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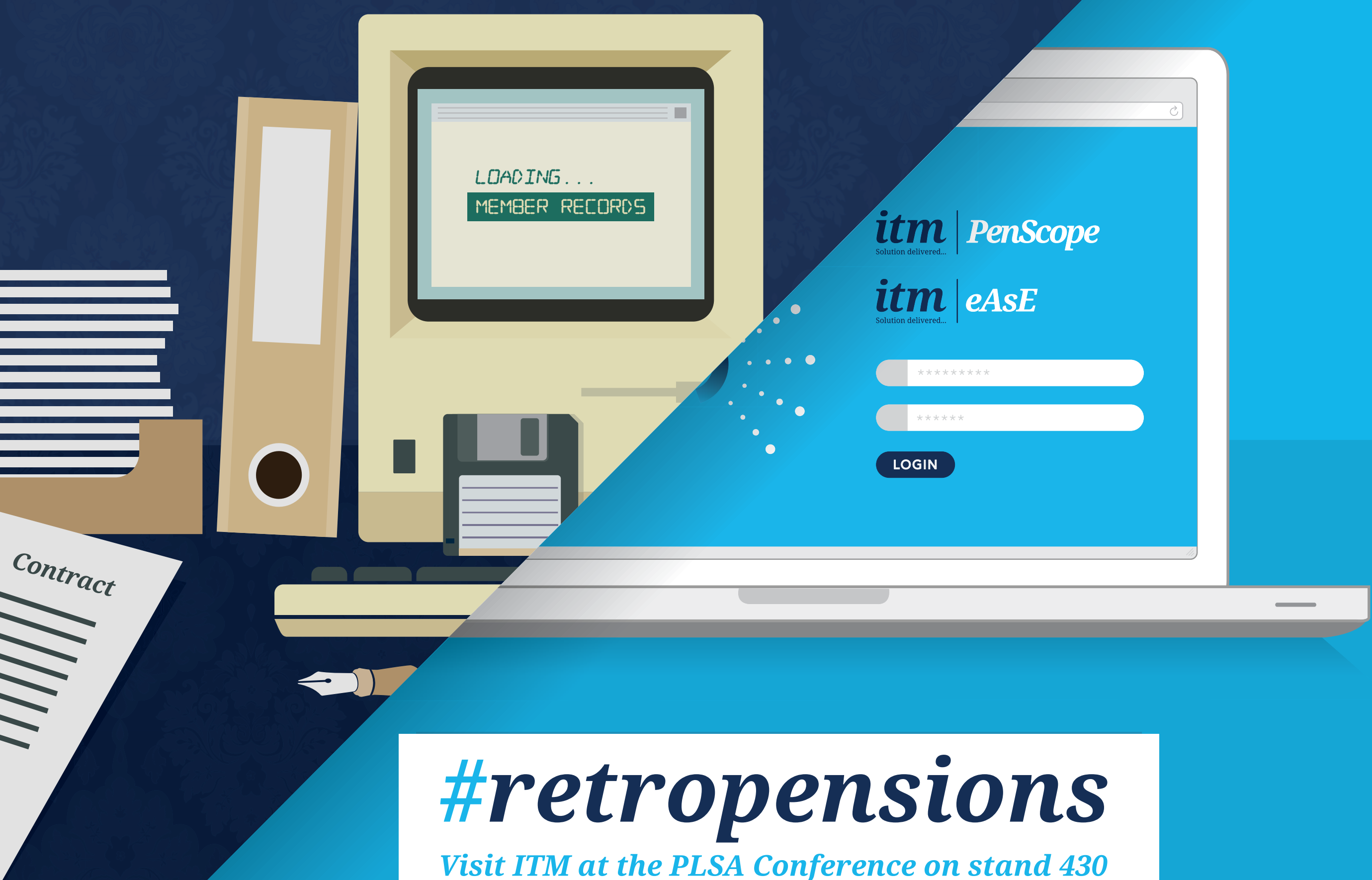
October 2016

# PENSIONS Age

The leading pensions magazine

## Systems today:

*Are you cloud-based, dynamic and pay as you go?*



# *Today's new standard*

ITM has broken the mould to offer its software on a pay as you go basis which gives users flexibility over costs.

This approach will be of particular interest to **small to mid-sized DB schemes** who feel their current supplier is under serving or over-charging them with little ability for the client to challenge fees, and **DC schemes** who want lower cost and high automation.

## *Buying and maintaining systems has changed. When did you last review your supplier?*

What is most impressive about the digital revolution is not that we can summon taxis and takeaways in an instant, or the fact we can source any movie or album we can think of within a few clicks. What's most impressive about all of this is just how… well… normal it's all become.

As consumers we're used to paying for what we need, when we need it. We like the fact our applications constantly evolve without even asking for it. And we enjoy accessing our data wherever we are, whenever we want it. But, by today's standards, it's all pretty normal.

The question is what have pensions systems been doing to keep up with the times? Have they been going through the same evolution or are they lagging behind? *ITM aren't waiting around; we are defining the new standard.*

**Blockchain technology**
The new financial transaction system set to revolutionise the pensions sector

**Investment strategies**
Why pension funds need to think differently to secure stable income

**Augmented reality**
How the technology being used in games can help with pensions comms

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# PENSIONS*Age*

The leading pensions magazine

***Robo-advice:*** *Is this new technology helping or hindering the current system of advice?*

***Trustees:*** *Calls are being made for trustees to modernise. But what does being a 21st century trustee really mean?*

# Watching the wheels turn

**Ideas for how the pensions industry can future proof itself**

UPP Unchaining Pensions from Politics

**Ros Altmann interview** - the former Pensions Minister talks about her government experience and the industry challenges ahead


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# Editorial Comment

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

What came first, the chicken or the egg? It's a conundrum you've heard many times before, and as such you've probably come to your own conclusion as to the answer. The same could be said for a similar discussion – did pension reforms occur as a result of societal change or did society change as a result of the recent spate of pensions reforms?

The answer may seem obvious. After all, everyone knows the pensions industry is a giant, old, lumbering beast, slow to adapt to societal change, right? Wrong. Sure, the industry has hardly been at the forefront of change in some respects – its slowness to incorporate online technology when it first emerged being just one example – but on the other hand, society's habits are already changing as a direct result of auto-enrolment.

The industry is not just reacting by doing what it's told from the powers-that-be either; it is perfectly capable of sparking change by itself. For instance, it has begun to utilise the still-quite-infant technology of augmented reality *[see p78]*, which began in the gaming sector, and is keeping an eye on the frankly embryonic blockchain technology starting to be used in the financial sector to assess the benefits it can bring to pensions *[see p74]*.

This shouldn't be a surprise. The pensions industry is entirely built around preparing for the long term; it shouldn't be unusual to find that the sector is looking ahead and future proofing itself.

So while the pensions industry's reputation as old fashioned may have once been the case, the pace of change within the past decade or so means this really no longer stands up to scrutiny.

And that's what has been so delightful to note when putting together this month's issue with its theme of innovation. When looking at industry innovation, the features have not involved crystal-ball-gazing, *Tomorrow's-World*-style musings, which we will likely come back to in 30 years' time and laugh at how silly our predictions seem. These innovations are happening now and should be noted.

That is why here, in this issue, we want to celebrate the success of the industry and the modern, innovative work that is being achieved. Our cover story *[p50]* explains how this is occurring within all aspects of the sector. We have also highlighted the excellent work our Pensions Age Awards 2016 Pension Scheme Innovation winner MNOPF is doing *[p72]*, have showcased the ways in which pension schemes are adapting their investment strategies to a volatile world *[p68]* and have marvelled at the many ways pension scheme trustees are responding to their increasingly challenging roles *[p63]*.

However, innovation does not have to mean more complexity. The industry has quite enough of that. As our *Nice and simple* feature *[p70]* shows, keeping things simple for the saver and sector itself can be a form of innovation in its own right.

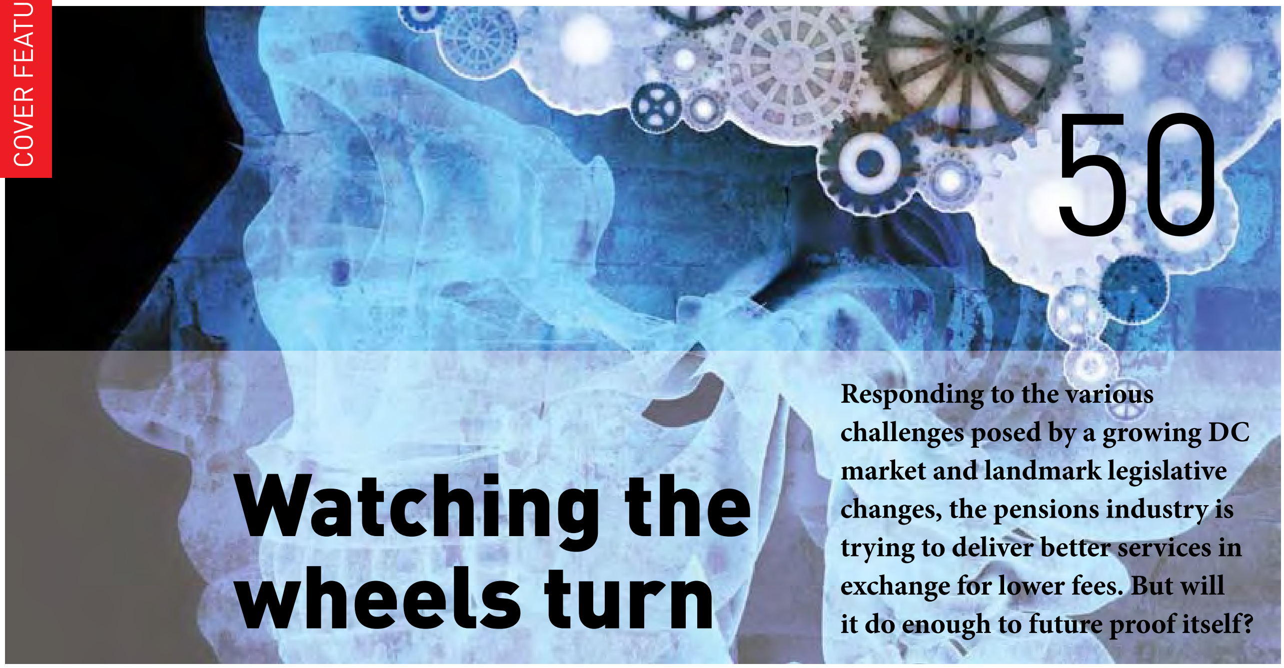
After all, innovation for innovation's sake is useless; it is the result it generates that counts. Just like the chicken and egg/societal change versus pensions reform discussions, what came first is not important, what is left at the end is.

For instance, it is of no consequence whether the chicken or the egg came first; you can still make delicious food (roast chicken or fried egg – sorry vegetarians) from either one. And whether the modifications in the pensions sector occur as a response to societal trends, or whether pensions reforms spark public change, either way the end result should still be new, innovative products that serves savers' changing needs. So let's all tuck into some tasty innovation.

**Laura Blows, Editor**

COVER FEATURE

# Theme: Innovation



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## Watching the wheels turn

Responding to the various challenges posed by a growing DC market and landmark legislative changes, the pensions industry is trying to deliver better services in exchange for lower fees. But will it do enough to future proof itself?



# Features & columns

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**NEW circulation figures**

**Pensions Age now has its new circulation figure from the Audit Bureau of Circulations (ABC). This is our BEST EVER circulation audit, and we would like to thank all our readers for their support. The average circulation July '14 to June '15 comes in at 15,579 print copies, near double most of our competitors. This is 100% requested and/or copies sent as a member benefit (NAPF, PMI, SPC, AMNT). (source: ABC, see www.abc.org.uk). Pensions Age is also sent as a Tablet Edition to our 24,000+ online subscribers (source: Publishers Statement September '15).**

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# Dateline - September

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

**1 September** The **Local Authority Pension Fund Forum** urges FTSE 350 companies to "disregard" the FRC, stating the regulator "has no mechanism to deliver the correct functions in its standards that companies and auditors follow".


Image by: TungCheung / Shutterstock.com

**2 September Marks and Spencer**'s DB active scheme members will no longer earn new benefits in the scheme from April 2017. The firm says members will be offered the chance to join the company's DC plan and as part of the pension changes, the company has agreed to extend the cash supplement support (offered as part of the proposals) for affected colleagues from two to three years.

**5 September** DB pension deficits for the UK's 350 largest listed companies increase to a record level of £189bn at the end of August from £139bn at the end of July, **Mercer** reports. According to Mercer's *Pensions Risk Survey,* deficits rose over the month despite growing asset values, which reached £737bn, an increase of £20bn from the previous month.

**6 September Post Office** employees vote in favour of industrial action against plans to terminate the DB pension scheme, despite having a £100m surplus. The ballot, organised by union Unite, found that 64.3 per cent were in favour of strike action and 78 per cent supported industrial action just short of a strike.

**7 September The government** introduces a Bill to legislate for the Lifetime ISA, which will launch in April 2017, despite doubts from the industry that there will not be enough time to develop a product.

**8 September** There is a "real risk" that pension scammers may exploit the current high DB transfer values by tempting savers into "bogus investments", according to **Xafinity**. The warning follows a new record seen by the Xafinity Transfer Value Index which has now increased by £37,000 (18 per cent) since the start of 2016. In addition, at the end of August 2016 the Xafinity Transfer Value Index stood at £241,000.

**9 September Sir Philip Green** hits back at Work and Pensions Committee chairman Frank Field for "untrue and totally inaccurate" comments, as he confirmed he is working to resolve the BHS pension crisis on a "daily basis".

**12 September Associated British Foods**, which owns Primark, reveals its expected year end pension scheme deficit has plummeted to £200m. In its trading statement, the group notes that its struggling pension scheme is largely a result of record low gilt yields following the UK's decision to leave the EU. These long-term bond yields are used to value defined benefit pension obligations.

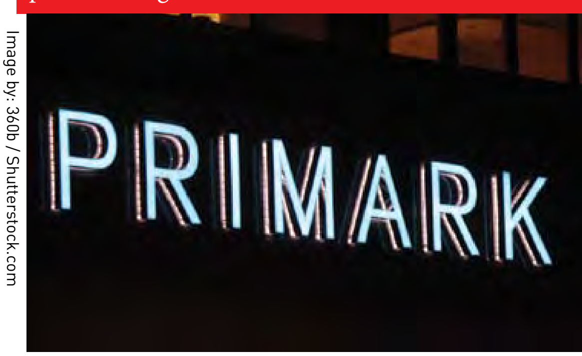



Image by: 360b / Shutterstock.com

**13 September The PPF** 7800 deficit grew by £82.6bn in August, causing its funding level to fall to just over 76 per cent. The aggregate deficit of the 5,945 schemes in the PPF 7800 Index is estimated to have risen over the month to £459.4bn at the end of August 2016, from £376.8bn at the end of July. The position has significantly worsened from the previous year, which recorded a deficit of £233.2bn at the end of August 2015.

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

**15 September** Trivial commutation is the most misunderstood pension term, **MyCSP** finds. Trivial commutation ranked highest with 97 per cent of scheme members stating they do not understand the term. This was followed closely by effective pension age with 94 per cent and partnership pension account with 90 per cent of members.

**14 September** Annuity rates are on track for the biggest ever annual fall, according to research by **Moneyfacts**. Based on a benchmark annuity (standard level without guarantee), the average annuity income for a 65-year-old has fallen by 14.8 per cent on a £10K purchase price and by 15 per cent on a £50K purchase price so far during 2016.

**16 September The Pensions Advisory Service** saw a 73 per cent increase in the use of its services for the year 2015/16. In its annual review, the service says it helped 175,000 customers through its national helpline, online webchat facility and website enquiry form and dispute resolution services. In addition, over 2.7 million people visited the website seeking out pension information.

**19 September** The total value of cash in pensions that exceeds the lifetime allowance has jumped by 62 per cent over the last year, according to **Salisbury House**. The figure has risen from £78m in 2014/15 to £126m in 2015/16, meaning many savers are increasingly caught in a 55 per cent "super-tax trap", Salisbury House says.

**20 September Kingfisher**'s UK defined benefit pension scheme has seen its surplus drop £68m since the 31 January 2016. In its half year results up to 31 July 2016, the group says its UK DB surplus was £178m, compared to £246m at the end of January 2016. It says the adverse movement reflects a significantly lower discount rate being applied to the UK scheme liabilities (£3bn at 31 July 2016), largely offset by the growth in UK asset values over the period due to the interest rate hedging in place.

**21 September** A consultation paper on amending the definition of financial advice so consumers only receive regulated advice when they are offered a personal recommendation for a specific product has been launched by the **Treasury**. The document seeks views on the costs and benefits of the change in definition.

**23 September The Pensions Regulator** says that although defined benefit pension schemes are "scary" and "frightening" they are still affordable and there is no crisis. "We do not believe that there is a pensions crisis," the regulator says.

**26 September The Labour Party** backs a motion at its annual conference by the UCATT for a flexible state pension age for workers. UCATT acting general secretary Bryan Rye says the previous Labour government "failed" on the issue of the state pension age and the current Conservative government are "making a bad situation worse".

Image by: Sabuhi Novruzov / Shutterstock.com

**27 September BMW** announces plans to close both of its final salary defined benefit pension schemes. The German car maker is to launch a consultation, which will run until 26 September, on its plans to close both schemes to future accrual from 1 June 2017.

**28 September** The employee opt-out rate in smaller employers reaches 17 per cent in comparison to 8 per cent to 11 per cent among larger-sized employers, the **Pensions Policy Institute** (PPI) reports.

**29 September** Some occupational DC schemes have 99 per cent of savers paying into a default fund, **Columbia Threadneedle** finds. The study highlights that a significant proportion of workplace DC scheme members are not proactively choosing where to invest their savings, and instead, opt for the default fund, which may not generate the best return for their retirement needs.

# News focus

# Govt confirms pensions dashboard prototype will be ready by March 2017

**The government is also consulting on financial advice and has said it will increase the PPF long-service cap**

A plan to build a prototype of the pensions dashboard by March 2017 is now underway in an effort for pensions to "catch up" with the "revolutionary" mobile banking sectors.

Economic Secretary Simon Kirby said people should be able to review pension balances online as part of online banking, change how they save in a pension at the click of a button or have personalised pension forecasts running on a mobile app, and a pensions dashboard could "unleash this kind of potential".

Aviva, Aon, B&CE, HSBC, LV, Nest, Now: Pensions, Royal London, Standard Life, Willis Towers Watson and Zurich have agreed to work together to build a first working prototype of the dashboard. The ABI has agreed to project manage the whole process.

"For it to really be effective, I think there are three main principles that must underpin its whole design," Kirby stated.

"Firstly, it will need to be open. No single dashboard can meet the needs of millions of people who all have very different individual circumstances. There is definitely no government website that could do that either. There is no monopoly of wisdom. The dashboard needs to be an infrastructure of open standards – like a common language and system for finding, collating, and sharing pension information.

"And it should be open to a range of companies who can meet basic standards of security and data protection – including banks and fintechs, not just pension providers. They should be able to access its information to deliver the products or advice their customers ask for.

Secondly, the dashboard needs to be flexible. It is unrealistic to expect every provider to be ready to contribute the same data to the dashboard at the same time. It is probably impossible to present all the different types of pensions in exactly the same way. And who knows how technology or other changes might transform pensions in the future? The infrastructure therefore needs to be built in such a way that it can adapt and expand over time."

Finally, the dashboard cannot be a "single, monolithic platform set in stone forever", Kirby said, and needs to be reliable.

"If we want to encourage people to save more, then they need to be able to trust in pensions. That starts with people being able to access basic information, across all their pension pots, without having to pay to do so.

"There's nothing wrong with charging for useful services – be it advice, savings plans, consolidation services or other possibilities that don't yet exist. But we need to get the free provision of the basic information right, and make sure it's consistent across different types of pensions."

To help the development of the

prototype, the government has launched a steering group. Pensions Administration Standards Association chair Margaret Snowdon has been appointed to the group, serving as an independent member of the group, representing the pensions industry.

In addition, the government has also launched a consultation paper on the definition of financial advice, so consumers only receive regulated advice when they are offered a personal recommendation for a specific product.

The document seeks views on the costs and benefits of the change in definition and follows on from *The Financial Advice Market Review (FAMR)*, which suggested people would benefit from "high-quality and more specialised and detailed guidance services".

Barnett Waddingham senior consultant Malcolm McLean said the change is "absolutely necessary" and is "long overdue".

"There is still in the minds of many otherwise experienced pension providers, employers and others, a good deal of confusion as to the difference between guidance and advice, where the boundary lies between the two and how far they can go in seeking to provide help and support to individuals in this important area.

"This is particularly relevant in relation to major take-up initiatives such as auto-enrolment, where workplace talks and the like about pensions and their importance can often be instrumental in encouraging employees' engagement with any available pension scheme. And yet most of the communications employers receive from regulators, for example, seem to be directed at their not being seen to influence workers rather than providing positive support and guidance for them to proceed in a more positive direction.

"I have long thought we are missing a trick here in not making it crystal clear what counts as advice and what doesn't. A cleared definition hung around the 'personal recommendation for a specific product' strapline would also help promote better consumer understanding of the advice/guidance options and what they mean for them. For the vast majority of the population, advice and guidance are currently probably one and the same thing."

Furthermore, after a warning from former Pensions Minister Steve Webb not to scrap the policy, the government has recently confirmed that it will introduce the necessary legislation for the Pension Protection Fund long-service cap.

In a written statement, Pensions Minister Richard Harrington announced the launch of a consultation on the draft regulations needed to ensure the long-service cap in the PPF.

"The consultation will last for eight weeks and, after I have considered the responses, it is my intention to put before parliament amending regulations, with the expectation that the PPF long-service cap will be in place from April 2017."

PPF compensation is currently capped at £33,678. However it can effectively penalise long-serving employees by treating them the same as higher earners with shorter service. From next year, the compensation limit is expected to be increased by 3 per cent a year for every additional year of service beyond 20 years, subject to an overall limit of twice the standard limit.

Despite provisions being made for this in The Pensions Act 2014, Harrington said the legislation has not yet been brought into force, as some changes were needed to secondary legislation. It is these changes on that he is now consulting on.

**Written by Adam Cadle and Natalie Tuck**

## NEWS IN BRIEF

**The Waltham Forest local government pension fund** has become the first LGPS fund to commit to divest from all fossil fuels. A recommendation approved at the fund committee meeting stated that it would 'exclude fossil fuels from its strategy over the next five years'. The Waltham Forest fund, worth £735m, currently invests £23.9m in the oil and gas industries. The decision to divest comes exactly a year after data was published showing that UK local government pension schemes invest over £14bn in the fossil fuel industry.

**The Pensions Administration Standards Association** has announced the latest two organisations to join PASA – Allen & Overy LLP and Lothian Pension Fund – taking PASA scheme member representation to over 11 million.

UK workplace pension providers are teaming with **Independent Governance Committees** (IGCs) on a new initiative to understand members' attitudes to 'value for money'. Eleven IGCs, with their respective providers, are collaborating in an extensive research programme coordinated by Sackers. The key objective is to gain an understanding of what members value and why.

**Tesco**'s pension scheme deficit has more than doubled from £2.61bn to £5.85bn in the half-year to 27 August. The pension scheme grew by £3.2bn in the year to £5.85bn as a result of lower bond yields. Tesco's IAS 19 net pension finance costs also fell from £84m last year to £58m this year.

# Retirees risk losing 20% of lifetime income by not shopping around

**The research follows The Pensions Advisory Service's calls for providers to stop attempting to keep clients in "their own walled garden"**


Retirees are at risk of losing 20 per cent of their potential lifetime income if they do not shop around and seek professional advice when choosing a pension product, My Pension Expert has warned.

The financial firm's advice follows its finding that nearly half of its customers, 45 per cent, changed the product they would have had from a lifetime annuity to something that suited their individual personal circumstances better.

The research follows The Pensions Advisory Service's chief executive Michelle Cracknell's call for providers to stop attempting to keep clients in "their own walled garden", trapping their customers into a scheme that may not be right for them.

The research found that pensioners who remained with a lifetime annuity and switched provider saw significant improvements in their lifetime income. An example of this comes from a sample of Prudential customers who saw an average income increase of 22 per cent.

Following recommendations to shop around, the use of The Pensions Advisory Service (TPAS) has increased since the pensions freedoms announcement. It has reported a 73 per cent increase in the use of its services this year.

In its annual review, the service said it helped 175,000 customers through its national helpline, online webchat facility and website enquiry form and dispute resolution services. In addition, over 2.7 million people visited the website seeking out pension information.

TPAS said that 2015/16 once again saw a focus on the freedoms and flexibility introduced in the 2014 budget, with customers contacting the service to discuss their options and talk about retirement planning. Calls to the helpline were up by 42 per cent and web chat continued to be a popular channel with increased customer contact of 63 per cent. Commenting on the review, Cracknell said that last year was a "milestone" for pensions and TPAS.

"We saw more people recognising the importance of saving for retirement, by helping a staggering 175,000 customers. It is clear that the pension freedoms were seen positively by the customers contacting us, as it gives them more options for accessing their savings," she said.

**Written by Talya Misiri and Natalie Tuck**

VIEW FROM THE ABI

**The pensions dashboard became closer to reality in September as Simon Kirby MP, Economic Secretary to the Treasury, announced the next phase of the project.**

The ABI will be managing a project to develop a prototype dashboard, to test how a saver could use a digital identity to access real but anonymised data about their DC, DB and state pension entitlements.

This is a significant step forward in creating a one-stop place to help savers see and understand their various pension pots.

The ABI-led cross-industry project group will be reporting to HM Treasury, who will oversee the project following their commitment to launch a pensions dashboard by 2019.

**"*[The pensions dashboard]* is a significant step forward in creating a one stop place to help savers see and understand their various pension pots"**

A range of firms have agreed to join the project group, including insurers, master trusts, administrators and a large employer scheme.

Given the diversity of pension provision, we would welcome as much input as possible from across the market.

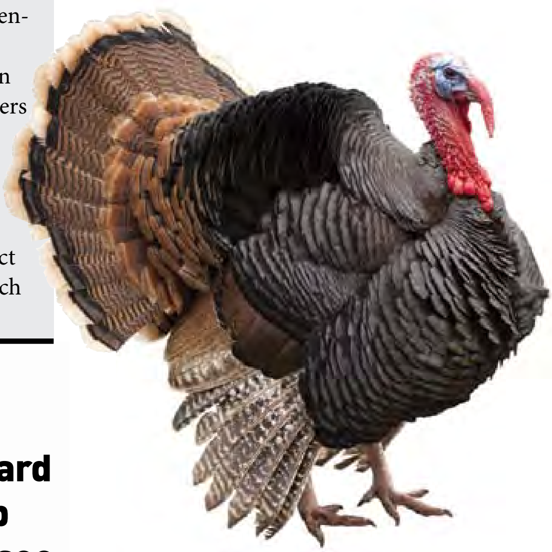
We would urge any other pension providers, administrators or schemes who would like to be involved in or know about the project to get in touch with us.

**Written by Rob Yuille, head of retirement policy, Association of British Insurers**

ABI Association of British Insurers

# Buyer's offer to take on Bernard Matthews DB scheme rejected

**The original offer from the buyer was rejected by the seller, which now means the scheme joins a growing list of those who have come face to face with the PPF in recent months**



An initial offer by Ranjit Singh Boparan to purchase Bernard Matthews from Rutland Partners, which included the responsibility of the defined benefit pension scheme, was rejected by Rutland Partners, *Pensions Age* can reveal.

Instead, Rutland Partners accepted a later offer from the Boparan Private Office, the private investment vehicle of Boparan, which did not include the DB pension scheme.

The type of sale is known as a pre-pack administration deal, which involves a buyer taking on a company's assets, but without liabilities such as its pension deficit. As a result the Bernard Matthews DB scheme will now enter into the Pension Protection Fund assessment period.

"Those members who are no longer at the business and have yet to receive benefit will be transferred to the PPF as requested by the private equity seller. It should be noted that the Boparan Private Office's initial offer to the seller included all assets and liabilities, including all pension liabilities. This offer was rejected," a spokesperson for the Boparan Private Office confirmed.

Prior to the sale of Bernard Matthews the PPF said they had been "made aware that Bernard Matthews has gone into administration" and "members can be reassured that we are there to protect them".

However, sources close to the situation have told *Pensions Age* that the new owner, Boparan Private Office, could still step in and rescue the scheme. The news follows comments by the Work and Pensions Select Committee chairman Frank Field, who called on The Pensions Regulator to stop the "dumping" of the scheme into the PPF.

A spokesperson for Rutland Partners declined to comment on why it rejected the earlier offer.

The pension scheme is one of many in recent months that has received some high profile media attention, along with BHS, Tata Steel and the Halcrow Pension Scheme. As a result of this, and especially following the vote for the UK to leave the European Union, there has been many reports concerning the health of DB schemes in the UK. However, The Pensions Regulator director of regulatory policy Andrew Warwick-Thompson has said that although DB pension schemes are "scary" and "frightening" they are still affordable and there is "no crisis".

**Written by Natalie Tuck**

VIEW FROM THE AMNT

**Most organisations review their performance in order to rectify deficiencies, but when they find something done well, they try to replicate it across the business. I'd like to see this logic applied to pension schemes and in particular to TPR's 21st century trusteeship project.**

TPR director for regulatory policy Andrew Warwick Thompson's recent comment on pensionsage.com seems to suggest scheme governance will only be improved through regulation and support from an outside agency, namely TPR. I'm not suggesting for a minute that TPR shouldn't seek to drive up standards of governance, but I'd like to see it look for role models among schemes and trustee boards that exceed basic expectations.

The quantitative data Andrew offered focuses on what's wrong with schemes, not what's done well. Rather than thinking of clever regulation, benchmarking existing best practice would seem to offer better value for money for TPR's far too limited budget.

Let me tell you why. AMNT's typical member is male, over 55 and more than half are still working. Almost two thirds of them are elected MNTs with an average of eight years' experience.

Trustees have done a good job on the whole. There is a lot of talk about trusteeship quality, but it is usually the worst-resourced function of any scheme. Most AMNT members believe they are given sufficient time for trustee activities, but fewer than a third are paid for their time and more than 10 per cent do not get all their expenses covered.

There is no better example of the alignment of interests than through trustees representing their membership. Instead of simply finding flaws in the system, TPR should marvel at its achievements and seek to preserve the best practices.

**Pádraig Floyd, committee member, AMNT**

Association of Member Nominated Trustees

# ESG policy compulsory in govt's new investment guidelines

**The news comes as the first LGPS fund in the country commits to divesting fully from fossil fuels over the next five years**

The Department for Communities and Local Government has outlined new guidance on preparing and maintaining an investment strategy statement (ISS).

This statement will replace the statement of investment principles (SIP) and requires that funds have a policy on social, environmental and corporate governance factors.

In order to comply with the guidance, administering authorities must take proper advice. They should also explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors and must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments.

In addition, they should not pursue policies that are contrary to UK foreign policy or UK defence policy and should explain their approach to social investments.

The new rules contain provision for the Secretary of State to issue a direction, where he or she deems an administering authority not to have followed the new guidance. However, The UK Sustainable Investment and Financial Association (UKSIF) has previously called for this power to be used only where an authority has breached its fiduciary duty.

Commenting, UKSIF chief executive and GSIA member Simon Howard said: "The Department for Communities and Local Government has rightly acknowledged the value in responsible investment and we welcome the requirement for funds to have a policy on ESG and stewardship."

The news comes as the Waltham Forest local government pension fund revealed it is the first LGPS fund to commit to divest from all fossil fuels. A recommendation approved at the fund committee meeting stated that it would "exclude fossil fuels from its strategy over the next five years".

The Waltham Forest fund, worth £735m, currently invests £23.9m in the oil and gas industries. The decision to divest comes exactly a year after data was published showing that UK local government pension schemes invest over £14bn in the fossil fuel industry.

Commenting on the decision, Waltham Forest chair of the pension fund committee Cllr Simon Miller said that as well as divesting from stranded assets, it will also be actively investing in cleaner, greener investment that will benefit the community and environment.

Friends of the Earth campaigner Rob Platts said Waltham Forest has shown "true leadership". He added that by divesting from fossil fuels the fund is protecting pensioners from "risky investments" and "joining hundreds of public institutions worldwide in taking a stand against an industry that is causing climate chaos".

**Written by Natalie Tuck**

VIEW FROM THE PLSA

**You don't have to do much EU-watching to see that there are plenty of tensions between its member states, institutions and politicians.**

With Brexit, the now famous Article 50 states that the 'Council' (ie national governments) will 'conclude' the deal with the UK, 'after obtaining the consent of the European Parliament'. Already the EU institutions of the European Council, Parliament and Commission are jockeying for prominence.

