Allowances
How medical staff exceeding AA and LTA allowances is affecting the NHS

Sponsor engagement
The best approach to get employers engaged with their DB schemes

The Pensions Ombudsman
The lessons for the industry to learn from TPO's latest determinations

www.pensionsage.com

April 2019

PENSIONS Age

The leading pensions magazine

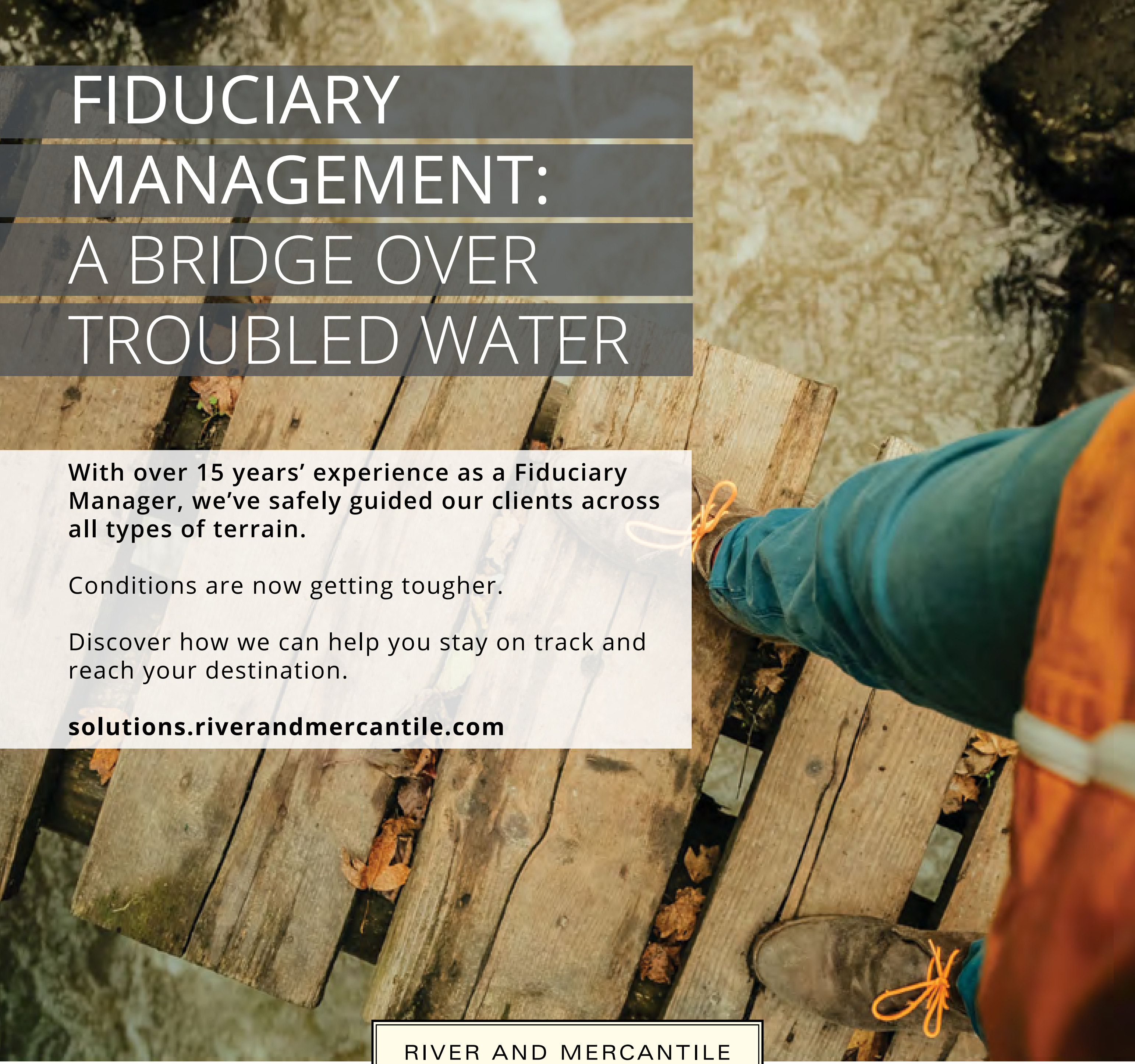
Auto-enrolment: *The impact of the AE contribution increase on employers*

Triennial valuations: *How relevant is the triennial valuation in today's world?*

The weight of responsibility

The pressure of increasing professionalism within pensions trusteeship

Case study: Norfolk Pension Fund's class action against a US pharma



Over 97% of our DB clients have outperformed their liability benchmark[1]

Our DC performance is ranked in the top 3% relative to our peers[2]

[1]Represents all fiduciary management clients which have fully delegated authority to R&M. Liability Benchmark is a mixture of gilts, swaps and cashflow benchmarks which have been designed to match our fully delegated fiduciary clients' liability values for movements in interest rates and inflation. Calculated in line with the IC Select performance standard from individual client inception date to 30/09/2018.

[2]Performance of R&M Long Term Growth Fund within the ABI Mixed Investment (40%-85%) peer group from 30/10/2011 to 31/10/2018.

Past performance is not a reliable guide to future results

This financial promotion has been issued and approved by River and Mercantile Solutions, a division of River and Mercantile Investments Limited which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (FCA). It is part of River and Mercantile Group PLC. Registered office: 30 Coleman Street, London, EC2R 5AL. Registered in England and Wales No. 3359127. FCA Registration No. 195028. Please note that all material produced by River and Mercantile Investments Limited is directed at, and intended for, the consideration of professional clients only within the meaning of the Financial Services and Markets Act 2000 (FSMA). Retail clients must not place any reliance upon the contents.

Editorial Comment

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

Unlike government lately, this past month has seen the industry move from talk to action with two significant developments: that of collective DC (CDC) and the pensions dashboard *[see pages 10 and 12 for more information]*.

Mid-March saw Pensions Minister Guy Opperman announce that the government will be pushing ahead with the introduction of CDC pension schemes, while the beginning of April had Secretary of State for Work and Pensions, Amber Rudd, say that the government will facilitate the delivery of the dashboard as a "key priority" and hopes to see an industry dashboard developed and tested this year.

Both announcements received broadly positive responses, but that does not mean they have been universally rejoiced by all of those working within the UK pensions industry.

Those voicing their dissent have expressed many valid concerns about things that may go wrong, difficulties in their implementation, and how they certainly will not solve all the problems within their sectors.

Neither the first UK CDC scheme or the pensions dashboard are up and running yet. Once they are, I can almost guarantee that they will not be perfect for everyone in all situations. But how could they ever reach that impossibly high barrier?

At the PMI's recent conference, Royal Mail head of pensions strategy Douglas Hamilton highlighted an interesting issue; why this new idea of CDC is being held up to such greater scrutiny than what is currently on offer.

"I do get a little bit irritated sometimes that such a high bar is being set for CDC communications when as an industry we have failed so miserably to communicate either DB or DC over the past however many years," he pointed out.

Whether members will sufficiently grasp the nature of CDC and the risk it has of member cuts is yet to be seen, but Hamilton is right; it's hardly like people are so au fait with what's available in the pensions market now, and the risks DB and DC have in their nature. Go out on the street and ask people if they know whether they are in a DB or DC pension, how each works and their pros and cons, and let me know the number of blank stares you get back. (Conducting the poll in your own office of pension professionals would be cheating by the way).

Meanwhile, the pensions dashboard may launch with too much or too little data for some people's taste. We could spend eternity debating back and forth what level of detail is required, but we won't really know until it launches and we can see how people engage with the service. So now, with that green light from government – if still the haziest of timelines for when it will actually go live – let's get on with it.

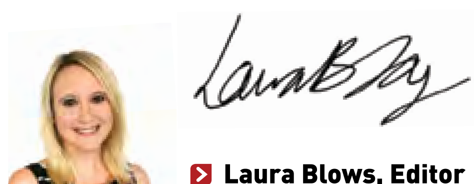
The main concern about the dashboard seems to be that schemes will not have the correct data, in the right format, to supply to the dashboard. The Pensions Regulator has highlighted the importance of good data for years, but there are still many schemes holding poor quality records. Correct information is vital to the running of pension schemes, and this growing pressure to clean up data I believe would still be occurring even if the dashboard had never been dreamt up.

So as a focus on data is increasingly required anyway; criticising the effort in getting information ready for the dashboard is not on its own an argument against its creation. Shouldn't the desired aim, the benefits it may bring, be the deciding factor, or are we only looking for innovations that are easy to produce to for the industry, irrelevant to the usefulness of the consumers?

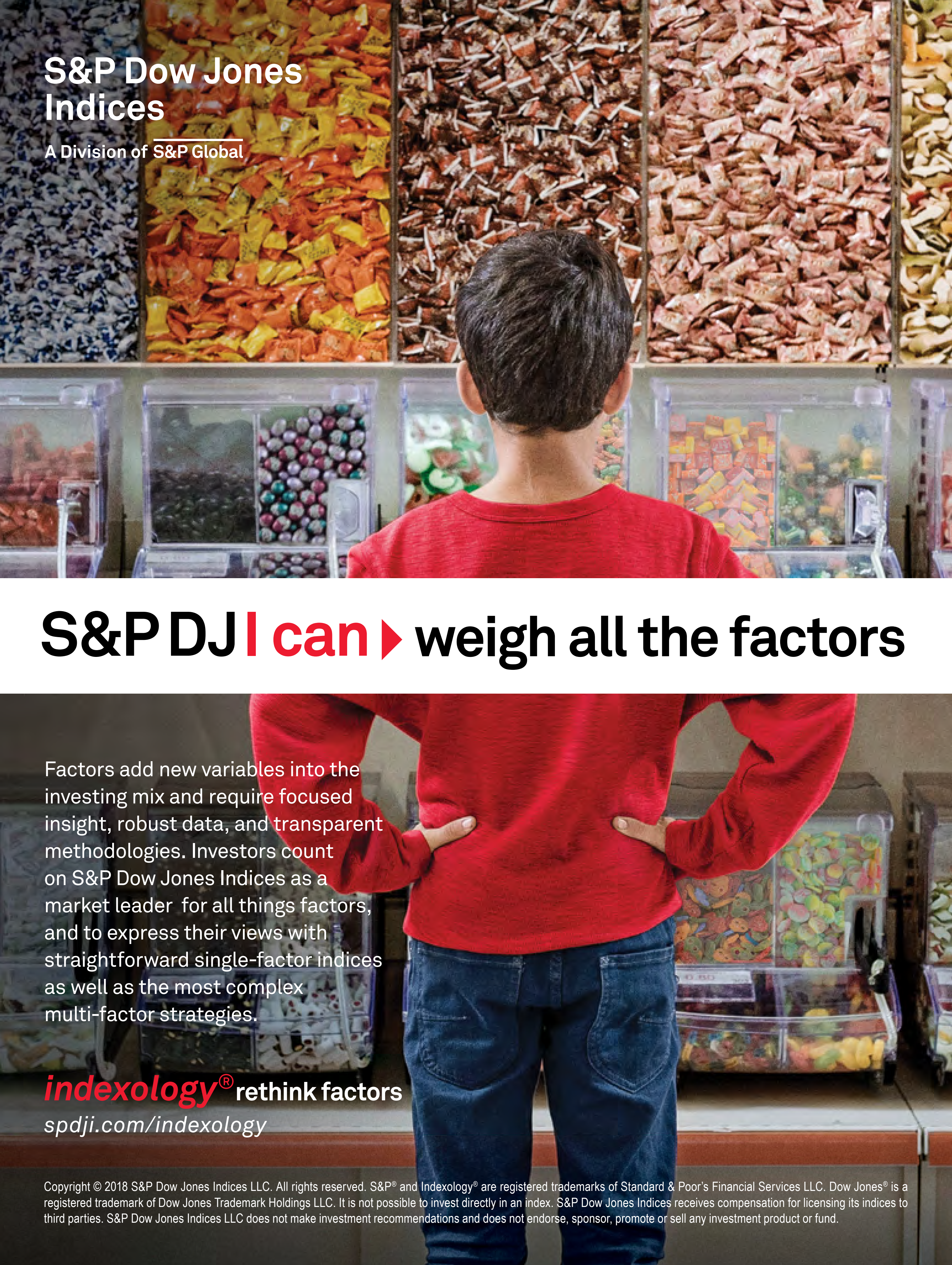
Not doing anything, just maintaining the status quo, is actually still an active decision. It is one that sends a message out to the wider public; that the pensions industry is not interested in adapting to the evolving needs of savers. In response, society may infer that pensions are an old-fashioned saving tool that is not relevant to them – if they even think about pensions at all.

CDC and the pensions dashboard may not be completely perfect straight away. However, making the effort to create new solutions that does solve some, if not all, long-term saving problems, and being seen to continually move forward and improve services, speaks volumes about the type of industry we are.

CDC and the pensions dashboard are opportunities for positive news to come out about the pensions industry for a change. Whether these messages are received is down to us.



Laura Blows, Editor


S&P Dow Jones Indices
A Division of S&P Global
S&P DJ I can ▸ weigh all the factors
Factors add new variables into the investing mix and require focused insight, robust data, and transparent methodologies. Investors count on S&P Dow Jones Indices as a market leader for all things factors, and to express their views with straightforward single-factor indices as well as the most complex multi-factor strategies.
indexology® rethink factors
spdji.com/indexology
Copyright © 2018 S&P Dow Jones Indices LLC. All rights reserved. S&P® and Indexology® are registered trademarks of Standard & Poor's Financial Services LLC. Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC. It is not possible to invest directly in an index. S&P Dow Jones Indices receives compensation for licensing its indices to third parties. S&P Dow Jones Indices LLC does not make investment recommendations and does not endorse, sponsor, promote or sell any investment product or fund.

COVER FEATURE

Theme: Playing by the rules

52

The weight of responsibility

David Adams explores the pressure of increasing professionalism within the pensions trustee board structure

Leading the class 62
Norfolk Pension Fund recently acted as the lead plaintiff in a class action against US pharmaceutical company, Puma Biotechnology, which it won. Natalie Tuck speaks to the fund's investment and actuarial manager, Alex Younger, along with its legal representative, Robbins, Gellar, Rudman and Dowd LLP partner Mark Solomon

AE's tipping point 66
With minimum automatic enrolment contributions for employers having increased to 3 per cent this month, Natalie Tuck looks at the impact of the policy on employers, and whether they can face further increases to contributions

Carrot or stick? 78
Pensions Age finds out which option the industry thinks may be the most effective in motivating sponsors to take their DB scheme responsibilities seriously

The triennial sideshow 80
With more tools and techniques at trustees disposal, as well as improvements in technology and a shift in focus to the long-term journey planning of schemes, is there a danger that the long-standing triennial valuation process is becoming a dangerous sideshow? Theo Andrew investigates

This may sting a bit... 90
Maggie Williams explores how medical staff navigating the lifetime and annual allowance limits is affecting how the NHS functions

Lesson learnt 92
Talya Misiri looks at common trends in The Pensions Ombudsman's recent decisions and what the industry needs to do, and be aware of, to prevent similar issues occurring

PERSPECTIVE PUBLISHING

PPA Publisher Member

abc Audit Bureau of Circulations Member

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

recycle

Pensions Age magazine, and its content in all and any media are part of Perspective Publishing Limited. All Perspective Publishing Limited's content is designed for professionals and to be used as a professional information source. We accept no liability for decisions of any nature, including financial, that are made as a result of information we supply.

Features & columns

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

Working towards a third way for pension schemes 25
Minister for Pensions and Financial Inclusion Guy Opperman reveals the government's intentions for collective defined contribution (CDC) schemes

Gold's precious mettle 27
Gold is back in the limelight. But now there's a better way of investing in the precious metal than just buying bullion

Focus on higher or lower earners? 29
Steven Leigh explains how it may be for differing reasons, but both higher and lower earners need support during their retirement saving journey

Spotlight on volatility: Re-examining DGFs 31
Tristan Hanson highlights the importance of monitoring DGF strategies throughout the investment cycle

Creative funding strategies 33
Arron Slocombe and Tom McNaughton reveal the challenges and opportunities creative fund strategies can provide for scheme sponsors and the modern trustee

Pensions tracing: Making huge strides in a changing world 34
Alex Mitchell, head of tracing and data solutions at Capita, meets Francesca Fabrizi, editor in chief of *Pensions Age,* to discuss recent trends in the pensions tracing space

A drip, drip, drip approach 38
Speaking at the recent PLSA investment conference, Plumbing Pensions chief executive Kate Yates explains how the DB master trust has been reducing its risk and why you do not always need to know the ultimate end game at the start of the de-risking process

Data: What's the future? 39
The pensions industry is changing; regulation, technology and disruptors are all influencing the challenging yet opportunistic environment the industry is in. Our data seminar, in association with ITM, looked at where the industry is heading and what the industry can learn from the past

Infrastructure focus: The foundations for growth 43
Claire Smith considers potential developments that may negatively impact upon infrastructure investment, while Alastair O'Dell finds out how DB schemes are increasing their allocations to infrastructure

A balancing act 48
Laura Blows talks to the Society of Pension Professionals president, Paul McGlone, about both the industry's and the society's latest developments

Sustainability Summit 2019: Sustainable investment can enhance returns 50
Industry members came from far and wide to discuss what stricter ESG regulations mean for the pensions landscape, what more needs to be done to promote sustainable investment and how to achieve enhanced returns from those investments

The weight of responsibility 52
David Adams explores the pressure of increasing professionalism within the pensions trustee board structure

Keep it professional 55
Tim Middleton discusses the newly-launched standards for professional trustees

Focus on factor investing: Its role within fixed income 57
Dr Philip Messow explores the role of active, quantitative investing in corporate bonds, while Elizabeth Pfeuti examines how factor investing can be applied to fixed income

News, views & regulars

News round up	8-18
Appointments	20
Market commentary: Brexit	22
Word on the street	23
Soapbox: Engagement	24
Diary	26
Interview: Criterion's Caroline Mansley	30
Opinion: Dashboard	104
Pensions history, cartoon and puzzles	105

Leading the class 62
Norfolk Pension Fund recently acted as the lead plaintiff in a class action against US pharmaceutical company, Puma Biotechnology, which it won. Natalie Tuck speaks to the fund's investment and actuarial manager, Alex Younger, along with its legal representative, Robbins, Gellar, Rudman and Dowd LLP partner Mark Solomon

AE's tipping point 66
With minimum automatic enrolment contributions for employers having increased to 3 per cent this month, Natalie Tuck looks at the impact of the policy on employers, and whether they can face further increases to contributions

Roundtable: The many facets of multi-asset 69
Our panel of experts discusses the definition of multi-asset investing, and how different multi-asset strategies and approaches can play a part in pension portfolios today

Carrot or stick? 78
Pensions Age finds out which option the industry thinks may be the most effective in motivating sponsors to take their DB scheme responsibilities seriously

The triennial sideshow 80
With more tools and techniques at trustees disposal, as well as improvements in technology and a shift in focus to the long-term journey planning of schemes, is there a danger that the long-standing triennial valuation process is becoming a dangerous sideshow? Theo Andrew investigates

De-risking focus: Planning ahead 83
Looking at how trustees and employers will incorporate an LTFT into a journey plan, and new regulator powers

Driving positive change 88
With many changes afoot across the UK pensions landscape, Theo Andrew sits down with Pensions and Lifetime Savings Association policy lead for defined benefit and Local Government Pension Schemes, Tiffany Tsang, to discuss the body's key projects and challenges

This may sting a bit... 90
Maggie Williams explores how medical staff navigating the lifetime and annual allowance limits is affecting how the NHS functions

Lesson learnt 92
Talya Misiri looks at common trends in The Pensions Ombudsman's recent decisions and what the industry needs to do, and be aware of, to prevent similar issues occurring

Roundtable: Spotlight on fixed income ETFs 94
Our panel of experts looks at the various roles fixed income ETFs can and should be playing in pension fund portfolios now and into the future

By agreement, Pensions Age is distributed free to all PLSA members as part of its package of member benefits

By agreement, Pensions Age is distributed free to The Pensions Management Institute (PMI) members as part of its package of member benefits

Pensions Age is distributed to The Association of Member Nominated Trustees members

By agreement, Pensions Age is distributed free to all SPP members as part of its package of member benefits

PENSIONSAge

Publisher
John Woods
Tel: 020 7562 2421

Editor-in-Chief
Francesca Fabrizi
Tel: 020 7562 2409

Editor
Laura Blows
Tel: 020 7562 2408

Deputy/News Editor
Natalie Tuck
Tel: 020 7562 2407

Senior Reporter
Theo Andrew
Tel: 020 7562 2425

Reporter
Jack Gray
Tel: 020 7562 2437

Reporter
Sunniva Kolostyak
Tel: 020 7562 4380

Design & Production
Jason Tucker
Tel: 0207 562 2404

Accounts
Marilou Tait
Tel: 020 7562 2432

Commercial
John Woods
Tel: 020 7562 2421

Camilla Capece
Tel: 020 7562 2438

Subscriptions
Tel: 01635 588 861
£149 pa within the UK
£197 pa overseas by air

NEW circulation figures

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

Managing Director
John Woods

Publishing Director
Mark Evans

ISSN 1366-8366
www.pensionsage.com

ALTERNATIVES MULTI-ASSET QUANTITATIVE ACTIVE EQUITIES **FIXED INCOME** REAL ESTATE PRIVATE MARKETS

Multiple fixed income perspectives. One focus. Yours.

Our collaborative global research network and comprehensive fixed income capabilities, spanning developed to emerging markets, public to private, and investment grade to high yield, mean we are well placed to deliver focused fixed income solutions to our clients.
aberdeenstandard.co.uk/income

Capital at risk

Aberdeen Standard Investments

Aberdeen Standard Investments is a brand of the investment businesses of Aberdeen Asset Management and Standard Life Investments.
Aberdeen Asset Managers Limited is registered in Scotland (SC108419) at 10 Queen's Terrace, Aberdeen, Scotland, AB10 1XL, Standard Life Investments Limited is registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL, and both companies are authorised and regulated by the Financial Conduct Authority in the UK.

DH: GB-050319-84576-1

Dateline - March 2019

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

1 March Just one in 20 Nest members think too much of their income goes into their pension savings, according to new research from **Nest Insight**. Nest surveyed its members before and after the April 2018 increase in minimum auto-enrolment contributions to understand how the changes affected savers.

4 March The **Financial Conduct Authority** urges British Steel Pension Scheme members who were advised to transfer out of the scheme to take action if they believe the advice to be unsuitable. Any member who is unsure if the guidance that they received was suitable should first make the complaint to the firm that provided the advice.

5 March Defined benefit schemes are expected to set a long-term funding target (LTFT) with an investment strategy in place to achieve it, according to **The Pensions Regulator** (TPR). In its latest Annual Funding Statement, TPR issued investment guidelines for trustees in order to help them achieve their LTFT, depending on the strength and maturity of their scheme.

6 March Aon confirms it is not pursuing the acquisition of Willis Towers Watson. In a statement Aon says: "Aon had considered such a possibility with regard to Willis Towers Watson. News of that consideration subsequently became public and Aon was required to issue a statement because Willis Towers Watson is an Irish company and is subject to Irish regulatory requirements."

7 March The retirement age in the UK would need to increase to 70 by 2030 to keep the 'stable support ratio' recorded in 2010 at the same level, according to **Border to Coast Pensions Partnership** CIO, Daniel Booth. Speaking at the Pensions and Lifetime Savings Association's 2019 Investment Conference, Booth explains that the retirement age in the UK would have to increase at a faster rate than the government has planned.

11 March The Pensions Regulator drops its anti-avoidance investigation into Johnston Press, having found no evidence it planned to avoid paying deficit repair contributions (DRC) after falling into administration last November. The regulator says the group had no "viable alternative" to enter into administration, and that the timing of the administration had not been "artificially engineered" to avoid a DRC of £885,000 into the Johnston Press Pension Plan.

12 March The **Department for Work and Pensions** (DWP) welcomes the findings of the Competition and Markets Authority's (CMA) investigation into the fiduciary management and investment consultant markets, and will look to bring regulations into force by 2020. In its official response to the CMA's investigation, the DWP says that it will now move to introduce regulations into the main body of pensions law, replacing the CMA's final order, which is expected in June this year.

13 March New pension rules requiring providers to disclose environmental, social and governance considerations are "not enough" to protect savers from the risks posed by climate change, according to **UKSIF** chief executive, Simon Howard. Speaking at the Pensions Age 2019 Sustainability Summit, Howard praised the progress that had been made, but insisted that more needed to be done to protect the next generation of pension savers.

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

14 March Savers have accessed over £3.2bn of their savings through pension freedoms without taking any financial advice, new research from **Saga** reveals. The study, which interviewed more than 2,000 adults, also found that only 20 per cent of people would consider taking advice when accessing their pension pot through pension freedoms.

Editorial credit: Natalia Mikhaylova / Shutterstock.com

15 March Arcadia owner **Philip Green** and his advisers are planning to propose a company voluntary arrangement to financially restructure the retail group. The plan would require approval from the Pension Protection Fund to be introduced. According to *Sky News*, Green is hoping to launch the restructuring within weeks, in a move that could involve a substantial number of store closures and job losses.

18 March The government announces that it will be pushing ahead with the introduction of **collective defined contribution** pension schemes to improve the retirement outcomes for both employees and employers. Pensions Minister Guy Opperman says that the plans will pool savers' risks and give them more stability in retirement, in a move that could boost savings by up to 7 per cent.

19 March Trustees name employer covenant risk as the greatest risk facing DB pension schemes, according to **PTL**'s latest *DB Risk Survey*. According to the study, 26.1 per cent of trustees named it as the top risk in January 2019, an increase of 1.8 per cent from October 2018.

20 March Trustees remain unconvinced of the merits commercial consolidators could provide to the security of member's benefits, new research reveals. The study of DB scheme trustees by **Hymans Robertson** found that just 25 per cent of trustees believed that moving to a commercial consolidator would improve the security of members' benefits.

21 March The cost of equalising guaranteed minimum pensions is likely to be almost half of the £15bn anticipated by the industry after the ruling, new analysis finds. According to research by **Hymans Robertson**, the cost of equalising to pensions schemes is more likely to cost around £8bn, suggesting that most companies will not see "significant" disruption to their long-term funding strategies.

22 March Employee contributions into defined contribution pension pots outstripped defined benefit contributions for the first time, according to figures from the **Office for National Statistics**. In 2018, employee contributions into DC pensions totalled £4.073bn, while contributions in DB pension pots was recorded at £3.216bn. DB contributions fell slightly over the year from £3.369bn in 2017, compared to the £1.387bn that was paid into DC schemes.

25 March An estimated 1.25 million people are set to breach the current Lifetime Allowance (LTA) limit for pensions tax relief, according to new research from **Royal London**. Analysis from the mutual insurer found that 290,000 workers already have pension rights above the £1.03m limit, while more than half of these are thought to be continuing to add to their pension pots.

26 March The "primary responsibility" for changing the environment on executive pay rests with the asset owners – pension funds - the **Business, Energy and Industrial Strategy Committee** says. The committee's report, *Executive rewards: Paying for success*, examines the progress the government is making on the gap between executive and employer pay and the performance of the company.

28 March Participation in workplace pension schemes has increased to 71 per cent, up from 49 per cent, since the introduction of automatic enrolment (AE) in October 2012. According to the **Department for Work and Pensions**' recent study, the *Family Resources Survey*, the number of employees enrolled in an occupational pension scheme increased by 22 percentage points between 2012/13 and 2017/18. The amount of working age people in pension schemes also rose, to 49 per cent. However, the participation rate for self-employed people, who are not eligible for AE, fell from 19 per cent in 2012/13 to 16 per cent in 2017/18.

News focus

Govt gives go-ahead for CDC schemes

Pensions Minister Guy Opperman has said the government will facilitate the provision of collective defined contribution (CDC) schemes as 'soon as parliamentary time allows'

The government has announced that it will be pushing ahead with the introduction of collective defined contribution (CDC) pension schemes to improve the retirement outcomes for both employees and employers.

Pensions Minister Guy Opperman said that the plans will pool savers' risks and give them more stability in retirement, in a move that could boost savings by up to 7 per cent. The announcement follows a consultation by the government, in which it said that a "vast majority of the responses were "supportive of the proposals".

Opperman said: "CDC schemes will provide employers with new options for managing their pension obligations, with benefits for workers and employers alike. As I said in the forward to the original consultation, CDC schemes are not a catch-all solution to concerns around retirement outcomes. But I am confident that well designed and run CDC schemes can offer advantages for some employers and employees in the UK."

Opperman added that it will facilitate CDC provision "as soon as parliamentary time allows". The initiative has been spearheaded by the Royal Mail, backed by the Communication Workers Union (CWU), after it drew up the plans for its 140,000 employees, based on the 'world leading' pension systems in the Netherlands and Denmark.

The government added that once it has ironed out any issues with the Royal Mail trial, it will look to expand CDCs to master trusts and multi-employer pension schemes.

CDC is an issue that has divided opinion in the pensions industry over the years, with many believing there is likely to be both winners and losers to the new proposals. According to the government, the biggest challenge for schemes regarding the implementation of CDC is the communication of the "variable nature of the pension income".

In a CDC scheme, contributions are pooled and at retirement individuals will receive a regular income from the fund. Their income is not guaranteed and could fluctuate depending on the fund's performance.

Willis Towers Watson director and CDC adviser to Royal Mail, Simon Eagle, said: "The government is not just giving a green light to the Royal Mail proposals – it is talking about moving 'promptly' to a second stage, where it opens the door for CDC to come in different shapes and be adopted by employers of different sizes.

"That is essential for CDC to take off: unless it can be offered through a third party such as a master trust, CDC will usually only be an option for large employers."

Also commenting on the announcement, Aon senior partner, Kevin Westbroom, said: "The consultation makes it clear – as we have argued – that clear and accurate

Editorial credit: chrisdorney / Shutterstock.com

communication of CDC benefits to actual and prospective members will be a real challenge.

"The pensions industry is regularly accused of failing to communicate pensions effectively – so the communication of CDC schemes needs to be an exemplar for the whole industry."

Royal London director of policy, Steve Webb, voiced his concern that the government's proposed legislation was "very narrow in scope". Although he was "pleased that they are moving forward with the concept", he highlighted two areas of major concern.

Webb specified the decision to legislate only for a single employer or associated employer model, because "the trouble is that even this will take years to go from primary legislation, secondary legislation into implementation even for Royal Mail".

He also detailed that the decision "not to legislate for models with a 'capital buffer' which could help to smooth the ups and downs of investments" was "quite restrictive". Other industry members have issued a mixed response to the government's announcement on the introduction CDC pension schemes.

Most experts agreed, however, that if CDC schemes were to be successful, it would take time and innovation to establish the appropriate legislation.

Commenting on the announcement, AJ Bell senior analyst, Tom Selby, said: "CDC schemes have the potential to be a positive new addition to the UK pensions landscape. But anyone expecting an immediate retirement revolution or a massive 'pensions boost' resulting from the design of such schemes probably needs to reassess their expectations."

In response to the government's announcement, CWU deputy general secretary Terry Pullinger said: "The pensions industry desperately needs innovation if we are to enable people to retire with dignity and security.

"The CWU is proud, along with Royal Mail, of being at the forefront of such innovation and will be delighted to prove that CDC options will prove to be a watershed moment in pension provision and benefit working people way beyond our own membership."

Written by Jack Gray and Theo Andrew

NEWS IN BRIEF

The Pensions Administration Standards Association (Pasa) has announced Law Debenture as its first trustee member. Pasa chair, Kim Gubler, said: "We have the privilege of working with some of the largest and most influential third-party administrators and pension funds in the industry. It demonstrates different types of organisation are realising the benefits good administration brings."

The **Financial Services Compensation Scheme** (FSCS) has recovered just under £300m over the past five years from failed financial services firms. The lifeboat added that it has recovered billions since the 2008 banking failures, after it took a £20bn loan from the government following the crash. The loan has now been repaid in full, mainly due to its recoveries work. FSCS also said that the recoveries allow it to reduce the cost of compensation for its levy payers.

Aegon has announced that the total assets under management of its Aegon UK master trust has now reached £1bn. The master trust was a 'key component' of the BlackRock acquisition and became Aegon Master Trust (AMT) in July 2018.

Women who have entered drawdown since the launch of pension freedoms in April 2015 have pension pots that are worth 34 per cent less than men, according to research by **AJ Bell**. The research, undertaken by Censuswide, found that women on average have £118,000, compared to £179,000 for men. As a result, average annual withdrawals for women are significantly lower (£6,710) than men (£8,002). It also found that women tend to be less confident in their knowledge of the pension freedoms.

VIEW FROM THE PLSA

Evidence is growing that the long-term success of a company depends on motivated employees feeling financially secure and professionally fulfilled to carry out their job. The workforce as a source of value has been relatively under-explored.

To highlight the issue, the PLSA has been undertaking work to help investors ask for better information from companies to understand how well they train, motivate and develop their workers.

To help with this we have just launched an updated Hidden Talent report – commissioning the High Pay Centre to undertake the analysis – to gauge whether FTSE 100 companies have improved their reporting on these issues.

The findings were telling.

Despite significant policymaker interest in fair pay, just over half (51 per cent) of companies disclosed the gender pay gap at the level of the board and managerial staff whereas 52 per cent disclosed the gender pay gap among all staff and subsidiaries.

There was some good news, however. We found that 61 per cent of companies gave meaningful overall commentary on the composition of their workforce, providing context and linking to the company's broader strategy and performance.

Although there have been some improvements there is still a way to go. A company that cares about its workforce produces better outcomes for investors, workers and their own bottom lines. It's vital that pension fund investors in these companies continue to push for better information on these areas.

PLSA policy lead, investment and stewardship Caroline Escott

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Govt gives dashboard green light; '3-4 years' to deliver

The government presses on with pensions dashboard plans, compelling schemes to provide consumer data, with the expectation that the first industry model will be developed and tested in 2019

The government has given the go ahead for the pensions dashboard, with the expectation that pension schemes can complete delivery within three to four years.

In its consultation response, Secretary of State for Work and Pensions, Amber Rudd, said that the government will facilitate the delivery of the dashboard as a "key priority" and hopes to see an industry dashboard developed and tested this year. As a result, the government added that it will be legislating "at the earliest opportunity" to compel providers to provide consumers' data. However, this could potentially be held up by Brexit.

In a written statement, Rudd said: "Government remains committed to ensuring the individual is in control of their data and is conscious of the need for pace in order to deliver dashboards. Our priority is to ensure that information is presented securely, in a clear and simple format to support consumers with their retirement planning."

The government has also confirmed that state pension data will be included "as soon as possible", at a cost to the Department for Work and Pensions (DWP). Despite this, in an effort to limit costs, the DWP said schemes will only be required to give "basic information" at the outset, but did not confirm whether consumers will face costs for using the platform.

It stated: "Several respondents suggested that dashboard providers may wish to charge for premium or additional services. We are clear that consumers should not have to pay to access their own basic information; however, we are not against business models which charge for services beyond this."

Schemes will be compelled by a "staged timeline" to ensure strong member coverage, with the anticipation that large defined contribution schemes will be the first on board their members. The industry has been urged to deliver data on a "voluntary basis" to help inform delivery. The government also reiterated its intention to enable multiple dashboards, supported by the same digital architecture, with the "same basic information from the same number of schemes".

