christmas Eve that year, the couple became engaged. However, two days later, McCullan died. At the time, he had worked for Translink, a public transport operator in Northern Ireland, for around 15 years and had been contributing to the local government pension scheme.

9 February The Pensions Regulator reveals it has paid £1.4m in external costs for the Silentnight legal case. In January this year, the regulator revealed it had been successful in a legal challenge regarding an anti-avoidance case concerning the Silentnight Group defined benefit pension scheme.

10 February The **Insolvency Service** says it is undertaking a "comprehensive forensic exercise" into BHS. In a letter to Work and Pensions Committee chair Frank Field, Insolvency Service chief executive Sarah Albon says she could not provide specific details on the investigation as it may prejudice the outcome of the enquiry. However, Albon says she could provide details of the investigation process, in which she states that it has completed the information-gathering first phase of the investigation.

13 February Pensioner households are £20 a week better off, after housing costs, than typical working age families, according to research by the **Resolution**

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

Foundation. The think tank's report *As Time Goes By* has tracked the scale of income growth across the different generations over the last 50 years. It finds that recent growth in typical pensioner incomes has been driven by new cohorts of pensioners who are more likely than their predecessors to still be in work, own a home and have access to private pension pots.

16 February The **Financial Reporting Council** announces plans for a 'fundamental review' of the UK Corporate Governance Code. The review will take into account the work done by the FRC on corporate culture and succession planning, and the issues raised in the government's green paper and the Business, Energy and Industrial Strategy Committee (BEIS) inquiry. The FRC says it will build on the code's globally-recognised strengths developed over the past 25 years while considering the appropriate balance between its principles and provisions and the growing demands on the corporate governance framework.

14 February The aggregate deficit of all schemes in the **PPF 7800** reduces by £27.4 billion, as the funding ratio improves to 88.2 per cent. Figures reveal that the total deficit for all 5,794 schemes in the index fell from £223.9bn at the end of December 2016 to £196.5bn at the end of January 2017.

15 February Thousands of **Tata Steel** employees vote in favour of a proposal to alter their pensions. A consultative ballot addressed to all union members of Unite, GMB and Community asked if they accepted the proposal of moving the final salary pension scheme to a less generous scheme. The offer also involved a £1bn investment commitment at Port Talbot and no compulsory job losses.

17 February The Pensions Regulator is to end regulatory action against the Coats Group following the news that it has confirmed a £225m settlement with the trustees of its pension schemes. The thread manufacturer, formerly the Guinness Peat Group, has been involved in a long-running dispute with the regulator over its pension schemes.

20 February The **government** proposes introducing 'conditional indexation' for defined benefit pension schemes so an employer could suspend increases to pension payments if it was in a stressed financial position. The suggestion is made in a government green paper and it would mean that no increases would be paid if the scheme was in deficit and the sponsor was unable to make up the deficit, and the trustees were satisfied that the best interests of members would be served by suspending indexation to allow the employer to strengthen its corporate finances. The government notes that increases could be recommenced in the future, once the employer had recovered.

photocritical / Shutterstock.com

21 February The Royal County of Berkshire Pension Fund is to acquire a 20 per cent stake in investment manager Gresham House.

22 February Women could encounter a pensions shortfall of £47,000 at the end of their working life if the gender gap in employer contributions is not addressed, **Zurich** reports. According to the *Zurich Workplace Savings Barometer*, which analyses over 250,000 pension plans, employer contributions are generally lower for women's pensions than men, resulting from the gender pay gap, career breaks and men working in larger businesses.

23 February Almost four times the amount of people accessing their pension pots to buy an annuity are using the freedoms to withdraw their whole pension pot, according to data from the **Financial Conduct Authority**. In its most recent data bulletin, it reveals that in the quarter three (July to September 2016) 79,916 pension pots were accessed for the first time to withdraw the full pot, whereas just 20,538 were accessed to buy an annuity.

24 February The **Pensions Ombudsman** rules in favour of Scottish Widows after a complaint was made against it involving a delay to a pension fund transfer, which resulted in a financial loss of £1,466.33. The complainant, known as Mr D, wanted compensation of £2,366.33, which included his financial loss and the time and money spent on phone calls, estimated by him at £900.

News focus

Govt suggests 'conditional indexation' for 'stressed' DB pension sponsors

In its defined benefit green paper the government also said it is against giving The Pensions Regulator powers over M&As and running an arms-length 'superfund' for schemes

The government has proposed introducing 'conditional indexation' for defined benefit pension schemes so an employer could suspend increases to pension payments if it was in a stressed financial position.

The suggestion was made in a government green paper, entitled *Security and Sustainability in Defined Benefit Pension Schemes,* which has been launched following high-profile cases involving the DB schemes of BHS, Bernard Matthews and Tata Steel. The proposal would mean that no increases would be paid if the scheme was in deficit and the sponsor was unable to make up the deficit, and the trustees were satisfied that the best interests of members would be served by suspending indexation to allow the employer to strengthen its corporate finances. The government noted that increases could be recommenced in the future, once the employer had recovered.

Despite the proposal, it was noted that there is a "moral hazard issue" as there is a danger that it could encourage employers to allow the funding level of their scheme to deteriorate in the hope that it would reduce their liability to inflation link the scheme benefits.

Currently, for pensions accrued between 1997 and 2005, there must be an annual increase of inflation capped at 5 per cent, and for pensions accrued after 2005, inflation capped at 2.5 per cent. Pensions accrued before April 1997 do not have to be increased unless scheme rules require it. The government does not, however, specify which index inflation increases should be linked to, and for public-sector pensions it switched from the Retail Price Index to the Consumer Price Index in 2010. However, some schemes that have a specific index, 75 per cent with RPI, written into their scheme bill have not been able to change which one they use.

For example, in the case of Tata Steel there was a suggestion that the scheme could be saved by switching the indexation of pension payments from the RPI to the CPI, but for them it would have required a change in the law. However, in the green paper, the government said allowing schemes to switch to CPI from RPI would have a "significant impact on members' benefits". CPI has been lower than RPI in 22 years out of the last 27 years, and so would represent a reduction in members' benefits. Furthermore, the government raised concerns that such a move would also affect the government's ability to issue debt in a cost-effective way. This is because it would also likely have significant interactions with the gilt market and wider government financing objectives. Currently, index-linked gilts (ILGs) are linked to RPI, as this was the standard measure of inflation when ILGs were introduced and pension funds hold nearly 23 per cent of their assets in ILGs.

However, it noted that Pensions and Lifetime Savings Association (PLSA) DB Task Force research found that "increasing pensions by a lower level of inflation was seen to be the most palatable benefit adjustment if one had to be made" and that "introducing a statutory over-ride to allow schemes to switch from RPI to CPI could amount to a saving to sponsors and lower future pension increases for members amounting to £90bn as discussed previously". PwC's global head of pensions Raj Mody described the green paper's plan to suspend increases to pension payments as giving "hope to some *[struggling]* employers" who are unable to keep up with rising costs of DB schemes.

However, the government is against giving The Pensions Regulator power to veto corporate restructuring activities, such as mergers and acquisitions, as it would be 'disproportionate', the government has stated. The government said that it would need to be certain that any new powers are proportionate, and take into account the impact on the regulator's resources and the levy on pension schemes, which funds its activities.

"On the issue of corporate restructuring, it has been suggested that the regulator would be more effective if it had powers to act proactively in order to prevent certain corporate activities. Our view is that a blanket requirement on parties to obtain clearance from the regulator ahead of any planned corporate actions would be disproportionate," the paper stated.

Furthermore, the government also said it is against designing and running a DB 'superfund' through an arms-length body but is open to supporting the industry create new ways of consolidation. It did, however, state that there appears to be a "strong case" for supporting greater voluntary consolidation. This is because it recognises that data suggests small schemes have higher administrative costs, are unable to benefit from the economies of scale available to larger schemes, and tend to have less-effective governance.

There are around 6,000 DB pension schemes with approximately 11 million members. However, 10 per cent of these members are spread across 81 per cent of these, meaning there are many small schemes. About a third of all DB schemes, each consisting of one to 99 members, hold total assets worth just £14.2bn (about 1 per cent of total assets held by all DB schemes) as at 31 March 2016. With regards to a superfund as a consolidation vehicle, the government said it has concluded that "it would not be appropriate to take this option forward".

"We have asked whether it would be appropriate for government to provide some structures or incentives to encourage the pensions industry to innovate and to provide new consolidation vehicles," it stated as an alternative option. One idea for the superfund would be a vehicle targeted at smaller schemes that are at or close to 100 per cent funding on a buyout basis. It could have a single benefit structure, and a single consolidated fund, rather than having assets allocated to individual schemes. It would then pursue a low-risk investment strategy, allowing both employers and trustees to be discharged. Commenting, former Pensions Minister and Royal London director of policy Steve Webb described the paper as "remarkably timid" on the issue of awarding the regulator more powers, and that the "lack of firm proposals is disappointing". The consultation is open until 14 May 2017.

Written by Natalie Tuck and Talya Misiri

NEWS IN BRIEF

National LGPS Procurement Framework has appointed Capita Employee Benefits to provide third-party pension administration and pension administration support services. Established by the LGPS, for the LGPS, and developed by Norfolk County Council in partnership with several LGPS funds, the framework has been designed primarily to support local government pension scheme funds but it can also be used by all public-sector pension schemes.

Aon has announced that the Aon MasterTrust has completed the master trust assurance framework, an independent review made against a defined set of criteria. The framework, produced by the Institute of Chartered Accountants in England and Wales (ICAEW), sets out how trustees should report against a series of 'control objectives' related to governance and administration of a master trust, and which are aligned with the standards set out in the The Pensions Regulator's (TPR) DC code.

Nottinghamshire County Council Pension Fund has awarded Kames Capital a £300m buy and hold fixed income mandate. The mandate will be invested in a portfolio of corporate bonds with a target yield of LIBOR +1.25 per cent after fees with the aim of providing periodic cashflows to meet the fund's planned commitments to infrastructure. Commenting on the investment, Nottinghamshire County Council Pension Fund group manager of finance Keith Palframan said: "We have made a long-term commitment to infrastructure and plan to make staged investments from March 2018 to the end of 2021."

VIEW FROM TPR

Our intervention has ensured that over 40 authorities and schools have submitted information to the Teachers' Pension Scheme (TPS) for almost 8,500 members.

This has ensured that records have been maintained and accurate benefit statements issued to TPS members.

We have issued a regulatory intervention report outlining how we worked with TPS to ensure the authorities and schools acted correctly.

Scheme administrator, Capita, approached us in May after three local authorities and 40 non-local authority employers failed to submit audited End of Year Certificates (EOYCs) for 2014/15 to the scheme manager by the legal deadline. Certificates were outstanding for 8,349 members.

The certificates provide assurance to a scheme manager, in this instance the Secretary of State for Education, that contributions have been correctly credited to the scheme. Information in EOYCs form part of the scheme's records that its scheme manager is legally obliged to maintain. Without accurate records there is a real risk that people will not get paid the right benefits.

By working closely with the scheme and non-compliant employers, we have increased their understanding of EOYCs, the necessary certificates have been submitted and we have not had to invoke our legal powers.

Scheme managers, employers, administrators and members of pension boards have a duty to report breaches of the law to TPR. We urge them to engage with us in a prompt and open manner.

Mike Birch, director of case management at TPR

The Pensions Regulator

Over a quarter of pension savers believe they do not pay admin fees

The research comes as fees have been described as the 'Darth Vader' of the investment business and criticised for their lack of transparency, with many savers unable to calculate what fees they are paying

Over a quarter of pension savers believe they do not pay any administration fees for their investments, Alliance Trust Savings has found.

The firm's nationwide survey of 1,000 people investing in at least one investment product, including workplace pensions, personal pensions, stocks and shares ISAs, general investment accounts or investment funds, found that 27 per cent were unaware of administration fees. Of those who said they pay administration fees, more than two thirds (68 per cent), do not know how much they pay.

Women and over-45s were found to be least informed on how much they're paying. Three quarters of each group, 75 per cent and 74 per cent respectively, admitted to not being aware of the costs of their investments.

In comparison, 38 per cent of the surveyed group knew specifically whether they pay a flat fee or a percentage fee for their pension or investment.

Alliance Trust Savings head of platform proposition Sara Wilson commented: "Fees can make a huge difference to the value of a pension pot over time. Whether you pay flat fees or percentage fees for your platform, administration can also impact your investment returns significantly over a 20-year period.

"Many platforms charge a percentage fee, but the reality is that it does not cost 10 times as much to service a £500,000 pension as it does to service a £50,000 one. For people with larger accounts, flat fees can offer excellent value and make a big difference to what you could get back over the longer term."

The research comes when fees have been described as the 'Darth Vader' of the investment business. Speaking at the Transparency Task Force symposium in February, PZena Investment Management president William Lipsey noted that at present, "we never have full transparency…fees are the Darth Vader of the investment business".

TCF Investments founder and CEO David Norman shared a similar opinion when it came to investment fees. "Fees need to be disclosed in pounds as people cannot do percentages," he said. He suggested that people are tricked into departing with considerable proportions of their money as they are unable to do the maths. "Calculated in this way, fees add an additional layer of opacity for the consumer," he said.

The day-long conference hosted a range of speakers from either side of the active/passive management debate, in which they considered the advantages and limitations of each method. Lipsey explained that "the logic that one *[form of management]* is superior to the other is hard for me to embrace".

Written by Talya Misiri

Court rules unmarried woman is eligible for survivor's pension

The Supreme Court ruling has prompted those in the industry to suggest that reform is "long overdue" for cohabiting partners

The Supreme Court has ruled that an unmarried woman is eligible to receive a survivor's pension from her deceased partner's pension.

Denise Brewster had lived with her partner William McCullan for 10 years up to December 2009. On Christmas Eve that year, the couple became engaged. However, two days later, McCullan died.

At the time he had worked for Translink, a public transport operator in Northern Ireland, for around 15 years and had been contributing to the local government pension scheme. Brewster believes that McCullan had nominated her to be eligible for a survivor's pension. However, the administrators of the scheme said they did not receive a form and therefore refused to pay her a survivor's pension.

Under regulations passed in 2009 the LGPS required that unmarried co-habiting partners be nominated by their pension scheme member partner in order to be eligible for a survivor's pension. The survivor must also show that he or she has been a cohabitant for two years before the date on which the member sent the nomination and has been in that position for two years before the date of death.

There is no similar nomination requirement for married or civil partner survivors. The Department of the Environment of Northern Ireland (DENI) included a nomination requirement in the 2009 regulations in order to ensure 'parity' with other local government pension schemes in Scotland and England and Wales, which at the time had similar requirements.

Brewster applied for a judicial review of this decision and the High Court ruled that the requirement of nomination of a cohabiting partner in the 2009 Regulations was incompatible with article 14 of the European Convention on Human Rights (which prohibits discrimination) read together with article 1 protocol 1 (peaceful enjoyment of possessions).

However, the Court of Appeal allowed the respondents' appeal, finding that the nomination requirement was neither unjustified nor disproportionate. In the meantime, prompted by the judgment of the High Court, the equivalent regulations in England and Wales and in Scotland were amended to remove the nomination requirement in those schemes.

When the appellant became aware of these changes, she applied to the Court of Appeal for her appeal to be re-opened. Her application was refused, which is why she appealed to the Supreme Court.

The Supreme Court "unanimously" ruled that Brewster should be allowed to receive a survivor's pension. The Court ruled that a survivor's pension as a 'possession' falls within the ambit of article 1 protocol 1 and that the appellant, as a surviving unmarried cohabiting partner, enjoys a relevant status for the purpose of article 14 and is in an analogous situation to a surviving married partner or civil partner. It ruled that the requirement of nominating a longstanding cohabitant was a "discriminatory" effect that "cannot be justified".

The successful appeal prompted the law firm that represented Brewster in her claim to say that "reform is long overdue". Deighton Pierce Glynn solicitor Gareth Mitchell said that denying bereaved cohabitees access to a survivor pension causes "huge distress as well as significant financial hardship". He noted that around one in six families in the UK are cohabiting and therefore "reform is long overdue".

"The Supreme Court has decided that there was unlawful discrimination on grounds of marital status. This is the first marital status discrimination claim to reach the Supreme Court. It is likely to have a significant wider impact, both in relation to pensions and in other areas where long-term cohabitees are treated less favourably," he explained.

"The rule, which the Supreme Court has declared was unlawful, is found in most of the UK's public-sector pension schemes, of which there are around 12 million members. This includes the NHS, teachers and civil service schemes. It is also found in many defined benefit pension schemes in the private sector.

"Although the Supreme Court has only declared the Northern Ireland local government scheme to be unlawful, the reasoning behind the court's decision means that the identical provisions found in many other public-sector schemes are likely to be unenforceable.

"In addition, while the Human Rights Act does not extend to private-sector pension schemes, members of those schemes will rightly expect their employers not to participate in schemes which discriminate unfairly on grounds of marital status."

Written by Natalie Tuck

VIEW FROM THE ABI

It is widely acknowledged that the concept of automatic enrolment can and should be adapted to benefit the self-employed, and the ABI was pleased to see that this will be considered as part of the government's 2017 Automatic Enrolment Review. However more research is needed to better understand gig economy workers, who they are, and what specific challenges they face in interacting with the welfare system and saving for retirement.

Among other things, the government should consider how the concept and framework of AE could be adapted from its current form to benefit the 'gig economy' via an equivalent system of pension saving.

This system could be based on an adaptation of a model put forward by one of our members, where the self-employed are opted in to a scheme based on Class IV National Insurance Contributions, which are usually paid through self-assessment returns. This seems the most obvious system to deliver an AE-like 'nudge'.

However, it's important to recognise the potential problems that might arise for self-employed individuals who may save enough money to pay their tax at the end of the financial year, but may not have the additional funds to contribute towards a pension.

The government will need to communicate any rollout of a pension policy for the self-employed with a national awareness-raising campaign aimed at individuals submitting self-assessment returns, with frequent signposting to tailored information and guidance from the government's new financial guidance body.

Rob Yuille, assistant director, head of retirement policy, ABI

Vauxhall pension deficit could be a 'deal breaker' in takeover

In other pension fund news, the Royal County of Berkshire Pension Fund has acquired a 20 per cent stake in Gresham House and Aon has completed an ETV for the Aon Minet Pension Scheme

Chris Warham / Shutterstock.com

A deal to sell the European arm of General Motors, which includes Vauxhall, to France's PSA Group could be terminated due to the British company's pension scheme deficit, the BBC has reported.

Referring to Vauxhall's pension scheme, one of the largest in the UK with 15,000 members, pensions expert John Ralfe said the PSA Group would not touch the scheme "with a barge pole", assuming that it has a deficit of around £1bn.

According to the company's most recent available records, at the end of 2014 the pension scheme had assets of about £1.8bn but liabilities of approximately £2.6bn, resulting in a £840m deficit. Since 2014, record low interest rates are likely to have hit returns on government debt that larger pension schemes invest in, therefore the deficit is likely to have grown, Ralfe explained.

He also told the BBC's *Today* programme that the size of the deficit was "a major issue for the takeover...At best it's a stumbling block, at worst it could be a deal breaker".

In other pension fund news, the Royal County of Berkshire Pension Fund is to acquire a 20 per cent stake in investment manager Gresham House.

The deal, which is subject to and conditional upon the passing of the Resolutions at the General Meeting and Admission occurring, will see the fund acquire over 2.5 million new ordinary shares for 325p per share.

The acquisition by Berkshire of 10 per cent or more of the ordinary shares in Gresham House is subject to approval by the Financial Conduct Authority (FCA) as a result of the indirect interest that Berkshire will acquire in the company's wholly-owned subsidiary Gresham House Asset Management Limited (GHAM), which is authorised by the FCA.

In addition, Aon Hewitt has completed a bulk enhanced transfer value (ETV) for the Aon Minet Pension Scheme with a 33 per cent take-up rate, improving its buyout position by £60m. The ETV added to Aon's longer-term de-risking objective for its UK defined benefit schemes. This followed three buy-in transactions for Aon-sponsored pension schemes completed in the past five years for an estimated £1.2bn.

Deferred members of the Aon Minet Pension Scheme were offered the ETV for a limited period and were provided with paid-for independent financial advice to support their decisions.

Written by Talya Misiri and Natalie Tuck

People on the move

Peter Harrison

The Investment Association has appointed Peter Harrison as the new chair of its board.

Harrison, who is currently group chief executive at Schroders, will take on the new role at the Investment Association on 1 May. He will replace current chair Helena Morrisey, who will step down and join Legal & General Investment Management.

Accompanying him, the Investment Association has also appointed Henderson Group chief executive Andrew Formica as deputy chair, joining the board on the same date. Both Harrison and Formica will serve on the board for a two-year fixed term. Commenting on the appointment, Harrison said: "As the incoming chair of the board of the Investment Association, I look forward to continuing to work closely with Chris Cummings and the rest of the team. Our industry is experiencing a period of significant change and it is important we work together to ensure we meet our responsibilities to clients and deliver value to them over the long term."

Matthew Pheasey

Just has appointed Matthew Pheasey as director of intermediary distribution. In the new role, created by the company's recent merger, Matt will be responsible for leading the business development and sales activities for all of Just's intermediated distribution. Before joining Just, Pheasey worked in a variety of positions, including retail distribution director, national sales director and specialist sales director at Aegon.

Jane Middleton

Pi Partnership Group has appointed Jane Middleton to its independent trustee team. Middleton joins the group with an extensive background as a CFO and has served in a number of senior positions at Rockwell Collins, Virgin Atlantic, TNT Express and Pizza Hut. She also has a history of developing and agreeing plans with The Pensions Regulator as well as assisting companies looking to mitigate their balance sheet risk.

Grant Hadland

M&G Investments has appointed Grant Hadland as institutional equity and multi-asset business development director. Hadland has more than 30 years' experience in insititutional investment management, formerly at Standard Life Investments, where he managed relationships with a range of investment consultants. In his new role, Hadland will be responsible for developing M&G's equity and multi-asset business presence in the UK.

Julian Cripps

RPMI has appointed Julian Cripps as managing director, investment business and as an executive director of the company. Cripps will report into CEO Chris Hitchen and will work to lead RPMI Railpen's pension arrangement. He joined the firm in 2015 as COO investments from River and Mercantile Asset Management and is now set to take a wider role in leading the business as a leading asset owner. He will also sit on RPMI's board.