Quite how these EU big beasts will coordinate their efforts remains to be seen, but we can be sure that each will bring different views and interests to the table. More recently we have seen a major falling out between the commission and the three European supervisory authorities (the 'ESAs' - ESMA, EIOPA and EBA) over new rules on the derivatives markets.

The commission wants to leave pension schemes out of new rules that would ban financial institutions from posting more than 50 per cent of the initial margin on their non-cleared derivatives contracts in instruments denominated in a single currency. For UK schemes, with most of their government bond holdings in UK-issued gilts, the commission's amendment would be very helpful. But the ESAs want to keep the 50 per cent limit in place and the two sides are now in a stand off over the drafting.

This might sound arcane, but for large schemes with plenty of hedging, the detail of these rules really matters.

The lesson for organisations like the PLSA is simple enough: we need to understand all the EU's points of view if we want to influence the EU as a whole. Of course, doing so is far more complex.

**James Walsh, policy lead for EU and international, Pensions and Lifetime Savings Association**

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

# Market commentary: Real estate

Compared to bond yields and dividends from equities, many real estate investments are providing an interesting, stable, income for pension funds.

According to Invesco Real Estate managing director of client portfolio management Simon Redman, the "developing sector of the UK private rental sector is fast becoming a more accepted institutional sector".

"Similarly, investments such as long-let hotels are also interesting for pensions funds," Redman adds.

Mercer's head of European real estate Paul Richards states that real estate debt funds also help with Libor matching and cashflow matching but "the challenge is that these asset types are seeing high levels of demand, long queues and limited capacity".

"They are increasingly being seen as components of multi-asset secure income portfolios," he comments.

Schroders Real Estate head of real estate product Tom Dorey argues that real estate investment trusts (REITs) are a good way of gaining exposure to real estate. "These are structured as companies that invest directly into UK or European real estate and as such provide underlying investments that are comparable to daily dealing bricks and mortar funds.

"As they are listed on the London Stock Exchange, their shares are tradable daily and are not subject to fund suspensions. The share price of these property investment trusts anticipates the change in property valuations and with shares of UK trusts trading at below their net asset value, possible valuation falls are already in the price."

Direct real estate can also provide a stable return compared to those assets listed on exchanges. One doesn't have the day-to-day market volatility of daily traded assets. Moreover, unlike listed assets

JFarq / Shutterstock.com

where it's important to buy well and sell well, with real estate value can be added to an investment through the use of active management. But with any asset class a number of risks remain inherent within real estate. "There is still a lot of uncertainty around Brexit and this will remain for some time until negotiations with the European Union and other bodies are much more advanced," Aon Hewitt principal consultant Oliver Hamilton states.

"As was very publicly reaffirmed immediately after the European referendum result, property is an illiquid asset class and it can be hard and expensive to exit under such circumstances. However, pension schemes are long-term investors and this gives them the ability to invest over many property cycles and allows them to time their exit from the asset class."

So what does the future hold for this asset class?

The overall opinion is that real estate is expected to remain stable in a low interest rate environment. "We believe we will continue to see our clients diversify their property portfolios and move away from solely investing in UK core commercial property," Hamilton points out.

"This includes investing in property debt, more globally, in the UK private rented sector and considering value-add and opportunistic strategies."

**Written by Adam Cadle**

# People on the move


Stephen Halliwell

**Legal & General Capital** has appointed Stephen Halliwell as its new chief financial officer to support its continued growth. Halliwell joins LGC from 3i Infrastructure, where he held the same role, focusing on UK and European infrastructure investments. He has served at 3i since 1998 and has played an integral role in the firm's development.

Halliwell acted as a key figure in leading public markets, managing operational, financial and reporting requirements for 3i's infrastructure business, with £2.5bn of assets under management. He has also served as the business's group finance director during 2009 and 2010 and head of financial planning and analysis fior 3i Group prior to the listing of 3i Infrastructure.

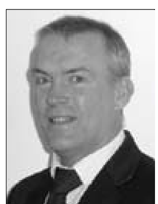
Legal & General Capital managing director Paul Stanworth said: "The seniority of Stephen's appointment and his infrastructure experience appropriately sets the tone of our ambitions at Legal & General Capital." Halliwell added: "I relish the chance to be involved in this unique business at such an opportune time."


Mark Bathgate

**BlueBay Asset Management** has welcomed Mark Bathgate as portfolio manager. Bathgate will manage BlueBay's investment grade team, reporting into co-head of the investment grade Mark Dowding. Prior to this, Bathgate was co-founder of macro hedge fund ABD Investment Management, where he served as head of research and business development. Bathgate has also held senior research roles in the industry.


Gilbert Van Hassel

**Robeco Institutional Asset Management** has welcomed Gilbert Van Hassel as its new chief executive officer. Van Hassel will succeed Leni Boeren as CEO and chairman of Robeco's management board. He has more than 30 years' experience in the financial services sector, particularly in asset and wealth management in Europe, Asia and the US. Van Hassel was previously global CEO at ING Investment Management.


Paul Wright

**Momentum Pensions** has appointed Paul Wright to its board, following FCA approval. Wright joined Momentum as head of administration UK in October last year and has over 30 years of experience in personal pension management and administration of SIPP and SSAS funds. He previously worked at AJ Bell, where he served as head of technical services and served at Scottish Equitable before this.

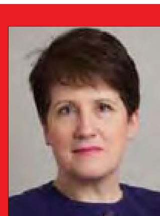

Steve Groves

**Retirement Bridge Group** has welcomed Steve Groves as its new chairman. Groves was formerly CEO of annuity and equity release provider Partnership Group from 2008 to 2016, and stood as managing director from 2006 to 2008. He also held the position of non-executive director on the board of the Guardian Group from 2011 to 2016. Groves will work closely with the senior management team and CEO.


Nick Buckland

**JLT Employee Benefits** has appointed Nick Buckland as senior investment consultant.

Buckland has a strong background in the pensions sector, previously working for Dorset County Council as chief treasury and pensions manager for its pension fund. In his new role, Buckland will work closely with JLT's head of local government pension scheme investment consulting Kieran Harkin.


Margaret Snowdon

**HM Treasury** has appointed Pensions Administration Standards Association chairman Margaret Snowdon to the senior level steering group for the pensions dashboard prototype project. Snowdon will be one of two independent members of the steering group and will represent the pensions industry on the venture. Commenting on her appointment, Snowdon said: "A pensions dashboard is a platform allowing any individual to see all their pensions pots in one place and, therefore, empower them to plan for the retirement in a much more practical and effective way – this can only be a good thing.

"At PASA we are very supportive of the dashboard concept and we are dedicated to devoting our time and energy to helping both administrators and schemes plan for their important role in a future dashboard or dashboards."

Snowdon is also currently non-executive director for The Pensions Regulator and a council member for The Pensions Policy Institute.

VIEW FROM THE SPP

**Post-pension freedoms it is only natural to ask how Nest should adapt to the current market. However, have we lost sight of the reasons behind the government-backed scheme? Are the proposals in DWP's consultation on the evolution of Nest a step too far?**

Nest was established to address a possible market failure to meet the auto-enrolment needs of the SME market, not to compete with the private sector. In reality, this market failure has not materialised as the industry has innovated and developed new products. Nest is presented to employers as the 'government backed' pension savings scheme; many have used Nest as the default option, some without any comparison of suitability.

The consultation suggests that the scope of Nest should be extended to offer decumulation products and permit greater access. With no market failure or consumer demand to justify these changes, is it right that taxpayers should fund the expansion of Nest? If these proposals do go ahead, the state risks encroaching on the private sector and distorting competition. The government stresses the importance of shopping around at retirement. One issue is that offering decumulation products from a scheme that is already seen as the default solution is likely to discourage members from seeking the best deal. However, there are many ways Nest could enable its members to access pension freedoms without having to manufacture its own solution.

Whilst it is easy to see why Nest would want to expand into the retirement market, careful consideration needs to be given to the longer-term consequences.

**Alison O'Brien, DC committee member, SPP**

THE SOCIETY OF PENSION PROFESSIONALS
*leading pension thinking*

# In my opinion

**On the need for a SPA campaign**
"State pensions are the bedrock of retirement security for many people, so the government must take proper care when managing a policy that will affect so many people so profoundly. The DWP has spent huge sums advertising the new state pension and for state pension top-up, but not for state pension age changes."
***Former Pensions Minister Ros Altmann***

**On resolving the BHS pension crisis**
"Contrary to all the coverage I have been working on this issue on a daily basis, and will continue to do so with my best efforts to achieve a satisfactory outcome for all involved as soon as possible. I, together with my executives, have been co-operating with The Pensions Regulator for some 17 to 18 months providing whatever has been requested."
***Former BHS owner Sir Philip Green***

**On unchanged interest rates**
"If markets are to be believed, we could see interest rates stay at current record lows for the next five years, which is not good news for pension schemes. This means there is no respite in sight from the record pension deficits caused by the Bank's interest rate policy. As a result, there are going to be inexorable demands on employers for significant increases to cash funding of pension schemes."
***JLT Employee Benefits director Charles Cowling***

**On the proposed Pensions Advice Allowance**
"It is encouraging that employers are open to helping their employees get access to financial advice at retirement. We called for an increase to the advice tax allowance for employers in our response to the Financial Advice Market Review as this change, alongside the introduction of the Pension Advice Allowance, will make it far easier for consumers to get affordable professional advice. This is a real opportunity to increase access to regulated financial advice through the workplace and help many more people get the best outcome in retirement."
***LV= head of policy Philip Brown***

**On the 'dumping' of the Bernard Matthews pension scheme**
"The Pensions Regulator needs to act robustly and quickly to stop such activities being mimicked by other asset buyers who wish to dump pension liabilities. We cannot have firms changing ownership at the price of pensions being dumped with the Pension Protection Fund – such dumping involves promises being broken, and the cuts in benefit that result."
***The Work and Pensions Committee chairman Frank Field***

**On govt redefining financial advice**
"I have long thought we are missing a trick here in not making it crystal clear what counts as advice and what doesn't. A cleared definition hung round the 'personal recommendation for a specific product' strapline would also help promote better consumer understanding of the advice/guidance options and what they mean for them. For the vast majority of the population advice and guidance are currently probably one and the same thing."
***Barnett Waddingham senior consultant Malcolm McLean***

VIEW FROM THE PMI

**This summer, The Pensions Regulator issued a consultation paper called *21st Century Trusteeship and Governance*, which sought industry views on ways to improve governance standards for UK pension schemes.**

One long-standing problem that the consultation sought to address is the regulation of professional trustees. Currently, there are no formal barriers to prevent anyone describing himself as a professional trustee: given that five years have now elapsed since the GP Noble trial, this should be grounds for concern.

**"Currently, there are no formal barriers to prevent anyone describing himself as a professional trustee"**

Whilst it is true that many professional trustees belong to professional bodies that regulate their conduct, they are not specifically regulated in respect of their work as trustees and are not required to do trustee-related CPD. The establishment of the Association of Professional Pension Trustees (APPT) in 2012 has done a great deal to promote high standards for those working in the field, but membership is voluntary. Unless and until there are agreed formal criteria that identify an individual as a professional trustee, there can be no formal guarantees about the quality of service that is to be provided. With the continued expansion of the professional trustee sector – and the increasingly onerous demands that have made this expansion inevitable – it is now surely time for the introduction of formal entry barriers.

The regulator is to be congratulated for raising this as a subject for discussion; the industry has a responsibility to suggest viable solutions.

**Tim Middleton, technical consultant, PMI**

# Soapbox: A radical move for Labour?

Members of the Labour Party have voted in something radical recently, and no, it's not Jeremy Corbyn that I refer to. Instead, they voted for a policy that was first mooted in this country by UKIP at the last General Election.

I'm referring to a flexible state pension age, which delegates at the Labour Party Annual Conference voted in favour of developing policy on. Corbyn himself, when first competing for the role of Labour leader, spoke in support of the idea, but it was UCATT acting general secretary Brian Rye who brought up the issue at this year's conference.

Rye was blunt; he said previous Labour governments "failed" on the issue of state pension age but the current Conservative government are "making a bad situation worse".

"A one-size-fits-all pension age is inherently discriminatory, it takes no account of the ability of a worker to undertake the tasks they're employed to do. It doesn't take a genius to work out that doctors and lawyers are likely to be able to keep working longer than a brick layer or a prison officer, yet they are both entitled to a pension at the same age," explained Rye.

He noted that workers in professional roles such as doctors, lawyers and accountants have a life expectancy of 80 but for many manual workers their life expectancy is under 73 years. And with the life expectancy of manual workers rising more slowly than other groups, Rye said we have created a "double whammy" for manual workers, where they are forced to retire before the pension age and then likely to die seven years before many others.

"That is not social justice, this is discrimination by job, it is simply not acceptable for this party to tolerate such a policy," he said.

It's not Rye's job to develop the policy, however, so the detail now needs to be worked out. In case you're not up to speed on UKIP's 2015 manifesto, the party proposed a state pension age window to allow people to take an early state pension in return for a reduced lifetime amount. Systems like this already operate in Scandinavian countries such as Norway, Sweden and Finland.

But will Labour's policy proposal offer the same as UKIP? Perhaps not, they are two very different parties. The whole idea behind the Labour movement is to make it fairer for manual workers who have a limited life expectancy, compared to those in professions such as lawyers, doctors or accountants, to name a few.

In principle, the idea is as Rye said "a great leap forward in policy", but it is the detail that will prove difficult. After all, statistics may say that a lawyer will live longer than a builder but when it boils down to individual cases, it may not be so. Life expectancy is dependent on so many variables other than ones' profession.

A person's genes, diet and environment are just several things that have an impact on a person's life expectancy, right down to luck. That is why it will be a very difficult policy to develop. In reality, a flexible state pension age must be offered to all, not just to those who are manual workers. But of course, for anyone taking an early state pension, there must be a trade off, which brings the whole question of fairness back into the spotlight.

**Written by Natalie Tuck**

# Seeking an alternative solution

**Jonathan May describes how diversified, absolute return strategies can help meet the return requirements demanded by pension schemes, without sharply raising their overall risk profile**

Brexit, stubbornly low inflation and falling bond yields – both sovereign and corporate – are among a number of challenges that are proving painful for institutional investors and are unlikely to go away anytime soon.

With liabilities increasing and deficits widening, schemes are being forced to revisit their approach to risk and consider whether they should broaden their exposure to other asset classes in order to increase potential returns.

At Pioneer Investments, we believe diversified, absolute return strategies that seek to generate positive returns in different market environments could provide a solution. Their alpha-seeking investment focus combined with the potential to manage downside risks and market volatility could help meet the return requirements demanded by pension schemes, without sharply raising the overall risk profile.

In order to pursue these features, we believe it is key to build an investment process that seeks to generate multiple, low correlated sources of return by investing in traditional and non-traditional asset classes.

Our multi-asset team have run absolute return strategies since 2004, with over £3 billion of investor assets under their care, and have developed a robust investment process that seeks effective diversification through allocating risk across four components. We refer to these components as the 'Four Pillars' approach.

**'Four Pillars' approach**

The first pillar in the investment process starts with the **macro strategy**, the directional, top-down element that expresses the view of the world. The macro component may also include long-term structural thematic investments, such as robotics and longevity.

Risk management is a ubiquitous thread that runs through every investment decision. The second pillar is **macro hedging**, where an independent team of hedging specialists assess risks to the macro strategy and seeks to protect the portfolios from 'tail risks'.

The third pillar, **satellite strategies**, tend to be relative value in nature and invest across multiple asset classes. Relative value investing can dramatically expand the investment universe and help to generate new sources of alpha, independent of equity and bond markets. This is a key differentiator from long-only funds that are directional in nature. Each satellite strategy has a target price and strict drawdown management levels to ensure disciplined position management.

The final pillar is **selection strategies**, which aims to improve diversification and generate income by investing in sovereign bonds and high quality credit, while seeking to generate stable yields above cash rates.

For institutional investors looking to boost asset returns while continuing to protect their portfolio from downside shocks, we believe that absolute return strategies are an investment component that needs to be explored.


**Written by Jonathan May, head of UK institutional business, Pioneer Investments**

In association with PIONEER Investments®

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VIEW FROM THE ACA

**Whilst significant differences in life expectancy continue to exist between different sectors of society, we believe that the retention of a universal but rising state pension age will become increasingly difficult. However, we think that there are practical difficulties in identifying specific groups for differential state pension ages.**

Our recent paper submitted to the 'Cridland' review of state pension age says that further thought should be given to alternative measures that would allow individuals with shorter life expectancies to access their state pension before their 'official' date.

The ACA paper considers a number of models. Some could be no cost or low cost to the government, particularly those encouraging people to use non-state pensions before reaching SPA, or allowing broadly actuarially neutral early access to the state pension, albeit there would be costs associated with implementation and means-testing implications.

Other models, including where, for example, a state benefit might be introduced for individuals meeting certain ill-health criteria ahead of SPA, or where there could be early access to a state pension based on the length of working life, would involve additional costs. These would require reduced state spending elsewhere or might mean an even higher SPA for the rest of the population.

The ACA paper rules out one possible approach – giving all individuals within a certain age range a right to draw down their state pension as they wish as this was likely to mean too many would exhaust their state pension unless there were constraints on annual withdrawals.

**Bob Scott is chairman of the ACA**

ASSOCIATION OF CONSULTING ACTUARIES

# Diary: October 2016 and beyond

### PMI Annual Lecture 2016

**17 October 2016**
**J.P. Morgan Asset Management**
**Blackfriars**

Following a successful event last year, PMI's Annual Lecture is back for its second year with key speaker author, futurist and highly respected thinker on technology and societal trends, Mark Stevenson. The PMI Annual Lecture attracted over 200 attendees last year and is looking for the same number this year. The technical seminar is free of charge for members and non-members.

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

### PLSA Annual Conference & Exhibition

**19-21 October 2016**
**ACC Liverpool**

The challenge facing the industry remains the same as ever: how do we help people to save enough? But this year it's different as well. Pensions freedom, more policy reforms and political upheaval have completely changed the context in which we operate. So we need fresh thinking on long-term saving. The Annual Conference and Exhibition is your chance to find out how your organisation fits into this future. Sir Lenny Henry is a key speaker and is not to be missed!

**For more information, visit:**
**plsa.co.uk/conferences_and_seminars**

### CIPP Payroll and Pensions Update Seminar

**1 November 2016**
**London [Location TBA]**

The CIPP payroll and pensions updates events are aimed at non-members and trial members of the CIPP and are designed to provide an overview of how the CIPP can support payroll and pension's professionals and the benefits of CIPP membership, providing attendees with access to support and guidance. Speakers include NOW:Pensions regional partnership manager Gavin Horwood, among other CIPP professionals.

For more information, visit:
**www.cipp.org.uk/event/**

### Irish Pensions Awards

**24 November 2016**
**Shelbourne Hotel**
**Dublin**

The Irish Pensions Awards give recognition to those pension funds and providers who have proved their excellence, professionalism and dedication to maintaining high standards of Irish pension provision over the past year. Now in its fifth year, it is an event not to be missed, with over 300 guests attending in 2015, this year is set to be even bigger and better. The deadline for entries has now closed.

**For more information, visit:**
**europeanpensions.net/irishawards/**

**Visit www.pensionsage.com for more diary listings**

Month in numbers

## 99%

Some occupational DC schemes have 99 per cent of savers paying into a default fund, research by the Pensions Policy Institute has found.
The study, commissioned by Columbia Threadneedle, highlighted that a significant proportion of workplace DC scheme members are not proactively choosing where to invest their savings, and instead, opt for the default fund, which may not generate the best return for their retirement needs.

## £310bn

The UK's annual pension savings gap has fallen by 4 per cent in the last six years from €379bn (£321bn) in 2010, to €365bn (£310bn) in 2016, according to Aviva.

## 98%

The percentage of DB schemes reporting high levels of satisfaction from fiduciary management, rating their experience as excellent, good or satisfactory, Aon Hewitt has reported.

# Winning gold: Bullion as a portfolio diversifier

**Percival Stanion explains why gold represents a valuable hedge and portfolio diversifier**

Gold holds an important position in investment portfolios these days as a diversifying and hedging asset. But this hasn't always been the case for what John Maynard Keynes called a "barbarous relic".

One of the seismic side effects of the global financial crisis was to resurrect an investment case for gold, an asset long derided by mainstream asset managers.

Before the crisis, gold was indeed a poor investment. Warren Buffett once pointed out that it is dug up in Africa, shipped half way across the world only to be sunk back into the ground in a heavily fortified bank vault. Gold doesn't generate an income, is too unwieldy to be used as money and incurs storage and insurance costs.

But since then, repeated bouts of severe market turmoil, concerns about systemic financial crises and rising political risk have all helped to make a case for owning gold, not least thanks to its shock absorbing properties. As Dirk Baur and Brian Lucey at Dublin City University and Trinity College Dublin respectively have argued that gold is a moderate hedge against equities and bonds during normal market conditions, becoming a very good hedge in times of crisis, albeit for short periods.

This is an attribute investors should prize right now. In a world of unorthodox central bank policies, where a third of developed economy government debt posts a negative yield, where income generated by bonds is in many cases so paltry that investors peg all their hopes on capital appreciation, where financial and political crises follow each other like buses, gold's defensive qualities come into their own.

Gold's ability to mitigate the impact of market upheavals owes much to its distinctive correlation with other asset classes. Most of the time, the precious metal is marginally more correlated with bonds than equities but not particularly correlated with either. But in times of market stress, it becomes more negatively correlated with equities, giving investors useful protection against bouts of risk aversion. Over the past five years, gold, among other major asset classes, has had one of the lowest correlations with global equities according to our propriety risk indicator.

Adding gold to a typical investment portfolio with an initial 60 per cent allocation to equities and 40 per cent to bonds would over the past decade have reduced volatility – thus improving the portfolio's Sharpe ratio – and would have lessened peak to trough falls and lowered worst losses in slumping markets. Its persistently low correlation with equities would have provided diversification benefits. Indeed, a 10 per cent holding in gold (and proportional reduction of equities and bonds) since the start of 2007 would have improved a portfolio's annual returns and lowered its volatility by half a percentage point, according to our analysis.

Gold also acts as insurance against potentially damaging effects of policy errors. Ultimately, ever more extreme monetary measures will trigger inflation. And when inflation finally arrives, there's a substantial risk that central banks will be reluctant to step on the brakes for fear of causing another severe recession. Although gold's performance as an inflation hedge has been mixed over some periods, it has been a useful store of value during periods of very high inflation such as during the 1970s. Which is why it tends to be seen as a barometer of expectations about future price pressures. As Alan Greenspan argued when he was chairman of the Federal Reserve, "the price of gold… can be broadly reflective of inflation expectations".[1]

Currently we have over 6 per cent of our fund in bullion and nearly 2 per cent in gold mining stocks.[2] We have built up a position in the miners because they'd become very cheap after suffering a multi-year bear market.

Of course, there are potential risks to holding gold. In extreme circumstances, authorities may try to restrict its use. There is a precedent. In 1933, US President Franklin Roosevelt issued an executive order forbidding "the hoarding of gold coins, gold bullion and gold certificates", and furthermore that almost all gold was to be sold to the Federal Reserve.[3] But for the ordinary spectrum of bad economic outcomes – high and rising rates of inflation that central banks find themselves unable to control, market meltdowns and financial crisis of the type we've experienced over the past few decades – gold represents a valuable hedge and portfolio diversifier.

**Written by Percival Stanion, head of international multi asset, Pictet Asset Management**



[1] "The Fed Aims for Price Stability," Challenge, vol 36, no 5 (September/October 1993), p. 5.
[2] Holdings in the Pictet Sicav II – Dynamic Asset Allocation Fund as at 09.09.2016.
[3] https://fraser.stlouisfed.org/docs/meltzer/bogsub040233.pdf

# Gilts: To buy or not to buy, that is the question

**Sam Roberts explains why gilts are still an attractive investment holding for pension schemes**

Maybe I wasn't watching closely enough before, but I've recently noticed some respected commentators wanting UK defined benefit pension schemes to reverse the trend of buying UK government bonds (gilts), or at least to not buy any more. Liability-driven investment (LDI) seems to come in for particular criticism. Instead, so the argument goes, pension scheme money should be invested in growth assets such as equities, property and infrastructure to earn a higher investment return, receive a higher yield, and take the pressure off sponsoring employers' rising pension contributions. That way, UK businesses can reinvest more in themselves and pension schemes can invest in the future of the UK and the global economy. I can definitely see the attraction!

**So why am I sceptical?**

What this non-gilt approach seems to ignore is that trustees' time horizons and risk appetites are rarely as long or as large as assumed. There are five main reasons that persuade me to continue to talk to my clients about the benefits of investing in gilts (and LDI in particular):

**Trustees should target a bulk annuity, which moves with gilt prices.** Trustees' ultimate objective is to pay all members' benefits in full. The most reliable way to do this is by purchasing a bulk annuity, even if the current high cost of a bulk annuity means that we need to rely on some higher expected risky investment returns over the medium term to achieve it. Bulk annuity prices move broadly in line with gilt prices rather than equities, property or infrastructure, because insurers need to consider all the different risks and they have one chance to get the price right.

**The reliance on the employer should be reduced.** The strength of an employer's support for the scheme, and its ability to absorb the scheme's investment risk if there is a market shock, is difficult to measure at the best of times. But both the employer's support and the investment risk can change quickly, unpredictably, and undermine the health of the scheme at the same time (eg in an economic recession). If an employer is no longer solvent then the bulk annuity cost at that time will directly and immediately determine what proportion of their benefits members will get – in a flash, the trustees' time horizon has gone from many years to zero. Even if an employer remains solvent, the employer's available cash could be severely limited forcing the trustees to adjust their asset allocation and crystallise what could have been a temporary investment loss. The trustees' ability to provide members' benefits in full could also be severely damaged (as lower employer contributions and lower expected investment returns).

**Regulatory changes are moving in this direction.** Despite Brexit, and maybe because of BHS and Tata Steel, regulatory changes (eg IORP II) may push trustees to disclose and manage their risks more akin to how insurers manage their annuity books. Targeting a bulk annuity (see above) and buying gilts/LDI should be consistent with this.

**I'd expect employers to be sympathetic.** Most employers understand the impact of pension scheme risks on their accounts, and would prefer to remove these often large non-core business risks as soon as it's affordable to do so. Trustees should not be scared to start this conversation.

**LDI helps not hinders.** LDI allows schemes to invest in both gilts and growth assets at the same time. By introducing LDI, trustees can typically maintain their expected investment return (avoiding any immediate increase in the employer's contributions) and reduce the volatility of the deficit. It's not magic fairy dust, it's sensible risk management with an eye on the liabilities.

I'm always looking for ways to help my clients to challenge the status quo and find better ways of doing things, but I'm yet to be convinced that avoiding gilts/LDI is one of these such opportunities.

**Written by Sam Roberts, head of investment consulting, Cartwright Group**

In association with

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**Wednesday 2 November 2016**

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EVENTS

# Financial Empowerment: Managing the risks of poor member choice

Freedom and choice provided pension scheme members with a greater range of options in respect of their benefits. This in turn led to a significant increase in the number and type of decisions members need to make. Without good financial literacy there is a risk that members will make poor decisions.

This seminar will provide delegates with an opportunity to hear from a range of experts about what they must, should or could do to manage the risks of member choice.

Topics include:

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- Legal responsibilities
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- Member guidance – how can guidance lead to better member outcomes?
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# An ongoing success?

**As October sees the fourth anniversary of the launch of auto-enrolment, Talya Misiri examines how it is progressing and the obstacles it has faced**

Exceeding the 6.5 million auto-enrolled employee mark at the end of July 2016, as stated in The Pensions Regulator's *Declaration of Compliance* report, highlights the success of auto-enrolment so far.

In response, Minister for Pensions Richard Harrington has said: "Auto-enrolment is the cornerstone of our private pension reforms [...] it is clear that there is real momentum growing."

While the success of auto-enrolment is undoubtable, it has been noted the number of employees going through the process is still increasing, but now more slowly as small and micro employers begin to auto-enrol their businesses.

In 2015, five million people had auto-enrolled into a pension, whereas in 2016 just under one million employees have been auto-enrolled. This may be due to more employers, but with far fewer employees, auto-enrolling at this stage.

Furthermore, a year on from its October 2015 launch and subsequent industry debate about its effectiveness, the 'Workie' workplace pension campaign has continued to spread the AE message. The giant fluffy creature is the face of the campaign and is used as the physical embodiment of the workplace pension. Aimed at smaller employers,the series of adverts show Workie visiting multiple work environments asking them not to ignore him.

Since then, AE discussions include: self-certification, non-compliance fines, increased contribution rates encouraging opt-outs and the Lifetime ISA threat.

Employers' self-certification of their auto-enrolment has been compared to "letting drivers do their own MOT" by LEBC. Its divisional director Glynn Jones explained: "TPR says 90 per cent of employers are compliant, when in fact 90 per cent of employers are filling in a form to claim they are compliant, which is as reliable as a DIY MOT on your car."

The rise in penalty notices issued by TPR to employers who haven't auto-enrolled their business has brought the compliance issue to light.

The fine for small employers with one to four employees who have consistently failed to comply to penalty notices from TPR is £50 a day, and £500 a day for employers with five to 49 workers.

The Chartered Institute of Payroll Professionals found that 69 per cent of businesses have encountered additional costs related to auto-enrolment.

Furthermore, the employee opt-out rate in smaller employers has reached 17 per cent, in comparison to eight to 11 per cent among larger employers, the Pensions Policy Institute reported.

An additional threat to auto-enrolment and increasing opt-out rates has been the new Lifetime ISA. It is feared that people may leave their employer pension for a LISA instead. This is possibly due to a lack of understanding as to where their money would be better off or the benefits of employer contributions.

In March this year, members of the Work and Pensions Committee re-opened an inquiry into AE and invited written evidence on the impact the LISA could have on opt-out rates. There are also concerns that employers could encourage the LISA as a means of avoiding their obligatory contributions.

Moreover, a large, unmissable issue is that people generally do not know where their pension is invested. It is this lack of knowledge among pension scheme members that may be encouraging opt-outs or inadequate savings levels. Some members are not even aware that their pension is invested at all.

Commenting on the minimal investment knowledge, Columbia Threadneedle head of institutional sales EMEA Dominik Kremer said: "They *[auto-enrolled scheme members]* are not able to maximise the potential of their investment and risk sleepwalking into a pension income black hole."

Looking to the future, the government has confirmed its plans to delay the increases to AE contribution rates to 2019. The changes are an amendment to The Employers' Duties Regulations 2010 and came into force on 1 October 2016.

Punter Southall Aspire managing director Alan Morahan said: "Employers will be pleased [this] will certainly help their financial planning process over the next couple of years."

While the delay definitely has its benefits, it has not been received with great optimism by all. The government's plan to increase minimum contributions has led enrolled savers to state that they "might" or "definitely will" opt out of their workplace pension, according to research from NOW: Pensions. Its CEO Morten Nilsson noted that: "Losing savers at this stage could be damaging and have long-term consequences for the success of the policy".

Ultimately, however, we will have to wait a few more years to see if these concerns are well founded and how AE will impact the sector in the long term.

**Written by Talya Misiri**

# Effective delegation

**Claire Collier examines how court cases and legislation can reveal tips for trustees on how to successfully implement fiduciary management**

Fiduciary management is becoming an increasingly popular option for UK pension schemes: *Aon Hewitt's 2016 Fiduciary Management Survey,* for example, indicated that take-up rates had more than doubled, from 18 per cent in 2011 to 45 per cent in 2016, while 20 per cent of those surveyed who do not yet use fiduciary management said that they plan to explore or are currently exploring fiduciary management. But legislation and case law in this area is fairly limited, so it can be difficult for trustees to get to grips with how they should go about delegating their investment functions and what limits should be placed on any delegation.

The recent private trust case of *Daniel v Tee*[1] provides helpful (and timely) guidance on the hallmarks, from a legal perspective, of a successful delegation to a fiduciary manager. The case concerned a trust fund with assets of around £3 million, which was set up for the benefit of two children following their father's death in 1999. The trust fund suffered substantial losses following the bursting of the dotcom bubble. The claimants in the case argued, amongst other things, that the trustees did not themselves consider whether the investments made on behalf of the trust fund were suitable or whether the portfolio was appropriately diversified. The trustees had delegated the exercise of their investment powers to one of their number, who had in turn delegated decisions as to suitability to an investment adviser. The claimants said that this delegation was excessive and impermissible.

In dismissing the claim on the facts, the High Court also observed that:

- trustees are required to exercise supervision and control over the strategy and pattern of investments (which the trustees in this case did);
- however, trustees are not required personally to make or to be involved in making each individual investment decision, particularly in light of the potential complexity of investment choices in the 21st century and the number of decisions that are likely to need to be made over a period of several years.