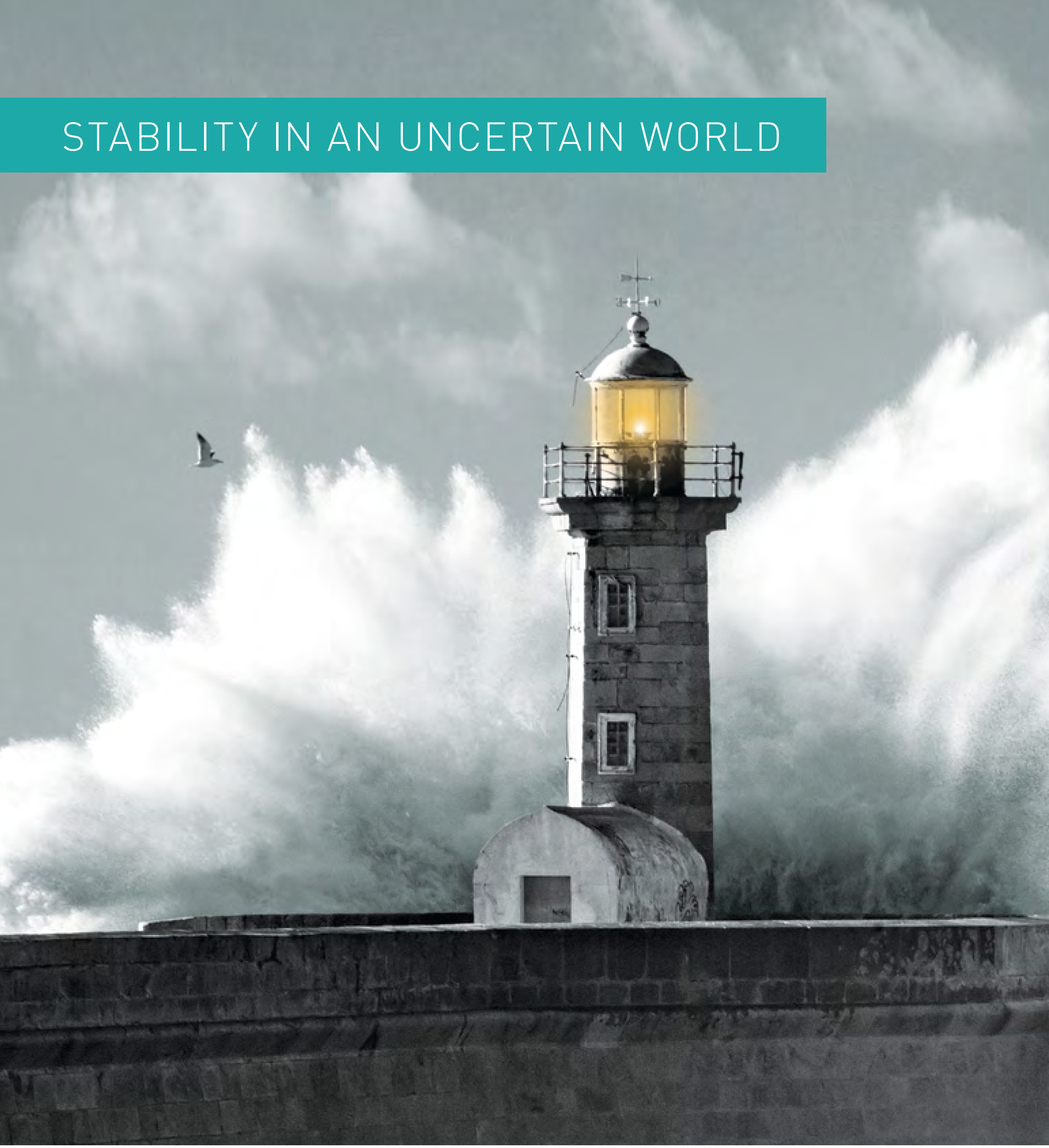
It aims to set up a delivery group, made up of key industry stakeholders and accountable to the Single Financial Guidance Body (SFGB) by the end of the summer, which will help facilitate its improvements.

"The priorities for the delivery group in 2019 are to create a clear strategy for delivering the digital architecture, design a robust governance and security framework and to work with industry on their readiness to provide data via dashboards," Rudd added.

"Pensions dashboards can be an enabler for a real step-change across the sector to modernise the way it communicates with its members. They also provide an opportunity to build trust with consumers, ensuring they can access their pensions information in a convenient way."

Industry members and experts have welcomed the release of the government's pension dashboard consultation response, but warned that if the dashboard does not give people a full understanding of what they have saved and is not widely publicised, it could falter.

Written by Theo Andrew and Jack Gray



A changing world makes it vital to partner with an accountable fiduciary management specialist. Through our tailored advice and dynamic inhouse management we can help you achieve better outcomes.

Find out more at www.cardano.com

cardano

VIEW FROM TPR

We recently published our Annual Funding Statement, which clarifies how we expect trustees and employers to fund a defined benefit scheme. It is particularly relevant to those conducting valuations with effective dates between 22 September 2018 and 21 September 2019.

We have put additional focus on scheme maturity, more strongly emphasised that employers and trustees should establish a long-term funding target and for the first time, set out our expectations on investment and covenant. Trustees and employers should set a long-term funding target and agree a clear strategy, recognising how the balance between investment risk, contributions and covenant support may change over time.

We have articulated how a comprehensive approach to Integrated Risk Management (IRM) should allow schemes to ensure they only take an appropriate level of risk with investments. IRM helps trustees assess the employer covenant, investment and funding risks, only taking investment risk where it can be supported by the covenant.

We expect scheme maturity issues to assume greater significance for setting funding and investment strategies in the future, particularly where schemes are experiencing high levels of transfer values.

This year we are contacting more schemes before triennial valuations are submitted to identify potential risks that could impact on members.

TPR executive director of regulatory policy, analysis and advice, David Fairs

The Pensions Regulator

New funding rules could see a £100bn rise in DB deficits

The updated code of practice could double pension contributions for a typical employer, KPMG finds

The new pensions funding code, expected in 2020, could increase UK defined benefit pension deficits by £100bn, according to research by KPMG.

KPMG's analysis suggested that the updated code of practice on funding defined benefits and the rising deficits could result in a doubling of pension contributions for a typical employer.

Employers are expected to need to prepare for stronger funding standards and member protection, which could result in an average pension scheme's deficit rising by 50 per cent. Deficit contributions are predicted to double as a result, while employers that rely heavily on investment returns could be forced into even higher contribution increases.

Commenting on the research, KPMG pensions partner, Mike Smedley, said: "The Pensions Regulator (TPR) pledged in 2018 to become clearer, quicker and tougher and they have been living up to this mantra. The new code will benefit members in the long term but could have a significant impact on pension schemes and employers.

"Employers will question whether higher cash contributions are the most effective way of protecting the scheme – particularly if this comes at the expense of investment in the business. And trustees may come under pressure to implement ever-more prudent investment strategies.

"As a result we expect to see more creative solutions to bridge the gap and more contingent funding arrangements as a substitute for cash contributions."

As part of TPR's 'comply or explain' regime for the new standards, pension schemes are expected to be tasked with setting a low risk long-term funding target and managing investment risks better. A first glimpse of the new code was promised by summer this year.

Smedley added: "TPR wants members to be better protected, and is increasingly telling schemes and employers how that should be achieved. But at the moment the details of the new code are sketchy.

"The c.2,000 pension schemes that are due valuations this year will have the difficult job of planning for new rules, which won't be published before the summer."

The news may not be welcome for trustees, who have again named employer covenant risk as the greatest risk facing DB pension schemes, PTL's latest *DB Risk Survey* revealed.

According to the study, 26.1 per cent of trustees named it as the top risk in January 2019, an increase of 1.8 per cent from October 2018.

Written by Jack Gray

FOR INSTITUTIONAL/WHOLESALE/PROFESSIONAL CLIENTS AND QUALIFIED INVESTORS ONLY – NOT FOR RETAIL USE OR DISTRIBUTION

The value of investments may go down as well as up and investors may not get back the full amount invested. J.P.Morgan Asset Management is the brand name for the asset management business of JPMorgan Chase & Co and its affiliates worldwide. LV-JPM51793 | 02/19 | Material ID: 0903c02a824de253 | Activity ID: 95997

ALTs by

J.P.Morgan
Asset Management

VIEW FROM THE ABI

A recent DWP consultation proposes nudging smaller DC pension schemes into consolidation.

The benefits of scale are clear and encouraging consolidation will not only benefit savers but drive efficiency in the industry. Schemes with poor data and manual processes are a drag on the performance of the whole industry and this adds costs to all participants. Larger schemes are better able to achieve efficiency while smaller schemes are not able to contribute data to pensions dashboards, and many occupational schemes are slower to transfer DC pensions than FCA-regulated firms. There is a growing body of evidence that smaller DC schemes are struggling to demonstrate that they provide value for members (VFM). Also, they do not often provide adequate information in their chair's statement.

The Pensions Regulator (TPR) found in its annual survey of DC trust-based schemes that the trustees of just 10 per cent of small schemes and 33 per cent of medium-sized schemes are doing everything TPR believes is essential to assess VFM. In its thematic review, TPR reviewed 68 chair statements, finding that for 37 per cent, no VFM assessment had been carried out and over 50 per cent of statements provided inadequate or incomplete explanations of how the costs and charges of the scheme represent good VFM.

The ABI will continue to work towards a future where all pension schemes provide value for members and good outcomes.

ABI policy adviser, long-term savings, Reuben Overmark

ABI

Responsibility to change executive pay rests with pension funds – BEIS

The committee has also suggested that executive and employer pensions should be aligned

The 'primary responsibility' for changing the environment on executive pay rests with the asset owners – pension funds – the Business, Energy and Industrial Strategy (BEIS) Committee has said. The committee's report, *Executive rewards: Paying for success*, examines the progress the government is making on the gap between executive and employer pay and the performance of the company. The report noted that over the past decade chief executives' earnings in the FTSE 100 have increased four times as much as national average earnings, and describes this differential as having been "baked into the pay system", in part by a heavy reliance on over-generous, incentive-based pay and partly by the weakness of remuneration committees. The report concluded that "primary responsibility for changing the environment on executive pay rests with asset owners – the pension funds that invest our money for the long term".

However, it said that although it has heard that levels of engagement by the best asset managers with large companies are generally good, too few institutional investors, such as pension funds, are active enough. "For most asset managers, remuneration will simply not be a priority, compared to the other reasons on which investment decisions are taken," it added. "Given the complexity of executive pay and the difficulty of securing a consensus for change, there are understandable practical disincentives to engagement. We cannot rely on shareholders to exert pressure."

In addition, the committee has called for 'greater alignment' of the pension contributions of executive and employer pay. In the report it noted that it has

previously advocated greater alignment in the way in which profits are shared between executives and employees. "The same should apply to pension contributions," the report said. The report stated that there has been a tendency for a crackdown on one element of pay to lead to corresponding increases in other elements. "Pension contributions is one such area, where chief executives in the FTSE 100 have enjoyed pension contribution rates around 25-30 per cent, while their employees receive around 9-10 per cent; an unacceptable example of weak corporate governance and flagrant disregard for any notion of fairness," the report said.

However, it added: "There are indications that some companies are now acting to ensure greater alignment. This should have happened much sooner. We welcome the Investment Association's announcement in February 2019 that it will monitor and flag up any company that pay pension contributions to new directors in a way not aligned to the majority of the workforce."

Written by Natalie Tuck

DON'T LEAVE ALPHA ON THE TABLE.

PGIM Fixed Income is an active asset manager that navigates across the global fixed income markets in the pursuit of consistently strong, risk-adjusted returns.

We draw on nearly 90 years of experience, through all market cycles, utilizing a credit and quantitative research-driven approach, and supported by disciplined risk management, to help clients achieve their investment objectives.

SOLID RISK INFRASTRUCTURE

BROAD FUNDAMENTAL RESEARCH TEAM

FOCUS ON CONSISTENCY OF RESULTS

Get our perspective at **pgimfixedincome.com**

For professional investors only. All investments involve risk, including possible loss of capital. Past performance is not a reliable guide to the future and there is no guarantee that objectives will be met. No risk management technique can guarantee to mitigate or eliminate risk in any market environment.

PGIM FIXED INCOME

NEWARK | LONDON | TOKYO | SINGAPORE

©2019. PGIM is the primary asset management business of Prudential Financial, Inc. (PFI). PGIM Fixed Income is PGIM's public fixed income investment advisory business and operates through PGIM, Inc., a U.S. registered investment adviser. Prudential, PGIM, their respective logos as well as the Rock symbol are service marks of PFI and its related entities, registered in many jurisdictions worldwide. PFI of the United States is not affiliated with Prudential plc, a company headquartered in the United Kingdom. In the United Kingdom and various European Economic Area ('EEA') jurisdictions, information is issued by PGIM Limited with registered office: Grand Buildings, 1-3 Strand, Trafalgar Square, London, WC2N 5HR. PGIM Limited is authorised and regulated by the Financial Conduct Authority of the United Kingdom (Firm Reference Number 193418) and duly passported in various jurisdictions in the EEA. As of 31 December 2018. 2019-0918

VIEW FROM THE PMI

February saw the official launch of formal standards for professional trustees.

This was the culmination of almost two years' work by the Professional Trustee Standards Working Group (PTSWG), assembled by The Pensions Regulator (TPR) *[see p55 for more information]*. PTSWG was tasked with plugging a regulatory hole that had been all too apparent since the GP Noble scandal: professional trustees play an increasingly important role in the governance of UK pension schemes but until now have not been required to conform to any specific regulatory regime.

Few would dispute that formal standards are necessary. In a recent PMI poll, 92 per cent of respondents stated that regulatory standards for professional trustees are necessary.

The crucial issue is whether the bar is set at the right level. If it is too low, it would be easy for unsuitable applicants to achieve accreditation. If it is too high, many trustees who are perfectly capable of providing a high standard of service may be excluded.

Trustees will need to complete a 'fit and proper test', find two references, complete the Trustee Toolkit, the Award in Pension Trusteeship and a new 'soft skills' assessment. On an ongoing basis, there will be an attestation and a 25-hour CPD requirement.

Over time, the standards will evolve to meet the changing needs of the market. This should be thought of more as a beginning than an ending.

PMI technical consultant Tim Middleton

Field requests update on Arcadia pension schemes' deficits

In other pension fund news, Kier Group has reported a DB pension deficit of £14m, compared to a surplus of £8m six months earlier, and Morrisons has reported a DB surplus of £688m

Work and Pensions Committee chair, Frank Field MP, has written to Arcadia Group pensions manager, Margaret Hannell, requesting an update on its two schemes following contribution increases.

In April 2017, Arcadia agreed to double the pension schemes' deficit recovery contributions to £50m per year for 10 years. The agreement was put in place after, in March 2016, the schemes were found to have asset values £993m less than the amount needed to secure all member benefits with an insurance company.

Field noted that the combined funding deficit of both schemes was £565m "on an ongoing basis". Seeking an update on the changes to the schemes' deficits, Field wrote: "Might you please let us know to what extent the increased deficit recovery contributions have materially improved the deficit in both schemes?"

Last month, owner Philip Green announced plans to financially restructure the retail group, which included seeking approval from the Pensions Protection Fund for a company voluntary arrangement. Commenting at the time, an Arcadia Group spokesperson said: "Within an exceptionally challenging retail market and given the continued pressures that are specific to the UK high street we are exploring several options to enable the business to operate in a more efficient manner."

In other news, Kier Group has reported a defined benefit deficit of £14m as at 31 December 2018, compared to a surplus of £8m six months earlier. According to its results report, the movement was "primarily driven by the recent performance of the schemes' assets" and a guaranteed minimum pension equalisation charge of £6.1m.

Kier operates four DB pension schemes, which had total assets of £1,652m and liabilities of around £1,668m, as of 31 December 2018, and related deferred tax assets of £2.8m. This represents a £29m fall in assets and £5m reduction in liabilities in comparison to 30 June 2018. However, the deficit had improved in comparison to the end of 2017, when Kier posted a DB pension deficit of £19.3m.

And finally, Britain's fourth largest supermarket, Morrisons, has reported a net pension surplus of £688m in its full-year results. The supermarket revealed that the surplus is down from £834m at the end of the first half, but up from £594m at the end of 2017/18.

It stated that it closed its Retirement Saver Plan (RSP) to new members and future accrual in the year, which resulted in one-off costs of £19m. It also made provision of £7m to accommodate the cost of equalising guaranteed minimum pensions for men and women, following the High Court judgment.

Furthermore, Morrisons said it is continuing to work with pension trustees to identify opportunities to de-risk the schemes. In January 2019, the trustees completed a further £413m buy-in of part of the Safeway scheme liabilities, bringing the cumulative total to £819m so far.

Written by Jack Gray and Natalie Tuck

*FREE TO ATTEND

PENSIONS Age CONFERENCES

PENSIONS AGE NORTHERN CONFERENCE

13 June 2019 | Leeds Marriott Hotel

PMI CPD: This event attracts up to 7 PMI CPD hours

Register to attend and stand the chance to win an Apple Watch on the day of the conference!

www.pensionsage.com/northernconference

Sponsored by

AberdeenStandard Investments · ATLAS · Ferrier Pearce · J.P.Morgan Asset Management · M&G Investments · PICTET Asset Management · SEI New ways. New answers.

For the latest news and updates about the Pensions Age Northern Conference follow us:
@PensionsAge #PensionsAgeLeeds

*this event is FREE to attend for qualifying individuals, please check the website for more information

Appointments


Nigel Waterson


Joanne Segars

Chair of the trustee board at **Now Pensions,** Nigel Waterson, has announced that he is standing down after more than seven years in the position.

Joanne Segars, who was appointed to the trustee board in 2017, will take over the role on an interim basis while the board decides how to proceed.

Commenting on the announcement, Waterson said: "I am proud of what we have achieved at Now Pensions. When I joined, we had no members and no funds. Today, we are the third-largest master trust and a major player in the wider pensions sector. With the historic administrative issues largely resolved, we are well placed for authorisation, and for the Cardano Group to acquire the business following authorisation. This feels like a natural point to step down."

Now Pensions non-executive chairman, John Rowland, added: "Nigel has been with Now Pensions from the outset and has made a huge contribution, helping to ensure that we keep members at the heart of everything we do."

The **West Midlands Pension Fund** (WMPF) has awarded a mandate to **Impax Asset Management**.

The mandate is to run their ethical funds through the Global Opportunities Strategy. This could be the largest allocation to actively managed sustainable equities ever made in the UK, with total awards of £1 billion across the partner funds expected in the first year. The WMPF appointed four other managers alongside Impax, who "surpassed rigorous assessment criteria and are committed to the LGPS code of transparency".


Chris Hannon

The Railway Pensions Trustee Company has named Chris Hannon as its new trustee board chair. Hannon brings over 40 years of experience as a pensions professional to his new role, including as trustee director of the Railways Pension Scheme since 2005. He also spent 12 years as head of pensions at Network Rail and held management and trustee supporting roles with other large non-rail employers, including Safeway Supermarkets and Thomas Cook Group.


Paul Bucksey

Smart Pension has named Paul Bucksey as its director of UK distribution.

Bucksey joins Smart Pension from Aegon/BlackRock, where he was defined contribution managing director. He played a key role in the part VII transfer of Aegon's acquisition of BlackRock's UK DC platform. Prior to that, he assisted Fidelity in establishing a 'strong foothold' in the UK workplace pension landscape.


Catherine McFadyen

Hymans Robertson has named Catherine McFadyen as its head of LGPS actuarial, benefits and governance.

McFadyen is an existing partner at Hymans Robertson, joining the company in 2003. Prior to joining Hymans Robertson, she held project and change management roles at British Energy, PepsiCo and PwC, and has provided strategic advice to some of the largest LGPS schemes in England and Scotland.

Brunel Pension Partnership has appointed **Quoniam** and **Robeco** as its Low Volatility Global Equity portfolio managers. The portfolio was initially worth £400 million, with an expectation that it could increase to at least £600 million.

When searching for its portfolio managers, the areas Brunel were interested in were understanding how managers address risk of valuation bubbles in low volatility strategies, and their use of ESG considerations to help further reduce risk. Brunel was supported in its search by Redington.


Maurice Tulloch

Aviva has appointed Maurice Tulloch as its new chief executive officer (CEO), with immediate effect.

He will also return to his role as non-executive chairman. Tulloch joined Aviva in 1992 and was appointed to its board in 2017. Prior to his new role, Tulloch was CEO, international insurance, after being CEO of Aviva UK and Ireland General Insurance. He will earn a basic annual salary of £975,000 and will receive pension contributions of 14 per cent of his salary.

Commenting on the appointment, Aviva chairman, Adrian Montague said: "Maurice will be an outstanding chief executive of Aviva. He knows the business inside out. He has led our businesses in the UK and internationally and built strong teams across life insurance and general insurance."

Tulloch added: "I am honoured to lead Aviva, a business I have been part of for 26 years. There is a clear opportunity to realise Aviva's significant but untapped potential."

Trustee workbench.

Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

THURSDAY 6 JUNE 2019

Grange City Hotel, 8-14 Cooper's Row, London, EC3N 2BQ

TOPICS FOR DISCUSSION AND SPEAKERS INCLUDE:

> **CHAIR:** Chris Parrott, PMI Trustee Group Chairman

> **DEFICIT REDUCTION, DB TO DC TRANSFERS, NEW IDEAS:**
Paul McGlone (Aon)

> **MOVING FORWARD IN UNCERTAIN TIMES:**
Liz Pfeuti (Rhotic Media)
Ian McKnight (Royal Mail)
Chetan Ghosh (CIO Centrica)
Kevin Wade (SAUL Trustee Company)

> **BUY IN / BUY OUT:** Tom Seecharan (KPMG)

> **HOW NOT TO FALL FOUL OF THE PENSIONS OMBUDSMAN:**
Anthony Arter (Pensions Ombudsman)

> **TPR'S NEW POWERS:** David Fairs (TPR)

FREE FOR TRUSTEE GROUP MEMBERS
MEMBERS: £250.00 + VAT
NON-MEMBERS: £300.00 + VAT

VIEW FROM THE AMNT

'Differences challenge assumptions.' Anne Wilson Schaef

Literal definitions of words are often at variance with the way society uses or understands such words. This reflects the fact that language is a living thing changing with time and cultural influences.

We now primarily see diversity as the condition of having or including people from different ethnicities, gender and social backgrounds, whereas the original definition was; a variety or assortment: a diversity of opinions.

These two understandings and applications of the word are not exclusive, as including people from a variety of backgrounds and genders provide that diversity of opinion. What is, clear as Anne Schaef stated, is that "differences challenge assumptions".

There is recognition by investors that diversity within company board structures provides a range of opinions that prevents the danger of 'group think' and consequence governance failures. Yet there are serious concerns that the Hampton-Alexander target of 33 per cent female representatives on FTSE 350 boards will not be met by 2020.

There are similar issues within pension boards for, though The Pensions Regulator states in its trustee board guidance: "As far as possible, trustee boards should be diverse and well-balanced". The latest moves towards collective DC schemes' and superfunds indicate governance regimes that are uniform and unvaried.

Accepting the premise that pension governance bodies should have member nominated trustees would be an excellent starting point for diversity.

AMNT member Stephen Fallowell

AMNT Association of Member Nominated Trustees

Market commentary: Brexit: Extra time

As Brexit enters the murky waters of extra time, and Prime Minister Theresa May's deal gets voted down again, the indicative voting process has led to mumblings of a softer Brexit, or perhaps even, whisper it, no Brexit at all.

But with no certainty in sight *[at the time of writing]*, and a deadline of 12 April for the UK to let the European Union know how it intends to proceed, what have the markets got to say about the UK's latest political plight?

According to Lombard Odier Investment Managers (IM), with the "very negative tail" of a no-deal Brexit being removed, it predicts that the Great British Pound (GBP) should "find a floor" with the US Dollar and the Euro.

Lombard Odier IM senior investment strategist, Charles St Arnaud, says: "However, some uncertainty will remain in the form of the potential next steps (election or referendum), and what the outcome will mean for the new long-term relationship between the UK and the EU."

Despite this, he suggests the risk of a no-deal Brexit "by accident" is low, but should be contemplated by investors in the short term.

While investors should at least consider the possibility, independent hedging advisory JCRA CEO, Jackie Bowie, believes that funds should not make a currency hedging decision based solely around a single event.

"Macroeconomic events will always crop up in different guises.

"Some, like Brexit, will be known events while others will take the market by surprise," she says.

"Therefore, funds need to ask themselves whether they are willing to tolerate currency risks that can significantly impact the performance of the fund, or whether they will evaluate

the full extent of the exposure and design a hedging strategy to manage it."

One area of the economy that has potentially changed is the notion that we will no longer see a rise in interest rates.

Hargreaves Lansdown senior analyst, Laith Khalaf, says: "Markets are now almost totally discounting the possibility of a 2019 rate hike, whereas just a month ago, it was priced in as a 50/50 chance.

"The ongoing Brexit drama has of course helped to dash hopes for an interest rate rise, but so have concerns over the global economy.

"In recent weeks some pretty poor economic data from the Eurozone, combined with a dose of caution from the US central bank, have dampened expectations for global growth, and so for potential interest rate rises too."

UK accounting firm Mazars believe that investors should make sure they are sufficiently diversified, and avoid any Brexit risk.

Mazars chief economist, George Lagarias, said: "Our model had indicated that the probability of a general election was elevated two months ago, suggesting a mere 15 per cent probability that May would pass her deal from the parliamentary floor.

"These forecasts still stand, but unless investors possess real insight as to the workings of the Conservative Party, they should make sure they are sufficiently diversified and avoid any Brexit investment risks if they can afford to do so."

Written by Theo Andrew

In my opinion

On partial pensions being offered to members of the NHS Pension Scheme
"Pension taxation is never popular, but this is not about politicians winning over older voters, it is about the risk of damaging a critical UK institution – the one that ensures the health and wellbeing of the nation. If that is not enough to promote change, then nothing will be."
Quilter head of retirement policy, Jon Greer

On TPR granting 11 master trust authorisation application extensions
"You can expect us to challenge trustees on why they need more time. There are two main reasons why schemes apply for extensions. The first, and a common reason, is a key change to a scheme, such as a new owner, administrator or trustee. The second reason is because we are encouraging those filing authorisation applications in the last two weeks of March to also apply for an extension. We are keen that schemes file the best possible application for authorisation, and this ensures that schemes can send us any additional information."
The Pensions Regulator head of master trust authorisation and supervision, Kim Brown

On the DC member contributions outstripping DB for the first time
"The latest figures from ONS show the meteoric rise in DC pensions, fuelled by automatic enrolment and the huge growth in master trusts. In 2018 for the first time, employee contributions to DC outstripped those into DB pensions."
Aegon pensions director, Steve Cameron

On the 44 month prison sentence given to a fraudulent accountant trustee
"Fraudsters who abuse positions of trust to line their own pockets with other people's hard-earned savings will feel the full force of the law. I welcome the sentence handed down by the courts today, and the regulator's action in bringing this prosecution."
Minister for Pensions and Financial Inclusion, Guy Opperman

On the cost of guaranteed minimum pension equalisation being half what originally expected
"It is really encouraging news for UK business that our more detailed analysis indicates that it will be closer to half that amount. This suggests that most companies will not see significant disruption to their long-term funding strategies."
Hymans Robertson head of GMP equalisation, Matt Davis

On the pressure faced by the government to speed up AE reform
"It will genuinely take the best part of nine months to go through all the data and get a definitive understanding of where we are on the 8 per cent. It seems utterly wrong for me to seek to change the nature of the legal basis until I have a real understanding of the impact of the 8 per cent increase."
Minister for Pensions and Financial Inclusion, Guy Opperman

VIEW FROM THE SPP

Since the publication of the Office of Fair Trading's 2013 report into the workplace DC pensions market we have seen a host of measures from the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR).

Many of these have been intended to increase value for money and improve the quality of DC pension schemes. Even if consolidation was not the primary driver of this, it has certainly been one of the impacts with the number of schemes with more than 12 members falling from 4,100 in 2010 to 2,180 in 2018.

DWP is taking things a step further by consulting on a new requirement for scheme trustees to assess whether or not they should continue or whether they should consolidate into a different scheme. That's reasonable; the empirical evidence seems to show that larger schemes offer both higher investment returns and lower operating costs. There seem to be no diseconomies to scale either.

But these rewards on scale seem contingent on the quality of governance. That means that if this consolidation drive is to succeed, schemes need to be able to identify well run schemes to consolidate into. Recent reforms to the regulations governing bulk transfers without consent have streamlined the transfer process and sensibly include a requirement for trustees to receive independent advice prior to transfer. How well these regulations work to encourage and enable transfers into high quality pension schemes will strongly shape the success or failure of the proposed consolidation measures. No doubt DWP will keep a close watch on how effective they are.

SPP council member, Gregg McClymont

THE SOCIETY OF PENSION PROFESSIONALS
leading pension thinking

VIEW FROM THE PPI

Pension schemes could benefit by investing in illiquid assets such as infrastructure or private companies not listed on the stock exchange.

While illiquid investments involve locking funds away for a period of time, over the long term these assets are expected to deliver a higher overall return than publicly-traded stocks, provide exposure to a wider range of assets, and spread risk across a range of assets, which generally don't rise and fall in value at the same time as those on the public market.

However, there are challenges facing DC schemes who wish to invest in illiquid assets. Illiquid funds are not readily available on most DC platforms because these assets are priced differently than the assets that platforms usually offer. Adjustment would require development and innovation by platform managers. Schemes have also found it difficult to assess compliance with the AE 0.75 per cent charge cap for default funds.

The government is trying to remove challenges to investment in illiquids. It has issued consultations clarifying that DC schemes are permitted to invest in illiquid assets, and suggested a new method of charge cap compliance. There is also an education gap, as some DC scheme providers are unsure of the benefits of investing in these types of assets. A holistic approach to removing challenges should include a communication and education strategy with the main intermediaries dealing with DC scheme providers.

PPI head of policy research Daniela Silcock

PENSIONS POLICY INSTITUTE
PPI

Soapbox: The youth of today

For years, the pensions industry has wondered how to improve engagement with younger savers. There is a perception that they don't care, or are too short sighted, about understanding the long-term benefits of saving into a pension scheme. The Pensions Policy Institute (PPI) noted that it believed young people had a "live for today attitude"; that there was a "perceived" lack of affordability and a lack of knowledge amongst the younger generations. This could all be true. It does seem as if young people are apathetic towards saving for the future, and the pension industry has tried a multitude of actions to remedy this attitude.

Technology is being embraced more than ever, with the announcement of the pensions dashboard and number of institutions launching initiatives in an attempt to move with the times proving this to be the case. However, its adoption has been too slow; the industry and government only needs to look at the success of online banking to see where it could have progressed to.

Auto-enrolment has been credited with helping young people save for their future, but auto-enrolment isn't improving genuine engagement. Forcing young people into saving for pensions does not educate or increase their interest in saving for their retirement. It is wishful thinking to believe that auto-enrolment has been successful in improving young member engagement; rather it has just improved the numbers saving.

For all the reasons given for why young people are uninterested in pensions, there is one factor that is the most important, influential and critical to the lack of engagement amongst the younger generation, and that is living costs.

Why would someone aged 20-30 spend time considering what their financial security will be like in 40-50 years time if their current financial situation means that they can't even afford to rent, let alone buy a house, while having income spare for other essentials?

Do we really believe that young people have the money to put into a pension scheme when the gap between the cost of living and wages is so slim, house prices are so high, and rail travel costs are through the roof?

According to the Nationwide Building Society, the average house price in the UK in 2018 was around £217,000, while the *Annual Survey of Hours and Earnings* found that the average annual wage of an employed 22-29 year old was £24,850.

BDI Resourcing estimated that the average cost of living and renting in the UK was around £1,300 per month, or £15,600 per year, and this does not account for any additional, emergency costs or luxuries. Therefore, the average young person has around £11,000 per year in disposable income, or less than £1,000 per month.

If that young person is looking to purchase a property, they would have to save every penny of their disposable income for nearly two years, with no luxuries and no emergency fees, before they would even have enough to put down a 10 per cent deposit on an average property.

Furthermore, it's not just houses that young people may be saving for. They may need a car, an engagement ring, or want to go travelling. With this in mind, is it any wonder than young people are not engaging enough with their pension? Their problems are in the here and now, and are too deep rooted for the pensions industry to remedy by itself. Until things improve economically for the younger generation, the apathy towards retirement saving will continue.

Written by Jack Gray

Working towards a third way for pension schemes

Minister for Pensions and Financial Inclusion Guy Opperman reveals the government's intentions for collective defined contribution (CDC) schemes

When Royal Mail and the Communication Workers Union (CWU) began championing a 'third way' to deliver retirement savings for their employees and members, the government listened.

We worked closely with CWU and Royal Mail to develop firm proposals for new collective defined contribution (CDC) schemes – a departure from the established landscape of defined benefit or defined contribution pensions. In the process I got to know Terry Pulinger from CWU and Jon Millidge from Royal Mail very well!

And now, after lots of hard graft and constructive dialogue, we are in a position to deliver the very first CDC in Britain. An innovation that has the potential to boost the retirement prospects of millions of people, in time.

Credit is due here. If you want an outstanding example of a trade union working with an employer then look no further than the CWU and Royal Mail. The positive way in which they have collaborated shows what can be achieved in the interests of both bosses and workers, and you won't meet employees who have a greater understanding of, or are more engaged with, their pensions than Royal Mail's workforce.

The pensions industry has broadly embraced the proposals on which we consulted, recognising that CDCs could yield better investment returns for workers while cutting costs and red tape for employers. In fact, they wanted us to go further, faster, ensuring they become a big part of the pensions scene in future. But responsible government is about balancing risk and reward, and our focus is on posting a success with the inaugural CDC.

To those who claim that CDCs are just 'Ponzi' schemes that transfer the contributions of those currently employed to the retired, I say you are wrong. The government will not allow any CDC scheme to use future contributions to offset current underperformance. Schemes will not be permitted to apply reductions in benefit value to younger members in order to limit reductions to older members or pensioners.

We want first-class, well-designed CDC schemes, set up and governed so that members are not exposed to unreasonable risks. There are risks, yes, with returns linked to how investments perform, so some fluctuations are possible. But we want CDC schemes to be transparent too, providing effective and clear communication about how they operate to their members and the markets. That will forge understanding and confidence in this new type of pension.

There is clear support from trade unions for their members to have access to CDC schemes because they know that for many ordinary working people they are a good way of getting a regular income in retirement. Members get more certainty with regular payouts from their scheme and, unlike traditional final salary pension schemes, those payouts aren't jeopardised if an employer goes to the wall. As I said earlier we will proceed carefully, however, making sure that the pioneering Royal Mail-CWU scheme is signed, sealed and delivered successfully before rolling out CDCs more widely.

This government is working hard to make Britain the best country in the world in which to grow old, transforming Britain's retirement savings culture with vital innovations such as pensions dashboards to help people plan better for later life. And, of course, more than 10 million people have benefitted from our drive to enrol them automatically into workplace pensions.

Hard-working people deserve to be able to look forward to retirement with confidence and CDC schemes can open new avenues for employers and their workers to find the type of pension provision that works best for them.

Written by Minister for Pensions and Financial Inclusion Guy Opperman

VIEW FROM THE ACA

We are seeing a step change with The Pensions Regulator's Annual Funding Statement for the first time, including expectations on investment strategies and examples of scenarios with scheme types being segmented by maturity as well.

As expected, there is a growing focus on establishing and agreeing long term objectives – a positive step as technical provisions often fall significantly short of a sufficient run-off funding level.

It is important however that such plans address demographic risk as well an investment risk as the scheme moves toward this type of long-term target.

We note the regulator is looking for trustees to evidence and justify departures from the expectations set out in the various scenarios set out in the statement, which will need appropriate advice and input from their actuaries and other advisers.

Sponsors, trustees and their advisers need to be assured that the changing approach will not herald an overly inflexible one and that the regulator will remain proportionate in using its powers, particularly those situations where employers are engaged in corporate restructuring – often with the specific aim of enhancing the organisation's future prospects and therefore the covenant supporting the pension scheme.

Identifying a fair balance between competing calls on employer resources must remain largely a decision taken at company level, taking due note of advice and after proper processes have been followed.

ACA chair Jenny Condron

ACA
ASSOCIATION OF CONSULTING ACTUARIES

Diary: April 2019 and beyond

PLSA Introduction to Trusteeship - Part 1: The Theory

8 May 2019
PLSA, 24 Chiswell Street, Moorgate, London, EC1Y 4TY

This course is the first of two one-day courses, which together provide an introduction to the role of a pension scheme trustee. If you are new to trusteeship or thinking about becoming a pension scheme trustee this course is right for you. Learn the theory of pension scheme trusteeship, including what is expected from trustees and how to apply good scheme governance.

For more information, visit:
https://www.plsa.co.uk/Events/Calendar-of-events/Event-Detail/eventDateId/600

PLSA Local Authority Conference 2019

13-15 May 2019
De Vere Cotswold Water Park Hotel, Gloucestershire

The conference is taking place in Gloucestershire at the De Vere Cotswold Water Park Hotel from 13-15 May 2019. The event is the largest of its kind dedicated to the Local Government Pension Scheme that has over 13,000 employers, over five million members and assets of over £225 billion.