Mark McNulty

JLT Employee Benefits has appointed Mark McNulty as head of investment solutions. McNulty will lead JLT's Investment Solutions business, which implements innovative investment strategies for DB, DC and wealth management clients. He joins from State Street Global Advisors, where he was managing director and head of UK business and served at the Bank of Ireland Asset Management before this.

James Double

PSIT has promoted James Double to the position of head of trusteeship.

Double is an experienced professional pension trustee and associate of the Pensions Management Institute (PMI).

Having been with PSIT since 2014, as head of trusteeship, Double will be responsible for developing the firm's independent trustee services. He will also sit on PSIT's managing board.

Commenting on his appointment, Double said: "I am excited to take on this new role. In my three years at PSIT, the business has moved from strength to strength and independent trusteeship is growing in importance, not least due to The Pensions Regulator's focus on the 21st century trustee. I look forward to continue working with our great team to develop professional trustee services to meet the demands and needs of pension schemes into the future."

PSIT managing director Wayne Phelan added: "James is ideally suited for our continued growth and developing opportunities for our professional trustee team."

VIEW FROM THE PLSA

Sometimes it's best to be bold. Pensions scams are a case in point.

Scams are a major threat to people's retirement savings. They undermine trust in pensions. They generate masses of time-consuming due diligence work for trustees – and sometimes the member goes ahead regardless.

The plans in the government's recent consultation, broadly sensible and welcome as they are, don't go anything like far enough. They miss the central point – that being a registered pension schemes is no proof of being a legitimate pension scheme.

We need a much more ambitious approach. The PLSA has proposed a completely new authorisation regime, starting with new schemes with fewer than 100 members and existing schemes with fewer than 100 members that wish to receive pension transfers. This would cover Small Self-Administered Schemes (SSASs), which, together with overseas schemes, present the greatest scams risk.

These schemes should be required to appoint an independent professional trustee with a duty to blow the whistle if they suspect a scam. Independent professional trustees would have to hold a mandatory qualification similar to the requirements for trustees of master trusts.

An alternative would be for small schemes to have a recognised professional, such as a lawyer, accountant or actuary, as the independent trustee.

Some would say this is very bold thinking. But our proposal is no more than what the regulatory system should have been doing all along – protecting people from losing their life savings while letting legitimate schemes flourish. Put it like that, and an authorisation regime doesn't seem quite so radical after all.

James Walsh, policy lead for EU and international, PLSA

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Market commentary: Rising inflation

After months of very little or almost no inflation, the past three months have seen an increase in the rate of Consumer Price Index each month, with the most recent figure for January 2017 coming in at 1.8 per cent.

The figure was slightly below the 1.9 per cent economists had predicted but Investec Wealth & Investment bond strategist Shilen Shah says that the increase is a sign that "inflationary pressures are building in the UK".

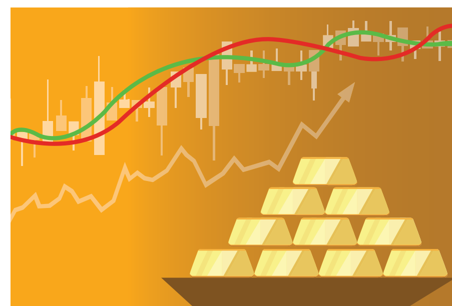
This is a thought shared by Royal London Asset Management economist Ian Kernohan: "We expect CPI to rise further and move above target later in the year, as the impact of sterling devaluation takes time to feed through. This will squeeze real earnings growth to close to 0 per cent, unless wages rise by more than we expect. We see no interest rate increase from the Bank of England this year or next."

Shah, however, notes that we may eventually see a stronger reaction from the central bank if the path of CPI is stronger than it currently estimates. Currently, though the bank's neutral stance is significantly supported by its latest estimate about the amount of spare capacity in the economy.

Contrastingly, Heartwood Investment Management investment director David Absolon believes the longer-term inflation outlook remains "benign by historical standards".

"Core inflation is likely to drift higher – but not to levels that historically have impacted capital markets – given that, among other things, ageing demographics and technological advancements are likely to contain any material wage pressures."

Regardless of where the rate lies on a historical scale, the current rising inflation is not good news for pensioners, says Prudential retirement expert Vince Smith-Hughes. He notes that although research has highlighted some pensioners



are enjoying higher levels of income, others are much closer to the breadline.

"Inflation has been consistently rising over the past three months, which will squeeze the living standards of retired people living on a fixed income, particularly as they often spend a disproportionate amount of their income of fuel, food and heating.

"Pensioners drawing down an income from their pension funds and savings will have to think again about how much they draw from their funds, particularly with the volatility we are seeing in investment markets. Increasing the amount of income they are taking from their pension or savings to meet the rising prices means they run a greater risk of exhausting their pension and savings." Furthermore, pensions technical director Andrew Tully notes that with households "feeling the squeeze", this is perhaps why one in two over 50s say they will work beyond their planned retirement age.

"Even moderate inflation can have a devastating impact on incomes in retirement. But how do you balance the need to pay the bills and also ensure your savings last the duration of your retirement? Stocks and shares are usually seen as the best hedge against inflation, showing the benefit of using a blended approach of using an annuity to meet essential expenditure and income drawdown for flexibility and to create an element of inflation proofing."

Written by Natalie Tuck

In my opinion

On the effects of record CPI inflation rates:
"Pensioners drawing down an income from their pension funds will have to think again about how much they draw, particularly with the volatility we are seeing in investment markets. Increasing the amount of income they are taking from their pension or savings to meet the rising prices means they run a greater risk of exhausting their pension and savings."
Prudential retirement expert Vince Smith-Hughes

On banning all forms of pension scam communications:
"Banning cold-calling and other measures in the consultation should help, but we need to make sure cold calls aren't just replaced by a deluge of spam emails and texts. That's why we think further measures to stop fraudsters from using other forms of technology need to be considered by the government."
ABI director of long-term savings and protection policy Yvonne Braun

On £1,500 financial advice allowance:
"The government is absolutely right to allow people to access money from their pension pot to pay for advice and it's positive this reform covers both traditional and 'robo-advice' to meet consumers' changing habits."
LV= director of advice strategy David Stevens

On pensioner incomes overtaking working age earnings:
"One of the most intriguing aspects of the recent living standards story across Britain has been typical pensioner household incomes overtaking working age households for the first time. This has led some to assume that all pensioners are enjoying some kind of boom amid the painful squeeze for everyone else. The main driver of pensioner income growth has been the arrival of successive new waves of pensioners, who are more likely to work, own their home and have generous private pension wealth than any previous generation."
Resolution Foundation economic analyst Adam Corlett

On possible effects of hard Brexit on SPA:
"Dramatic changes to migration make this balancing act even harder. If migration does fall, so too will the number of workers to support the increasing numbers of people of pensionable age. Undoubtedly this will put pressure on the affordability of the state pension, and as a result the age at which you can claim it."
Hymans Robertson head of corporate consulting Jon Hatchett

On the pensions green paper:
"This must be one of the 'greenest' green papers in living memory. Despite months of public debate led by the select committee and the pensions industry, the government's own thinking does not seem to have advanced significantly. The most worrying proposal is to allow certain schemes to 'suspend' annual pension increases if money is tight. There is a significant risk that relaxing standards on inflation protection could be exploited..."
Royal London director of policy Steve Webb

VIEW FROM THE SPP

The Work & Pensions Select Committee recently expressed frustration at the UK's fragmented DB provision and the SPP recently met one of their civil servants to discuss this. The select committee called for consolidation and proposed an 'aggregator fund' but what are the barriers to consolidation and how far can the government help?

There's little doubt that, starting from scratch, the present DB provision could be more cost-effective and better governed if spread across fewer schemes. However, starting with 6,000 schemes, it is a difficult task to whittle this down to 60 schemes.

Unfortunately, each scheme has different members, benefits, assets, trustees and statutory employers and merging these usually results in winners and losers. Few employers want to be responsible for others' funding risks and few trustees want to transfer their members to a less well-funded scheme or one with weaker trustee powers. Members may object to benefit accrual, indexation or death benefits cuts in the name of 'harmonisation' and 'actuarial equivalence', and reviewing rules, cleansing data, member communications and actuarial advice all cost money.

An aggregator fund may sound great in theory, but we need to be clear: who bears the risks when things don't go to plan? Securing benefits for members with no risk to employers does not come much cheaper than a buyout but are there cheaper and easier ways of achieving economies of scale? Many companies do want to consolidate their own DB schemes but the contracting-out transfer rules often present practical difficulties. This is something the government could do to help the industry on.

Glyn Bradley, council member, Society of Pension Professionals

THE SOCIETY OF PENSION PROFESSIONALS
leading pension thinking

VIEW FROM THE PMI

It's unfortunate, but not unexpected, that pension schemes and their members are being targeted by fraudsters. According to a recent RSM *Pension Fraud Risk* report, 37 per cent of the schemes surveyed in 2015 had experienced fraud; more than double the proportion in 2013.

Therefore, in preparing our response to HM Treasury's recent pensions scams consultation, we asked our members to cite examples where they had personal experience of attempted fraud. We found that members' details were obtained through a cold call/text/mailshot.

Our research also revealed that scams have taken the following forms: Dormant company sets up occupational DC scheme for its 'employees'; 'introducer', which is not FCA-registered, seeks to obtain information on a member; and FCA-registered firm cold calls offering a 'free' pensions review.

"A clear definition of what constitutes cold calling needs to be in place before any ban is enforced"

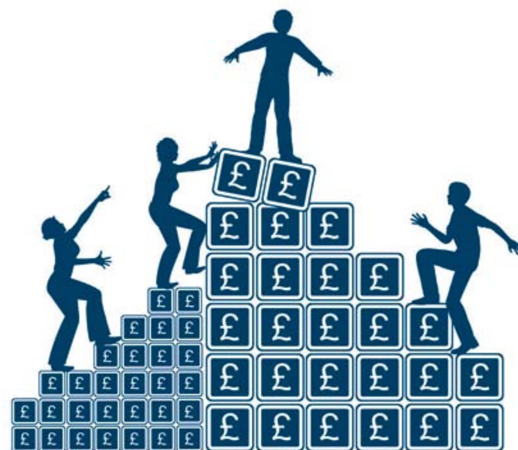
Of these three approaches, how is the average member of the public to know which is legal and which might be a scam? In our view, cold calling should be regarded with suspicion and a ban would be appropriate. Nevertheless, a clear definition of what constitutes cold calling needs to be in place before any ban is enforced.

An enforcement regime managed by the Information Commissioner's Office is a positive step forward. However it must be remembered that the regime would only cover scammers based in the UK; the possibility that scammers will simply move any cold calling operation abroad cannot be overlooked.

Tim Middleton, technical consultant, the Pensions Management Institute

Soapbox: Taking action

Too many cases have made headlines recently regarding women's pension shortcomings and the gender pay gap.



A report by Aegon last year found that just 10 per cent of women are prepared for retirement based on their current savings. On average, women have £20,000 saved into a pension plan in comparison to an average of £52,000 among men.

While women's work patterns have remained fairly similar for a considerable number of years, I cannot help but ask: why are so many still failing to find a solution to adequate pension saving?

For decades, a large number of women have fallen victim to the 'triple effect', being a combination of lower salaries, career breaks and smaller contribution rates, which leads to insufficient income at retirement.

The Zurich *Workplace Savings Barometer*, which analysed over 250,000 pension plans, found that employer contributions are generally lower for women's pensions than men's, resulting from the gender pay gap, career breaks and men working in larger businesses.

From this, Zurich claimed that women could encounter a pensions shortfall of £47,000 at the end of their working life if the gender gap in employer contributions is not addressed.

In addition, many have missed out on auto-enrolment pension saving as a result of having more than one job. Although the government has confirmed its plan to consider this issue in its auto-enrolment review later this year, it is essential that women are provided with greater information or seek guidance on how to ensure they are saving enough. There is most definitely a need for the government, employers and members to be active rather than reactive when it comes to saving for retirement.

With the introduction of the Pensions Advice Allowance, employers should work to encourage women to take the tax-free money for financial advice earlier rather than later, preferably, considerably in advance of their pensionable age, so that they can develop an effective savings plan for a comfortable retirement.

Zurich Insurance head of new retail distribution Rose St Louis says: "Workplace engagement and guidance has a central role to play in helping women make the most of their saving potential while they are working full time, but it is now crucial to focus on ensuring that this gap is not allowed to grow any further."

While women have worked to gain a position of independence and equality in the workplace and society, they must take action to ensure that they do not resort to historic traditional gender roles in retirement. When it comes to financial planning, pension saving must also hold precedence so women are not left relying on their male counterparts or individually suffering when they leave the workforce.

Written by Talya Misiri

Education, communication, education

Julie Yates explains why financial education – both at work and further afield – is vital if members are to get the most out of their pension

Gone are the days when employees simply had to pay regular contributions into a defined benefit pension to have a reasonable idea of how much they would live on in retirement. Now in a DC-dominated world, with no default retirement age and few guarantees on the amount of money an employee can expect at the end of their working life, greater financial awareness and education are more important than ever.

There are two sides to financial education, both of which are essential if employees are to understand their pensions and, equally importantly, manage their own money more broadly. The first aspect is better general public awareness of personal finance planning – the second is the role that the pensions industry specifically can play.

General awareness needs to start early. We are starting to see moves to introduce education around personal finances into school and this must begin at an early age. However, although improving education in schools is a good starting point, there is still a vacuum of understanding about savings and debt management that needs to be bridged once individuals enter the workplace.

Auto-enrolment has gone some way towards closing that vacuum and helping people to manage their funds and finances. It has also provided opportunities for the savings industry – whether pensions providers or third party educators – to offer additional support in the workplace. For this, the impending introduction of the pensions dashboard is a good starting point.

In a trust-based DC environment, trustees also have a key role to play in helping members better understand their pensions. However, they may have less involvement in broader financial education.

With the introduction of pension freedom, financial awareness is now particularly important as people approach retirement. Personal contact is by far the best way to help members understand their options and ensure that they get what they want and need from retirement products. Anecdotal evidence has shown that as many as 50 per cent of employees actually now want something different from the traditional approach.

The role of technology

While nothing can truly replace face-to-face interaction, particularly around significant decisions like retirement planning, technology can play a big part in supporting financial education.

Supermarket giant Morrisons is a good example of this, with its 'Save your Dough' campaign making extensive use of online tools to help its workers. Videos, financial planning tips and 'payday podcasts' are just some of the tools that the retailer has used to get messages across around general financial planning and pensions in particular.

However, while this approach has obviously worked well for Morrisons, each individual employer needs to consider the best way of delivering education and communications within its own workforce. Online tools are great – but unless an employer is prepared to ensure that all employees have access to the internet, they may not be appropriate. Mobile technology, particularly smart phones, are another increasingly popular channel, but with similar limitations.

Technology also provides employees with 'self-service' capabilities, enabling them to check and update their own personal information as well as finding out more about the performance and nature of the pension funds they are invested in. However, some companies and providers have been loathed to implement 'self service' to date, because of the poor quality of their underlying data. For trust-based schemes at least, The Pensions Regulator's focus on improving data quality has gone a long way to addressing that particular barrier.

Whatever the means of delivery, where does the boundary lie between communications and education? They are both part of the same thing. Communication is about delivering the right information to the right people in a form that they can use. Good communication can help to create self-educators, providing those communications are as clear and straightforward as possible and are sufficient to help people make educated judgements.

Written by Julie Yates, head of administration, Cartwright

In association with

Musings of an MNT

It's a 'dad lecture'

Recently I was asked by a union education representative to undertake pension workshops at one of the offices of a large financial company that has both DB and DC pension schemes. I was to give a short introductory talk followed by a 'question and answer' session on general pension issues.

The sessions were well attended and my presence well received. However having prepared myself for questions on the health of the pension fund, investment strategy, the strength of the sponsor and myriad others reflecting on my role as trustee, I was actually confronted with one overwhelming question from defined benefit employees; when and how can I get money out of the pension fund?

Steve Webb, the then pension minister, attracted media attention in March 2014 when he remarked in a television interview that due to the coalition governments pension reforms, he was relaxed if pensioners wanted to spend their savings on a Lamborghini.

This remark was an apparent attempt to make sexy the boring world of pensions and, though ill-advised, it succeeded for a while, making pensions newsworthy and part of the public's consciousness.

Sadly this euphoria did not last long and the subject has once again effectively disappeared from the news, only reappearing as part of larger stories around buccaneering owners and store closures.

However what seems to have remained in employees' minds is the ability to withdraw their fund from a scheme, even if that scheme is a defined benefit scheme.

This is reflected in the significant increase of enquiries and transfers we have within the pension fund in which I am a trustee, and I expect this is mirrored in other schemes. Although we are monitoring this position, we are not unduly concerned as transfers out reduce the liabilities of the fund.

We are though mindful of the potential for pension liberation fraud. The law, however, obliges us to make such transfers provided we make the necessary checks.

When I was asked the question at the workshops I was able to go further than normal checks by asking the question; 'why do you want to withdraw from the fund?' The consensus seemed to be simply because it was a pot of money that they hadn't realised they could get at. There was little or no concern as to what that would mean for their future retirement income.

The workshops had been advertised for anyone who was in any form of pension fund; disappointingly only one person came who was a member of the contributory pension fund.

Because there was only one person I effectively gave a one-to-one talk to the individual. Well into my stride I suddenly realised what I was doing – helped by the rather glazed expression on the persons face – I was doing what my daughters called, when they asked my opinion on a subject, a 'dad lecture'!

I apologised, saying I had realised what I was doing. The individual kindly said that she had recognised what I was doing as "her dad did the same" and that he had even encouraged her to come to the workshop.

We had a better dialogue after that, discussing the many calls on her income; student loan, saving for a mortgage deposit and general living costs. Pension provision was not foremost on this list.

Many of my generation were the fortunate recipients of a final salary pension scheme; I did not have to make a choice as I was automatically placed into the scheme. One of the great decisions I never had to make. But perhaps both generations deserve more help from all of us than simply receiving a 'dad lecture'.

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

Pensions history

Did you know?

Did you know that there were personal pensions before Personal Pensions?

Personal Pensions were made available from 1 July 1988, under the Financial Services Act 1986 but are you aware that – 30 years earlier – a personal pension saving facility was introduced for self-employed persons and for persons without employer-sponsored pension provision?

The Finance Act 1956 created the option for persons who were not eligible for an employer's pension scheme to set up a 'tax relieved' Retirement Annuity Contract. Subsequently, these were described as 'Section 226 pensions' referring to Section 226 of Income and Corporation Taxes Act 1970. Unlike Personal Pensions 30 years later, the 1956 contract only provided for contributions by the individual and did not provide for contributions from any employer.

Contributions were paid to a deferred annuity contract. There was an annual limit – dependent upon the age band within which the individual fell – as to how much contribution an individual could pay into the Retirement Annuity Contract (ranging from 17.5 per cent of earnings if aged 50 or less to 27.5 per cent for the age band 61-74).

A tax-free lump sum benefit was available based upon a maximum of three times the remaining pension at retirement.

Since A-Day and 'Simplification,' Retirement Annuity Contracts were brought into line with Personal Pensions, including the maximum tax-free lump sum becoming 25 per cent of the fund.

Although it is no longer possible to take out a new Retirement Annuity Contract, contracts taken out before 1 July 1988 can remain in existence.

Are you willing to help conserve pensions' history? Do you wish to know more about the history of pensions? If so see the History of Pensions section on the PAT website. Do please contact us with your information of long established pension schemes via www.pensionsarchivetrust.org.uk or at: malcolm.deering@btinternet.com

Malcolm Deering, friends co-ordinator of The Pensions Archive Trust

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from their pension provider.

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VIEW FROM THE ACA

A survey we published recently has exposed weaknesses in the coverage amongst private sector employees of the government's AE policy, which will particularly affect the numbers of employees that will be enrolled into schemes over the next year as auto-enrolment is extended to around a further one million small employers.

The survey found that unless the government's 2017 review of AE reduces the earnings trigger – the point below which employees are ineligible for auto-enrolment (currently £10,000pa) and somehow extends the scheme to cover the rapidly-rising numbers of self-employed, around 12 million private sector workers will be outside the AE tent by mid-2018.

It is estimated that, based on ONS figures, over 40 per cent of employees of micro employers – around 840,000 firms with fewer than five employees – earn below £10,000pa. These employees are not eligible to be auto-enrolled into workplace pensions, and with the survey finding employee opt outs rising to over 21 per cent of eligible jobholders in smaller firms, it seems likely that upwards of 60 per cent of employees amongst the vast majority of firms left to stage may miss out on joining the ranks of pension savers.

Our survey underscores that in smaller firms the problem is heightened, with those joining AE generally at or near the minimum levels of total contributions, which amount to less than 2 per cent of earnings at present.

In our survey report, we make a number of recommendations that we hope the government will consider in its 2017 AE review.

Bob Scott is chairman of the ACA

Diary: March 2017 and beyond

Aon Pension Conference 2017
14 March 2017
Bristol

Free to attend; Aon's conference will focus on market challenges and hot topics in pension and savings. The conference is ideal for pension managers, finance directors, trustees of pension schemes and those involved in the management or governance of pension schemes. A full day's attendance will entitle the attendee to 4.5 hours CPD. Aon will be hosting a series of pension conferences around the UK in the coming few months.

For more information, visit:
aon.com/unitedkingdom/events/

IFoA Current Issues in Pensions
15 March 2017
Edinburgh

Hosted by the Institute and Faculty of Actuaries, this full-day event will look at the role that actuaries responsible for UK pensions schemes can play in the context of integrated risk management, the expectations of trustees, a rapidly-changing economic climate and the impact of the pensions freedom. The event is mainly aimed at UK actuaries who are responsible for UK pension schemes and is open to members and non-members.

For more information, visit:
actuaries.org.uk/learn-develop/attend-event

PMI Administration Summit
20 March 2017
America Square Conference Centre
London

This full-day seminar will help delegates stay up to date with the latest pensions admin developments, as well as investigate practical solutions to all the admin issues their scheme/clients' schemes are facing. It will provide delegates with the opportunity to network with other professionals within the industry and discuss current strategies. The event will feature a range of speakers including representatives from JLT, Barnett Waddingham and KGC Associates.

For more information, visit:
pensions-pmi.org.uk/events/

Defined Contribution Pensions Conference 2017
22 March 2017
St Pancras Renaissance London Hotel

At this year's Defined Contribution Pensions Conference, hosted by Lane Clark and Peacock, industry experts will tackle some of the biggest issues facing DC schemes, bring new ideas to the table and leave scheme tustees with an action plan of how to make the most difference for scheme members. Speakers will provide key insights into actions that could be taken to get the best value for money in the year to come.