In a pensions law context, it is also worth rehearsing the relevant provisions of the Pensions Act 1995. Most importantly, Section 34 provides that any discretion of trustees to make any investment decision may be delegated to a fund manager (that is, a person who manages the investments held for the purposes of the trust) who is authorised under the Financial Services and Markets Act 2000. Trustees are not responsible for the acts or defaults of any such fund manager if the trustees have taken all reasonable steps to satisfy themselves that the fund manager has the appropriate knowledge and experience for managing the scheme's investments, and is carrying out his work competently and complying with the requirements of Section 36 of the Pensions Act 1995 (which relates to choosing investments).

So, what can we conclude from the legislation and *Daniel v Tee* about the hallmarks of a successful delegation to a fiduciary manager? The following points are key:

- Trustees should think carefully about who should be selected as their fiduciary manager, ensuring as a minimum that their chosen provider has the appropriate knowledge and experience. It may assist trustees to appoint an independent adviser to help with the selection process.
- Trustees should ensure that the respective roles and responsibilities of the trustees, the investment sub-committee (if there is one), the fiduciary manager and any other advisers (for example, any independent adviser appointed to assist in monitoring the fiduciary manager) are clearly defined and understood by all parties. In particular, trustees need to be clear about which investment decisions are being delegated to the fiduciary manager.
- Trustees must retain responsibility for overall investment strategy and risk management, but other investment decisions, such as asset allocation (within agreed ranges), investment manager selection, liability hedging and dynamic risk reduction can be delegated to the fiduciary manager. The extent of the delegation tends to vary from one scheme to the next depending on the trustees' specific requirements.
- Trustees should put in place procedures for regularly reviewing and monitoring their fiduciary manager's performance and compliance with legal requirements. Again, it may be appropriate to appoint an independent adviser to assist in this process.
- Trustees should ensure any potential conflicts of interest are identified and appropriately managed.

Ultimately, responsibility for investment decisions rests with the trustees, but *Daniel v Tee* provides useful recognition from the High Court that it is possible, by applying appropriate controls, to design and implement a successful fiduciary management arrangement.

**Written by Claire Collier, senior associate, Baker & McKenzie**

In association with Baker & McKenzie

[1][2016] EWHC 1538 Ch

# Pensions administration – upping the game

**Francesca Fabrizi meets Mark Adamson, director at JLT Employee Benefits, to discuss the current trends in pension scheme administration today**

**What are some of the key issues currently impacting administration?**
There is plenty going on. The three things I would pick are freedoms and the implications of freedoms. Somebody needs to help members understand what the freedoms mean, what their options are, what they might do with those options and what the implications are, and that falls typically to the pensions administration provider to do that.

Scams are another issue. We are still seeing a lot of scam activity around – unscrupulous advisers seeking to help or persuade innocent members to move their pensions somewhere where they shouldn't and, again, it's the administrator's role to identify those and try and deal with them.

The third issue is around data management – putting sponsors and trustees in a position where they can be confident of their data; so making sure it is where it should be, it's up to date and it is properly maintained.

**What are admin providers doing to further support members?**
Members requirements rarely change – they want good service in a timely manner. What has changed and what continues to change are the methods of delivery because, although the members' requirements are basically the same, their expectations grow year on year. Use of the web, for example, to empower members and educate members – that's a very important thing that finally is beginning to take off in the administration sector.

Also, online identification of members, this is something that will help members when they come to a key event like retirement, for example – they won't have to send in their certificates that could get lost. People don't like parting with these personal items, anxious that they can get lost, and online verification speeds things up as well so it's an important development.

Also, we have suffered in the administration sector from over-compliance sometimes, and we have now loosened up a bit. For example, phone transactions can take place more than they could, so the member who doesn't want to use the web, for example, can ring up and ask for something and doesn't have to write in to ask for it. Coming back to one of the earlier points, guiding the member through the options, proactively doing that is key. When members come to retirement, for example, they get a letter that says an awful lot of stuff – administrators are taking on the mantle of being proactive, ringing up the member, talking to them over the phone, offering to meet them, to take them through the options they have so they recognise what the implications of those options are and help them actually enact those options.

The final thing is systems – I don't know if you have heard of Origo, it's software that speeds up pension transfers for the member. At JLT we have deployed Origo and it is beginning to pay real dividends, we have managed to reduce end-to-end time from an average of six weeks to six days – that's really good for the member and we have done that over very large numbers of transfers.

**What are providers doing to further support trustees and employers?**
Trying to help the trustee and employer reduce their risks is important – administrators are recognising that risk management is vital to those people running pension schemes. So finding ways of reducing risk by improving automation, improving audit, improving compliance activities – those are quite important features that typically are welcomed and recognised by trustees.

Data activity is key – so working hard on data quality, cleansing it where it's necessary, but at first understanding what the quality of the data is, working with sponsors and trustees to identify what needs to improve, what needs to be maintained. This is very important to sponsors and trustees because when they come to issues like de-risking they need their data to be in good order.

Something we are working on at the moment is voice analytics – this is recording phone calls that members make, analysing what they are talking about and seeking trends that wouldn't necessarily otherwise be identified. The final thing – and some of these things all link together as you'd expect – is about providing trustees and sponsors with a seamless service to the membership, so enabling the member to come to a retirement point, transfer point, whatever it might be, and provide a range of services from that point onwards, which means not just working with them to identify what their options are, but enabling them to carry out those options, whatever they may choose to do – this can be provided by one sole supplier. Trustees and sponsors like that and that is something the administration provider is looking to improve on.

**What should trustees/sponsors do if their admin provider isn't delivering?**
It happens from time to time, inevitably, and hopefully those things can be easily corrected. I think trustees in particular, who often have the day-to-day contact with the administrator, need sometimes to take the initiative to identify there's an issue and do something about it.

Their issues are often around service quality, around unexpected costs, around partnerships – a true working partnership can be hard to create and can be very easy to lose. Those are the kinds of things that very often trustees can feel dissatisfied with, so engaging to identify those points and talking to their administrators about them is essential, then agreeing with their administrator performance measures, performance improvements, deadlines and making it clear to the administrator what the consequence is if they don't get to where they have agreed they are going to get to. That's not in a threatening manner – that's simply to ensure that the trustees and sponsors are being delivered the service that they have contracted with their provider to deliver.

So hopefully that kind of engagement has the desired effect. If it does, then happy days. If it doesn't then they, at that point, regrettably, should move on and find another provider that they believe will do the job for them.

**What should cause in-house administered schemes to consider outsourcing?**
There are still quite a lot of schemes, far fewer than there were of course, that remain in-house administered. This is because they may be paternalistic or avuncular and they want to look after their employees, and ensure they are getting the right sort of guidance and the right sort of service, so that's an important feature of why schemes remain in-house administered.

I think it may also be because sponsors feel they can control costs more easily if they have the team managed in-house and that may be true. Of course it is sometimes the case with in-house schemes that the predicted costs tend to be limited to the cost of the people without always taking into account wider costs, so you need to be careful to make the right comparison as to what an in-house team is costing.

Also, if a scheme is being managed in-house for a while, which they will have been, they will probably have experienced people, people who know the scheme inside out, people who provide an excellent knowledge base for administration and deliver good administration. One doesn't want to say goodbye to those attributes if they are there. But as time goes on, of course things change – schemes close, then fewer and fewer active members of course are members of pension schemes; deferred members may still be employed with the scheme and the employer, but perhaps there is less contact and less connection with the deferred members than there used to be with actives.

Systems of course can also be an issue – systems may have been in place with the in-house team for 20 or more years, so perhaps they are beginning to creak, they need updating, upgrading, perhaps even replacing. That can be costly and that can cause sponsors to perhaps think about outsourcing.

**What would you say to in-housed managed or outsourced schemes about how they should change their provider?**
Trustees and sponsors can do it for themselves and if they have a pensions manager in house, for example, that has experience of having done this before, they can then use that experience and carry out a selection process on their own – that's entirely possible. Others may turn to what we call third-party evaluators, who are experts in helping schemes, trustees and sponsors to find a new provider for a particular scheme.

In terms of process, it's really the obvious, like ensuring there is an RFP *[request for proposal]* and an ITT *[invitation to tender]*, which sets out everything the scheme requires; sets out the services that are required, the standards that are required, asks the right questions of the administrators to get the appropriate responses back, so that process obviously is fundamental and typically schemes might send that out to four, five, six different providers. Then, following the RFP process, they generally narrow those down to around two or three providers and carry out site visits. That's very important – kicking the tyres, seeing what's going on in that environment; seeing the people working, getting as much feel for how administration is done in that environment as possible; meeting the people, talking to the people who you will be working with. Then of course taking up references from existing clients of those providers – that's clearly an important feature. So those are three key steps – of course there are others around that.

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

**Written by Francesa Fabrizi**

In association with JLT

# Pensions Age Autumn Conference: Raising the game

**The autumn conference this year looked at how trustees, policy makers, investment managers and consultants can raise their game in a time of economic and political uncertainty**

Since the vote to leave the European Union, pensions, especially defined benefit schemes, have faced increased turbulence, with some signalling the 'Armageddon' of pensions. At the beginning of the Pensions Age Autumn Conference there was a palpable downbeat feeling in the room.

This however, did not last long. It came as a relief that the opening keynote speaker, The Pensions Regulator executive director for regulatory policy Andrew Warwick-Thompson, put minds at ease when he declared that there is no pensions crisis.

Warwick-Thompson said that TPR has the best data on pension schemes, as all schemes have to submit a scheme return. He reassured trustees that analysis of the data by TPR has found that most employers with DB schemes will be able to meet their long-term financial obligations.

Warwick-Thompson noted that these headline figures that are in the trillions are based on buyouts and as insurance companies base their buyout prices on bond yields, which have fallen, it means prices have gone up, making deficits look like they are in the trillions.

"What the trustees look at, what the employers look at, what they negotiate about and what they decide will be their deficit recovery contributions stand at about £320 billion. That's still a big number but it's not unaffordable."

### Investment

Of course, in order to manage defined benefit pensions, the right investment choices are key, which is challenging in the current economic climate. However, M&G Investments multi-asset fund manager and head of research Eric Lonergan explained to delegates how to "navigate a world of negative interest rates".

Cash, he said, has no volatility but it is guaranteed to deliver a negative interest rate. Lonergan noted that just because something has low-level volatility, it doesn't mean it is going to provide a good return.

In addition, he advised people to be "deeply sceptical" about the economic future as no one really knows what the outcome will be, giving particular reference to Brexit. Instead, he advised that some

simple investment choices could make a difference. For example, he said bonds are not irrational but they are low returning and risky. On the other hand, equities are highly probable to deliver returns but this could be violently quick or cumulative.

As with any investment strategy for a defined benefit scheme, the objective is to be able to generate income to meet near-term liabilities whilst providing the opportunity for capital growth to contribute to deficit recovery. UBS global investment solutions strategist Stephen Friel and senior strategist and director Michael Walsh spoke to delegates about ways to achieve this.

Similarly to Lonergan, Walsh noted that assets held in cash would be of no help to the scheme in meeting its overall requirements. In addition, Friel noted that asset classes like government bonds, which have virtually no credit risk and allow for certainty about what the returns will be, ultimately generate low yields.

Aon Hewitt partner and head of European distribution Sion Cole talked the audience through the three evolutionary stages of fiduciary management; choice, transparency and outcomes. He noted that the market has evolved, providing greater choice in all areas.

He said this has led to a lot of growth in assets under management, with over £100 billion invested in fiduciary solutions in the UK, and around 15 per cent of private schemes now use fiduciary management. With increased choice comes improved transparency, Cole said, particularly when it comes to fees: "The two areas that we are seeing a greater focus on transparency are fees and performance." He said that as a result they are witnessing some great outcomes and 98 per cent of customers are satisfied or better than satisfied with their fiduciary manager.

### Administration

Barnett Waddingham administration manager Ben Clacker focused on overcoming the challenges of overseas pension transfers and pension scams. With regards to Qualifying Recognised Overseas Pension Schemes (QROPS), Clacker noted how the "good faith" element of QROPS has been removed by HMRC, which is reflected in the name change to Recognised Overseas Pension Schemes (ROPS). Therefore, he warned that "significant due diligence" is required as HMRC will not clarify what they expect.

He said one of the big problems has been with overseas property developments, where people are promised a 7 per cent return but only during the construction stage, nothing is promised on completion. He also said a feature of a scam scheme is accounts that show no contributions, only transfers in. He said there is often member restrictions and a lack of investment diversification and pre-emptive transfer applications. He also added that the purpose of these schemes is usually described as a vehicle to invest in a named manager.

ITM director Maurice Titley and ITM senior consultant and client manager Matt Dodds spoke to the audience about data management. He described it as "the development, execution and supervision of plans, policies, programmes and practices that control, protect, deliver and enhance the value of data and information assets". Dodds said that in today's world there is much more of a need and a desire to be thinking longer term about data to prevent things from going wrong in the future.

In addition, Titley informed the audience about the new data protection framework adopted by the European Union, which will be implemented by all member states from May 2018, without the need for national legislation. Despite the UK voting to leave the EU, Titley still thinks that the new framework will apply to UK pension schemes. One of the big changes, he said, is that if you breach it there is a maximum fine of €20 million or 4 per cent of turnover for big corporates.

### Defined contribution

With regards to defined contribution pensions, Schroders head of UK institutional defined contribution Stephen Bowles touched on the importance of managing risk. He said that in pensions, as like most situations in life, it is "simply not realistic to expect us to take no risk".

He said to manage risk, you must have an objective and for defined contribution savers that must be to have enough money in retirement. "A risk on uncertainty that they face is that they have insufficient funds in retirement".

Therefore, Bowles stated that managing risks help consumers feel engaged with their pension savings and could improve outcomes. Furthermore, from an investment perspective he said that if they can generate a good outcome in monetary terms they can show that managing risk can provide an improved financial outcome.

Bluesky Pensions CEO Paul Bannister talked to delegates about

about the current issues facing members, master trusts and DC schemes when considering consolidation. He said that with the pension freedoms people have been given the opportunity to look at their pensions again and do more with them. He said as a result member consolidation is has an opportunity to come back but we need suitable products to manage member consolidation.

He noted that consolidation isn't a bad word but it may not be perceived as a positive thing for members. However, he said the word 'partnership' could be used instead to promote more positive connotations of consolidation. "As part of a bigger machine, consolidation could be a positive," he said, noting that scale can bring better governance and member engagement.

**State pension**

Another keynote speaker was the Department for Work and Pensions' State Pension Age Review team head Sofia Stayte, who talked delegates through the process of how increases to state pension age will be explored.

Stayte said the age will be reviewed against three key pillars; fairness, affordability and fuller working lives to ensure that it is "fair and sustainable". "At first we thought it would be very straightforward, we thought 'we know exactly what we need to consider'. But what we discovered is actually, it's very difficult to define fairness and affordability."

Stayte explained that the review measures affordability through looking at its dependency ratio: how many workers it takes to pay for a pension, public expenditure: how much of GDP should be spent on

pensions and economic growth and productivity – which is somewhat "difficult to control and predict".

**The view from pension managers**

Providing a view from what its like to be on the inside of a pension scheme, Ladbrokes senior reward manager Phil Rixon explained to delegates that 2016 is proving to be an interesting year. In particular this is due to a proposed merger of Ladbrokes with Coral, which would double the company's defined benefit pension scheme liabilities to around £900 million. In addition, the defined contribution membership will double to around 16,000 people.

"My personal pensions position is that pensions are a massive part of the overall reward package but they are only one part," he said. "We shouldn't view pensions as one thing sitting in an ivory tower somewhere to the detriment of everything else."

On trustees, Rixon said he struggles to understand why there isn't independent trustees in most arrangements: "Pensions are so complicated, I don't understand why it isn't a go-to point for most sponsoring employers.

"I wouldn't put very well meaning, very talented, very dedicated, very good individuals in charge of a business unit with massive assets and liabilities, so I'm not going to do the same for a pension scheme."

In terms of what's going on with pensions policy, Heathrow Airport Holdings head of pensions Chris Parrott criticised the government for only focusing on the short term. He also said we need to think about who is driving policy – "the Department for Work and Pensions…but if you really want the answers ask the Treasury".

He also criticised Tata Steel for trying to walk away from their pension obligations and pleaded with the government and The Pensions Regulator to not let them: "If Tata Steel get their way, there is going to be a queue of employers that will seek to change their obligations as well."

In addition, he talked about the pensions versus property argument, which has been covered in the press recently. He said property is a "one-way bet" and added that the Bank of England's chief economist Andy Haldane's comments telling people to invest in property are not helpful.

"There's a lot of advantages of pensions over property. That's not to say pensions are the only thing, as long as there is a balance and a sensible reasoning."

# In it for the long term

**David Watt highlights some of the key points for pension schemes to consider when selecting an insurer for a buy-in or buyout**

In selecting an insurer, price is an important factor for pension schemes, but price should not be the only factor and a low price may not always be the most meaningful consideration in the long term. Unlike the short-term insurance business (for example, motor and property insurance), where the consequences of under-pricing quickly manifest themselves, the repercussions for the pension buy-in and buyout business may not be realised for many years. This poses a challenge for pension schemes who are entrusting an insurer to meet the obligation to pay scheme members for the next 50 or more years.

One of the main benefits of buy-ins and buyouts is that the security of members' benefits naturally increases as they move out of the pension's framework into regulated insurance. However, not all insurance companies have the same financial strength and this should not be overlooked when selecting an insurer.

In the US, the 1991 insolvency of Executive Life, a California-based annuity writer, offers an interesting case study that ultimately led to a system under which pension plans cannot select insurers that have not first met independently-assessed 'safest available provider' criteria, irrespective of the price they can offer.

In the UK, a prudent regulatory framework exists to ensure that insurance companies remain strong, but no such specific requirement exists for buyout providers to be independently assessed against set criteria. To a large extent, pension schemes implicitly rely on rating agencies, the Prudential Regulatory Authority (the PRA) and any covenant advice that they take to assess and ensure the financial strength of insurers. The PRA is responsible for the regulation and supervision of insurance companies, while rating agencies consider various criteria in order to provide opinions on the financial strength of insurers in respect of their ability to pay claims to policyholders.

Regulatory capital coverage ratios and rating agency opinions are helpful to pension schemes in assessing the short-term financial strength of prospective buy-in and buyout providers, but what criteria might those schemes and their advisers use to form their own view?

**Capital requirements**

Insurers hold capital to ensure they can pay policyholders. Under the current regulatory capital regime (known as Solvency II), insurers are required to hold capital that reflects the risks they are exposed to, such that the insurer is 99.5 per cent certain of its ability to pay policyholders over the following year. In practice insurers hold a range of buffers above this requirement, making failure over the following year theoretically less likely than 0.5 per cent. Because it contemplates a one-year horizon, this measure can drive trustee and other decision makers' focus onto these shorter-term measures. Over the longer term, considerations, such as the quality, size and diversification of the insurer's balance sheet, are also important indicators.

**Balance sheet quality, size and diversification**

Insurers back the pension promises they take on with a variety of investments and must strike a balance between investing with caution and sourcing assets that generate yields sufficient to support competitive pricing. A large, established insurer with a high quality, well-diversified investment portfolio may in some instances charge a higher premium than those insurers that operate less diversified investment portfolios.

The benefit of diversification also extends beyond an insurer's investments. Mono-line insurers that focus on a specific product are exposed to a much narrower range of risks than multi-line insurers. Pension schemes therefore need to decide whether a higher premium represents good value for the additional security offered.

**Long-term value**

Whilst price will always be an important consideration, trustees and sponsoring companies should also pay close attention to the value of the policy they are buying. The long-term security of the insurer – demonstrated by a large and well diversified balance sheet – is an important and often overlooked point in that value consideration.

**Written by David Watt, new business director, Legal & General**

# A matter of trust

**_Pensions Age_ and Aon recently undertook a reader survey to discover what issues really are the most important within the master trust market. Here we reveal the findings**

Master trusts have been the subject of fierce discussion lately within the pensions industry, with conversations veering widely – on one side it is touted as the 'saviour' of DC saving, while the other warns of market over-saturation.

This conversation began in earnest ever since auto-enrolment launched four years ago, resulting in new members saving into pensions in their millions.

Master trusts were understandably seen as the ideal answer as to where and how these new savers should have their money managed. After all, master trusts – professionally managed, multi-employer DC pension schemes – are widely accepted as the providers of improved governance and better value for members, through economies of scale reducing costs, compared to individual employers managing their own trust-based DC scheme.

But with over 100 master trusts now in existence in the UK, the focus has turned to the sustainability of the market, with consolidation of the market expected to occur. And now, as such high volumes of members are saving in master trusts, scrutiny as to the governance of these structures has understandably increased.

Exactly how effective and independent oversight of master trusts should occur, how they are regulated and what protections need to be in place for members, have formed the central subjects of debate.

These are all valid points to consider, as solutions cannot begin to occur without these discussions taking place. However, without a clear focus on what needs to be addressed and what the users are looking for with master trusts, it can be difficult to find solutions within the muddled swirl of conversation.

This is why *Pensions Age,* with Aon, recently decided to survey our readers about the issues that really matter to them when considering using master trusts. By really understanding what the selectors of master trusts require and desire, we can then ensure that master trusts will evolve in the 'best' way and truly meet the needs of modern DC savers.

***Pensions Age***

In the past five years the UK's pension landscape appears to have embraced the old adage that the only constant is change. While the goal of achieving the best possible member outcomes has stayed in place, with almost-annual changes to legislation, regulation and pension options it's starting to feel like the playing field is continually shifting underfoot.

And yet, against this backdrop, master trusts are emerging as a stable vehicle for DC provision and are increasing in popularity. And, why not? They offer a compelling combination of professional governance and administration relief for companies, the potential for increased engagement, flexibility, and communication for members (thanks, in part, to embracing new technology) and they use economies of scale to keep costs down.

In light of all of this, Aon recently undertook an extensive survey with *Pensions Age* to better understand what they see as the benefits, challenges and opportunities of master trusts. We received over 130 responses from *Pensions Age* readers – and here's what they had to say:

**Growth in popularity of master trusts**

Some estimates indicate that there are up to 150 master trusts currently available and recent research by Aon Hewitt suggests that within five years master trusts could make up 13% of the DC pensions market, accounting for £70 billion in assets.

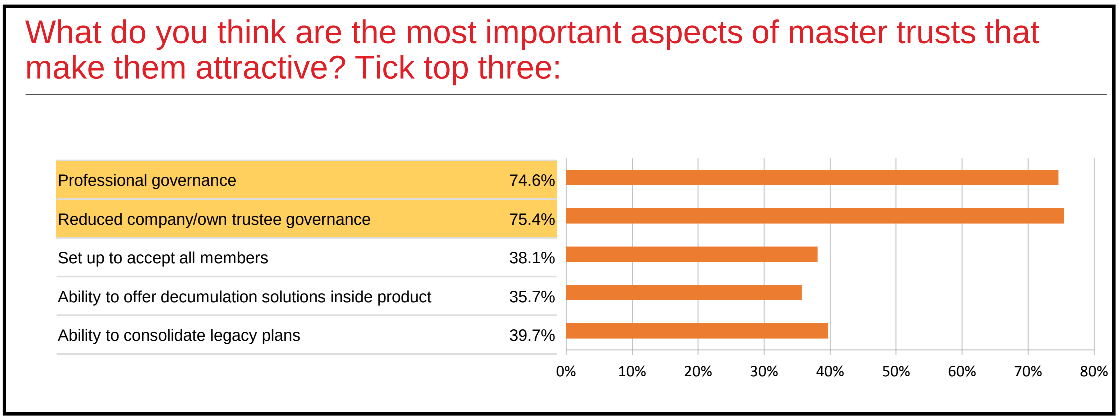
Results of this survey seem to support these claims, with over 55% of respondents planning to use master trusts for at least some part of their DC workforce within the next five years, compared to only 37% of respondents that are using them today.

Respondents consistently cited a shift to professional governance as one of the most attractive elements of moving to master trusts, with cost and quality key to choosing between them. They saw their potential to engage members through technology as a promising sign for the future.

It is not all untethered optimism, however. It's difficult to imagine a scenario where so many master trusts can survive and at the same time offer the levels of engagement and economies of scale that make them so attractive in the first place. These concerns, however, are being addressed, with the recent Queen's Speech including a Pensions Bill, featuring 'greater protections' for master trusts. What these 'greater protections' will involve is yet to be seen but our survey respondents – who share in these concerns – had some ideas *[see Chart 2 opposite]*.

Clearly, it's a critical time for the master trusts market. Like any early frontier the landscape holds both opportunity and risk and it's likely not everyone will survive. The only certainty is that there are plenty of changes ahead.

Chart 1




**So, why the increase in popularity of master trusts?**

The introduction of auto-enrolment, coupled with new legislative and governance pressures, including the reduction of annual management charges and charge caps and it's no surprise to see our respondents list a shift to professional governance as the most attractive aspect of master trusts *[see Chart 1 above]*. When asked to compare the strengths of all the DC arrangements available today, governance was again emphasised as one of master trusts' distinguishing features. But respondents also pointed out that it was superior to other options in terms of its ease of use and time-saving ability, its potential to deliver in-built decumulation services and, to a lesser degree, its charges.

It's also worth noting that the only times that master trust wasn't the majority response was when respondents considered them 'all the same'. It's clear that in most cases master trusts are the preferred DC arrangement.

**Still, concerns abound. Are they justified?**

The concerns of those in the industry and government – regarding the early frontier nature of the current master trust landscape – appear to be shared by our respondents. We asked respondents to consider this statement:

"There are currently over 100 master trusts in the market with fears that they can't all survive. The recent Queen's Speech included a Pensions Bill featuring 'greater protections' for master trusts."

And then asked whether there are currently too many master trusts. Over 72% of them answered 'yes'. With 57% citing a reduction in pension confidence – after the inevitable failure of some trusts – as part of their concern.

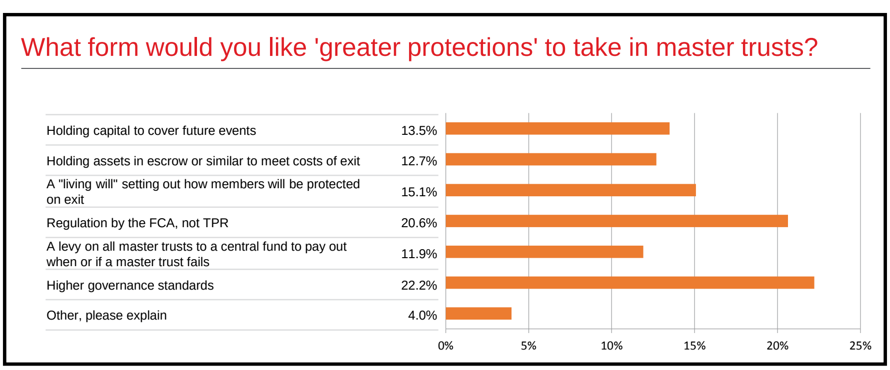
For those with a master trust, when asked how concerned they were for their particular arrangement, given that some might fail, over 45% held no strong view; but 38% were confident that theirs would survive even if the sector shrank in the future.

In response to their concerns respondents were asked what form they would like "greater protections" to take. Interestingly, this was one of the most evenly split responses in the whole survey, with 'higher governance standards' and 'regulation by the FCA' the slightly more popular options.

Master trusts – with their combination of professional governance and administration, their potential to increase engagement and communication with members via new technology and economies of scale – appear uniquely suited to alleviate many of these pressures. And even though there are inevitable challenges and changes ahead – who will survive, what form will 'greater protections' take and how will Brexit affect the landscape – all the signs, including the results of this survey, point to master trusts being a significant opportunity for the future.

*To receive a copy of the full survey write-up, please email talktous@aonhewitt.com or visit aonhewitt.com/mastertrust to download a copy.*

Chart 2




**Tony Britton, head of consulting, Aon Delegated DC Services**

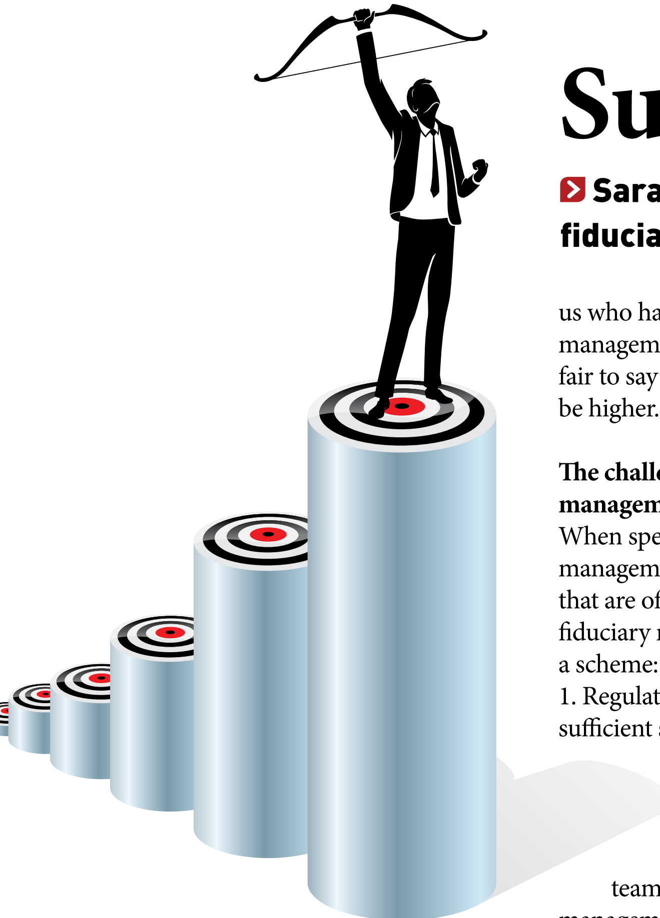
In association with AON Empower Results®

# Fiduciary management focus:
## A secure future

**Survival of the fittest** - *Sarah Leslie looks at the evolution and challenges of fiduciary management* ***p42***

**Branching out** - *Edmund Tirbutt examines where fiduciary management is heading* ***p44***


Sarah Leslie, head of fiduciary management, UK & Ireland, Russell Investments



# Survival of the fittest

**Sarah Leslie looks at the evolution and challenges of fiduciary management**

Charles Darwin's theory of evolution states that all life is related, descended from a common ancestor, evolving to adapt to changes – survival of the fittest. In a similar vein, fiduciary management is the offspring of a governance model that was found wanting. A governance model that had to evolve to survive the continuing challenges faced by pension schemes. Reflecting this, fiduciary management has grown in popularity over the last decade. But why doesn't everyone use it?

**Introduction**

The fiduciary management industry in the UK has grown significantly over the last decade, with broadly one in ten schemes using some form of fiduciary management according to one of the leading surveys. While this number seems significant, for those of us who have been involved in fiduciary management since it began, I think it's fair to say we would have expected it to be higher. So why isn't it?

**The challenges of fiduciary management**

When speaking to people about fiduciary management, there are five core themes that are often highlighted as reasons why fiduciary management is not suitable for a scheme:

1. Regulation and governance: We have sufficient structures in place to manage our scheme, so we not need fiduciary management.
2. Size and resource: We are too big / have an in house team / too small for fiduciary management to be applicable.
3. Control and delegation: We don't want to lose control and there are things we wouldn't want someone else doing (picking managers, picking asset classes etc).
4. The ultimate end game: We are well funded, nearly 100 per cent, so what benefits would a fiduciary manager bring.
5. Cost: It must cost more, particularly if we are small, and we may end up paying for services we don't need.

Each point is a valid one for why schemes haven't been adopting fiduciary management. However, while listed as five points above, each is interlinked and really boils down to one point – people.

**The template for success?**

Before we drill in to the above challenges, like most UK fiduciary management related articles, this wouldn't be complete without a reference to the home of fiduciary management, the Netherlands. The fiduciary management model has been extremely successful in the Dutch market, albeit some would argue this is in part perception rather than complete truth. However, I believe we have two good lessons to learn from the Netherlands: regulation and governance.

Firstly, regulation. In the Netherlands the regulatory environment has had a much sharper focus on solvency, risk and liabilities. This has provided trustees and companies, as well as those providing pension services, greater clarity and focus on the challenges faced – which is vital in order to move forward.

Governance then provides a framework of how we can move forward to get the most successful outcome, addressing the challenges faced now and in the future. Governance, while vitally important, is often seen as tedious. It has also struggled with demonstrating its value. This means it can often be seen as an afterthought, a nice-to-have. In contrast, in the Netherlands, governance is at the centre of the pensions industry, with trustees and companies more consistently asking what is best practice when fulfilling their fiduciary duties.