For more information, visit:
https://www.plsa.co.uk/Events-Local-Authority-Conference

Pensions Age Northern Conference

13 June 2019
Leeds Marriot Hotel

The Pensions Age Northern Conference offers pension funds and those working in the UK pensions space the tools and information that they need to get it right at a time when managing pension schemes is more challenging than it has ever been. Now in its fourth successful year, this one-day conference is open to pension scheme managers, trustees, FDs, advisers, pension and HR professionals.

For more information, visit:
http://www.pensionsage.com/northernconference/

European Pensions Conference 2019

20 June 2019
London Marriott Hotel Grosvenor Square

The inaugural European Pensions Conference, which comes from the team behind *European Pensions* magazine and the European Pensions Awards, aims to tackle some of the key challenges facing Europe's pension schemes today, while highlighting many of the successes in this dynamic sector. At this one-day event, meet key players in the European pensions arena, including pension funds, associations, advisers and providers.

For more information, visit:
http://www.europeanpensions.net/conference/index.php

Visit www.pensionsage.com for more diary listings

Month in numbers

1.25 million

An estimated 1.25 million people are set to breach the current Lifetime Allowance limit for pensions tax relief, according to new research from Royal London. Analysis from the mutual insurer found that 290,000 workers already have pension rights above the £1.03m limit. Those who breach the limit are set to face a 55 per cent tax bill on savings above this level, while fewer than half of the 290,000 thought to have breached the allowance have applied for protection against past reductions.

£60 billion

The UK's defined benefit pension scheme deficit increased by £60bn to £260bn at the end of March, PwC's Skyval Index has revealed. The index, which checks in with the UK's 5,450 DB pension funds found that total assets hit £1.650bn, while the liability target was recorded at £1,910bn.

44 months

An accountant trustee who fraudulently took over £290,000 from a company pension scheme has been sentenced to 44 months in prison.

Gold's precious mettle

Gold is back in the limelight. But now there's a better way of investing in the precious metal than just buying bullion

Once again, political and economic uncertainty is pushing to the fore gold's attractions as an investment haven. But this time investors wanting to allocate capital to the precious metal have a better option than just buying bullion bars or futures contracts. Gold mining stocks are looking particularly good value. Indeed, gold miners have become such an attractive proposition that they're proving irresistible to some of the industry's best informed bargain hunters – their rivals.

Ever since Barrick Gold took over Randgold Resources last September for $6 billion – and then followed up with a hostile $18 billion bid for rival Newmont in February – there's been growing enthusiasm for mergers and acquisitions in the sector.

When miners start acquiring each other, this suggests the market is under-pricing the value of their assets, namely the gold they've yet to mine. What's more, not only are gold miners' stocks attractively valued relative to their reserves and the price of bullion, but also compared with the materials sector as a whole and with global equities in general.

Gold mining stocks are trading at a price-to-book ratio of 1.4 times against a 10-year average of 1.9 times. And valuations are well below those of the wider materials sector and global equities, on ratios of 1.5 and 2 times respectively[1]. The sector was hit hard by a downturn earlier in 2018 in gold prices and has been slow to recover.

We've responded accordingly, broadly taking as much of a position in gold mining stocks as in the precious metal

itself – around a 2 per cent weighting in each (as at March 2019).

Hedging with gold

But while we see good potential upside in gold miners from further industry consolidation, their main attraction is as a relatively inexpensive proxy for the precious metal itself. Gold is attractive because it doesn't move in lockstep with other major asset classes, and also has a habit of showing its mettle during times of crisis.

Take last autumn. In October, when most investors were caught flat-footed as both equities and bonds simultaneously headed south, gold bucked the trend. It has continued to rise since and has gained some 10 per cent since the start of the fourth quarter of last year.

As Dirk Baur at Dublin City University and Brian Lucey Trinity College Dublin explain, "gold is a hedge against stocks on average and a safe haven in extreme stock market conditions."[2] That's to say, although gold is just a moderate hedge against equities and bonds during normal market conditions, it's a very good one in times of crisis.

And that's particularly relevant now given that many parts of the world are in the grip of political upheaval. On their own, the trade show-down between the US and China, Brexit and increasingly regular bouts of political turmoil in Italy would be enough to justify taking out some crisis insurance. But add to that a sea-change in global monetary policy, and investors have plenty to contend with.

For instance, there is still a risk that central banks could overdo policy tightening by missing warning signs of an economic slowdown. Alternatively, even if, say, the US Federal Reserve puts the brakes on further interest rate hikes this year, it doesn't have a great deal of leeway to support growth in case of economic weakness. Notwithstanding that the Fed has been raising rates since the end of 2015, US borrowing costs are still near historic lows. Meanwhile, stopping the Fed's balance sheet reduction is one thing, restarting quantitative easing would be quite another. The former is eminently possible, the latter, politically hazardous.

Instead, any economic boost will most likely have to come in the form of further fiscal stimulus. With deficits already high, that becomes strong medicine with seriously inflationary side-effects. And as real asset, gold provides a good haven against an inflation-inspired erosion of the dollar's value.

Meanwhile, in a world of low interest rates, the opportunity cost of holding gold – forgoing yields on income-generating assets – declines.

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

In association with PICTET 1805 Asset Management

[1] MSCI Materials and MSCI ACWI indices. Data as at 31.12.2018.
[2] "Is Gold a Hedge or a Safe Haven? An Analysis of Stocks, Bonds and Gold" Dirk Baur and Brian Lucey, The Financial Review 45 (2010) p. 217

Reaching for the STAR(s)

Theo Andrew sits down with STAR transfers steering group co-founder, Criterion managing director, Caroline Mansley, to discuss issues facing the pensions industry and how she bagged herself a ticket to the Commonwealth Games on the Gold Coast

What is your pensions career CV?
During my early career I worked at United Friendly Insurance (now part of the Royal London Group). It progressed when I began consulting for Cap Gemini with various client engagements across the industry, eg Wesleyan, and RSA, specifically looking at improving the client experience and interaction with intermediaries. My role as business transformation and IT director at Scottish Widows immersed me into the pensions world. My previous role before joining Criterion, as global customer operations executive, introduced me to the very complex underwriting processes deployed across the USA – fascinating!

What other areas have you worked in and what roles have you held prior to joining the pensions industry?
I have worked across a number of business sectors, banking, consulting services, manufacturing, insurance, and telecomms. I have held EMEA based roles as a CIO and as a consultant, my last role at AIG was global, with responsibilities across 175 operational centres around the world speaking 57 different languages.

What is your greatest work achievement so far?
It's a close draw really between leading the design and launch of the Trainline internet booking service in 1998 for Virgin Trains, which was fantastic and the first of its kind to launch in the UK; but the scale and cultural complexity of my role at AIG is a tough one to beat.

What do you still wish to achieve?
Increase simplicity – especially for customers when they are engaging with a supplier, business or service provider. All businesses should look out not in! My current focus is ensuring the pensions industry tackles the issue of transfer times consumers are facing when they move their investments and pensions. We launched STAR, a joint venture between Criterion and TeX, to crack this nut. It's one of those issues where there needs to be momentum and the snowball needs to start rolling. We think it has started already with 21 companies now involved. It's an important issue, consumers now have the choice to liquidate their savings post-freedoms, state pensions are being squeezed, and the new working generation who benefit from auto-enrolment are more mobile and will want to aggregate more frequently – a perfect storm is upon us. The government and the regulator are focused on this and the industry needs to step up to the plate if it wants to avoid mandatory transfer times being imposed.

What is your biggest regret within your career?
I've been lucky and have enjoyed the vast majority of my career, but after studying a degree in Fuel and Energy Engineering at Leeds, graduating in 1984 – I do wish the world would have been faster in embracing alternative energy sources – although I might have missed all that fun in IT and financial services!

Excluding your current role, what would be your dream job (in or out of pensions)?
That's an easy one – golf course design, tester and assessor.

What was your dream job as a child?
Astronaut.

What do you like to do in your spare time?
I have two voluntary roles, as chair of Netball Scotland for nearly three years – exciting and how else would I have got to the Commonwealth Games last year, held in the Gold Coast, Australia. My second 'job' – I am in my second year as Lady Captain of Ratho Park Golf Club. Sport takes up most of my spare time – I just love it and I am really enjoying bringing my commercial and business skills to help these small businesses grow and develop. 2019 is a big year – World Cup Netball in July being held in my home city of Liverpool and the Solheim Cup comes to my 'back yard' – Gleneagles!

Any particular skills or party tricks
I have a tried and tested method of getting rid of hiccups! Never fails! But it's a secret.

Who would be your ideal dinner party guests?
John Lennon, Princess Diana, Neil Armstrong, Billie Jean King.

Do you have a particular phrase or quote that inspires you?
Striving for perfection often gets in the way of implementing good practice moving problems forward!

Written by Theo Andrew

Focus on higher or lower earners?

Steven Leigh explains how it may be for differing reasons, but both higher and lower earners need support during their retirement saving journey

It is easy to generalise that higher earners are much better off than lower earners financially, so do we need to provide more support to those earning less? What about the individual's attitude towards money and wider financial circumstances? Aon's research with Ipsos surveyed the situation of over 1,000 UK employees. One surprise was that more high earners (over £55,000 a year) had payday loans than low earners (below £25,000 a year). This article discusses how you can work better with both your high and low earners.

Setting a target

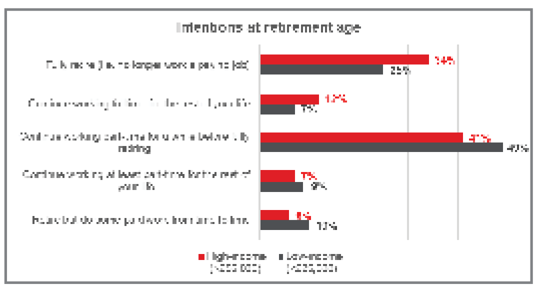
Low earners need a greater proportion of their pre-retirement income in retirement, but get a lot more of this from the state pension. Lower earners only need around 25 per cent of their pre-retirement income from sources such as their company pension, while higher earners need over 41 per cent.

In Aon's recent survey, we found that lower earners tend to overestimate this amount, and higher earners tended to underestimate. For lower earners, overestimating may make their target feel unachievable and so discourage any saving. Higher earners may be able to save more but do not know that they are not saving enough! You can help both groups understand how much they need at retirement to maintain their living standards.

Conflicting financial commitments

Our research suggests that those on low incomes are most likely to have unpaid credit card debt each month, suggesting that they have less available to contribute towards their pension. These individuals are likely to be less receptive to 'save more' communications and in most cases will be better served by prioritising paying off high interest credit card debt.

We found that higher earners are more likely to have a payday loan than lower earners, with 1 in 10 of them having this type of debt. Just because someone earns more, it does not automatically follow that they are better at managing their personal finances; this group will have higher outgoings, and some budgeting support could be helpful.



Source: Living the Dream: Aon's DC Pension and Financial Wellbeing Survey 2019

Retirement expectations

While, unsurprisingly, a higher proportion of those on higher incomes are planning to retire fully at retirement age rather than continue to work part time, we also found that a higher proportion expect to continue to work full time for the rest of their life compared to lower earners.

For lower earners, the higher proportion expecting to work part time into retirement is more likely due to affordability, with continuing earnings needed to supplement pension income in later life.

Does your pension provision reflect this range of expectations for late life working patterns?

Support

Higher earners are more likely to feel that they are too busy to sort their finances (27 per cent) compared to those on lower incomes (14 per cent). However, those with higher incomes are also more likely to have difficulty understanding financial matters (25 per cent) compared to those on lower incomes (16 per cent). This could be down to the complexity of pension tax rules for higher earners, as well as potentially having a wider number of areas to consider, such as inheritance. These topics are less likely to resonate with lower earners and may lead to disengagement. Your communications need to be tiered or targeted to give people information that is engaging to them.

Methods of communication

Focusing on workplace pensions communications, members' preferred method is email, followed by hard-copy letters and face-to-face meetings. However, for the different income groups, there are some noticeable differences, with 35 per cent of lower earners preferring to be sent letters in the post (compared to 17 per cent of high earners). This shows that it is not just the message, but also the range of channels that are used to communicate with members, that is important to support the desired retirement outcomes.

While the drivers are different, it is evident that those on both higher and lower incomes could benefit from extra support from employers and trustees on financial matters, not just pensions saving. The best schemes will consider the similarities and differences to deliver the right message at the right time in the right way.

To request a full copy of our DC Pensions and Financial Wellbeing research, email talktous@aon.com

Written by Steven Leigh, senior consultant, Aon

In association with Aon Empower Results®

For Investment Professionals only.

This document does not constitute an offer or solicitation. The services and products provided by M&G Investment Management Limited are available only to investors who come within the category of the Professional Client as defined in the Financial Conduct Authority's Handbook. M&G Investments is a business name of M&G Investment Management Limited and is used by other companies within the Prudential Group. M&G Investment Management Limited is registered in England and Wales under number 936683 with its registered office at Laurence Pountney Hill, London EC4R 0HH. M&G Investment Management Limited is authorised and regulated by the Financial Conduct Authority. MAY 2018 / IM1573

Spotlight on volatility: Re-examining DGFs

Tristan Hanson highlights the importance of monitoring DGF strategies throughout the investment cycle

Pension schemes have used diversified growth funds (DGFs) for years for the dual objectives of lowering volatility in portfolios and generating attractive returns in a wide range of market conditions. However, the past two years have proved a challenge, both during the calm conditions of 2017 and in the turbulent 2018, when US interest rate dynamics and political uncertainty contributed to heightened market volatility and price declines across 90 per cent of asset classes[1].

As market conditions change, we increasingly see the assumptions behind many diversification models being challenged. This is arguably to be expected, as an investment portfolio is not inherently diversified because it uses a multi-asset or multi-strategy approach. Correlations between asset classes are not static and historical relationships change, as evidenced today in equity and bond markets.

Instead, it is essential to take a forward-looking view of correlations. Asset valuations, the nature of near term price action, and the prevailing economic regime can all provide information about how much genuine diversification is available, and provide an advantage over simple 'set-and-forget' collections of best ideas.

Managing volatility throughout the cycle

While valuation signals provide important signals around the prospects for long-term returns through strategic asset allocation, we believe this must be supplemented by dynamic asset allocation to deliver DGF-style objectives throughout market cycles. This is because valuations and correlation patterns can shift materially – and sometimes frequently – in the short term, providing opportunities to both capture potential upside and mitigate downside risk.

Dynamic asset allocation can be primarily achieved by investing in liquid asset classes such as equities, bonds and currencies to enable quick responses to changing market conditions. Position scaling and sizing can be an effective means of providing downside protection, and our overall equity exposure is scaled quite significantly up and down over time.

To protect capital in our target return proposition, our most conservative DGF, we target a nominal volatility limit and observe short-term drawdown thresholds rather than a volatility objective relative to equities. Through this we aim to preserve capital in volatile periods, while targeting a positive return over the longer term.

We believe appropriate use of alternative assets, such as ABS, infrastructure, private loans and property, can provide effective diversification – especially given today's correlated weakness among major asset classes. However, it is also important to recognise their limitations. Investors need to distinguish between assets that are genuinely less volatile and those that are simply illiquid or undiversified. Often illiquidity or concentration of positions can mask the fact that apparently alternative assets are still sensitive to broad factors like growth, interest rates and inflation.

What can schemes expect from DGFs in 2019?

The DGF investment universe is so broad that we believe each fund should be assessed individually and carefully. We expect continued divergence in realised outcomes should market volatility persist, and potentially fewer strategies being able to deliver DGF-style outcomes. Nevertheless, for investors looking to manage volatility in 2019, we believe a flexible, multi-asset approach still offers the widest range of tools to protect capital without excessively compromising potential returns.

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

Written by Tristan Hanson, fund manager, M&G Global Target Return Fund

In association with M&G INVESTMENTS

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

[1] **Source: Deutsche Bank, January 2019**

For Investment Professionals only. Not for onward distribution.
This article reflects M&G's present opinions of current market conditions. They are subject to change without notice and involve a number of assumptions which may not prove valid. Past performance is not a guide to future performance. The distribution of this article does not constitute an offer or solicitation and should not be considered as investment advice or as a recommendation of any particular security, strategy or investment product. Information given in this article has been obtained from sources believed to be reliable although M&G does not accept liability for the accuracy of the contents.
M&G Investments is a business name of M&G Investment Management Limited and is used by other companies within the Prudential Group. M&G Investment Management Limited is registered in England and Wales under number 936683 with its registered office at Laurence Pountney Hill, London EC4R 0HH. M&G Investment Management Limited is authorised and regulated by the Financial Conduct Authority.

BOOK YOUR TABLE

European Pensions
AWARDS 2019

Join us at the awards
for an unforgettable evening

AWARDS CEREMONY
20 June 2019
London Marriott Hotel, Grosvenor Square

Celebrating excellence in
European pension provision

@EuropeanPension #EuropeanPensionsAwards
www.europeanpensions.net/awards

Sponsored by

BNP PARIBAS
ASSET MANAGEMENT

Degroof
Petercam
ASSET MANAGEMENT DPAM FUNDS

Creative funding strategies

Arron Slocombe and Tom McNaughton reveal the challenges and opportunities creative funding strategies can provide for scheme sponsors and the modern trustee

DB pension schemes are now as much a creditor risk to manage as an employee benefit. They can absorb as much c-suite and treasury team energy as that of the pensions team.

Contingent funding arrangements – bespoke legal structures supporting alternatives to 'simple' cash funding, using non-scheme assets – are unlocking mutually beneficial funding plans with longer term targets. The regulator's March 2019 Annual Funding Statement now explicitly recommends their consideration:

• "If concerned about risk of trapped surplus, consider using escrow, asset-backed contributions (ABCs), and contingency planning".

• "Strengthen short-term security through other means such as contingent assets and guarantees where available."

Contingent assets in context

Contingent assets sit alongside benefit changes (eg scheme closure, and RPI to CPI inflation switches) and consolidation (eg scheme mergers, asset pooling) in the modern trustee's and employer's toolkit.

There is no more collaborative area in the pensions field: legal expertise crossing pensions, funds, and banking must dovetail with specialist actuarial and covenant support to galvanise trustees and employers to meet their goals:

• Trustees: formal recourse to non-cash or non-scheme assets – or widening legal covenant support to group companies; pre-agreed triggers for funding injections; a framework for a better long term funding target (a specific regulator focus);

• Employers: as well as better cash management or spreading, the bespoke triggers and the potential for retaining control over (and potential return of) assets/investments.

Varieties of contingent assets

A non-exhaustive list includes:

• **Asset-backed funding** – typically trustees take a limited partnership interest indirectly linked to income streams from a group asset (eg property or even intra-group loans) – all structured properly to navigate 'employer related investment' constraints; with a legal 'underpin' to protect the trustees if it were unwound.

• **Guarantees** – from a parent or bank; tailored caps (fixed/floating); backing scheme ongoing contributions and/or s75 debts; 'evergreen' or fixed term; potential scope for guarantor replacement.

• **Escrow accounts, charged accounts, trust accounts** – different legal structures, but fundamentally similar: (1) a special vehicle (escrow account, ring-fenced company account, external trust), (2) an 'agent' role (escrow agent, custodian, or external trustees) to administer the vehicle, and (3) trustee and employer agreement governing applicable assets, control, and – again key – the 'triggers' for passing the assets into the scheme or – in good times – back to the employer.

More advanced forms may combine the above with other objectives (eg RPI to CPI switches, investment de-risking and buyout journey planning) into one carefully negotiated 'framework agreement' or 'memorandum of understanding'.

Triggers and consequences

Key to trustees, employers (and now TPR) is to document 'triggers' for contingent funding, cash or covenant support measures – and the pre-agreed consequences when engaged.

These usually cover downside risks but potentially also positive funding milestones.

Trustees

Trustees may be more focused on making assets and income streams 'bankruptcy remote', ensuring ring-fencing of assets, or legal charges or security (being careful not to label something as 'security' when it is not). Trustees may seek triggers at an earlier (measurable) stage of corporate distress than formal insolvency or to extend triggers to group companies. Particular care is required in respect of overseas covenant support.

Employers

Treasury and legal teams must scrutinise the detail and at least share the agenda-setting with trustees. They must ensure 'pension' triggers align with debt facilities (say) and avoid cross-default triggers.

The future

Early fears that the white paper's focus on defining 'prudence' and 'appropriate' recovery plans would lead to a reversion to a prescriptive funding test – and conceivably stifle innovation – have eased with later reference to a 'comply or explain' approach.

The regulator's March 2019 Annual Funding Statement certainly shows that employers and trustees must add contingent assets to their toolkits.

Written by Arron Slocombe, partner and Tom McNaughton, senior associate, Baker McKenzie

In association with Baker McKenzie.

Spotlight on pensions tracing: Making huge strides in a changing world

Alex Mitchell, head of tracing and data solutions at Capita, meets Francesca Fabrizi, editor in chief of *Pensions Age*, to discuss recent trends in the pensions tracing space

You have been involved with Capita for several years, in various roles. Could you tell us about your current role, what your aims and objectives are?
I came back into the tracing business around four and a half years ago, having set the business up nearly 15 years ago, because I felt there was a seismic change taking place in the data and tracing arena. It's been a real growth area for us and is seen as one of the biggest areas of expansion within Capita, so it's very exciting at the moment.

What specific areas of growth have you seen within the business?
Out of all the services that we provide, the biggest area of growth has been around manual and forensic and international tracing. This really falls off the back of the standard batch processing that a lot of providers are giving to clients, because the clients want to understand what more they can do. They understand that doing the same thing over and over again isn't going to give them a different result. So, by having people look at it at a manual level, *[they can]* understand if there's a break in financial transactions *[and if so]*, how can that be found? If the data's poor, there's a missing date of birth, missing financial information – we're able to look at these things and actually repair them.

For example, last year alone we did 178,000 manual reviews with the team, and this is just an area that continually grows. It's been a real focus area for me.

Have you also seen a change in the way that end users are engaging with the service that you provide?
Absolutely. When I joined the team four and a half years ago, one of the key elements that we took on board was online verification, given the digital age, and allowing customers to interact with us outside those normal customer hours, because we've all got working lives.

When it first came on board, it was trialled through a number of different clients and take up was slow. Traditional methods were there in terms of the phone and the form, but now over half of the people who interact with us are doing it online, because of ease and convenience.

There's a trust element that goes with that as well, because people are seeing us on forums, *[so they are]* understanding this is a trusted environment.

It's been an education about how we present ourselves as a partner with our clients. That's been instrumental as well.

But it's just the biggest growth area, because it's so easy for individuals to sit on their own on a Saturday morning, on their iPads, look at the email communication, go through, tap a few buttons and within 60 seconds it's done. Very simple.

With new datasets becoming available all the time, how far have you gone to locate somebody?

If I look at our manual area, one of the key things that we understand better now is how to look at international data. One particular case sticks out from last year, which involved a financial company that came to us; they had an asset relating to an individual that they wanted us to locate, who had been in London in the '90s. We managed to link this person back to a business in Iraq. Unfortunately, through Iraqi news, we were able to identify that they passed away in the late '90s, but they had family relatives and connections in Texas. So, we followed the trail out to Texas, found the family connection, made contact with them, and they were able to return the assets.

So, that took us from London to the Middle East to North America. A couple of years ago, we wouldn't have been able to do that. We wouldn't have been able to have that connection of datasets to be able to move as we did, and at the speed that we were able to do it as well.

Are you also seeing a difference in the type of data being presented, and is that affecting what you can do?

Yes – if you look at the UK, and you look at the batch services, traditionally that used to be all about electoral roll, BT OSIS, landline services, but landlines are falling at the fastest rate that they have done in quite some time. People are also withholding their consent on the electoral roll. So, you're now looking more at the transactional side of things; and obviously with the increase in Amazon, Just Eat and so on, transactional data has significantly grown. With that, we're leaning so much more on that information, because it's very transactional-based, but you do have to be wary about that information.

It's a lot more data, so it will need a lot more analysis from the teams to ensure that there is an accurate element towards that. You're always leaning on the credit data as well. So, it's great to have the extra datasets out there, it's great to have that extra information, but you've just got to know how to use it.

Have you seen a change in client attitudes in the last year or so since GDPR?

The key element for me here is ownership and accountability. The clients understand that this data has to be managed in the correct way, because ultimately, they have that responsibility for those individuals. We're getting a lot more questions asked about how we can support in an advisory matter, so not just around the tracing, but how we manage that as an ongoing basis, because it's not just about repairing the past. It's actually about how we prevent anything from occurring in the future as well. It's about having that framework in place, which is really important for any scheme going forward, particularly with auto-enrolment and the movements that are going to take place around that and controlling those communications and the information that's held on those people.

Looking ahead, what are the key issues that you're going to be focusing on, that clients are going to have to think about?

The biggest challenge that we all face is engagement. It's the verification of those individuals. We're seeing this massive increase in datasets that are available to us, and therefore the find rates at batch level and manual are at the highest they've ever been, but that only takes you so far. You need to have the interaction from the individuals. You need to understand how they engage back with the business, because a business isn't just going to take electronic data as gospel – they need those individuals to engage; that has to be the key focus.

One way we're looking at that is around the analytics and the MI, and how those methodologies around analytics can support us – that's a key driver for us. It's how we break that cycle, because what we find is that we can trace those people to those new addresses. But if they don't interact, they then slip back into the 'gone-away' population, and that's frustrating for businesses that have spent an amount of money to go and find those people. We need to understand how we change that piece.

So, there are lots of positive things happening, but some challenges that go alongside that?

There's no silver bullet in our industry, and that's what I find the most exciting, because we're all trying to look at innovative ways in which we can take the market forward. There's no script. I am constantly challenging my teams to look at different ways that we can interact. But also, it's important to have clients that are willing to push those envelopes as well, and look at new methods, or new ideas, on how we can interact with individuals. The dashboards that are coming up are going to be a big step forward, and clients need to be ready at that core, in terms of the data and the quality of it, to be able to communicate to their members effectively.

Written by Francesca Fabrizi

In association with CAPITA

European Pensions
Conference

European Pensions
CONFERENCES

EUROPEAN PENSIONS CONFERENCE

20 June 2019 London Marriott Hotel, Grosvenor Square

The inaugural European Pensions Conference aims to tackle some of the key challenges facing Europe's pension schemes today, while also highlighting many of the successes that have taken place in the European pensions space.

At this interactive one-day event, key players in the European pensions arena - to include pension funds, associations, advisers and providers - will come together with a series of presentations and panel discussions to discuss and reflect on:

- **Investment strategies and asset allocation trends in play across Europe's leading pension funds**
- **Risk management and de-risking solutions that Europe's pension funds can and should be utilising**
- **The increasing role that ESG and sustainability is playing in the European arena**
- **The cross-border pensions debate and how this is developing**
- **A spotlight on innovation and which pension funds are leading the way in this area**

and much more.

For all the latest news and updates about the conference follow us @EuropeanPension #EPannual

www.europeanpensions.net/conference

The event will be attended by European pension fund managers, trustees, CIOs, advisers and providers and is a must-attend forum for anyone involved in running pension funds in any country in Europe, as well as a great opportunity to learn from and network with some of the key representatives from across the European pensions space.

- **Peter Borgdorff**
  Director,
  Pensioenfonds Zorg en Welzijn
- **Robert Branagh**
  Managing Director,
  London Pension Fund Authority
- **Francesco Briganti**
  Secretary General,
  CBBA-Europe (chair for the day)
- **Théodore Economou**
  Chair, Investment Committee,
  Lombard Odier Pension Fund
- **Evalinde Eelens**
  Supervisory Board Member
  Delta Lloyd corporate pension scheme; Executive Board Member, BPF Particuliere Beveiliging; Board Member, BPF Schilders
- **Snædís Ögn Flosadóttir**
  Managing Director, FÍA and LSBÍ Pension Funds
- **George Graham**
  Fund Director,
  South Yorkshire Pensions Authority
- **Julien Halfon**
  Head of Pension Solutions,
  BNP Paribas Asset Management
- **Martin Hedensiö**
  Head of Communications and Sustainability, Alecta
- **Ruud Kleynen**
  Chairman of the Supervisory Board, Stichting Pensioenfonds Medisch Specialisten
- **Luigi Leo**
  Member of the Investment Committee,
  Stichting Pensioenfonds Vopak
- **Hillevi Mannonen**
  CRO, Chief Actuary,
  Ilmarinen
- **Peter Meier**
  Board and Investment Committee Member, SV Stiftungen (Pension Plan of SV Group); Investment Committee Member, Pensionskasse der Saurer-Unternehmungen
- **Piet Molenaar**
  Chairman of the Board at Pensionfund
  Lloyd's Register Nederland and board member/investment committee member of PNO Media
- **Kevin O'Boyle**
  Head of Pensions, BT Group
- **Tim Reay**
  Treasurer, International Employee Benefits Association (IEBA)
- **Christophe Schaer**
  Chief Investment Strategist,
  Compenswiss
- **Jens van Egmond**
  CFA, Board Member (trustee) and Member of the Investment Committee, Stichting Sportfondsen Pensioenfonds
- **Theo van Kessel**
  Director Business Improvement & Change, APG
- **Giovanni Vergani**
  BoD member,
  Cassa Pensione Città di Lugano

Sponsored by

BNP PARIBAS ASSET MANAGEMENT

Sustainability Panel Sponsor

Degroof Petercam ASSET MANAGEMENT DPAM FUNDS

In association with

CBBA CROSS BORDER BENEFITS ALLIANCE EUROPE

A drip, drip, drip approach

Speaking at the recent PLSA investment conference, Plumbing Pensions chief executive Kate Yates explains how the DB master trust has been reducing its risk and why you do not always need to know the ultimate end game at the start of the de-risking process

"Nothing is straightforward when you run a multi-employer pension scheme," Plumbing Pensions chief executive Kate Yates states. However, she lists three things that have helped the scheme on its investment journey – getting the governance right, understanding its risks and timely trustee training.

Plumbing Pensions is the industry-wide pension scheme for plumbers around the UK. It has assets of over £2 billion, 35,000 members and 350 contributing employers. It was set up in the 1970s to provide plumbers access to good quality, low cost, DB pension plans.

It closed in 2014 to new employers and is currently consulting on whether to close to future accrual – if so, that is likely to occur later this year.

The scheme's trustee board is made up of employer and trade union representatives, along with two independent trustees. It used to have a larger trustee board, but a smaller board sped up decision making, Yates notes.

The trustee board reports into a group made up of employer trade associations, representing all the geographical regions around the UK, and a union. This group has the decision-making powers that a sponsor in a typical pension scheme would have, she explains.

Plumbing Pensions made the deliberate decision not to have a separate investment committee, desiring to keep these decisions at board level. However, a sub-committee is used for some investment matters, such as the first-round interviews of new investment managers.

According to Yates, the trustee board has spent considerable time looking at the employer covenant that underlines the scheme.

"We have been lucky as we have not had to ask employers to pay extra contributions to plug a funding gap. However, that means that our employer covenant remains untested," she says.

As the scheme closed to new employers, it had "a quite racy investment strategy", which "produced some great investment returns and it helped keep pension contribution rates low and affordable", Yates states. However, the risk of this strategy going wrong "did not make for easy sleeping", she adds.

Therefore, the scheme considered a buy-in. According to Yates, it took time for everyone to get comfortable with the idea of transferring a significant sum of assets to an insurer as a one-off decision; there's no going back. "Our trustee board were particularly concerned about the long-term viability of the UK insurers being considered."

The buy-in of all pensioner members occurred in June 2017. Everyone is happy with this, Yates says. "We have swapped reliance on employer covenant for a large chunk of our liabilities with reliance on a highly-regulated UK insurance regime. We've got perfectly matching assets for all of our pensioner members and it helped with our cashflow too," she explains.

The plan after this was to adopt a mostly return-seeking strategy, as with just active and deferred members left, "there was quite a long timeframe before we needed the money to pay their benefits".

However, it was around this time that employers started to tell Plumbing Pensions that they could not afford to pay any higher pension contributions. Also, some wanted to leave the scheme.

In response, a less risky, diversified investment approach was decided upon.

Therefore, the past year has seen Plumbing Pensions sell off all of its UK equities, and most of its global equities. Instead it is looking to invest in a range of assets, which includes credit, leveraged liability-driven investment, property and illiquids, such as infrastructure.

"We know that our risks will reduce over time. As our members get older and start to take their benefits, it will get easier for the pension scheme to buy matching assets and hopefully cheaper to do further buy-ins," Yates says.

"We are in a fortunate position because we are nearly fully funded on a self-sufficiency basis. But we don't know at this particular point in time whether our end game is self-sufficiency or whether it is full buyout. But it doesn't particularly matter, as the initial journey for both of those end games is the same," Yates explains.

Therefore, Yates states that Plumbing Pensions is adopting a "slow and steady" approach to de-risking.

"We don't quite know what our end point is going to be, but we are pretty sure we are heading in the right direction and it's been an interesting journey so far."

Written by Laura Blows

Sponsored by

Data: What's the future?

The pensions industry is changing; regulation, technology and disruptors are all influencing the challenging yet opportunistic environment the industry is in. Our data seminar, in association with ITM, looked at where the industry is heading and what the industry can learn from the past

Beginning the day, ITM executive chairman, and conference chair, Duncan Howorth, noted that the seminar's aim was to cover looking ahead, rather than look back on the past, setting the tone for an agenda that was full of forward-thinking, intelligent and thoughtful discussion.

Keynote speaker, The Pensions Regulator (TPR) policy manager, regulatory policy directorate, Louise Sivyer, was very much focused on the future, giving delegates an update on the current master trust authorisation process.

She stated that the master trust authorisation process is not only key to maintaining consumer confidence, but it will also allow TPR to pay much closer attention to administration, including data standards and systems, and processes for managing data and information. "What we want is to make sure that trustees have the right knowledge and experience, and the right controls in place that oversee the running of their schemes," she said.

Top of the agenda

In a panel session, three pensions experts discussed what is top of the agenda for their schemes. West Midlands Pension Fund head of operations, Amy Regler, noted that one of the schemes' priorities is on digital transformation. "It's about enhancing the online services that provide for our members and employers; we're working in partnership with our software providers to create more efficiencies and also to improve the service that we offer to members."

National Grid UK Pension Services pensions technical manager Simon Lewis gave a similar response, noting that his scheme's focus is very much on pensions technical projects as well. However, it was also noted by Cosan Consulting director, Ian Bloxham, that there hasn't been a time in his career when administration has been more critical on a member and project side.

Regler added that one of the biggest issues for her scheme is that the employer base has grown a great deal in recent years, from around 300 to over 640 employees, which means they have to make sure the data they are getting is accurate.

Adding input on Local Government Pension Schemes, ITM client delivery manager, Sarah Millson, noted that one of the biggest changes in the LGPS over the past few years was the introduction of CARE in 2014. She also stated that there is much more focus on quality of data across the public sector now.

With regards to data, Lewis said

Sponsored by itm Solution delivered...

that for his scheme it is about having a "joined-up approach" with the sponsoring employer, and he is trying to find out as much information about other projects going on in the business as he can.

Looking at the administration market, Bloxham said that it is a very interesting period as there has been a lot of providers withdrawing from the market, and some consolidation. He also said that there are some very interesting changes afoot, and "people are waiting in the wings with new disruptive models, particularly around digital transformation." He believes this is a good thing as "choice has been restricted over the past couple of years".

Pensions dashboard

The upcoming pensions dashboard was a popular subject during the day. Sivyer believes it will play a key role in helping people plan for the future. She said the regulator welcomes the government's commitment that all schemes will need to supply data, adding that good quality data is "absolutely critical".

The general consensus from all the speakers was how important the dashboard's role can be in helping people to plan and understand their retirement. In a panel session dedicated to the pensions dashboard, independent pensions professional, Richard Smith, said that there is a real opportunity for the dashboard to increase the national level of confidence in retirement.

However, the slow progress of the dashboard development was noted by PensionBee CEO, Romi Savova, who stated that it was first mentioned in 2002. Smart Pension head of policy and communications, Darren Philp, added that a pensions dashboard is "long overdue".

During the panel session there was debate surrounding how to get the dashboard up and running, and whether all of an individual's pension information needs to be on the dashboard right from the start. Philp said the big question is whether the state pension should be on the dashboard from day one, because for many people the state pension is a big chunk of their retirement.