For more information, visit:
lcp.uk.com/events/2017/

Visit www.pensionsage.com for more diary listings

Month in numbers

Mid-70s
UK state pension age is likely to rise further in the wake of Brexit, state pension age reviewer John Cridland has said.

The most recent calculations have suggested that a hard Brexit, whereby migration is significantly reduced, could potentially force people to work into their mid-70s.

Cridland said that Brits may have to work longer if immigration is cut once the UK leaves Europe.

25%
A quarter of UK pension schemes could return to surplus if they adopted an alternative approach to set their valuations, Punter Southall Transaction Services (PSTS) has found.

£20 richer
Pensioner households are £20 a week better off, after housing costs than typical working age families, according to research by the Resolution Foundation.

Trustee boards – what are they really like?

Aon Hewitt senior partner John Belgrove looks at the different characteristics of trustee boards and how behavioural biases can be avoided

Have you heard about 'in-group bias'? It is a simple concept, but one that has powerful effects on people, societies and life in general. We recognise great diversity and complexity within an affinity group to which we belong. However, we easily label groups we are not part of with singular and simple descriptions of 'what they are like'.

So who knows what trustees are really like?

You do not have to look too far for assertion or rhetoric but is such perception fair? There is actually little formal research on the effectiveness of DB pension fund trustees, despite being responsible for £1.5 trillion of pension assets and the retirement outcomes of 11 million members. This was one of our starting points in creating a research partnership with Leeds University Business School (LUBS) to look at the trustee landscape in the UK, and further understand trustee decision-making. In the largest survey of its kind, LUBS surveyed 197 trustees, looking at different aspects of trustee governance including decision-making, financial literacy, attitudes to risk, and socio-demographics. Here we summarise the first set of results.

What does the typical trustee board look like?

No surprises here. The average trustee is a 54 year-old male, with over 70 per cent of trustees aged 50 and above. Fewer than 1 in 5 trustees in our sample is a woman – mirroring the membership of the Association of Member Nominated Trustees.

Education vs experience?

Trustees appear to have both. The average trustee has been a trustee for 10 years and has a university degree. Moreover, 27 per cent have a Master's Degree and 5 per cent have PhDs. They are a smart bunch with an especially high concentration of financial qualifications. That should be good, right? But actually, a diverse set of subject knowledge may be more valuable to a board.

Trustees exhibit a high level of financial literacy. We benchmarked trustees' levels of understanding by assessing objective financial literacy – looking at factual awareness, and testing key concepts. Seventy-two per cent of DB trustees scored five out of five and 21 per cent scored four out of five in some standard tests. The majority of trustees understand diversification and on average, rank the risk of different asset classes correctly.

Why does all this matter?

A room of the most qualified thinkers may not always arrive at the best outcome. Why? Because we are human and prone to behavioural biases like loss aversion, reputation and authority effects that mean the decisions we make are not always the most rational.

So how can we avoid these behavioural biases? Being aware of them is step one. One of the most prevalent is GroupThink – where members quickly herd towards the same views and decisions, with no-one comfortable to play 'devil's advocate'. We have created the Aon Trustee Checklist to help with these common biases. You can read more about the Checklist, and download your own free copy at aonhewitt.com/trusteechecklist.

Looking at decisions from different perspectives helps mitigate some common traps. For example, the presence of women on corporate boards has been shown to help with monitoring and board process (Adams and Ferria, 2010). Age and type of experience/social background can also have a big impact.

Skills audits can be really useful to identify strengths and weaknesses and consider gaps when choosing new trustees. Using frameworks to consider multiple viewpoints and scenarios builds a more robust picture of the challenges we face.

What next?

Aon started this research because we are committed to supporting trustees in achieving better outcomes for their schemes. It sees us working with Dr Iain Clacher at LUBS to launch the first major piece of academic research investigating what makes trustees tick. We will be releasing more information as we delve deeper into the topic during 2017.

And finally….

In-group bias is powerful but not always fair. When we read or hear what this or that group are like, let's also consider the authority and evidence behind the view. Finding comfort within affinity groups is also natural – I have many group affiliations and one of them is 'investment consultants' – and we all know what they are like, right?

You can download a copy of the research at aonhewitt.com/investment

Written by John Belgrove, senior partner, Aon Hewitt

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Helping trustees stop scams

Andrew Warwick-Thompson reveals TPR's top tips for preventing scams

The theft of consumers' pension savings has proved hard to prevent under the current legislative and regulatory framework. But we can and should narrow the open goal presented to scammers by the current occupational pension regime. That's why we welcome the government's pension scams consultation.

The Pensions Regulator (TPR) has been in the forefront of raising awareness of pension scams through the Scorpion campaign since 2013. We also chair the multi-agency Project Bloom, which co-ordinates government, law enforcement and regulatory agencies' response to a variety of scam and associated criminal activities. And we have been directly involved in some of the highest profile pension scam cases.

We are ideally placed to identify those changes that will best protect pension scheme members. Here are the top three measures I believe will make pension scamming as difficult as possible for the criminals who prey on consumers' pension pots.

An outright ban on pension cold calls would send a powerful message to all pension savers – "A cold call about your pension will be from a criminal. Just hang up!" But this probably doesn't go far enough and the ban could extend to cold email and text campaigns too. No reputable pensions company is going cold call, text or email you.

Second, we need to help trustees and scheme managers. They face a horrible dilemma. On the one hand they are exhorted to carry out due diligence to make sure they only make transfers to legitimate receiving schemes. On the other, the courts have found them to be at fault if they refuse to make a transfer to what they suspect is a dodgy scheme.

So I favour a restriction of a member's right to a statutory transfer to either an authorised master trust or an FCA regulated product (S32, GPP, SIPP etc).

That's clean and simple, it answers the legitimate calls from trustees and scheme managers to drastically reduce the cost of due diligence with which they are burdened now, and addresses the overriding consumer need to be confident in the safety of the scheme in which they save. The FCA already publishes information about its regulated providers, and we will publish a list of all master trusts we authorise after implementation of the Pension Schemes Bill.

Thirdly, we need to close off once and for all the second half of the 'open goal' – relevant small schemes, commonly referred to as small self-administered schemes or just 'SSAS'.

The findings of this year's annual *DC Trust* report shows that of the 34,500 DC schemes in the market now, 32,000 are schemes which have 2-11 members and of these, 21,000 are SSAS. In fact this understates the size of the problem – only SSAS with two or more members are obliged to register with us. In addition to the 21,000 we know about, the consultation suggests there may be in excess of 750,000 one-member SSAS.

SSAS are exempt from many of the legal duties applicable to larger schemes. The ease with which a SSAS can be established, and the minimal legal and reporting requirements for such schemes, makes them the vehicle of choice for criminals setting up a scam.

SSAS have gone far beyond the scope of the policy intent that created them and parliament should consider banning any future pension transfers to SSAS arrangements. Indeed, I believe the outright ban on the establishment of any more SSAS arrangements warrants serious consideration.

Together, these three measures offer a practical and proportionate solution to pension scams – they give a strong, clear consumer message about cold calling, clarity and legal certainty to trustees and scheme managers, and will end the flagrant and often criminal abuse of the SSAS regime.

Written by The Pensions Regulator executive director for regulatory policy Andrew Warwick-Thompson

DC: Transferring in bulk? Then you don't need an actuarial certificate…

Darren Philp explains why an actuarial certificate is not the most efficient way to ensure quality when consolidating DC schemes

In what will be a very busy year for pensions, 2017 is likely to see a reasonable amount of market consolidation in the DC space. With that will come a lot of administration for some larger schemes, as they swoop in to rescue schemes that either fail or voluntarily (sort of) decide to exit the market.

One major irritation that we'd argue has no place in bulk DC to DC transfers (of the kind that this sort of consolidation will require) is the need for an actuarial certificate. In fact, we'd argue that not only does it not provide any discernible benefit to scheme members (surely the biggest consideration), it might actually impede bulk transfers being made. It's a historical legacy. Twenty years ago there were hardly any bulk DC to DC transfers and the DB rules were just copied across without much thought.

Don't get me wrong. There must be a quality assessment before a transfer takes place. And there need to be quality criteria as to what is required from a receiving scheme. Our view is that these criteria need to be set out by TPR and be applied by the trustees of the ceding scheme.

I'd wager that this criteria will end up being pretty similar to the criteria that underpin the master-trust assurance framework and that will underpin the authorisation criteria that TPR will police moving forwards. On that basis, master trusts that have already met the required criteria probably don't have to be assessed again, but should be monitored on an ongoing basis to check they still meet the required standard.

Duplicating and adding unnecessary process simply wastes time and money for providers and the regulator. And given that providers only have money belonging to their customers, and TPR only has public money, spend really needs to be kept in check on all fronts.

One reason why the regulator needs to lead the way by issuing guidelines on this is because some, but not all, lawyers are taking the view that in order that the receiving scheme be assessed as 'broadly, no less, favourable', the underlying investment funds have to be assessed as delivering the same return as the funds in the ceding scheme.

As it is nearly impossible to predict whether one investment fund will deliver greater or lesser returns than another in the long run, on a strict (but clearly not proportionate) interpretation this requires that any transfer to a receiving scheme requires the latter to set up a fund that mirrors the former. Taking this to its logical conclusion, taking this approach means true consolidation cannot take place after transfer, and that the ceded scheme would, in effect, remain a distinctly-managed entity within the receiving scheme.

If we think about it, fund mirroring makes no logical sense. All funds are managed, even passive ones. So even if a ceding scheme had remained in operation, the mix of assets and investment philosophy would have changed as the macro and micro economic environment evolved. So to truly 'mirror', a receiving scheme would not only have to replicate the asset mix on the day of the transfer and the investment philosophy, it would also have to make the same asset adjustments and adaptions of investment philosophy that the fund managers to the ceding scheme would have made, had they continued to manage the fund, potentially for the next 40 years. Makes you tired just thinking about it, doesn't it!

That's obviously quite an extreme example, and I'm using a strict interpretation of the law to make a point. But think about what consolidation in the DC market is meant to achieve. Simplicity. Strong governance. High-quality pension schemes. Good retirement outcomes. None of which are things that require an actuarial certificate if a transfer is made to a well-regulated and quality pension scheme. It's time to bin the actuarial certificate for bulk DC transfers, before consolidation becomes a headache rather than a force for good.

Written by Darren Philp, director of policy and market engagement, The People's Pension

In association with
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2017: The data challenge

Laura Blows talks to Duncan Watson, managing director of products and services, EQ Paymaster, about why pension schemes should focus on data quality

Why should pension schemes be looking at data quality, and why now in particular?

2017 could be a perfect storm in terms of pension scheme data for a number of reasons. There is a convergence of issues from several sources. This is a combination of legislative changes, government policy and regulator interest, but also some market trends in terms of member access to data, which are continuing to grow in 2017.

We've got IORP II, the European legislation that is due to come into force in 2018. Clearly with the state of play with Europe and Brexit, there are some commentators that are suggesting we may not adopt the full breadth of IORP II. But equally there are many commentators that are saying we should plan on the assumption that we will adopt some of that legislation.

If we do adopt that legislation in the UK there will be a stipulation for trustees to communicate with all of their members, including their deferred members, and give them an annual pensions benefits statement. Now clearly that has an implication for data.

The second point is the pensions dashboard. This is the government's initiative to give pension scheme members, and the public, access to all of their pension scheme information in one place. Pension schemes will need to have that data if they are going to take part in the dashboard.

The third area I want to talk about is The Pensions Regulator. The Pensions Regulator has, to be frank, dipped in and out of data quality over the past 10 years or so. But it has issued particular guidance on record keeping in the past and I think it expects trustees to take that guidance seriously and get their data in order.

On the 30 November 2016 the regulator issued a press statement effectively saying it wasn't happy with the way trustees had been progressing data quality over recent times. They are challenging trustees to include a statement in their reports about data quality.

The fourth area is the reconciliation and rectification of the contracting-out records that schemes hold and HMRC holds with NICO. Most schemes are engaging in that exercise now and are looking to sort out their contracting-out data.

The government has also published a consultation around GMP equalisation, an issue that has been rumbling on for many, many years, if not decades, without a resolution. Now if that eventually does reach a resolution then trustees will need to act and address the GMP equalisation issue, straight off the back of contracted-out reconciliation, which is another reason why data is becoming increasingly important this year.

The final reason is the continuing trend to give members self-service access and access to their pension information, regardless whether this is through the dashboard or through individual pension-scheme websites. If the data isn't robust and up to date there is no point giving members access.

The Pensions Regulator has always been interested in data quality, but it seems it has ramped up its attention to data over the past year or so. Why do you think the regulator is so concerned?
It is concerned at the progress, or lack of progress that has been made. Whilst I think some progress has been made around common data reporting, clearly the results of the regulator's recent survey indicate that not as much progress has been made in other data areas – in particular the conditional data aspects.

While the regulator may have been distracted by other issues over 2016, BHS being one of them, I think it is now turning its attention to data, off the back of the survey, to say 'come on, you really need to make some effort here'.

What risks are trustees and sponsors exposed to individually if data isn't up to scratch?
I think 'risk' broadly falls into two main categories. There's the cost risk of having poor data but there's also the reputational risk of having poor data.

The cost risk manifests itself in many ways. There's a cost of getting data wrong, getting individual benefits wrong, and the member discovering the error and coming back for rectification to take place. Rectification costs money and also leads to reputational risk. There's the risk of lawsuit or class action from the members against the trustees and the scheme sponsors.

I think from an overall funding perspective, clearly if the data isn't robust then the actuaries' value on the scheme's liabilities may be out, running the risk that sponsors are potentially funding too much in terms of contributions into the scheme.

Another risk is if the regulator really does lose patience or the government starts levying sanctions on the schemes for poor quality data.

Another risk is the price for a buyout or buy-in. If data is of poor quality, the likelihood is the insurer will charge a risk premium to the scheme for that transaction. It could increase their absolute-pound costs for that exercise, and also it could delay the exercise.

I think the reputational risk is clear. If you think about the pensions dashboard, if some schemes are participating, questions may be raised by the members of other schemes as to why their trustees or sponsors are not.

There are clearly a number of risks regarding poor quality data. But in contrast, what benefits does having good quality data provide for schemes?
Simply put, cleaner data allows automation and self-service to be put into place. The more automated the scheme, the more access to self-service, where the member corrects information themselves or accesses quotations and information, which lowers the cost of administration, which is then passed on to the scheme trustees and the sponsors.

There is a benefit of not only lower cost, but a better experience for the scheme members who want to access information and engage with their pension.

Better data means faster transactions when going to the market for a buyout or buy-in, or any liability-hedging deal. And clearly better data and swifter engagement equals a better experience between the scheme and its members.

Why has the industry arguably been so slow to ensure data quality?
Trustees and sponsors can get away with 'just in time' data fixing. By that I mean they wait for a member to die, retire or transfer, and then they go in and cleanse the data for that particular member. So there wasnt that burning platform to clean and address data quality.

From a pensions valuation perspective, assumptions can be made around the quality and completeness of the data. It's not ideal, but trustees and sponsors can probably get away with not really addressing their data and still satisfying the actuary and caveats around the data quality.

But there seems to be a convergence and acceleration of issues that may prompt trustees to act. It is not a very easy process to fix; it's very manual in some cases. And frankly to date, trustees have had higher priorities to do with their time and money, but I think 2017 will be the year when data comes to the top of trustees' set of priorities.

Could you provide some practical advice for how to improve data quality?
The first step for trustees, sponsors and scheme managers in both the public and private sector is to take a good honest look at your data.

So do an assessment. How complete is it, are there any issues with some of the conditional or calculated data in terms of robustness? When I say take a look, I mean take a look through several lenses as well.

Clearly the regulator has a particular lens on the data and they've set that out very clearly in their record-keeping guidance. There's also the lens of what the dashboard might require and what insurers might require if a de-risking transaction is to take place. What might IORP II require if schemes need to communicate with deferred members on an annual basis?

So there are several lenses that need to be applied. I don't think trustees should be scared of that. There are some very simple tools that can be applied to have a look at data.

This isn't going to be resolved in months, it's not going to be resolved in years, but the first step is to take that honest assessment and then prioritise where the focus should be in 2017, 2018 and beyond.

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

Written by Laura Blows

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The regulator's trustee focus

Matthew Swynnerton looks at TPR's response to its discussion paper on the modern trustee and scheme governance

In 2016, The Pensions Regulator (TPR) published its discussion paper on 21st century trusteeship and governance to stimulate a dialogue about raising standards of trustee competence and improving the governance and administration of pension schemes. In this article we report on TPR's response to the discussion paper, in particular highlighting what TPR intends to do next.

TPR states that it is not seeking to impose new standards of governance and administration but it expects trustees who are not meeting the standards to start doing so. TPR's research and case experience has shown that the quality of governance and administration is "patchy" and TPR states that it is "not prepared to stand by as a compromised, second class membership emerges". TPR is determined to drive up standards, including through more targeted education and tools (with an education campaign expected to start in the spring) and tougher enforcement against trustees who fail to meet the required standards.

Areas of focus

TPR will focus on the fundamentals of good governance and the building blocks to ensure effective management of the scheme such as: board competence; clear roles, responsibilities and accountabilities of key scheme participants; effective governance structures and decision-making processes; and effective business planning.

TPR will also focus on key areas that it thinks are vital for good member outcomes but which trustees are finding challenging or where engagement is insufficient. This includes investment governance (in respect of which TPR will publish guidance in the first part of 2017), conflicts of interest, administration and record-keeping.

Qualifications and barriers to entry

Issues raised by the discussion paper included whether there should be barriers to entry (such as qualifications or registration) for professional trustees, whether there should be minimum qualifications for chairs of trustee boards and how trustees can demonstrate they have the minimum level of competence required to fulfil their role. The response reports that while many respondents supported some form of barriers to entry for professional trustees, few thought that mandatory qualifications would be appropriate for lay trustees or chairs. Many respondents who were in favour of greater regulation of professional trustees recognised the challenge of defining a minimum standard and many thought that formal qualifications were not necessarily appropriate.

TPR's next steps include setting out clearly the standards that it expects in practice of professional trustees and the specific qualities and skills that it expects chairs to bring to trustee boards. In the first part of 2017, TPR also intends to clarify its definition of professional trustees.

In a section of the response looking ahead to the longer term, TPR notes that many respondents thought that mandatory qualifications are not the best way of ensuring board competence, and states that it thinks a more holistic approach is needed. In the first instance, TPR will provide greater clarity about its expectations around board competence and good governance, supported by greater targeted enforcement. It will then consider the evidence from the drive to improve standards as to whether a 'fit and proper' regime, including barriers to entry, may help.

Streamlined guidance

Noting responses about the volume and accessibility of material on its website, in 2017 TPR will start to make changes to streamline its guidance. In particular, TPR intends to consolidate some of its guidance into key overarching pieces of guidance about principles or issues common to all pension schemes.

TPR will also create further practical tools and products – such as checklists, templates, best practice examples and case studies – to help trustees apply TPR's messages to their own circumstances and take action.

Comment

Whilst TPR states that it is not seeking to impose new standards, the publication of this response document provides a useful reminder for trustees to consider their governance and administration processes and whether any improvements are needed. It will also be useful for trustees to consider their scheme in light of guidance issued as part of TPR's upcoming education campaign.

Written by Matthew Swynnerton, partner in the pensions practice, DLA Piper

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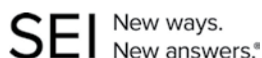

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Factors that fit

As more investors benefit from factor-driven approaches, there's growing recognition that broader adoption could help them target their specific investment goals

Growing numbers of investors are looking to systematic rules-based approaches that allocate assets to investment factors (cohorts of securities chosen around certain characteristics) that have historically provided distinct return premiums. This trend has been fuelled by rising demand for more transparent and lower-cost solutions, alongside the desire for exposures that have low correlation with broad market moves.

Factor investing defines the smart-beta approach, whose underlying idea has been to capture equity risk factors, such as value, momentum and size. Over time, this approach has extended beyond equities and into bond markets.

More recently, the factor investing concept has begun to venture outside traditional asset classes to identify and capture alternative risk premiums—sources of systematic excess return from non-traditional investments and strategies.

These may involve equities, bonds, currencies and commodities and correspond to long/short portfolios (for example, the value factor for equities can be extended beyond long exposure to traditional equities into bonds, currencies and commodities). As well as capturing style and structural risk premiums from alternative investments, some approaches can replicate certain hedge-fund exposures in a highly cost-effective way.

In addition to worrying about the costs of accessing alternative investments, many investors also have concerns about their transparency and liquidity. Factor approaches targeting alternatives could open up attractive opportunities to access these investments' potent diversification and return potential with better transparency and higher liquidity—while also paying lower fees.

As the scope of factor use has widened, factor investing has also begun to encompass more bespoke approaches that rely heavily on managerial skills and proprietary research.

Factor premiums are expected to deliver over the long term because they reward investors for bearing risk or stem from markets' structural limitations and investors' behavioural biases. But the effectiveness of different risk premiums will change as the macroeconomic environment evolves. So investment managers need to make judgement calls on which factors to select—and when.

We believe a holistic assessment is the best approach to identifying which factors are attractive and which aren't. This analysis should include a quantitative assessment of potential upside, an evaluation of the macroeconomic environment and, finally, human judgement.

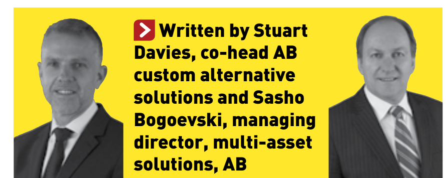
In our view, actively managed approaches that incorporate fundamental viewpoints can deliver much more rewarding outcomes than those that manage exposure mechanistically (for example, by dialling down equity exposure in response to volatility triggers). More dynamic approaches can, for example, choose to temper exposure to factors like momentum which tend to lag when equity markets are particularly volatile.

Unlike traditional assets, alternative risk premiums may be accessed by combining multiple trading instruments or assets (including long and short strategies) and applying specific trading rules to isolate the alternative risks being harvested. This means risk premiums can be tailored with great precision to deliver fully customised, actively managed solutions aimed at helping investors meet specific goals.