Don't get me wrong, both regulation and governance have made leaps and bounds forwards in the UK. However, recent events at BHS have put pensions front and centre in the news, reminding us just how far we have to go.

So does regulation and governance fix everything? No. But it helps us focus on the real challenges we face.

**Addressing the challenge**

Firstly, we all need to fully recognise the objective we have been set. Increased regulation could support this, but ultimately we are all aware of the objective – to pay the benefits promised, most realistically expressed through a solvency / buyout metric.

Once we understand the full extent of the objective, we can then ask how we best meet it.

We all have a part to play in this – and it is therefore important to understand the challenges we each face, and how these can potentially impact our success. These challenges may include:

• Treating everyone as 'experts'. The pensions industry, who wish to encourage people to focus more on their pensions, often continue to talk in a language that disengages most of the population.
• Engagement challenges. Companies want to support their members, but aren't as engaged with their obligations as they could be due to the challenging dynamics often found and other commitments that pull resource and time.
• Responsibility translating to a need to do rather than delegate. Trustees, who have taken on a significant responsibility, often feel obliged or a desire to be involved in the detail – particularly the more interesting aspects of investment.
• Resource challenges. In-house teams and pension managers, who provide support, resource and expertise for our pensions, in many cases would like greater support, resource and expertise to deliver better for their members.

By recognising where we are, the challenges we face, and where we need to get to, we can truly begin to make progress forwards – improving the outcomes for each and every beneficiary. This is where a clear and robust governance structure is important. There are two parts.

Firstly, look at all the decisions that need to be made for your scheme. Order these from high level (objective setting, risk and return targets) through to the more detailed decisions (picking asset classes, sub asset classes, styles, managers, trading, custodian selection).

Then comes the difficult second part. Objectively assess who is best to make these decisions and what framework this should be within (for instance, what oversight and control there is). When carrying out this assessment, involve everyone you can (trustees, companies and other stakeholders). Ask individually and in groups. Reverting back to the five challenges we started with, some questions you may wish to include:

**1. Regulation and governance:**
Are your structures optimal or do you end up ratifying what is recommended? How confident would you be to challenge a recommendation? If circumstances changed, how quickly would you know? And how would you react?

**2. Size and resource:**
Is big / small to us, big /small to the rest of the industry and others who can do these functions? Are there options we can explore to complement our size? Is our structure robust (if someone leaves / goes on holiday / is ill, what happens?)

**3. Control and delegation:**
What can we do to add the most value to the scheme? How much do we want to control versus how much should we control? What experts can we use to help us?

**4. The ultimate end game:**
Are we really well funded? On what metric? Would buy-in/out make sense, or is the hidden cost of doing so (loss of capital to deploy) too great?

**5. Cost:**
What is the value to us of good process and governance – both now and if things change? Do we know it will cost more? What do we get for the additional cost? And is this something we should have regardless?

Remember at this stage: delegation is not a negative term. In fact, most schemes have already delegated many aspects (stock picking, pension payment, administration, calculation of benefits due etc). The important point is finding the right structure to get the best outcome for your scheme.

**So is fiduciary management right for all?**
I believe for most it is.

It enables us to ask the hard questions and understand our responsibilities.

Working together, it then assists us with creating a bespoke yet robust governance structure, built around relationship, understanding and accountability.

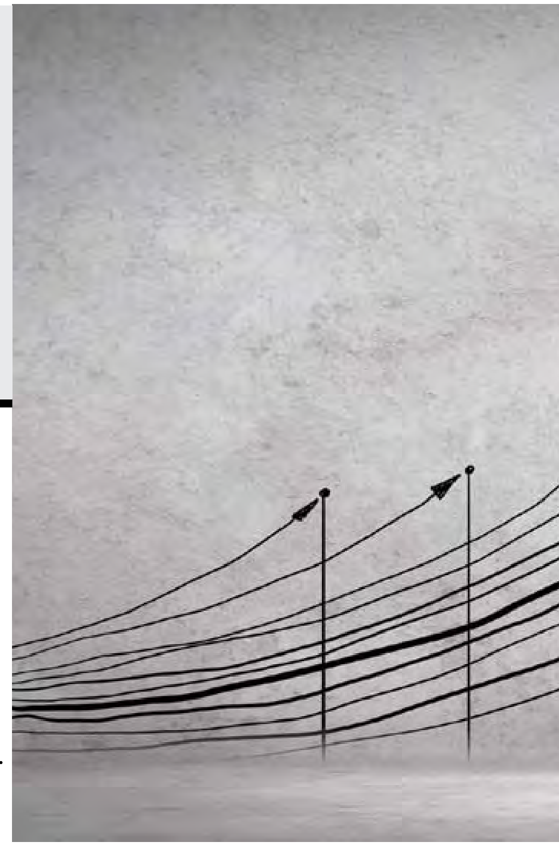
Finally, by combining the resource and expertise needed, fiduciary management supports trustees and companies to deliver the best possible outcome for every beneficiary.

**Written by Sarah Leslie, head of fiduciary management, UK & Ireland, Russell Investments**

In association with

Russell Investments

**Summary**
- To date fiduciary management has been most popular with trustees of smaller schemes, as larger ones tend to have greater in-house resources, more time available and better governance structures.
- A key development in the evolution of fiduciary management has been an increased usage of third parties, both to advise on the initial appointments of fiduciary managers and to monitor them on an ongoing basis. The development of benchmarking services promises should also make it easier for trustees to monitor fiduciary managers themselves.
- There is an opportunity for the use of fiduciary management to extend out to DC schemes, but the auto-enrolment charge cap may be a limiting factor.



# Branching out

**Edmund Tirbutt examines where fiduciary management is heading**

Feedback about the progress of fiduciary management within the defined benefit (DB) sector is notorious for the way in which it differs from one source to another.

For example, the *2015 KPMG UK Fiduciary Management Market Survey* finds that one in 10 UK DB schemes are now using some form of fiduciary management, but Aon Hewitt's *2016 Fiduciary Management Survey* finds that nearly half of UK schemes have either a full (32 per cent) or partial (13 per cent) fiduciary mandate.

The situation almost certainly arises because the term fiduciary management can mean very different things to different people.

Mercer principal Tim Banks describes it as simply an investment service that involves running investment strategy and taking control of it to meet clients' objectives.

Russell Investments head of fiduciary management, UK and Ireland, Sarah Leslie acknowledges the fact that a lot of people struggle with not knowing exactly what fiduciary management is. According to Russell Investments' definition, it is: 'Giving appropriate access to resources and expertise to give you the best outcome for members'. But she acknowledges that this is not something that is going to appeal to all DB schemes.

"A lot of trustees may be reluctant to delegate day-to-day management of the challenges they face as they feel a fiduciary responsibility. It takes quite a big person to take a long hard look and conclude that they are not best placed to deal with the real-time challenges, and that they need specialists," she says. "But we have more frequency of information and the ability to act nimbly on that information."

**Current developments**

To date the approach has been most popular with the trustees of smaller schemes because larger ones have tended to have greater in-house resources, more time available and better governance structures. For schemes with assets of under £100 million, the Aon Hewitt survey finds that it is used by 49 per cent, whilst KPMG puts the figure at 66 per cent. This momentum is continuing but, as the market matures, the client base is also starting to broaden.

Banks says: "We are seeing much greater interest from larger schemes but they might not access it via the same route as they may use part of the suite of services rather than the whole service. The key point is that fiduciary management services are becoming much more widely understood."

Another key development has been an increased usage of third parties, both to advise on the initial appointments of fiduciary managers and to monitor them on an ongoing basis – in some cases by sitting in at every quarterly meeting but in others simply by providing a health check every year or even three years. Leslie feels that the majority of public searches now involve an independent third party and that the numbers doing so have probably doubled during the past two years.

Additionally, the development of benchmarking services promises should also make it easier for trustees to monitor fiduciary managers themselves.

Hill Dickinson partner Paula Warnock says: "Going forward there

Some of this change will be around service and some around cost but for most it will be a combination of the two."

Leslie is bullish about the future prospects of fiduciary management within DB, anticipating at least a continuation of the year-on-year growth of around 30 per cent the market has been enjoying.

She continues: "Growth could even increase slightly as things become more complex and volatile. With most major asset classes looking expensive, trustees have an even bigger challenge."

is a definite push to help DB pension schemes compare like with like, and in a couple of years' time I expect usage of benchmarking services to be a commonly accepted requirement for trustees."

But Spence & Partners head of investment consulting Simon Cohen isn't so sure. He says: "I am a little sceptical about the success that benchmarking will meet with because the fiduciary mandates are very bespoke. They may be using different asset allocations and different funds for different clients, and it remains to be seen how easily they can be lumped into categories in a way that benchmarks are trying to do."

Even without the aid of benchmarks, market reviews of existing fiduciary managers every three or five years have started to become more common.

Leslie says: "We are aware of several schemes using fiduciary managers switching providers in the last two years and I expect this trend to continue.

**Moving to DC?**

Growth could also expand out from DB to DC. However, charges are also likely to present a major barrier to fiduciary management making progress within the DC sector, where it is still in a state of relative infancy. This is because auto-enrolment default funds within DC schemes are subject to a 0.75 per cent cap on the annual management charge.

But DC fiduciary managers emphasise that their ability to obtain discounts on the underlying funds can offset much of the cost burden.

Aon Hewitt head of DC product consulting Tony Britton says: "For the right DC scheme, using fiduciary management might not be much more expensive than not using it. Our charges could amount to as little as 0.12 per cent to 0.15 per cent for a very large scheme only wanting passive investment but at the other extreme, if the trustees outsource all their responsibilities, they could take up the full charge cap."

Another commonly voiced reservation about the usage of fiduciary management within DC is that master trusts are effectively offering a similar service, so actually converting to one might be more cost-effective than outsourcing to a fiduciary manager.

Zurich head of corporate funds proposition Martin Palmer says: "Fiduciary management has more ability than master trusts to have bespoke investment arrangement but there is a fair bit of bespoking in master trusts. We feel that, unless trustees want something particularly bespoke or the scheme is very large, master trusts probably present a more cost-effective solution. They are the obvious way to go for smaller schemes as trustees' responsibilities are growing all the time and the costs to the employer are mounting."

But PTL client director Colin Richardson sees some potential on the DC side, expecting usage of fiduciary management to grow from "miniscule" at present to "perhaps 10 per cent to 20 per cent of new contributions in five years' time". Robeco executive director of European pensions Jacqueline Lommen even predicts the approach "will take off in the UK for DC schemes", and she points out that it has already been used in the Netherlands for DC for 30 years under a different name.

Nevertheless, any reduction in the charge cap would certainly hinder progress. So, to a certain extent, the future of fiduciary management within the DC world would seem to be heavily interlinked with the outcome of next year's charge cap review.

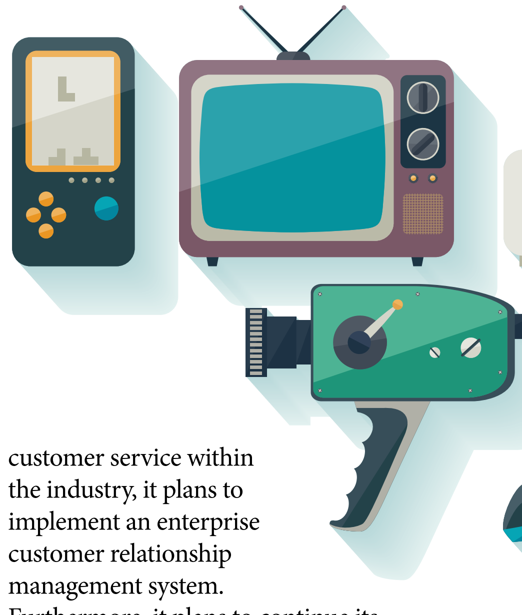
**Written by Edmund Tirbutt, a freelance journalist**

In association with

Russell Investments

**Summary**

- Automatic enrolment is a driver for change across all business sectors of the UK because it affects all employers with at least one worker. This has energised the pension and service industries to provide new technology and product solutions to support employers with compliance, and scheme members with timely and accurate information about their savings.
- TPR's innovation plan is aimed at opening a debate with industry on how it can do more to integrate technology into the way it educates and enable the regulated community.
- The Financial Conduct Authority's 'Project Innovate', launched in October 2014, aims to use the power of innovation to the benefit of consumers. The Advice Unit has a specific remit to support firms developing automated advice models that seek to deliver lower cost advice to consumers. The focus will be on models that look to serve the gaps in the current market identified by Financial Advice Market Review. That is, investments, pensions and protection.
- The FCA is also being pushed to bring pensions into the smartphone age. Increasing numbers of people now want to digest information in bite-size chunks and have it at the tip of their fingertips.



# Out with the old, in with the new

**Adam Cadle explores the levels of innovation occurring within regulators and associations to meet the changing needs of the pensions industry**

Whilst some pension commentators believe innovation hasn't hit the levels predicted following Chancellor George Osborne's freedom and choice reforms, there has nevertheless been a noticeable augmented level of product development within the pension space.

As consumers needs have adapted to the changing investment and regulatory environment, given the increase in freedoms, so has the need for innovation within associations and regulatory bodies. Both have a particular duty to continue to evolve their innovatory processes in order to support savers and safeguard the industry itself.

**TPR**

The Pensions Regulator is one regulatory body that recognises the importance of keeping up with the latest developments in order to help increase its effectiveness as a regulator.

"Automatic enrolment is a driver for change across all business sectors of the UK because it affects all employers with at least one worker. This has energised the pension and service industries to provide new technology and product solutions to support employers with compliance, and scheme members with timely and accurate information about their savings," a TPR spokesperson says.

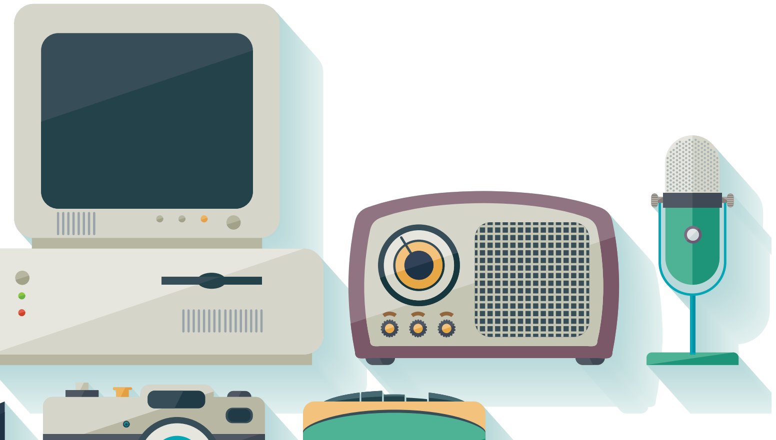
As part of the regulator's plans to increase efficiency savings and improve customer service within the industry, it plans to implement an enterprise customer relationship management system. Furthermore, it plans to continue its website development, particularly around the issue of online transactions and interactive communications. A selection of technology improvements are also planned for 2016-2017, including enhancing interactive features and improving online help and contact functions.

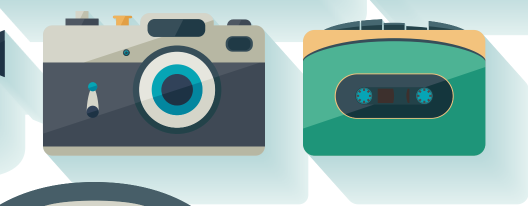
**Payroll**

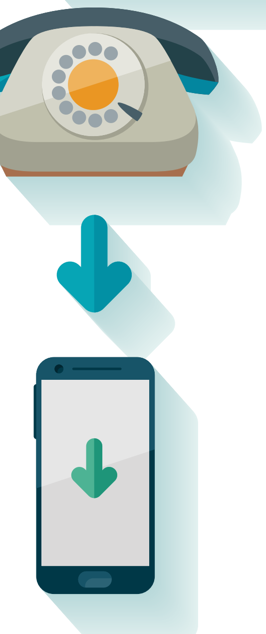
One particular area of importance where innovation is occurring within the regulator is around payroll.

"We are currently working with HM Revenue and Customs to look at how the information they receive from employers through payroll submissions may further assist us in targeting out regulatory responses to automatic enrolment compliance breaches," a TPR spokesperson states.

"As well as this, our innovation plan opens a debate with industry on how we can do more to integrate technology into the way we educate and enable the regulated community, and recognises that we have a role in supporting the pensions industry explore new ideas such as a pensions dashboard for savers. We will be publishing a response to







our innovation and regulation consultation in due course.

"While ensuring schemes are alive to the threat of cyber security, we are determined to fully embrace the benefits technology will bring in areas such as communication, access to the data we publish and online interactive tools such as the trustee toolkit. We have also used innovative ways of communicating our messages, such as using animation to further explain how employers can carry out their legal duties."

**FCA and 'Project Innovate'**

Innovation does not stop short with The Pensions Regulator however. The Financial Conduct Authority's 'Project Innovate', launched in October 2014, aims to use the power of innovation to the benefit of consumers. One particular area of note to the pensions industry is the regulator's Advice Unit.

"The Financial Advice Market Review, or FAMR, explored the barriers preventing people from accessing financial advice and set out recommendations for overcoming these challenges," FCA director of strategy and competition Christopher Woolard explains.

"Technology takes centre stage among these recommendations. Take, for example, 'robo-advice', or 'automated advice' as we prefer to call it. Automated advice offers the chance of ensuring consistent outcomes for consumers, while also stimulating a more engaging and cost-effective advice market. The Advice Unit has a specific remit to support firms developing automated advice models that seek to deliver lower cost advice to consumers. The focus will be on models that look to serve the gaps in the current market identified by FAMR. That is, investments, pensions and protection.

"To be clear, automated advice models must meet the same standards as face-to-face advice, and the responsibility for ensuring their model meets the regulatory requirements rests with each firm's senior management."

The FCA is also being pushed to bring pensions into the smartphone age. Increasing numbers of millennials now want to digest information in bite-size chunks and have it at the tip of their fingertips. Indeed, last year the FCA published a paper on how information can be delivered to consumers in "smarter, more effective ways". This included innovative techniques to move away from a paper-based mindset.

**NAPF to PLSA**

One of the biggest pieces of news flooding the industry was the re-branding of the National Association of Pension Funds to the Pensions Lifetime and Savings Association, allowing the organisation to broaden further its reach and influence.

Speaking about the rebrand at the NAPF annual conference and exhibition in 2015, PLSA chief executive Joanne Segars said: "Retirement simply doesn't look like it used to – today people work later in life and they fund their retirement in all sorts of ways. The lines are blurring between work and retirement, between pensions and other forms of saving and between scheme and saver responsibility. Our new identity has its roots in our heritage. We'll still do what we've always done – help schemes help their members save confidently for retirement – but our new identity allows us to share our knowledge and expertise directly and readily with more schemes and more savers."

Segars said the new association would "embrace a wider membership" and would turn its attention to "the several ways in which people build up their lifetime savings" in order to generate a retirement income.

A statement about this by the PLSA reads: "Pensions, even great workplace pension schemes, don't operate in isolation anymore. They interact with other savings and at times the welfare system, especially as people live longer and it's likely greater numbers of people will have to rely on some form of long-term care. So our lobbying work, research and thought leadership on policy and legislation have to look beyond just pensions. We'll have to consider the role property, work and other savings play in funding retirement."

The pensions industry is a constantly morphing landscape and innovation within regulators and associations is also mirroring this effect. Whilst innovation has not necessarily been rife as such in the DB and DC pensions world, what we can say is that the regulators and associations are approaching the innovation sphere head on as they do all they can to keep up with regulatory and consumer demand.

**Written by Adam Cadle**


# A spotlight on multi-asset credit

**Francesca Fabrizi is joined by Craig Scordellis, portfolio manager at CQS, to find out why multi-asset credit is seeing so much interest today and why pension funds should not be ignoring this dynamic investment strategy**

**What is multi-asset credit investing and why is it getting more and more interest from pension funds today?**
Multi-asset credit strategies have garnered a huge amount of interest over the past three to four years, and by multi-asset credit what we mean are funds that have the ability to invest in multiple credit asset classes on a global basis.

There are a number of reasons why pension funds ultimately have an interest in this space. First and foremost, the traditional fixed income universe – as I would refer to it – being investment grade corporates and investment grade sovereigns, have very very low yields today and so pension funds are facing pressure with low yields on the asset side. Of course their liability costs are going up and, as a result, what pension funds are looking to do is rotate out of traditional fixed income into multi-asset credit, which gives them the opportunity to increase yields and not put on too much incremental risk.

Interestingly, on the other side of the coin you have investors who want to de-risk their equity portfolios but still achieve a certain degree of yield and as such we are seeing a rotation from equities into multi-asset credit.

Then the final point relates to interest rate duration risk – or the risks of interest rates moving upwards. Multi-asset credit, by accessing more floating rate products over traditional fixed products, is to a certain extent able to mitigate any movements in interest rates. It's very difficult to predict when that will happen, but it is an inevitability over either a medium- or long-term period.

**What would a typical multi-asset credit portfolio include?**
They tend to be quite variable. Traditionally, what we have seen is managers use a combination of investment grade bonds, high yield

bonds, senior secured loans and asset backed securities but as interest has grown people have started to introduce other products – convertible bonds are very popular in the strategy; we have seen the addition of emerging market debt; we have seen the addition of distressed debt, for example, and the illiquid credit space otherwise known as direct lending.

**So what are the benefits of a multi-asset credit strategy given the current market conditions?**
There are lots of benefits and I have already touched on the interest rate risk point and, very interestingly as well, from a fund management perspective, a multi-asset credit approach allows the fund manager to be much more selective about the companies that they are lending to. At the same time it gives the asset manager an opportunity to be a bit more agile and select relative value about the right asset class in credit to be in at the right time.

If we explore that a bit further, if we look at it from a fundamental perspective, because you're investing in multiple asset classes within the credit universe, you have a much larger universe of potential investments to make so a manager can be so much more selective about what they are lending to. Then on the other side, from a portfolio management perspective, what we have certainly seen is that markets have behaved within credit very differently because of technical factors such as fund flows, regulatory factors, which are increasingly important, and of course those fundamental factors. So managers are able to position multi-asset credit funds ultimately to take advantage of opportunities in credit markets and also very importantly to many investors, mitigate a lot of risk that's highly prevalent in today's credit markets.

**Risk is obviously a key factor to be considered by any pension scheme – what are the risks of multi-asset credit and how can they be managed?**
Any strategy has inherent risks in it – an example of a multi-asset credit risk might be that a manager might mis-allocate to the credit asset classes thereby ultimately missing opportunities in credit or missing the opportunity to mitigate a lot of the risk that's out there in the credit markets. Ultimately, this strategy's principal risk is that of default risk and loss risk to investors and as a result fundamental credit research is absolutely essential when looking at any multi-asset credit strategy.

**How does CQS differentiate itself from the other multi-asset credit managers out there?**
We have been incredibly fortunate that we have been running multi-asset credit for a number of years and we are very grateful to the seed investors who helped us with the original structuring of the funds. The reality is, having run it for a number of years, we are constantly learning and adapting. Importantly, we do return to our key investment processes and key investment philosophy which is a combination of fundamental credit research and active management, that is at the heart of all our investment philosophy at CQS. We are fortunate as an institution because within the credit markets we invest in a wide breadth of global investment products which gives us the knowledge of those technical risks, regulatory risks, and of course of those fundamental risks as well, which we think positions us well in a multi-asset credit format.

**How are portfolios currently split in terms of regions and asset classes and why, and is that likely to continue?**
With any multi-asset credit strategy it can change day-to-day let alone month-to-month. That reflects the dynamism that is required in multi-asset credit strategies in that managers have to be nimble at selecting the relative value at the right time the markets. Interestingly, we are positioned today from a relative value perspective in loans and asset backed securities – we think we are paid extremely well in those two asset classes within credit for the risks and part of that is driven by the regulatory environment with banks lending less and funds like this providing an opportunity to lend to corporates. Geographically we actually see better relative value at the moment in the US over Europe and that's just because we are getting paid a little bit more for the risks we are taking for our investors.

> **"We are positioned today from a relative value perspective in loans and asset backed securities - we think we are paid extremely well in those two asset classes within credit for the risks"**

**How should a pension fund select the right multi-asset credit manager?**
A strategy of this nature is all about partnership – what's absolutely critical is that there is alignment between the pension fund and the manager with respect to risk and reward dynamics. In addition of course we would suggest pension funds look at people with extensive experience in multi-asset credit because that experience has given managers the opportunity to build a strong investment process and a strong investment philosophy which can help navigate what today are volatile credit markets.

**To watch this interview, please visit pensionsage.com**

Written by Francesca Fabrizi

In association with CQS

**Summary**
- Pension providers need to find a way to better package, present and deliver their existing products.
- It is expected that the pensions industry will use principles from consumer-facing organisations, such as the use of technology to segment communications.
- Gamification within pensions may still be in its infancy, but it already promises to deliver on two fronts – education and better engagement.
- Services such as robo-advice look set to take off from next year, once the government's Pensions Advice Allowance, which allows people to withdraw up to £500 from their pension savings tax free in order to obtain advice, comes into force.
- The upcoming pensions dashboard will help member engagement and understanding, but needs to include as many different streams of saving as possible, including the state pension.
- In the future it is predicted that a completely holistic, transparent, virtual reality, artificially intelligent, real time, blockchain-based technology will replace the current pensions set up.

# Watching the wheels turn

**Responding to the various challenges posed by a growing DC market and landmark legislative changes, the pensions industry is trying to deliver better services in exchange for lower fees. But will it do enough to future proof itself?**

On the face of it, pension providers should be looking forward to a golden age of saving.

EY estimates that the world needs an extra $500 trillion to provide a good retirement for its inhabitants. And in the UK, the success of auto-enrolment and demise of defined benefit has guaranteed that the value of defined contribution pots are set on a steep upward trajectory.

But lurking behind the headline figures, regulation, disruptive technology and economic reality are making it harder for the traditional pensions industry to guarantee that it can deliver the retirement savings that tomorrow's retirees want.

"The industry is working to become more customer-focused, but the harsh reality is that there will always be more to do," says EY partner Ed Jervis.

"In a long-term, low interest rate environment, it's proving hard for investments to keep pace with our increasing longevity. That will keep the focus squarely on the companies that provide those investments. Governments, regulators and the public will be looking for low costs, appropriate levels of risk and new sources of growth.

"But we can only have growth for customers and profit for shareholders through a relentless focus on cost efficiencies and scale."

Pleasing both camps became even harder earlier this year with the release of the FCA's thematic review into life insurance's longstanding customers. The watchdog made it clear that it was no longer enough to simply meet the terms of a contract; they had to be reviewed in light of any changing circumstances.

"That's difficult when a company's promises to its shareholders are based on those terms," says Jervis.

"Will investors back companies if revenue that's factored into the financial plan could be downgraded at any point?"

Added to economic pressure is the lack of trust that so many consumers have, of both the government and financial services. This was brutally pointed out by the *Financial Advice Market Review (FAMR)*, which was carried out by the FCA and the Treasury and published in March.

Misgivings about providers could be accentuated by poor decisions made by savers in the new pension freedoms environment, warns Intelligent Pensions marketing director Andrew Pennie.

"What is evident is that there's a lot of people making the wrong decisions, often unwittingly, and the more that continues, the more people are going to lose out financially and look for recompense," he says.

"So the pressure to offer the right support and guidance to help people make the most of their options and choices will come to the fore."

**Reframing products**

In order to meet this demand, Pennie argues that providers have to find a way to better package, present and deliver their existing products.

"I don't think we are waiting for more innovation. The products have always been there. It's how people are using them, that's where we need to evolve," he says.

Capita head of DC proposition and

strategy Anish Rav believes that part of the solution to guiding savers onto the right path is about personalisation.

"What we should do is pick up some principles from some consumer-facing organisations," he says.

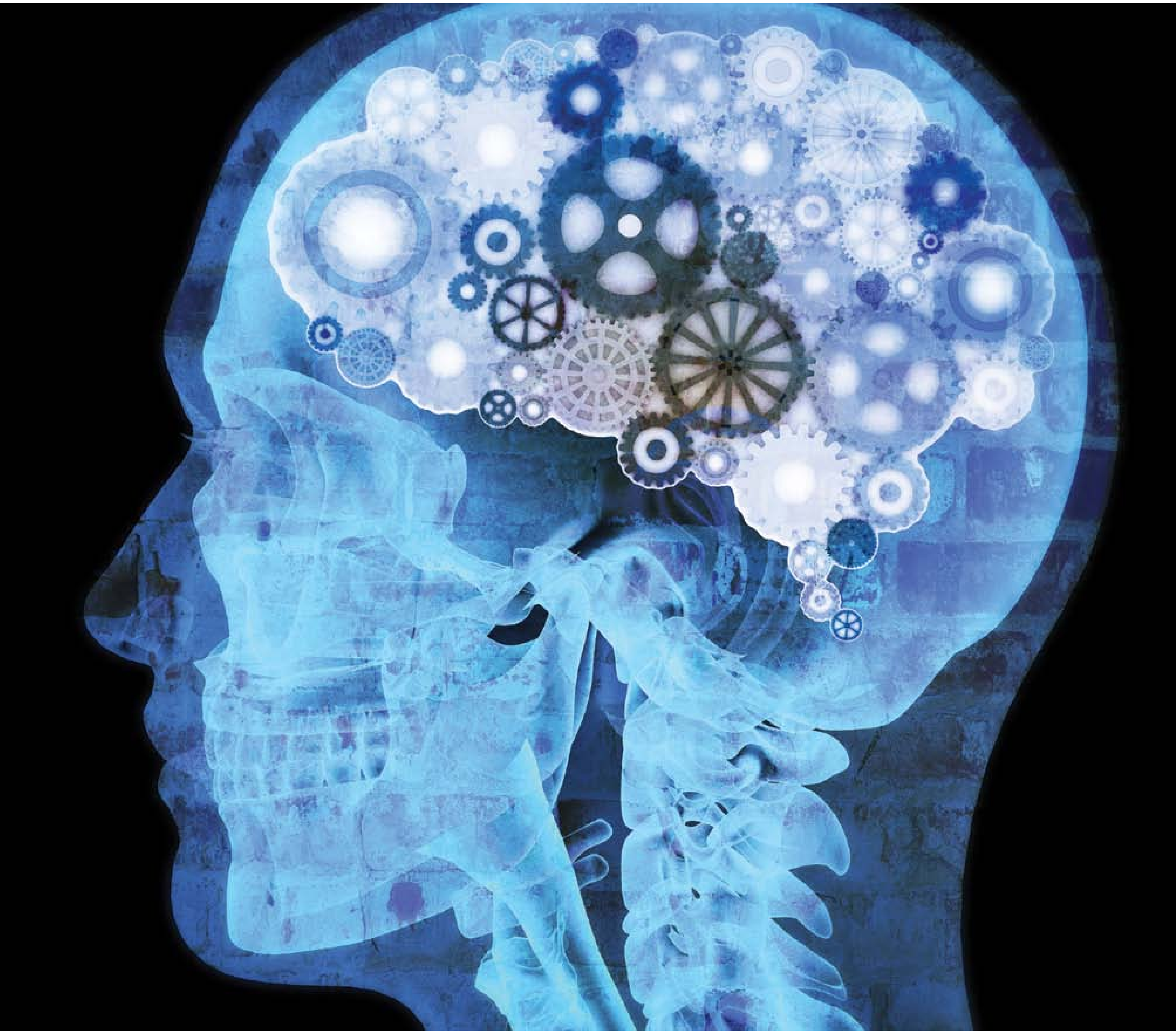
"We must understand what the person is trying to do and who they are. That will make things easier for us. Using tech is absolutely key and we can do a lot more with it now."

One example of using technology in this way is to segment communications. "If you're a 20-something, and the provider is talking about something that's 40 years away, are they really going to be that interested in it? It's all about making it relevant for the individual."

**Gamification and robo-advice**

Tailoring pension savings for individuals could also be helped by the rise of gamification.

eValue founder Bruce Moss says that gamification within pensions may still be in its infancy, but it already promises to deliver on two fronts – education and better engagement.



One product that eValue has been user testing involves the tricky subject of pension transfers. Users explore a site and learn about the subject before taking a quiz, after which stars are awarded for high-scoring results. An adviser sits behind the software and can see a user's score and how they navigated the site, allowing consumers to approach an adviser for clarification on any areas, should they wish.

"Gamification can make the whole process interesting, and fun," says Moss. "We've had very good feedback so far."

eValue also hosts an automated advice service, commonly referred to as robo-advice. The programme is now gaining popularity at a time when a clear hole has emerged in the at-retirement advice space.

"There are about 320,000 people who retire every year with a DC pension pot," says Moss.

"Currently, there are about 4,000 advisers who are available to give advanced pensions advice.

"In the past you bought an annuity with it. Now, you've got lots of other things to consider and the capacity within the adviser space to help people with some of these complex decisions is pretty small."