There was also the question of whether fees should be available to view on the dashboard. However, this could all affect when the dashboard will be ready available to the public. Savova said the main trade-off will be how soon does the industry want to get the dashboard live and "that really should drive what is achievable".

"The industry has no common format for reporting charges today, and if we have to go through that process first before we can get the dashboard live then we're definitely in the middle of the process of getting a dashboard," she said.

Smith, who drew up the plan for automatic enrolment, believes that compulsion of data from providers can't start until 2022, and that we will start to see a comprehensive dashboard by 2024. Savova agreed for the most part with Smith, but she does not think the dashboard will be comprehensive by 2024. "I think there will be a staging time that will likely begin in 2024," she said. Also taking part in the debate was Royal Mail Pensions and Civil Service head of engagement, Mick Mulligan, who added that 2024 was a "reasonable timeframe".

Good data

It is no surprise that the focus on schemes having good data was a key theme of the day. Arc Pensions Law, Anna Copestake, praised the regulator for pushing the industry in the right direction when it comes to data. She also noted that when you think about data, you should focus on getting back to basics – it's about paying the right people, the right benefits at the right times.

"From my perspective it's not just about data. Data is the bedrock, but it's about what can you check that data against? There's another half of that story…ultimately it's against what's in the scheme documentation to work out what the member requirement is. It is the core trustee legal duty to administer the scheme as set out in the legal documentation."

However, Copestake did not shy away from the fact that the pensions industry might be falling short, as data is often unreliable. "The regulator knows

Sponsored by

mistakes will happen, and we know mistakes will happen, and there's nothing we can do about it."

Whilst nothing can be done to stop mistakes occurring, ITM does help lots of schemes to put them right. Blue Prism account manager Adam Reynolds may also have a solution, as he talked to attendees about the company's Digital Workforce that automates many of the processes holding financial organisations back. He explained that simply put, it is software that emulates what humans are doing.

"It interacts with your current systems and applications the same way your staff do, there's no invasive techniques and it's code free." There are many benefits to the software, Reynolds said, but one of them is that no human errors are made, which take time to rectify. "That's one of the main things that customers come back to me and say they have realised," he noted.

De-risking

Copestake noted that the industry has moved away from "if you haven't got good data you might not get a good price, to if you haven't got your data in line then you probably won't get a seat at the table".

De-risking was also discussed in detail in a panel session featuring representatives from three different companies that offer de-risking options in their own way. Featuring on the panel was Clara Pensions CEO, Adam Saron, who said that de-risking is all about making "pensions safer for the member".

With regards to consolidation, Saron said that is not only about costs but it is also about governance, and there is also the question of covenant, as he believes you can improve member outcomes with a stronger covenant.

Saron noted that Clara Pensions offers a bridge to buyout, noting that a buyout is the "gold standard" for pension schemes. However, TPT Retirement Solutions head of direct distribution, Adrian Cooper, explained that his firm operates as a DB master trust, aimed at schemes with assets between £25 million and £500 million, where they can achieve "economies of scale".

With regards to the digital world and de-risking, Aviva commercial lead, John Smitherman-Cairns, said as a company they "completely buy in to digital engagement with customers" because a significant proportion want to engage digitally. However, he said that once people hit 65 they see a real turning point with people who want to engage digitally.

"It's not a one-size-fits-all; you need to be able to engage with people digitally, but we have customers that need to be able to engage with us in a way that suits them," he said. He stated that he has a team focused on engaging with people over the phone, particularly for members of buyout schemes, he said, who tend to be older.

Rounding up the day, ITM director Matt Dodds said that all of the speakers had their own points to make. "Almost every presenter has talked about being on a journey of some description, whether that's journey to buyout, journey to better efficiency etc," he said, adding that everyone is on their own journey and it's completely different. "That's good for us because it makes things more interesting."

Data in the wrong hands

One of the highlights of the day was a talk by comedian Bennett Arron on how having his identity stolen has impacted his life. He was one of the first major victims of identity theft in the UK, with companies claiming he owed thousands of pounds to banks, phone companies and department stores – but it wasn't him that had racked up this debt.

It all happened 20 years ago, when he was about to buy a house, but due to this identity fraud, was unfortunately denied a mortgage and was left homeless. The process of clearing his name was long and drawn out, taking him two and half years, by which point house prices had soared, leaving him unable to get on the property ladder.

But how was the identity thief able to commit the crime? "The home shopping company had sent out little postcards to people saying 'would you like a catalogue' to anyone that had received one of these in the past," Arron explained. "Even though I had my post redirected this had filtered through to my previous address. The guy moved in there, said yes, and they sent him a catalogue.

"He ordered something, and set up an account in my name. With this account he went to a mobile phone shop and said this is me, 'can I have a phone', and he was given two, with these two proofs he went to a bank, credit card company, building everything up from this one little post card."

Investing in infrastructure with greater stability?

If you want to broaden your investment horizons, Schroders can help you get to where you want to be. With over $2.3 billion in infrastructure finance, we are one of the top-five most active global investors in European infrastructure debt.

Our commitment to private assets and long-standing reputation for reliability and efficiency mean we have every tool you need to pursue your long-term goals.

Please remember that the value of investments and the income from them may go down as well as up and you may not get back the amount originally invested. Infrastructure assets are subject to greater illiquidity risk.

Source: Schroders, Preqin as at 31 December 2018. Capital raised since January 2016 to December 2018.
For professional investors and advisers only. Marketing material issued by Schroder Investment Management Limited, 1 London Wall Place, London EC2Y 5AU. Registration no. 1893220 England. Authorised and regulated by the Financial Conduct Authority.

For what matters most. Schroders

PENSIONSAge

Sponsored by

Schroders

What could derail Britain's infrastructure investing boom? – *Claire Smith considers potential developments that may negatively impact upon infrastructure investment* **p44**

Building momentum – *After years of publicity, DB schemes are increasing their allocations to infrastructure. Alastair O'Dell reports* **p46**

Infrastructure focus:

The foundations for growth

Schroders

Sponsored by

What could derail Britain's infrastructure investing boom?

Claire Smith considers potential developments that may negatively impact upon infrastructure investment

The UK has for many years been heralded as a treasure trove of investable infrastructure assets. Core infrastructure equity has been generating double-digit internal rates of return (IRRs) and there has only been one instance of an A-rated UK infrastructure bond defaulting, over a 34-year period (versus 10 in the US)[1]. However, sceptics fear that may be coming to an end on the wave of some recent developments.

- Firstly, the Labour Party has stated a desire to renationalise all infrastructure assets should it come to power.
- Secondly, the UK water and energy regulators, Ofwat and Ofgem respectively, have stated publicly that infrastructure asset owners should not be making such large profits off the back of their investment into core UK assets.
- Thirdly, Brexit. While many believe this won't overly impact UK investor demand for UK infrastructure assets, currency volatility could scare off foreign investors seeking the low volatility, highly predictable, cashflows that infrastructure usually offers.

We will analyse each of these factors in turn and consider the impact on private infrastructure equity and private infrastructure debt.

Labour government would renationalise

Labour's 2017 manifesto and subsequent policy announcements have stated the party will renationalise some or all of the water, energy and rail sectors, along with Royal Mail and a number of PFI deals (private finance initiatives).

There have been varying estimates of how much it would cost to renationalise all UK infrastructure. The Centre for Policy Studies estimated it would cost over £55.4 billion for energy, £86.25 billion for water, £4.5 billion for Royal Mail, and £30 billion for PFI nationalisation, although they note this estimate is particularly uncertain[2].

Figures from *Infrastructure Investor,* a specialist publication, show that since PFI's inception, in 1992, there have been 716 operational projects with a total capital value of £59.4 billion[3].

The Social Market Foundation, commissioned by a group of water companies, estimated that the upfront cost of renationalisation would be £90 billion, which includes a 'typical' acquisition premium of 30 per cent[4].

The disparity in the estimates stems from a few factors, such as whether the government would pay the regulated asset value (RAV) or the enterprise value (EV) for the equity component, which can differ significantly depending on the sector and the asset. Even for assets that don't have a regulated asset value, equity valuations can vary markedly depending on the calculation methodology and the assumptions used in the modelling. This makes the acquisition price for an equity asset especially uncertain, particularly where there is a bilateral negotiation with a captive buyer and not a competitive bidding process.

Conversely, debt to private infrastructure companies is facilitated through either bonds or loans. These debt instruments are legal contracts between two parties that clearly outline the principal and interest payment schedules, so there can be no room for negotiation on the value of the debt. The main risk for debt holders is if the debt is prepaid before the end of the agreed term and there is no protection for such an outcome. If renationalised, a UK government may elect to prepay the debt early, as it may be able to refinance it more cheaply through the issuance of government bonds.

Regulatory risk

There has been a lot of discussion over strategic UK water and electricity assets and their performance versus the profits taken by their owners.

The main criticisms have been around the price set for consumers and the assumptions in the cost, which lead to large profits paid to the equity owners, while some argue the service is sub-par. Another point of contention has centred around companies structuring their finances with offshore lending facilities, reducing or negating the level of corporation tax they pay. This in part is due to tax deductions on interest payments to these offshore vehicles.

When Ofgem and Ofwat set energy and water prices, they factor in the cost of servicing debt. Some sceptics argue they have been too generous when setting the funding costs that have historically generally been less than budgeted, increasing profits for the asset owners. Regardless of whether or not this is true, it is fair to say that in future even if the budgets for interest on debt are reduced, it will affect the equity owners' profits rather than the returns that debt holders receive, as debt returns are contractual and equity dividends are not.

Brexit

We do not believe that Brexit will affect demand for core UK infrastructure. A key feature of infrastructure is that it relates to an essential service that is generally not transportable between countries. So, whether Britain is part of the European Union or not, this shouldn't affect the UK's need for water, energy, social housing, and so on. However, where Brexit does have an impact is on the UK currency.

At the start of 2016 £1 bought €1.358. On 1 March 2019 a pound only bought €1.161, a fall of 14 per cent. Given that the final outcome of Brexit is still impending, many foreign investors are waiting before committing to an increased exposure to the pound.

For equity owners, we have seen a tendency to hold on to UK assets until Brexit passes and other investors become more comfortable with the pound. This has reduced the supply of investable equity assets in the UK – an advantage for equity owners who have the luxury to be able to wait out the storm.

For debt, as it has a legal maturity date, it needs to be refinanced regardless of market conditions. Less foreign investors lending to the UK could actually lead to an increase in returns on infrastructure debt, particularly if the European Investment Bank stops its historic practice of providing 50 per cent of the debt to UK infrastructure assets. The reduction in liquidity could prove profitable for investors still willing to lend in the UK, either as they have sterling liabilities or if they're able to hedge their currency exposure (or withstand it).

Conclusion

The potential risks and rewards of investing in UK infrastructure have clearly changed significantly over recent years so investors need to rethink how they approach such assets. The main trends we have seen, in the industry – potential renationalisation, regulatory reforms and Brexit – may all pose significant risks for UK infrastructure equity owners. Conversely, we think these exact challenges may actually increase the opportunity for investors in debt who are willing to lend to UK infrastructure assets.

Written by Claire Smith, alternatives director, Schroders

In association with Schroders

[1] Moody's "Infrastructure & Project Finance: Infrastructure default and recovery rates, 1983-2017"

[2] "The Cost of Nationalisation", Centre for Policy Studies, 21 January 2018.

[3] Infrastructure Investor, "UK's Labour vows to nationalise PFI deals", 26 September 2017.

[4] "The cost of nationalising the water industry in England", Social Market Foundation, 5 February 2018.

Building momentum

After years of publicity, DB schemes are increasing their allocations to infrastructure. Alastair O'Dell reports

Infrastructure investment has evolved substantially during its decade-long path to becoming an established option for defined benefit (DB) pensions schemes.

The Investment Association's (IA) 2018 survey stated DB investment is becoming "more prominent" and expected it to be a "key growth area in the coming year". IA asset manager members increased their holdings from £29 billion to £40 billion during 2017.

Infrastructure provides an illiquidity premium, extra returns for long-term commitment. Assets typically provide contract-based fixed or inflation-linked cashflows, used to match liabilities.

Pensions Infrastructure Platform (PiP) chief executive, Paula Burgess, says: "Investment-grade debt, as well as core and core-plus equity assets, have a low sensitivity to GDP and little or no market risk."

Public infrastructure

LGPS infrastructure investment has been gaining momentum since 2011, when the Treasury set a £20 billion target for public projects that would raise allocations from 1-10 per cent. The creation of eight pools complicated matters and GLIL Infrastructure only recently emerged as the leading platform *[see boxout]*.

Government initiatives tend be greenfield projects that include construction risk, while many investors seek stable and predictable cashflows. USS head of real assets, Gavin Merchant, says: "This leads them to focus more on brownfield assets, which are already well developed and have a track record."

One notable exception is the Thames Tideway project. The government provided guarantees against low-likelihood but high-impact risks for the major construction project. "This was an excellent example of how public-private collaboration resulted in a good basis for both," adds Burgess.

Scheme maturity is increasingly a barrier for closed schemes. "The Osborne-inspired overexcitement was probably borne of the misconception that DB schemes have very long-term liabilities," says PTL managing director Richard Butcher. "While local authority schemes remain open, the vast majority of private ones are closed and their time horizon limited. They will not be building roads and holding them for 100 years."

Illiquidity premium

The success of infrastructure has brought pressure on returns. "Over recent years, as more investors identified the benefits, more capital has been invested," says Merchant. "This has created significant additional demand and contributed to increasing market values. We have seen returns compress across the entire capital structure."

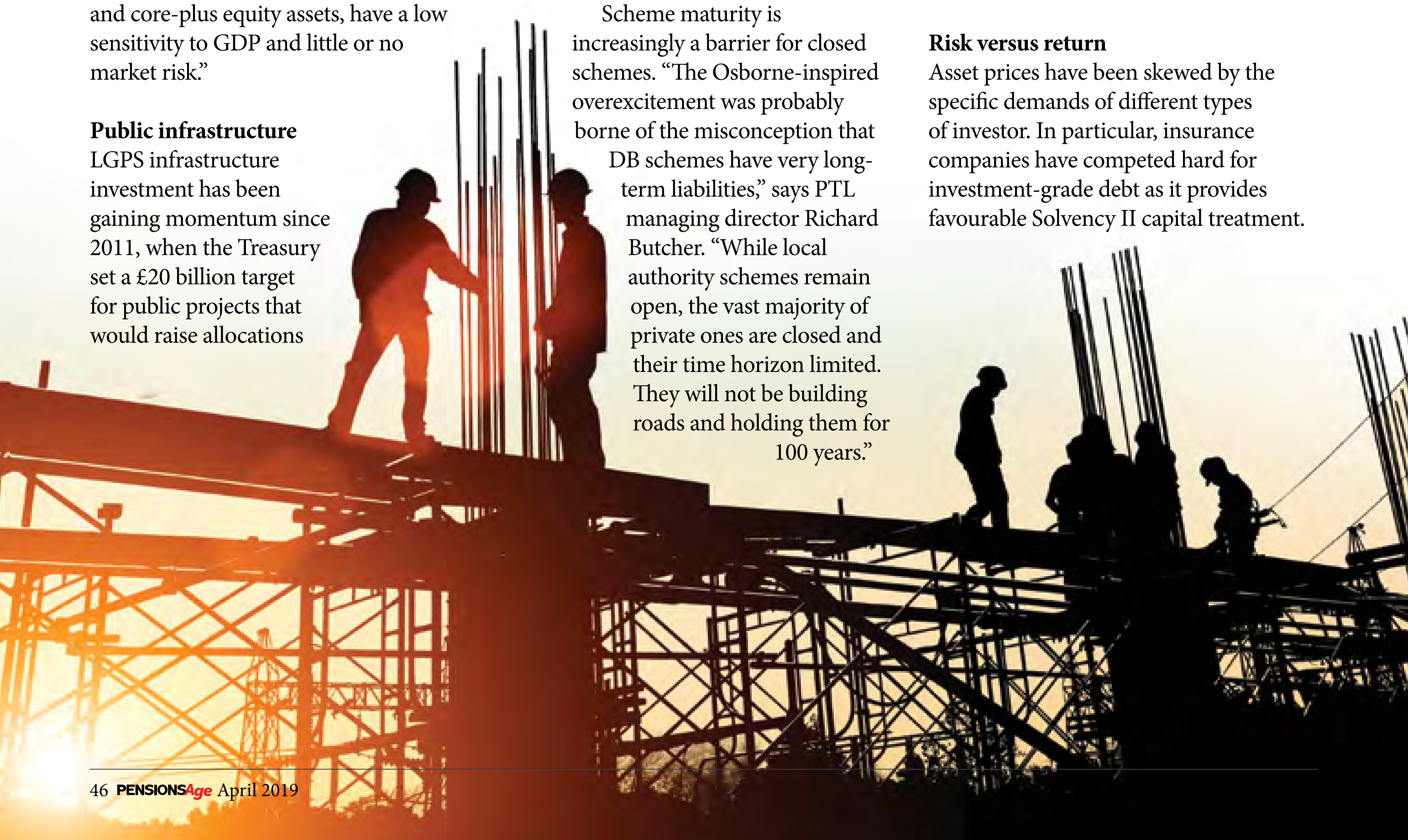
Merchant adds that USS has still been able to originate and execute attractive investments by "focusing on where we have something unique to offer on a transaction".

Greater Manchester Pension Fund assistant director, Paddy Dowdall, notes that in just a few years the anticipated returns from airport equity has fallen from around 15-9 per cent. "The compression of returns, across all asset classes, means that the focus on fees becomes more important," he says.

It's wise to pause at times of high prices and tight rates of return, according to Burgess. "Opportunities can still be found, especially if there is willingness to invest time in building relationships and understanding particular sectors."

Risk versus return

Asset prices have been skewed by the specific demands of different types of investor. In particular, insurance companies have competed hard for investment-grade debt as it provides favourable Solvency II capital treatment.



Pension funds therefore have a relative advantage in junior debt, according to Schroders alternatives director, Claire Smith: "We see a good opportunity."

The spread over investment-grade tranches is around 3 per cent with expected losses increasing just 30bps, according to Smith citing Moody's 36-year dataset. "The increase in expected returns is 10 times the increase in expected losses. The junior market is less well known and there are fewer participants," she adds.

Junior debt, typically BB-rated, is issued by corporations large enough to tranche debt, including utilities and airports. It also often results from the consolidation of project finance.

Schroders' strategy is to lend to core, stable borrowers on a secured subordinated basis, one step up the risk spectrum, and on a senior secured basis to companies that do not quite provide stable cashflows – both for a maximum of 10 years. "As long as the risks are adequately explained to clients, there are opportunities in senior secured infra-like companies," adds Smith.

In Europe, banks aren't as active in the junior space. Smith says: "We originate the opportunities directly with the sponsors, which requires internal underwriting and structuring. The smaller pool of capital chasing these opportunities means the rewards are very good."

Butcher adds: "*[Lower-rated debt]* is fine as long as it matches your risk profile, if you are willing to accept additional risk for additional return. We are in a lower-for-longer environment, for all asset classes, so there is little room for manoeuvre."

Alignment

Private markets are less transparent than public ones so nothing should be taken on trust or, as Burgess puts, it "the basis of trust is the alignment of interest".

The £64 billion USS has the scale to support an internal team that is completely aligned with its 400,000 members. CEM Benchmarking found the team saved £61 million on its DB section's 2017 investments.

However, most UK pension schemes are not of sufficient size to directly invest hundreds of millions of pounds and contribute to governance, perhaps taking a board seat, and therefore need to invest in pooled funds.

Equity mandates typically include carried interest – but this can incentivise the manager to sell even if the scheme wants to remain invested. Burgess warns that incentives should not encourage the manager to deploy capital quickly, encourage risk taking or prematurely sell assets to crystallise payments.

Debt does not have the carried interest problem as contacts naturally end but Smith agrees that "alignment is definitely an important issue". Schroders overcame it by creating an AIFM-regulated joint venture for its infrastructure business – its teams take stakes that cannot be sold for 10 years. "The platform's growth depends on fund performance and reinvestment, which incentivises the team to grow the platform in a stable and low risk way."

ESG

Infrastructure is particularly suitable for environmental, social and governance (ESG) investment, given strategies' long-term commitment and high concentration.

USS has a five-person responsible investment team; ESG is fully integrated into its processes and it uses its board positions to ensure ESG is considered appropriately. "For example, resilience to physical climate change is thoroughly assessed, particularly with regard to infrastructure," says Merchant. "Several of the scheme's direct infrastructure holdings have produced detailed climate scenario models as part of their resilience planning."

All GLIL funds have very clear policies for their listed assets and it is in the process of making replicating that for private assets. Dowdall says: "In many cases we want to have more direct involvement in the ownership of the underlying assets. One of the advantages of a direct platform is that you can improve governance."

Schroders applies a scorecard approach with 13 of its 48 criteria dedicated to ESG. It conducts its own research into issues from carbon emissions to workplace accidents and the effect on local communities.

Case study: GLIL Infrastructure

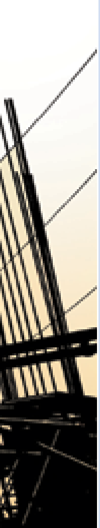
The Greater Manchester Pension Fund and the LPFA set up GLIL Infrastructure in 2015 and other LGPS funds have since joined. "We had a desire to disintermediate managers and invest in UK infrastructure directly," says Dowdall.

The founding LGPS schemes had grown increasingly uncomfortable with "high fees and ownership cycles" linked to the interests of the manager. "The manager aims to make a profit between buying and selling, but this incurs transaction costs and pension funds would like to hold them in perpetuity.

"We wanted a vehicle that would reduce the fees and let us control our destiny – and influence the governance of infrastructure assets from an ESG perspective. Local authority pension funds have a wider interest in society."

GLIL has commitments totalling £1.8 billion with £1 billion already invested. In 2018 GLIL restructured to become a regulated alternative investment fund, so it can admit limited partners. Entrants to the open-ended fund take stakes in existing and future investments.

"We are trying to build a UK asset owner investment platform that compares with similar ones in Canada and Australia. There is potential for growth from the existing partners and there is very much a desire to work with other LGPS pools."



Written by Alastair O'Dell, a freelance journalist

In association with Schroders

A balancing act

Laura Blows talks to the Society of Pension Professionals president, Paul McGlone, about both the industry's and the society's latest developments

You became SPP president in June 2018. Since then, the industry has seen significant developments emerging, such as DB consolidation, collective DC and the pensions dashboard. How do you think they will bed in throughout your time as SPP president, and beyond?
The good thing about all of those things is that they are all positive developments; they are not responding to a crisis or a problem in the industry, which is fantastic.

Looking at DB consolidators, I think the time is absolutely right for that. Schemes are getting better funded and are looking to do something different from what they've done in the past. I think there is a danger that the market will not be as widespread as people hope it will be. There are certainly benefits for a number of organisations to have consolidators across a range of price points, whereas the *[DWP]* consultation seems to suggest they will all have to be towards the upper end of being relatively secure. There are reasons for that, but *[DB consolidators]* might not deal with all the issues the industry was hoping it would.

CDC is another good news story. We've got a very large organisation that's actively interested in it. That's a huge positive. We've seen so many ideas in the pensions industry over the years that are really good ideas but just never take off. So to have an organisation saying that 'actually, this is for us', is positive, and there are other organisations out there that are equally interested. Even if it turns out to be a relatively niche product for a small section of the industry, that has still got to be a positive.

The dashboard, I must admit I'm a little bit worried about. I think it's a fantastic idea. I can't question the idea that people should be able to go somewhere and see all of their benefits in one place. What worries me is how we balance simplicity and complexity to get something that works. If it's too simple, it won't work. If members go on and all they find is that they've got a pension and the provider, then they will have to go elsewhere to find the information. And if that's all we need the dashboard to be, then we just need the tracing service.

On the other hand, if we make it too complex there's a danger it may just fall over or never get completed. So we have got to tread that fine line where there is enough information on it that it evolves so that people want to go back regularly but without so much on it that it will fail. Then there's cyber risk. If it's not got the right level of security then it's going to be a dream come true for the hackers and scammers.

A lot of these developments for the industry require a lot of work and consideration for their implementation. How does the SPP decide which areas to focus on, and what is the SPP specifically focusing on at the moment?
We're always working on quite a lot of things at the same time and the nature of our membership means we are interested in quite a wide range of things. For example we have a piece of work going on at the moment about auto-enrolment. We're looking at how auto-enrolment works and how we think it can be improved. It's a fantastic success story for the industry. There are 10 million more pension savers as a result of auto-enrolment, so that's great news. But for employers, it's still quite clunky. There are things that can be improved. So we have done some research and we are hoping to publish it this year on how auto-enrolment can be improved.

A key one right now is GMP equalisation. The reason it is important is because of the impact it has on members. There are members out there that stand to have almost financially life-changing amounts depending on how this is dealt with. It is incumbent on the industry and various government departments to get this sorted quickly. We are involved in these groups to try and ensure we get the best outcomes as quickly as possible.

SPP represents the whole range of providers catering for workplace pensions, so I assume they may sometimes have quite strong opposing views. How do you balance that to ensure the SPP still represents the views of all its members?
We think about this regularly. That diversity of opinion is hugely positive. We see it in our evening events, conferences and seminars. For example, our legislation committee isn't just made up of lawyers and the investment committee not just investment people. That has huge benefits as you start to hear the views of people who do not just think the same way as you do. If I walk into a room of actuaries and talk about actuarial things, I tend to not come out with an awful lot new, while I come out of a SPP meeting with a lot of additional information.

When it comes to reconciling views, we tend to take the view that it is not the SPP's job to do so. There's no point me going out to a DWP consultation for example, saying some people thought this and some thought that so on average we thought this very bland thing in the middle. We would rather highlight how there are different views out there and have the policymakers recognise and reconcile them.

When you became president you mentioned a desire to focus on new media channels to reach new and existing members. How is that coming along?
It is coming along but with all these things, it is coming along a bit slower than I would like. Communication is always a huge challenge but we continue to do new things. We are now regularly videoing all of our evening meetings and some of our conference this year. We are looking to reinvigorate evening meetings outside of London. This is all for the aim of getting what we do out to the members in a more effective way. We continue to improve the way that we communicate to members, primarily through email, and one of the projects we have got this year is to review the whole database and communications structure to make sure the right things are going out to the right people at the right time.

Clearly communicating effectively to members is a key issue for you. Is there anything else you would like to achieve before your time as SPP president finishes?
GMP equalisation is important and I think if that goes badly, it will reflect poorly on the industry as a whole. If we start to hear horror stories in the press of members suffering because the industry and government are not doing what is required fast enough, that would be hugely damaging and we have a shortfall of trust in the pensions industry already. We need to regain that trust as a long-term issue. So that's for members and the industry at large. For our membership, it's all about communication. It's about them getting to the end of the year and saying 'I really value being a member of the SPP because of its information and events'.

The final thing is I have to hire a new senior team at SPP before I leave. Our senior person in the office, John, is due to retire before my term of office finishes. I will be looking to hire someone from outside or within the industry, so if anyone is interested then get hold of me.

Written by Laura Blows

Sponsors
AberdeenStandard Investments
M&G INVESTMENTS
NEWTON Investment Management

Sustainability Summit 2019: Sustainable investment can enhance returns

Industry members came from far and wide to discuss what stricter ESG regulations will mean for the pensions landscape, what more needs to be done to promote sustainable investment and how to achieve enhanced returns from those investments

As we move into the future, with the rest of the world focused on the chaos of Brexit and Donald Trump, experts from across the industry gathered to discuss what must surely be a much more important topic: sustainability.

On a wet and cold Tuesday in the Waldorf Hilton, the weather was the initial focus of discussion. Not, however, the weather outside that day, but rather climate change, which is becoming a more and more obvious issue as time goes on. To help tackle the rapidly changing climate, attendees talked about what the pensions industry could do. Sustainable investment was obviously a hot topic, and how to make it financially viable as well as environmentally friendly, while financial regulators' guidelines were examined as to whether they were doing enough.

More needs to be done

There was a mixture of commendation for the amount of progress that had been made and calls for further and faster improvement. Proceedings were kicked off by UK Sustainable Investment and Finance Association (UKSIF) chief executive and keynote speaker, Simon Howard, who began with a rousing cry for people to follow the new regulations and, if possible, take things further. Noting that the industry was at a turning point, he began: "If everyone in the pension value chain does what the new pension rules obliges them to and, ideally, if they go further, we should see significant change in how UK pensions invest.

"This is the outcome that we want, what society wants and what the government wants, and I'm sure what you all want as well. The outcome we want is that schemes plan properly to provide benefits in the future, radically transformed by climate change and society's response to it."

He warned, however, that the industry needed to go "much, much further and far, far quicker" in order to prepare businesses and people for the rapid environmental changes. He called for pension schemes and their trustees to ask their advisers about sustainability issues and insist on satisfactory answers.

Howard continued: "If the answers aren't good enough, you must change you adviser or your fund manager or whoever is the problem. If you are a service provider, make sure you can answer pension scheme questions."

Financial regulators' progress with ESG guidance was praised but, again, the need for further progress was highlighted. Howard detailed that a systems-wide problem needed a systems-wide approach to be overcome, calling for the government and regulators to work together and with the industry to bring together climate science and policy with financial regulation. Howard encouraged the establishment of a new sustainable finance committee.

He concluded: "We want this new committee to be powerful, to be able to commission enquiries into areas of finance that may not be managing climate related risk responsibly, and we want the committee to have the power to require regulators to take action.

"Pension funds exist to give people a secure retirement. We want and need pension schemes to be the best exponents of responsible investing. This need will fundamentally effect the license to operate of all pension providers and schemes. That license to operate comes

Pictet Asset Management Schroders World Gold Council Supported by UKSIF UK Sustainable Investment and Finance Association

initially from the likelihood of them funding retirement, but going forward it must depend on them not damaging the environment."

Strong sustainable returns

Howard was followed by an eye-opening and engaging presentation from Pictet Asset Management senior investment manager, Justine Vroman, discussing global sustainable credit and ways to ensure positive returns while following ESG regulations. She stressed the importance of selecting robust and sustainable companies that will be "successful in adapting to the challenges".

In keeping with the tone of the conference, Vroman detailed that ESG can be beneficial for credit performance. "ESG actually complements traditional credit analysis," she stated. "ESG can enhance credit performance, and ESG and traditional credit analysis are mutually reinforcing. As an asset manager we should be using their work as a starting point for our own analysis."

Audience engagement was particularly high at this year's summit, and once Vroman had fielded questions from the industry, the discussion turned to how equity investing can generate an income stream that complies with the sustainability framework. Newton Investment Management global equity portfolio manager, Raj Shant, explained that, if a pension scheme is reaching maturity or its decumulation phase, equity investing can provide a sustainable income.

The asset management industry was praised for the majority integrating ESG considerations into their investment

approach and decisions. Shant added: "That is a huge amount of progress and I think the largest proportion of the world's asset management industry now does do that to some degree, increasingly better and better."

It was also noted, however, that the final mandate for portfolio managers is delivering the best risk-adjusted returns, and therefore not always taking ESG into consideration when the going gets tough. However, Shant explained that this didn't have to be the case: "We are putting the ESG considerations right up there with a par with those financial considerations. You're not having to give up returns, you can actually help to generate better returns for your investors."

Trustee responsibility

Bringing a legal perspective to the summit was ClientEarth lawyer Joanne Etherton, who encouraged trustees to take a more proactive approach to sustainable investing, and to hold their investment managers to account.

She explained: "Pension trustees can't just leave it to chance how those investment managers are acting. Asset owners such as pension fund trustees are fiduciaries and therefore need to act prudently in carrying out their investment duties on behalf of the pension fund members.

"They need to think about who they are instructing to carry out their investment duties, as the legal responsibility for investment remains with trustees."

Three broad business strategies were examined: 'business as usual', 'manage decline' and the 'adapt and resolve approach'. Etherton argued that 'adapt and resolve' was the most appealing option, as it "involves an acknowledgement of the trend before decarbonisation".

She continued: "Most companies will need to change to some extent, but it will require time, money and willingness to

invest in innovation."

Trustees and other industry members were also encouraged to respond to and follow the new stewardship guidelines.

The conference was concluded with a call for more transparency in the industry, as more people are wanting to support sustainable investments, members need to know what they are investing in and how to invest in the areas they feel passionate about.

Speaking at the summit, Schroders ESG product manager, Belinda Gan, said: "There is growing member pressure. In our global investor study, which we've run over the past three years, we've seen strong and increasing interest in sustainable investing, across all age cohorts.

"So sustainability has become too important to ignore from an investment point of view, a regulatory point of view and a member point of view."

ShareAction senior campaigns officer, Lauren Peacock, added: "There's a lack of transparency, and this creates confusion around what a sustainable fund is, what it is trying to achieve, and how it intends to do that. If sustainable investing is done well, we believe it enhances long-term returns. But if it is done poorly, it can create problems."

Although we can't halt climate change entirely, this conference brought a sense of hope that, as people from so many different backgrounds were putting sustainable investment first, we can work together to protect the planet and future generations.

Written by Jack Gray

Summary

• In recent years, more pension schemes have made use of professional trustees and trusteeship has become increasingly professionalised, as regulatory requirements on trustees have increased and the task of trusteeship has become more complex.
• The industry welcomes new standards for professional trustees, although some hope these will become tougher over time.
• With further tightening of regulatory requirements affecting lay trustees, efforts to provide more support will continue, possibly including more remuneration of lay trustees.
• Other models of scheme governance may be considered in future.
• There are fears within the industry that numbers of lay trustees will continue to fall.

The weight of responsibility

David Adams explores the pressure of increasing professionalism within the pensions trustee board structure

The UK has an illustrious history of amateur endeavour, which has created some of the most valuable features of our society, such as the charity/voluntary sector. But as the nature of pension scheme trusteeship has changed over time it has become apparent that this may be one aspect of national life where unpaid lay trustees would benefit from additional support to help them complete their duties. Consequently, in recent years pension schemes of all kinds have made more use of professional trustees, while trusteeship has been forced to become more professionalised in general, as regulatory demands have increased.

"It's clear that trustees in pension schemes are operating in a trickier environment than 10 or 20 years ago," says Pensions and Lifetime Savings Association (PLSA) policy lead for investment and trusteeship, Caroline Escott. "Being a trustee is more complicated than it's ever been."

Other trends in pensions have helped raise the stakes for many schemes, particularly for DB schemes, says KPMG pensions advisory director, Claire Whittaker. "We're moving to a stage where DB scheme trustees are being asked to make pretty big decisions, like whether or not to go for a buyout," she explains.

PTL managing director and professional trustee, Richard Butcher, believes multiple factors have driven an increase in the use of professional trustees and in the professionalisation of trusteeship, but he believes the regulator's drive to improve scheme governance is the most important element. "The regulator also has a preference for professional trustees because they help mitigate conflicts of interest," he adds.

Raising standards

There was no consistent, objective way to assess the capabilities of professional trustees until February 2019, when the Professional Trustee Standards Working Group (PTSWG), which was established and supported by the regulator and has been developing a set of standards for professional trustees since 2017, published those standards, alongside details of an accreditation process. To hold accreditation, professional trustees will now have to complete an initial application process, including a fit and proper person test. They will also have to complete a minimum of 25 hours of learning and development every year.

The Pensions Regulator executive director for regulatory policy, analysis and advice, David Fairs, suggests the standards should be seen as part of a broader drive on the part of the regulator to improve trusteeship, which has included its 21st century trusteeship campaign.

"We have this overall focus on getting good member outcomes and therefore we want to ensure that trustees are governing pension schemes to the highest possible degree," says Fairs. "We think professional trustees have a particular role to play, so it's right they should be held to a higher standard than a lay trustee."

Dalriada Trustees' senior trustee representative, Vassos Vassou, who is also a council member at the Association of Professional Pension Trustees (APPT), suggests that one important purpose of the standards will be to discourage those who have merely 'dabbled' as professional trustees from continuing to do so.

Butcher is not convinced. "I don't think they create a high enough bar to entry," he says. "They're not particularly difficult to comply with. How can you claim you've driven up standards if you leave everyone who was in the market still in the market? It's a good start, but more work is needed." Both Vassou and Pensions Management Institute (PMI) technical consultant, Tim Middleton, who were involved in drafting them, confirm that the standards are intended to evolve over time.