Getting the right fit involves a clear understanding of what investors are trying to accomplish with their portfolios—and determining how it can be achieved most effectively. This might involve more targeted exposures to desired factors, delivering specific outcomes at substantially lower costs or a focus on environmental, social and governance (ESG)-friendly investments.

How might this work in practice? Investors concerned about a more reflationary environment and unintended duration risks lurking in their overall portfolios might seek a bespoke 'reflation-proof' strategy. Others might require hedge fund like downside protection potential, but with daily liquidity.

These examples show that rather than providing 'one-size-fits-all' commoditised products, alternative risk premiums can be harnessed within highly focused investment solutions that seek to deliver bespoke tailoring at off-the-peg prices—while also providing valuable transparency and liquidity benefits.



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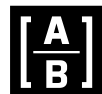

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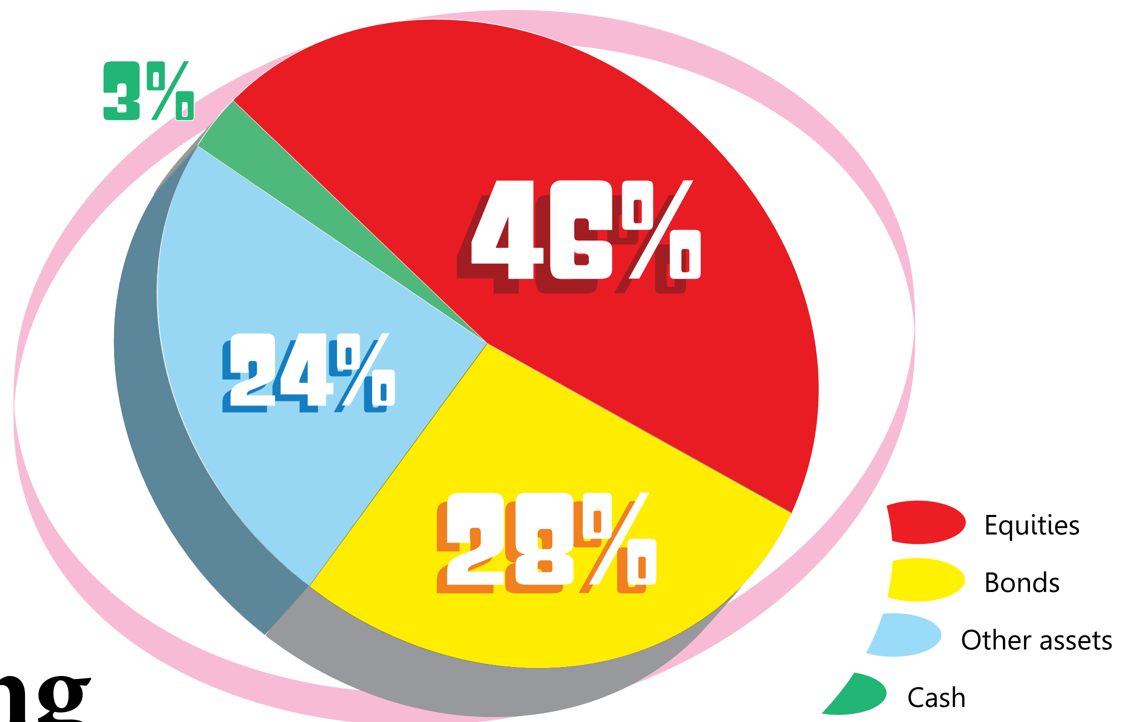

Taking stock

Laura Blows finds out what the trends are within pension funds' most popular asset classes – equities, fixed income, cash, alternatives and property

While each pension scheme is undoubtedly unique, there is still some commonality, particularly when it comes to investment portfolio composition. Here, the same handful of asset classes appear time and time again. Willis Towers Watson's *Global Pensions Assets Study 2017* found that at the end of 2016, the average global asset allocation of the seven largest pensions markets was 46 per cent equities, 28 per cent bonds, 24 per cent other assets (including real estate and other alternatives) and 3 per cent cash.

It also found that since 1997, bonds, equities and cash allocations have been reduced to varying degrees, while allocations to other assets (real estate and other alternatives) have increased from 4 per cent to 24 per cent.

So while the allocations may be changing, five asset classes – equities, fixed income, cash, alternatives and property – remain as the staple of a pension fund's asset allocation. But what's in store for these asset classes? *Pensions Age* asks the industry:

Equities

Politics have exerted a dominant influence upon financial markets last year, with all major developed-world markets delivering gains in Q4, and UK-based investors' returns from overseas equity indices were significantly enhanced by sterling weakness. US equities stood out among the major markets as generating the greatest gains. While the broadly-positive reaction to Trump's initial policy comments certainly buoyed US equities, more than half of the return was actually attributable to the appreciation of the dollar.

We feel that the structural factors inherent in modern economies suggest rates of growth and inflation will be lower than those experienced in the past, but in the meantime, market valuations are once again pricing in elevated expectations for growth and pricing power. We believe the swing in valuations means that opportunities to build holdings in companies and sectors that are able to provide consistency of earnings without the necessity for support from a cyclical upswing have been presented. Record levels of indebtedness mean, we believe, that those with stronger balance sheets should prove a safer bet than their more highly-geared counterparts.

Newton Investment Management global head of distribution Julian Lyne

Receding cyclical recession concerns, a more synchronised growth environment, still easy monetary policy and generally robust balance sheets should lend support to equities. Expectations for

earnings growth have been revised sharply up as a reflection of this. However, the experience of the last few years has been that this early optimism has soon faded. With valuations for equities at demanding levels, we need to see earnings growth in order for them to provide good returns this year. The recent pick-up in the ratio of earnings upgrades to downgrades by brokers supports our view that market expectations for growth are improving, even if this temporary, and that this is a good indicator for better earnings growth.

We anticipate strong returns from currency-hedged Japanese equities in particular, driven by the macro environment and by bottom-up company activity. US equities continue to offer high quality but valuations are expensive. We remain neutral on the prospects for UK equities and in Europe; while valuations are relatively attractive, poor company fundamentals and a lack of meaningful momentum overwhelm the investment case. Our preferences across emerging markets are for Europe, the Middle East, Africa and Latin America over Asia.

US equity markets have reacted strongly to the prospect of fiscal stimulus in the US, and UK markets have continued to benefit from weakening sterling exchange rates. Moreover the recent rise in oil prices as a result of the OPEC agreement to cut production has provided a large positive stimulus to the valuations of one of the largest components of the FTSE indices. Additionally, the Bank of England, Bank of Japan and the European Central Bank have continued to maintain a loose monetary policy over the quarter.

Monetary policy is a 'risk' factor to our view on equities, with the conclusion that over the medium term, investing in equities purely to play the monetary policy guessing game seems fraught with danger. We are cautiously negative view on equities this quarter.

The US stock market in particular has achieved record high prices in an environment with little evidence of a pickup in earnings that could justify a return to a normal range for the price to earnings ratio. We feel share buybacks have played a key role in raising valuations, at the expense of investment that could provide the required future earnings growth.

Barnett Waddingham partner Matt Tickle

Fixed income

Financial repression is alive and kicking so pension funds need to keep spreading their bets when it comes to fixed income. This includes taking on more loans to companies and individuals. These can be riskier than lending to governments but it is not a new business: other financial institutions like banks already make these loans so it is a question of emulating their credit checks.

Invesco Perpetual head of UK institutional sales and service Hugh Ferrand

Pension funds' approach to fixed income varies on what part of the spectrum you look at. High-yield bonds and emerging-market debt offer comparatively high yields compared to other asset classes, helping pension funds meet their cashflow needs. However, as high-yield bonds have rallied over the past year, yields have fallen and the duration of the asset class has become more of a concern. Loans are another attractive income option, and their floating rate means that pension funds are not left vulnerable to changes in interest rates.

Fidelity International investment director Katie Roberts

Government bond yields have risen to the point where they are relatively attractive once again given our view that both their defensive properties will be maintained and inflation expectations do not run away from current levels.

The nearer-term fundamental outlook for investment-grade bonds appears constructive with central bank support still helping to underpin the market. Valuations still appear reasonable, but they are starting to look increasingly expensive. High-yield bond credit spreads have continued to narrow and valuations are starting to look rich on an absolute basis but the underlying fundamentals remain robust with low expected default rates. As such we expect the income to be the primary driver behind returns for high-yield bonds over capital appreciation. Local currency emerging market bond markets face some headwinds although select opportunities exist where the risk-reward profile is favourable.

Investec diversified growth fund co-portfolio manager Michael Spinks

Cash

Funding challenges and low yields mean that cash is already an unattractive asset for many pension funds, not to mention the impact of rising inflation. While we don't believe inflation will run away, it does mean that real returns on cash are likely to be negative. Higher yields on safe-haven assets like US government debt have also undermined the attractions of cash, offering investors a safe place to park their money while earning at least some of an income in the short term.

Fidelity International investment director Katie Roberts

Alternatives

Increasingly, the alternatives asset class has been decomposed into risk premia versus manager skill, cost-effective versus expensive, and liquid versus illiquid. We are already in the middle innings of this journey, with a growing number of well-resourced pension funds stepping back from the traditional fund-of-funds model and engaging directly

with managers. Others have worked closely with experienced consultants to achieve the same outcome. The overall result has been a substantial compression in fees, with the previous, very high fee models disrupted heavily. In a world of low expected returns and near-zero cash rates, this is a welcome and exciting development for investors.

Damian Leach, Director Systematic Strategies, Fulcrum Asset Management

Alternatives are an area of increasing interest, with many vehicles able to deliver an attractive income with some inflation protection. Alternatives help to diversify pension exposures away from traditional asset classes, which have been bid up by loose central bank policy over the past few years.

Pension investors have particularly favoured infrastructure investments over the past few years. Social infrastructure projects (eg schools/hospitals) provide availability-based revenues, where cash flows are dependent on the use of an asset – eg a school or a hospital. Economic infrastructure projects are higher risk but pay higher yields. Cash flows here are demand based – eg the lease of an aircraft depends on whether you have airlines who want to lease it. While these areas are higher risk, investors can compensate for this risk by investing higher up in the capital structure, through debt rather than equity. Given their long-term approach, pension funds are also less affected by liquidity issues around alternatives.

Fidelity International investment director Katie Roberts

Property

The UK has a desperate housing shortage, especially in the rental sector, which has more than doubled since 2003. This was acknowledged in the Autumn Budget – a housing infrastructure fund of £2.3 billion by 2020-2021 was announced then. But trustees can help now by funding and investing in new estates and accommodation blocks. It is what the government wants; what the country needs; and it is profitable.

Invesco Real Estate managing director, client portfolio management Europe, Simon Redman

Given its stable income payments, physical property has traditionally been a favourite of pension funds. While office- or retail-based exposures can see their rents fluctuate in line with the economic cycle, there are property vehicles that do not offer this risk. Civitas Social Housing, for example, is an equity-listed vehicle that invests in social housing and offers a yield of 5 per cent. Given that demand for social housing should be countercyclical, income payments should be maintained even in a recessionary environment.

Fidelity International investment director Katie Roberts

Investment flows have taken a hit since the vote with commercial property investment in London falling by 55 per cent compared to 2015 and we remain cautious as the UK heads into negotiations with the EU. However as property prices have proven resilient so far, this can be attributed partially to the lack of a major increase in supply. This leads us to view the yield as attractive and the risk of price falls over the coming year as 'manageable' for long-term investors.

Barnett Waddingham partner Matt Tickle

Written by Laura Blows

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Floating rate relief from rising interest rates

Pioneer Investments head of UK institutional business Jonathan May believes that floating rate securities could be a useful portfolio diversification tool in a rising rate environment

The Federal Reserve raised US interest rates at its December meeting and it is Pioneer Investments' view that the pace of further tightening could be faster than currently envisaged. With this in mind, how should institutional investors position themselves for a rising interest rates environment?

We believe diversification is key. Seeking out investments strategies that are lowly correlated to core asset classes can help shield portfolios from volatility during periods of market transition.

Floating rate securities can be an attractive hedge to interest rate risk while also providing an attractive yield profile.

What are floating rate securities?

Floating rates securities are debt instruments, typically bank loans, with coupon payments that fluctuate, or 'float', based on short-term reference rates, such as 90-day US LIBOR. These bank loans are arranged by commercial or investment banks on behalf of corporate borrowers and then distributed to investors such as mutual funds and pension funds.

The companies that issue bank loans are typically rated below investment grade. In terms of credit rating, they are similar to high yield bonds. However, a key difference is that bank loans are typically senior to high-yield bonds in an issuer's capital structure and are secured by specific company assets which can result in lower credit risk. As a result, their senior and secured capital structure position has historically allowed bank loans to have lower default rates and higher recovery values than high-yield bonds.

Why invest in a floating rate securities?

A primary reason to consider floating rate securities is their risk and return profile characteristics. Because bank loans are issued by below investment-grade rated companies, they typically offer a higher yield than investment grade rated bonds. However, because of their senior secured capital structure position loans tend to have less credit risk than high-yield bonds.

Another important reason for investing in bank loans is their floating rate coupon. This presents a unique opportunity to invest in an income generating investment with low price volatility. The coupon of a floating rate loan typically adjusts on a quarterly basis to a predetermined spread over LIBOR (usually 90-day LIBOR). This short reset feature allows the bank loan coupon to quickly adjust in line with any interest rate movements. This quick reset feature also means that bank loans are a very short duration instrument, which can allow them to help diversify a core fixed income portfolio. Additionally, it is always helpful to bear in mind that the income generated by bank loans will increase if short-term interest rates rise and vice-versa.

These unique characteristics of floating rate funds have allowed them to have relatively low correlation to other assets classes. This leads to increased portfolio diversification.

Consider diversified and higher quality approach

At Pioneer Investments, we believe a more conservative approach to the asset class is the most efficient way to benefit from the diversification benefits bank loans offer. Our approach focuses on the higher credit quality and more liquid segment of the bank loan market and aims to produce attractive risk-adjusted total returns over the long term. We utilise a highly diversified, value-oriented approach driven by rigorous fundamental credit research.

Access through multi-asset credit

Floating rate securities can be accessed through a multi-asset credit strategy where the portfolio's exposures are actively monitored and can be quickly adjusted in response to a changing investment case. Moreover, floating rate securities are just one of a wide range of attractive opportunities available within the multi-asset credit universe and it is our view that maintaining a well-diversified portfolio can help to protect assets during periods of market volatility.

Pioneer Investments' credit opportunities and dynamic credit strategies are actively managed and the flexible, multi-asset credit approach is designed with the aim to transform market challenges into investment

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Cautious optimism in a challenging world

Matthew J. Bullock, investment director in Global Multi-Asset Strategies, Wellington Management, meets Francesca Fabrizi to discuss how multi-asset strategies can help investors

What is your outlook for markets, given how stretched some asset valuations look to have become, given central bank policy, populist politics and so on?
We are cautiously optimistic because while there remain many threats in the marketplace, there may also be opportunities. It's important to think about opportunities because we don't believe investors should completely avoid risk in portfolios.

Starting with the risks, there is political uncertainty in the US; uncertainty around Brexit, and the implications of a hard Brexit, which is the direction we seem to be heading; and around Europe, where we have several elections this year. All this creates uncertainty.

The overall theme for this year is being active in portfolios. The last three to five years saw a lot of emphasis on taking macro views, buying broad exposures and indexing in many cases to generate returns. With heightened uncertainty and stretched valuations – an unfamiliar environment – we feel we need to be much more active and tactical.

What this means for portfolio construction is that even though we have some broader market exposures, our emphasis across a number of different strategies takes more of an absolute return focus – where we seek to take advantage of pockets of volatility. For example, in relative value, we evaluate different markets against each other; in momentum, we assess market behaviour over a period of time.

Our other area of focus is what we refer to as 'manager alpha'. Even in challenging times, some stock pickers or bond selectors can have a much greater chance of outperforming particular indexes. We look to remove the broader market exposure to try to isolate the outperformance.

What are the risks for investors?
We feel one of the main risks for investors is assuming that strategies that have worked in the past will continue to do so. For example, the sorts of broader multi-asset approaches that have worked very well over the last three to five years have had very large exposures to equities and bonds, and sometimes also currencies.

Looking forward, we have to think differently. With valuations stretched, we cannot rely on what has worked in the past. It's very important that investors keep monitoring the way markets are behaving and, occasionally, when there's a period of euphoria, try to take some risk out of their portfolios and move closer to an absolute return exposure.

How did the multi-asset absolute return sector perform through the market shocks caused by Brexit and Trump?
There are many varieties of multi-asset fund. Focusing on the multi-asset growth sector – which is referred to as diversified growth in the UK and could be referred to as absolute return in much of the rest of Europe – the last 12 months have highlighted that even this sector comprises very different funds.

Many funds, particularly more market-heavy ones, did very well following the Brexit vote, often because sterling fell sharply and they were unhedged. However, this highlights that these funds were running full currency risk. Some funds also did exceptionally well when markets rebounded strongly, which shows a heavy reliance on equities, bonds and currencies to generate returns.

That isn't necessarily a problem, although many investors move into multi-asset investing for an absolute return or risk management focus, and it's very hard to generate absolute returns when focusing on a very small number of asset classes. For example, in the week following the Brexit referendum, markets fell sharply and recovered almost as quickly. Many funds did exactly the same, which raises the question: if you are investing for an absolute return or total return and funds are behaving just like the market, what are you getting for your

fees? In many cases, investors may be better off buying indexes and accepting the associated volatility.

In contrast, more absolute return-focused strategies performed okay last year, generating positive returns – which is their aim – but not nearly at the levels of some of the more market-reliant strategies. Going forward, investors should in our opinion look for strategies that haven't relied on a few asset classes to generate returns, even though these may not necessarily have been the best performers recently.

Given the potential risks ahead, investors have to prepare themselves for shocks. An absolute return focus is what we feel they should be considering if they are concerned about capital preservation.

How would you rate the multi-asset absolute return sector's performance and value for money versus other active and passive options?

Performance has been mixed. Some strategies have performed true to label, but most haven't in our view.

After the year we've had, it's healthy to debate costs and fees. Markets performed strongly despite major surprises, and absolute return-focused multi-asset funds didn't by their nature keep up with that. That's to be expected because diversification and risk controls necessarily mean the performance of such funds is likely to lag in a rising market.

I don't believe investors should pay active fees for funds that behave exactly like the market, such as those that replicated the v-shaped recovery following the Brexit vote. What is worth paying for, though, is strategies that are true diversifiers that seek to add value and don't just imitate the market. There is again a healthy debate about fees, although I don't believe a race to the bottom, i.e., buying the lowest-cost fund, is the best solution. What's more important than cost is value for money.

What are the main opportunities you see for investors going forward?

We see some interesting opportunities. For example, President Trump is proposing protectionist policies and fiscal stimulus, which we expect should, at least shorter term, be good for mid and small-cap US companies. Europe is largely unloved, although unloved sectors are sometimes where you can find interesting opportunities.

There are also opportunities in India, where several policies of Prime Minister Narendra Modi are starting to feed through into economic growth. Japan has long disappointed, although stimulative government and central bank policies and the focus of many companies on generating growth may also create opportunities.

These aren't opportunities that can generally be accessed through broad exposures. We believe being active and very focused on finding quality names is more important than ever. A market that has run very hard and is reliant on expectations is likely to react with volatility or even shock if expectations prove wrong.

What are the main options available to investors looking to preserve capital?

There are different types of multi-asset growth funds: some rely on markets (technically, 'beta'); others are more absolute return focused. We believe investors looking to preserve capital should consider absolute return strategies, which have more chance of preserving capital in periods of volatility. The disadvantage is that moving away from broader equity and bond exposures requires a bit more due diligence.

Important questions investors should ask include: Where are returns coming from? What is the relationship between equities and bonds in generating returns, and what is the correlation? What are the costs of running the funds?

Questions such as these will help investors to identify the best performing funds of the future. As I mentioned earlier, these may not be the best performers of the past.

How can investors look to generate income in a challenging environment?

Everybody needs income. The challenge is that many of the ways in which income has traditionally been generated rely on bonds, and we're in a very low-yielding environment with interest rates likely to remain low for some time.

Investors will either have to accept a lower level of income or will have to diversify. However, income funds should generate income, with sometimes a small amount of growth to preserve the value of that income. I would question the risk management procedures around any income funds that consistently generate double-digit growth.

We take a multi-asset approach to the challenge of generating income. We start with traditional equities and bonds but also look across a wide range of other assets, for example, infrastructure and property trusts. Risk management is exceptionally important, and we want to create a portfolio that is more total return focused. This retains exposure to market fluctuations but with a longer-term objective of generating positive returns.