Added to this is the problem that the average size of a DC pension pot at present is around £20,000. Trying to deliver conventional advice to a huge number of people at a sensible price is quite a challenge.

Robo-advice streamlines the whole process *[see p60 for more information]*.

**Future proofing the state pension**

The growing cost of the state pension is one that has exercised the government's mind for some time.

As AJ Bell senior analyst Tom Selby highlights, before the EU referendum the government warned that the triple lock, linking annual increases to the highest rise in either earnings, prices or 2.5 per cent, would come under threat in the event of a Brexit vote.

"Some have suggested a double lock could be introduced in its place, removing the 2.5 per cent from the equation," he says.

"However, scrapping the triple lock could be politically toxic given it would hit those most likely to re-elect the Conservatives at the next General Election."

Thomas Miller Investment private client partner Sarah Thorpe also says that changes to the women's state pension age are unfair and that alternatives need to be examined.

"From April of this year, a woman who originally thought that their retirement age would have been 60, will now have a retirement age of 63," she says.

"The need to raise state pension ages for both sexes is a proper response to a population that is growing older. However, it seems to be particularly iniquitous to do so, so relatively quickly to this cohort of woman."

It can be purely computer-advice driven and cost no more than £50 for simple requirements – in contrast to traditional advice that could cost between £1,200 to £1,500 on average – and can be complemented by a real-life adviser.

"You can take it further and talk to someone to make sure you're not missing something," explains Moss.

Services such as robo-advice look set to take off from next year as well, once the government's Pensions Advice Allowance comes into force. Allowing people to take out up to £500 tax-free to seek advice close to retirement, it will be introduced at the same time as the LISA, which will add further complexity to the savings arena.

**Perfect timing**

The advice allowance will be coupled with the pensions dashboard, a prototype of which is expected to be up and running by next spring.

Theoretically, the dashboard should make it much easier for savers to assess all their retirement funding options, as long as it fulfils two criteria, says AJ Bell senior analyst Tom Selby.

"It must accommodate state pension savings as a starting point, given the fact this is the foundation on which private savings are built," he explains.

It's also vital that it is as all-encompassing as possible, argues Selby. Most modern platforms, providers and auto-enrolment schemes should have no problem linking into the technology once it is up and running. But the dashboard – built by Aviva, Aon, HSBC, LV=, NEST,

Now: Pensions, The People's Pension, Royal London, Standard Life, Zurich and Willis Towers Watson, and managed by the ABI – could be seen as a threat by some.

"Closed-book providers operating on outdated back-office technology systems may need to be dragged kicking and screaming to participate, through legislation if necessary," says Selby.

**Blockchain**

But before the dashboard is even fully up and running, it may already find itself behind the curve.

Writing on his blog, www.dawid.com, Redington co-founder Dawid Konotey-Ahulu warns the industry that its innovation is all centred on "fintech, auto-enrolment, diversified growth funds and saving-made-easy-on-an-app (which is our idea of radical innovation)".

Although working on these areas is important, they're part of a constrained mindset which, he predicts, "will be the end of us".

"The inconvenient truth is that we are Blockbuster trying to figure out how to sell our VHS cassettes for £3.99 instead of £4.59, and still make a profit. And at the time, some broke 19 year old is sleeping in her car working on new technology that will take us all down."

He has identified blockchain technology – networks that allow for a secure and quick digital ledger of transactions to be shared among users – as the vehicle that will transform financial services *[see p74 for more details]*.

"I expect we shall soon see a completely holistic, transparent, virtual reality, artificially intelligent, real time, blockchain-based system replacing the current set up, namely 'Superpowers of Finance' that each employ several thousand costly humans," he says.

"You will have a deep and detailed understanding of your financial situation and you will have control and management of your personal investments and insurance arrangements at a level you cannot currently conceive."

For DC savers, Konotey-Ahulu says that this will mean that investments will be based entirely on the individual.

So if you stop smoking and feed that information to your provider, then it will use your new metrics to adjust your portfolio automatically, based on the fact that you will probably live for three years longer.

"What once seemed fanciful, isn't anymore," he says.

"In our industry, the winners will be those who appreciate that the game is changing out of recognition and adapt now."

**Written by Marek Handzel, a freelance journalist**

**Watching out for Google?**

Back in February, the then Pensions Minister Ros Altmann said that an outside player such as Google could take the pensions market, which had become too complacent, by storm.

"If you consider tech-based organisations like Google, their strength in technology has a natural synergy with the future needs of the pensions industry," says Trowers & Hamlins senior associate in the corporate pensions team Rebecca McKay.

"As consumers look for more sophistication and information regarding their options (in both accumulation and decumulation phases), they will need providers to invest in technology to meet these needs."

Embark Group owns businesses in the SIPP and SSAS space. Its CEO Phil Smith believes that disruption will come – just not from Silicon Valley.

He predicts that the big four traditional accounting firms are the ones to look out for.

"They have all the detailed expertise and experience globally to dissipate in this space.

"They are already materially involved in tax planning, and they have the digital models to allow them to do that in very complex situations. They have similar capital and buying strength to Google – it just doesn't happen to be publicly displayed.

"And they're always scratching the digital itch.

"Within five to 10 years, one of the big four will enter this space with a digital proposition."

# DC focus: Tipping the risk/return scale

***Closing the retirement income gap*** *- David Calfo explains how equities can provide the inflation-beating income pension savers need* ***p56***

***A need for change*** *- Lynn Strongin Dodds explores how default funds need to become more sophisticated in a developing pensions market* ***p58***


**David Calfo, DC Strategist, Capital**

# Closing the retirement income gap

**David Calfo explains how equities can provide the inflation-beating income pension savers need**

Traditional glide path strategies that look to de-risk a pension pot near or in retirement, are presenting significant issues for savers in defined contribution (DC) schemes. These strategies tend to use an asset mix of diversified growth funds (DGF), bonds and cash that prioritises volatility management at the expense of returns. When combined with the challenges presented by an ultra-low interest rate environment, this means the needs for both capital preservation and income in retirement are not being met. In addition, with life expectancy continuing to rise, DC members are faced with the very real danger that their hard-won retirement income might not last as long as they do, meaning capital growth is also needed. In our view, growth assets such as equities should be held for longer – both up to and into retirement. The yield from dividends and equities' capital growth potential can offer a compelling alternative for generating a secure, inflation-beating income for today, tomorrow and beyond.

In the past, DC schemes have typically followed one tried-and-tested investment strategy: building the biggest pension pot possible, before gradually de-risking as retirement draws nearer. But times and markets have changed, and this traditional model now has several potential drawbacks.

**An ultra low-yielding market environment creates an 'income gap' for pensioners**

Broadly speaking, de-risking a pension pot means moving into DGFs, bonds and cash. Although this introduces some element of diversification, it also means that savers are solely dependent on these assets to provide growth as they approach retirement, and growth and income thereafter. However, with the outlook for the global economy still uncertain, yields on high-quality bonds have slumped to record lows, and may stay there for some time. For savers, this ultra low-yielding world raises the prospect that traditional bond holdings might struggle to produce the levels of income needed in retirement.

One way of making up for any income shortfall is to simply start selling assets that have been accumulated pre-retirement. This can create 'sequencing risk': should you need to sell on a day when the market falls, you will realise a low price and permanently impair the assets available to you, which in turn leads to an even lower income stream in the future. Hence it is best to avoid being a 'forced seller' since the 'sequence' in which assets are sold matters significantly.

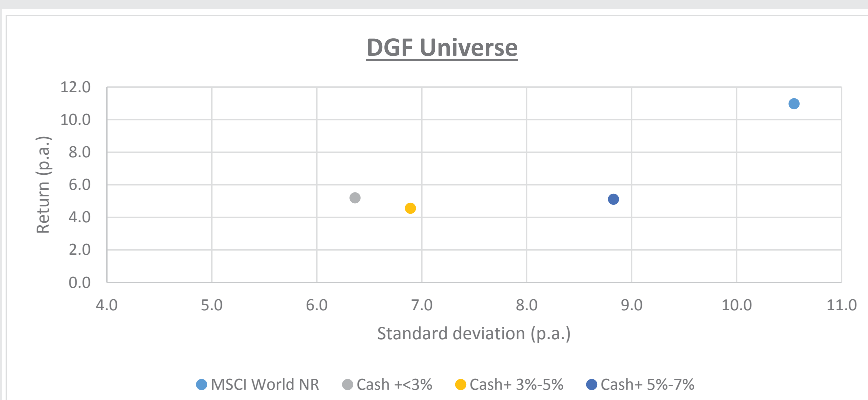
Moreover, this sustained spell of ultra-low bond yields has coincided with an unprecedented increase in longevity. This has major implications for DC schemes, with savers needing assets that can provide growth and income for today, tomorrow, and in perpetuity – without eroding the underlying capital.

**Dividend-paying equities: an alternative source of growth and income**

In our view, savers looking for lower volatility growth and a secure, inflation-beating stream of retirement income should consider holding dividend-paying equities as part of their investment strategy. Not only can equities be owned in perpetuity, which brings obvious advantages as lifespan extends, but they may also offer growth potential, both in the capital value of underlying assets and in the scope for distributions to grow in the future.

Of course, equities are riskier than bonds: distributions to shareholders are entirely at the discretion of a company's board of directors, whereas the coupon payments on bonds are a contractual obligation. However, UK studies have shown that, after accounting for inflation,

**Exhibit 1: Risk/return of DGF funds versus global equities**




Past results are not a guarantee of future results. For illustrative purposes only. DGF = diversified growth funds. Median results shown for diversified growth universe based on those seen in the CamraData DGF survey from Q1 2016. Scatter chart reflects data from 31 May 2003 (inception date of Capital Group Absolute Income Grower strategy) to 31 July 2016. Returns and standard deviation in GBP terms as at 31 July 2016. Sources: CamraData, Morningstar, Capital Group the volatility of returns from equities might be lower than the volatility of returns from government securities over longer timescales. In fact, investors in UK gilts have, on average and if invested for more than a decade over the last century, experienced higher volatility and lower annualised real returns than investors in equities.[1] This means that investors with longer time horizons need to give these implications serious consideration.

DGFs have historically been used in the consolidation phase of DC default funds to introduce greater diversification and reduce volatility. Such funds tend to target 'cash plus' returns, based on the assumption this is a proxy for equity returns over the long term. As shown in exhibit one, while such funds have demonstrated lower volatility than global equities, this has been at the expense of delivering total return. In contrast, incorporating dividend-paying stocks in the accumulation and consolidation phases of default funds, as well as through retirement, can help to lower volatility without necessarily sacrificing returns.

Not only have dividend-paying stocks demonstrated greater resilience than their non-dividend-paying counterparts in bear markets, they have also had lower volatility. When combined, these attributes can have a significant positive impact on cumulative investment returns over the long run.[2] Moreover, evidence shows that companies that have been able to grow their dividends over a number of years have generated superior total returns compared with those that pay flat dividends, declining dividends or no dividends at all. This may seem counter-intuitive for those who look for retained profits as a signal that companies are preparing to invest and lay the groundwork for expansion and profit generation in the future.  However, the evidence suggests that the commitment to pay dividends instils a healthy degree of corporate discipline, which is recognised in equity returns.

**Exhibit 2: Dividend growers have historically provided superior long-term returns around the globe**


Past results are not a guarantee of future results.

Note: Returns are based on the weighted average of total returns in USD (with gross dividend reinvested) of a global universe of companies. The universe consists of the 1,000 largest companies in the S&P BMI Global Indices for North America (50% weight), Europe (25%), Japan (10%) and the 500 largest companies for Emerging Markets (10%) and Pacific excluding Japan (5%) from December 1989 to December 2004; and the 1,000 largest companies in the MSCI Investable Market Indices (IMI) for North America, Europe and Japan, and the 500 largest companies for Emerging Markets and Pacific excluding Japan, thereafter. The universe constituents are rebalanced quarterly. Volatility reflects annualised standard deviation of monthly total returns. Data from 31 December 1989 through 31 December 2015.

Sources: FactSet, Compustat, Worldscope, MSCI, Capital Group

## Conclusion

Against the backdrop of ultra-low bond yields and rising life expectancy, assets like dividend-growing equities can help to close the gap between savers' retirement income and their likely future financial needs. The relative resilience of dividend-paying equities, and the fact that they can be held in perpetuity, can also help to preserve capital and to ensure that pension pots last as long as possible.

It is time to take a fresh look at what those saving for, and already in, retirement need, and to focus on investment strategies that deliver:

1. Low volatility growth, but not at the expense of delivering a favourable return
2. Capital preservation
3. Growing, inflation-beating income generation, achieved without liquidating underlying capital

Dividend-paying stocks (and those committed to growing their distributions year-on-year) can, and should, play a part in the construction of DC default funds during all phases from accumulation through decumulation.

**Written by David Calfo, DC Strategist, Capital Group**



[1]COURTIERS' analysis of Barclays Equity Gilt Study 2015, which takes UK data from 1900 to 2014, suggests that the volatility of real returns from UK equities fell below the volatility of gilts over timescales of more than 10 years, while annualised real returns were significantly higher. Source: COURTIERS 2015

[2]Established global dividend-growers and distributors experienced less severe drawdowns than the MSCI All Country World Index. Data from 30 September 2004 to 31 December 2015. Sources: Capital Group, MSCI

# A need for change

**Lynn Strongin Dodds explores how default funds need to become more sophisticated in a developing pensions market**

**Summary**
- Default funds, which are the mainstay of the defined contribution world, need to become more sophisticated to reflect a changing world according to investment experts.
- At the moment around 99 per cent of savers in a DC pension scheme opt for the default fund.
- One of the problems cited with diversified growth funds is that they are overly concerned with volatility and do not pay enough attention to returns.
- Multi-asset class target-date funds are a more suitable alternative than traditional lifestyle strategies. This is because, unlike the latter, which follow a fixed path to retirement, TDFs are actively managed, which means they are able to adjust to fluctuating market conditions.

It has been over a year since the shackles have come off the pension regime, handing individuals greater freedom over their retirement savings. However, the default funds that are the mainstay of the defined contribution world need to become more sophisticated to reflect a changing world.

At the moment around 99 per cent of savers in a DC pension scheme opt straight away for the default fund, according to a new study conducted by Columbia Threadneedle Investments and the Pensions Policy Institute (PPI). These typically adopt a traditional lifestyle approach, which includes diversified growth or target-date funds or a combination of both.

The theory is that funds will invest in riskier assets such as equities in an attempt to garner capital and then shift into more conservative investments such as fixed income, which are seen as safer and more secure as retirement nears. This de-risking stage typically occurs around five to 10 years before the member's retirement age, and bonds were seen as a good match for the annuities that had been the preferred exit route.

However, returns have been squeezed by the prolonged depressed interest rate environment, leading to the new freedom and choice reforms introduced by the government last year to broaden investor horizons. As a result, only 13 per cent of retirees have gone down the annuity path with their pension cash, although the majority of the 55-plus contingency continued with the status quo. In other words, they made contributions into their pension via their employer and did not withdraw any savings.

**Drawdown income**

Going forward, drawdown income is expected to be the preferred option, but as the Columbia Threadneedle paper points out, this will require a greater focus on the investment strategies during the earning years. It points to the Russell *10/30/60 Retirement* report, which shows that the amount saved during one's working life typically accounts for only 10 per cent of the stream of income paid out during retirement. Investment growth pre-retirement might account for 30 per cent, while up to 60 per cent of retirement income is dependent on investment growth during retirement.

The study notes that one of the biggest challenges is to build a large enough nest egg to fund a lengthier retirement. At the moment, the industry is failing as those savers relying on a DC pension face an income shortfall. "Before the freedom and choice regulation, people would take 25 per cent in cash and buy an annuity with the rest but today that is no longer the case," Legal & General Investment Management head of DC Emma Douglas says. "One of the main problems is that people do not know when they will retire and the danger is that the investment thinking has remained in the past in terms of what people should do with their DC pot."

This will not only require innovation on the fund manager's part but also a change in mindset for individuals. Both have time to adjust. "It is important to remember that the numbers of those members currently retiring have relatively small DC pension pots on average and they are more likely to have other forms of retirement savings, such as defined benefit pension plans," says Douglas. "The next generation of retirement savers will need to adopt a different approach. I think lifestyle funds will still be in place but they may remain invested in riskier assets for longer."

Royal London's pension investment strategy manager Lorna Blyth agrees, explaining that if the retirement age is going to move out to 70, then by the nature of the way lifestyles work, individuals should stay invested in riskier assets for longer and will not start to start to de-risk until they are 65.

"I do think that lifestyle funds have become more sophisticated. If you go back 20 years, they were mainly equities and bonds, but today our lifestyles include exposure to property, absolute returns, commodities and a range of fixed income from gilts to high yield," she adds.

Capital Group DC strategist David Calfo also believes that income-oriented

equities that pay healthy dividends will play a greater role in the future as investors enter the consolidated phase of 45 to 65. "One of the problems with diversified-growth funds is that they are over-concerned with volatility and do not pay enough attention to returns," he says.

Calfo suggests introducing these strategies early on so that individuals can reinvest the dividend income and then move to the distribution stage when they want to draw an income – either on retirement or even at a later stage, "Since they will be in the same asset class, the transition will be seamless. I am not suggesting that these would be in lieu of DGFs or fixed income but as a complement to existing strategies that are into default funds," he explains.

The other criticism of DGFs is their patchy performance. A recent study by Cambridge Associates showed that high levels of volatility in equities as well as the continued impact of quantitative easing on the fixed income market and alternatives such as commodities has taken its toll. It found that the median manager of the 35 DGFs it surveyed lagged a simple 60:40 portfolios by nearly 3.3 percentage points between 31 October 2007 and 31 March 2015. The funds each had at least £30 million of assets, which is considered the minimum size of fund regarded as 'investable' for pension funds.

**TDFs**

AB (formerly Alliance Bernstein) lead portfolio manager multi-asset solutions EMEA David Hutchins believes that multi-asset class target-date funds are a more suitable alternative than traditional lifestyle strategies. This is because unlike the latter, which follow a fixed path to retirement, TDFs are actively managed, which means they are able to adjust to fluctuating market conditions.

TDFs, which group together investors targeting a specific range of retirement or target dates, are typically associated with the US market, but they have gained traction in the UK over the past two years. Government-backed auto-enrolment scheme Nest has been a pioneer in the country, while Spence Johnson predicts that these products will capture 20 per cent of assets by 2024.

"People are not only uncertain as to when they are going to retire but they also do not know what they need and do not want to be locked into a strategy," Hutchins adds. "One of the biggest mistakes that the pensions industry makes is to assume that the world does not change. They set hard and fast rules such as 'interest rates will remain high at 6 per cent to 7 per cent'. Target funds are flexible and on average have performed better over the last five years."

In addition, they have lower and more transparent switching costs from pre- to post-retirement, according to JLT Employee Benefits associate consultant in investment consulting Jean-Marc Zoghbi. "It is much easier to move from one to the other because they are in a master trust and the administration charges tend to be lower. This is not usually the case with a traditional lifestyle approach."

**Balance**

AB, like other asset management groups, are exploring ways in which investors can better balance between growth, income and capital protection. Last April it introduced its Retirement Bridge, a low-cost drawdown offering, aimed at paying a sustainable income in retirement using an age-appropriate diversified investment approach and using a dynamic asset allocation to smooth out the ride.

State Street Global Advisers has also thrown its hat into the ring with its Timewise Target Retirement Choice Fund, introduced under its umbrella of funds for UK workplace pensions. It invests across a diversified spectrum and the aim is to allow members to either drawdown income over time, take periodic cash withdrawals, or purchase an annuity.

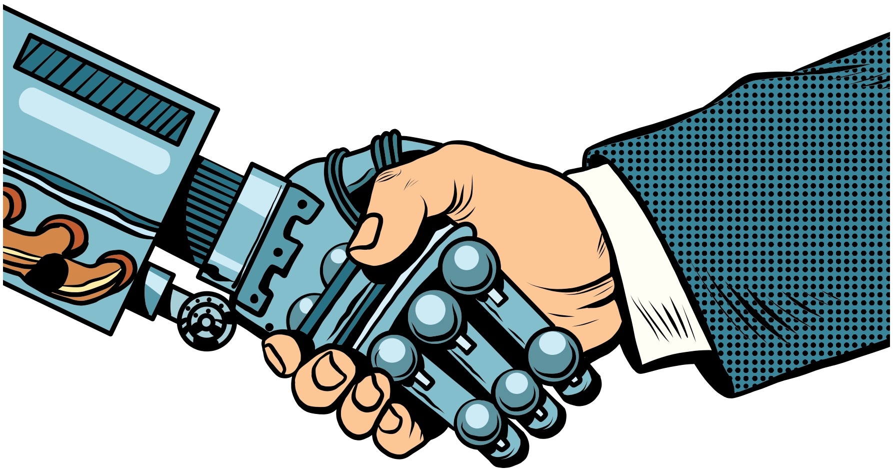
"As the macroeconomic environment, investment opportunity set and consumer behaviour constantly change, we need to build default funds that are flexible and can adapt," says State Street Global Advisors European head of defined contribution Nigel Aston. "Members find it difficult to predict what retirement will be like, therefore default options need to be adaptive, offering a more appropriate level of risk for members based on their stage of life - rather than targeting a specific outcome, be it cash, annuity or drawdown on a particular date."

**Written by Lynn Strongin Dodds, a freelance journalist**

In association with

CAPITAL GROUP®

**Summary**
- As the new pension freedoms have provided greater options at the decumulation stage, there is a greater need for advice.
- Robo-advice could be useful for those wanting to consider their pension savings, but are unaware of where to start.
- However, pensioners have expressed a need for face-to-face advice rather than completely computer-led guidance.
- The best solution is likely to be a collaborative approach, whereby robo-advisers work alongside human advisers.



# Robo–advice: Friend or foe?

**Robo-advice and its strengths, limitations and future has dominated industry discussion lately. Talya Misiri discusses whether this tool will help the pensions market, or cause problems of its own**

Machines taking over, once a futuristic concept, seems to be a reality fuelling society lately. With each new development, those asking the 'what if' questions of technology outperforming – or even outmastering – humans seem a little less absurd. Another question being asked is how long it will take for industries that are far-removed from these technologies to also incorporate them into their businesses. The recent introduction of robo-advice tools into the pensions market suggests that the sector is willing to incorporate computer-based systems into its processes.

Robo-advice is a newly created algorithm-based tool that provides online financial advice, mostly without the intervention of human financial planners. The tool was introduced as an alternative option to face-to-face advice, in order to close the financial advice gap, and offers some financial direction at a low cost.

Industry reaction has swayed between both acceptance and scepticism towards the method. On the one side, there are concerns as to how accurate and specifically tailored this form of advice can be and whether it can be adopted as a mass market product. While on the other hand, it has been accepted as a low-cost alternative to independent financial advice and a step in the right direction towards encouraging people to actively think about their pensions.

Since the introduction of the pension freedoms, greater options in the decumulation stage have led to a heightened emphasis on the need for advice. This is something the government recognised, by including with the reforms the requirement for those with pension pots greater than £30,000 to take financial advice if they wish to cash in or transfer their savings. To help with this, the FCA also recently announced that pension savers will be able to take out up to £500 tax free from their pension pot, in order to pay for financial advice.

Nonetheless, the majority of savers who qualify for compulsory advice may find independent financial advice too costly, and therefore look for lower-cost alternatives such as robo-advice. While this is still a fairly new concept to pensions, the speed of technological advancements today can lead us to question whether robo-advice tools will eventually become a front runner in the savings advice sector.

### Lone warrior

"There is no fundamental reason why a robo-advice provider couldn't provide the same level of advice at the point of retirement as a human could," Alpima founder and CEO Pierre Mendelsohn says.

Research by The People's Pension, *Public attitudes to financial advice*, found that 53 per cent of savers would use a free online retirement planning tool to help get information about what to do with their pension pots.

Commenting on its findings, The People's Pension director of policy and market engagement Darren Philp notes that "almost a third of pension savers said that they would prefer using an online tool to plan their finances to speaking to a financial adviser at retirement. I think this shows that there is a clear appetite for robo-advice to be part of the mix".

Moreover, robo-advice could also be useful for those who are aware they need to think about their pension savings, but are unaware of how to begin. Speaking at a recent panel, The Pensions Advisory Service (TPAS) chief executive Michelle Cracknell argued that "people don't know what they don't know" when it comes to pensions and that "more people need to think about pensions" earlier. If this is the case, then robo-advice may be what is needed to prompt savers in the right direction to engage with their finances. Robo-advice could potentially ask the questions that Cracknell suggests people are unaware they need to be asking.

Mendelsohn also argues that the human element in financial advice may lead to a number of biases – something that robo-advice cannot do.

"Let's start with the well-documented fact that most human beings, even if rational most of the time, are subject to a number of judgement biases, ranging from risk aversion to overreliance on recent historical data.

"Khaneman & Tversky and many others have researched and documented this brilliantly in recent decades. So one could argue that, when well used, systematic investing can help reduce risks to an extent by protecting human beings from themselves, removing emotions from the decision process and sticking to rigorous quantitative metrics to allocate and invest," Mendelsohn adds.

Nonetheless, we cannot deny the fact that humans are social beings and so, many do also appreciate human guidance in areas that are unfamiliar to them, especially for those who are not computer-literate. For this reason, a purely computer generated approach to advice and wealth management may have its limitations.

**The human touch**

In a recent survey of 104 retirement and investment advisers, 71 per cent said that they are not concerned that their business will suffer with the launch of technology-led and low-cost alternatives. Metlife, who commissioned the research, says this is because of potential demand from savers for face-to-face advice.

The People's Pension's *Public attitudes to financial advice* highlighted that when asked to imagine needing help to understand their financial options at retirement, over half, 59 per cent, of UK adults say that they would like to receive this information face to face.

The complexity of the sector and the target age group who seek advice on their retirement options (generally a minimum of 55 and above) may find robo-advice tools alone too impersonal and want detailed, jargon-free explanations from professionals.

MetLife UK wealth management director Simon Massey comments: "Robo-advice and digital technology have a major role to play in ensuring savers have as wide a choice as possible of how they get advice. Advisers are right to be confident that they can prosper alongside robo-advice as the value of face-to-face independent financial advice is clear and demonstrated by the potential demand from savers."

Just Retirement group communications director Stephen Lowe supports this viewpoint, stating that "customers don't want to make product choices just in front of a computer", and so it is not guaranteed that robo-advisers are likely to take over from human advisers in the near future.

**Collaborative approach**

While we may pose these human and machine methods against one another, a collaborative approach may be the best option for financial planning.

Pension planning that is both robo and human-directed could effectively help to bridge the advice gap and possibly cut the extensive costs of just using an IFA for individuals with smaller pension pots.

Many pension providers, including Just Retirement and Selectapension, have launched hybrid forms of financial advice – whereby robo-advice tools are used as an initial assessment, which is then followed by over-the-phone or face-to-face financial discussion with an adviser.

Other firms have also incorporated methods, where advisers and consultants talk members through robo-advice-led questions, rather than the individuals having to work through the tool by themselves. Both of these can work out as more time and cost effective for members with smaller funds and therefore lower budgets for advice.

"The holy grail in our view is a thoughtful human and machine approach that offers true personalisation flexibly, transparently and at a reasonable cost," Mendelsohn opines.

Industry professionals have argued that robo-advice alone cannot deal with complex issues and take into account a rounded view of a person's financial situation. However, a combined strategy could be the answer to overcome these technological shortfalls and tackle cost concerns.

Ultimately, at present, robo-advice can be taken as a welcome companion to the financial sector but is unlikely to take over just yet.

"While there is a place for it, it is a method that can complement other options," Intelligent Pensions head of pathways Andrew Pennie argues.

A collaborative approach, as currently used by a number of pension providers, may be the best method. It is largely evident that we are a long way off from robo-advice being a fully effective mass market product. For each piece of advice that is generated, there needs to be a professional monitoring the outcome. If and when enough data is collated, then in the future each possible situation could be categorised to provide a more tailored service without the need for additional human confirmation.

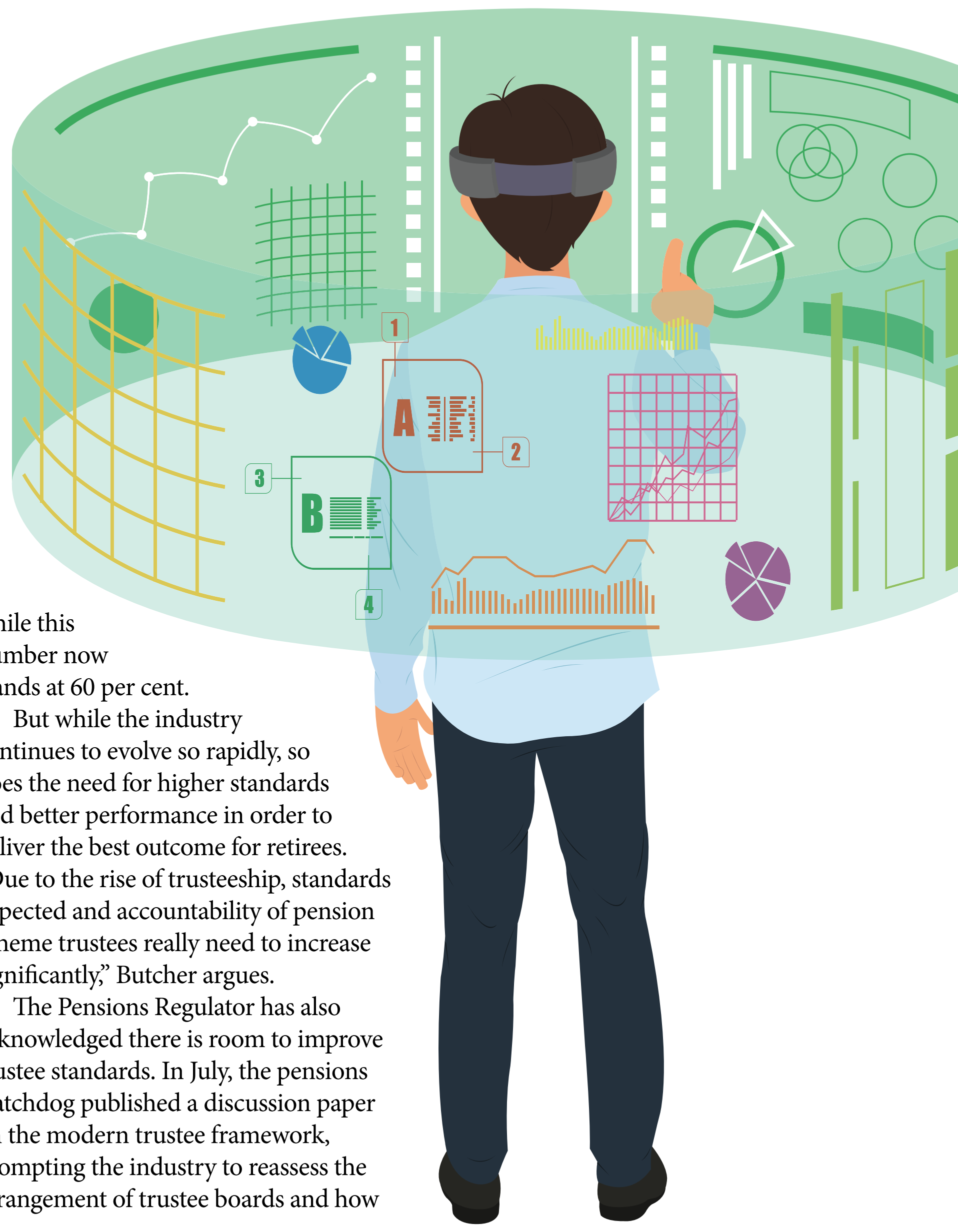
**Written by Talya Misiri**

**Summary**

- As the industry continues to evolve rapidly, questions are being asked about the need for trustees to adapt accordingly.
- TPR has released a discussion paper on the modern trustee framework, prompting the industry to reassess the arrangement of trustee boards and how they can manage and meet the challenge of scheme governance in the 21st century.
- Potential problematic areas within trustee boards are board effectiveness and diversity, the role of the chair, engagement and in particular, effective governance.
- Better training is encouraged to ensure trustees are well equipped to make decisions. The frequency of trustee meetings is also a matter for consideration.

# Navigating the 21st century

**As The Pensions Regulator makes headway with its research into how it can best support trustees with an increasing workload, Lauren Weymouth explores what it really means to be a 21st century trustee and the challenges that lie ahead**




The role of a pension scheme trustee has never been easy. Collectively, the boards of pension schemes across the UK are responsible for managing £1.8 trillion of assets on behalf of their members; safeguarding the retirement funds of millions of people across the country.