Fairs says the regulator also plans to consult on the possible introduction of a benchmark against which member-nominated trustees (MNTs) should demonstrate their knowledge and understanding of issues affecting their schemes, although this benchmark would not be set so high as the accreditation requirements for professional trustees.

But many fear this will add to the already heavy burden of regulation applicable to lay trustees; and will continue to reduce the number of people prepared to act as lay trustees. As the Association of Member-Nominated Trustees (AMNT) committee member, and RBS Group former MNT, Stephen Fallowell, puts it: "Members want their voice to be heard; and there's a danger that voice will be dampened, or extinguished by the move to professionalise trustees."

Some schemes and sponsoring employers are already running programmes to spread awareness among scheme members of the need for effective lay trustees; and to provide constructive feedback and encouragement to individuals who seek to become lay trustees but don't get through the recruitment process.

Time and money

There is also general agreement about the need to continue to improve training, education and other forms of support for lay trustees. In addition to the regulator's Trustee Toolkit, training and education is available from multiple sources, including the PMI and AMNT. But Middleton says it appears that many trustees still fail to dedicate much time to it – sometimes because employers fail to allow them enough time to carry out their trusteeship duties. "It would help if employers could be more supportive," he says. "We do hear from lay trustee group members that they find themselves under pressure from employers not to spend so much time on trusteeship. I think it would be helpful if the DWP could make a statement reminding people of the importance of lay trustees being given time to do the job."

Some schemes pay MNTs and ENTs to be trustees, as well as reimbursing them for their expenses. Whether or not remunerating trustees is appropriate depends on the specific circumstances of a scheme, says Independent Trustee Services (ITS) director Rachel Croft. "It's such an important role that I don't think people should be doing it off the side of their desk or in their spare time if they've got a full-time job," she says.

Vassou can also see a good argument for paying lay trustees in some circumstances, particularly in light of the large amounts of money a scheme may be paying to advisers, even though "what they do is sometimes of questionable value to members". But Middleton worries that if remuneration became standard practice there would be a risk this might attract some people to trusteeship for the wrong reasons.

There is also a theoretical risk that remunerating trustees could lead to them being regarded as professional trustees by the regulator and thus subject to the professional standards – but this should only happen if a trustee is also remunerated by a second, unrelated pension scheme. Fairs says the regulator does not have a view on the rights and wrongs of remunerating trustees in general. He seeks instead to highlight the professional and personal benefits individuals gain from serving as a trustee.

Sounding board

If it proves impossible to find lay trustees, another possible solution would be for trustee boards or sole trustees to consult an advisory committee on which some scheme members could sit, but which would have no legal status or liability. "We have seen some of these things already," says Butcher. "Some work well; some work less well."

Escott says the PLSA has also been considering the merits of a governance model in which a small trustee board is responsible for longer-term strategy, but an executive body, perhaps including (for example) investment advisers, an administration provider, an investment consultant, an actuary and a lawyer would have responsibility for day-to-day running of the scheme.

Whether or not more use of professional trustees and more professionalisation of pension scheme trusteeship eventually alters the nature of scheme governance, both trends do seem set to continue.

"The Pensions Regulator estimates that 25 per cent of DB schemes now have a professional trustee appointed to the board and that's something we would expect to expand," says Middleton.

Butcher is among those who are concerned about the position of the lay trustee on the board in the longer term. "We need lay trustees – they bring diversification, they bring that link to the employer and to the membership," he says. "But I'm not sure everyone else agrees. The employer sees the risk of sub-optimal decisions; and I'm not sure regulators and legislators value lay trusteeship as much as we do. They are ramping up the pressure on all trustees – so they are part of the problem when it comes to retaining lay trustees.

"So I'm afraid I'm not optimistic about the future for lay trustees – it's just getting more and more difficult."

Written by David Adams, a freelance journalist

Keep it professional

Tim Middleton discusses the newly-launched standards for professional trustees

Until very recently, professional trusteeship has been unusual in that there have been no formal barriers to entry and no regulatory standards imposed on those practising in this sector. This has of course been serious grounds for concern. The GP Noble scandal demonstrated that those users of professional trustee services had no guarantees about the capability of those they appointed or the quality of work that they would provide. In response, the Association of Professional Pension Trustees (APPT) was established in 2012, though membership of this body still remains voluntary. With an increasing number of schemes appointing professional trustees to their boards, it is now more important than ever that there is market confidence in the credibility of those operating in the professional trustee sector.

Responding to this, in 2017, The Pensions Regulator (TPR) formed a working group which was tasked with devising a formal regulatory structure to cover the UK's professional trustee sector. Chaired by Andrew Bradshaw of Ross Trustees, the Professional Trustee Standards Working Group (PTSWG) included representatives from APPT, the Pensions Management Institute (PMI), the Association of Corporate Trustees, the Pensions and Lifetime Savings Association (PLSA) and TPR itself.

Agreeing standards – and associated accreditation requirements – proved to be a considerable challenge. Whilst TPR's description of what constitutes a professional trustee was clear enough, it was important to determine the type of pensions arrangement to be covered. Early on, the PTSWG decided that Small Self-Administered Schemes should not be part of its remit. Another concern was ensuring that the standards should be applicable to both firms and sole traders and that they should be realistically achievable for both.

Following a consultation at the end of 2017, the PTSWG's remit was expanded to ensure that its views appropriately reflected the views of all the different commercial models operating in the UK.

The standards themselves are set out in three key area schedules. The first covers general trusteeship, but following comments received during the consultation exercise, addresses those characteristics that distinguish the professional trustee from a layman. Central to this is the concept of 'fitness and propriety' and is consistent with standards required of master trust trustees. Other standards in this section address topics such as dealing with conflicts of interest and the circumstances behind a professional trustee's appointment to the board.

The second schedule covers those professional trustees who chair their board, and the third is specific to sole trusteeships. A particular concern of the working group was that sole trusteeship should only be undertaken by firms where more than one individual would provide governance for a scheme. This would provide diversity of opinion in a way that would not be possible from a single individual.

The most difficult facet of the group's work was to agree suitable accreditation requirements that would appropriately assess understanding of and compliance with the standards. The requirement for completion of the trustee toolkit and the award in pension trusteeship demonstrates rudimentary technical knowledge, but the new soft skills assessment is designed to show that an applicant can display the behavioural competencies that characterise an effective professional trustee. After the experience of the GP Noble case, the inclusion of a 'fit and proper' test is crucially important.

On an ongoing basis, accredited trustees will need to submit an annual attestation that they remain fit and proper and complete at least 25 hours Continuing Professional Development.

With professional trustees playing an increasingly influential role in pension scheme governance, the establishment of formal standards has been long overdue. In a recent poll, 80 per cent of PMI members believed that the introduction of the standards will improve the quality of scheme governance significantly. It is important that there should be both challenging barriers to entry and ongoing behavioural requirements. Whilst the working group is confident that it has set the bar at the right level, the evidence of success will be improved retirement outcomes for members.

Written by PTSWG member Tim Middleton

- Technological innovator in active asset management
- 20 years of expertise in multi-factor investing
- >40% of assets are managed in line with sustainable criteria

www.quoniam.com/en/ESG

Quoniam
QUANTITATIVE INVESTMENT ENGINEERING

Sponsored by

Quoniam
QUANTITATIVE INVESTMENT ENGINEERING

Multi-factor investing for fixed income *– Dr Philip Messow explores the role of active, quantitative investing in corporate bonds* ***p58***

Factoring in bonds *– Elizabeth Pfeuti examines how factor investing can be applied to fixed income* ***p60***

Focus on factor investing:

Its role within fixed income

Dr Philip Messow, associate partner fixed income, Quoniam Asset Management

Quoniam
QUANTITATIVE INVESTMENT ENGINEERING
Sponsored by

Multi-factor investing for fixed income

Dr Philip Messow explores the role of active, quantitative investing in corporate bonds

Being able to simultaneously consider large amounts of relevant information is crucial when it comes to making the right investment decisions. In view of the ever-increasing deluge of data, systematic, factor-based investment approaches are becoming all the more important. A decisive force for success is to have an appropriate mix of different factors.

When it comes to answering the question as to what is the right mix of risk and return, it is increasingly clear that looking at the differences between individual asset classes alone is not sufficient. This is because every asset class comprises several factors, each with its own individual risk-return profile. While this offers many opportunities, it also makes investment decisions much more complex. This is where factor investing kicks in.

Implementation of factor strategies

By now, academic research provides extensive analysis on systematic factor strategies that promise extremely attractive returns. However, numerous obstacles prevent investors from putting these single-factor strategies into practice. For instance, liquidity and risk management play decisive roles – yet they are often ignored in studies.

One other aspect is that factor investing has generated a great deal of interest among practitioners, which means that more investors are trying to capture the popular risk premia. As a result, these premia are set to decrease significantly – or even disappear – over the medium term. Therefore it is essential to develop more sophisticated (and thus more complex) factors in order to be able to capture premia in the longer term.

Furthermore, it is necessary to combine single-factor strategies in an intelligent way as part of multi-factor strategies. The way in which the factors are combined is decisive in determining how successful a multi-factor strategy will be. There are two different approaches. With a top-down factor mix, several portfolios are combined, each of which represents its own single-factor strategy. By contrast, an integrated multi-factor approach processes the information at a single-issue level, i.e. bottom up.

As an advantage of the multi-factor approach, single bonds can be selected to provide a well-balanced, positive contribution with regard to a number of factors. The factor mix identifies issues that have an extremely positive exposure, i.e. a positive impact in relation to one factor, but does not control possible simultaneous negative exposure to another factor.

The choice of different approaches

The effects of these two different approaches can be illustrated by means of an empirical study. In order to illustrate single factor returns, the figure shows long-only-portfolios over a period from January 2005 to December 2018. The investment universe comprises 11,367 bonds ranging from AAA to BBB in ratings.

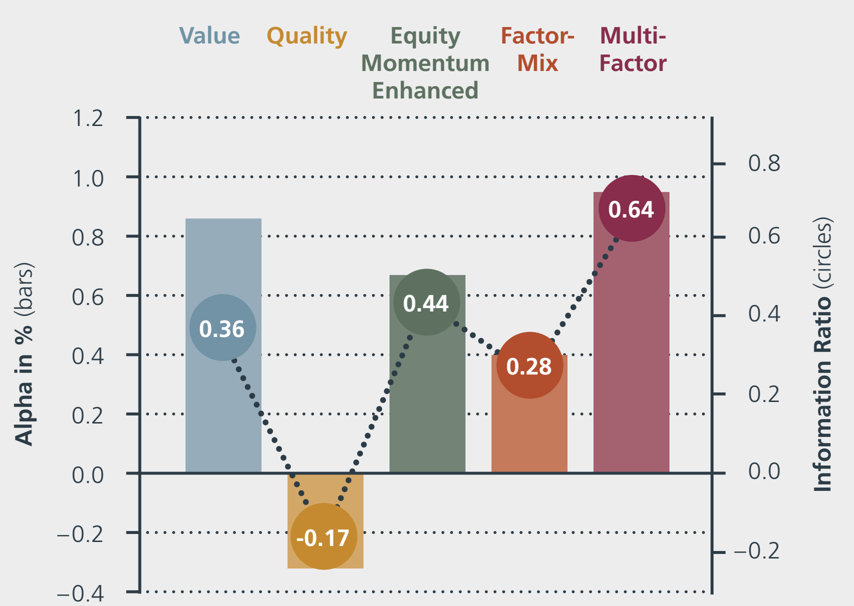
First, three individual factors were considered: 'Value' – which relates a model spread to the market spread in order to determine the attractiveness of a security's valuation; 'Quality' – which aggregates key parameters, including those relating to profitability, leverage and solvency, and finally 'Equity Momentum' – which measures the risk-adjusted performance of the underlying share over a period of 12 months.

Second, the results of the factor mix strategy and the multi-factor strategy are presented. The former combines three individual factors with a ratio of 40 per cent 'Value', 40 per cent 'Equity Momentum' and 20 per cent 'Quality'.

As a result, it is obvious that the bottom-up multi-factor strategy, with an alpha of 0.95 per cent and an information ratio (IR) of 0.64, is clearly preferable to a capital-weighted benchmark. With an IR of 0.64, the multi-factor strategy also achieves significantly better results than the factor mix's IR of 0.28. Incidentally, it makes obvious sense to add 'Quality', a strategy that displays a negative alpha at single-factor level.

Even if the correlation between 'Value' and 'Quality' is not constant over time, both factors are fundamentally opposed. This is particularly noticeable during times of crisis. In such a scenario, 'Quality' – on average, more expensive than the market average – will become (even) more expensive, but 'cheaper' again when the economy recovers. This trade-off between 'Value' and 'Quality' in corporate bonds means that by adding 'Quality' in times of crisis, unwanted tail risks can be reduced. The cushioning effect of mixing factors in these times more than offsets the marginal performance loss experienced during calm market periods. Thus, the maximum drawdown of the multi-factor strategy (-14 per cent) is markedly lower compared to the Value strategy (-28 per cent) and the benchmark (-17 per cent).

Empirical analysis: multi-factor beats factor mix



The returns displayed are calculated after transaction costs, and taking realistic restrictions in terms of liquidity and risk into account (January 2005 to December 2018).

Source: Quoniam

Enhanced risk/return profile

Multi-factor strategies benefit from correlation structures between the factors; as a result, their risk/return profile is significantly more appealing. Whether intentional or otherwise, every bond market investor is exposed to the aforenamed factors.

Hence, it makes sense for any practitioner to manage their factor exposures actively rather than passively, with the aim of maintaining control over factor risks and returns. This applies not least against the backdrop of constant shifts in the factor universe.

In addition to combining sophisticated individual factors, another aspect is important: the structure of the data for analysis and its integration into systematic, factor-based investment approaches. Whereas in the past, structured data served as the basis for investment research, nowadays the analysis of unstructured data (e.g. images, texts, audio) plays an increasingly important role. The latter requires a high-tech infrastructure, with ample performance capability.

Written by Dr Philip Messow, associate partner fixed income, Quoniam Asset Management

In association with Quoniam
QUANTITATIVE INVESTMENT ENGINEERING

Factoring in bonds

Elizabeth Pfeuti examines how factor investing can be applied to fixed income

Summary
- Once a niche part of financial academia, risk factor investing has gained popularity.
- Investors need to be aware of differences in using the approach with fixed income.
- The approach can help identify truly skilled managers or those 'riding the wave'.

Since the financial crisis, a previously niche part of economic theory has become mainstream in investor portfolios and parlance.

Risk factors, a term once only found in academic journals or within the blurb of highly quantitative-led strategies, can now be seen taking centre stage in the portfolios of even some of the smallest pension funds.

Often using the moniker of 'smart beta', these factor-led strategies promise to tease out what drives performance in certain conditions and fails in others. By using these levers carefully, investors – in theory – can ride the right wave at the right time.

They have been so popular that exchange-traded funds running these strategies have outstripped the explosive growth seen in the sector as a whole. The assets in plain vanilla ETFs grew 321 per cent in the decade since 2009, while the money in smart beta ETFs grew 4,870 per cent, according to data by Refinitiv.

However, until recently, smart beta and factor-based strategies were mainly confined to equity investing both in mutual funds and ETFs. Now, they seem set to take over other parts of the investment world, but for different reasons than what attracted investors to stock market-based strategies.

The move to factor investing in equities was largely driven by a "revolution in manager selection", according to Research Affiliates' European research and business strategy lead, Vitali Kalesnik.

"Factor investment and smart beta became popular in equities as investors realised how large fees were in active management," says Kalesnik. "By using factor-based strategies, investors could get active-like performance, but for lower fees."

For investors burned by the financial crisis it was a no-brainer.

Getting smart (beta)

"Factor investing sat between active and passive," says Kalesnik. "There was a need in the market for investors who wanted higher than passive returns, but for a simple, transparent fee."

Whether investors opted for a branded smart beta fund or used other ways of implementing the strategy, the die was set, and the idea took hold.

The next step is to explore how these factors can be applied in fixed income, but it is not a straight copy and paste exercise from one sector to another.

For Amundi head of smart beta and factor investing, Bruno Taillardat, there are many benefits to taking this approach but investors need to be prudent.

"There are differences in how the two asset classes function with a risk-factor approach," says Taillardat. With equities, investors saw factor investing as a pure substitute for beta, although with the potential for some alpha, too.

"Applying a risk factor approach to fixed income, you are not just trying to capture the same beta," says Taillardat. "You will not create a substitute for beta – you will get something additional."

For Quoniam Asset Management head of fixed income, Andrea Dacquin, this "something additional" might come from not only selecting the usual large issuers that appear in many bond funds with more targeted precision, but also finding smaller issuers that have less research coverage.

Dacquin says: "A second consequence of a broader investment universe coverage is usually a higher degree of portfolio diversification, which results in less unsystematic (issuer-specific) risk

in the portfolio, more and smaller active positions, and lower tracking errors."

There is an additional diversification bonus in adding a manager with a risk factor approach to an existing portfolio.

"The return profile of factor strategies tends to differ considerably from traditional investment styles, allowing investors to achieve style diversification between different bond managers," says Dacquin.

Even if a fund manager does not construct their portfolio using a factor-based approach, the factors are still present and are driving performance.

"An important incentive in the use of factor-based strategies in fixed-income is risk reduction, which is achieved by diversification over a number of factor classes that are lowly correlated," Dacquin adds.

Risk management

However, investors need to be aware that there are additional, different factors to consider that do not appear in the world of equities. With credit, which is where the approach is most applicable, credit, duration and liquidity are important factors that can impact a return, says Taillardat.

While some factors like quality or carry are identical or very similar in both fixed income and equities, other bond-specific aspects have to be taken into account when constructing portfolios.

The major difference between factor investing in corporate bonds and equities is that the risk premium is directly observable for corporate bonds – the spread – while it has to be estimated by making model assumptions for equities, according to Dacquin. This should, in theory, lead to "less noisy factor premia estimates" for bonds.

"On the other hand, volatility is much lower in investment grade corporate bonds compared to equities, which means outperformance is more difficult to achieve in a fixed income universe," says Dacquin.

Is this why it has taken so long for the approach to shift across to fixed income?

Shifting sands

MSCI global head of factor index products, Mark Carver, says part of the reason is a lack of data.

"With equities, we have very clear data from more than a century," says Carver. "We can test and determine factors and forecast risk. Other asset classes don't have that level of historical data."

Additionally, due to their nature of being predominantly traded over the counter, transaction costs are higher with bonds, impacting their pricing, and the asset class's liquidity is not the same as equities', many of which are traded every split second.

However, there is a push from regulators to get more bonds traded on exchanges, which should rapidly increase the amount of reliable data that can be used to figure out which factor is driving performance.

MSCI is working on a range of indices across various asset classes against which investors can measure their returns and spot where one factor or another was doing the work.

"Then we will be able to see which managers were truly skilful and those who were just riding the wave," says Carver.

This could also lead to an uptake in the number of investors taking this approach as there has been a perception that while active equity managers often overcharged for underperformance, bond managers have offered value.

"It became apparent, that for equity investors, showing alpha creation outside these factors was hard," said Kalesnik.

Outcome-focused

With the advent of better benchmarks, investors will be able to look closer into how fixed income managers have performed, but that is only one benefit.

"This shift is more evidence of the evolution of how investors allocate capital," says Carver. "It is moving from asset classes to factors, which means they are focusing more on outcomes and precision."

If you don't know what your risk is or where it is coming from, you cannot diversify properly.

"It is important for trustees to know what to expect from different factors in different scenarios," says Taillardat. "It is important to try and avoid big surprises."

Using, or at least being able to understand what factors are driving returns – or losses – in a portfolio is vital, especially in a time of crisis.

"Some factors will bounce back quicker than others, but some may not have fallen so far to begin with," says Taillardat. "It is all about diversification."

While it is not as straightforward as assessing a company balance sheet, using factors to select bond purchases can help diversify a range of fixed-income instruments to help protect a portfolio from prolonged downturns in a transparent way.

With all this in mind, should we expect the risk factor juggernaut to hit fixed income?

Dacquin foresees a steady flow of investors considering the move.

"The biggest challenge for investors remains the low-yield environment and this means the right choice in terms of issuer selection, diversification but also transparency is even more important today than it was in the past," she says.

Written by Elizabeth Pfeuti, a freelance journalist

In association with Quoniam
QUANTITATIVE INVESTMENT ENGINEERING

Leading the class

Norfolk Pension Fund recently acted as the lead plaintiff in a class action against US pharmaceutical company, Puma Biotechnology, which it won. Natalie Tuck speaks to the fund's investment and actuarial manager, Alex Younger, along with its legal representative, Robbins, Gellar, Rudman and Dowd LLP partner Mark Solomon

Norfolk Pension Fund has recently won a class action against a US pharmaceuticals company. Can you tell us how the situation came about?

Robbins, Gellar, Rudman and Dowd LLP partner Mark Solomon (MS) - Like many local government pension schemes, Norfolk Pension Fund invests in, among other things, shares of companies whose securities trade on the world's stock exchanges such as the LSE in the UK, and the NYSE and NASDAQ in the USA. When executives have engaged in fraud in order to artificially boost the price of its company's stock, investors (the true owners) are often severely harmed when the truth eventually emerges and the value of the shares they own collapses. My law firm and I specialise in the USA in identifying such fraudulent misconduct by publicly-traded companies and financial institutions, as well as representing pension funds globally in securities fraud class actions, in order to recover sums lost to fraud and to instill corporate governance enhancements where possible. We monitor the investment portfolios of pension fund clients worldwide, including those of Norfolk Pension Fund. When Norfolk was alerted to its losses suffered in its Puma Biotechnology investments (Puma trades on the NASDAQ) and the apparent wrongdoing that caused them, it decided to seek the role of lead plaintiff in the proceedings, which were in Federal Court in Santa Ana, California. Having done so, we then prosecuted the case together for over three years. That involved document disclosures and depositions, including a representative of the fund being deposed. Unusually, the case did not settle ahead of trial and, instead, was tried before a jury some 43 months after it had first been filed.

The trial lasted three weeks and Norfolk's representative from the fund again testified – this time in front of the Santa Ana jury. Out of the thousands of securities class actions filed in America since 1995, only 15 have been tried to a jury verdict; two of them in Santa Ana where the Puma case was tried – the first, a case against executives of Helionetics, Inc. in 2000, which me and my partners tried and won a $15.4 million verdict; the second, the Puma trial, which was led by Norfolk and which is expected to yield recoveries of up to $100 million.

What was it that motivated the fund to take legal action against the company?

Norfolk Pension Fund investment and actuarial manager, Alex Younger (AY) – The fund has in place securities fraud monitoring by two US law firms so that it is alerted to instances where the fund may have suffered from fraud in the securities markets. Both firms also assist the fund in ensuring that it participates in all recoveries on settled cases where it has had a holding. The purpose is to enable the fund to maximise returns for the benefit of present and future pensioners, reduce the burden on its sponsoring employer, to advance good governance, and to support the deterrent effect for future misconduct in financial markets. If a case succeeds, all of the damaged investors garner a pro rata share of the amount recovered – amounts which vary from tens of thousands of dollars to hundreds of millions of dollars depending on the size of the investor and the amount of damage caused.

The fund's experience in Puma and its recoveries from the work of others on other cases, demonstrates the value of investors standing up for each other and taking their turn to step up where their rights are uniformly violated. Each of the cases prosecuted requires a defrauded investor sufficiently responsible to lead the case to retain and liaise with the lawyers they choose to litigate the case for the benefit of all. When appropriate we recognise that includes the fund taking an active and responsible role.

Can you talk us through the process of taking legal action against a company What is the first step, how long does it go for, what are the different stages? How did the fund end up becoming the lead plaintiff? And what did this involve?

MS - In the USA we have what is known as an 'opt-out' class action mechanism. That means, in the field of securities class actions, that if you are one of a number of investors damaged as a result of buying shares (or other securities) during a time period when the price you all paid for your shares was artificially inflated by fraud, then in any class action to recover compensation, each damaged investor is a member of the 'class' and ordinarily will be entitled to a share in any recovery won in the class action, unless you opt-out of the class. Each securities class action requires a damaged investor to act as lead plaintiff and in the USA there is a competition for that position in which, to put it bluntly, the biggest loser wins. Put less bluntly, there is a presumption written into statute that the investor who steps forward to lead the case with the biggest interest in its outcome compared to all other investors stepping forward is entitled in the ordinary course to the lead plaintiff position.

As a result, pension funds, quintessentially large investors that also sometimes are large losers in particular investments owing to fraud, often compete for the lead plaintiff position. The path to the position is prescribed by statute. The investor responsible for filing the first class action in any particular case must publish a notice inviting other class members to seek appointment as lead plaintiff within 60 days. Investors, often public pension funds, with their chosen lawyers, regularly compete to be appointed lead plaintiff for the good of the class in the hundreds of securities class actions filed in the USA each year. After leadership of the case is decided, the lead plaintiff and the lawyers retained by the lead plaintiff prosecute the case in one, consolidated proceeding. Cases that proceed into the discovery phase of litigation typically settle in a two to four year timeframe, although the duration can vary wildly. Exceptionally, as with Puma, the case may go to trial by jury. In Puma, it was apparent that Norfolk had sustained a significant loss and the facts, if

Case overview

Norfolk Pension Fund won a class action against US pharmaceutical company, Puma, in which it was found liable for securities fraud. The jury in the United States District Court for the Central District of California, in Santa Ana, California found that Puma, which is listed on the NASDAQ, and its CEO and chairman, Alan H. Auerbach, committed securities fraud and are liable to compensate a class of investors who purchased Puma shares between 22 July 2014 and 13 May 2015 at prices inflated by the defendants' misconduct.

The jury found that Puma and Auerbach knowingly misled investors about the effectiveness of a breast-cancer drug called neratinib, sold commercially under the name Nerlynx. The jury determined that the fraud inflated Puma's share price by $4.50, which is over 15 per cent of the price at which Puma's shares currently trade and which may cost defendants, when all claims are counted, up to $100 million.

The case against Puma and Auerbach featured forensic evidence showing that Auerbach had created counterfeit official meeting minutes of the US Food and Drug Administration to advance the defendants' fraudulent scheme. Auerbach sent these forged minutes to underwriters of a $218 million public stock offering in 2015.

challenging, appeared highly persuasive. Accordingly, my firm and I were retained by the fund and, having been appointed lead plaintiff and lead counsel respectively, together we prosecuted the case to its successful conclusion.

Why is it important that pension schemes take action against companies they are unhappy with, rather than just divest? How important is it to Norfolk Pension Fund on a personal level?

AY - If a fraud is discovered, disinvestment from the company may ultimately be an appropriate course of action. However, this action is unlikely to address the issues of losses in asset values that the discovery of the fraud by the market normally brings about. It may also not be an appropriate course of action for a long-term investor. Divestment can be highly disruptive and at odds with the aims and processes surrounding long-term investment. Rather than turning a blind eye when a fraud has been perpetrated by executives of publicly-traded companies in which the fund has ownership stakes, the fund adheres to the belief that when securities fraud is committed it is important that responsible investors call it out and seek compensation for themselves and others similarly harmed. The ultimate aim of action, either indirectly as the result of the settlement payment and related publicity, or directly via negotiated governance reforms, will be governance improvements at companies where fraud may have occurred.

Are there any other companies that Norfolk Pension Fund is taking legal action against/or using stewardship to change procedures/strategies at any companies it invests in?

AY - Monitoring of our investments is ongoing and we regularly consider the impact of different events or disclosures within the portfolios. We have not initiated any similar litigation since the favourable jury verdict in the Puma case but do not rule out doing so in appropriate circumstances. Litigation remains a last resort and the fund requires all its investment managers to actively engage with the companies where it has a shareholding. We also have a well-developed voting policy to ensure that our ownership rights are exercised to support good governance. As part of the wider Local Government Pension Scheme we support the Local Authority Pension Fund Forum in its engagement activities with UK and overseas companies. We also support initiatives on carbon disclosure and The UK Living Wage Campaign. We genuinely believe that institutions should be responsible stewards of the assets they own and recognise their wider responsibilities as part of a much larger investor base.

What advice would you give to other schemes that could find themselves in a similar situation and considering legal action?

AY - Pension funds could consider introducing portfolio monitoring by a suitably qualified firm or firms. This will allow them to be confident that they are collecting the proceeds of settled actions and to be made aware and consider if it is appropriate for them to become involved in litigation in a case. Internally you will need to consider your own governance capacity and resource to review monitoring, interact with your advisers and ultimately take a case forward if required.

It is important that the choice of firm is made carefully and with eyes wide open. The criteria for selection may include the history and track record of the firm, the depth and experience of its client base, the financial capacity of the firm to take on corporations with large budgets and teams of corporate lawyers (important given the contingent basis of most plaintiff funding) and a record of persevering with cases, with a demonstrable willingness to take go to trial where it is in the optimum interest of the class to do so. As a client you will need to be able to work openly and honestly with your lawyers and to trust and depend on the advice they give you as class representative. It would strike a note of caution if a firm being considered showed a propensity to early settlement.

Written by Natalie Tuck


PENSIONS Age
CONFERENCES
PENSIONS AGE AUTUMN CONFERENCE
19 September 2019 | The Waldorf Hilton, London
SAVE THE DATE!
www.pensionsage.com/autumnconference
Sponsored by
ATLAS
Powered by Capita and Schroders
M&G INVESTMENTS
Quoniam
QUANTITATIVE INVESTMENT ENGINEERING
RiskFirst
TCW
Follow the event on Twitter - @PensionsAge #PensionsAgeAutumn

AE's tipping point

With minimum automatic enrolment contributions for employers having increased to 3 per cent this month, Natalie Tuck looks at the impact of the policy on employers, and whether they can face further increases to contributions

Summary
- Auto-enrolment has been hailed a success but it is widely acknowledged that contributions need to be increased.
- The industry is split over whether employers can take on more contributions.
- The Pensions Regulator is coming down hard on employers that don't comply to AE regulations – and has seen compliance of over 95 per cent.
- There have been calls for auto-enrolment procedures and legislation to be simplified, as there are lots of hurdles to overcome making it easy for employers to trip up.

When the number of employees saving into a pension through automatic enrolment hit 10 million earlier this year, Work and Pensions Secretary, Amber Rudd, declared the policy an "extraordinary success" that will offer people a more "secure future and a better retirement".

With opt-out rates remaining low following last year's minimum contribution rate increase, industry experts are hopeful that the increase to 8 per cent this month (5 per cent employee, 3 per cent employer) will also have little impact. A policy paper by Royal London concludes that it is "highly unlikely to lead to large numbers of people to give up in saving in a workplace pension".

But what has been the impact of the policy on employers and how supportive have they been? Pensions and Lifetime Savings Association (PLSA) director of policy and research, Nigel Peaple, notes that its members have been "extremely supportive" of the work the policy has done in getting "millions more saving for retirement".

Employers, of course, not only have the costs of the contributions but can also incur additional costs associated with payroll, administrative support, communications and appointing a pension provider etc. However, research by The Pensions Regulator (TPR) found that once auto-enrolment has been set up, most employers do not pay anyone outside of their organisation to assist them with completing their ongoing duties (65 per cent of micro, 56 per cent of small, and 71 per cent of medium employers).

TPR's director of auto-enrolment, Darren Ryder, adds that the time burden of duties per month is "typically no more than two hours per month" according to its initial survey conducted in spring 2017.

Room for improvement

Despite the policy being a success, the industry is in agreement that a combined contribution of 8 per cent is not enough to secure savers an adequate income in retirement. The PLSA is one of several voices in the industry calling for the equalisation of employer/employee contributions, with a target of 12 per cent combined contribution.

"We believe that employers can cope with increasing contributions if the government adopts proposals we've previously suggested, which would see a very gradual increase in contributions," Peaple says.

"To help ensure savers have the best chance of enjoying a comfortable retirement we outlined in our *Hitting the Target* report proposals that minimum contribution levels for automatic enrolment need to raise from 8 per cent of band earnings to 12 per cent of total salary between 2025 and 2030,

with at least 50 per cent of this coming from employers."

It also seems that employers themselves would support a small increase to their contribution. Recent research by the Association of Consulting Actuaries found that employers would support a contribution rate of 4 per cent employer/4 per cent employee, whilst larger employers were willing to contribute 5 per cent. However, this still falls short of the 'golden' 12 per cent target, so it remains to be seen whether there is support for anything that could achieve this.

Not everyone in the industry is of the opinion that minimum contributions should be increased. However, Hargreaves Lansdown senior analyst, Nathan Long, recently likened auto-enrolment to a "cheap balloon at a kid's party", in that it gets better the more you inflate it, "but at some point it cannot take it anymore".

Long warns that this month's rise could impact savers and employers more than the April 2018 rise. "It's widely expected that opt-out rates will remain low this time round, however this is not quite that simple. Since auto-enrolment was introduced, 10 million employees have been auto-enrolled into pensions, but around 11.5 million were already in a pension.

"Many existing schemes already had contribution structures that required payments of at least 5 per cent, but far fewer paid 8 per cent contributions, so this latest increase will impact on more people."

In addition, Sackers associate director Ferdinand Lovett notes that not only could a further rise in contribution rates run the risk of more members opting out, but some employers might also find the hikes difficult to sustain.

"Employers would support a contribution rate of 4 per cent employer/4 per cent employee, whilst larger employers were willing to contribute 5 per cent"

"The government recently stated that it does not wish to force the pace of change in automatic enrolment, and that it wants to study the impact that the forthcoming DC contribution increases have on opt-out rates first. This seems sensible, as any plans for future increases would no doubt involve a careful balancing act," he explains.

"In the meantime, we expect discussion to continue around other potential changes, such as reducing the lower age limit from 22 to 18, removing the earnings trigger, and extending auto-enrolment to the self-employed."

Regulation

For employees, auto-enrolment is of course still optional, with the policy relying partly on people's inertia, in the hope that very few will actually opt-out – something that seems to be working well so far.

Employers, however, have to enrol their staff in a workplace pension; those that try and evade their duties face the wrath of the regulator. In reality, Ryder says that if the regulator finds an employer that is non-compliant, its case teams take a positive approach and work to help them.

"We know that most employers want to do the right thing for their staff and we are here to help, but we will take action where an employer is non-compliant to ensure staff receive the pensions they are due. If employers don't comply with all of their auto-enrolment duties, they face being fined at least £400. This can increase to up to £10,000 a day for large employers so the cost to a business can be substantial.

"If we have to take the next step and prosecute employers because of non-compliance this could result in them ending up with a sizeable bill from the court and a criminal conviction – as well as still having to become compliant."

The regulator has not been shy with its regulatory action. Its compliance and enforcement quarterly bulletin for October to December 2018 revealed it had issued 22,000 compliance notices in the final quarter of 2018. The figure was down on the previous quarter, but the regulator said it continues to use new approaches to "disrupt, deter and punish dishonest activity".

There have also been a number of stories in the press recently on cases in which employers, and others with responsibilities for workplace pensions, have been prosecuted by the regulator for failing to comply. An accounts manager for a chain of Indian restaurants was recently ordered to pay £5,000 to the regulator for attempting to conceal the fact that the restaurants had not enrolled their staff into a workplace pension.

In another example, an accountant was fined almost £7,000 for falsely telling TPR that one of his clients' staff, for which he acted on its behalf, had been enrolled into a pension scheme. It was the first time that TPR has prosecuted a third party, working on behalf of an employer, for this offence.

The regulator's action against non-compliant employers has the support of the PLSA, with Peaple stating: "Where employers have deliberately evaded their duties, there is clearly a case for the regulator to action." However, he points out that compliance is very high; TPR's most recent figures show that compliance with the law is above 95 per cent.

From a legal perspective, whilst Lovett notes that having an effective regulation and enforcement regime is an "essential component", he believes the legislation is "overly complex". He adds that there are many "procedural hurdles to overcome, making it all too easy for an employer to unwittingly trip up". Therefore, he would welcome any scope for simplifying the procedural steps, for example at the next statutory review in 2020.

For now, employers will have to navigate the current processes in order to comply. Ryder's words for any employers that think they can get away with not complying: "Put simply, don't," he says.

"Our systems highlight cases of non-compliance for us to investigate and we remain committed to tackling those who are snubbing the law. There is guidance on our website and we also have people on hand to offer employers and advisers help on how to comply with their automatic enrolment duties. If you fail to become compliant, or try to hide the facts from us, you should be prepared to be prosecuted."