To view this video interview in full, please visit pensionsage.com

Written by Francesca Fabrizi

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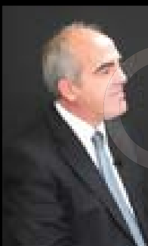

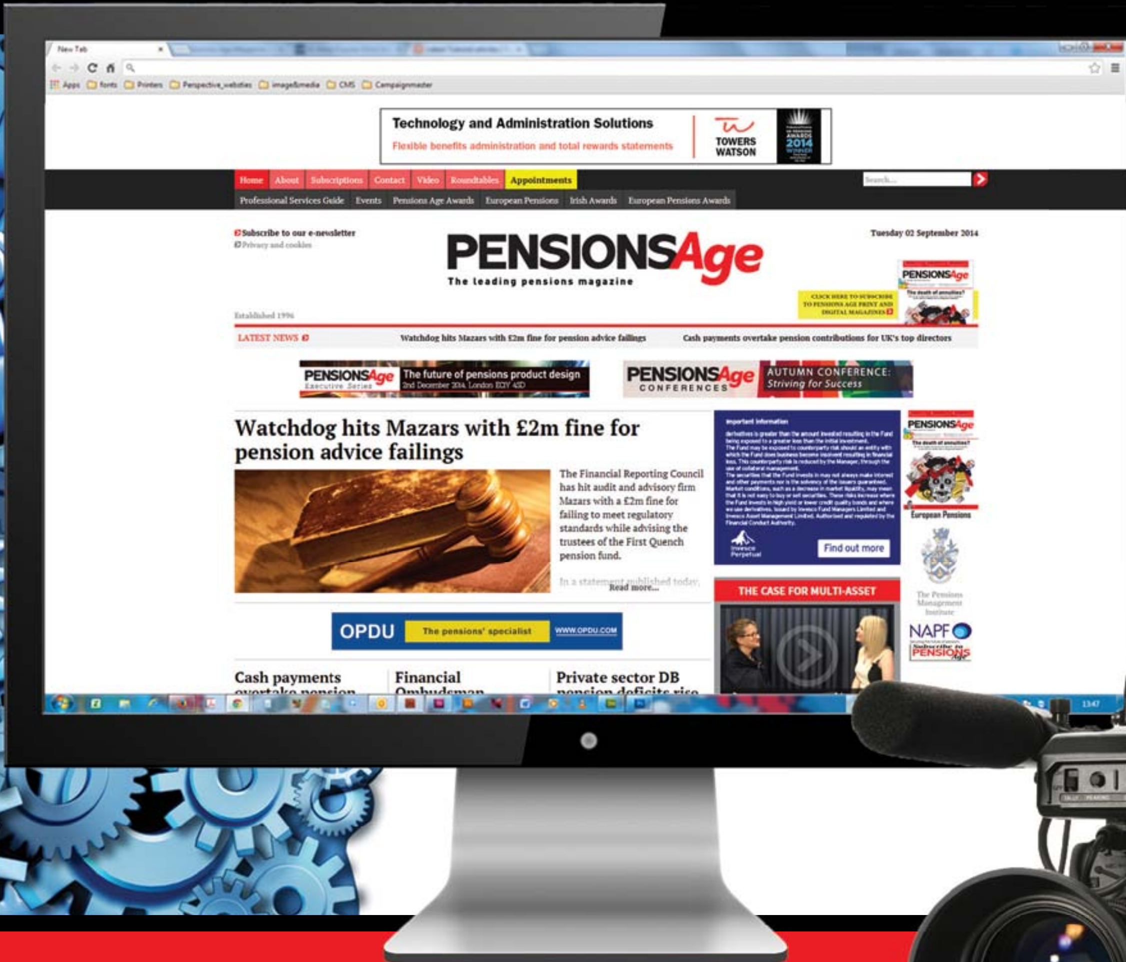

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A realistic approach to infrastructure investment

Adrian Jones tackles some of the concerns about infrastructure debt investing and discusses why pension funds should consider the first-mover advantage

Investing in long-term, low-risk infrastructure assets with an increased focus on environmental, social and governance impact and broad societal and macroeconomic positives seems intuitive to most. But while some investors are flexible and adapt to a changing market, others exclude themselves because of unrealistic return requirements or project pipeline predictability. As the range of infrastructure opportunities is likely to become more varied, this will favour more sophisticated investors who take a forward-looking, relative-value approach.

Since 2014, AllianzGI's clients have invested approximately £750 million in primary UK infrastructure investment-grade project bonds (and ten-times that amount in EUR and USD) with an average spread over sterling swap rates of 200bppa. Over the same period, average spreads on equivalently-rated listed UK utility bonds averaged around 140bppa[1]. During that time sterling rates fell from 3.5% to 1.5%, thus infrastructure debt generated 20%-30% more gross income than for those electing to stay in public fixed income markets.

Investors that ultimately decide not to invest in infrastructure debt worry about an insufficient 'illiquidity premium', an unclear future pipeline of opportunities, or political and regulatory uncertainty e.g. Brexit/Trump/Scottish independence. However for those taking a less reactive approach, the reluctance of other investors is good news – the logic of supply and demand indicates that the first-movers should extract greater value.

Illiquidity premium

Some investors appear to require an absolute (arbitrary?) illiquidity premium regardless of the broader yield and spread environment. Some fail to recognise that 'liquid' and 'illiquid' are not mutually exclusive quasi-quantum mechanical states. Rather, there is relative liquidity among the different private market opportunities and the listed debt products used to benchmark illiquidity. For example, in the indices of listed utility bonds a third of the index members are debt issues only just 'benchmark size' of £250 million. Within the index of listed bonds, companies in the same narrow sector with the same credit rating can price quite differently.

On the private investment side, infrastructure debt takes on a bond-like structure (fixed rate, fixed redemption profile, freely transferable, prepayment protection, formal investment-grade rating) and is therefore more fungible with traditional fixed income than other types of illiquid investment, so requiring a lower illiquidity premium.

In reality, it is only at the very high quality end of the credit spectrum that one can directly observe a pure illiquidity premium, eg when one looks at UK government guaranteed debt vs. gilts, one sees a clear pricing differential for identical credit risk. Moving down the credit curve, factors such as size, credit risk, illiquidity and complexity blur into a general requirement for some extra margin, but its specification is art, not science, and ultimately negotiation.

It should be recognised that liquidity is not a property of the individual investments, it is a property of the broader market. By definition, first-movers buy into a less liquid market than late-adopters who drive down prices while increasing liquidity.

Future uncertainty

In an environment of increasing uncertainty, the greatest risk is an inability to adapt to change.

Investors often fail to acknowledge the relative fragility of classic fixed-income contractual structures compared with private debt. From a contractual perspective, senior unsecured listed bonds are little more than tax-efficient preferred equity with a right to be paid ahead of shareholders on an insolvency. Indeed, the price of liquidity results in these bonds being structured so that the maximum number of potential buyers can hold them easily, meaning investors are mere spectators and not involved in the direction of the underlying enterprise.

Well-structured private infrastructure debt benefits from security and covenants that give creditors a say in how the underlying enterprise reacts to unexpected, especially adverse, change. And when one is investing in essential infrastructure for 30 years one should anticipate that change will occur and structure investments to allow an active role in managing that change.

Considering unforeseen events such as Brexit, the advantages of being an active investor with control rights are clear. The only alternative to control is to passively rely on liquidity remaining ….even when everyone else is running for the door as well.

Written by Adrian Jones, portfolio manager, infrastructure debt, Allianz Global Investors

In association with

[1] Source: Bloomberg sterling utility indices

www.infrastructuredebt.co.uk

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Summary
- Pension scheme trustees have been accused of being 'recklessly prudent' with their investment approaches.
- Cashflow-driven investing, LDI and increasing investment in a range of credit vehicles have all been recommended to help schemes tackle their deficits.
- A renewed focus on equities and implementing a diversified investment strategy are also suggested.

Preparing to fight

DB shortfalls are threatening to scupper the plans of both schemes that are on the route to de-risking and the few that remain open. Some trustees are prepared to take the fight to their deficits with their investment strategies. But which weapons should they be using?

It was the former chairman of The Pensions Regulator, Michael O'Higgins, who first tagged defined benefit (DB) scheme trustees with the "recklessly prudent" oxymoron.

Using it back in 2012, he cautioned them against being both too conservative with their investment strategies and too demanding in deficit contribution negotiations. O'Higgins suggested at the time that scheme trustees who were blessed with a strong sponsor covenant would be wise to pursue more ambitious investments rather than large employer contributions, in order to avoid jeopardising the scheme, and indeed, their employer, in the long run.

Almost five years later, however, does O'Higgins' admonishment still stand true?

"It is difficult to generalise, but if I was to, I don't think that all DB schemes are being unduly prudent, given their situation," says Aviva Investors head of investment strategies John Dewey.

"We've got to remember that around a half of all UK DB schemes are cashflow-negative with liability payments in excess of the income that they receive from contributions. So they're having to find liquidity from their portfolio. And that situation is only going to perpetuate over time.

"Over the next 10 years, the amount of cash that is going to be paid out by schemes is likely to double."

In those circumstances, Dewey says that it's not sensible to take significant amounts of risk.

Barnett Waddingham partner Matt Tickle concurs. He explains that there are not many DB schemes that could be called recklessly prudent any longer, partly due to the growth in acceptance of liability-driven investment (LDI). In the not-so-distant past he says, trustees used to have to sell equities and buy some gilts or low-risk bonds to cut risk. Now, they can use bonds far more effectively through leverage, which means that schemes are holding onto more risk than they ever intended to only five years ago.

"They can deal with their big risks like inflation through LDI, which is becoming ever more commonplace," says Tickle.

"And in general they're taking more investment risk because deficits have

gone up. Schemes are using risk assets to plug deficits, as well as looking for money from sponsors."

KPMG's head of the pensions strategy team, Simeon Willis, takes the argument a step further. He believes that some schemes are approaching investment from a recklessly simple outlook. This sees trustees settling for strategies that are sub-optimal on the basis that they are straightforward and easy to understand.

"And in doing so, they're missing out on strategies that could be more suited to their needs," he says.

"Cashflow-driven investing is becoming more relevant as DB schemes mature, and not just for the bigger players either"

Not taking the right risk

This can also mean that they are not taking on the right types of risk for their current circumstances, says Dewey. This is perfectly illustrated, he says, by the fact that – according to the Pension Protection Fund – around 37 per cent of assets in a typical DB scheme are still invested in equities.

"While this has been in steady decline, that's still quite a material risk profile to be invested in, given the volatility that we've seen in those assets."

As trustees have a closing window of time over which to correct their deficits, Dewey suggests that there is a better way to address deficits – through different forms of credit.

"We think about alternative income assets, which deliver consistent predictable cash flows over time, but that will give a premium above traditional listed assets," he says.

"So we're talking investment-grade private assets like infrastructure debt, real-estate debt, private credit and certain types of infrastructure equity, which deliver quite a high degree of security. And you can still generate a good premium above some of the lower return, fixed-income instruments."

Aviva like to call this approach cashflow-driven investing. Dewey says that it is becoming more relevant as DB schemes mature, and not just for the bigger players either. Pooled funds can give SME pension funds access to areas such as private credit and infrastructure.

Of the alternative credit avenues that Dewey mentions, Tickle identifies private debt as the one that continues to attract strong interest, whether that is loans at the more secure end, or private lending at the more daring end.

"Schemes are looking at it to generate more return in a more controlled way and accepting the illiquidity that comes with that. But it also helps with cash flow, because they're still paying out decent coupons at four, five, even six per cent potentially."

The most obvious example of the move to private credit was the decision by The Universities Superannuation Scheme (USS) to agree to buy a majority interest in a $3.1 billion portfolio of loans made by Credit Suisse.

Another tactic that trustees would do well to consider is integrating LDI and corporate bonds, says AXA IM head of UK LDI Jonathan Crowther.

He says that in this scenario it is possible for the LDI manager to hold less collateral assets (such as cash and gilts), meaning that freed-up contributions can then be re-invested into the corporate bond portfolio.

"This is possible because the LDI manager has ready access to the corporate bonds," explains Crowther.

"In the event that interest rates rise substantially and additional collateral assets are needed, there are a number of alternatives that the LDI manager can select from to turn the corporate bonds into collateral assets, without necessarily having to sell.

"If schemes access this opportunity,

then the collateral asset allocation can be reduced by 10-20 per cent, thus increasing the expected return by about 1 per cent per annum on any such assets reallocated to the corporate bond portfolio."

Willis says that this re-evaluation of credit is eminently sensible for most DB schemes. Instead of sitting on a very large holding of index-linked gilts that are generating next to no return, DB schemes could be much better off securing a large proportion of assets invested in high quality, relatively low yielding assets that deliver a premium above gilts. Derivatives can then be used to provide some matching that the gilts are currently providing.

"Rather than having a portfolio that's made up of black and white, you're probably better served having more grey," says Willis.

Equities

Some of that grey, says Thomas Miller Investment managing director Matthew Phillips should be made up of a renewed focus on equities.

One of the problems with cautious investment, as he sees it, is that trustees are driven by the triennial cycle of liability calculation, and not the very long-term nature of the liability itself. He believes that schemes should be concentrating on the long term and the shape of their liability curve, not short-term liability modelling.

"To be clear, I am not talking about open season for risk, with pensions schemes backing Bermuda property developments and interesting crowd funding ideas with 80 per cent of their assets," he says.

"What I am arguing for is to think about the long-term ability of equities to produce real returns over and above most other assets classes."

In order to take more risk and produce real growth, Phillips says that he would suggest nothing more than a plain vanilla, diversified investment strategy, using a mixture of passive and active funds.

"I would certainly consider matching investments and LDI for a proportion, but this should be driven by the nature of the liability and not be undertaken at the expense of the long-term growth of risk assets."

Intech Investment Management president David Schofield says that equity investment need not immediately be labelled with a huge risk sign when the idea is floated at trustee meetings.

Intech has seen a heightened interest in the past year or so of pension funds looking to increase their allocations into higher return seeking assets such as equities, but in a reduced-risk way, with lower absolute volatility.

Low volatility strategies can insulate schemes from the worst equity market drawdowns by 20 to 30 per cent, thereby considerably shortening a recovery period.

More sophisticated strategies can also give a scheme protection from overcrowding, which is always a danger when institutional investors simply build up their portfolios with the least volatile stocks that are out there.

"You need a diversified way of doing it," says Schofield. "We have a very different approach ourselves, a mathematical one that we have been using for almost 30 years now. We call it smart alpha. It has a source of return that doesn't require the stocks in the portfolio to outperform for the portfolio to outperform."

Essentially, it is a process based on rebalancing the portfolio. The manager builds a portfolio filled with hundreds of stocks and has a target weight for each stock. The manager then consistently rebalances back to the chosen weight and this act of rebalancing, over the long run, generates a premium. Schofield says that it is an alpha source that is underutilised.

"You can apply that even in a low-volatility portfolio," he says. "You use it as your source of return and still reduce the overall volatility by using the correlations between stocks. So you need to consider how the stocks in your portfolio move relative to each other."

This means that even in a low-volatility portfolio, a scheme can afford to include some stocks that are more volatile, since they contribute well to the rebalancing premium.

"We're seeing pension funds making specific allocations to this rebalancing premium as a defined source of return alongside more traditional risk premia."

It all almost sounds rather, well, prudently reckless.

Written by Marek Handzel, a freelance journalist

Are DC default funds ambitious enough?

DB schemes can garner sympathy for their caution, but can the same be said of DC plans?

There is an impression that the caps on investment fees and auto-enrolment project have dampened enthusiasm for ambitious default funds, with the latter not wanting to scare off savers and the former pushing schemes to basic passive management.

DC savers who have Royal London as a provider end up in its balanced fund as the automatic default. At the initial stages, 75 per cent of contributions are exposed to equities, 17 per cent to property and 6 per cent to commodities. The rest are split between long duration bonds and gilts. When members get to five years outside retirement, equity exposure drops to 38 per cent, property to 12.5 per cent, while commodities stay the same. Meanwhile, there is a bigger allocation to bonds, cash and absolute return.

"*[The balanced fund]* is quite diversified as well, compared to some that are 100 per cent equities at first," says the provider's investment strategy manager, Lorna Blyth.

With that in mind, Columbia Threadneedle director of DC Andrew Brown says that, on aggregate, it is difficult to argue that DC members require higher allocations to riskier assets.

"We believe that many members are already too heavily exposed to stock market volatility due to the increased use of passive investment designs for the bulk of their accumulation phase," he says.

"This is only partially mitigated through lifestyle strategies that reduce volatility as a member nears their retirement date. We would argue that DC schemes are too heavily concerned with cost and that active asset allocation and an increased focus on risk-adjusted returns is key to ensure good member outcomes."

State Street Global Advisors senior DC strategist Alistair Byrne also argues that some default funds focus too much on equities.

"Asset class diversification can improve the efficiency of the portfolio," he says.

"We're seeing interest in strategic diversification across asset classes to improve portfolio efficiency, and in dynamic asset allocation and volatility management techniques that can allow schemes to hold equities and other growth assets in favourable markets and provide protection in more volatile conditions. Smart beta is also a growing focus, based on evidence that factor-based portfolios can have the same level of return as market capitalisation weighted portfolios, but with lower levels of volatility."

When it comes down to it, however, says Blyth, no matter what the exact investment split is in a default fund, the biggest factor in a successful default fund will always be contributions. And they remain far too low.

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Fiduciary management focus: Monitoring performance

Fiduciary providers: Separating fact from fiction *– Pieter Steyn asks whether your fiduciary manager really is as good as they say they are* ***p48***

The measure of success *– As the fiduciary management market grows, so does the responsibility for pension schemes to ensure their fiduciary managers are doing a good job. But whose duty is it to oversee the work being done, and how should schemes measure performance? Lauren Weymouth explores* ***p50***

Pieter Steyn, head of delegated investment services UK, Willis Towers Watson

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Fiduciary providers: Separating fact from fiction

Pieter Steyn asks whether your fiduciary manager really is as good as they say they are

Humans are subject to any number of behavioural biases affecting how they invest. They suffer from regret, or loss aversion, which leads them to hang on to poor investments because to sell them would confirm they had made a poor decision. Investors also frequently prioritise allocations to familiar investments, ignoring the advantages from diversifying their portfolio through less familiar assets. They chase trends in the mistaken belief that historical returns predict future returns. They are sometimes over-confident and over-estimate their skill and ability to make predictions.

All of these biases, and more besides, can be addressed through better governance. It is not surprising, then, that many pension schemes have started to ask themselves searching questions about the governance they put around their investment decisions. They have come to the realisation that most long-term value creation is derived from sustained organisational excellence, rather than from fund manager or stock selection processes.

Although some schemes have already developed strong governance structures, for others the process is in its formative stages or yet to be formally addressed. The typical structure for many schemes still involves delegating part of the investment process to a sub-committee of their board and then seeking help from advisers. Accountability is not always particularly clear under this arrangement and, almost certainly, the frequency with which decisions are taken is a function of when meetings can be shoe-horned into busy diaries.

Research[1] has shown that best practice investment governance includes, among other things, a competent investment executive function with delegated authority and clear accountability. Pension schemes with sufficient scale have the resource to develop in-house executive functions. However, for most institutional investors best practice is probably more feasibly achieved by embracing the outsourced CIO (OCIO), also known as the fiduciary management model.

Growing recognition of fiduciary management services

The evidence shows that institutional investors are gravitating towards fiduciary management as a means of improving investment governance and investment outcomes. Willis Towers Watson is approaching $90 billion in its services, mainly for pension schemes in the UK, the US, Canada and Germany. Other regions are starting to take note too.

The rapid uptick in adoption worldwide reflects the fact that most pension schemes, primarily due to lack of time and resources, are not structured optimally to maximise investment returns and manage risk appropriately. Opportunities are missed in both these areas and value slips away amid protracted decision-making processes. Allied to this, the commercial pressures that most company sponsors now face has led to a desire to better manage costs and obtain the most from scarce resources.

OCIO or fiduciary management services address the gap that exists between the investment strategies available to the largest schemes with sizeable internal management resources and the governance capabilities of more typical schemes. For example, Willis Towers Watson has clients with assets below £200 million, but their portfolios and manager fees are akin to schemes with tens of billions. This is the advantage of scale and scope. Fiduciary management enables pension schemes to do more, employing diversified investment strategies that are more appropriate for today's complex and volatile markets. This leaves trustees free to concentrate on the strategic

aspects of managing their pension schemes.

Governance challenges

But is the answer as simple as that? Do you just appoint a fiduciary manager and wait for wonderful outcomes to emerge? Regrettably it is not quite that simple.

A few governance challenges remain and these feature in a fresh research paper[2] looking into the OCIO model. The first challenge is to ensure that the roles, delegations, accountabilities and goals are in sync. The fiduciary manager does not operate in a silo. It is merely the outsourced version of what would typically happen in-house if you had the scale and necessary resource.

The in-house team would ideally understand where it fits into the decision-making structure of the fund and each party would be clear about its roles and accountabilities. This includes the trustee board, committees, in-house team and underlying asset managers. The same therefore applies to the fiduciary manager that acts as an extension of the internal governance.

The fiduciary manager should complement the decision-making of the trustee board or investment committee, especially where accountabilities intersect. This is why we feel that good fiduciary management is more than just asset management. The fiduciary manager needs real governance acumen to understand how best to complement a trustee board. Equally, the trustee board must work hard to get most from this model.

The second challenge stems from the fact that fiduciary management is a form of outsourcing. A materially-delegated structure creates what is called a concentrated principal-agent problem. Or perhaps, in plain English, the 'all your eggs in one basket' problem.

The trustee board of the pension fund becomes heavily reliant on the fiduciary manager. It is also reliant on the fiduciary manager's (the agent) ability to keep its own interest secondary to that of the trustee board (principal). This is probably at its most difficult when the fiduciary manager mostly uses in-house asset management products.

The way schemes address this governance challenge is by professionalising the investment committee. An experienced professional committee would be highly alert to the agency issues and will be able to put metrics in place to protect the principal's interest.

Smaller schemes may have trouble building a professional investment committee, and the growing intermediary market is offering the opportunity to appoint a strategic adviser to the trustee to manage this risk. The intermediary 'oversees' the work of the fiduciary on behalf of the trustee. It ensures the right metrics are being reported and it gives the trustee someone to turn to in case of concern.

Deeds, not words

The main ingredients of an excellent OCIO offering, we think, are timely and insightful strategic advice, allied to outstanding execution.

The trouble is, investors find it hard to work out if providers excel in these two key areas and to distinguish between differing OCIO offerings. Providers of delegated or OCIO solutions tend to present similar pitches to prospective clients, which can confuse schemes, particularly since they generally have little prior experience in selecting an OCIO provider. Most providers will cite their dynamic process, their focus on investment diversity and risk management, while some will also talk about their ability to secure sizeable manager fee discounts.

However, not all providers are able to match these words with deeds, and prospective clients cannot be sure which providers have superior capabilities, if they possess the capabilities at all. In short, it can be a real struggle to make an informed judgement.

Evidence

Investment suffers from spectacularly noisy outcomes. This means it is very close to impossible to discern over the short term whether outcomes were created by skill or luck. We suggest trustees ask for as much evidence as possible from the 'pretender to the throne' fiduciary manager during the selection process. When they explain a supposed differentiating factor, trustees should seek to understand how that will create an advantage over other professional fiduciary managers. Remember, hope is not a strategy. Do they really match their words with deeds? And trustees should also seek to understand the extent to which these differentiating factors are used in the portfolio. There is no point assigning much weight to it if it is hardly used.

In conclusion

As with many other professional services selections, the devil is in the detail. Providers work hard at composing an overall appealing message. But look at the evidence and ask yourself or your intermediary, is it also credible? And is it also differentiated? Only then will you be able to believe that it can produce advantage for you.