But on top of their traditional duties, trustees are also responsible for keeping up with fast-paced changes in a landscape that is continually growing whilst longevity is also rising. Over the past few years, auto-enrolment has drafted in waves of new people into workplace pensions and small schemes have been popping up at an almost daily rate.

Because of this, there has been a huge surge in trusteeship. According to PTL managing director Richard Butcher, around 15 per cent of DB schemes had a professional trustee eight years ago, while this number now stands at 60 per cent.

But while the industry continues to evolve so rapidly, so does the need for higher standards and better performance in order to deliver the best outcome for retirees. "Due to the rise of trusteeship, standards expected and accountability of pension scheme trustees really need to increase significantly," Butcher argues.

The Pensions Regulator has also acknowledged there is room to improve trustee standards. In July, the pensions watchdog published a discussion paper on the modern trustee framework, prompting the industry to reassess the arrangement of trustee boards and how

they can manage and meet the challenge of scheme governance in the 21st century.

The paper was launched after TPR chief executive Lesley Titcomb said she would like to have a debate with the industry about what it means to be a 21st century trustee, and what the regulator needs to do in order to provide better support.

"I want to have a good open debate with the industry about what we all think a good 21st century trustee looks like, the challenges they face and what this means for us as the regulator," Titcomb said at the Punter Southall Annual Pensions Conference 2016.

As part of the research, TPR has been closely examining the work of 800 trustees from DB, DC and hybrid pension schemes across the UK. But even during some of its initial findings, the regulator had already found a number of problematic areas such as board effectiveness and diversity, the role of the chair, engagement and key governance activities.

**Good governance**

Of all the areas of concern, though, governance is highlighted as the element most in need of attention. Pensions and Lifetime Savings Association (PLSA) policy lead of stewardship and corporate governance Luke Hildyard argues it really should be the "number one priority".

"Having people in the right environment equipped with the right resources and incentives gives schemes the best possible chance of achieving the best results for savers," he says. "Poor quality governance drastically reduces schemes' ability to deliver these results."

BESTrustees chairman Alan Pickering agrees, but argues that instead of aiming for 'premier league'-style governance, the industry really needs to be pursuing "championship level governance". Elaborating, Pickering explains that the return generated by each pound spent in getting trustees from good governance, which is fit for purpose, to world-class governance, which is 'overkill, "merely ends up producing diminishing returns".

So, how does the industry find the balance between promoting good governance, whilst not trying to promote 'premier league'-style governance? Pickering says, without discouraging trustees from learning more about the finer details of the pension system, what should be added to the syllabus is "board dynamics and effectiveness".

"Trustee boards are non-executive supervisors and not executive doers", he notes, "we must focus on ensuring that our subcontracted experts are up to speed and that their contracts of appointment leave no scope for doubt and reflect modern business practice.

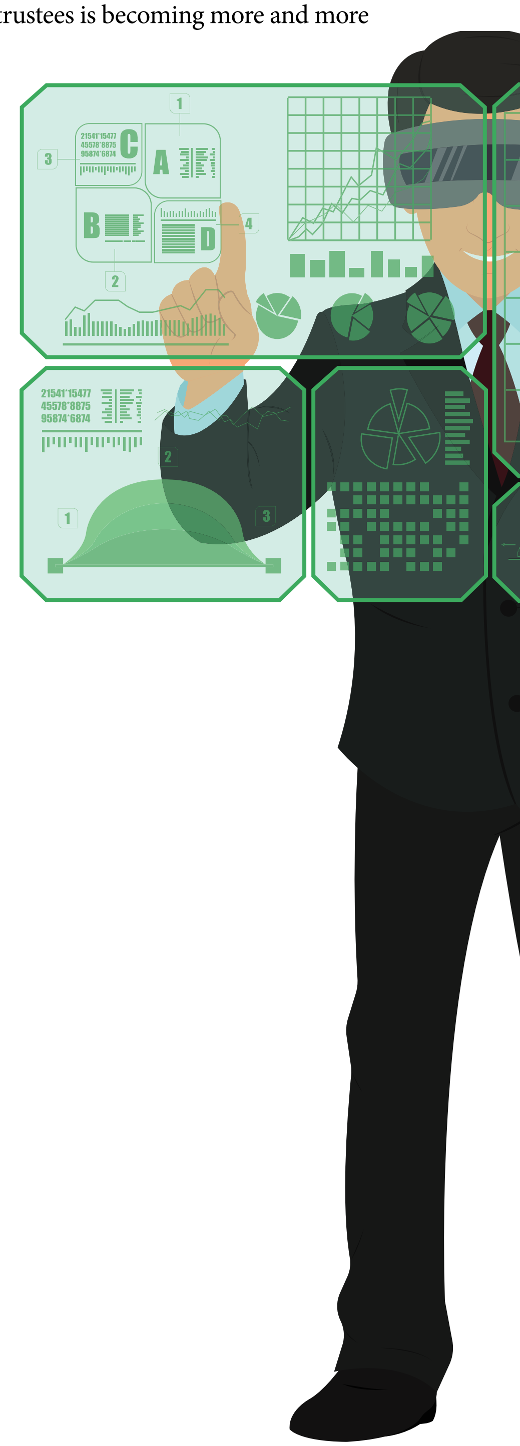
"If a trustee has to choose between knowing how to conjugate a GMP or manage a contract, they should always plump for the latter", Pickering concludes.

**A better knowledge**

But while it is important to ensure trustees spend more time focusing on board dynamics and executive decisions, better training must be encouraged to ensure trustees are well equipped to make the decisions, argues Butcher.

"Going forward, it is important trustees hold the relevant qualifications and put themselves forward for relevant exams, in order to generate better and more expert knowledge of pensions," he explains.

It appears to be common consensus among the industry that training for trustees is becoming more and more



vital as the number of workplace pension schemes continues to surge.

Earlier this year, a survey conducted by the Pensions Management Institute (PMI), revealed that 90 per cent of industry respondents think it is "absolutely crucial" for trustees to have relevant professional qualifications.

But, much like PMI president Kevin LeGrand said at the time, it is "little wonder" that such high importance is placed on validating that trustees have the right knowledge and competencies to perform their duties to a high standard, given the decisions made by trustees are so influential to members' retirement prospects.


**Teamwork**

Aside from building up expertise and participating in the relevant training, the 21st century trustee also has to ensure contemporary and relevant issues are all being properly addressed at board meetings, so decisions can be made efficiently.

While trustee meetings typically take place every quarter, constant regulatory change has prompted concerns about the frequency of these meetings and whether four meetings a year, often for just a few hours, is enough time to deliver optimum results.

According to recent research by Aon Hewitt, 70 per cent of DB and DC scheme trustees have said their decisions take months from being raised to being implemented due to being overburdened with their workload, thus making decision-making processes much slower.

But despite this, Butcher argues that the regularity of trustee meetings should be of less concern than the efficiency of the meetings themselves. "If the meeting is chaired properly, with relevant documentation being sent in advance for review and an accountability and responsibility for all participants to be fully briefed, prepared and contribute to the meeting, then there is no reason why meetings should be held more often than they currently are."

He recommends that trustees should perhaps consider implementing subcommittees, relevant to their skill set, that focus on specific things that are "empowered to at least recommend if not make certain decisions between meetings".

However, after years of functioning successfully, trustee boards are fully capable of making strong-minded decisions, but only if all parties involved in the scheme are properly represented. Weeks describes how a pension scheme is like a triangle, with the sponsoring employer, professional fund managers and advisers and the scheme members all forming a side each.

"It is so important for trustees to keep all three sides in balance and for trustees to represent all three sides," he says. "So in term of the make-up of the boards, all three sides of that triangle really need to be represented", he adds.

**Moving forward**

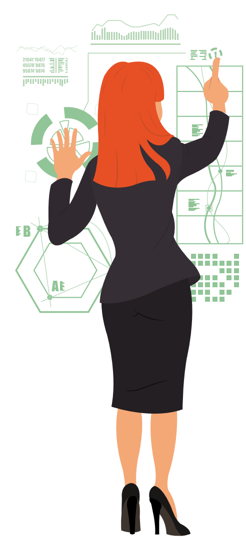
Although a trustee's role may not always be simple, there are a number of different elements that are clearly already being addressed, or are at least open for discussion. But trustees still have some work to do themselves.

"A major task ahead is to increase trust in pensions. Only then will scheme members invest sufficiently to fund their (lengthening) retirement," Weeks says. "Currently, the average rate in auto-enrolement is 2 per cent. Our target really should be 15 per cent."

TPR's research into the 21st century trustee is only one step of this journey.

"The consultation paper acknowledges the positive contribution that trustees make to the governance of pensions in the UK," Pickering adds. "Many previous enquiries have suggested that the medieval concept has no role to play in today's complex financial world and should be pensioned off.

"As trustees, we can, however, always do better".



**Written by Lauren Weymouth, a freelance journalist**


# Shaping the future

## Adam Cadle talks to former Pensions Minister Ros Altmann about the current pensions landscape

**You are back in your role of consumer champion following your stint as Pensions Minister. What are your aims and ambitions in your current role?**
My aims and ambitions are the same as they have always been really – to try and help people have better pensions, to try and help the government make better pensions policy and to highlight where things might be going wrong if I think policy is on the wrong track.

**What would you say the biggest hindrance within the government is to passing pension legislation and pushing through policy to ultimately make the pensions sphere a better place?**
I think there are a number of barriers to making better pensions policy. One is there aren't enough people who actually understand how pensions work within the government and within the civil service. I was quite surprised to find that although I've spent nearly 40 years working on all aspects of pensions. The other problems stem around the time it can take to get any legislation agreed and passed. There were so many examples of issues I felt were really urgent, but I was told it would take nearly two years to get any primary legislation completed and even when this was done you would have to wait for regulations to be passed which can take another one or two years. For example the issue of net pay, where low earners are being forced to pay significantly more for their pensions than people who earn more than they do. That issue is still not even close to being addressed. I highlighted it for a year and nobody has even started looking at legislation that might help change that.

There are a number of areas like the Pension Protection Fund cap, where legislation was passed two years ago. Nothing has changed for the people for whom it was meant to. The regulations were ready to be consulted in the week that I left office and suddenly the government has delayed them.

**Touching on your ministerial role again, looking at the WASPI campaigners, you had a fight on your hands to begin with. How did you go about dealing with the ordeal?**
The state pension age for women issue

was a really terrible one for me. I fought hard to try and persuade the coalition government in 2011 that what they were planning to do to women's state pension age was unfair and was going to cause hardship. The government didn't want to change its plans. Since then, I had been hearing from some of the women and working with them to help them address the hardship.

When I was appointed Pensions Minister, I knew there was an issue here that I wanted to try and deal with. But unfortunately everyone around me, from the Secretary of State down to all the policy officials, did not want to know. They said this is law that was made five years ago, its tough luck, and it's not going to change. I kept working and getting officials, reluctantly, to try and work out how much it might cost, how we might be able to help, but nobody in government would listen. The women understandably blamed me because I was nominally Pension's Minister. But as Pensions Minister I realised you didn't have the power to make those kinds of changes. Also as a minister you are bound by collective responsibility. I couldn't just stand up and say I disagree with the government and I'm going to change it because you cannot do that as a minister. You either have to leave, in which case you are not in the position to do anything anyway, or you have to stay and I was trying to find a form of words that helped the women know that I did have sympathy with them and I was trying to help. Every time I expressed even a tiny indication that I had sympathy with them, I was hauled over the coals by my department and by the Secretary of State. I wanted to try and meet them and talk it through, again I was barred from doing that until we got a new Secretary of State, who at least said yes you can talk to them. But talking to the women was not the same of course as finding a solution. The Work and Pensions Select Committee was talking about solutions, I was trying to find out if I could work out something.

To be honest, it wasn't helpful that the demands made by the campaign were not something that was ever going to be deliverable or that I had ever supported. I do think they were let down, they were not properly informed. The DWP failed to ensure they did know.

**Turning our heads towards the DB space, looking at the BHS pension scheme saga, in your opinion what can be done to prevent future occurrences of this sort happening?**

We certainly haven't seen the last of employers failing and their pension schemes falling into the PPF.

What I think we need to do though is to make sure that if a company has an employer with deep pockets, and has resources that could be used to fund the pension scheme, the employer should not be able to just sell the business and get rid of any future liability to the pension scheme. You don't want to force every employer to get clearance before they do a deal however. What you do need to do though is to make sure that if the employer hasn't yet funded the scheme adequately, and in the BHS case The Pensions Regulator was already concerned that the contributions being made were not sufficient, there is a requirement that a plan is in place to deal with the pension scheme. What I find quite shocking was the Work and Pensions Select Committee received the papers that preceded the sale of BHS for £1 and they said that this business was being sold 'debt free'.

**Is the threat of the Lifetime ISA a big issue that we are going to have to deal with?**

Absolutely, the biggest threat that I see on the horizon in the pensions landscape is this thing called the Lifetime ISA, which is guaranteed to not last a lifetime. It is really dangerous.

An ISA is an ISA and it is not a pension. The behavioural incentives within this so-called Lifetime ISA are all wrong. The LISA is likely to mean less money going in than we would see with a pension and less money lasting for later life than would happen in pensions. This is a classic example of government officials and politicians not understanding how pensions work for people. The LISA is a gimmick, it is dangerous and it will confuse people. All it gives you is the equivalent of basic rate tax relief. It is a classic example of how not to make long-term policy.

**To watch this interview, please visit pensionsage.com**

**Written by Adam Cadle**

**Summary**

- Fund managers are calling on pension funds to think differently if they are to secure stable income and grow their assets.
- Persistent low gilt yields as a consequence of quantitative easing, imposed by central banks determined to stabilise the economies in the years that followed the financial meltdown in 2008, mean pension funds must look for alternative sources of income.
- Emerging market bonds, high yield bonds, equities, property and infrastructure are areas pension funds have been advised to look at.
- Capacity is a major issue for pension funds attempting to invest.

# Thinking outside the box

**Gill Wadsworth explores the need for pension schemes to invest in the unknown to ensure stable income**

Fund managers are calling on pension funds to think differently if they are to secure stable income and grow their assets in a world where traditional investment strategies no longer make the grade.

### Fixed income

Fixed income – once the go-to source for asset liability matching – has been in the doldrums since the global financial crisis, while equities appear overblown and expensive.

Persistent low gilt yields as a consequence of quantitative easing, imposed by central banks determined to stabilise the economies in the years that followed the financial meltdown in 2008, mean pension funds must look for alternative sources of income.

Investec Asset Management's multi-asset team investment professional Atul Shinh says: "Attractive and sustainable income levels are still accessible to pension funds, despite the overarching low-yield environment, through investing in a broad global opportunity set that includes emerging market bonds, high yield bonds, equities, property and infrastructure."

Essentially it is time for pension funds to capitalise on their long-term investment horizons and benefit from the illiquidity premia available from the assets proposed by Shinh.

BlackRock managing director for institutional clients Andrew Stephens echoes this position and encourages schemes to 'think outside the box'.

Stephens says: "Moving into alternative asset classes isn't brave, it's obvious. Pension schemes are seeking alternative income and embracing less liquid strategies to enhance returns, as yields from traditional asset classes remain scarce. With many schemes' recovery plans being in excess of 10 years, the illiquidity premia that schemes can source from private markets are compelling and UK pension schemes, with their long investment horizons, are ideally positioned to benefit."

A survey of 174 of BlackRock's largest institutional clients, conducted at the end of 2015, found more than half of schemes (53 per cent) intended to increase their allocation to real assets this year. Many are looking to illiquid assets to insulate themselves from market volatility and to reap the rewards of illiquidity premia.

While the addition of alternative sources of income looks to be an attractive alternative for pension schemes, accessing these asset classes is challenging.

### Capacity

Mercer European director of strategic research Phil Edwards says capacity is a major issue for pension funds attempting to invest.

"One constraint is capacity; some of these asset classes aren't necessarily huge. On the real asset side – long lease properties, ground lease properties, infrastructure equity and debt and the types of asset class with a low risk profile and a decent level of real yield - there isn't a large market for those assets but there is a high level of demand," Edwards says.

The challenge is exacerbated for smaller pension funds, which Edwards says may lack the resource and governance structure of their larger counterparts. However, he notes that since small funds have identical needs to larger schemes – the need for stable, reliable income – more investment opportunities will open up in the coming months and years.


Edwards says: "It is a new space for these strategies so there aren't many pooled funds out there. Plenty of small and medium schemes need cash flows and are looking at this kind of asset class so it won't remain the preserve of the large investors; it'll be one that goes mainstream."

Irrespective of size, multi-asset credit portfolios offer pension funds unable to dedicate the time and resources to actively managing an alternative fixed income allocation.

Like other multi-asset funds that went before them, diversified credit funds invest in a range of assets that are rebalanced and actively managed by the fund manager on the pension scheme's behalf.

Aviva Investors investment strategist Boris Mikhailov states: "We are seeing an increased level of interest from pension funds and consultants in multi-asset alternative income strategies. This is where a manager can select from a wide range of assets that helps with deployment time and allows them to exploit any relative value opportunities between and within private asset classes."


**Asset growth**

But pension funds cannot focus on income alone. With the UK's total defined benefit deficits reaching £459.4 billion in August, according to the Pension Protection Fund, the need for schemes to grow assets is paramount.

Yet reliance on traditional equity exposures will not, according to JLT Employee Benefits senior consultant and head of manager research Murray Taylor, deliver the goods.

Taylor says: "We have seen equities bouncing about and the indication we get from investment managers is valuations for the most part are stretched across the board. There are pockets *[of growth]* here and there but we are not expecting a great deal from the asset class as a whole."

Where there is growth to be had in equities, Shinh says Investec is focusing on companies that generate cash and deploy it at high rates of return on a consistent basis.

He adds: "Our regional preferences are for Japan and emerging markets excluding Asia, while our sector preferences include industrials and consumer discretionary."

Outside of equities, asset managers are again using alternative asset classes to deliver growth. Shinh says his multi-asset fund invests in property across the UK, Continental Europe and the US.

He says: "From a sector perspective, we have a preference for logistics-based companies, as beneficiaries of the rise of e-commerce, while we are light on cyclical office exposure."

Asset managers are also considering emerging market debt, high-yield bonds and infrastructure as future alternative sources of growth.

In the space of a year European pension funds increased asset allocation to alternatives by 13 percentage points and now hold 40 per cent of overall holdings outside of traditional classes, according to the *2015 Mercer European Asset Allocation* survey.

It is clear schemes are willing to embrace alternatives, but since demand outstrips supply it is up to fund managers and consultants to help find ways for funds of all sizes to access these non-traditional opportunities in a challenging investment environment.

**Written by Gill Wadsworth, a freelance journalist**

**Weird and wonderful**

The need to venture into the investment unknown is imperative if funds want to ensure long-term growth and stable income.

BlackRock managing director for institutional clients Andrew Stephens is quite clear it is time to move on from traditional bonds and equities.

Stephens says: "Pension schemes need to do something different in order to get different investment outcomes. They need to think outside the box to meet their scheme objectives. The strong asset returns we've seen since 2009 haven't fed through to improved funding levels for defined benefit pension schemes and forward-looking returns from public markets alone won't meet their objectives."

Pension funds are already willing to embrace some of the more unusual investments in their portfolios thanks to the rise of alternative investment.

For example the Clwyd County Council pension fund has exposure to a caravan park as part of its property and private equity portfolio.

Meanwhile the Cumbrian and Strathclyde pension funds both invest in healthcare royalties as part of their more esoteric investments.

Such investments are typically part of a wider objective to improve diversification and increase yield, which usually includes the addition of alternative assets that incorporate more unusual investments.

JLT Employee Benefits senior consultant and head of manager research Murray Taylor says: "When you invest in private equity, property or multi-asset funds, you are giving the manager a brief to make you money so alongside the usual boring assets, you might see different ideas that wouldn't make a standalone allocation."

Including 'unusual' asset classes in a portfolio requires some faith in the investment manager but it also requires research and governance on the pension fund's part, too.

Russell Investments head of client strategy and research David Rae says: "Trustees must be comfortable, ensure the framework is appropriate and understand the asset classes and the inherent risk."

Pension funds are opening up to an unfamiliar world in the pursuit of return, but given the governance and legal constraints, trustees are unlikely to venture too far into the unknown.

Schemes may welcome the advent of the esoteric investment but they will always be kept under a watchful eye.


**Summary**

- With the growth of DC, it has become more important for savers to understand pensions. Trusteeship has also become more difficult as the pensions system has become more complex.
- Too many confusing choices can lead to poor outcomes for individuals. Many different observers have also criticised overly complex language in scheme member communications as a source of misunderstandings or disengagement among members.
- Another source of complexity and confusion is the vast amount of regulation and legislation applied to pensions. The industry has argued the focus should be on improving the quality of trustees – seeking to recruit individuals with the professional skills and expertise needed to do a better job.
- There is regulatory confusion that has arisen out of both The Pensions Regulator and the Financial Conduct Authority having a mandate to regulate different parts of the pensions system.
- The industry and trustees must put their efforts into making an inevitably complex system less confusing and easier to understand for scheme members. Complexity at the point of production must be accepted, and then turned into simplicity at the point of consumption.

# Nice and simple

## David Adams analyses how a complex pension system can be turned into one of relative simplicity

Simplicity is not always preferable to complexity: Dvorak's *New World Symphony* sounds a lot better when played by a full orchestra than if reproduced on a kazoo. But unnecessary complexity can create problems, confusion and disengagement – as we have seen in the UK pensions system in recent decades.

With a growing number of pensions now based on DC arrangements rather than DB, it has become more important for individual savers to understand pensions and the financial decisions they have to make in relation to them. Trusteeship has also become more difficult as the pensions system has become more complex; and this complexity also gives employers another headache in relation to the pension schemes they sponsor.

So are there ways in which some kind of simplification of the system, or at least a reduction of its complexity, could be achieved, in the interests of savers/scheme members, retirees, trustees and employers?

Complexity can clearly have negative effects on individuals. A number of industry participants and pieces of research have demonstrated that too many confusing choices can lead to poor outcomes for individuals making retirement decisions. Many different observers have also criticised the overly complex language in scheme member communications as a source of misunderstandings or disengagement among members.

"I think we secretly quite enjoy having these complicated terms," says Pensions Administration Standards Association (PASA) chair Margaret Snowdon. "People need to be able to see at a glance what the benefits are. Lots of schemes seem to think they've got to put all the small print in – and that if they don't they'll be vulnerable to attack by the regulator."

Hymans Robertson partner and senior consultant Rona Train acknowledges there is a problem in finding the right balance between communicating a key message but also meeting all regulatory demands. "Still, it should be possible to create a document that communicates the most important information clearly," she says.

Professional trustee and PTL managing director Richard Butcher thinks it is inevitable that the system itself will be complex. What's really important, he suggests, is that trustees and the pensions industry collectively shield scheme members and other consumers from this complexity. "We, the pensions industry, can package pensions in such a way that they are manageable for the end consumer," he suggests.

But of course, comprehensive communications with individuals must involve some complexity. The new pensions dashboard, a digital facility that will enable access to information about all of an individual's pension arrangements, should make it easier for individuals to access this information – but presenting that information in a way that makes sense to a non-expert end user will be tricky, because there are so many additional details that need to be included and explained, such as guarantees attached to a specific pension.

"We're still talking about what that should look like," says Pensions and Lifetime Savings Association (PLSA) DC policy lead Tim Gosling. "We need to work out very carefully what information should be on it, in addition to fund values and what state and DB entitlements you might have."

**Regulation and legislation**

Another source of complexity and confusion is the vast amount of regulation and legislation applied to pensions. Aries Insight director Ian Neale points out that the sheer volume of pensions legislation has increased at an exponential rate over the past 40 years; particularly during the last decade. Successive Finance Acts and interventions by Chancellors of the Exchequer have created "enormously complex and convoluted legislation", Neale complains. A second problem, he suggests, is the regulatory confusion that has arisen out of both The Pensions Regulator (TPR) and the Financial Conduct Authority (FCA) having a mandate to regulate different parts of the pensions system. In theory there is a clear division: TPR is concerned with occupational pensions and the FCA personal pensions, but of course in some instances occupational pensions actually are personal pensions.

Pensions Management Institute (PMI) technical consultant Tim Middleton has a suggestion as to how to reduce complexity and remove – at least to some extent – politics from pensions: the creation of a standing pensions commission. "Auto-enrolment demonstrates how well pensions policy works if it's created in an environment of consensus between political parties and industry," he says. "A standing pensions commission could create a culture of simplicity, neutrality and consensus. Pensions policy would not be a political football and could be designed for the long term."

Meanwhile, trusteeship has become much more difficult and some in the industry fear that an endless stream of guidance and regulation is worsening the situation. Butcher believes the focus should be on improving the quality of trustees – seeking to recruit individuals with the professional skills and expertise needed to do a better job.

Association of Member Nominated Trustees (AMNT) co-chair David Weeks also feels there is too much complexity in the regulations affecting trustees, but says his organisation does not think it is reasonable to expect trustees to be experts in every aspect of the job from day one: "We think you can overdo the need for training in terms of knowledge: the task has a base level from which trustees can work upwards."

The most important attribute of a trustee is, he says, "a willingness and the capacity to hold the experts and professional advisers to account".

**Investment**

Interactions with the investment world can be a particularly problematic source of complexity, for trustees and for individual savers. "I'm convinced that the investment industry deliberately invents complexity in order to try to impress us," says Butcher. "They repackage old ideas and give them new, sometimes misleading names."To be sympathetic to them, there is huge complexity in investment. But I don't think the investment community helps. They could convert what they do into simplicity for consumption, but they choose not to."

But despite concerns expressed about the problems caused when individuals have to choose between many different investment products, there is no sign that the investment industry will be reducing choice any time soon. Instead, says Aviva senior pensions policy manager Alistair McQueen, the aim is to offer consumers a comprehensive list of options that can be reduced if necessary: from 2,000 possible funds to six or seven, or even fewer. "Choice brings competition and competition must be in the interests of the saver," he says. "I would not advocate any reduction in choice."

He admits, however, that there is room for improvement when it comes to communications: "It's a world that revels in jargon, but we need to speak in a language that means something to savers."

**Tax**

Finally, there is the way that the pensions system interacts with the tax system. Readers will be familiar with the ongoing debate around the way tax relief is applied to pensions, but there is also support within the industry for reform of VAT applied to pensions services. A problem arises if a third party supplies both investment and management services to a scheme and these costs are not invoiced separately. In September HMRC announced an extension to current transitional arrangements, which allow 30 per cent of the combined cost to be attributed to management and 70 per cent to investment. HMRC has not ruled out further extensions to this arrangement. This is a complex compromise. Snowdon believes that ultimately every expense that relates to running a pension scheme should be regarded as a justified business expense and thus be exempt from VAT.

Ultimately, any attempt at wholesale simplification of the pensions system will create further complexity and cost. Replacement or radical reform of the system will be immensely time-consuming, expensive and, yes, complex. Butcher's view is that the industry and trustees must instead put their efforts into making an inevitably complex system less confusing and easier to understand for scheme members and other savers. "We've got to accept complexity at the point of production, and turn it into simplicity at the point of consumption," he says. In that sense, reducing complexity in order to deliver better outcomes for savers and retirees is surely not an impossible dream.

**Written by David Adams, a freelance journalist**

# Challenging the status quo

**Following the Merchant Navy Officers Pension Fund (MNOPF)'s Pensions Age Pension Scheme Innovation Award 2016 accolade, Talya Misiri speaks to MNOPF chief executive Andrew Waring on the success of the fund and how it has continually innovated to keep up with the changing pensions climate**

**What has been your biggest challenge since being CEO at MNOPF?**

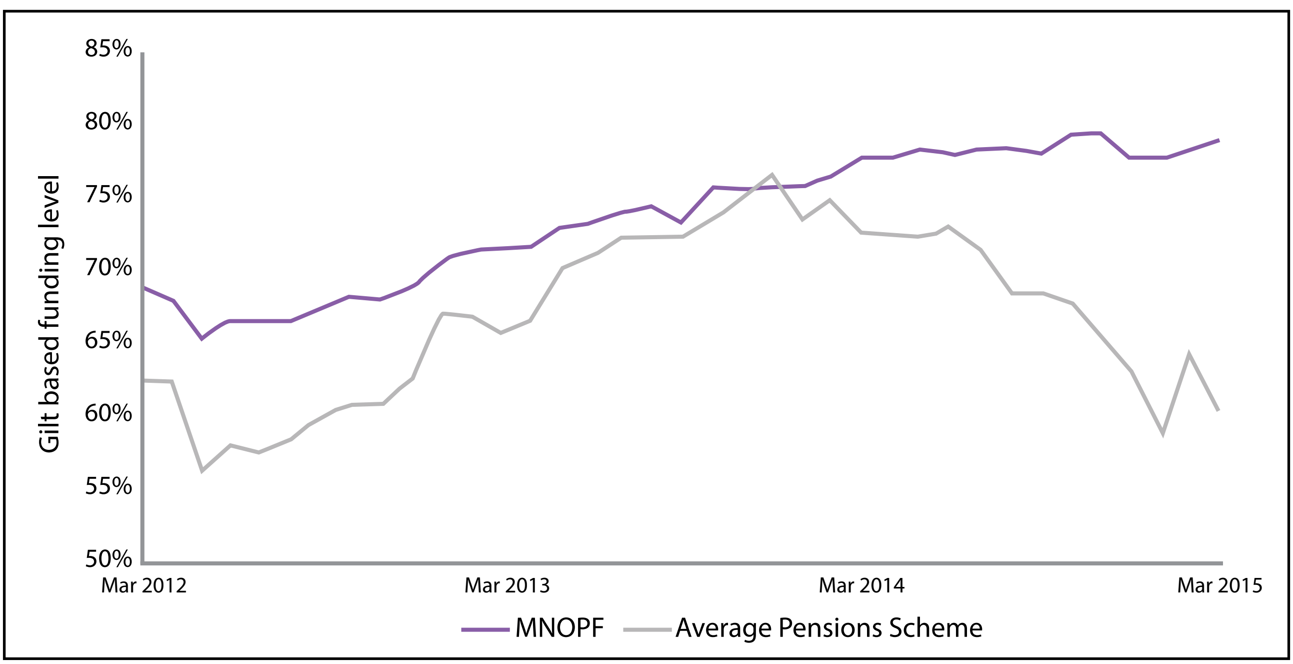
When I was appointed as MNOPF CEO, the fund was a typical 'mature' DB pension scheme and the main challenge was to look at how the fund could break that mould and move to improve funding levels to secure member benefit promises without putting undue burden on the participating employers. Working alongside a progressive trustee board that has not been afraid to innovate has been critical to achieving this.

**How has the MNOPF's industry-wide DC scheme, the Ensign Retirement Plan, been received? What are the main benefits?**

The Ensign Retirement Plan has been well received by participating employers and member feedback has been positive. The plan is Pensions Quality Mark Ready, allowing individual employers to gain PQM or PQM Plus accreditation. The Plan was designed to be a modern offering embracing pensions flexibilities and providing members and employers in the industry with a low cost, high quality pension and retirement benefit provision. Members who were moved to the Ensign Retirement Plan (for the MNOPF) on closure to future accrual benefit from 30 per cent contribution rates (10 per cent member and 20 per cent employer) and through the BlackRock Retirement Income Account, they can utilise drawdown at retirement if they wish to. If not, then they can use their DC benefits as part of their retirement cash or to purchase additional pension. The plan communications are maritime focused and through MyMNOPFPension, members retain a single point of contact for their DB and DC benefits.

**Please could you discuss your de-risking process? Could you put the success of the method down to one key feature?**

The MNOPF has utilised a wide range of de-risking options, having utilised buy-in transactions, a buyout of the old section of the fund and a longevity hedge transaction. This has all occurred alongside investment de-risking that has seen excellent returns delivered at



MNOPF chief executive Andrew Waring

far lower risk levels. Good governance is probably the key. The trustee manages the fund through a journey plan that targets funding level over a set time period and includes risk triggers to prompt consideration of risk reduction actions. A management sub-committee of the full trustee board can meet at short notice to make key decisions, which may be required in response to such triggers and the full board reviews the journey plan's progress at every meeting and considers an appropriate action.

**What are the key investment portfolio changes you have made in the last few years?**

The MNOPF trustee worked with the delegated chief investment officer after their appointment to review, restructure and extend the (initially limited) portfolio in order to broaden the use of alternatives, add specialisation and place focus on risk diversity, not just asset diversification. A programme of core hedging strategies was established with return-seeking specialist investment mandates which have proved invaluable to reduce interest rate, inflation and longevity risk. The use of free capital to hedge unrewarded longevity risk, significantly reduced the overall risk in the fund. The use of specialist managers has been increased substantially and has contributed significantly to fund performance and recent fund returns have been derived largely from the success of the liability-matching portfolio.