Written by Natalie Tuck

In association with

MERCER M&G INVESTMENTS RPMI RAILPEN AON RIVER AND MERCANTILE SOLUTIONS BMO Global Asset Management CFM

Multi-asset roundtable

The many facets of multi-asset

Our panel of experts discusses the definition of multi-asset investing, and how different multi-asset strategies and approaches can play a part in pension portfolios today

Chair: It would be good to understand how different investors and institutions define multi-asset investing, given the term encompasses a wide range of interpretations.

Andrew: For me, multi-asset is about managing the nature of the exposure from a risk perspective. You can also do things from a volatility management perspective too; but the paramount consideration for my clients is how can they experience the return profile that they are seeking, whilst having a clear eye on the nature of the underlying risk, and how that risk evolves as the journey is being undertaken. A crucial point there is that it needs to be a dynamic asset allocation framework. We need to be responding to changes in valuation, we need to be responding to changes in fundamentals and we need to be managing that journey on behalf of our clients. The important distinction therefore for me is one of a risk management journey, rather than volatility management.

Nicholson: From a consulting point of view, multi-asset investing offers a governance-friendly way of accessing a wider range of asset classes. The alternative, of course, is for clients to invest in the underlying assets themselves and manage the dynamism themselves, but some clients can't take decisions quickly enough themselves to be able to do that. We have clients who take both approaches.

Vial: Portfolio construction and asset allocation are both part of a manager's skill – certain managers allocate dynamically, others do fixed; but if I take a step back, multi-asset encompasses a

In association with

Multi-asset roundtable

CHAIR

Chair: Kishen Ganatra, European Strategic Research Director, Mercer

Kishen is a principal within Mercer's Wealth business in London. In his roles as European strategic research director and as the lead for the Manager Research's Solutions effort, Kishen is responsible for developing intellectual capital on portfolio construction, asset-class views and key investment themes, including outcome orientated investment solutions. Kishen is a member of Mercer's Global Strategic Research Committee and the Multi Asset Research Group. He is also part of the Hedge Fund Boutique.

PANEL

Steven Andrew, Fund Manager, M&G

Steven joined M&G in 2005 as a member of the portfolio strategy and risk team, before moving to the multi-asset team, where he helped to formulate asset allocation strategies for M&G's multi-asset fund range. He has been the fund manager of the M&G Episode Income Fund since its launch in 2010 and also deputy fund manager of the M&G Sustainable Multi Asset Fund which launched in early 2019. Steven began his career at the Bank of England in 1987 and subsequently worked at F&C Asset Management and Merrill Lynch before joining M&G.

Craig Heron, Head of Public Markets, RPMI Railpen

Craig is head of public markets and the fund manager for the Growth Fund, Railpen's liquid return seeking portfolio. Craig joined Railpen in September 2011 and has 22 years' investment experience. Before joining Railpen, Craig held a position as a multi-asset manager, responsible for a range of portfolios and regional funds at Henderson Global Investors and New Star Asset Management. Craig has a Bachelor's degree in Actuarial Mathematics and Statistics, holds the Investment Management Certificate (IMC) and is a CFA charterholder.

Adrian Mitchell, Chief Investment Officer, Delegated Consulting Servives, Aon

Adrian started his career at Bacon & Woodrow in 1984. Initially he worked as a pensions actuary and then moved to the investment consultancy practice where he provided investment advice to a wide range of large pension scheme and charity clients. He joined Fleming Asset Management in 1994 to set up and lead the Quantitative Portfolios Group, managing UK, European and global equity mandates. After Fleming was purchased by J.P. Morgan in 2000, he left the firm to join FF&P Asset Management (the Fleming Family Office).

Ross Nicholson, Managing Director, and DB Consulting Team Head, River and Mercantile Solutions

Ross is a managing director within River and Mercantile Solutions and is head of the DB consulting team. He has worked as a consultant to a wide range of trustee groups under different engagement models over the past 12 years. He is lead consultant to a number of clients and helps different trustee boards with a wide range of investment issues, including setting objectives and journey planning, manager evaluation and selection and prioritising changes.

Erik Rubingh, Head of Systematic Factors, BMO Global Asset Management

Erik Rubingh joined the firm in July 2007 and is managing director and head of factor investments. Prior to joining, Erik worked at ABP Investments (now APG Investments), first as senior portfolio manager in the Global Quantitative Strategies Group and later as head of that group. Erik graduated from Groningen University with an MSc in Econometrics. He is also a CFA charterholder. Erik is a regular contributor to the investment press and a commentator on global asset management.

Stéphane Vial, Managing Director and Head of Investor Relations EMEA, CFM

Stéphane is managing director, in charge of CFM's EMEA client base. He joined CFM in 2007 and spent his first two years at CFM's headquarters in Paris where he was responsible for European client coverage. He then made the move to Tokyo where he was the director of CFM Asia KK, before moving to London in 2013. Stéphane has 20 years of experience in trading capital markets in both London and New York having worked for Chase Manhattan Bank, Renaissance Technologies and Commerzbank.

RIVER AND MERCANTILE SOLUTIONS
BMO Global Asset Management
CFM INSIGHT.DATA.CLARITY.
In association with

very wide range of strategies. It starts from your traditional betas (bonds and equities) mixed together in a 'long only' fashion, to funds that are less constrained, where you're not meant to be just 100% beta. You can have strategies with capital-based allocations such as traditional strategies that deliver similar risks to the market itself; or strategies based on risk allocations – risk parity being one example.

Next you have diversified growth funds (DGFs), which came into existence 15 years ago off the back of looking for investment solutions after the bubble in 2001, where the benefit was to mix asset classes and strategies together to mitigate risks.

Then there are absolute return multi-asset solutions, where you're not necessarily benchmarked. Moving from long-only into the alternative space, you find alternative risk premia, or alternative beta, which tend to be risk based and, unlike DGFs, make use of leverage and derivatives.

Then you can go all the way to hedge funds – a hedge fund is essentially a multi-asset vehicle often using more complex and proprietary strategies.

So, multi-asset is very broad and there are a number of dimensions to differentiate all these, such as how much beta it has, if it is it long-only, leveraged? How risk is allocated, risk-based versus capital allocation; and whether it's just purely physical or whether it is synthetic through the use of futures and derivatives.

Mitchell: From our point of view, there are five key asset classes. You've got equities, bonds, property, currency and commodities. Multi-asset allows you to access some or all of those types of strategies, either long or short, to produce a return target which tends to be either cash plus or inflation plus, with a whole continuum of solutions, ranging from the highly alpha-driven at one end to extensive use of beta or even leveraged beta with risk parity at the other end. Trying to categorise them in a way that clients understand is the challenge, of course.

Heron: It is a challenge. If you go back to balanced funds, the modern DGF is just a balanced fund with extra bells and whistles, in my opinion. Then you go through that litany of different choices that were mentioned earlier, and if you are trying to get access to any one of those, whoever you are speaking to will tell you they can do it – whatever you ask for.

But if you are looking for one definition of multi-asset, I would say it's a portfolio with a combination of assets. Beyond that, it's very tricky to define.

Using multi-asset within a portfolio

Chair: So, we've understood multi-asset covers a wide range of approaches. From an asset allocator's point of view, what are the ways in which a multi-asset strategy can be used within a portfolio? One of the issues investors have had with traditional DGFs is what role they play in the portfolio, because they're almost a whole portfolio solution in themselves. How do they form a piece of the portfolio?

Mitchell: When we build funds in the DC world, you're a lot more constrained. You have to offer daily liquidity to get onto platforms and this impacts returns.

In the DB world, we would build a multi-asset portfolio. It would be bespoke for every client, because it takes into account their particular needs – they're not just delegating their assets to us, they're delegating the management of the liabilities to us as well, so we need to take a more holistic view when building the portfolio. For DB clients using LDI, we can build a portfolio to meet the funding cost of the LDI and then an excess return, aiming to close the deficit over time.

For those DB schemes that perhaps want more of a CDI approach, then we can build portfolios that have a more predictable income within the liquid part of the multi-asset space.

Nicholson: Investment consultants that are building multi-asset portfolios themselves are doing it either with a core multi-asset mandate with some things around the outside, or they are just building it themselves with the individual asset classes and the trustees (or the fiduciary manager) are managing the dynamism themselves. Again, it depends. It comes back to trustees' governance constraints. Smaller clients that don't meet very often perhaps have a greater need for something that has dynamism built into the fund.

Heron: Yes, it depends. I want to be able to control my asset allocation, but there'll be times where I want to have

In association with

Multi-asset roundtable

exposure to certain risk premia.

If I think about putting a DGF into that portfolio, what we see some consultants doing is going into DGF strategies, experiencing three years of bad performance, and then moving into the next DGF strategy.

So, when it comes to building a multi-asset portfolio, sometimes it's appropriate, other times very difficult. For smaller schemes that don't have the ability to throw hundreds of millions of pounds here, there and everywhere that can't move quickly, it is theoretically a good solution for them, but it's caveat emptor, as always.

Andrew: I agree on the point of the variability – there are people who are successful for short periods of time and then disappear, and then another system or trend or process is seen as rewarding multi-asset funds or DGF funds. That should just be a reminder that there is no holy grail. There is no one system that will constantly win time and again, but we, collectively, never learn. We're always seduced, collectively, by the latest fad.

Isn't it therefore beholden on all of us, both providers and intermediaries, to open the box and ask: "How do you claim to offer an edge, offer a genuine observation on the markets that isn't already there, isn't already in the price, doesn't already get reflected? Do you have an analytical edge? Do you have an information edge? Show me the transparency of your investment thinking, your investment process. I appreciate, as a client, sometimes the market's not going to favour that for a bit, but at those times, if I've understood your investment process, that's the time when I would want to be adding exposures to your fund.

Rubingh: From my perspective, it's like a journey starting in long-only equities, then in short equities, and then based on that experience, you think these concepts can be applied in other asset classes as well – long/short, market neutral, capital appreciation – and hopefully, you'll be able to deliver on that. You get diversification in that space as well.

But the great advantage for the client is that it makes explicit the split between the asset allocation decision on a high level – so how much in bonds, how much in equities – and how much can we add to that, using reasonably transparent techniques.

You won't reveal everything you're doing in detail, but the general concepts can be reasonably well understood, even by not overly sophisticated clients. So, it's the split between the beta decision and where you think you can get some additional returns on a diversified basis.

Chair: I would agree that the use of multi-asset strategies primarily comes down to an investor's governance constraints. For those investors that are governance constrained, a traditional core multi-asset strategy may be of use. However, for those investors that are less constrained by governance, they should be looking to build their own multi-asset portfolios to best meet their objectives, with the potential use of some idiosyncratic multi-asset strategies as part of their liquid alternatives allocation. On the topic of liquid alternatives, a lot of investors have been taking allocations out of things like DGFs and multi-asset strategies and opting for alternatives risk premia type approaches. Why are some investors are doing that?

Vial: There's a range of reasons, but the historical reason is that DGFs came into existence 15 years ago, at a price that was the right price for the product in the market, particularly in the UK which has fee constraints, and it's a one-stop-shop solution.

The challenge for an investor to allocate to DGFs is that you have many underlying strategies, which may include esoteric forms of beta. And you can end up in daily funds that do listed derivatives, listed real estate, convertibles and all kinds of different things.

If you have to do due diligence, can you actually go through all the 50 or 100 different sub-strategies?

Our approach is to offer a relatively low number of strategies known as alternative betas, in a market neutral framework, so investors can take back control of how much beta they want on one side, and how they want to have those exposures implemented it.

On the alternative side, think about risk budget and also think about what sort of strategy you believe in. You may believe in what your manager offers you or you may believe in just a portion. But

RIVER AND MERCANTILE SOLUTIONS
BMO Global Asset Management
CFM INSIGHT.DATA.CLARITY.
In association with

my point is that it's customer friendly, you can pick and choose strategies as well as target a fixed amount of risk for each. The benefit is to diversify traditional betas of the portfolio with these non-traditional uncorrelated betas in a manner where investors keep control.

A traditional DGF that has a lot of beta will go with the market, in terms of volatility. If there's no volatility in the market, it will be very difficult to get volatility in your DGF. If there is a crisis in the market, your DGF will deliver high volatility.

Ultimately, we are giving more control to investors.

Mitchell: One issue with DGFs is the perception that they promise to provide equity like returns with lower volatility. They've certainly delivered on the low vol, but they probably haven't delivered on the return side of things. Investors can buy market exposures, relatively cheaply, elsewhere in their portfolio, so it's about understanding what the drivers are within a multi-asset fund and not overpaying for beta.

Funds that are more market neutral – hedge funds, alternative risk premia – may make a lot of sense alongside market exposures held within client portfolios.

Heron: When the alternative beta strategies don't work, you can quantify that much more easily, because it's a market phenomenon. If something is opaque and has 50 different strategies in it, and you get your quarterly report and it's down another 0.5 per cent, you will have trouble understanding why.

A lot of alternative beta strategies were very disappointing in 2018. You can look at why that's the case. And from a client perspective, it's not great, but at least you can understand.

Outcomes are going to be good and bad. That's the reality of life, unfortunately, and investments. Understanding why they're good or bad is very important, rather than just, it's a good year – great. It's a bad year – I'm going to give the fund manager a hard time.

Performance measurement

Chair: Performance measurement is a difficult task for many investors when it comes to multi-asset portfolios – what are some of the group's thoughts on how to approach this topic?

Vial: On the alternative beta side, it's becoming benchmarked, so you can clearly measure your managers, one versus the other. Managers do more or less the same thing, using similar strategies so it's the implementation details that will set them apart, provided they deliver performance consistent with their benchmark.

Mitchell: As fiduciary managers, we're trying to achieve a better funding ratio for our clients, so we usually have a liability benchmark.

What's more interesting, when you're investing in these types of strategies, is the attribution, understanding the drivers. What has actually produced the return that year? Is it in line with your expectations of what that manager should have produced? It may have been a tough year, for example, but was it a tough year within historical norms that you can live with and understand?

Andrew: I agree. A lot of this is also about timeframes. It's not good enough to just look at an arbitrary calendar year and say, "it failed to reach its objective" or "it way surpassed its objective", in terms of whether it was a good or a bad year. You need to look at whether it met your expectations in the medium term for the delivery of what's suited to you, as a client.

Rubingh: I would also say, especially on the alternative side, it's important to relate back to your underlying asset class; so, if you say it's an alternative play that's market neutral, then it needs to be seen to give that market neutrality. Timeframes are important, of course, but if you look at your returns over a three-year period and even though you claim to be equity market neutral, a lot of the returns can be explained by the equity market, then you've not really delivered on what you were promising, even if it's positive. That's an important element.

Chair: While we're talking about performance measurement, the past couple of years have seen mixed performance across the board. How should investors be reacting to that?

Vial: The very first thing is you have to understand what sort of Sharpe or what sort of risk adjusted return you should expect and you should frame that into an appropriate timeframe – three to five years I think is a good timeframe for these strategies. Performance of any given calendar year – take it with a pinch of salt. Look at it, but don't force yourself to make changes after 12 months.

The second thing you can do is

In association with MERCER M&G INVESTMENTS RPMI RAILPEN AON

Multi-asset roundtable

look through either your back test, or at the historical returns. You should ask yourself, for example: Is this out of the norm? Is there something that you're not meant to expect in that sort of strategy? Have returns been delivered in a way that doesn't make any sense? This is an inward-looking analysis that any investor can make of their manager.

The third thing is to analyse externally – how do I compare? These strategies, such as alternative beta, have been in the market for a very long time. They're not new. They've been traded in many ways and for many years, therefore you can look at whether you are an outlier and being an outlier, on the up side or the down side, should raise questions. The fact that there are benchmarks is very useful.

Mitchell: When you're looking at diversified growth funds' performance over the last three years – with 2018 being a tough year for most asset classes – less than half of DGFs outperformed cash by more than 4 per cent pa.

We'd encourage clients to think about the fact that maybe they're paying active manager fees for products that are largely beta-driven. Cheap passive DGFs are available and risk parity can provide some leverage there as well, in that space. Or if they prefer active management, move towards the more alpha-driven part of the market.

But even there, for a manager to outperform cash by 4 per cent pa, over the long-term, purely in a market neutral way, using alpha, that's a tough ask, I would say. So, people need to be more realistic about returns they're likely to get from that end of the DGF spectrum.

Andrew: An important question to encourage clients to ask, or at least get clients to get their consultants to ask, is: "Show me your process in action, because I'm not necessarily investing here with a sense of faith that you can deliver LIBOR plus four. I'm investing because you've shown me a process that I think I understand, that I think I know how it will behave in certain market environments, but more importantly, that I think I know how you will act, given a certain opportunity set that the market's offering you. So, show me, over periods of volatility, how you responded, if indeed that's what your mandate is to do."

It's very important, amid those periods of volatility, that they can give you a very clear sight of whether or not they are sticking to their plan.

Heron: There are some very persuasive empirical studies of institutions' records of hiring and firing managers and consultants' records of recommending managers, and even among the very best managers, the probability of them having three consecutive years of poor performance is much higher than you would expect.

We tend to frame the medium-term as three to five years. My time horizon at Railpen however is much longer, so my medium-term should really be 20 years. It's difficult though. When you sit on an investment committee and there's a row of red numbers, psychologically it is difficult not to react.

What you then need to do is ask yourself if you still have the same faith in the manager that you had when you first appointed them. Ask yourself what kind of evidence there is that you should still have that faith.

Nicholson: One of the challenges over the past couple of years is that a large proportion of pension schemes have more in DGFs than perhaps they should have; trustees are a bit more comfortable giving, say, a quarter of their growth assets to a DGF manager rather than a straight-up equity manager. This has been challenging when some DGF managers haven't performed.

Chair: Why do you think that is?

Nicholson: It can be seen as an easy way of accessing diversification, but what we've seen is the cost of that diversification has been quite a drag on performance when managers don't perform.

Choosing a manager

Chair: An important point Craig *[Heron]* mentioned was about evidencing your faith behind choosing a manager. Could you describe some of the work that an investor may want to do when looking at the multi-asset space? What types of things would be appropriate to tick the box on, given performance is not one of the defining factors?

Heron: Performance is not one of them. Attributing where performance has come from, and whether that follows the stated process is fine, but the one, three, five, ten years of performance doesn't matter – it's just noise. It doesn't tell you anything.

In association with

Multi-asset roundtable

In terms of due diligence, it essentially boils down to the various 'Ps'. Managers should have a philosophy as to why they think their strategy can beat a particular market benchmark to produce a return. There then needs to be a process as to how they're going to apply that philosophy to a portfolio, in good and bad times.

So, to summarise, what's the philosophy? What's the process? How do they evidence that they actually do that? You've got to try and get yourself as close to working in that company and understanding what they do, as you can, without actually going and working in the company.

Andrew: I couldn't agree more and the answer isn't in the numbers. You're not going to find the answer looking at a screen at your desk, going through the spreadsheets.

The answer lies in how your manager makes their investment decisions. How do they describe how they make their decisions? How can they evidence that? They need to be able to show their process, the robustness and coherence around it.

Mitchell: One of the attractions of multi-asset investing is the breadth that you can make decisions across, but that's also a problem, because does the manager have skill in all those areas?

We run fiduciary portfolios. We try and pick the very best managers in each asset class, so we're not reliant on a single manager to have all the necessary skills. We can pick the specialists in each area and bring them together. So, if I was looking at a fund's attribution, I'd be looking to see where the Achilles heel was with the multi-asset fund, where the manager has strength in depth; and the areas where perhaps they're a little bit weak, and they might think about outsourcing that part of their portfolio.

Innovation

Chair: One of the innovations happening across asset management as a whole, but particularly in multi-asset, is the prevalence of systematic forms of investing. Could we get some thoughts in terms of what role systemic forms of investing can have when managing multi-asset portfolios versus more traditional discretionary forms of multi-asset investing?

Rubingh: One approach is to stick with what the market deems to be the best allocation, perhaps some form of cap weighting, and then take exposure to certain styles in a systematic way, in order to try to generate positive returns. There it's quite important that the factors you take exposure to are not just shown to have historically generated positive returns but that there is also a sound reason as to why they generated positive returns.

Chair: So it's about the fundamentals behind the factors and to ensure they remain persistent in the future?

Rubingh: Yes, that fundamental rationale is important, rather than just saying, "Momentum will always work, so let's put everything on momentum", for example.

Chair: Is there room to allocate between factors?

Rubingh: That is very difficult, so we prefer a reasonably static allocation to a number of factors that we think will be rewarded; we don't think there's a lot of benefit in being very dynamic, in that sense.

Vial: We're in the same camp. It's interesting because systematic managers try to avoid human biases that can lead to mistakes, for example one such bias is to think we are superior at timing

the market. So typically, as a systematic manager, we want to avoid timing; we allocate fixed amount of risks into strategies for which, individually, we have modest expectations but if you make a decent combination of them, then you get something that aims at beating the risk-adjusted returns of the market.

Chair: So how does timing around asset allocation come in to it, and being dynamic around that asset allocation?

Vial: It's about picking a handful of strategies that exhibit persistence and plausibility – and once picked, one should keep a constant risk weight to those over the long run. Take the human element out and keep the weight to the strategies, regardless of short term performance. Excessive rebalancing or timing over your models or long term risk allocation has the effect of ruining your investment framework. It is a human bias to interfere therefore hard to stay away from.

Andrew: For me, it's not about timing as much as pricing. Time is irrelevant – what I want to know is the journey of the price. Does the passage of time mean

In association with MERCER M&G INVESTMENTS RPMI RAILPEN AON

Multi-asset roundtable

that wants to get a good price and not a bad one, not just ride whatever trends the market's currently taking me on.

Heron: In terms of decision-making timing, even between systematic and discretionary, there are underlying similarities which are very apparent. Essentially a systematic approach is rules-based, coded, essentially, and you don't override those rules. Discretionary is more human, but it's still rules – it's just heuristics. You're relying on the humans, or the team, the process, to take the information in, distil it, disseminate it, go through that decision-making process in the same way, every single time.

Heron: Some clients are going to like the discretionary, some will prefer the computer to make the decisions.

Mitchell: If you take the cynical view that alpha is just beta that's not been discovered yet then, in a sense, one of the attractions of the more systematic approach is that as time goes by and you find out what these heuristics are, and you like them, you can codify them and take advantage of them, in a cheaper way.

Andrew: That sounds very appealing and alluring, that the machine's doing it for us, but there's a human sitting at the computer, plugging in what the machine needs to be thinking about, from a framework perspective; which term it uses, which kind of decay factor it uses for its correlation statistics. What are the influences on the inputs that are very important?

Clearly, we're still a long way from getting that right. I wouldn't be dismissive of it though, despite the fact that I am a subjective, judgement-based fund manager/asset allocator, I think the investor can be well served by a CTA type approach.

Vial: What's also interesting is that discretionary is at times an easier conversation to have with investors. They can relate to it. Discretionary relates better to the way investors think about what strategy makes sense for their portfolio. With systematic, it's a bit more difficult, even though the world is moving towards more automation, and it's generally understood that computers are better at dealing with large amounts of data than the human being. You have to explain that human beings are full of biases that are remarkably persistent across generations, and that those biases don't mix well with investing.

Andrew: If we can codify the biases, then happy days. I just don't have confidence that we can codify the complexity and granularity and sophistication of the twisted ways in which the human mind then manifests itself in its decision making, and the imagination we all bring to the elaborate narratives and justification for our own decisions.

Vial: It's very tricky. That's what systematic firms are trying to do. Certain traits are well known and documented, such as following trends whether it be social, fashion, or prices of financial instruments. One example is the paradox of Investment Committees debating new investments. It is incredibly difficult for IC's to approve a new investment that has had a recent poor performance, even though it may be perfectly within expectations. The clear bias is to approve past winners!

Chair: We have had a good discussion in terms of discretion and systematic. Do we think the asset management world is going one way or do you think there's always going to be room for both types of approaches?

Nicholson: There is room for

anything in a short run sense, to market behaviour? Yes, but it shouldn't. When we're thinking about timing our entry points, the time of our entry points is when the market's offering us a heavily discounted price on a good fundamental asset. If we can take advantage of a period of volatility that we think has non-fundamental sources – that is sourced in human behaviour, that is sourced in the misapprehension of risk – then we will build portfolios of those sorts of opportunities, which come at very different times – hopefully – but they come at the same price, which is cheaper and discounted for reasons that we would have an argument with.

Mitchell: The genuine episodes like that are infrequent though.

Andrew: They're very infrequent. In 2016 we had a few of them, mostly for political reasons, when the market was worrying about political stuff – like Trump, like Brexit, like Marine Le Pen. All of that was unsettling the market from a price behaviour perspective, and opening up a nice degree of opportunity, which then paid off very well and has continued to pay off very well, because you acquire these assets at a good price.

That for me is the number one piece of information that we should all be focusing on – what am I being asked to pay for this asset, because I'm an investor

RIVER AND MERCANTILE SOLUTIONS
BMO Global Asset Management
CFM INSIGHT.DATA.CLARITY.
In association with

multiple types of DGFs as they can play different roles in the portfolio.

Rubingh: In the past few years there's been quite a lot of attention to factors and there is almost an implicit assumption that this is a one-way street. However, if you go back in time and think about, for example, 2005 and 2006, what went on then in especially the equities space, but also in asset allocation generally to some extent, it was all about what was uniformly labelled as quant. Then we got to 2007 and 2008, and it went completely out of favour, and now it has come back. So, these things come and go in cycles, and it's never a one-way street.

One of the strengths though of a systematic approach is that it takes away that human element, that behavioural element, as much as possible. It doesn't mean that it's always easy or that it will always generate positive returns, no matter what, but it gives a stronger reference point than a more discretionary process. What you'll do if things are not going quite the way you expect them to is go back and look at the models again, but you're not going to intervene and reverse the position.

Heron: If you ask however which direction is the world going currently? If you take it back to a single asset class 'equity', there's a very determined move into passive and there has been for three, four years, probably, maybe even five.

Also, in relation to multi-asset, a lot of money went into discretionary DGF strategies, some of which have disappointed and now people are recycling back out. Not all of them of course, but some of the big ones raised a lot of money and disappointed, and money is cycling out of those and, as I understand it, into more of the systematic, rules-based, alt-beta strategies. So, in terms of where the world is heading now and has done for the last three or four years, it's definitely away from the discretionary decision making.

What turns it back, if it turns back? If I had to guess, it's probably the next bear market, in equity world.

Andrew: That will be determined by the nature of returns – the nature of the market. We are in the current phase of volatility aversion for a reason. People have been pained by volatility. It hasn't been costly to be too cautious. It has been costly to be overexposed, in terms of the volatility experience that your client has achieved. When the pendulum swings, and it is a when – it just might not be in our working lifetimes - but when the pendulum swings to the cost of caution has been high, on a relative basis, and either you've lost money in your German government bonds and you're down 20 per cent, or you see all of your neighbours, in a metaphorical sense, having participated in a 30 per cent to 40 per cent gain by holding something that you weren't holding, because you had volatility aversion, then you'll embrace a more returns-seeking manager – then you'll embrace those things and the market psyche will swing.

The obsession with volatility management and over-caution is a product of the environment that we've been in and seem to remain in, given the behaviour of the past 12 months.

Mitchell: The market cycle is also important – there are certain types of multi-asset funds, particularly the beta-driven DGFs and the risk parity funds that you want to be in at the start of the cycle, then you move into more defensive DGFs later on in the cycle.

Chair: We have heard from asset managers on the topic of dynamic asset allocation, but a question for the asset allocators in the room, how do you use dynamic asset allocation within your broader portfolios? Is that something you value and is that something you look to manage in-house, or do you look to outsource that to a multi-asset manager?

Nicholson: We manage it in-house for our fiduciary clients and then, for advisory clients, it depends on the client and their engagement. We do have some advisory clients that are more willing to be asset allocators themselves and are open to us providing the monthly asset allocation views, and then implement it off like that. Others haven't got that sort of decision-making framework in place. So, it depends on the client. It probably depends on the size of the client. It depends on how often they meet and their governance budget.

Mitchell: We do a combination on the fiduciary side – the key decision is the strategic asset allocation for each client. We will then take shorter-term tactical positions relative to that strategy but the positions are fairly constrained. Occasionally we'll take bigger, strategic moves if the opportunities come along, usually following severe market dislocations, but that's rare.

We also delegate to managers who we believe have skill in dynamic asset allocation – for example in the hedge fund space we invest in global macro managers who we feel may have an edge and may provide some extra returns. But mostly we control strategy from the top down.

Carrot or stick?

***Pensions Age* finds out which option the industry thinks may be the most effective in motivating sponsors to take their DB scheme responsibilities seriously**

BHS, Carillion, Toys R Us: Lately we've heard a number of tales of big, bad bosses ill-treating their DB scheme through abuse or neglect. But what can be done to get company executives to pay attention and treat their DB deficits with the respect they deserve?

In February, three ideas were proposed to tackle this, broadly along the lines of 'incentives', 'compulsion' and 'punishment'.

Incentives: Encouraging executives to fund DB schemes before making payouts to shareholders

Research undertaken by Sun Yat-sen University, University of Exeter Business School and Lancaster University Management School found that incentivising executives to fund their pension schemes is more likely to see defined benefit schemes survive, rather than penalising bosses once schemes have failed. Compelling bosses to pay into their staff defined benefit pension schemes before they pay out to shareholders would also help make DB more sustainable, the research claimed.

The research examined around 1,655 firms from 2003 to 2011, among which 277 made share buybacks and other windfall payouts. The authors found that companies use transitory cash to make payouts to shareholders as opposed to funding pension benefits. Therefore, it suggested encouraging companies to fund DB schemes before making payouts to shareholders as an alternative solution to penalising bosses after the DB pension scheme has collapsed.

Results of their study also show that for firms without well-funded plans, the probability of share buybacks and other windfall payouts increases by 62 per cent, which partly justifies The Pensions Regulator's concern that firms distribute cash that could be used to reduce pension deficits.

"The implication of our findings is that trustees, actuaries and The Pensions Regulator should scrutinise the existence of transitory excess cash in sponsors' accounts in light of mounting defined benefit deficits over a number of years. Forcing companies to use excess cash to fund defined benefit schemes is more likely to ensure the sustainability of the pension schemes and the welfare of employees in the long run," the researchers stated.

Compulsion: Force bosses to join the same pension plan as their staff

According to research from Warwick Business School (WBS), CEOs are 77 per cent less likely to close their company's defined benefit scheme if they themselves are a member of the scheme, while they are 62 per cent more likely to close an underfunded scheme if they are a member of a separate executive scheme.

The study, conducted by WBS, University of Exeter Business School and Queen Mary University, examined 322 publicly-listed firms that offered a DB scheme between 1999 and 2013.

WBS professor, Joanne Horton, said: "If the government wants to tackle 'reckless' executives who undermine company pension schemes, they could harness CEO self-interest. Shareholders do it all the time. They offer CEOs stock options to ensure they share their interests, including closing the firm's defined benefit pension scheme."

Horton added that it could prevent future 'Carillions' from taking place.

"If Carillion CEO Richard Howson and his executives had been members of the company's main pension plan the outcome might have been different," she said. "If they had paid more into the main pension plan alongside their employees, instead of having their own executive pension scheme, they would have stood to lose the most when the company collapsed."

Punishment: Imprisonment for allowing pension deficits to be unsustainable and £1 million fine

The Secretary of State for Work and Pensions Amber Rudd outlined plans to introduce a seven-year jail term for the "wilful or reckless behaviour" of company directors who play "fast and loose" with their pension scheme.

The new proposals, outlined in the *Government Response to the Consultation on Protecting Defined Benefit Pension Schemes – A Stronger Pensions Regulator*, will target "reckless" company bosses who have "got away scot free" through "acts of astonishing arrogance … punished only with fines that barely dent bosses' bank balances".

According to the government, the law will be aimed at company bosses who allow the pension deficit to reach unsustainable levels, "or who endanger their workers' savings through chronic mismanagement".

Furthermore, the government said it will also introduce an "unlimited fine" for those who fail to comply with a contribution notice, which is a notice issued by The Pensions Regulator that requires a specific amount of money to be paid into a pension scheme, as well as a new civil penalty of up to £1 million.

Pensions Age recently put these options to a Twitter poll: Which of the three options do you think would have the greatest impact on motivating sponsors to take their responsibilities seriously and continue running their DB scheme?

The result was overwhelmingly 'incentivise' through encouraging pension payments over dividend payments, with 71 per cent of respondents voting for this option, compared to 10 per cent for forcing bosses to join their staff's pension scheme and 19 per cent for fines and imprisonment of pension scheme neglect.

But that's not to say that respondents were overly optimistic about any of these approaches:

@pensionsdave: Most feel a bit meh. Join scheme is a bit niche (most are shut). You'll have to be pretty heinous to end up in the clink. So 1 for you 1 for me over dividends feels the most significant

@PensionsSimon: Talk of dividends over DRCs is a point of focus but there are many other ways cash can leave an employer, plus TPR currently has no power to enforce. Joining staff DB scheme won't happen unless changes to personal allowances and tax issues. Assuming punitive fines/jail can be used efficiently and without protracted challenge, they may be most effective but, as I say, the caveat is if they can be used and if TPR has the appetite to use them.

@AWarwickThomps1: Better balance between dividends and scheme funding is the only one that will deliver improved benefit security. Hence TPRs focus on dividend v deficit recovery contribution ratio in recent years. Jail for executives is just political click bait.

@pensionsdaz: Level of proof required to get a prosecution against a director makes *[imprisonment]* pure regulatory grandstanding.

Contacting *Pensions Age* regarding the poll, Barnett Waddingham partner Simon Taylor pointed out the winning poll option, prioritising pension contributions over dividends, is "likely to hasten the demise and buyout of DB schemes rather than keep them open".

"If execs are forced to pay more to the DB schemes they will want something in return, most likely settlement of benefits and reduction in quantum of the scheme," he explains. "It would almost certainly have some nasty side effects on UK equity markets as well which, would create a vicious circle with funding levels dropping."

Regarding the idea of executive compulsion into DB schemes, Taylor highlights that "most are already in the same scheme as their employees – the DC scheme". However, they may be participating in the DC scheme with a higher employer contribution rate – "but that's a different question", he adds.

As well as meeting derision on Twitter, the imprisonment and fines option was greeted with scepticism when it was announced.

For instance, commenting at the time of the announcement, Barnett Waddingham senior consultant, Malcolm McLean, said: "There are also serious doubts as to how easy it will be to establish the new criminal offence of 'wilfully' or 'recklessly' mismanaging funds.

"These are ill-defined terms that a clever defence lawyer is more than likely to successfully challenge on the 'beyond reasonable doubt' test needing to be satisfied in a criminal case."

Ashurst pensions counsel, John Gordan, argued that the lack of clarity around criminal offences will cause anxiety in the industry.

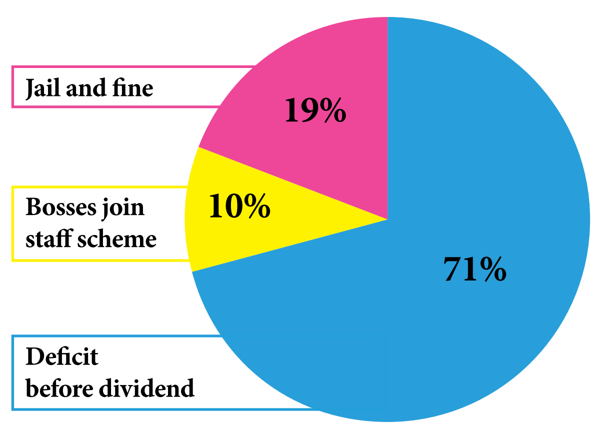
"Many directors will wonder what constitutes 'wilful or reckless behaviour in relation to a pension scheme', in the knowledge that, if they get this wrong, they could face a long prison sentence and unlimited fines," he said.

Lincoln Pensions CEO, Darren Redmayne, agreed that the proposals will be difficult to implement.

"In principle, Amber Rudd's proposals are hard to argue with and probably good politics – trying to show that the government isn't simply beholden to Brexit issues. However, establishing a clear framework over what constitutes wilful or reckless behaviour in court will be very hard in practice."