Written by Pieter Steyn, Head of delegated investment services UK, Willis Towers Watson

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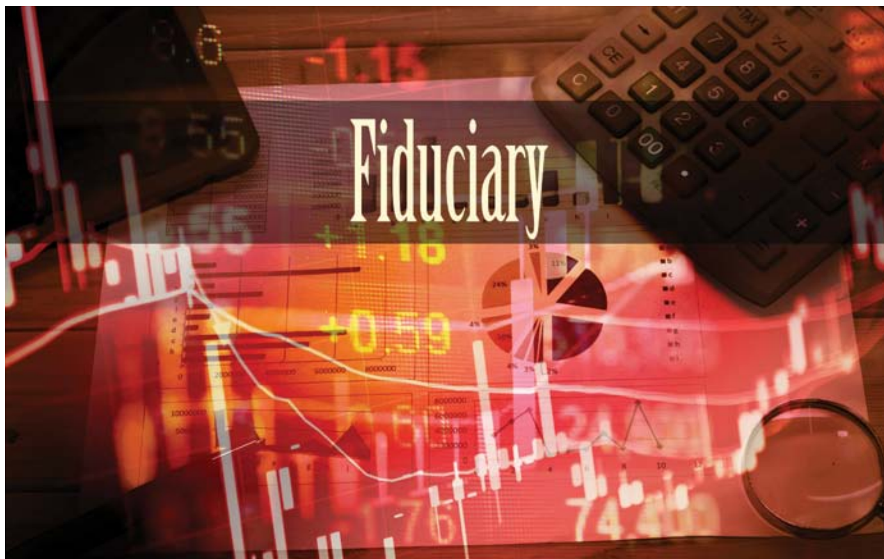
1. Best Practice Investment Management: Lessons for Asset Owners from the Oxford-Watson Wyatt Project on Governance - Gordon L. Clark and Roger Urwin 2007
2. The Outsourced Chief Investment Officer Model of Management and the Principal Agent Problem – Gordon L. Clark and Roger Urwin 2017



The measure of success

As the fiduciary management market grows, so does the responsibility for pension schemes to ensure their fiduciary managers are doing a good job. But whose duty is it to oversee the work being done, and how should schemes measure performance? Lauren Weymouth explores

Summary

- Fiduciary management has seen considerable growth over the past five years.
- The use of fiduciary management among schemes had increased to 46 per cent in 2015 – up from 18 per cent in 2011 and 37 per cent in 2014.
- The past couple of years have seen considerable growth of third-party providers that help schemes to select and appoint a fiduciary manager.
- Trustees must be absolutely clear on the scope of the contract with the fiduciary manager, any benchmarks to be used and the objectives of the scheme if they are to hope to be able to measure the performance of their fiduciary manager.

Over the past decade, the fiduciary management market has grown consistently. In 2016 alone, the market had increased by some 50 per cent, with take-up rates surging to 45 per cent among pension schemes in the UK. The demand is rising, as trustees face the increasingly-complex job of successfully running a scheme and ensuring members are granted the outcome they expect and deserve.

As well as helping to eliminate the increased pressures placed on trustees to deliver better member outcomes, fiduciary management is also proving popular for reducing the overall costs of running a pension scheme. According to the LCP *Fiduciary Management Survey*, which collated responses from more than 100 UK trustees, pension professionals and finance directors, 65 per cent said they believe overall costs are much lower under fiduciary management.

A change in demand

But there are reasons for such an increase in appetite that stem from deeper roots than cost. Willis Towers Watson head of delegated investment services, Pieter Steyn, claims for many, the appetite has come from "disappointing funding levels, coupled with low-growth expectations from mainstream markets".

"Fiduciary managers give clients a scale benefit, but also the scope to seek out opportunities that would otherwise be too challenging to implement," he adds. "Others find the improved governance structure appealing. The trustee sets strategy, a professional fiduciary manager executes the strategy, which leaves the trustee free to oversee the execution. The accountabilities in this structure is clear."

With growing deficits and lengthening recovery plans, the expectation to deliver high investment returns has never been greater. But this expectation has also brought with it the need to challenge the traditional, slow-moving approach to scheme investment.

Oversight

But, while the demand for fiduciary managers is surging, so is the need for oversight and a better measurement of success. In order for fiduciary management to be worthwhile and beneficial for all parties, there needs to be clear evidence that their input is enhancing the scheme's performance.

This issue surrounding a lack of oversight was evident in LCP's survey, which found only 20 per cent of pension professionals received advice on monitoring the continued performance of their scheme's fiduciary manager.

In 2015, the FCA launched a review into the asset management industry and said it would be looking to increase transparency among fiduciary managers due to a lack of "publicly available, comparable performance information", which makes it hard for investors to assess value for money.

But while there have been many issues surrounding oversight, many industry figures would argue that trustees are already working to overcome this themselves.

Aware of the fact that better regulation is needed to ensure maximum results, trustees are commonly looking to appoint third-party intermediaries to help out. PTL director Keith Lewis says it is a "developing trend" for trustees to be supported by an independent third-party to oversee the fiduciary manager."This may include an annual review of whether the fiduciary manager remains "fit for purpose" and continues to demonstrate the key attributes that won them the appointment in the first place," he explains.

However, Steyn says the extent of the oversight varies from situation to situation. "For some smaller schemes, it involves annual meeting attendance and review of performance and service, whereas the more intensive ones involve multiple interactions per quarter as well as all meeting attendance. Our experience is that trustees generally find the work of overseers valuable."

BlackRock managing director in the institutional client business, Graham Jung, agrees that the appointment of an independent overseer is both valuable and increasingly common. He notes how almost all of the selection exercises he's seen have been run by an external, independent evaluator, rather than the trustees themselves or the incumbent adviser.

The appointment of a little help doesn't mean the trustees responsibility stops there, though. Whilst delegating the day-to-day investment management, trustees still remain responsible for investment strategy and for investment performance. This means they also continue to retain an oversight role of the fiduciary manager, including the responsibility to review the appropriateness of the fiduciary manager alongside the scheme's other advisers.

Measuring success

So how exactly can success be measured? Steyn argues that investment outcomes are "spectacularly noisy", which means it is almost impossible to infer over the short term whether returns came from skill or luck. But, there are of course methods, and methods that help determine just how valuable the role of the fiduciary manager is.

In most cases, fiduciary managers are set a benchmark, which is usually liability driven. Quite simply, the target will be to achieve a return in excess of the liability. If they can beat this, then they have done their job. However, this isn't always the most accurate representation of the work done.

Lewis argues that in practice, "it is more complex than that and it is probably appropriate to consider a number of measures, including performance broken down into the key drivers – the level of risk taken should also be considered".

There are currently several efforts across the industry, such as the FCA's review into the asset management industry, to create industry-standard performance reporting, which would allow for a more concise breakdown of the areas in which fiduciaries have exceeded and fallen short. This would be widespread and every fiduciary manager would be aiming to meet the same benchmarks.

But, Jung argues, while this is the case and industry-standard performance is important, most fiduciary management appointments are bespoke mandates created for each trustee's own circumstances. As such, he claims the best measure of success for schemes to monitor is the progress of the funding level towards the "agreed objective, supported by a clear attribution of the decisions that were taken".

A tailored approach

Transparency has been highlighted as one of the biggest areas for improvement within the fiduciary management market for years, and it is something that is actively being worked on, with the help of industry figures. But this is just a minor room for improvement in an industry that is consistently booming.

In 2016, Aon Hewitt's *Fiduciary Management Survey* found a staggering 98 per cent of those using the service rated their experience as excellent, good or satisfactory.

But perhaps most interestingly, against fierce action from regulators for greater transparency and oversight within the fiduciary management market, the research found that when looking at performance of a provider, 87 per cent of schemes noted they prefer to take an individual approach, where they measure the performance of the fiduciary provider relative to their scheme's specific requirements rather than a general approach.

Trustees are already showing signs of seeking independent bodies to help with the oversight of their fiduciary managers, and in the meantime, as Aon Hewitt partner Sion Cole concludes: "No two pension schemes are the same. Therefore, it is important when implementing a fiduciary solution, that trustees make sure that their provider creates a bespoke benchmark that accurately reflects their precise objectives and their unique liability profile.

"It is key that performance is shown clearly versus this benchmark and that trustees have a full breakdown of what is behind that performance."

Written by Lauren Weymouth, a freelance journalist

In association with

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Rising up to the challenge

Summary
- Once avoided because of a fear of damaging returns, now not incorporating some kind of ESG strategy could leave pension funds exposed to risks.
- There has been an increase in pension funds facing pressure from government, campaign groups and members to divest from certain asset classes.
- However, incorporating more long-term ESG policies is gaining traction, with pension funds also taking on more of a stewardship role to manage risks.
- Each fund will differ in their ESG priorities based on varying factors.

As environmental, social and governance issues rise up the global investment agenda, Natalie Tuck looks at the pressures on pension funds to invest responsibly

Several years ago, the motives for taking an environmental, social and governance (ESG) approach to investments were largely based on ethics and morals, perhaps because there was a view from pension funds that responsible investing would damage returns.

Funds were encouraged to take the lead in the area, even by Prince Charles, who, at the National Association for Pension Funds' (now PLSA) 2013 conference, told the industry the world is facing a "perfect storm" of resource scarcity, climate change, and financial stress, stating that pension funds have "a need, and arguably a duty" to ensure these risks are managed. But as far as pension funds were concerned, there was risk involved with ESG.

Fast forward to 2017 and the pensions industry has, rather like a climate change, warmed to the idea of ESG investments. Pensions and Lifetime Savings Association policy lead for stewardship and corporate governance Luke Hildyard notes that pension funds are moving beyond the debate about whether or not the environmental and social impact of their investments impact long-term returns, and instead the conversation is moving onto what they should do to manage it.

In the past few years, the motives have changed, the pressures have increased; where there was once a risk of damaging returns, there is now a risk that by not investing responsibly you could damage long-term returns. KBI Global Investors chief economist Eoin Fahy says that using ESG investments is now for a large part about managing risks, adding reputational risks to the list.

However, reputational risks are more likely to concern local government pension scheme funds because of Freedom of Information requests, says Squire Patton Boggs pensions partner Clifford Sims.

For other schemes, there could be industry-specific reasons to avoid a certain investment, such as those within the health sector, which are unlikely to invest in the tobacco industry. Campaign groups also target corporate schemes in certain sectors and influence members through the media. When it comes from the member, it tends to be individual members, says Sackers associate director Ralph McClelland.

"The more sophisticated members will start out by asking questions about the scheme's policies and strategy. The more information the member has, the more detailed (and time consuming for the trustees) their questions can become. It is very easy to provide a copy of the scheme's statement of investment principles but much more work is involved in, for example, compiling and sending on very detailed information about the voting records of the scheme's managers or information about carbon footprints," he says.

However, Bfinance senior director Richard Tyszkiewicz notes that there has been a shift away from basic negative screening to clients looking at ESG as a positive long-term investment strategy. Tyszkiewicz says he has seen interest in unlisted infrastructure funds focused on renewables. In addition, Fahy notes there has been an 'explosion' of interest in alternative energy and water.

ESG issues and three (excluding major natural disasters) can definitely be classed as climate change risks. For comparison, going back almost a decade to 2008, the biggest risk was asset price collapse, followed by, retrenchment from globalisation, the slowing Chinese economy, oil and gas price spike and pandemics. It is perhaps unsurprising that pension funds have shifted their attitude to climate change as it has climbed up the global agenda.

However, a recent report by the PLSA on ESG risks within defined contribution default funds found that these schemes should be more concerned with other areas. In a typical default fund, human capital, business ethics, product safety and data privacy and security stand out as the most material ESG issues based on portfolios, despite not receiving as much coverage as climate change.

"Some of our clients are also looking at adding impact investing to their listed equity portfolios as it's seen as the next logical step down the ESG road. The challenge is to maintain adequate financial performance alongside the non-financial aims, as well as measuring the actual impact achieved," Tyszkiewicz adds.

Key themes within ESG

A report by Bfinance noted that certain institutions place more importance on specific sub-themes within the ESG spectrum, most notably climate change. Most certainly, out of all the themes within ESG, such as tobacco, arms manufacturing and adult entertainment to name a few, climate change receives the most attention globally.

At the recent World Economic Forum in Davos, political and business leaders classified the biggest risks for 2017. These are weapons of mass destruction, extreme weather events, water crises, major natural disasters and failure of climate change mitigation and adaptation.

Notably, all of these are related to

Funds also look to the United Nations Global Compact or PRI principles as a basis for their ESG guidelines, explains Tyszkiewicz. However, he adds that for many, it will be based on the underlying business or where the member base has a strong influence.

Taking an active approach

With added risk surrounding pension fund investments, there is a need for funds to take a more active approach to the management of that risk. McClelland notes that trustees are faced with the question of whether to take on a stewardship role and influence businesses or whether it is safer to divest.

In the area of divestment, Squire Patton Boggs pensions partner Clifford Sims says there has been an increase, particularly in the local government pension scheme, for disinvestment in fossil fuels in the last couple of years.

However, PLSA research reveals that a growing number of schemes are incorporating voting and engagement practices are becoming a part of an overarching integration process. The PLSA explains that stewardship strategies typically involve two components: engaging with investee companies to encourage (more) responsible social and environmental practices, and developing proxy voting guidelines that cover environmental and social (in addition to corporate governance) issues.

This increase in interest has been aided by a progressive regulatory and policy environment, which includes the publication of the UK Stewardship Code and the Kay report, as well as codes and guidelines developed by industry and civil society, such as the PLSA's annually updated corporate governance policy and voting guidelines.

"Shareholder engagement is more common that straightforward divestment", says Sims, stating that it can be more efficient "behind closed doors". "Even then the largest schemes will use collective bargaining power via their managers to promote changes in, for example, executive pay," he adds.

Whatever they choose to do, trustees are primarily responsible for setting the schemes investment principles, beliefs and strategy, says McClelland. "They also have a key role in that they will make decisions about allocation of assets between different types of asset and the selection of the managers within each allocation. Alongside this, they must make a decision about the role of ESG type issues and how those beliefs fit in to the strategy as a whole. The expression of the trustee's ESG beliefs will, to some extent, be determined by how their assets are allocated and the types of manager they have appointed."

As Prince Charles noted, pension funds do have a 'need' to address ESG risks, especially since in the years following his comments the risks surrounding ESG have increased for schemes. However, it seems with increased levels of stewardship, pension funds are rising up to the challenge.

Written by Natalie Tuck

Being clear

Andy Agathangelou reveals the many ways that fee opacity is negatively impacting upon the pensions industry, and why industry-wide improvements need to occur

The FCA is not at all content with the status quo; and it's right not to be. The FCA's *Asset Management Market Study Interim Report* is as hard-hitting as it is truthful; it is a scathing exposé of the failings of the asset management sector. For instance, it states: "The evidence suggests there is weak price competition in a number of areas of the asset management industry. This has a material impact on the investment returns of investors through their payments for asset management services.…We think further investigation is therefore needed, which is why we are consulting on making a market investigation reference to the Competition & Markets Authority on the investment consultancy market."

It is perfectly clear from the FCA's market study and its consultation paper 16/30 *(Transaction Costs in Workplace Pensions)* that it is concerned about costs. Only when there is full transparency on costs and charges will the 'invisible hand' of market forces working as they ought to.

This article seeks to shine a light on why fee transparency is particularly important in pensions.

It isn't just asset management where greater fee transparency is needed

If we think of the pensions industry as a car, with the asset management sector being the car's engine, we also have a drive-train, brakes, suspension etc. to think about, i.e. the pension providers, platforms, advisers, actuaries, administration companies and so on. The pensions industry is full of 'moving parts' that need paying for and the sum total is too expensive. Fee opacity is a pervasive problem in pensions; we desperately need more transparency in all areas.

Albert Einstein and compound interest

Einstein's claim that 'compound interest is the most powerful force in the universe' is usually referred to when explaining the wonderfully beneficial effect that time has on the growth of investments, i.e. the money that money earns, earns money. But the point is equally valid when thinking about the corrosive effect of fees on outcomes, as shown in Figure 1.

It is the very long-term nature of pensions investing that makes it especially sensitive to costs. That is why achieving greater fee transparency is particularly important to pensions.

Do costs matter to DB?

Yes, they most certainly do. They matter to members because high costs increase the risk of pension benefits being diluted by the sponsor; and of course they reduce the 'total reward budget' available to them for other benefits too, including salary increases. They matter to the sponsor because they may jeopardise their commercial viability. Think BHS – I wonder whether the highly-publicised lack of governance in that scheme stretched into poor cost control; and what the effect of excessive costs may have been on deficit levels over the life of the scheme. If I were an investigative actuary I'd do some maths on that…and then talk to a forensic accountant.

It is a complete fallacy to think that fee transparency doesn't matter to DB schemes.

The success of automatic enrolment is not yet assured

It is too early to claim that auto-enrolment is a policy success – we should assess success/failure on AE when contribution rates are at their peak, because if opt outs rise sharply the strategy is fundamentally flawed. Many factors could drive a mass exodus from schemes, including whether they represent value for money, and they won't

Figure 1:

Assumptions:

A 20-year-old saves £400 per month into a pension until 65.
The Gross Market Return (i.e. before any costs) is 5% p.a.
All costs = 2% per annum.

Outcomes:

Total fund at age 65 if there were no charges at all = £787,167
Total fund at age 65 after charges = £452,255
Amount of fund lost to charges = £334,912

➢ **Percentage of fund lost to charges = 42.55%**

if we have persistent low returns and high charges. I dread what might happen when auto-enrolled members look at their pension statements in years to come, especially once the media picks up on yet-more 'pension rip-off' stories.

Litigators love losses

If you're involved with a pension scheme I urge you to look into the class action litigation taking place in the USA (see *Jerome, Schlichter & Denton*, amongst others) to get a feel for what might happen here.

I suspect issues such as closet trackers, stock lending, soft commissions, inappropriate benchmarks, foreign exchange market practices, invoicing irregularities, unjustified roundings, dark pools, unfair contract terms, undeclared income, unresolved conflicts of interest, failure of fiduciary duties, transaction costs generally and portfolio turnover specifically are all topics that might keep British lawyers busy in years to come.

Greater transparency is urgently needed in all these areas. Just think about closet trackers as one example, as it's an area the FCA has righty picked up on. It has said: "There is around £109 billion in expensive funds that closely mirror the performance of the market (they have a tracking error below 1.5) and are considerably more expensive than passive funds." Scope for litigation?

Transparency, truthfulness and trustworthiness

Many people favour buy-to-lets over pensions because they do not trust pensions. But it isn't just landlords that feel that way. The pensions brand is so tarnished that some in the industry believe the word 'pension' should be dropped altogether. One wonders how much of the Treasury's apparent non-support for pensions is because it has lost confidence in the reputation of the pensions industry as a whole.

Does LISA's seductive straightforwardness and immaculate reputation explain her appeal? Can the pensions industry have any hope of repairing the self-inflicted reputational damage that it has suffered for decades without achieving full fee transparency? – I think not; it's an absolute prerequisite if pensions are ever to become popular again.

Written by Andy Agathangelou, founding chair, the Transparency Task Force

PENSIONS Age

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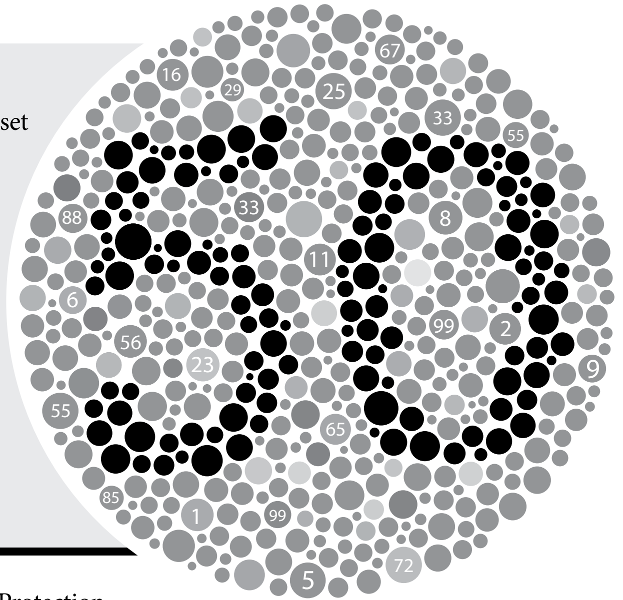
Summary
- Using gilts to calculate pension scheme deficits may be flawed, as the asset class has been depressed since 2008 and pension funds invest in many other asset classes. Trustees may also be overly prudent when estimating members' longevity.
- A quarter of schemes may return to surplus if an alternative approach to calculating deficits was adopted. Options include basing future growth forecasts on inflation or basing discount rates on the assets in which the scheme invests.
- To prevent a swing from overly prudent to unnecessarily reckless, consultants recommend trustees focus on TPR's integrated risk management framework.
- As there are different ways to calculate liabilities, sensible dialogue between trustees the sponsor is required.



Fifty shades of grey

Gill Wadsworth reveals the difficulties of accurately determining pension scheme deficits

There is no affordability issue for defined benefit pension schemes. This was the controversial view put forward by The Pensions Regulator's executive director Andrew Warwick-Thompson in defence of what appears to be the endless downward spiral for UK final salary deficits.

Even in the face of the BHS pension debacle, which saw sponsors fail to take responsibility for a multi-million pound pension deficit, Warwick-Thompson says the majority of employers can afford to plug the gap in their DB plans – which stands at £223.9 billion at the last count in December by the Pension Protection Fund.

An accurate picture?

Warwick-Thompson says the multi-billion pound deficit figures are based on bonds yields, which do not fairly represent the true funding picture since the asset class has been depressed since the 2008 financial crisis.

In January, Barclays Equity Research reported that real bond yields remain in negative territory at -80 basis points (bps); a fall from 60bps in June last year.

Barclays says that 'using a very approximate rule of thumb' a 10bps reduction in the real discount rate increases pension obligations by 1.5 per cent, meaning liabilities can be expected to have increased by roughly 6 per cent since 30 June 2016.

BlackRock head of UK strategic clients Andy Tunningley says: "For UK pension schemes, 2016 was like a marathon on a treadmill. Energy was spent, pain incurred, but the finish line looked upsettingly similar to the starting post. The PPF 7800's aggregate funding ratio yo-yoed all year – at the mercy of wildly-fluctuating bond yields – and ended back near where it started."

Warwick-Thomson argues that all this yo-yoing means pension schemes should abandon bonds and gilts as a discount rate for liabilities. Instead they should base assumptions on the asset classes in which they actually invest, such as equities, infrastructure and property, which are less sensitive to central bank economic policies such as quantitative easing.