**What types of innovation have the MNOPF worked on that could also work well for other schemes?**

The MNOPF trustee believes that the use of a delegated chief investment officer, often referred to as fiduciary management, has been key to the success of the fund, allowing more specialisation and focus on delivering journey plan objectives than would have been possible using a 'traditional' governance approach. The liability hedge transaction was also innovative and the model of using an offshore, capital-efficient captive arrangement is one that other schemes who would previously have been considered too small to hedge longevity could utilise to positive effect.

**How have funding levels been over the last few years? Has there been any significant changes?**

MNOPF funding levels have increased in line with journey plan expectations, but importantly have shown steady growth in challenging conditions. The graph *[left]* shows that MNOPF funding levels increased by 10 per cent over the last valuation period, which compares very favourably to average pension schemes.

**What would be your top tip(s) for running a successful and innovative fund?**

I think the key is not to be afraid to challenge the status quo. Some great innovation comes from pushing back when people are telling you not that something 'will not work' or 'you cannot do that', but you need to ensure that you are not getting blinkered and pursuing a course of action that is misguided and ill judged. Good governance is a big key as well. A trustee board that is not afraid to push to be better and recognises their own strengths and limitations can deliver some great results.

**Written by Talya Misiri**

# New kid on the block

**Blockchain technology has been gathering a lot of attention for its potential to 'revolutionise' the financial sector and beyond. Laura Blows explores its potential applications within the pensions industry**

The first computer was created back in 1946. The internet began implementation in 1983. The first smartphone was launched in 1992 – 15 years before the first iPhone drove us all into a frenzy. Following slow starts, these innovations became 'disruptive technologies' that fundamentally changed all aspects of the world around us, including within the pensions industry. And now another emerging technology is expected to have just as much of an impact: Blockchain.

**About blockchain**

Blockchain is a "game changer" according to Protiviti managing director, IT security and privacy, Ryan Rubin."A disruptive technology that fundamentally calls into question many of the industry structures that have been in place for decades, if not centuries."

Blockchain technology is a new way to process financial transactions. While traditionally these transactions required the use of 'middlemen' to verify the transaction securely (custodian houses and the London Stock Exchange are two such 'middlemen' for example), blockchain removes the need for these intermediaries. The result is transactions can be completed more swiftly and with less 'processes' to go through, which can therefore lower costs.

To achieve this, the digital record of a financial transaction is encrypted into a 'block'. A number of blockchain users' computers (as independent entities known as 'blockchain miners') then verify if it is a genuine transaction. If they all approve the transaction the money will be passed from A to B.

The 'block' representing that transaction is then bound onto the 'chain' that records the movement of that money using algorithms – thus creating a continuous, linked list of transactions that provides a secure and unchangeable history of electronic transactions, Equiniti director Paul Sturgess says.

Or, to put it simply, EY director Jason Whyte compares it to the old mobile phone game *Snake*, where every time the snake 'ate' a block on screen, the block got added onto the end of the snake.

The details of each transaction/block are not stored, only the fact that the transaction happened, along with the unique 'digital signature' of that transaction/block, which cannot be converted back into its original form. "If the original data was altered it would produce a different digital signature that would alert the network to the mismatch," Gowling director Liz Wood explains.

To put a visual slant on it, imagine someone holding a picture of themselves holding a picture of themselves holding a picture of themselves etc – each block has this 'picture' of all the previous transactions, and the further along the

**Summary**

- Blockchain is a new technology for processing financial transactions without the need of intermediaries. Each transaction is encrypted into a 'block' that is linked together into a 'chain' using algorithms and cannot be modified. Data can be stored within each block.
- Blockchain was first used by online-only currencies, such as Bitcoin, but its uses are currently being explored by the financial services industry.
- Pensions funds may use blockchain to improve the cost, transparency and speed of financial transactions and for the effective storage of data to help with administration services.
- A current barrier to blockchain's implementation is the 'newness' of the technology, with teething issues to overcome.

chain, the more repetitions of the 'picture' each block would have. Therefore any tampering would stand out throughout the chain.

Also, as the data is distributed to so many computers, it should be much harder for hackers to attack it compared to traditional financial transaction processes. Blockchain's use of multiple peer devices to authorise every transaction means "it quite simply can't be overridden by one party attempting to manipulate records", Hames states.

Adding to the blockchain's security is the element of tracking and transparency. As there are no 'middlemen' recording the movement of money, the blockchains showing the financial transactions are instead available for everybody to view, via a distributed (or 'shared') ledger.

IFDS director of innovation Phil Goffin adds that blockchain provides both investors and financial institutions with the same industry-standard cryptography controls to enable secure communications. This removes trust issues such as identity theft, thus enabling parties to maintain shared ledgers of their economic affairs, he explains.

**Financial beginnings**

Blockchain technology was first conceived in 2008 and was implemented in 2009 to be used with the online-only currency (which is a currency that has no gold or silver standard attached to it, no government backing, and is only worth as much as people are prepared to trade for it, also known as a 'cryptocurrency') Bitcoin.

So far, the amount of money moved using blockchain amounts to just 0.025 per cent of global GDP, or $20 billion, according to the World Economic Forum. But while the amount is currently small, this is set to grow rapidly, particularly as the financial services industry has started to explore blockchain's potential.

There are currently a number of blockchain trials taking place within the financial service industry, such as R3 Cev, which is a consortium of over 40 banks developing the settlement of securities using blockchain and setl.io, a group that is developing an institutional payment solution for the UK banking system.

The Bank of England is also leading a trial to replace the Real Time Gross Settlement System (RTGS), which sits at the heart of the UK banking system.

Also, the Financial Conduct Authority said that it was considering approving a "small but significant number of firms", Alpha FMC principal Olivia Vinden says. "A group of seven banks, including Santander, CIBC and UniCredit were amongst the first financial institutions to move real money across borders using blockchain-based technology," she adds.

Financial services firms embracing this technology may seem strange, as it has the potential to be an existential risk to entire sections within the industry.

"For some financial companies, blockchain strikes at the heart of your business, if your business model is in managing those assets for people who want to trade them," Whyte says. "But then the question is if you think this is going to cannibalise your industry, are you better to cannibalise it first and build a new business model around it or wait for it to happen to you?"

Vinden agrees that blockchain could represent a risk to those parts of the financial industry that support clearing, settlement and safekeeping. "However, the possibility to reduce costs as a result of this technology should be seen as an opportunity, rather than a threat," she states.

For instance, Capita divisional head of marketing and research Robin Hames thinks it could quite easily take off in emerging economies where the financial infrastructure is less developed and less ingrained, so can more easily be overhauled. "It's the 'advanced' economies themselves in catch up, ironically," he adds.

Asset management is expected to be the first aspect of the financial services sector to take this opportunity and implement blockchain. Alternative assets in particular are normally quite illiquid, but blockchain could help turn them into more tradeable assets, Whyte predicts.

**Pensions' explorations**

So it is not surprising that the financial services sector is among the first to see if the benefits of blockchain can be utilised beyond the movement of online currencies. But what may be more surprising is that its potential within pensions is already being explored.

Dutch pensions manager APG recently announced that it has earmarked a significant part of its innovation budget for the coming years for working alongside other companies to explore the practical applications of blockchain.

The California Public Employees' Retirement Systems (CalPERS), the largest public pension fund in the US, has also discussed the possibility of investing in blockchain technology, while reports have emerged that the Chinese government will soon start using blockchain technology to process social security payments.

Even the UK's Department for Work and Pensions (DWP) is in the process of a three- to six-month blockchain trial, which began in May this year, with up to 24 participants. This is conducted by a private sector company, that handles the claimant's data independently from government.

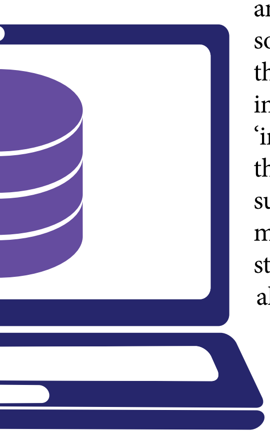
"This is a small scale, voluntary trial. There are no restrictions or limits on how welfare payments are spent for those involved in the trial and all personal information is removed before the data reaches DWP," its spokesperson states.

**Industry uses**

Within the pensions industry itself, people are beginning to consider the benefits blockchain could provide.

According to BTL Group founder and CEO Guy Halford-Thompson, "for industries, such as pensions, which have suffered from a lack of transparency in the past, there is a huge opportunity to transform the industry with a small amount of investment in blockchain technology".

State Street head of UK pensions and banks, asset owner solutions, Andy Todd thinks it will initially impact the most 'inefficient' areas of the pensions industry, such as those that are manual, require a lot of stakeholders to engage, align and sign-off, or have intermediaries that add cost to the system.



Certainly smoothing the many layers within the pensions industry generally could be beneficial to savers.

Currently, the pension fund member is connected to a set of underlying assets via pension fund managers, asset managers, brokers and investment funds. Blockchain technology offers the prospect of sweeping away a lot of this complexity and frictional cost, Rubin says.

"For example, how long does it currently take the industry to undertake a pension fund transfer? Typically several months. To a customer who is already getting used to the fact that they can transfer money reliably between bank accounts now in a matter of minutes via Faster Payments, the length of this delay is difficult for the industry to explain. Blockchain technology could bring this time down to a matter of minutes if implemented correctly," he explains.

The greater transparency of ownership of pension fund assets could make well-performing funds more attractive to buyers, therefore helping generate better investment decisions overall, Rubin adds.

Blockchain technology could also instigate the use of 'smart contracts', where the technology has rules built in to automate simple transactions when certain conditions are met (such as a market fluctuation or a pension saver reaching a certain age). This would offer greater transparency on payments/fees/allocation of funds and shorten the time taken to complete transactions.

Blockchain's ability to 'link' financial transactions together could also be a valuable mechanism for recording an individual's pension savings.

"Instead of having a new pension every time I go to a new employer, the record of my pension and the contributions paid in may be added to my one blockchain, despite the different employers throughout my working life paying into my pension. And as it cannot be modified, we will always know that it is an accurate record," Whyte says.

Blockchain could then also have a role in the secondary annuity market where initial and ultimate beneficiaries will change over time, Sturgess adds.

It is important to note that blockchain technology has the potential for recording and linking any data, not just financial, meaning its uses within the pensions industry could extend beyond finance to administration.

For instance, blockchain could be used to improve upon pensions communications. If a member had several pots with various providers, that information could be pooled into a blockchain so as to form an overall position of the member's pensions savings, Wood states.

The industry is currently in the process of implementing a pensions dashboard to enable people to see all their savings in one place, so it would not be surprising if this area was an early adopter of blockchain within the pensions industry, Hames adds.

Documents such as member records, scheme documents, service contracts and accounts could be kept and updated through blockchain. All parties would be able to view the same information, so the problem of version control would disappear, Pensions Administration Standards Association chairman Margaret Snowdon says.

Blockchain may become a powerful weapon against pension liberation fraud, due to the increased transparency it provides. Data could also be included within the blockchain to confirm whether advice has been taken before the money is transferred to the saver, Snowdon adds.

"From a financial advice perspective it would be great to be able to hand over an accurate record of a pensions holdings and have a financial adviser view that blockchain very rapidly to get a view of what they have got and might need," Whyte says.

He adds that "you can imagine the government being quite interested in blockchain for tax records".

Hames agrees that it would be "tremendously useful" for regulators and auditors who struggle with reconciliation activities, which could be done automatically. "A very prescient example would be the current GMP reconciliation requirements, which will exorcise the minds and time of administrators and trustees alike for the next couple of years," he says. "Imagine how less painful, or frankly unnecessary, this work would be had a shared, validated ledger existed."

**Risks**

So already the industry is imagining blockchain technology having a wide number of benefits for the sector. Imagination is a wonderful thing. But could the reality be not so pretty?

Despite blockchain still being a new technology, and the security it provides much heralded, it has already been subject to hacks. For instance, recent attacks on digital currency exchanges DAO and Bitfinex saw over $50 million taken.

*The Business Blockchain* author William Mougayar states that while security is an inherent feature of blockchains, a blockchain application could be badly written and have security holes, "just as a web application could have security weaknesses too".

Breaches so far seem to be exploiting the trouble users have protecting their online currency (as they are generally stored in digital files) instead of the distributed ledger system of blockchains itself being compromised.

But the whole 'newness' of the technology could also be an issue. The Financial Stability Oversight Council, which is a group of US regulators, has already warned that "operational vulnerabilities *[with blockchain]* may not become apparent until they are deployed at scale".

A teething problem that has already occurred, Whyte notes, is when two transactions happen at roughly the same time, which can result in a short period of time where a blockchain has two chains until the 'real' chain is established.

Another issue is that the technology is changing very quickly. For instance, Accenture has just taken out a controversial patent on a technology that lets them edit a blockchain. A key part of blockchain's security is that it cannot be tampered with, but the argument for this patent is that it would provide a cleaner way to undo  a mistake, such as if someone made a 'fat finger trade' and added an extra '0' onto a transaction, Whyte explains.

The evolving nature of the new technology also generates a risk around standardisation and cooperation.

"As the technology is still evolving it is possible that we could end up with a VHS versus Betamax situation," Sturgess warns, "where both technologies were technically excellent for the purpose, but ultimately it was disagreement regarding standards and licenses that allowed VHS to dominate the market."

**Reluctance**

There is also a risk that the pensions industry itself may be reluctant to utilise blockchain technology. As is often the case with technology advances, legacy systems are the biggest barrier to implementation.

It really required online banking to take hold before many in pensions were prepared to embrace the digital channel, Hames states. "And let's be honest, there are still plenty of schemes that are well behind the online curve, let alone exploring blockchain," he adds.

To counter this, Snowdon recommends the creation of a technology forum for the pensions industry.

But in the meantime, it seems unlikely the pensions industry would want to risk putting pension fund members savings in cutting-edge technology. While the technology is still being developed and is not yet being widely used by banks, a court may not look favourably on a trustee who invested in a company using blockchain if this resulted in the loss of pension scheme money, Wood warns.

And while blockchain may have benefits for the pensions sector, and could reduce some inefficiency, it will not be a panacea to all the industry's problems. For instance, it will not provide insight as to where money should be invested to achieve positive returns with low volatility. It will not stop human error, such the wrong amounts being put into the system. And it will not address the need for people save more for retirement and engage with those savings.

**Overhype?**

So as it is certainly not a 'cure all', does that mean blockchain technology is overhyped?

"It is approaching the peak of Gartner's Hype Curve," Sturgess states, "and as such will soon drop into the wonderfully-named 'trough of disillusionment', at which point many early-stage companies are likely to fail and the market will become frustrated by the lack of useable products and tangible benefits. The technology companies will then start to consolidate and prepare for mainstream adoption as clearer business use cases start to emerge."

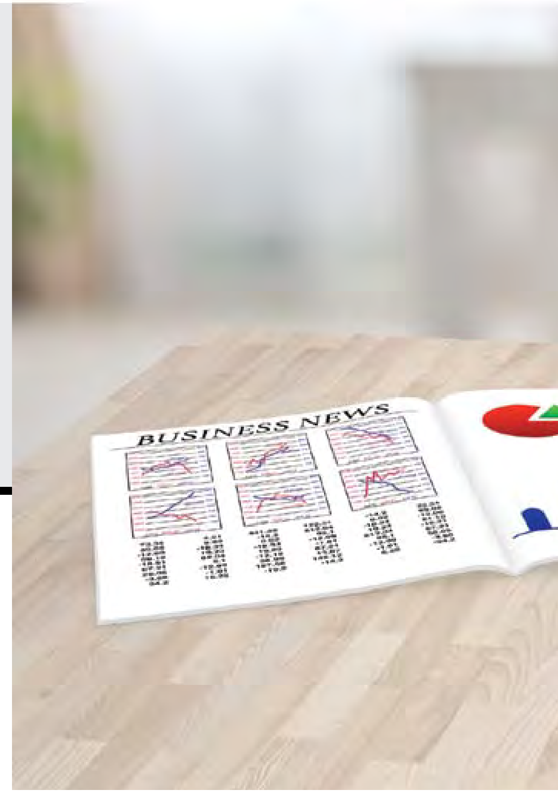
It has to be remembered that the technology is still very new. Currently, blockchain is being compared to the internet in the 1990s, where the first internet sites looked and behaved more like traditional shops until people became used to the new technology and its applications.

As it still early days for the technology, no doubt blockchain will see a number of false starts. But when considering if and when blockchain will have an impact on the pension sector, it is worth mulling over the words of a man at the heart of many technological innovations – Bill Gates. He has  stated: "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next 10. Don't let yourself be lulled into inaction."

**Written by Laura Blows**

**Summary**

- Augmented reality allows a user to scan a 'real life' trigger (such as a company logo) with an augmented reality app on a smartphone, to access an 'overlay'. This is an extra layer of detail that pops out over the view from the phone's camera, such as images, text or video.
- Augmented reality may be used within pensions comms by allowing the member to scan communications documents, such as a benefit document, to access more pensions information.
- Augmented reality can help overcome the ongoing challenge of engaging with members and employees who are often confused and frustrated by the complex and sometimes dry subject of long-term financial planning. It can also be used to attract younger savers.
- Augmented reality will not be a replacement for more 'traditional' communication tools. Instead it is used to enhance other communication paraphernalia.




# A new reality

**Augmented reality has been a successful addition to the world of mobile games. Now excitement is growing about the possibility of expanding this technology beyond gaming and using it to increase viewer engagement with marketing messages. Laura Blows finds out the opportunities it could bring to the pensions sector**

What does *Pokémon Go*, the insanely popular mobile game where people find virtual characters in real-life environments, and pensions communications have in common?

No, not just the need to catch creatures/savers – surprisingly it's the use of augmented reality to provide an enhanced experience for users.

The pensions industry may only just be waking up to the opportunities augmented reality can provide to enrich its pensions communications, but it will soon be increasing its use of augmented reality faster than you can say 'Pikachu'.

**About AR**

Augmented reality (AR) is where, using a mobile or tablet device, one can view their real-life environment and have it enhanced with virtual elements on screen.

Like Minds consultant Matt Hopkins explains: "By scanning a trigger with an augmented reality app on a smartphone, an 'overlay' can be accessed. This is an extra layer of detail that pops out over the view from the phone's camera. So, for example, you scan an image of a character and watch it 'come to life' in front of you. This extra layer can house interactive content such as video, a game or text."

It is not too dissimilar to QR code technology, but unlike QR codes, there is no need for a square barcode graphic on the materials. Instead the 'trigger' could be any image, such as a brand logo.

As a minimum, augmented reality apps require access to a camera, AHC head of web consulting and development Sam Charles says, but additional features become possible with other mobile device hardware such as GPS location and mobile data. "Augmented reality apps also benefit from the hardware being portable – increasing the scope of the user's ability to interact with the real world," he adds.

AR is not a brand new technology. It has already been successfully implemented in a number of different ways – one example is the graphics superimposed on sports broadcasts to aid viewer understanding, such as arrows on the screen showing the trajectory of the golf ball or the drivers' names appearing on the lanes in Formula 1 racing.

However, it is the launch of the game *Pokémon Go* earlier this year, with its staggering 100 million downloads and around 20 million daily active users in the US alone (resulting in over $200 million in revenue according to sources), making it a global phenomenon, which has made people excited about the


potential applications of augmented reality.

**Pensions possibilities**

As a 'disruptive technology', many industries are examining augmented reality's potential, including the pensions industry. According to Hopkins, "the possibilities for content are almost endless – it just takes a little bit of imagination".

Already using his imagination is Charles, who suggests that augmented reality may be used with a pensions benefit statement. The paper or online statement could be enhanced with different visualisations, depending on the member's circumstances, when viewed through an augmented reality app, he states.

"More advanced solutions could involve more real-world interactions," Charles continues. "For example a real-time barcode scanner could look up a price of a product based on the barcode and overlay a different image on the product representing the value of that purchase had the money been invested until retirement instead of it being spent now."

But it is not necessary to simply imagine how AR could be used by the pensions industry; it has already begun to be implemented within pensions communications.

Capita recently utilised AR technology for engine and power generation product manufacturer Cummins.

By using an AR app downloaded for free to smartphones or tablets, employees can now scan many different types of material – from posters around the building, to leaflets, floor transfers and coasters, which loads a computer-generated scene merged with the real images from the viewfinder on the device's camera lens.

According to Capita divisional head of marketing and research Robin Hames, the aim of this was to provide an innovative and engaging way to access rich educational pension content, such as animation, instructional films and a login to the Cummins Pensions Portal.

The process took three to four months and the app launched in February 2016. Employees were advised of the AR app download process via an email and poster campaign prior to the launch date, and according to Hames, "we worked closely with Cummins' IT department to ensure suitable technology and secure data checks were done".

Feedback has been positive so far, with over 1,000 apps downloaded from a 7,000 audience, Hames states.

**Growth potential**

Cummins may be one of the first companies in the UK to utilise AR for its pensions communications, but it's unlikely to be the last. The technology simply offers too tempting an opportunity to improve engagement with pension scheme members.

"Augmented reality is being adopted in the pensions sector to overcome the ongoing challenge of engaging with members and employees who are often confused and frustrated by the complex and sometimes dry subject of long-term financial planning," The Personal Finance Society chief executive Keith Richards states. "In the age of the smart device, it can also satisfy consumer demand for instant access to entertaining, interactive and informative subjects," he adds.

A key benefit is its potential for widespread use. It can be easily adopted by many users as it can be used by any device with a camera – essentially allowing any smartphone (or tablet) on the market to work as an augmented reality device, Charles explains.

However, while it has the potential for mass usage, it is its ability to segment users that is also attractive. According to Mercer UK Talent Communications principal consultant Rayna Miller, it provides a vehicle to help reach audiences that are typically harder to engage in the topic of pensions, such as younger people. "Members' intrigue about the technology could subsequently provide greater exposure to and greater engagement with the actual messaging," she adds.

**Complementing traditional comms**

The excitement about AR as a potential game changer for pensions communications is understandable, but it will not be a replacement for more traditional communication methods. Instead, it is its complementary nature that is likely to make augmented reality a successful tool within pensions communications.

Augmented reality cannot be used in silo, instead the very way it works is to enhance other communication paraphernalia.

For instance, some savers may not have smartphones or tablets or simply may not want to use AR. These people would still receive printed or online communications, as would those who do use AR. The difference being those that utilise augmented reality would be able to 'scan' the communications and receive the additional information and enjoy the interactive capabilities this generates.

As Hopkins says: "Augmented reality is a fantastic way of making pension messages more accessible to different audiences, even within the same document."

Yet however great augmented reality may seem, it will not lead to a successful comms campaign if it is used as a gimmick.

"The interactive content needs to be engaging enough to justify an individual going to the effort of opening their phone, downloading the relevant AR app if necessary and then scanning the communication 'trigger,'" Hopkins says. "And, as we are very much in 'early adopter' territory, instructions should also be included in the content. This can combat a lack of awareness, but also adds to the amount of content individuals need to digest."

Therefore, augmented reality has to have a meaningful message and useful content for members to engage.

"As with any communication, the objectives and the desired outcomes need to be clear from the outset," Charles says. "Augmented reality solutions will not salvage a poor communications strategy but, in conjunction with a solid strategy with clear objectives, a well-designed augmented reality solution can help bring these outcomes to bear."

Well integrated or not, either way it is unlikely we will see a flood of pensions comms implementing augmented reality straight away. Individuals generally – both savers and those in the sector – are still getting to grips with the technology (which, due to the ever-increasing speed of technology development, is constantly evolving). However, with more than 864 million smartphones already supporting AR technologies, The Personal Finance Society chief executive Keith Richards states that "the potential for the pensions sector is huge".

But whether the use of augmented reality becomes commonplace within pensions communications next week, next month, next year or further away, it should eventually become as normal a part of the communications strategy as sending a letter. Despite best efforts, savers currently are not sufficiently engaged with the concept of retirement. Any tool that can help combat this should be gratefully received. As Miller notes: "Providers and employers are realising that doing the same thing as yesterday will get them yesterday's results."

**Written by Laura Blows**

**Virtual reality**

While augmented reality aims to 'enhance' the user's real life experience, with virtual reality (VR) the aim is to replace the user's external stimuli and replace it with an immersive 3D experience.

"Virtual reality strives to extract the user away from the real world – a complete virtual reality experience will replace all a user's senses with virtual alternatives. Top-end solutions replace vision, hearing, movement and have haptic feedback so users can 'feel' events in the virtual world," AHC head of web consulting and development Sam Charles explains.

"Most consumer VR hardware focuses on replacing vision and hearing (using a VR headset) along with some movement through the use of motion tracking devices like Microsoft's Kinect. Current VR requires specific technological solutions – like a specialist headset that takes control of the users whole visual experience. Phone-based headsets (such as Google cardboard) are probably better considered as stereoscopic 3D experiences rather than VR, as they leave the periphery vision open to the real world," he adds.

Like augmented reality, there is plenty of scope for virtual reality's capabilities to be utilised for the benefit of pensions communications. However, potentially hampering this progress is that while augmented reality utilises technology that is pretty commonplace amongst savers – smartphones and tablets – virtual reality requires additional devices such as headsets and special gloves.

"Augmented reality can be achieved with day-to-day hardware (i.e. almost any smartphone or tablet). In this respect to cost of entry to augmented reality communications for a member is almost zero as almost all members will have access to one of these two devices," Charles says. "As a comparison the cost of entry for VR is much higher with the user needing a specialist headset (from around £100) and associated games console or PC."

Despite these current barriers, "I expect that in the not-too-distant future we'll be able to use virtual reality headsets to create virtual scenes where consumers can control their saving patterns over time, and then be presented with a view of their future possessions and surroundings based on their savings behaviour," The Personal Finance Society chief executive Keith Richards states. "Pension guidance could take on a whole new reality."

In association with

EM roundtable

# Emerging worlds

**The *Pensions Age* emerging markets panel asks whether the recent rally in emerging markets is likely to continue and how pension funds can make the most of the opportunities**

**Chair:** How is current market sentiment around emerging markets (EM)?

**Cogan:** There is some surprise at the extent to which the strength in emerging markets has persisted year to date, coupled with some angst as to whether it can sustain itself going forward. These are the two feelings we get the most from talking to our peers and clients.

A lot of the rally so far, we feel, boils down to the transition in central bank policy in the early part of the year and the associated discontinuation in dollar strength. The stable dollar has provided a more favourable environment for risk taking particularly as we've seen since mid-February and in EM.

People are now trying to figure out whether there's a sufficient fundamental rationale behind the rally and to what extent countries differ on a fundamental basis.

We think the rally can persist because the Fed, we believe, recognises the global implications of tightening US monetary policy and a stronger dollar, so you're probably going to see this risk-on environment persist longer. On top of that we see many attractive bottom-up opportunities within EM. However, we see a lot of differentiated risk between regions fundamentally, which warrants caution in terms of chasing it from a beta or a passive standpoint.

**Liu:** How do we feel about emerging markets? Better, in general, than we have done but I agree that many people are wondering whether this rally is sustainable. What's really driven the rally of emerging market debt this year? From the surface, the first leg was because of the oil price coming up, and then you had a correction of about 5 per cent; and the next leg was related to the so-called dovish world central bank. But if we look deeper, there is a more fundamental reason.

If you look at the beginning of the year, most of the EM countries had already experienced big sell-offs in the last few years, especially in the local markets. So, from a valuation point of view, there are some signs of overshooting, especially when we compare the commodity countries, which are the higher beta countries in emerging markets.

On the other hand, if you look at the fundamentals of these countries, the current account deficits of this group of commodity countries have actually been improving. So you have overshooting valuations and you also have improving fundamentals.

That's why we think that regardless of the oil price going up, and even if there was no dovish sentiment coming back, EM fixed income would still have done pretty well, probably not as well as right now, but well.

**Langham:** Sentiment at the start of the year was extremely poor in emerging markets following five years of absolute and relative underperformance; sentiment tends to follow performance so it's clearly improved. Overall I would say

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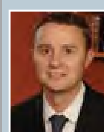
## CHAIR

**Chris Parrott, Pensions Manager, Heathrow Airport Ltd**
Chris is head of pensions for Heathrow Airport Holdings (formerly the British Airports Authority), responsible for the operation of all group pension arrangements and insured benefits. He has been working in occupational pensions since 1982, holding management positions for the operation of both public and private sector pension schemes. Chris is a fellow of the PMI and in 2013 was elected to the institute's council. He is also a member of the advisory council for AIMSE Europe.

## PANEL

**Andy Boorman, Trustee Executive, BESTrustees**
Andy joined BESTrustees in 2014. He was formerly the group HR and corporate services director for Henderson Group Plc. Andy has considerable knowledge of pensions, both DB/DC and SIPPs, in a variety of roles: as a principal employer, as the manager of in-house pensions administration and also as a trustee. Andy has been involved in the full range of 'modern' pensions management including buy-ins and buyouts, wind-ups, reducing costs and restricting benefits.



**Dennis Cogan, Senior Vice President, Co-Portfolio Manager, Calamos Investments**
Dennis is responsible for portfolio management and investment research for the firm's global, international, and emerging market equity strategies. Based in their London office, he joined Calamos in 2005 and has 15 years of industry experience. Previously, Dennis worked for Accenture in strategic planning and analysis. He received a B.S. in Finance from Northern Illinois University.

**Ross Teverson, Head of Strategy, Emerging Markets, Jupiter Asset Management**
Ross joined Jupiter in 2014 and is currently head of strategy, emerging markets. He manages the Jupiter China Fund and the Jupiter Global Emerging Markets Fund (Unit Trusts) as well as the Jupiter China Select fund and the Jupiter Global Emerging Markets Unconstrained Equity fund (SICAVs). Prior to joining Jupiter, Ross worked for 15 years at Standard Life Investments, where he managed a global emerging markets equity fund.

**Richard Dell, Partner, Mercer Investments**
Richard is the global head of Mercer's equity boutique, a unit within Mercer's investments business. He is responsible for equity manager research globally. Since joining Mercer, Richard has focused on researching managers across a range of equity universes and geographies, taking over as head of the equity boutique in 2013. Richard joined Mercer in March 2008 from Fidelity International, where he was a manager on the competitor and fund analysis team.

**Binqi Liu, Senior Fund Manager EMD, HSBC Global Asset Management**
Liu is a portfolio manager for the global emerging markets debt team. She joined as an analyst in 2008, focusing on sovereign analysis and local markets, developing the team's country credit and currency valuation models. Liu became a portfolio manager in 2011 when she was appointed as co-portfolio manager for their flagship local funds. Liu also serves as the economist of the global EMD team, responsible for global macro and sovereign economic research.

**Philippe Langham, Senior Portfolio Manager, Head, RBC Emerging Markets Equity**
Philippe is head of the emerging markets equity team in London, and lead manager for the emerging markets equity and emerging markets small cap equity strategies. He joined RBC Global Asset Management in 2009 and has worked in the investment industry since 1992. Prior to joining RBC, Philippe was the head of global emerging markets at Société Générale Asset Management in London. Previously, he worked at the Kuwait Investment Office and Credit Suisse.

**Lucinda Downing, Senior Asset Allocation Analyst, Aon Hewitt**
Lucinda develops asset class views within Aon Hewitt's global asset allocation team for investment advisory and delegated consulting clients. She was previously director of balanced funds at Russell Investments, where she structured and managed multi-asset, multi-manager funds. Before then, she was a portfolio manager at State Street Global Advisors, where she managed bond and currency portfolios and created forecasting models. She is also a regular commentator in the pensions press.

**Colin Richardson, Client Director, PTL**
Colin joined PTL as a client director in March 2014, having previously spent 25 years in pensions and actuarial consultancy. Colin acts as independent trustee on several DB and DC pension schemes, including four DC master trusts. Colin also is a member of the Internal Governance Committees for two leading workplace pension providers. Colin chairs the PTL Governance Advisory Arrangement for pension providers, which provides governance for 12 further pension providers.

**Maggie Stoker, Client Director, CCTL**
Maggie is a Fellow of the UKCFA and holds the IIMR qualifications. Following a successful career as an asset manager, she established a training consultancy that designed and delivered technical investment courses to investment firms in the UK, Asia and Europe, as well as several regulatory agencies. She was previously a fund manager at Capital House Investment Management, where she managed money for corporate and local authority pension schemes.

there is still some caution in terms of a short-term outlook in emerging markets, but people tend to have a more optimistic view on the longer-term story.

**Chair:** Can you expand on that?

**Langham:** If we look at the main reasons why emerging market performance has picked up this year, we would say that most are sustainable and are still in their early stages.