Encouraging executives to fund DB schemes before making payouts to shareholders may be the most popular suggestion out of those proposed to ensure company executives pay adequate attention to their DB scheme, but it is clearly no one would expect it be an easy fix. When it comes to increasing sponsor enthusiasm for funding their DB scheme, a mix of carrot, stick and a number of tools in between look likely to be required.

Poll: Which of the three options do you think would have the greatest impact on motivating sponsors to take their responsibilities seriously and continue running their DB scheme?



Editorial credit: ShutterStockStudio / Shutterstock.com

Summary

- 'Endgame' planning has become an integral part of trustees' psyche, but techniques on how to manage a scheme's flightpath has divided the industry.
- The Pensions Regulator is driving schemes' focus towards a long-term funding target, while its incoming funding code will put more emphasis on integrated-risk management.
- Those looking to scrap the triennial process want a more 'real-time' and flexible approach to scheme monitoring.
- Triennial advocates still regard the process as vital to trustee and sponsor negotiations.

The triennial sideshow

With more tools and techniques at trustees disposal, as well as improvements in technology and a shift in focus to the long-term journey planning of schemes, is there a danger that the long-standing triennial valuation process is becoming a dangerous sideshow? Theo Andrew investigates

There is little doubt that the UK pensions industry is growing up. As many defined benefit schemes set into maturity, some are able to cope with the ageing process in a more dignified manner than others.

As the ageing process takes hold, inevitably, things just might not work like they used to. The rituals and routines that you would normally swear by may have become outdated, or replaced by more thorough and frequent techniques than hadn't previously been available.

For years the triennial valuation framework has been an essential part of understanding the overall funding health of a scheme, but as trustees start to plan for their twilight years, the focus has shifted towards an integrated approach to determine a scheme's position.

Generally, schemes have 15 months to submit their valuations to The Pensions Regulator (TPR) and are required to do so every three years, but with the focus shifting longer term, many are questioning whether this is still necessary.

Scheme horizon lines are also a lot closer than we might think, so is it time to wave goodbye to the 'outdated' and 'irrelevant' triennial valuation process, or is it still a vital negotiating tool, enabling trustees to get the best possible deal for their pension scheme?

A dangerous sideshow

In March, the regulator set out what it expected of schemes when planning their long-term funding target (LTFT), suggesting that they put an investment strategy in place and issuing guidelines for trustees, depending on the health and maturity of the scheme.

With schemes being encouraged to think longer term and with more mechanisms in place to manage the scheme, some experts feel the triennial process helps to drive the wrong behaviours.

"Since the requirement came into force 20 years ago quite a few things have happened to make it appear out of date and almost irrelevant," says Independent Trustee Service (ITS) director, Rachel Croft.

"DB funding and risk management has gone hugely up the corporate agenda, in some cases you might have needed a valuation even just to get people round the table, but now I don't think that's the case anywhere."

Croft cites the LTFT, as well as "huge strides" in technology and industry efforts to improve data, meaning that "the basis of the valuation is more and more accurate every time we do it".

According to Barnett Waddingham partner, Oliver McMulloch, the technology is available for pensions schemes to measure their funding position on a daily basis.

Despite this, Aon partner, Lynda Whitney, believes the valuation process is still an essential tool to ensure that trustees get as much as possible when it comes to negotiating with their sponsor.

"It is the chance for company and trustees to really negotiate with each other to determine what contributions are and what security packages sit around the scheme," she says.

"There is an absolute need for company and trustees to negotiate those items, and having a three-year period that says to stop and have a full assessment, allows them to work on all the other items they need to in the rest of the cycle."

However, Dalriada trustee representative, Chris Roberts, argues that in the world of interactive modelling tools and tracking software, it feels "like a lot of effort" to submit a valuation, but that it does have its benefits.

"I do feel it has some drawbacks, but in terms of focusing peoples' minds and getting them round the table on a regular basis, it is a bedrock of the process. I don't feel they could regulate real-time monitoring to the same extent."

Pensions and Lifetime Savings Association policy lead for LGPS and defined benefit, Tiffany Tsang, agrees, and believes that without the valuation it isn't really possible for the trustees or the regulator to safeguard members' benefits.

But, if the tools are there to continuously manage the funding health of the scheme, Croft states that there is no need for the regulatory requirement for a triennial valuation.

If not then what?

While Croft believes that we may have moved past the point of triennial valuations being a regulated requirement, she concedes that some sort of framework would have to be put in its place.

The regulator's incoming funding code, its recently published Annual Funding Statement (AFS) and investment consultants' constant drive towards the 'endgame' are all set to give trustees clearer guidelines on maintaining the funding health of the scheme, but it is not clear how the triennial framework will sit in this process.

According to Lane Clark and Peacock's 2019 pensions de-risking report, 75 per cent of schemes surveyed will expect to reach their long-term goal over the next decade, which has left many wondering the best way to manage the process.

Croft says: "We need to be sure that we monitor progress against that long-term plan, and have the ability to review and discuss the funding target at the appropriate point."

Roberts agrees: "If you had a regime that monitored and considered funding and kept track of it, then there could be a framework in there, but it would be a fundamental shift and hard to get corporates to engage."

However, the regulator's ability to oversee real-time approach to valuation would also prove difficult to achieve. Herein lies the problem.

On top of this, Whitney believes that just because the focus has shifted to having a LTFT does not mean that the goal posts have to be moved.

"I'm very supportive of TPR's AFS, particularly around having a long-term funding target, then having a valuation which you test how you are doing in terms of a short-term plan to get us to a long-term plan is a very good thing.

"The conversation at a valuation is an integrated risk one, the conversation is not and shouldn't be focused on the detail, it should be a big picture conversation."

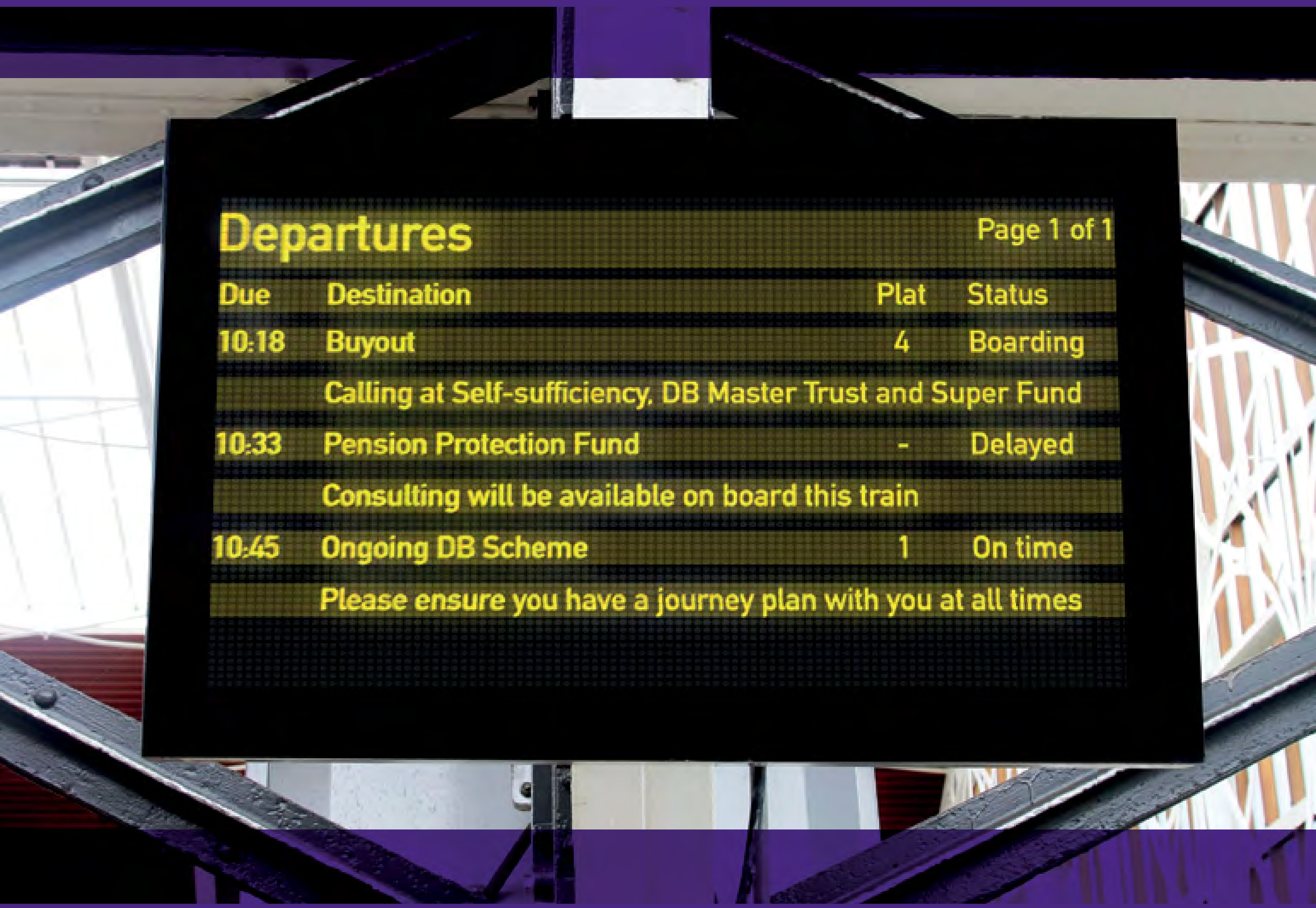
So despite calls from some areas within the pension industry to replace the valuation, with the Department for Work and Pensions track record for pensions reform, is it even a possibility?

Tsang concludes: "I've worked in policy enough to say you can never say never, but at the moment I think it is important to continuously review the governance structure, to work closely with trustees to ensure they have the right tools to make the right decisions for its members."

A growing trend has been to focus on managing the scheme through its final days. Whether it be a scheme's 'flight path', or maybe it's entering 'endgame' territory, developing a strategy to ensure the scheme grows old with dignity, is paramount for success.

Written by Theo Andrew

CAPITA



DB DESTINATIONS

It's time to choose yours

capitaemployeesolutions.co.uk

Sponsored by

CAPITA

DB destinations: Time to choose – *TPR's 2019 Annual Funding Statement encourages trustees to set a long-term funding target (LTFT) and a plan for getting there. This is a welcome development, but there are questions about how trustees and employers will incorporate an LTFT into a journey plan* ***p84***

Out of the spotlight – *Reports that employers who endanger their company pension schemes through reckless behaviour have meant that other proposed powers for the regulator attracted less attention, reports Graham Buck* ***p86***

De-risking focus:

Planning ahead

Colin Parnell, head of bulk purchase annuities, Capita

CAPITA
Sponsored by

DB destinations: Time to choose

The Pensions Regulator's (TPR) 2019 Annual Funding Statement encourages trustees to set a long-term funding target (LTFT) and a plan for getting there. Aligning trustees' funding targets with their de-risking plans is a welcome development, but there are questions about how trustees and employers will incorporate an LTFT into a journey plan

TPR highlighted that good practice often involves trustees and employers agreeing a clear strategy for achieving their long-term goal. TPR wants to bring this good practice into the scheme funding regime and one key feature of that is setting a LTFT. The example LTFT given is a funding reserve (target asset value to hold) that is large enough for the scheme to have reduced dependence on the employer and a high degree of resilience to investment risks. This is recognition that schemes' payments may run over several future decades, a period over which employer support and governance standards may diminish.

TPR expects that schemes' future investment and funding strategies, prior to becoming fully funded on the LTFT, are aligned with this target using journey plans, which look beyond becoming fully funded on the current statutory funding target, the Technical Provisions basis.

This will be a significant development for many trustees, especially of small schemes, since they will not have documented an LTFT or written a long-term plan. They will need to decide whether they should target the cost of insured buyout, the cost of consolidation in a superfund, or a self-sufficiency basis derived from the cost of running their scheme in a low-risk way.

What are the possible long-term funding targets?

Buyout

Some of the biggest schemes in the UK have signalled their intention to ultimately buyout. For example Rentokil has insured all of its scheme liabilities (circa £1.5 billion) and expects to wind up the scheme next year.

The argument for buyout as the LTFT is even more compelling for smaller schemes, due to their relatively high running costs per member, inability to access sufficient affordable expertise, failure to consistently meet the regulator's expectations on good governance, and highly variable funding outcomes due to the concentration of risk among a small number of lives.

There are challenges to having buyout as the LTFT. Many consider it to be the gold standard, because the tight regulatory regime that insurers observe means that members face low risk. However, it is also perceived to be the most expensive possible funding target. In March 2018, UK pension schemes had a Technical Provisions funding level of 91 per cent compared to an average funding level of 73 per cent on a buyout basis. Disclosing a buyout LTFT may unnerve employers when they see that the scheme has a large shortfall on this basis that may be identified by investors and lenders.

Some trustees have questioned whether buyout is an appropriate target because they think they may struggle to obtain competitive quotations from insurers. Our experience, however, is that well prepared schemes manage to obtain at least one insurance quote regardless of their size. Also, schemes' ability to meet the LTFT will change as they mature: there is more insurer competition for pensioner-only transactions and the cost of insurance also falls as members get older. Therefore, over the long term, insurance may be easier to obtain.

When setting the journey plan to their LTFT, trustees and their advisers may make allowance for heavier scheme mortality experience and greater investment outperformance than insurers might assume prior to reaching the LTFT. This may make the path to the LTFT appear a little less expensive and will require planning on expected timescales to reach the LTFT as the length of the journey plan will be a key determinant of the expected savings available.

Even so, some trustees will struggle to produce a credible investment and contribution plan to get them from fully funded on a Technical Provisions basis to fully funded on a buyout basis. TPR will have to intervene when there is no credible plan to reach a LTFT.

It is difficult to predict the long-term direction of insurance pricing. With nearly £2 trillion of UK pension liabilities heading for the exit and the opportunity for insurers to take on international business, demand for insurance may exceed supply over the long term, leading to a potential increase in insurance prices. Also, step changes in insurance prices are often driven by regulatory changes, which are hard to predict.

Superfund consolidation

It is currently difficult to make an accurate assessment of the cost of entering a superfund consolidation arrangement as there have been no transactions to date and the rules governing these arrangements have not been finalised.

Unlike for insurers, who offer indicative pricing that can be verified against actual transactions, it remains unclear what the cost of entry to a superfund will be, but, based on approximate analysis and the limited information available, we expect it to be 5-15 per cent below the cost of buyout for a typical scheme. However, until the superfunds achieve significant scale, offering this pricing may be challenging. Therefore, it is questionable whether trustees should use this as their LTFT while there is so much uncertainty.

Based on the expected pricing of superfund consolidation providers, the more mature a scheme becomes, the greater the convergence of the superfund consolidation price with the buyout price. Therefore, for significantly underfunded schemes that expect to have a journey plan spanning decades, the increasing maturity of the scheme may imply that the cost may converge on the buyout cost. In these circumstances, there will be little difference if buyout or superfund consolidation is named as the LTFT. For schemes that can afford to buy out within the foreseeable future, they are unlikely to have access to superfunds due to the gateway proposed by TPR. However, this still leaves a significant proportion of schemes that may select the superfund consolidation route as their LTFT once the market develops.

Self-sufficiency

For many schemes, reaching a level of funding that allows them to enter a superfund or to buy out may be some decades away. Therefore, they may target a self-sufficiency measure as their LTFT or as an interim step along their journey plan. Trustees and advisers have often struggled to define self-sufficiency. TPR has helpfully given guidance that the LTFT should reflect reduced dependence on the employer and a high degree of resilience to investment risks. However, even within this framework, there remain a number of areas that trustees will need to consider if they are to set self-sufficiency as their LTFT – some are listed here.

Reserve for future running costs

For small schemes, the present value of future running costs until the last member is paid may be 10 per cent of total scheme liabilities. To be truly self-sufficient, trustees will need to make allowance for this significant cost that most assume will be picked up by the employer.

Some advisers are trying to consolidate small schemes into efficient, all services arrangements to lower running costs (eg defined benefit master trusts or merging schemes with the same employer). With improved technology, one may believe that running costs will drop significantly over time. However, there are large barriers to overcome. For example, the fixed costs of automating processes are disproportionately large for small schemes. TPR appears to have no appetite for allowing trustees to simplify schemes, which may help to lower running costs (eg harmonising benefit definitions across schemes). Trustees have some existing powers to simplify benefits across different schemes, which could potentially lower future running costs. However, most trustees are reluctant to use these powers due to the creation of winning and losing members under any revised approach. Therefore, it appears that running costs will remain high.

Reserve to protect against investment risk

TPR talks about setting an LTFT with high resilience to investment risks. Therefore, if trustees and employers agree to take significant investment risk over the long term, presumably TPR will expect them to hold an additional reserve against this.

Reserve to protect against risk of data or benefit errors

When assessing the risk that they face, many trustees do not take account of the possibility that data or benefits may be incorrect. A common assumption might be that, if additional liabilities are identified, the employer will address the cost. To be self-sufficient, this risk needs to be eliminated (through data and benefit audit and ongoing maintenance) or a reserve held against the risk. It is difficult to determine what may be a suitable reserve. As an example, an insurer might charge trustees 1 per cent of the value of liabilities to hold data and benefit risk. However, they would only do this after carrying out extensive due diligence and correcting any errors – most ongoing schemes have not undertaken this so one could argue that the reserve within an LTFT for this risk should be higher.

Reserve to protect against small scheme mortality risk

Finally, small schemes face higher mortality risk as it is difficult to predict the lifetimes of small groups of members. A self-sufficient arrangement will hold a reserve against this risk.

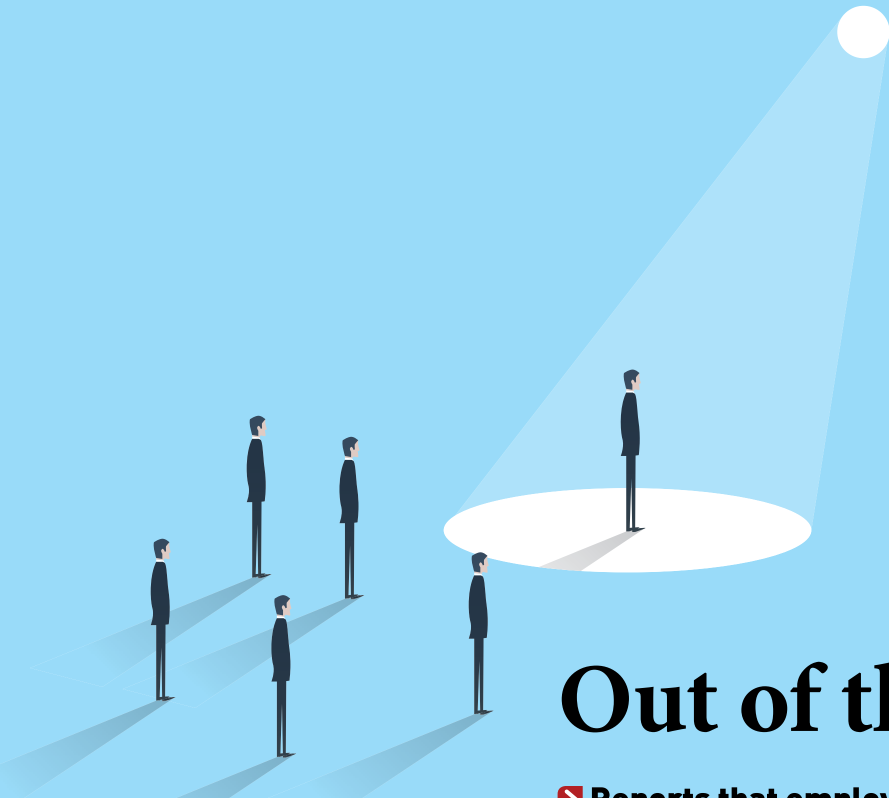
If trustees require reserves to cover running costs, investment risks, data risks and small scheme mortality risk, a self-sufficient measure of scheme liabilities may end up similar to the cost of entry to a superfund consolidation arrangement or even the buyout cost.

Conclusion

TPR's annual announcement will put greater pressure on trustees to plan for the long term. They may face difficult negotiations with employers about the ultimate destination of the scheme since this will determine the expected cost of getting there. Currently, we expect the most common LTFT to be the future buyout cost. However, many trustees will use an interim step of targeting a low-risk self-sufficient position that is below the buyout cost. If the superfund consolidation market develops, it may be possible to target the cost of entry to these arrangements at 5-15 per cent below the buyout cost.

Written by Colin Parnell, head of bulk purchase annuities, Capita

In association with CAPITA



Summary

- In keeping with proposals to beef up the powers of The Pensions Regulator (TPR), the mantra 'clearer, quicker, tougher' runs through the regulator's latest annual funding statement.
- For scheme trustees, the notifiable events framework is possibly the proposal that has the biggest impact on their duties and responsibilities.
- Reports suggest that the regulator is already making more initial enquiries and intervening on certain occasions where it has been contacted by the scheme's trustees.

Out of the spotlight

Reports that employers who endanger their company pension schemes through reckless behaviour have meant that other proposed powers for the regulator attracted less attention, reports Graham Buck

The demise of British Home Stores (BHS) and Carillion were symptomatic of a wider malaise across their respective industries, the retail and construction services sectors. The vulnerability of other high street names and the recent administration of Interserve further underline the potential for further corporate casualties and the jeopardising of their pension schemes.

A year ago, the government white paper *Protecting Defined Benefit Pension Schemes* proposed beefing-up the powers of The Pensions Regulator (TPR) to intervene when employers recklessly contravene their obligations to DB schemes. In February, the Department for Work and Pensions' (DWP) response confirmed jail sentences as the ultimate sanction for company directors endangering the pension scheme through wilful or reckless behaviour. The move was welcomed by Frank Field, chairman of the work and pensions select committee, despite criticisms that it smacked overly of "gesture legislation".

Indeed, for Aon Hewitt partner, Lynda Whitney, the more interesting part of the additional powers proposed is the notifiable events framework, which requires trustees and employers to notify TPR if certain events occur that could potentially give rise to problems impacting on the scheme. "When corporate merger and acquisition (M&A) deals are agreed, the trustees will need to become more involved and the company will be required to detail just how the deal will affect the scheme," says Whitney.

Clearer, quicker, tougher

Not surprisingly the TPR's just-published latest annual funding statement is widely seen as adopting a more prescriptive approach to DB scheme funding; for example confirming that companies should pay greater attention to paying down their DB deficits over fattening up shareholder dividends. It comes ahead of TPR's revised funding code of practice, scheduled for later this year.

"TPR would no doubt argue that its tougher approach has been in the making for several years," says former minister of state for pensions and now Royal London director of policy, Steve Webb.

"But there can be no doubt that the high-profile pressure from Frank Field and the committee has given additional impetus to the need to be seen to be intervening earlier and more effectively where employers are not doing right by their pension scheme."

"The pressure and criticism faced by TPR in recent years are definitely key factors in the ongoing evolution of its regulatory approach," agrees Allen & Overy partner, Jane Higgins. "But this isn't a step-change.

"The new mantra is 'clearer, quicker, tougher' – the latest statement is clearer, rather than necessarily tougher. It sets out TPR's expectations in more detail than before, with a greater focus on scheme maturity and covenant strength."

In its latest statement, the regulator stipulates that "as the pension scheme is a key financial stakeholder, we expect to see it treated equitably with other stakeholders."

So where the employer is "tending to weak, or weak", the scheme's deficit reduction contributions (DRCs) should be larger than dividend payments and other shareholder distributions, unless there is a strong funding target and short recovery plan. If the employer is weak and unable support the scheme, TPR expects shareholder distributions to cease entirely.

"TPR has published statistics that show there are many DB schemes in deficit where the amount the employer was paying out in dividends was a multiple of the deficit recovery payments," says Webb. "With BHS, huge dividends – larger than the profits of the company – were paid out in the early years and some took the view that this starved the business of investment, jeopardising its longer-term future. With Carillion, large and increasing dividends were being paid out right up to the brink of insolvency."

Many employers have negotiated longer recovery plans with trustees to pay off funding deficits on the basis that paying them off any quicker would damage the business, adds Capita Employee Benefits head of bulk annuities, Colin Parnell. However, TPR's 2018 scheme funding analysis found that median deficit recovery contributions across FTSE 350 companies were just 7 per cent of dividends paid – part of a downward trend in DRCs when compared to company dividends.

"In most cases, pension schemes are unsecured creditors that rank above holders of equity," says Parnell. "Therefore, trustees appear to have the power to push employers harder to speed up recovery payments."

At the same time, the onus is placed on them to determine when – and if – an employer should be regarded as 'weak'.

"Understanding the employer's 'covenant strength' can be difficult if the employer is not transparent," notes Webb. "An important part of the trustee's role is to stay close to what is happening in the business and also, where appropriate, to use professional advisers to provide an independent perspective on that covenant strength."

Parnell agrees that trustees are placed in a difficult position. "Obtaining appropriate advice and taking meaningful action can be expensive and is more difficult if delayed until a moment when the scheme and employer can least afford it. It is best to develop integrated risk management – usually with specialist covenant advice – while the covenant is still reasonable."

Long-term funding targets

The regulator's latest annual funding statement also places much emphasis on long-term funding targets (LTFTs), although, as Higgins notes, most schemes already have a long-term plan in place as part of their de-risking strategy and the comments may simply be there to help formalise good practice.

"LTFTs have already seen a lot of work between trustees and employers as in many cases a reasonable target needs to be agreed," agrees Whitney. "Consequently there can be considerable variation in the timescale. Integrated risk management is needed to determine the balance between the desired return, risk and security."

"The main new requirement is for schemes to have a clear statement of their destination – for example, are they heading for buyout and if so, over what period," says Webb. "This makes sense and will often have been implicit in the scheme's planning."

Parnell reports that "anecdotally, bulk annuity insurers have told us that larger schemes are better prepared to get to their ultimate destination than smaller ones. It is important that journey plans are sufficiently wide in their scope, also covering actions associated with data and benefit definitions, as well funding and investments."

Also still attracting attention is the issue of covenant leakage, particularly when the sponsoring employer is part of a larger group of companies. As two main examples, Parnell cites loans from the sponsoring employer to another member of the group and the sale of fixed assets where the sale proceeds are moved out of the sponsoring employer.

"However, it's hard to identify what actions are deliberate attempts to divert money from the statutory employer and, consequently, further away from the pension scheme," he adds.

"For example, many corporate group structures have cash sharing arrangements within the group, which help to reduce borrowing costs – ultimately improving the health of the sponsoring employer and scheme."

Higgins adds that instances of deliberate action to the detriment of a scheme without the offer of some mitigation remain relatively rare, since there is always the risk of TPR opening an anti-avoidance investigation.

The regulator also reveals that last year there were occasions when it made interventions ahead of a scheme conducting its latest valuation. Could this become a more regular occurrence?

"TPR is moving to a system of one-to-one supervision of the major schemes, rather than a three yearly reactive process," says Webb. "This will enable it to pick up issues earlier rather than simply wait for a valuation and then potentially spend months – if not years – disputing it.

"It is far better to be proactive and prevent these problems arising in the first place. Schemes are likely to see a more interventionist TPR than they have done in the past."

Whitney admits to feeling some sympathy for TPR, which "only a few years ago was being encouraged to be friendlier to plcs and focus on sustainable growth".

However, as she concludes: "The political climate has obviously changed; hence the new mantra and we've seen the regulator deliver a stronger message."

Written by Graham Buck

In association with CAPITA

Driving positive change

With many changes afoot across the UK pensions landscape, Theo Andrew sits down with Pensions and Lifetime Savings Association (PLSA) policy lead for defined benefit and Local Government Pension Schemes (LGPS), Tiffany Tsang, to discuss the body's key projects and challenges

With numerous government consultations on the go, it must be a busy time at the PLSA. What are the main ones you are looking forward to?
As we all know, we really can't go on with the status quo at the moment, because the PLSA's aim overall is to ensure that people have enough income in retirement and protecting members underpins all of the policy work that we do.

Within the defined benefit white paper, which the consultation came out about a year ago, you had the strengthening of The Pensions Regulator (TPR)'s powers, and now they have responded to the consultation and will start legislation. Superfunds is obviously a hot topic at the moment and it's something that we have been leading on for the past few years through our DB Taskforce.

We also have the chair's statement, and there is no official word yet but we do know that they intend to legislate on it rather soon, so there should be something on that later on this year and it is something we are keeping a really close eye one.

The last bit is around the funding code and the funding framework, which is a huge deal. These four strands really come together to complete this huge puzzle to highlight how we can showcase that we can get better at protecting schemes, as well as people and their pensions.

It's something that we are working on closely with TPR, helping it to arrange roundtables in 2019 and 2020, as well participating in its own workshops and roundtables. Broad strokes, that's what we are working on at the moment.

I think the intent is to get everything in place, so when the Bill happens it is all signed off and in there. However, there is a lot of uncertainty around the timings because of Brexit as well. The estimation is roughly the next 18 months from now and when things have been consulted on through the DB white paper and legislation.

You mentioned superfunds and the PLSA has been a big advocate. What effect do you think it will have on the pensions landscape?
It is a really interesting time for consolidation. In terms of next steps we can't really do anything until the government collates its responses to the consultation, which closed a month ago. We believe really strongly in superfunds because things just can't carry on as they are, the status quo just isn't enough. What we do know is that if things don't change and we do nothing, then the majority of schemes will be okay, but there a significant minority will not. It is this minority that the PLSA is focused on, because these schemes could amount to up to three million members losing their full benefits, which is an upsetting and dangerous scenario.

Without superfunds, these three million have a 50/50 chance of not getting their benefits. With superfunds, there is a guarantee that up to 95 per cent of people will be able to get their full benefits, which is a significant increase from where we are now.

Buyouts, the other option, is a fantastic product if you can afford it. But the problem is that a majority of schemes cannot. Superfunds distinguish themselves from buyout because of their affordability and its regulation.

One of the things I was very happy about in the consultation is that it draws very heavily on the master trust authorisation regimes. We know a lot of hours were poured into making that regime and it's a regime that we can have faith in.

LGPS is also another big part of

your role. What are the main policy pieces you are working on at the moment?
There is so much going on at the moment, with the same themes around protecting members and strengthening schemes.

The hottest topic going on in the LGPS right now is asset pooling. Again, it is a theme of consolidation just like in the DB world. It is a really huge piece of work that we are trying to help with, and we work really closely with the scheme advisory board. The next step for us in terms of asset pooling is to ensure that the statutory guidance is correct regarding the investment approach, what metrics you use before you realise something isn't working.

Another big thing to come out in January is the Fair Deal consultation, which we have been waiting for a long time for. Our involvement with the issue dates back to 1999, when the government started outsourcing their services, government employees would go with those services.

Now there is something called the New Fair Deal, which ensured that government employees who worked for the NHS, the police and teachers, were protected.

They have promised us it is the last consultation on the Fair Deal, which is very technical. Previously, stakeholders have flagged disparity between best direction and Fair Deal, which they hadn't seen themselves, so it's really good that the government is trying to make sure that it's being done fairly and correctly. The last consultation we had was in 2016, and then in 2018, they highlighted eight key themes in their response, which they hadn't already anticipated.

The last one came out in January and is running until April 4. We liaised with our members to see what their main worries were.

The cost cap also hit the headlines in the later end of last year. What's the update there?
After what happened in September, where the Treasury said there is most likely an initial breach of the cost cap floor, which essentially means that employer contributions would have to go up, good news for members, but obviously that caused a lot of concern. How did it happen? What can we do to sustain costs? What next?

Recently, the government said it was pausing the consultation on that. It is concerning because this is also the year that LGPS funds are doing their valuation, and how are they meant to be able to value their scheme if they don't know if the cost cap mechanism as of September will apply. So it could be a problem and cause huge administrative burden.

If in 2020 the government decides to turn its lens back on the cost cap, how will that be retro fitted? This is the main concern at moment.

What are the other challenges facing LGPS at the moment?
Another big thing we've been working on is something called talent management in the LGPS. Last year we did a huge research project after our members came to us and said they have a huge problem with talent retention.

We have good people who work for LGPS, but the problem is that people don't stay, so retention, recruitment and resourcing are the three main problems. We set out to understand the drivers and there is a huge policy implication.

It also ties in with a lot of the work we are doing around diversity and inclusion. It is not about diversity and inclusion itself – but what are the causes of these problems. Some of our respondents said to us we want more young people to be in the sector, but pensions is not a sexy thing.

One of the frustrations that came out in the research was that some of the funds felt they were in direct competition with the pools for talent. To what extent that conflict exists is too soon to tell, so there will be some measure of time before we can go back to the research. The work that we have done so far clearly says there is a question mark around the pools stealing the talent, because it's like starting a new company.

In the coming year we will be working around next steps of talent management, because once you peel a layer you realise how much more there is to go. We want to look deeper into the granular aspects of why certain funds are successful. Is it more flexible working? Maternity or paternity leave? What is it that's driving good retention?

Lastly, LGPS is focusing on the separation issue, linked to the talent management issue. It centres on the question of whether LGPS funds would run more efficiently if it was more independent from local authorities? There are pros and cons to this.

The pros are the obvious ones, that LGPS can be weighed down by bureaucracy. The cons is that many of the rules that have been put in place, comes from years of battling from the unions in order to encourage transparency, to ensure everybody has equal access to work and to be sure that everyone is being paid a fair wage.

Overall the term separation is more dramatic than it suggests, it is more just seeing how things can be simplified.

In general, how are the pools finding the process?
All the pools are working really closely together and they are in constant contact. They need to be applauded for how much they have accomplished in the time they have been given, as well as how open as they have been.

There is a lot of sharing of knowledge that I can see. It is very early in the process and now we need to work with them to establish these hard and soft metrics to track progress. It is exciting times to come.

Written by Theo Andrew

Summary
• Highly paid doctors and consultants are at risk of breaching the LTA and AA, so some are avoiding taking on extra shifts, placing strain on the NHS.
• The NHS has loaned staff £35 million to help cover AA and LTA tax charges.
• According to a survey of 4,000 consultants by the British Medical Association, six out of ten said that they expect to retire early, with many giving breaches of the LTA or AA as the reason for doing so.
• Health Secretary Matt Hancock has lobbied the Treasury about the LTA and AA on doctors' behalf.

This may sting a bit…

Maggie Williams explores how medical staff navigating the lifetime and annual allowance limits is affecting how the NHS functions

It's survived epidemics, political antipathy and a population increase of over 16 million since its introduction in 1948. But can the NHS survive its current pensions crisis?

Highly-paid doctors and medical consultants are facing punitive tax bills for breaching the Lifetime Allowance (LTA) or Annual Allowance (AA) and the knock-on effect is biting into the NHS' day-to-day business.

An investigation by the *Financial Times* showed that senior consultants who would formerly have taken on additional shift work to clear patient backlogs or offer specialist treatments are now turning this work down. They are concerned about AA tapering and tax treatment as a result of the additional earnings.

The issue has become so acute that, according to the *Financial Times*, the NHS loaned staff nearly £35 million in 2016/17 to cover AA-related tax charges. And the NHS's malaise could deepen further in future. According to a survey of 4,000 consultants by the British Medical Association, six out of ten said that they expect to retire early, with many giving breaches of the LTA or AA as the reason for doing so. Only 6.5 per cent of those polled said that they intend to work beyond the age of 65.

In an attempt to mitigate the effects, Health Secretary Matt Hancock has even lobbied the Treasury about the LTA and AA on doctors' behalf.

Breaches of the £1.05 million LTA and the £40,000 AA are an issue for the NHS, but it is the AA taper that is causing the most confusion. This is applied to taxable earnings over £150,000. For every £2 of income over £150,000, the AA is reduced by £1. Anyone with an income over £210,000 will have an AA of £10,000.

Medical staff are not alone in being snared in the tax net of the allowances and the taper. According to HMRC figures, the tax taken from AA breaches leapt from £179 million in the 2015/16 tax year, to £561 million in 2016/17 when the tapered AA first came into effect.

Workers in the public sector, such as the NHS, have been particularly hard-hit. "In the private sector, it is now common for employers to offer cash alternatives to employer pension contributions where workers find that pension saving is no longer tax-advantaged. Public sector employees seldom have that choice," says Willis Towers Watson senior consultant David Robbins.

Highly-paid workers in other professions who take on additional shift work or receive other types of one-off payment can be similarly affected. Mazars partner and head of financial planning Sarah Lord adds: "Bonus payments are often paid in March and that leaves it really tight to finalise *[details of earnings]* before the end of the tax year."