In a blog posted in September last year, Warwick-Thomson states: "A pension scheme does not have to invest only in bonds, but has great flexibility to diversify its investments across a wide variety of asset classes. As the returns on these assets are generally anticipated to be higher than the yields on bonds, the discount rate used to calculate the scheme-specific deficit will be higher too, and the deficit correspondingly lower. The real scheme data doesn't show there is a systemic DB affordability issue."

There is a growing consensus that using the gilt to discount liabilities is flawed.

Alternative approaches

Research from Punter Southall Transaction Services (PSTS) finds that a quarter of UK schemes would return to surplus if they adopted an alternative approach.

PSTS principal Richard Jones says: "Depending on your long-term objectives and positioning, gilts-plus may be a perfectly suitable approach. However for some schemes alternative

methods may prove to be a better option and would likely have a dramatic impact on funding levels and employer contributions."

PTST proposes dropping a gilts-plus approach in favour of basing future growth forecasts on inflation. This would assume a return from equities based on the current rate of inflation.

The second approach PSTS suggest is 'intrinsic value', which would base discount rates on the assets in which the scheme invests instead rather than on the bond markets.

Jones says adopting an alternative approach could see scheme's liabilities drop by 10 per cent, which would pull approximately one quarter of the country's DB schemes back into surplus, while another 25 per cent of schemes would see their deficit reduced by half.

Taking greater account of inflation in measuring liabilities is gaining importance as we move into a reflationary environment, which puts pressure on assets.

Research from consultant Mercer found that although bond yields had improved marginally at the start of this year, a fall in asset values nullified any positive impact on funding; an outcome that will be exacerbated by rising inflation this year.

Mercer UK DB risk leader Alan Baker says: "The positive effects of a reduction in liabilities of £3 billion were offset by a drop in asset values of £6 billion. There are real concerns as we move forward into 2017, particularly around inflation."

Discount rates are not the only element trustees might need to rethink if they are to get a better picture of the scheme's true funding level.

Longevity

Hymans Robertson says research from its specialist longevity consultancy Club Vita shows trustees are being overly prudent when it comes to calculating how long members will live.

Club Vita founder Douglas Anderson says schemes are overvaluing liabilities by 1 per cent, which amounts to a collective deficit of £25 billion.

Anderson blames a lack of data for these conservative assumptions, and instead recommends painting a more accurate picture of longevity based on member information.

"By pooling scheme data we are picking up more information on longevity based on members' post codes and their salaries at point of retirement. This data gives a much more predictive model of longevity than what we have previously used in the industry," Anderson says.

Both PSTS and Club Vita's approaches essentially allow sponsors more wriggle room when it comes to deciding on a recovery plan; something TPR must support as part of its statutory objectives.

Relaxation levels

A less prudent approach to funding plans is obviously good news for sponsors anxious to avoid throwing more company profits into the pension scheme, but trustees could be left vulnerable if assumptions are relaxed too far.

Jones says: "Due to the budgeting nature of a valuation, using a higher discount rate means that the scheme is asking for less money from the employer and therefore taking more risk that the employer will not be able to make good any deficit in the future should the discount rate view prove erroneous."

To prevent a swing from overly prudent to unnecessarily reckless, consultants recommend trustees focus on TPR's integrated risk management framework (IRM) which was introduced at the end of 2015.

IRM encourages schemes to look at all the elements that introduce risk to a scheme – including employer covenant, funding and investment – and consider these holistically when deciding the scheme's objective.

Baker says: "The regulator's IRM framework is crucial to developing the right plans and framework to deal with choppy waters ahead."

Jones agrees and says trustees should have "a full IRM plan in place, detailing what actions they would take to correct the position in the event that the discount rate needs altering in the future, before schemes implement any changes in their approach to the discount rate".

Negotiations

Whichever discount rate and longevity assumptions a trustee favours, their negotiations with the employer will be key in securing the scheme's financial future.

Independent trustee firm Capital Cranfield client director Andy Scott says since there are no right answers when it comes to calculating liabilities, sensible dialogue between all parties matters.

Scott says: "Deciding funding plans needs both sides *[employer and trustee]* to have a balance. The trustees need to be responsible for members but they must also appreciate the sponsor's positon and vice versa."

But there are those that feel the potentially-conflicting objectives of trustees, who want to protect members' benefits, and sponsors, who want to protect the company, require more definitive guidance from TPR on how to calculate funding levels.

Lane Clark & Peacock partner Bob Scott says: "The regulator could prioritise one objective, such as protecting the sponsor or the PPF, and ensure this carried more weight in calculations. At the moment we don't have that clarity or guidance; assumptions are very flexible and require compromise."

The outcome of a DB green paper is looming, which may provide more clarity for trustees and sponsors looking for the best way to calculate scheme funding, but finding answers to such a complex and contentious area be hard. For now, at least, when it comes to calculating funding levels, trustees and sponsors will have to make do and mend.

Written by Gill Wadsworth, a freelance journalist

Summary

- The Retail Price Index (RPI) is around 0.7 to 1 percentage point a year higher than the Consumer Price Index (CPI) measure of inflation, only reversing if there is a housing crash.
- Currently there is a 'lottery' of schemes that can switch from RPI to CPI, based upon the wording of scheme rules.
- A scheme could save around 10-15 per cent of total liabilities by switching from RPI to CPI.
- A RPI-CPI switch may result in a larger pension for members than the one they would receive in the PPF.
- There is concern that if all schemes were able to switch indexation, companies may move to CPI and therefore reduce the amount pensioners receive, despite having been able to afford RPI indexation.

The final nail in the coffin for RPI?

Discredited by the Office for National Statistics, but hardwired into many scheme rules, will the government finally give all defined benefit schemes the chance to switch from RPI to CPI? David Rowley reports

Amid the heavily-regulated world of defined benefit pensions, the concept of a lottery for sponsors and employees is an oddity that you would expect to be ironed out sooner or later.

While the widespread use of the word 'lottery' to describe whether the wording of a scheme's rules enabled it to switch from a Retail Price Index (RPI) measure of revaluation to a less-generous Consumer Price Index (CPI) measure or not, is loaded.

When the coalition government decided to use CPI as the measure of price inflation for the purposes of regulating occupational pension schemes in 2010, it provided welcome relief to around half of British industry and to local authorities. The measure was a quick and untidy fix for an economy still reeling from the impact of the global financial crisis.

Six years on and many employers, and some trustees, are now looking for parity in their right to change too in the forthcoming green paper on DB pensions.

Reading between the lines, one detects more sympathy for employers than employees from the government on the issue. Here are the words pensions minister Richard Harrington used in a speech to a Trade Union Congress conference on pensions in London on 1 February:

"Some employers think it is unfair, some employees think it is unfair. I am open minded, it has to be looked at. Hopefully some common sense can be applied to this. There was not the sophistication in those who were drafting the rules to say was it that inflation or another."

What might tip the scales in favour of change is the case of the deficit of the £15 billion British Steel Pension Scheme (BSPS) and the imperilled business of its sponsor Tata Steel. Its trustees are seeking one-off permission from the government to change the scheme rules on the basis that a switch to CPI would keep the scheme from entering the Pension Protection Fund (PPF), where members

benefits would be more severely cut.

An open letter from the trustee board of the BSPS on 27 January reads:

"If the only alternative is TSUK insolvency, the trustee would wish to agree separation terms that offer members a choice between staying in the BSPS (and so getting PPF compensation) and transferring to a new scheme that would provide modified benefits. For the vast majority of members and pensioners, these modified benefits would be better than PPF compensation."

The dilemma faced by the trustees of BSPS has posed the question on whether an override to scheme rules should only take place for schemes that would otherwise imminently enter the PPF.

This is the compromise that unions would like in their submissions to government on the matter.

That other trustees feel this way is revealed by Norton Rose associate Julia Ward. "Trustees are not always opposed to it, this is a way they can reduce liabilities and strengthen the health of the scheme," she says. "We have been asked by a few clients to see if it was possible."

Unions, though, only want the government to go so far. Association of Member Nominated Trustees co-chair and BECTU member Janice Turner says: "We know that there are pension schemes where companies are doing incredibly well and yet companies still want to close the pension schemes. If there was a power to reduce these liabilities, these promises, then to what degree are companies going to take advantage of that? That is a real worry."

One of the counter arguments expected to be used by employers is that a company with a DB scheme that can switch to CPI will have a competitive advantage over a company in the same sector that still has RPI.

Savings and losses

So how much could a scheme save by switching from RPI to CPI? Mercer partner Deborah Cooper says it could be in the region of 10-15 per cent of total liabilities for each scheme.

The figure will depend on the age of members, their length of service and accrual rates. "Not everyone would have had the same windfall gains," she says. "The extent to which it is a material bonus will depend on how big their scheme is and how big the deficit is."

One scheme where it has made a big difference is the National Milk Records pension fund, which cut its overall pension deficit from £9.7 million to £3.5 million by moving from RPI to CPI in 2015.

These figures could all change if interest rates rise. Various estimates put the difference between RPI and CPI at around 0.7 to 1 percentage point a year, only reversing if there is a housing crash, but as RPI is linked to interest rates, these calculations could widen if the Bank of England decided to increase interest rates.

This perhaps explains why various forecasts of a full CPI switch for all schemes are so different. Punter Southall estimated in late 2016 that UK firms could save £100 billion, while Hymans Robertson, in evidence to government, put the figure at £175 billion and at an average loss for members of £20,000 over the course of their retirement.

Legal

If the government's green paper does not permit full access for schemes to switch to CPI, then the courts will continue to be a source of redress wherever there is an element of ambiguity in the original wording around inflation increases.

The case law so far shows that a switch to CPI is not contrary to section 67. However, November's unsatisfactory 2:1 Court of Appeal verdict in the bid by the trustees of the Barnardo's pension scheme to have its scheme rules ('the general index of retail prices or any replacement adopted by the trustees') decided in favour of a switch to CPI is likely to lead to further legal action.

The basis of such legal cases have been encouraged by disparaging remarks made about RPI by the Office for National Statistics.

In March 2016 the National Statistician wrote: "I believe that the RPI is not a good measure of inflation and does not realistically have the potential to become one. I strongly discourage the use of RPI as a measure of inflation as there are far superior alternatives."

Telling members

Whatever the consequence of the government's green paper, any trustee attempting to switch to CPI will have a delicate communications exercise ahead of them.

Ward says a minimum 60 days consultation is needed to enable members to understand the reasons for the change and the consequences. Feedback from members must be factored into any final decision.

In the experience of pension communications specialists AHC head of client services UK and Australia Karen Partridge, her firm gets hired to do such communication whenever it is part of a wider set of changes.

When this happens she finds an indexation switch is usually not the main issue.

"Certainly we get feedback about RPI to CPI in consultations, but I would say it is not the most emotive of changes." Closing the DB scheme to future accrual tends to be a bigger blow for members.

She advises employers on how to pitch such communication.

"There is a need for honesty and openness, employers should not express opinion but let people investigate for themselves."

Willis Towers Watson senior consultant David Robbins says that one route for employers to take is to point out that RPI has been discredited in the eyes of many statisticians. Indeed, CPI is the preferred measure of the Office for National Statistics, not least as it has become an internationally-accepted measure of inflation.

Providing in-scheme drawdown: Thomson Reuters case study

Laura Blows speaks to Thomson Reuters' head of EMEA and APAC benefits, Matthew Webb, about how, and why, it was decided to provide a drawdown service within the scheme to members

Please could you provide details of Thomson Reuters' pension scheme?
There is a trust-based DC plan for Thomson Reuters. Currently we have just under 5,000 active employees and just over 7,000 deferreds. We are a touch below £500 million in assets under management. We offer 18 different investment fund choices within the plan. We use the Fidelity platform for this and we use Capita as our administrators. So it's a fairly classic DC plan.

How did you first contemplate offering drawdown within the scheme?
In 2014, when it was first mooted that the pension flexibilities would be available, our company had just come out with a new set of purpose and values. These were trust, partnership, innovation and performance. Our purpose statement is that we are trusted for the decisions that matter most, empowering customers to act with confidence in a complex world.

With that purpose and values in mind, it made us think that we should really look at offering drawdown seriously. So we had our consultant do a membership pot size analysis. This was really interesting; back in June 2014 we had 10,000-10,500 members. Seventy per cent of their pot sizes were below £30,000.

The consultant then made some assumptions in terms of future investment returns and contributions for that population. It found that by the time the members reached retirement, two thirds would have a pot size of over £50,000 and quite a lot with over £100,000. So the pot-size analysis, together with the purpose and values, started to point towards drawdown being quite interesting for our membership.

We did a pros and cons analysis and came up with three reasons why we should be offering drawdown within the fund. Those were cost, continuity and convenience.

On the cost side, we felt it would be more cost effective for members to remain in the scheme, rather than having to transfer out and go into a retail arrangement.

Continuity was with regards to long-term investment and strategy planning, and continued investment in institutional funds.

Regarding convenience, we know how many people default because they don't like to make decisions. Drawdown provides the convenience of the new flexibilities without having to transfer out.

Those were the three reasons that we put forward and it's very much a trustee and company combined approach. So those were the reasons why we wanted to go ahead.

You mentioned drawing up a pros and cons list – what were the cons?
The challenges we considered was administrative complexity. Maybe the cost would be prohibitive, but when we looked into that, cost actually became a pro rather than a con.

Obviously there is the risk of continued paternalism. Also, one of the risks that the trustees were worried about, and to some extent they still are, is the risk of cognitive decline when members get older.

When we looked at the pros and the cons, we felt if the company/trustee can offer this at no additional cost to the company, why wouldn't we? There was no, we felt, insurmountable reason why we shouldn't be providing it.

What was the process for setting up drawdown within the scheme?
We put a working group together of the company and trustee representatives, the administrator, the legal consultant to the trustee and the investment consultant. Then it was really just a matter of working through the regulations and deciding how administratively to put the drawdown option together.

It also involved some policy design and a legal review as to whether rules and trust deeds needed changing. We needed to work through the administrative and communications process, and then decide on whether it would be flexi-access drawdown or UFPLS *[Uncrystallised Funds Pension Lump Sum]* or a combination.

The trustees wanted to make it fairly simplified. For people with large pots who had quite complicated investment strategies, the SIPP route would always be a possibility and maybe preferable for them, but our offering was for people who wanted to keep the access of their retirement savings fairly straightforward and simple.

The cost structure was fairly straightforward. There is a one-off admin cost for going into drawdown and then it's an annual charge. For that members are able to make an annual election and can change that election once a year at no further cost. If they wanted to change it on a more frequent basis, that's when additional costs would start to come in. The membership pot analysis was done in June 2014 and we launched the drawdown option in November 2015, so the process took about 15 months.

Was the company on board with the idea of offering drawdown, or did it take some convincing?

Our company is US headquartered and when you look at 401(k) in the US, they're actually fairly familiar with the idea of drawdown. It's not a new concept for them, so there was no real pushback or difficulty with the company.

Were there any hurdles while putting drawdown into place that maybe you didn't anticipate?

The biggest one was the legal side. There was a real caution from the legal advisers and therefore, the trustees. At the time, in that 2014-2015 period, it was very unknown as to where the regulatory regime was going to go regarding advice. Around April 2015, it was confirmed that the advice requirement for people drawing down from an occupational trust would be a light-touch regime, rather than the full retail, FCA-based advice requirement.

Until that point, there was a real caution about whether, as an occupational trust, we could or should be doing this without formal advice being given to everybody. That would have been a barrier.

A year on from the launch, what have been the benefits of offering drawdown?

Like a lot of DC plans, we don't have a lot of retirees at the moment. It's fairly young, in terms of the membership, scheme. So we don't have lots of people going through that retirement process. Instead, this was, for us, a long-term sustainable policy design.

We were looking at some stats a couple of months ago with the trustees, and of the approximately 30 people who have retired, nobody has bought an annuity directly from their funds since drawdown has been an option.

Of the people that have taken their benefits, I think we've had about two thirds take the UFPLS option and about a third take the flexi-access drawdown option.

There's a bit of a mix between members not taking any funds, and just leaving their money in the pot, and actually drawing down income on a regular basis.

Our view is at the moment these people who are moving into retirement have probably got other retirement benefits as well. They're at that age where this wouldn't be the major part of their retirement funds. Either it's a top up or it's an add on to other DB benefits they have.

Have there been any knock-on effects of offering drawdown?

Yes, a couple of things. The trustees were quite keen that if we were going to put this in place, then we also think about an education strategy. So we worked with a third-party financial education company and put in place a process whereby, as members reach age 50, they're invited to a seminar that explains the options at retirement. More details are provided at age 55 as well.

In addition to that, we introduced a new pension modeller that incorporates drawdown. So for younger people as well, we felt it was important that the modeller includes drawdown as well as the normal things that a modeller includes.

This year the trustee is looking at its default investment strategy, because we feel drawdown will be the default for the majority of members, so the investment strategy has to reflect that.

Thomson Reuters is quite unique in offering this in-scheme drawdown. Why do you think it's still so rare for companies to offer this?

It's an interesting one. I've got a cynical response and a politically-correct response. The politically-correct response is those challenges that we talked about, such as the administrative complexity – why would a plan take that on if it didn't have to? That's an argument, I understand that. Plus members' cognitive decline risk; do we really want members to be responsible for financial decisions into their 80s and 90s?

I think a lot of companies are sat on the fence and the whole master-trust solution looks very attractive to them. Certainly for smaller sized funds, it might make more sense to go down the master-trust route for economy of scale.

But our point was to come looking at this from the members' perspective, looking at what's best for the members. So my view would be that people in positions of responsibility for these funds need to be a bit braver.

Written by Laura Blows

THOMSON REUTERS®

Summary
- With upcoming pension contribution increases, the industry must ask when, how and what will be the effect of increased contribution rates?
- The effects of economic and political uncertainties along with increased contributions could lead to higher opt-out rates.
- Communication is essential for members to recognise the importance of greater pension saving.
- Auto-escalation and/or a Save More Tomorrow approach could be effective to increase pension contributions beyond set rates.
- The establishment of a long-term savings culture is necessary to move away from a potential savings crisis.

The next step

As auto-enrolment becomes the norm, Talya Misiri considers how employers could increase contribution rates in the volatile financial climate

There is a great deficit when it comes to pension savings, and this is not in reference to DB funds' shortcomings. It is a known fact, industry-wide, that people are not saving enough.

While the government's auto-enrolment drive continues to reach new heights in terms of successfully enrolled pension scheme members and employers, savings figures are nowhere near where they need to be to ensure a comfortable retirement.

From April 2018, auto-enrolment will begin to take the next step to begin to tackle low pension savings. Minimum pension contributions are set to increase from the current 2 per cent to 5 per cent, with a contribution of at least 2 per cent from employers.

A further increase is projected for the same time a year on, April 2019, to 8 per cent, including a 3 per cent employer contribution.

Charles Stanley Direct pensions and investments analyst Rob Morgan states: "It is necessary for contributions to increase to help mitigate a widespread savings crisis."

For this to be achieved, however, the industry must ask: when, how and what will be the effect of increased contribution rates?

Uncertainties

A potential conflict could arise when the planned increases to pension contributions coincide with the UK's oncoming separation from the EU. Brexit is expected to lead to growing inflation and so a fall in the value of the pound. With this, salaries are simultaneously expected to remain stagnant or increase only slightly. As a result, it is likely that people who are already struggling financially may not be able keep up with increased sums being transferred from their pay into their pension pot.

Society of Pension Professionals president and Spence & Partners director Hugh Nolan explains that volatile markets could "lead to higher opt-out rates and undermine the success of AE to date".

Essentially, pension saving may take a back seat on individuals' priority lists, with both volatile markets and increased contributions potentially leading to escalating opt-out rates.

Although opt-out rates from workplace pensions have been relatively lower than predicted, currently at around 10 per cent, there are concerns that a percentage of auto-enrolled savers

may choose to leave the scheme when contributions are upped.

An active approach into tackling this possibility could be the introduction of an 'opt-down' option for those who cannot afford to keep up with increases. Nolan says: "I would prefer to see an 'opt-down' approach, where members who choose to opt-out following the increase are initially kept in the scheme at the old contribution rate."

Despite this, the industry cannot allow for more delays as this will only mean jeopardising and postponing increased pension savings that could make a significant impact on individuals' lives in the future. It can be argued that there will always be a reason as to why it is not the 'right time' to increase contributions. The fact that increased contributions have already been postponed from the originally proposed 2017 date is likely to mean that most employers and well-informed members should feel more prepared to put slightly larger amounts of money into their savings. Some will even be planning to, or are already paying above minimum contribution rates through agreed salary sacrifice methods, although this may not be affordable for all.

If current figures are a reflection of what's to come, however, it is possible to argue that: if backed up by a strong saving message and increased gradually rather than dramatically, then low opt-out rates could persist.

State Street Global Advisors senior DC strategist Alistair Byrne says: "Opt-out rates will certainly rise as contribution rates are put up, but evidence to date on the power of inertia suggests the rise in opt-outs won't be large."

The challenge now, JLT Employee Benefits head of technical John Wilson notes, is "to get more people talking about their pensions in the same way that those in American and Australia have conversations about their 401ks and Supers".

Communication is key

Communication is certainly a key tool to both ensure that savers are made aware well in advance so that they are prepared for oncoming contribution changes and to recognise the value of saving into a pension.

Zurich head of corporate fund propositions Martin Palmer notes: "We should also be looking at engaging people to save by helping them to understand the value of a pension, and the importance of building up a nest egg for retirement."

Greater communications with pension scheme members, therefore, is an essential tool to enable more savers to enjoy a comfortable retirement. According to research conducted by Prudential Retirement in June 2016, more than half, 51 per cent, of auto-enrolled savers felt that they could contribute more to their pensions each month. This could perhaps indicate that more people are becoming aware of the need to up their pension savings and so are more prepared to increase their contributions.

Furthermore, it is important that along with internal communications provided by employers and pension providers, that members are informed of other forms of assistance available to them. Greater information can be obtained by The Pensions Advisory Service or the government's Pension Wise service, as both can provide impartial guidance to scheme members. The planned single advice body is also likely to play a key role in assisting members and spreading the savings message further when it is introduced.

As greater changes are made, these bodies are likely to be of more use to members deciding on how best to organise their savings and for employers looking for advice on how to instigate increased contributions to their workplace schemes.

Sustainable escalation

One way in which contributions can be slowly and sustainably increased further is through auto-escalation, whereby pension schemes incorporate automatic increases on a set date at regular intervals into their design. Similar to the Save More Tomorrow approach used in the US, auto-escalation would see contributions automatically increase at a set date, for example annually.