We've seen a peaking in the dollar, particularly against emerging market currencies; valuations for emerging markets have been very cheap. Also we've seen a pick-up in commodity prices and particularly oil, and there tends to be a strong correlation between commodities and emerging markets. Finally, we've seen a pick-up in economic and earnings momentum. Of those factors, we feel, the vast majority are very much at early stages – the ones where we would suggest there probably isn't that much further to go would be the rally in commodities, and particularly the oil price, and in terms of economic momentum we would say that, for most emerging markets, there's quite a strong story to be had in the coming years. The one exception would be China where we feel, certainly over coming years, growth is more likely to slow.

**Chair:** Lucinda *[Downing]*, what are the discussions you're having with managers and clients on EM?

**Downing:** We've seen some increase in emerging equity exposure amongst value managers this year but, on a more general basis, there hasn't been so much of a build-up in emerging positions. That's across hedge funds as well as equity and multi-asset credit managers. I think it's because, as we've just discussed, a lot of the headwinds that have been facing emerging markets may have turned around, and that's been supportive. But we've got these big risks out there in China and the US and people are still very uncertain of these risks, so that's my take on why sentiment isn't totally positive amongst managers.

In terms of clients, we've been advising them to slowly build up their emerging exposure. They have been, in general, underweight market cap exposure on both the equity and the bond side, so we've been positive based on the fact that there are good strategic reasons to have an exposure to emerging markets. That's been coupled with the fact that, in the medium term, they have been looking cheap from an equity, bond as well as currency perspective.

Having said that, clients remain quite wary of emerging markets. I guess that's because the good performance is a fairly new development and because of the high level of global economic risk out there. Aon Hewitt still has a cautious view on the global economy and global markets.

**Dell:** Many of the managers we look at have been very slow to increase EM allocations. A lot of it comes down to their desire to see improvement in the underlying corporate financials before they start making increased allocations, rather than just shifts in the macro environment.

From a client perspective, we have been advising clients to have an overweight position relative to a market cap in emerging markets for many years. The last few years a number of clients have been taking advantage of fairly low valuations in emerging markets to increase their allocations. This has also been in response to the high valuations in many other areas, whether it's fixed income or developed market equities; so clients have been increasing their allocations to EM.

That did slow down to some extent as the flow of negative sentiment increased towards the end of 2015 and it hasn't really increased this year – I think we're too early into any recovery for many institutional clients to change that view immediately. One thing that has changed though in discussions with clients is that there's an increased awareness of the options available in how to invest in emerging markets; increasing discussions about strategies that are not core benchmark relative emerging market equity strategies but slightly more innovative ones.

**Chair:** So for those on the buy side, trustee representatives, in a low-rate, low-yield environment, is this where you go?

**Stoker:** Some of the clients we have are still concerned about the volatility

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and the uncertainty around investing in emerging markets. They've had their fingers burnt so many times that they tend to go into a diversified fund rather than necessarily asset allocate specifically. Also they're very cautious at the moment of moving into a market where the green shoots might wither and burn, so there is a bit of a wait and see attitude to see how things develop.

**Boorman:** I would largely echo that – there have been many years of relative and actual underperformance on the one hand, whilst on the other hand you've got a potentially attractive market. People are however, on the buy side, quite wary and if they have been persuaded to invest, it tends to be through a DGF and the problem with that is their money then is not being allocated as well as it could be. So it's one of those things that has great potential but there's a huge amount of uncertainty, and the risk always is that by the time the investment advisers are more certain about it, the opportunity will have gone. So I think the volatility and the serial underperformance over the last few years make this quite a big ask on the buy side.

**Richardson:** I echo the mixed comments given here today, although I sense a bit more positivity coming from some of the schemes we deal with. No one has mentioned Brexit yet but it's led to tricky hedging decisions on all overseas exposures including emerging markets; I think every scheme is considering the extent of hedging post Brexit.

In relative terms, however, compared to other asset classes, the picture is one of a gradual building up of positions rather than reducing positions. So a gradual build up with a degree of caution but overall reasonably positive sentiment.

**Teverson:** I would agree that clients are generally feeling caution towards the asset class. Because we have seen this rally – 16 per cent year to date in US dollar terms; up 30 per cent or more in US dollar terms since the bottom in January – people think perhaps they've missed the opportunity. That's why it's really important to frame this conversation in the context of where we're coming from.

We started this year with valuations looking very low in a historical context; at the type of price to book level for emerging markets where historically if you'd invested at around 1.3 times price to book, which is where we were in January, then your five year returns would be well in excess of 100 per cent. The other important context to put around it is just where we've come from in terms of fund flows; we've seen three years of very significant outflows from dedicated emerging market equity funds and there's a huge amount of money sitting on the sidelines that could come back into emerging markets once people are more convinced of the prognosis of the asset class.

**Market opportunities**

**Chair:** Moving onto the investment opportunities in greater detail, where do we think the opportunities are?

**Teverson:** I think there's too much of a preoccupation with what the Fed is saying and what the Fed is doing. I'm a bottom-up investor, I take an unconstrained approach and in this opportunity set across emerging markets, we've got thousands of companies experiencing rapid change; some of that change is very powerful and so it's a really exciting place to be right now. I think about the attractiveness of emerging markets in terms of how many compelling bottom-up ideas I can find and, as of now, in a 50 stock portfolio, I'm having to really think about what I'm going to exclude because actually I've got a lot of ideas that look very interesting.

**Langham:** We also have much more of a bottom-up focus but, from a top-down point of view, it's important to note that we've seen really quite sub-par growth over the last few years and, historically, following periods of sub-par growth, we've tended to see reforms in emerging markets and those reforms have eventually led to an improvement in growth. So certainly those countries that are embracing reforms would, for us, be the most important ones to think about.

Also, there are clearly some attractive industries/sectors/themes worth highlighting from a longer-term point of view. The emerging market consumer has been well talked about but we still feel, over the coming years, this is going to continue to be an important theme, given the number of people entering the emerging market middle class which studies have shown is where discretionary spend really tends to take off.

Other areas that for us would be of interest would be health and wellness – an important theme in the developed world, but in the emerging market world penetration is a lot lower than in developed markets, around 6 per cent of GDP compared to perhaps 14 per cent or 15 per cent. Trends such as lifestyle diseases, diabetes and obesity are increasingly prevalent in emerging markets as are the trends towards people wanting to spend money on healthy foods, natural foods.

Infrastructure is another area that will be important in the coming years; there's been a lack of spending on infrastructure in emerging markets; bottlenecks are building up and infrastructure, from

a long-term point of view in emerging markets, is important because of population growth and urbanisation.

In terms of technology, certain areas such as automation or the internet over the coming years should also see strong growth.

**Dell:** Turning the discussion more towards access, we find that people are looking for ways of investing in emerging markets that go beyond a traditional benchmark relative approach; part of that may mean moving down the cap spectrum and away from the well-covered large cap stocks, which are heavily invested in by large volumes of global managers or other asset allocators. This may also mean moving into some of the smaller markets, whether it's smaller emerging markets or frontier markets, or even looking at the opportunities that exist between, for example, emerging market bonds and emerging market equities. There are some interesting strategies that have been developed by asset managers that try and take advantage of those disconnects and those are some of the areas where we're going to see increasing opportunities arise to generate outcome.

**Boorman:** Investors need to perhaps avoid any kneejerk reactions into the very large-cap stocks in emerging markets because that's probably not where the value's going to be; the problem is though, from a trustee angle, when you try and get more granular it becomes quite country specific and you become faced with a lot of choice, and when it's only going to be a small percentage of your portfolio, it almost becomes too hard. That's why we tend to end up in something like a DGF so you can almost tick the box of having some emerging market exposure whereas actually in reality you probably haven't. But I still think at the moment allocating a large chunk of money to a China fund or to a proper emerging market fund is a very big ask at the moment.

**Cogan:** Picking up on the reform point that was made earlier, we agree there are some areas where meaningful reforms are taking place, supply side reforms that longer term are hopefully going to attract more capital and promote efficiency in the local economies. That brings us back to the original point about how we differentiate between some of these areas that have performed quite well in the rally this year. A fundamental narrative seems to have followed a lot of momentum in areas where it's really not developing as much as I think people are perceiving it to be. In Brazil, for example, you are seeing a lot more in the way of people talking about inflection points in terms of reforms but they're a lot further behind places like India, which is actually moving forward on a lot of these reforms.

I would also echo the comments on valuations continuing to look attractive on a relative basis compared to a lot of the developed markets and the importance of the bottom-up work on a fundamental level; but I would also emphasise the influence that the macro backdrop can have and the importance of monetary policy in today's environment in terms of capital flows being a precondition for these emerging market rallies to continue.

**Chair:** Is there a danger of quality being a crowded trade?

**Teverson:** There's a perceived dichotomy in emerging markets, where on the one hand you have some very expensive highly-rated consensus quality consumer names – take Hindustan Unilever for example, that's trading in excess of 40 times earnings because everyone feels very safe buying a perceived sure bet Indian consumer play and I think the price that people are paying for those types of quality stocks is too high today. The other part of the dichotomy in emerging markets is the cheaper, cheap for a reason type stocks – so people say, "Why should I buy into emerging markets when my options are expensive quality stock or stock that's cheap and cheap for a reason?" There are however opportunities that might exist elsewhere in the universe; you can go into the mid-cap space in emerging markets, for example, where you haven't got that crowded quality trade and you actually can find some very well managed companies with some compelling growth opportunities and you can buy into those at attractive valuations. That's the part of the investment universe we really need to be thinking about – the alpha generating opportunities, and it's a key reason why

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clients should be looking for active managers that are offering something quite different to a simple ETF type exposure or a quasi-index exposure to emerging markets.

**Cogan:** The asset class as a whole has done so well this year that, it seems to us anyway, the quality names, in terms of how we define it, have actually underperformed on a relative basis because it's been so much of a beta rally; so quality does not appear stretched as a factor the way it is in developed markets where we see a huge premium being put on low volatility, higher yield, better balance sheets etc. I think a lot of the names that we think of as higher quality in the EM space are in some of the more growth areas and we still see reasonable to attractive valuations there.

**Dell:** The message we try and get across to clients is to ensure that their exposure to emerging markets is as diversified as possible so that they're not accessing emerging markets through a systematic one-style bet, which might be quality, and if it is they want to be nervous about valuations; and secondly to ensure that they use an active approach. There's a role in portfolios for using passive in certain areas or even smart beta for gaining exposure to certain betas across the equity spectrum. For emerging markets, we'd strongly recommend using an active approach because providing your manager is doing a good job they can avoid these areas of crowded trade.

**Downing:** We would agree, however many clients still have a relatively small allocation to emerging equities and a limited governance budget, which means they're likely to only have the one manager. Without the ability to combine manager styles, common in developed equity allocations, clients

are often tempted to aim for more consistent return over the benchmark by appointing a manager with an approach that doesn't take large risks. We think a more unconstrained strategy is a better solution. Away from the heavyweight companies and markets that dominate benchmarks, there are more opportunities to benefit from the favourable emerging strategic themes and to pick attractive stocks. We do have a few clients that have three emerging equity portfolio managers and then a mix of different manager styles is possible. At the other end of the size spectrum, much smaller clients will follow a global unconstrained approach and appoint global managers that invest in both developed and emerging markets rather than an emerging standalone position.

**Stoker:** The issue we have with a lot of clients is that their allocations are very small, if anything, or they are via a DGF. It all comes down to the individual pension scheme – if you're running a very small pension scheme then I think the risk or the volatility in emerging markets is just too great; if you're running a very large pension scheme, you can be a bit more sanguine about some volatility but most DB schemes just can't take the risk and I think emerging market debt, if it was even considered, would be considered as quasi equity rather than fixed income – it certainly wouldn't be considered as a matching asset. Saying that, I do see an opportunity for some of the themes we've been talking about today in the DC space, making sure that you've got emerging markets funds available in DC products.

**Boorman:** I would echo Lucinda *[Downing's]* view that for the vast majority of clients we deal with, their way into emerging markets is via a global fund; I still don't think that is necessarily the best route to take in order to get the right value but what I just can't see in this current age is any, apart from the very largest pension funds, taking a more granular approach.

**Teverson:** We mentioned Brexit earlier and I'd have thought that the experience of Brexit would have opened a lot of people's eyes to the fact that risk is not being diversified. Emerging markets may be risky because they're volatile but actually they can be a very useful diversification tool particularly when you're thinking about the currency exposures you have and the real return risks that you are running in a pension fund.

**Chair:** I think Maggie *[Stoker]* raises an interesting point around DB mindset and matching.

**Richardson:** Yes it's hard to see them as matching assets in DB. Also, I would concur with the general higher level of caution expressed – it's an area where the trustee board is really going to look to their consultants to interpret, what managers say and what opportunities there are, so surely there's a lot of work here for the investment consultants in this area; and maybe fiduciary managers can help too in this space with diversification for smaller funds.

**Frontier markets**

**Chair:** Can we talk about opportunities in frontier markets?

**Dell:** Frontier markets are interesting – there are some quite strong alpha opportunities here but they are hard to access in a meaningful way. We do look at frontier strategies and we do recommend some frontier strategies to our clients but it's a very small number of clients because the governance required to invest in a dedicated frontier strategy is high, the volatility is high and the liquidity is low.

So for most of our clients we think there's an opportunity but they are best accessed in a very unconstrained broad mandate that might be global or it might more likely be a global emerging markets mandate, which has the capability to invest in frontier stocks as and when opportunities arise.

**Chair:** How do we differentiate between an emerging and a frontier market?

**Langham:** One of the key characteristics of frontier markets is that they would be expected to grow faster than emerging markets and also, certainly up to a few years ago, they were relatively undiscovered.

As has been mentioned, they are actually very illiquid and we've seen over the last few years a very large number of frontier funds being launched, many of which are chasing the same small number of stocks. As a result, valuations in frontier markets have ended up actually getting quite stretched.

We feel that a similar opportunity, one that shares similar characteristics but perhaps doesn't have the same disadvantages, would be smaller cap stocks in emerging markets. You also have the advantage of faster growth for these companies and that they are relatively undiscovered. Some of the key differences are the much larger universe and the fact there are very few funds that focus on emerging market smaller caps. Also, compared to frontier markets, there is a very large number of emerging markets small-cap companies.

**Cogan:** There are obvious benchmark constraints in the strategy but we look globally to pursue the best global opportunities that we can find from a bottom-up standpoint and try to pay as much attention as we can to the economic exposure that a name has. So whether it is domiciled in a frontier market or an emerging market matters to some extent but not as much as the bottom-up opportunity that it provides.

**Liu:** We have a lot of funds but we don't have a frontier fund and that says something in itself and it's the liquidity that is a really big issue. When you look at the external benchmark, you have more than 60 countries in the benchmark. About 30 of them have around 0.1-0.5 per cent of the benchmark and they're only issued once or twice, so just to buy and sell them can be really hard.

The second issue is the governance issue; we have been very cautious about frontier countries since 2013 when everybody was trying to buy them in the low-yield environment because we just don't think that you get paid enough to own them.

We prefer to invest in more traditional higher yielding emerging market names rather than very new frontier names because it's really hard to have access to the data to truly understand the frontier countries' balance sheets.

**UK pension fund trends**

**Chair:** Let's move onto UK pension fund current trends – are UK pension funds making the most of the emerging market space?

**Downing:** We would say probably not as there is still scope for pension funds to increase allocations to portfolio weights more in line with global market capitalisation. Emerging market returns are very sensitive to investor sentiment and so, better performance and stronger inflows will, hand in hand, feed on promising fundamentals and support the case for larger pension fund emerging market allocations. As trustees gain confidence, they'll also be more attracted to managers that take on a bit more risk.

**Dell:** Are clients making the best use of emerging markets? The clients we work with are getting to grips with the different approaches to investing in emerging markets and trying to embrace the idea of moving away from the benchmark. They recognise that this is a less efficient space, particularly as you get away from the mega cap stocks that are at the top of the benchmark and that there are opportunities there, and they're starting to look at some of the alternative ways of investing.

**Boorman:** As a professional trustee and somebody with a background in investment management, emerging markets are going to be volatile and I think many trustees find that difficult; they don't like that sort of surprise either up or down but that is just a fact.

**Richardson:** It's so scheme specific that it's hard to be generalistic about whether schemes are using EM to

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the best of their advantage but I think the answer is probably no; caution is natural but perhaps sometimes slightly overdone. I think it's up to trustees to debate precisely what the optimal allocation should be for their schemes and the tactical allocation limits for their circumstances and they should use their consultants to help them make those decisions.

**Stoker:** It is very hard to give a general answer for all schemes but I suspect the biggest opportunity – and one that I alluded to earlier – could be on the DC side. If we offer emerging markets as an option to DC members, that could offer them some potential to see some growth.

On the DB side, however, particularly as most DB schemes are now looking to match or buy out completely, it is very hard to encourage them to take very much risk.

**Looking ahead**

**Chair:** Is the rally sustainable?

**Langham:** If you look at the performance of emerging markets relative to developed markets over long periods of time, the divergence between the growth of emerging markets versus developed markets has tended to have a very strong link with the relative performance of emerging markets. So, five or six years ago we saw that emerging markets were growing something like 6% faster than developed markets and we've seen that gap over the last few years narrow to around 2 per cent to 2.5 per cent. If we then look over longer periods of time, we've had two or three occasions where historically we've had the same sort of underperformance but that underperformance has tended to be followed by reforms, and these reforms have tended to lead to much stronger growth in emerging markets. Over the last one or two years we've started to see a lot of signs of these reforms occurring again in a number of emerging markets – India, Indonesia, Malaysia, Mexico, even China, despite all the bad press it gets.

I would also say that certainly in terms of valuations, emerging markets in price of book terms are trading at very low levels relative to developed markets, something like a 30 per cent discount; emerging market currencies look very cheap. One of the other important factors that we've seen over the last few years is that return on equity in emerging markets, which tends to be quite cyclical, has fallen from around 15 per cent to 10 per cent. There are certainly signs of that stabilising and essentially the key reason that it's been weak has been overcapacity and faster wage growth; we're seeing both those two factors start to reverse.

So we feel that there are a number of factors that would suggest over the coming years emerging market performance can improve.

Perhaps one other factor to take into account in terms of growth is fiscal policy – there's far more scope for emerging markets to support fiscal policy with lower government debt but also in terms of monetary policy, real rates in a lot of emerging markets are still very high whereas interest rates have nowhere to go in the developed world.

**Cogan:** If we look at things from a higher level through our process framework, you have valuations that remain attractive, you have a global financial backdrop in terms of liquidity conditions that are supportive at the moment so those two are both positives. Some of the positive reforms that we've also discussed are going to be supportive of growth over the longer term and then you've got a lot of good, attractive individual names as a way to gain exposure.

I would say the chief risks to the sustainability at the moment would be a reversal in those global financial conditions that would cause capital to flow back out. At the moment it doesn't appear likely to us, based on how global monetary policy has evolved but there's obviously a risk given the extent to which it's driven performance we think year to date. We think another risk would be to put all these regions together into one category and then treat them as a beta or passive exposure when there are significant fundamental differences between some of these regions.

**Teverson:** When we talk about sustainability of the rally, the first question to ask is what timeframe we're talking about. I have no idea whether it's sustainable on a three- to six-month view; on a two-year plus view, however, I feel very good about the prospects for the companies that we're exposed to in emerging markets and to me that's the real acid test.

I know other people are concerned about the changes in monetary policy, they're worried about headline figures coming out of China, but to me what's far more instructive is to look at the individual companies that you can buy in emerging markets and what you are paying for what type of growth prospects.

Today you can buy a contact lens manufacturer selling into China – that's a market that is massively underpenetrated. You can be very sure of a strong growth trajectory there and you're paying an undemanding 15 times earnings multiple for it. You can buy an Indian low-cost airline, potentially the easyJet of India and it has the potential to grow to many multiples of what it is today; and you're paying about 12 times for that.

That for me is the reassurance, where the confidence comes from, that actually the medium- to long-term outlook for emerging markets is really compelling.

**Liu:** I agree about the medium-term sustainability. Short term, the rally has already been bigger than we expected since the beginning of the year, so although in the medium term we think emerging markets will still go up, it won't be in a straight line – we do see some pressure for a correction.

One of the reasons why emerging markets have been going up so nicely in the fixed income space has been because of the flows – when you look at the flow in the external and local markets it's been quite different; external markets did get a lot of flow because people are more generally comfortable with taking dollar risk. But on the local market side it's a very different story – you don't always get inflows locally when there is a rally. So whether it's sustainable or not very much depends on whether we can get more flows.

**Chair:** What about the volatility issue and the risks?

**Liu:** Looking at volatility, historically levels of volatility in emerging market fixed income have been at similar levels to the S&P, a risk which most people are actually relatively comfortable to take. When you look ahead to the next three to five years, how much annualised return you can get in EM bonds versus US Treasury, given our estimate of where the rates are going, you are likely to see a better result in EM bonds than US treasuries. If you're investing in negative yield bonds, we know that in the future, in the long term, whoever invests in those bonds will lose money because rates, most likely, will go up and you don't really have a buffer to protect you from that. However, in emerging markets it's different because you at least have the yield buffer even if rates go up; if spreads don't change you can still use the buffer to compensate the loss in capital when yields go up.

**Cogan:** From a longer term strategic standpoint, I would echo some of the earlier comments from around the table that it's attractive for a variety of reasons on a relative basis particularly compared to some DM markets. There are several thematic growth drivers where you can get exposure to long term secular tailwinds for growth. There is a good momentum at the moment so from a shorter term tactical standpoint you've got that plus what we would consider to be a sustainable macro backdrop as we've talked about.

In addition to managing EM portfolios my team has responsibility for managing  global equity portfolios and we have been increasing our exposure to EM in those portfolios throughout the year, based on the same evaluation of the relative opportunity set. So we're pretty optimistic on EM shorter term and longer term.

From a product or portfolio structure, I would echo the comments made earlier around taking a more active approach, and as Rich *[Dell]* mentioned in some cases a more innovative approach. We have an approach that we use in EM and other strategies too where we blend convertible bonds – which is a skill set that we've developed since our firm was founded – along with equity positions to try to dampen volatility and improve asymmetry at the margin in positions and markets that are otherwise more volatile. That's one way we can get exposure to the upside that we see in emerging markets but provide downside protection; and ultimately, through the cycle or multiple cycles as these markets tend to be very dynamic and volatile, you can lower the overall volatility of the portfolio while still participating well in the upside.

**Liu:** For the medium term we do think that emerging market debt will be one of the better performers and will probably still make you some money rather than lose you money. The immediate risks are China and also the Fed potentially becoming more hawkish than people expected. Having said that, both the two risks, we have experienced them already. EM had the taper tantrum and also EM had the oil price coming to $30 so even if we had a Chinese 'blow up' and the government came in to rescue it and spent 45 per cent of GDP, I wouldn't say that emerging markets are fundamentally going to be hurt massively by this action because that problem is mostly a domestic problem in China, so it's really going to be hurt just from the sentiment rather than the big fundamental story.

# Breaking promises?

**Following whispers that Tata Steel proposals to change its DB benefit increases from RPI indexation to CPI have currently amounted to nothing, *Pensions Age* asks what would the wider ramifications be if the rules were changed so that DB schemes were able to edit their pension 'promises'?**

"It is no surprise that the Tata plans to change RPI pension indexation to CPI have come to nothing. A pension deficit 'solution' that was little more than a reduction in members' benefits was never a viable solution – legally or politically. Members' accrued pension benefits are protected under legislation. Taking away members' promised pension benefits could possibly be viewed as little more than theft. Even if such an action rescues a company from insolvency, the problem is that the beneficiaries of such action – shareholders and employees – are not the same as those who have to pay the price in terms of lower pensions. Arguments about 'the greater good' would hold little sway with those pensioners who might rightly question why they, and not the government, have to pay for this 'greater good'. Moreover if this was achieved via a wider legislative change that other companies could enforce, there would then be the prospect of a major transfer of assets from pension scheme members to shareholders – hardly a vote winner."

**JLT Employee Benefits director Charles Cowling**

"The rumour that the government will be quietly shelving plans to allow British Steel Pension Scheme to amend their benefits should be welcomed. It would have proved virtually impossible to write regulations to allow one scheme to roll back on its promises and not allow other schemes to do likewise. I say *should* be welcomed as many employers watching carefully will be disappointed that they will not be given the opportunity to reduce some expensive accrued rights.

However, in welcoming this one has to acknowledge that in current markets, DB pensions look very expensive and for some schemes this is down to the lottery of the way their rules have been written. However, on balance it feels that allowing employers to disregard the words used in the Trust Deed and Rules is not the right way to address this issue.

Accrued rights must be protected on a business as usual basis and such changes should only be considered where the alternative of PPF benefits is unavoidable and only then where it can be demonstrated that the members have a better chance of receiving higher benefits outside the PPF. We've seen this in Halcrow-style deals and it is now expected these, while difficult to achieve, will become more common."

**Broadstone technical director David Brooks**

"The option allowing the trustees to reduce increases for all service pulverised a central tenet of pensions law and trust law itself because it meant taking away benefits that had already accrued. Whilst the proposed relaxation of section 67 only applied in relation to BSPS, it would have opened the door for other large schemes in distress (of which there are all too many) to argue that they should have access to this option too. In other words, a dangerous precedent would, although unintentionally, almost certainly have been created. The net result would be disastrous for members.

However, there is a case for intervention to allow a move from RPI to CPI for future service. For many schemes, where RPI is hardwired into the scheme rules, this is not currently an option. This means that, through what is essentially a quirk of drafting, some schemes may substantially reduce their liabilities overnight while others cannot. As the credibility of RPI continues to be questioned and most schemes are reeling with huge deficits post Brexit, there is a good opportunity for the government to end this disparity through the introduction of a statutory override."

**Trowers & Hamlins senior associate in corporate pensions Rebecca McKay**

"Had the precedent been set it could easily have radically changed the DB landscape. If a promise isn't a promise (and at the moment the only caveat is that the employer must continue to trade) then what is it? A huge number of employers could have made the case for their own 'unique circumstances' and so the ability to edit their promises. The consequences of all this: possibly greater pensioner poverty, certainly greater member insecurity and, quite probably, years of legal wrangle and argument."

**PTL MD Richard Butcher**

"Rushing a change to the law for one scheme that was bound to lead to a call for more wide ranging changes for others always looked like a bold move for government. But I find it disappointing if it has backed away from it.

It finally looked like one high-profile case might accelerate the debate on how as an industry we face up to managing DB pension liabilities. If the proposed changes had been rolled out more widely, they stood a chance of allowing us to better address the issue of reducing members' benefits in ongoing schemes. If we can't do this (with the appropriate checks and balances), we run the risk of condemning more businesses to insolvency, with more members getting PPF compensation, when it should be possible to pay them more if their benefits could be restructured in their own schemes.

We are in danger of letting our concerns about trying to protect 100 per cent of all current DB benefits (an aim which will end up being illusory in a lot of cases) blind us to other inequalities which are just beginning to become apparent; such as the impact of DB costs on dampening wages for the younger generation."

**Sackers partner Faith Dickson**

"On the one hand, many argue that accrued DB rights are sacrosanct and must be protected at any cost. Former Pensions Minister Steve Webb has described the precedent this would have set as 'contagion'. Others have followed the lead of Professor David Blake's paper *The Greatest Good for the Greatest Number*. This argues that up to a thousand DB schemes may never become fully funded and that adjusting members' accrued benefits would be a pragmatic alternative to overloading the Pension Protection Fund. We are now at a point where some form of compromise has to be reached. The 'half a loaf' principle requires us to adopt a realistic approach to funding and the security of member benefits. A reduced DB benefit still represents a preferable alternative to a promise that cannot be delivered."

**PMI technical consultant Tim Middleton**

"This complex issue raises a number of key questions, including the impact of historic pension liabilities on our global competitiveness. There are deep questions of fairness, balancing the impact of benefit changes on individuals against wider social issues such as the impact when a large employer downsizes. Also, the Pension Protection Fund cannot be considered in isolation, as it is funded by sharing the burden across the DB pensions industry.

A clear and well-regulated adjustment to the pension's regulatory environment to allow a change from RPI to CPI via regulated apportionments or a formal legislative change would be of value to the economy. Both are accepted measures of inflation and arguably much of the RPI basket is not directly relevant such as housing and mortgage costs. Pensioners would still have protection against the erosion of their purchasing power in retirement."

**Schroders head of global strategic solutions Neil Walton**

"Changing DB promises would be a big deal. You do not want the ability to cut benefits to be something that just leads to more going to shareholders in dividends. So you need a framework to protect members. The current balance is that the benefit promise only gets cut when the company fails and the members get PPF benefits. This is a harsh binary system that will not serve us well, if the days of 'lower for longer' interest rates continue. We need a system that permits some graduation of benefit changes – but with protections for members and especially pensioners who do not have the opportunity to make up any lost benefits."

**Aon Hewitt partner in the retirement practice Lynda Whitney**

"Whilst changing rules to enable DB schemes to edit their pension promises might seem counter-intuitive, many scheme beneficiaries might be better served in the long run if such a pragmatic approach was taken. Of course, the adjusted level of benefits would need to be planned and co-ordinated appropriately, with the buy-in and agreement of all affected parties. In many cases this approach would represent the least-worst option."

**The Personal Finance Society chief executive Keith Richards**

# Work talk: Sara Protheroe

**What is your pensions career CV?**
Like many people, I fell into pensions, and was surprised to find it so interesting that I've stuck around for over 14 years! My pensions career started out at the Department for Work and Pensions, where I did a couple of jobs, including Private Secretary to Malcolm Wicks, when he was Pensions Minister.
I've spent the last 11 years at the Pension Protection Fund, leading the development of the first risk-based levy, running major change programmes, and now overseeing services to our 225,000 members.

**What is your greatest work achievement so far?**
The recent achievement I'm proudest of was insourcing PPF member services. At PPF we want to put our members at the heart of everything we do, and successfully bringing member services in-house has brought us closer to our members and given us greater control and flexibility. However, nothing will quite compare to being part of the original team of three civil servants designing the Pension Protection Fund from scratch. And now I'm married to one of the other two! It is extremely rewarding, to know that as a result of our work the financial future of millions of people who belong to a defined benefit scheme is protected.

**What do you still wish to achieve?**
At the PPF we continue to build on our successes in improving member data quality. This gives us confidence that we'll be paying the right members the right amount at the right time, both now and in the future.

**What is your biggest regret within your career?**
As a woman with a much better voice than me famously sang: "Je ne regrette rien". Ask me again in another 20 years!

**Excluding your current role, what would be your dream pension job?**
I've often fancied being an MP, so Pensions Minister could be a dream job.

## Fun and games

### Wordsearch

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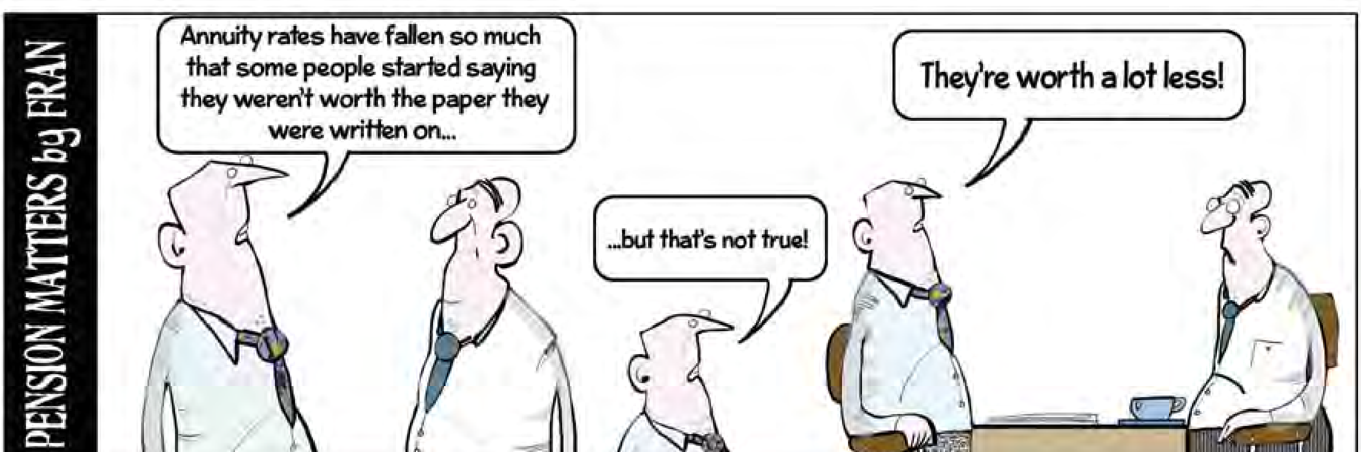
Answer at bottom of page




I know that face... Answer: Aberdeen Asset Management head of retirement savings Gregg McClymont

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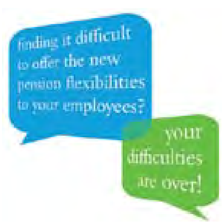


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