A Save More Tomorrow approach could also become a possibility in the UK pension savings landscape once the economy stabilises and members agree that it is financially viable. It is suggested that an ideal date to increase contribution levels is at the time of annual salary reviews and pay rises.

This would involve taking a proportion of every pay rise workers receive to add to their pension contributions, unless they choose to opt out.

Looking further to the future, it is important to make members aware that the planned 8 per cent contribution rate is not the cut-off for a sustainable pension. "We must be very careful that this figure isn't perceived as the top contribution," BlackRock head of UK DC Claire Finn warns.

Despite political and economic instability, auto-enrolment has largely survived and been a success to date, and with greater communications most members are likely to come to terms with the long-term benefit of increased contributions. As a result, Royal London business development manager Jamie Clark states: "Not only should we not even think about any delay in the increase of AE contributions in 2018, but we should be urgently planning beyond 2019."

"To engender a meaningful shift towards a long-term savings culture, we need to employ best engagement practices alongside targeted incentives," Legal & General Investment Management head of DC client solutions Simon Chinnery adds.

Summary
• There are mixed reports as to the number of members deciding to transfer out of their DB scheme. Those members with the biggest DB pots are often most open to considering their options.
• Explaining whether a transfer may or may not be in the member's best interests can be difficult, as it depends on so many individual factors.
• Financial advice can help ensure members make the most appropriate decision for their circumstances when deciding whether to transfer out of their DB scheme.
• A partial transfer could give a member a one-off lump sum, whilst leaving some of it in DB, giving them a secure lifetime income.

Time for a transfer?

Following transfer values reaching record highs, Louise Farrand asks if this has led to a surge of members moving their money from DB to DC schemes

The start of a revolution, or a storm in a teacup? Statistics about people's appetite for defined benefit to defined contribution transfers present a mixed picture.

Only a very small proportion of those surveyed by the Pensions and Lifetime Savings Association (PLSA) were planning to transfer their money from their defined benefit (DB) pension scheme into a defined contribution (DC) scheme. A mere 3 per cent of people with DB pensions were planning to access their pension pot by the end of 2015, according to a survey by the PLSA in January 2016 *(Pension Freedoms: No More Normal)*.

Yet advisers are reporting a leap in enquiries from DB scheme members who are considering transferring their money. Selectapension, a pension and investment software provider, reported a 66 per cent increase in DB cases analysed by advisers and paraplanners in 2016, compared to 2015. In April 2016, advisers analysed 96 per cent more DB cases than in April 2015.

Transfer what?

The government introduced its freedom and choice policy in March 2014. In the past, DC savers were required to buy an annuity with their pension savings when they retired. Now, they are free to do what they want with their savings at retirement, whether that's taking them as cash, drawing their money over time whilst leaving some of it invested, or buying an annuity.

By contrast, members of DB schemes receive a guaranteed monthly income for life. Such schemes, whilst typically more generous than their DC counterparts, are less flexible. However, it's possible to transfer out of a DB scheme and into a DC scheme. Indeed, some DB scheme members are thinking about transferring their money into a DC scheme to give them more flexibility.

What accounts for the mixed reports? The fact that it's early days plays a big part. While consumers may be exploring their options, they are not necessarily ready to act.

Opinions on members' appetites for transfers vary from expert to expert. "Anecdotally, it seems it's a damp squib," says the Society of Pension Professionals president president Hugh Nolan. "There are various reasons for that. Not least is the fact that many people are stuck in inertia – they might have a lot of ideas but not quite get around to doing them. It's easier to take the pension from your pension scheme."

According to ITM executive chairman Duncan Howorth, the company has seen a growing interest in pension consolidation generally, "with members looking to gather their pots into one and being able to make better decisions".

Hymans Robertson head of consultancy Jon Hatchett thinks the reforms have had a big impact. "Take-up rates have doubled in the year post freedom and choice and they're up another 15 per cent now. But from a low starting point," he qualifies.

Hatchett continues: "We have also seen a real divergence between schemes. Those schemes who are actively

communicating with members about their choices are seeing much more activity than those who are doing very little.”

A difficult balance

Explaining the pros and cons of DB to DC transfers is not an easy tightrope to walk. Whether a transfer is in a member’s best interests depends on so many factors, from their general financial position to the terms of the transfer.

At present, with gilt yields low, transfer values look good value in general. “People tend to get very good value if they want to exit their DB scheme. This probably peaked towards end of last year and since then, transfer values have flattened out a bit,” says PLSA head of governance and investment Joe Dabrowski.

When it comes to explaining transfers to members, Hatchett thinks schemes should be straightforward and proactive. “The Financial Conduct Authority objective around freedom and choice is that customers should be given the right information, at the right time, to make decisions that are in their best interests. I think The Pensions Regulator ought to have a similar objective for trustees. Members should be given the right information, and that goes beyond telling them that they have a transfer value.”

Nolan adds: “It’s increasingly popular to quote a transfer value at retirement. That is a difficult balance to draw. Its right to tell your members about with it, but it’s easy to go from informing people to advertising options that might not be in their best interests. A good offering explained in the right way is fantastic.”

Sometimes, it’s a no-brainer to take the transfer. Nolan uses the example of a woman he spoke to when he was helping a client with a transfer exercise. “She had a pension of something like £15 a year that she could claim. We said, ‘if you want, you can have £300 instead’. To us it was just an admin issue of trying to clear people out of the scheme and not having to worry about keeping the records and tracing them when they are due to retire. She rang up and said ‘you have absolutely transformed my life with that money’.”

How? “She said: ‘I broke my glasses two weeks ago and I haven’t been able to afford another pair. I’m going to buy a pair first thing tomorrow and watch *EastEnders* and actually be able to see what’s going on’!”

For others, the decision to transfer

will be more complex. Nolan thinks of members in three tiers. The first tier is those with very small DB entitlements – in which case, it often makes sense to take the money as a lump sum, as the woman did in Nolan's example. The second tier have mid-sized pots. Their DB pot is typically a significant asset to them. Therefore, the choice of either cashing in all their money or keeping it in the DB scheme is a large one. Therefore, most are currently leaving it in their DB scheme.

Those with the biggest DB pots are often most open to considering their options. "For people at the top end, it's a great bit of flexibility," says Nolan.

People with weighty DB entitlements are often higher earners, who are typically more financially sophisticated. "This is the group who often want to release capital, and perhaps buy a buy-to-let property or pay off a big mortgage if they haven't done that already. They are likely to be more financially open to opportunities and able to take advantage of those," explains Nolan.

When advice is right

Schemes will be impacted in different ways if large numbers of members decide to transfer out, depending on the degree of investment risk they are taking, as well as the types of assets in which they are invested.

Even if it is advantageous for a DB scheme to see a mass exodus of members, the hope is that employers will be honourable in the way that they explain transfers.

For instance, Howorth says the main messages for schemes to communicate to members are for them to make a transfer decision based upon their personal circumstances and goals, and whether they can afford to take the risk that goes with losing the fixed annual income.

However, it would be very easy for companies to talk up the benefits of transferring out to members.

"Financial advice is the protection against that," says Nolan. "I'm hoping it will only be on the fringes of the industry, but you can imagine the desperate employer who happens to be the managing director and hired two of the trustees on the scheme; the member-nominated trustees are outvoted, and there's an aggressive attitude to trying to clear off liabilities that are less than the fair value to members. Members aren't in a position to judge that."

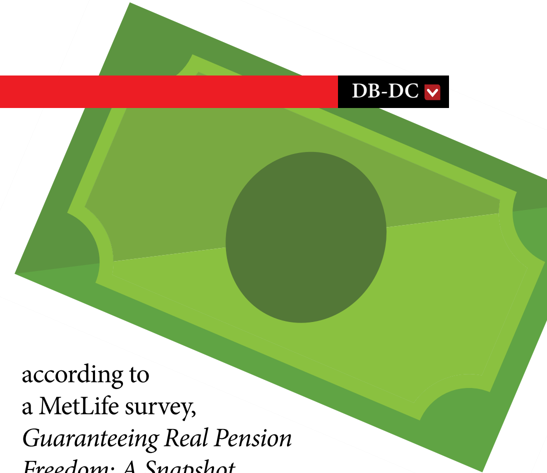
Yet some pensions consultants are concerned that there is a lack of suitably-qualified independent financial advisers (IFAs) who can help members who are pondering complex quandaries. Hatchett says: "It's hard in the retail space to find advice, and the advice is quite expensive because there's a high demand on advisers."

The issue has attracted the attention of the FCA, which published a note entitled *Advising on pension transfers – our expectations in January 2017*. The note cautions that IFAs should take a thorough approach to advising on pension transfers, considering the assets in which their clients' funds will be invested.

The note reads: "We are concerned that consumers receiving this advice are at risk of transferring into unsuitable investments or – worse – being scammed."

What members want

Ultimately, most retirees want security. Three quarters of over 45s agree that guaranteed income for life is important,



according to a MetLife survey, *Guaranteeing Real Pension Freedom: A Snapshot*.

That's why partial DB to DC transfers could give members the best of all worlds, say Nolan and Hatchett. A partial transfer could give a member a one-off lump sum, whilst leaving some of it in DB, giving them a secure lifetime income.

Nolan says: "Partial transfers haven't been embraced by the industry, but I think they are a definite possibility. If you give people the opportunity to take part of the money out and leave part of the money in, that's easier."

Hatchett adds: "People are very comfortable with the idea that people can commute cash at retirement. If it was straightforward to take a partial transfer, I think people would take it. It could be the best of all worlds: you get some cash, you get drawdown, and you get a partial DB pension."

At the moment, partial transfers are relatively nascent. Administrators and schemes are not always making them available to members. However, Hatchett is optimistic that this will change. "Technology has a big role to play in terms of education and communication. In the modern world, this is all doable."

Written by Louise Farrand, a freelance journalist

AE review: Looking beyond 2019

Bob Scott discusses why the AE review needs to result in action sooner rather than later

The DWP has recently sought views from a wide number of stakeholders with its 'initial questions' ahead of the 2017 automatic enrolment (AE) review. The questions asked were helpful in identifying some of the key areas that the review is likely to focus on – coverage of employees, engagement and contributions.

However, and this has already been picked up by Work & Pensions Select Committee chair Frank Field, on contributions post April-2019 the DWP paper notes: 'We do not expect to make policy recommendations in this area during 2017'.

I think that needs to be reconsidered, alongside the issues of AE coverage identified in the ACA's biennial *Smaller Firms' Pensions Survey*. We have conducted this survey of pension trends in businesses employing 249 or fewer people every second year since 1996; we published the 2016/17 survey in February of this year.

Welcome though auto-enrolment is in extending pension coverage to many more employees, the low level of contributions we found in our survey from employers and 'new' workplace pension scheme members is of great concern. Whilst holding costs down and careful investment is always important, by and large, sustained contributions at realistic levels are the most important element in delivering an acceptable income in retirement. We have a long way to go if this objective is to be met.

Policy pointers

There are three principal reasons why we believe pension policy needs to be reviewed in 2017 with smaller firms and their employees, who comprise 60 per cent of the UK private-sector labour force, particularly in need. The 2017 review of AE offers the opportunity to make a start.

First, the income level below which employees are excluded from AE is too high. This has meant a high number of employees in all sizes of firms have been excluded from enrolment. In fact, as at 31 January those ineligible for enrolment (6.5 million) are not far short of the numbers that have been added via AE (7.3 million). This survey points to those ineligible for auto-enrolment increasing to over eight million by 2018. When coupled with 4.8 million self-employed, the vast majority with no pension provision, we are looking at over 12 million people outside the AE tent.

Second, this problem is compounded by the ONS evidence that employee earnings are on average markedly lower in small firms and notably so where there are fewer than five employees. Here over 40 per cent earn below the level entitling them to be auto-enrolled. This means, without a policy change, we could reach the point where the final tranche of 750,000 firms to stage are being chased to register an AE scheme and meet compliance rules and costs to deliver up perhaps well under 750 million employees actually eligible and not 'opting out'.

Third, the increases in minimum pension contributions in April 2018 and 2019, with probably only modest increases in average earnings over the intervening period, suggest the government needs to consider whether they must budget for some national insurance or tax concessions to offset these sharp increases in costs. We make suggestions in our survey report as to how government might stimulate and protect AE by way of using some of the future expected reappraisal of pension tax relief (yes, we still expect further reforms) to boost the policy outcome.

Plan ahead

In the longer term, the ACA has advocated for many years that average pension and savings rates must increase so more people enjoy a comfortable income in part or full retirement – and hence we support such initiatives as auto-escalation and the extension of contributions to all earnings up to a ceiling. And, in the near-term, government may need to be pragmatic and, as an outcome of the AE review, radically simplify the compliance regime and offer some targeted financial incentives to help deliver the desired policy outcome of wider and deeper pension coverage in smaller firms.

The government needs to be very direct and honest with the public. The new state pension, whether triple or double locked, will not provide anything like an adequate retirement income for the vast majority of people. Without higher levels of private pension savings, very many people will continue to rely on other state benefits in retirement, the level of which and their persistency being very uncertain as we look ever farther ahead.

The consequences of widespread DB closures and the replacement of generous DB schemes with DC schemes at much lower contribution levels have yet to be felt as many retirees have DB provision for at least part of their service. But that may not still be the case in five years' time, which is why we urge the government to consider in the current review how it can build on the success of auto-enrolment post 2019.

Written by Association of Consulting Actuaries (ACA) chairman Bob Scott

Keeping things fair

Recent research has found that pensioner households are now better off than working-age families, due to home ownership, continued working and pension provision. However, future pensioners are warned not to expect the same levels of income as current pensioners. *Pensions Age* asks: What can be done to restore intergenerational fairness within pension provision?

"The recent headlines from research showing retired incomes having overtaken working-age group incomes were overstated. Calculations had used working-age income net of housing costs and the conclusion is invalid if these are added back in. Nonetheless the trend towards this outcome is correct and most analysts predict younger generations being, on average, worse off in retirement than their parents.

"Causes include withdrawal of DB pensions, paying for DB deficits, hopelessly low auto-enrolment rates, globalisation and automation impacting the job market, lack of housing supply and student fees. If a policy aim is to make current 20-40 year olds have retirement income of current 50-70 year olds then that is likely pie in the sky. The factors behind the trend are too large.

"Measures that could equalise this include means testing/reducing state pensions and abandoning the triple lock, plus steep increases in auto-enrolment contributions without a lower limit for qualifying earnings. Cutting back accrued DB benefits, higher taxes in retirement immediately, building a million new homes, writing off all student debt and a national minimum income for all would all help solve the issue."

PTL client director Colin Richardson

"One way to restore some intergenerational fairness within pension provision is to increase contributions that employers pay into workplace DC pension plans. The average contribution rate from FTSE 100 companies is around 10 per cent and this is often subject to the employee paying at least 5 per cent. Many employees are being auto-enrolled into plans and will receive just 1 per cent employer contribution, rising to 3 per cent after April 2019. This is in stark contrast to the employer contributions paid to support DB members. Whilst there is no appetite to resurrect DB schemes, perhaps over time employers should be encouraged to pay more into DC schemes to support younger generations save for their retirement."

Standard Life Investments investment director, UK institutional business, Andy Dickson

"To restore intergenerational fairness, the transfer of income in recent years from workers to pensioners should be reversed to the extent that a greater proportion of the overall tax revenue is contributed by pensioners. If accompanied by a significant increase in the proportion of additional income which accrues to workers being diverted into compulsory collective pension saving schemes, rather than more expensive personal pensions, we might achieve more fairness and less resentment between generations."

Aries Insight director Ian Neale

"A loosening or abolition of the annual allowance will, for some individuals, increase the attractiveness of pensions as a savings vehicle for later life. This should be coupled with markedly higher minimum contribution requirements for employers and employees, and potentially the removal of the ability to opt out of pension scheme membership. We shouldn't forget that the wealth of today's pensioners will be the inheritance of tomorrow's pensioners, so there will be some intergenerational transfer of wealth (less long-term care costs)."

Quantum Advisory Services partner Karen Kendall

"It is time for the government to recognise how important it is that pension regulation be considered in the context of long-term social and economic trends, rather than it be treated as a political football. Irrespective of how the government chooses to respond, the research highlights the underlying need for young people to develop a long-term financial plan as the future welfare state is unlikely to offer an alternative."

The Personal Finance Society CEO Keith Richards

"In a generation's time, there will be no defined benefit occupational pensions in the UK. These schemes are slowly, but surely, being replaced by defined contribution arrangements. This involves a transfer of risk (investment risk and longevity risk) from the employer to the employee. This means the younger generations are set to experience a more uncertain, and potentially less comfortable, retirement than their parents. Product innovation in the defined contribution area, and in particular in the new post-retirement/drawdown space, could help. New investment products that help younger generations with defined contribution pension schemes better manage investment and longevity risk may help to ensure that they also have comfortable retirements and do not run out of savings."

Commerzbank co-head of the pensions solutions team Joe Wicks

"Pensioners are not a homogeneous group. Most of the perceived unfairness between pensioners and those of working age relates to the incomes of the newly retired (early baby boomers), who rode the crest of the welfare state and final salary pensions: it seems unlikely that wave will reappear for some time. Older pensioners' pensions reflect their standard of living while in work, which was considerably lower than it is for those now entering the workforce.

"Perhaps a better question to ask is: 'why has pensioner affluence outpaced the working populations'? The answers include statutory indexation of pensions, but, more significantly, older people working for longer and owning property. Unless we propose to take people's jobs and homes away from them, the answers seem to be a reformed workplace, including more realistic minimum wages and controls on the distribution of wealth, and a more effective housing market."

Mercer UK retirement, innovation, policy and research team partner Deborah Cooper

"The most obvious target is the state pension triple lock, which was introduced to remove pension poverty and it has been successful in that endeavour. Now that the relative decline in the state pension has reversed, the triple lock should be reviewed from 2020 and replaced with an earnings link. The government should also consider future policy on universal pensioner benefits. Targeting these benefits more efficiently to those that most need help could allow policymakers to help younger generations."

Old Mutual Wealth pension expert Jon Greer

"Radical, and politically unpalatable, ideas must be considered: a country-wide reduction in benefits paid today (both corporate and government) to ensure there is provision for younger generations; mandatory enrolment in a new defined contribution savings system; significant tax credits (or government transfer payments) to ensure individuals entering work are saving an adequate amount (eg 25 per cent) of their salary for the next 40 years."

Mallowstreet chief executive officer Stuart Breyer

"Three things need to happen to redress this imbalance: Firstly, make the tax system fairer. The government has systematically favoured those with large final salary benefits whilst lacking the political will to compel employers and to pay more towards future pension provision for DC members. Secondly, allow more freedoms. A comfortable retirement is not just about accruing a large pension pot. It's about accumulating wealth over the long term. One of the key intergenerational flows of wealth is from young renters to older property holders. The pension system should be reformed to allow first-time buyers to access some or all of their funds to place a deposit or purchase their first home. Finally, rethink the policy on state pensions – the triple lock on state pensions should be removed."

Trafalgar House Pensions Administration director Daniel Taylor

AHC head of engagement Karen Bolan

What is your pensions career CV?
I started my career with Stanhope Pension Trust, initially in an administration role. I then moved to Bass PLC in the newly-created role of pension communication and training manager. After this, I joined Britvic Soft Drinks in a corporate communication role before heading back into pensions by joining AHC in 2003.

What is your greatest work achievement so far?
Encouraging employers and trustees to take a strategic approach to communication and focusing on the outcomes that communications can achieve rather than just on the outputs that are created. I hope that the communications I have been directly involved in producing have had a positive impact on the future retirement outcomes for many people.

What do you still wish to achieve?
More of the same. Definitely getting more schemes to take a strategic approach and help more members to achieve better retirement outcomes.

What is your biggest regret within your career?
Probably not practising enough of what I preached earlier in my career so that I could be planning to retire myself at the earliest opportunity.

Excluding your current role, what would be your dream pension job?
I think that I would like to influence the effective communications of pensions at a national level to ensure that as many people as possible get the chance at having the retirement they wish, at a time in their life that suits them.

Fun and games

Wordsearch

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Answer at bottom of page

I know that face... Answer: Former Shadow Chancellor Ed Balls (speaking at the PLSA investment conference in Edinburgh this month)

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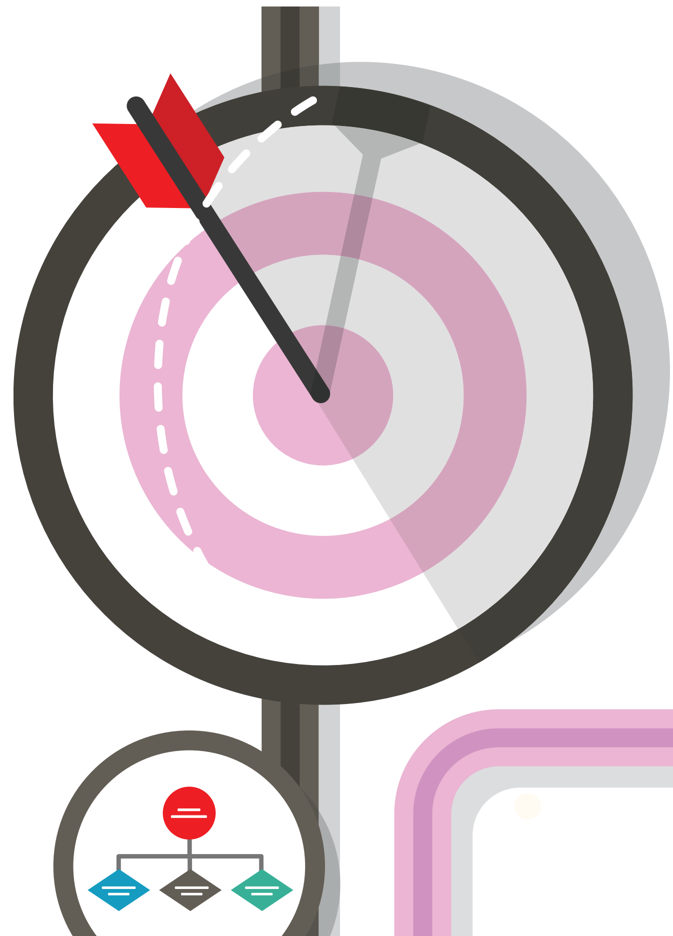

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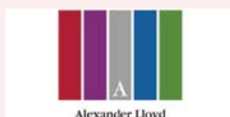

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