Punter Southall managing director for DC consulting, Alan Morahan, describes the LTA and AA with taper as "horrendously complicated".

"People are falling foul of them, often through no fault of their own," he adds. "The AA is impacting the ability of young, high-earning individuals to build retirement pots that are going to get close to providing a reasonable replacement for income in retirement."

What should be done?

Lengthening patient waiting times and loss of long-standing expertise from the workforce cannot have been the intended effect when the Treasury lowered the LTA and slashed the AA in 2010, then introduced the taper regime in 2015/16. Is it time to review the allowances and even consider abolishing them?

"This is mostly an issue for higher earners who are actively engaged with their retirement and tax planning. That fact could reduce the incentive on the government to make any changes," says Gowling WLG director, Christopher Stiles. However, Broadstone director – pensions and financial planning, Rachel Meadows, adds that "by trying to ration tax relief to high earners, the current limits actually draw mass middle savers into the mix, especially if they start to save and engage with pensions early in their career".

"The political calculation at the time the taper was introduced was probably that, even if this were a badly-designed tax, it would be a relatively painless way to raise revenue because there would be little sympathy for the high earners on the receiving end," concludes Robbins. "That judgment may have to be revisited if the tax is having real-world consequences in the NHS, but the Treasury will want to look at offsetting measures to raise revenue elsewhere."

Written by Maggie Williams, a freelance journalist

Remove, review, retain?

Should one, or both of the allowances be removed? Here are the options:

Retain the annual allowance and lifetime allowance, but remove the annual allowance taper

"High earning individuals with an adjusted income between £150,000 and £210,000 face a hugely complex tapered annual allowance," says TLT partner and head of pensions Sasha Butterworth. "And it can be difficult for people to work out how to carry forward unused annual allowances". Lord suggests returning to a single annual allowance for everyone, at the original rate of £50,000.

Pros: Reduces complexity and limits the risk of unexpected and unpredictable tax bills.

Cons: It won't solve the problem of high earners breaching the allowance.

Remove or significantly increase the annual allowance, but retain the lifetime allowance

"As long as it is in excess of £1 million, the LTA is fine as it is. However, the AA should be removed," argues Sanlam UK head of commercial Elliott Silk. "That would give people the opportunity to fund their pension as quickly as they want. If they experience a cash event, such as a property sale, business exit or an inheritance, then they can put money into their plan."

"The reason for giving tax relief on pension savings is to avoid double taxation; the savings will be taxed when they are paid out in the form of a pension, so they should not already have been taxed at the time that funds are put aside for that future purpose," adds Stiles.

Pros: Those who are unable to save for a pension earlier in life could 'catch up' in later life. The approach could better suit variable earnings patterns, including the self-employed.

Cons: High earners could still find themselves breaching the LTA limit.

Remove or significantly increase the lifetime allowance, but retain the annual allowance

"At a £1,030,000 lifetime limit, someone aged 65 purchasing an annuity with the whole pot, and opting for 3 per cent escalation, would only secure a pension income on todays' rates that generates £38,625 per annum – a comfortable pension for sure, but hardly enough to be a true 'high earner'," says Meadows.

Pros: Removing or significantly increasing the LTA would enable individuals to save more for retirement across the whole of their career. Altus Consulting head of retirement strategy John Dean says: "It would remove a heap of administrative burden and cost from providers, reduce the cost of tax collection for HRMC and help individuals plan much more clearly for their future."

Cons: Dean cautions that "removing the LTA would most likely be accompanied by a reduction in the AA to make it tax-neutral, or probably to raise a little more tax".

Remove or significantly increase both the lifetime allowance and the annual allowance

"The LTA and AA are great examples of the government taking the basically simple and fair idea of limiting tax relief on a 'fair use' basis but losing sight of the bigger picture when implementing the detail," says Meadows. "The backlash against higher earners in the immediate wake of the credit crunch, and very tight fiscal conditions, meant that cuts to both went far too far – and especially in the case of the AA, have continued to do so."

"The combination of the LTA and AA mean that people can't save at the point in their career when they want to," says Aon partner Lynda Whitney. "That means there are issues for long-term saving – and as the government keeps tweaking the allowances over time, that also causes issues."

Pros: Everyone would be incentivised to continue saving into a pension, throughout their working life. Senior high earners would continue to engage with pensions, which could have a positive effect for all employees. The risk of businesses losing expertise through early retirement because of tax penalties would diminish.

Cons: The Treasury would likely want to make the move cost-neutral in terms of tax revenue. That would mean painful tax increases elsewhere – plus the risk of political backlash over a policy that predominantly favours high earners.

Summary
• The Pensions Ombudsman (TPO) deals with complaints and disputes that concern the administration and/or management of both occupational and personal pension schemes. It tackles high numbers of cases regarding administration, transfers and scheme communications.
• A number of high-profile cases have heightened the importance of protecting members from incorrect transfer values and scammers when it comes to transferring their pension.
• Mismanagement of pensions administration processes and communications also stand as a key feature in a significant number of cases brought to TPO.
• For members to receive the correct benefits at the correct time, an abundance of up-to-date record keeping, thorough due diligence and robust administration processes must be in place to ensure errors do not occur.

Talya Misiri looks at common trends in The Pensions Ombudsman's recent decisions and what the industry needs to do, and be aware of, to prevent similar issues occurring

"The Pensions Ombudsman's decisions are, on the whole, more predictable and consistent than they used to be," says Arc Pensions Law partner Anna Copestake.

The Pensions Ombudsman (TPO) deals with complaints and disputes that concern the administration and/or management of both occupational and personal pension schemes.

Copestake explains: "It's easier for trustees, administrators and their advisers to have a feel for which way the ombudsman's decision is likely to go. If the answer feels pretty obvious, then generally speaking we tend to see a sensible finding of fact, which is to be welcomed, because findings of fact can't be appealed."

Nonetheless, TPO is still left to tackle high numbers of cases regarding administration, transfers and scheme communications, where the guilty party may not be as clear.

"Cases of incomplete, missing and inaccessible records are, unfortunately, not few and far between; but symptomatic of the industry," notes ITM director Matt Dodds. As a result, it is crucial that the industry learns from TPO's decisions to ensure similar cases are not repeated.

Transfers

With pension transfers high on the industry's and pension savers' radar, it is not surprising that transfers were ranked as the most common topic of completed and new investigations. TPO's most recent annual report and accounts for 2017/18 highlighted that general issues around transfers was the most common topic for completed investigations. In the year, it was also the most referenced subject matter of new investigations at 20.5 per cent.

Commenting on this, the ombudsman says: "The subject matter of new investigations was very similar to previous years, with one exception. During the year we took on a large group of similar complaints about the calculation of transfer values."

So, a number of high-profile cases have heightened the importance of protecting members from incorrect transfer values and scammers when it comes to transferring their pension.

Copestake highlights: "The ombudsman's determination on cases involving suspected pension scams, culminating in the Royal London case, helped put real pressure on government and industry to look seriously at what can be done to protect savers. It brought the issue more into the forefront and genuinely added to the debate," she says.

The case of Mr N versus Northumbria Police Authority in 2018 continued to emphasise the fact that adequate checks are not always being made for scheme members wanting to transfer out. The landmark case involved the complainant being permitted to transfer out of the Police Pension Scheme to the London Quantum Retirement Benefit Scheme, which was proposed by an independent financial adviser connected to an unregulated introducer. TPO ruled that the police scheme did not carry out adequate checks on the receiving scheme and failed to send the member The Pensions Regulator (TPR)'s anti-scam Scorpion document.

Commenting, Copestake says: "The grounds for that decision are debatable. I don't agree with TPO's conclusion that legislation requires transferring trustees to follow voluntary industry guidance. But it has increased the bar for trustee due diligence on transfers out, which feels like it was the ombudsman's intention and morally it's hard to disagree with that."

Pensions Administration Standards Authority (Pasa) board director, Chris Tagg agrees that there is a greater pressure on trustees and schemes to "identify suspicious activity". This includes "members being offered free pension reviews, pressure being exerted to quickly make transfer payments, overseas transfers for UK residents, etc", he says.

Nonetheless, Tagg agrees that the regulator's latest ScamSmart, (previously Scorpion) guidance is there for members to be referred to when considering transfer options.

This guidance "is mainly aimed at raising awareness, and also checking whatever register may be in place for advisers/schemes potentially involved in scam activity. Many third-party administrators will also have a transfer taskforce, or similar, containing people doing this kind of work on a regular basis and provide expert support to administrators," Tagg notes.

In addition to this, Tagg highlights that schemes, trustees and advisers can compare suspected scams against a list of cases when deciding on a transfer. "Most third-party administration firms maintain a list compiled from scam evidence they have seen of schemes and advisers potentially involved in suspicious transfer activities," he says.

"Procedures for dealing with transfer requests will often direct administrators to this list in case it identifies additional checks or action that might be required for individual cases."

Communications

Mismanagement of pensions administration processes and communications also stand as a key feature in a significant number of cases brought to TPO.

PensionBee CEO Romi Savova says: "It is important for administrators to take a customer-focused view at all times and to ask themselves: if I were the customer, what would I expect of my pension administrator today and when I look at this situation in the future?"

A recent TPO case between a scheme member and Prudential demonstrated how administrative errors can result in members falling short of pension information.

Prudential failed to provide the claimant, Mr K, with information about his benefits after he left the scheme it administered in 1990.

The ombudsman, Anthony Arter states: "Given Prudential knew that Mr K had left the plan in 1990, it ought to have issued statements directly to him from this time. Its omission to do so amounts to an administrative error. To deny Mr K information to which he was entitled, has denied him the opportunity to monitor the value of his pension benefits. Prudential provided correct information to Mr K for the first time in 2006, some 16 years after he left the plan."

Errors like this can be largely problematic for members planning for retirement and can also burden administrators who are then required to provide a backlog of information.

Nonetheless, gradual improvements are being made in the sector. "In administration, we are increasingly moving beyond a fixed-box approach and towards a system of principles," Savova notes.

Tagg adds: "Internal guidance available to staff at firms specialising in third-party administration has evolved significantly in recent years in light of errors and ever changing scam activity."

Moreover, "things are changing", agrees Dodds. TPR now requires both trustees and scheme managers covering trust and contract base schemes to review their common and scheme-specific data once a year.

"'Review' is a slight understatement, as these data checks go much deeper than checking presence and consistency of data, they must also measure the accuracy of data. And data scoring needs to expand beyond the main administration system – any separate records such as a payroll database also need to be included," he says.

It's clear that pensions is an area that requires an abundance of up-to-date record keeping, robust administration processes and thorough due diligence on changes and decisions made by members, schemes and regulators. For members to receive the correct benefits at the correct time, processes must be in place to ensure errors do not occur.

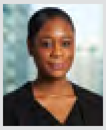
Dodds concludes: "Data and good record keeping are vital to running a pension scheme effectively and integral to performing the most basic function of making sure the right member, gets the right money at the right time. Of course, it can also deliver so much more than that, but let's just focus on the basics first."

Written by Talya Misiri, a freelance journalist

In association with STATE STREET GLOBAL ADVISORS SPDR®

ETF roundtable

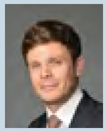
CHAIR



Hannah Smith, Head of UK Pension Coverage, SPDR ETFs

Hannah is a vice president at State Street Global Advisors, leading in the coverage of pension funds for the UK SPDR ETF business. She also covers hedge funds, asset managers and insurers. Hannah previously worked on the credit sales desk at Mitsubishi UFJ International, focused on growing the firm's UK institutional client base. Prior to this, she spent five years at Goldman Sachs International where she was responsible for advising family offices and UHNW clients on how to gain access to investment themes through the mutual fund and ETF universe.

PANEL



Joe Abrams, Principal, Fixed Income Researcher, Mercer

Joe is a principal within the fixed income manager research boutique, a unit within Mercer's investments business. Joe leads Mercer's research into global credit and absolute return fixed income. He researches bond strategies and assists clients in formulating their strategic allocations within fixed income and selecting managers. Joe is also a member of Mercer's strategic research group, which oversees the production of Mercer's intellectual capital, ranging from asset class specific material to multi-asset strategy.

Nico Aspinall, Chief Investment Officer, B&CE provider to The People's Pension

Nico is the CIO at B&CE. Previously, he was head of defined contribution (DC) investment at Towers Watson and head of DC for the Barclays staff pension scheme. He also chaired the resource and environment board and is a member of the Institute and Faculty of Actuaries council. Nico is a qualified actuary and has published papers on resource depletion and monetary sustainability – working to ensure climate change and other sustainability issues are understood and acted upon by actuaries.

Andy Cheseldine, Client Director, CCTL

Andy joined Capital Cranfield in 2017. Prior to this, Andy acted as an adviser to trustees and employers at Watson Wyatt, Hewitt Bacon & Woodrow and latterly as a partner at LCP. Using his experience of over 30 years in consulting on both DC and DB pension arrangements and liaising with regulators throughout the pension and financial services industry, he is able to use his wide knowledge and understanding for the practical benefit of trustee boards. He has served on the PLSA DC Council since 2013. He is a regular commentator in the pensions press and a popular speaker at pensions events.

Carl Hitchman, Head of Fiduciary Management Advisory (FMA), Stamford Associates

Carl is a qualified actuary with over 33 years pensions and investment experience, covering a wide range of areas including investment strategy, manager selection, transition management, derivatives, securities lending and foreign exchange. He has significant practical experience of the fiduciary management market, initially in an oversight role where he was responsible for undertaking assessments of fiduciary managers and now in the development of Stamford's FMA proposition.

Kate Hollis, Senior Investment Consultant, Willis Towers Watson

Kate joined Willis Towers Watson in September 2014 as a manager researcher on the fixed-income team. She leads traditional credit research and the exposure ASK and is a member of the credit – smart beta ASK. Kate previously spent 10 years at S&P Capital IQ, most recently as global head, fixed income/alternatives fund research. Before that she spent five years working for funds of hedge funds and 15 years in fixed income sales and trading, working for Deutsche Bank, Daiwa Securities, Scotia McLeod and Schroders.

Abhishek Kumar, Portfolio Manager, Emerging Market Debt Local Currency, SPDR ETFs

Abhishek leads the State Street Global Advisors' EMD team, managing both hard currency and local currency EM funds. He joined SSGA in September 2010. Previously Abhishek spent three years at ICICI Bank UK, managing global credit portfolios. He is a CFA charter holder. Abhishek holds a Masters in Management from ESCP Europe Paris, a post graduate diploma in Management from the Indian Institute of Management, India and a Bachelor's degree in Mechanical Engineering from the Indian Institute of Technology.

Antoine Lesne, Head of Strategy & Research EMEA, SPDR ETFs

Antoine is a vice president of State Street Global Advisors and head of SPDR ETF research & strategy for EMEA. Antoine's responsibilities include developing a strategy framework for the existing SPDR ETF range to align it with financial market developments and longer-term economic outlooks. This is delivered through research on ETFs as well as market bulletins that support the distribution of ETFs across EMEA. Prior to this, Antoine was a fixed income portfolio strategist covering Europe and global fixed income beta strategies.

Alan Pickering, Chairman, BESTrustees

Alan Pickering is chairman of BESTrustees and a trustee of a number of pension schemes. These include The Plumbing Industry Pension Scheme, which he chairs, and The People's Pension. Alan chairs the governance group of the Royal Mail Statutory Pension Scheme. He was a trustee of the Kosovo Pensions Savings Trust between 2011 and 2015. Until February 2013, he chaired the financial literacy charity, Life Academy. He has served as a non-executive director of The Pensions Regulator having previously been a member of the Occupational Pensions Board.

In association with

STATE STREET GLOBAL ADVISORS SPDR®

ETF roundtable

Rachit Sharma, Senior Investment Manager, RPMI Railpen

Rachit manages a number of pooled funds, government bond portfolios, and overlays, in addition to leading work on macro strategy that informs management of the growth fund. Rachit also manages portfolio implementation and capital markets activities, including relationships with counterparties and overseeing the outsourced dealing desk. Before joining Railpen in 2010 Rachit worked in private wealth management advising UHNW individuals and families on asset allocation and managing global multi-asset investment portfolios.

Paul Whelan, Fixed Income Manager Researcher, Aon

Paul is UK head of fixed income manager research for Aon Hewitt and heads up the UK transition management team. He covers the full spectrum of fixed income asset classes. Paul is an active member of the UK fixed income views team, working to expand the breadth of the team's output, formulating appropriate scheme hedging levels and informing the advice given to clients on managing their liabilities. Paul also works closely with the fiduciary business, Delegated Consulting Services. He often contributes to the pensions press.

Spotlight on fixed income ETFs

Our panel of experts looks at the various roles fixed income ETFs can and should be playing in pension fund portfolios now and into the future

Chair: We have seen significant growth in the fixed income market since the financial crisis. The size of the market has grown from $80bn in 2009 to c.$980bn today with expectations it will reach $1tr during 2019. The demand from institutional investors has also increased dramatically with most of the growth occurring across corporate, global and emerging market bonds. This rapid growth suggests that institutional investors are using fixed income ETFs not only for their tactical but also for their strategic asset allocation needs.

ETFs have also helped to modernise fixed income markets, assisting investors with liquidity and accessing niche exposures within their portfolios, as well as enhancing transparency and providing investors with low-cost execution when establishing a diversified portfolio.

However, despite this growth, there remain a number of misconceptions within the fixed income ETF market, particularly around certain exposures such as emerging markets and also around liquidity.

Can I ask those of you around the table, what is your exposure to fixed income ETFs or ETFs in general, in your current roles?

Whelan: I head up the fixed income manager researcher team for Europe at Aon and, in terms of ETF usage, we directly use them within our fiduciary business, both for managing flows, more tactical exposures to markets and

In association with STATE STREET GLOBAL ADVISORS SPDR®

ETF roundtable

increasingly – but from a low base – more strategic allocations. In terms of clients, directly on the advisory side, both across insurance and pension funds, there is still relatively little usage of ETFs and still some nervousness around them.

Cheseldine: I am a professional trustee with CCTL, as well as a trustee of two relatively small DB schemes and half a dozen quite big DC schemes and in none of those do we currently use ETFs.

Aspinall: I'm the chief investment officer of B&CE. We sponsor The People's Pension – the largest DC master trust in the UK. We have some ETFs for our exposure to real estate and infrastructure. I would frame them as enabling us to get access to those exposures quickly. For our long-term exposures we would like to be more like the unlisted direct holdings in those pieces. I can see them managing some liquidity in that circumstance, so potentially offering proxy prices. But that's where we use them.

Hollis: At Willis Towers Watson, I am head of the traditional credit manager research team and also the exposure team, which includes indexation. We don't use ETFs at all in any fixed income asset class for our investment portfolios and very rarely for managing transitions. Our DB clients don't need the extra liquidity. They make strategic asset allocations and change them once every three to five years, and we find that ETFs are extremely expensive compared to the traditional index funds that we invest in.

Pickering: I am chairman of BESTrustees. I'm a full-time and professional trustee of both DB and DC schemes, and in both contexts, fixed income is becoming more important. It's the income aspect that's becoming more important than the underlying capital characteristics of the asset class that generates the income.

Trustees are, in DB land, grappling with a binary debate about CDI or LDI, and have come to the conclusion that it doesn't matter whether it's a C or an L prefix, it's the income which is important. Likewise, in DC land, particularly if we're regarding a defined contribution scheme as a savings product that provides an income that doesn't peg out before you do rather than a cash cow, income generating asset classes have a really important role to play.

Abrams: I'm Mercer's lead researcher for global credit and absolute return fixed income. I echo what Kate *[Hollis]* has said, in terms of the long-term nature of most of our clients, we also see very little exposure to ETFs there. On the fiduciary side, which can be a bit more dynamic over a short or medium term horizon, again, little use currently due to some of the expenses associated with ETFs.

Hitchman: I am head of Fiduciary Management Advisory at Stamford Associates. A big part of our proposition is very much around contractual cash flows from fixed income. However, to date, there's been very little use of ETFs in what we do.

Sharma: I am a fixed income and multi-asset portfolio manager at Railpen. I work in the public markets investment team. In terms of ETF usage, we use them occasionally, but it's not a big part of our portfolio.

Chair: As expected, there is a mix of uses and uptake in ETFs across a variety of exposures around the table.

Lesne: Yes and, as has been mentioned, there are a lot of misconceptions or myths around ETFs too. On average, the usage of ETFs in traditional asset allocation is growing but does not represent the largest pool of instruments used by investors. There's however a lot of coverage from a sensationalist headline perspective – a lot more coverage of ETFs than we've ever had on index funds in particular.

Hitchman: My understanding is that the use of ETFs is much greater in the US than it is this side of the Atlantic. I would like to get your perceptions on the dynamics of what's driven that.

Lesne: ETFs were launched first in the US, so they've got the first mover advantage. Also, one thing that has been driving the growth of ETFs there is the fact that there are some tax advantages to the structure in the US. Those were certainly the initial big drivers.

After that, I would almost disassociate the US versus Europe argument, in terms of the adoption of ETFs. ETFs in Europe are still very much used by investors like those around the table today that include large institutional investors, large asset managers, large discretionary private management/portfolio management but still very little by retail investors when compared with other fund structures. So far, the growth trajectory has thus been very different.

We believe there is going to be convergence, ultimately. In the US, we are starting to see a lot more pension fund investors and insurance companies use the wrapper; insurance has seen a slow uptake but there's been a change in

In association with

regulation which means that you may be able to use an ETF at systematic value in the US. This development could help increase the use of the ETF and treat it more like a bond rather than an equity. This is something that we have not seen in Europe yet. Regulation is very often a large driver of changes in habits and instruments uses.

Chair: In terms of how we have seen UK pension funds use ETFs, one of the ways in which they have used them is to access difficult areas, some of the more esoteric asset classes. Emerging markets is a good example, global convertibles as well, where a client or an investor would like to access a certain asset class, but they don't necessarily have the in-house capabilities or expertise to do so. So, instead of spending time doing manager research in an area they have limited expertise, they'll use an ETF to access those more niche exposures. That's been a big part of what we've seen.

Secondly, we have seen ETFs used as a liquidity sleeve. We find that institutional investors allocate a small portion of their overall portfolio to ETFs, mirroring the underlying portfolio. This allows them to facilitate any tactical allocations they may have or rebalancing, and also to be more nimble if they experience any outflows.

The final way we see ETFs used is more on the transition management side. If, for some reason, they have a manager and they are looking to move away from that manager, they may want to do that immediately, but they won't necessarily want to have that drag by holding that money in cash. So, they'll use an ETF in the interim, whilst they do the research on the new manager. Then, once they come to the decision as to how they want to allocate that money, they have not lost out on performance in the interim.

That's how we've seen them used, mainly, within the UK pension fund space.

Lesne: That's not so different on the continent. The types of uses of ETFs that you mention there are also very common. The markets where I've personally seen the biggest take up have been in the Nordics and in the Netherlands, where you also have some of the biggest pension funds. But we're starting to see that also develop in Italy, for example, and in other markets where regulation has changed to allow pension investors to start using this type of instrument.

It's very much regulatory driven, and in the uptake it's very clear that such instruments are used in the 'returns' portfolio of DB pension funds. DC is very different, of course, but if you are a DB fund, in the returns part of the portfolio, high yield ETFs or emerging market ETFs, for more tactical overweights, for example – depending on the cycle – have been of great use. We have also seen the use of investment grade corporate ETFs as well, and that has been driven sometimes by the challenge to access the market since the GFC. Price is of course a very important factor. We have seen things starting to change in relation to prices in the US, and they are also starting to change in Europe, where ultimately you will find ETFs which are as inexpensive as you could find in an index fund, and sometimes actually cheaper than index funds. So, that's something that ETFs are helping, and we are starting to see smaller pension funds use ETFs.

Responsible investment

Whelan: I head up the fixed income manager researcher team for Europe at Aon and, in terms of ETF usage, we have used ETF for managing flows and more tactical exposures to markets, but usage is still relatively light.

Lesne: There's a trend towards it generally and in the ETF space there has been some proliferation of products, but of course it is not huge. Looking at Europe, across both equities and fixed income ETFs, at the end of January this year, we had around €10 billion of ESG or socially conscious ETFs listed in Europe, according to Morningstar, of which around €1.2 billion was fixed income ETFs.

On may point to the lack of agreement on some standards around ESG as an impediment to a broader adoption.

Kumar: I agree, all the clients I have spoken to do not have a uniform perception of ESG – it means different things to different investors and until we have some sort of agreement on what exactly an ESG standard would be, then things can't move forward. As a result, most investors are going down a customised ESG version.

On a separate note, people are finding more uses for ETFs every day. I see much of the flows from active to index moves, for example. We also see clients who were invested in active funds, moving to more indexed funds via ETFs. So, from holding

In association with STATE STREET GLOBAL ADVISORS SPDR®

ETF roundtable

Chair: Absolutely. When we think about fixed income ETFs, the one element that is important to consider are the two areas of liquidity. So, there's both the primary market and the secondary market. The secondary market is where we see the fixed income ETFs trade intraday on exchange. This is, in times of increased volatility, a useful tool, because you can use the secondary market to match buyers and sellers, so it provides a tool for investors to trade relatively easily throughout the day.

The primary market is what comes into play when you're trading, for example, larger sizes of the underlying fixed income, and also when you perhaps need to redeem, and you don't see what you need on the secondary market.

So, the fixed income ETF market has this unique feature where there's both the primary and the secondary, and they both have the ability to provide liquidity.

What we find in stressed market environments is that ETFs could potentially offer additional liquidity compared to direct bonds. And, because you have this ability to trade on the secondary market, we see increased volumes, which results in fixed income ETFs trading more efficiently than the underlying bonds they represent.

Abrams: I can see how that secondary market liquidity is a nice feature for instant access, accessibility, transparency. ETFs are another menu option as a trading tool, but when it comes to a long-term allocation as part of an investment strategy, I think it's only fair to hold up those ETFs versus the broad market beta that exists.

What we see, for example, is high-yield ETFs fall short in terms of performance over the past few years, and you can explore the reasons why that is. It may be time-variant in nature, but as a starting point, high-yield ETFs track a subset of the most liquid bonds in the marketplace, hence they might be lower yielding, and they omit the less liquid, smaller part of the market – I think there are often good opportunities within that part of the market for making additional return.

Secondly, one of the things that I think is worthy of further exploration – and I think investors are right to ask questions about this – is around that primary market liquidity piece: when conditions change and if the market participants/the market makers decide to step away from trading in the market, that could move the price of an ETF away from its NAV. In this respect, you may be unlucky enough to buy an ETF at a significant premium and sell it at a significant discount – of course, it might be the other way around. But if you were after a long-term beta allocation to a market, I don't think it's easy to hold ETFs up as a panacea for access to that market, in terms of the beta. What we see in terms of our active managers, is that alpha can be variable as well. But if we take, say, the median statistic of our active manager universe, they have tended to outperform high-yield ETFs over the years.

Hollis: A related question for Abhishek *[Kumar]* – what do you do when part of your beta suddenly becomes totally illiquid – I'm thinking here of Venezuela, where since the sanctions went on, I understand the trading is essentially non-existent. J.P. Morgan is still pricing it within the index, but if they decide to take it out of the index, what will you do? How will you manage that exposure?

Kumar: We are lucky to have very little of Venezuela.

a few concentrated bonds, they get the full diversified basket of the universe at a very cheap level. If they had gone in the market and bought and sold the bonds, it could have been quite expensive. Given that the bid/offers of the ETFs are pretty small, the transition would have been done cheaply for even the most expensive asset classes like high yield or EM.

Pickering: Can you say a few words about the role of an ETF wrapper as a mainstream wrapper rather than a complementary wrapper? You did mention earlier the liquidity associated with ETFs. In DB land, those of us who are on a journey know that we may well get to risk transfer more quickly than we originally anticipated. Many schemes have got tailwinds rather than headwinds, and whenever we go into an asset class, or a wrapper, we want to know how easy it is to get out of it without being a forced seller. Likewise, we're trying to deploy the brainpower that was traditionally utilised in DB land, in the DC world.

One of the difficulties there is that, notwithstanding the long-term nature of the pension, we do have to provide daily liquidity. Again, can you comment on the role of an ETF as a mainstream wrapper, bringing together good ideas in a market that puts a premium on liquidity?

Liquidity

In association with STATE STREET GLOBAL ADVISORS SPDR®

ETF roundtable

As an ETF provider, one of our main points of focus is liquidity – that's why we have liquidity constraints in our funds. You have to think about the possibility that at a point in time, your universe will not be liquid enough and you should be willing to sacrifice a bit of the value for liquidity. Venezuela this year – at least in January – has been the best performing country though it can't be crystallised now due to sanctions.

You may have to sacrifice a bit of your return for liquidity. The bonds rated CCC and below are not that liquid so whenever a country gets rated as CCC by any one rating agency, we remove it. In doing so, we do sacrifice a bit of potential upward swing in price movement if they were to quickly bounce back.

For example, in Venezuela, if there's a change of regime and it bounces back, the rating agencies will likely upgrade it. There may be a delay in this review and we may lose a bit of initial rally.

Hitchman: But what if you have material exposure?

Kumar: If you have material exposure, then it can be slightly difficult. We have been in difficult situations before in EM, for example, we had problems in Malaysia in November-December 2016. Just after the US elections, the markets panicked and started to sell EM assets. Central Bank in Malaysia took an extreme measure and clamped down on currency repatriations and that created even more problems. So, we've had situations like that, where the market was difficult, and the trading costs were slightly elevated. But we haven't been in any very difficult situations in the past, at least in past seven years.

Lesne: An ETF is, to some extent, a tool that is used to express what the market price would be, if you were to do it. You can exchange shares of the ETF without having to trade the underlying. You're transferring the risk, and you have to pay for that action of course.

Sharma: It's also worth noting that ETFs aren't creating liquidity in the underlying asset class. If Venezuela is illiquid, it's illiquid for all portfolios, whether the exposure is through an ETF or through a segregated portfolio. Even in a segregated portfolio, as a manager, sometimes you would end up with securities that have become illiquid, and you end up holding them for a long time. So, as an investor, that risk doesn't necessarily go away if the structure is not an ETF.

Lesne: I think the risk is the same, as you said, for the ETF. From a liquidity standpoint, I'd say that it's either better for the ETF, because of the secondary market layer, where you exchange blocks instead of exchanging many, many bonds. Or it's as bad as what everybody would face – active, passive, any type of instrument. I cannot believe that an active manager would be any better of – we've got exactly the same trading desks. We've got very strong trading capabilities. If we face the issue, they will face it, unless ETFs are the only instrument being sold that day – and this is not what we experienced in previous volatility bursts.

Hitchman: A lot of this, for me, is about investors understanding the nature of the risks and the potential consequences. It's fair enough to say that with ETFs liquidity might be better, but that liquidity potentially comes at a price. My question is, what is that price? That price could diverge both positively and negatively relative to the underlying assets. So I come back to the question about what happens if you have a big chunk of assets in, for example, Venezuela.

How does that start unravelling over time and what do people see as the downside risks – because if you're a large pension fund and you're sitting on a bond portfolio, then what you're really worried about is default risk, and may be well placed to sit and ride through the volatility. But if there's a market event with an ETF and that forces the ETF to unwind, forces it to sell, that is a dynamic that might be a concern for a pension fund holding ETFs.

There are a lot of people who are positive about ETFs but there are also a lot of concerns out there, and until we've got over that, and there's complete transparency around what they are and the nature of the embedded risks, there's going to be nervousness around them.

Cheseldine: This links back also to Alan *[Pickering's]* point earlier – that pension trustees are investing predominantly for income.

Sharma: Within the ETF structure itself, are there mechanisms to deal with part of the portfolio becoming illiquid?

Kumar: There is. We explored that option when Malaysia started to seize up. You create a sub-fund, which is just a buy and hold account, and the ETF gets a share of that sub-fund. Then, as and when that sub-fund is liquidated, the ETF is paid back.

Sharma: What happens to

In association with STATE STREET GLOBAL ADVISORS SPDR®

ETF roundtable

redemptions from the ETF?

Kumar: The investors get a share in that sub fund and cash.

Lesne: There's a price there that someone will be willing to pay on that – it might not be a nice price. But that's a cost of liquidity, and that's very well known. If you're trying to sell your Venezuelan bonds today, for example, there is a market for it, but you might just not like the price. However that's the current market price. That's what you will see being reflected in the ETF. So, the same thing would happen for an active fund or any type of fund, which gives the potential to investors to be trading, at least every day or every week.

Sharma: But there are securities that sometimes just don't have a price for a period of time.

Kumar: As an ETF manager, I want my investors to challenge me on the liquidity of the ETFs. That's what I think is missing. If you look at the biggest ETFs in Europe, they continue to hold defaulted bonds, because it is an allowed investment. Then you should question – is this liquid enough, and you should be holding it?

Sharma: What happens if there are large redemptions? Does the last holder get left basically with an illiquid portfolio?

Kumar: No, every investor is treated fairly. As long as you think there is a price, it is continues to be in the main pool; if it's deemed that a price is no longer available, that it can't be sold, then it has to be carved out, and it's put in a sub fund and each investor gets a share, so that every investor is treated fairly. The last one out doesn't suffer.

Aspinall: But who is this for? Ultimately, I fully understand creating a new layer for retail, to enable me to put a pound into a broad market. That's great. As a buy and hold investor, I give up a lot to go through any pool, so is this just the next competitor for UCITS, for example? Is that the positioning? In which case, it's a scale thing for trusts. They'll go through this phase, some of us might be lucky enough to get out the other side. Even in that tier, why would I put the retail guys in, because their panics become mine. I'm sharing panic. Why would I put liquidity between those two groups – the market does that already for me?

Lesne: In answer to your question, who is this for, it's meant for everyone. Do you want to share your risk with others? That's the question you've got to ask yourself in your position.

Aspinall: It's a subtly different question – I already share my risk with others, through the price mechanism of the underlying market. Everyone trades in the same place but if I divide those trades between five or 10 pools, then I must be in a lower liquidity environment overall, even if fundamentally it's simpler because there's aggregated trading at the top level. So, you're not creating any more liquidity at any part of the system, just moving it around.

Also, I get all the transition arguments that are made around ETFs, that they can help us go from A to B a lot smoother. I'm not quite clear as to how they save transaction costs.

Lesne: It's the secondary market – it's where the intermediary is doing this. They may hold, actually, some of the paper, and then deliver this. That's where this mechanism of creation is not necessarily always for cash, it can be for bonds, and someone may be holding bonds as in inventory, and making that market. Ultimately, you're going to pay for the risk you're taking, but everybody is.

Abrams: There's also opportunity cost to consider. This is maybe a side argument, but we're also talking about passive versus active management in some of these more volatile or less liquid markets. If you need to use a stratified sampling technique to replicate, for example, high-yield markets in the first instance, that involves an active decision. If you're applying that active decision in a naïve or systematic way, my view is that if you're in a more volatile and less liquid market, you can generate a better outcome using an active approach. Opportunity cost also needs to come into the equation, as well as the transaction cost element.

Lesne: We are facing the same issues as any active manager. Afterwards, you've got to find the right active manager in terms of doing the trade-off in terms of sampling, or trying to replicate beta. Then if the active manager has got to sell, because there's a redemption, they would be facing the same issue that everybody does.

So, the point for us is, in order to mitigate some of that risk (we cannot eliminate that risk completely), we're looking for diversified indices. I agree that high yield is maybe a less liquid universe, but if you're thinking about the high-yield liquid index of 10 years ago, and the high-yield liquid index of

In association with

ETF roundtable

today, it's a very different animal. You had 80-100 bonds 10 years ago, maybe 200 in the US. Today, you're talking about close to 1,000 bonds. It's a really important point for us, because in order to dilute that specific idiosyncratic risk at issue or at bond level, we need to have this diversification.

It comes back again to the question of how you define the index that you're going to track. That is investable and diversified enough so that one can replicate its characteristics and returns patterns. That is what we provide you with: the best possible beta in that context.

To your point, you might want to have a beta that is also including the illiquid premium. That maybe is something different.

But ultimately, an ETF is becoming a financial instrument like other types of instruments – it's the secondary market layer that is helping it. If there are big enough funds that can trade easily, like you would add futures on some exposures, then you can have a global aggregate ETF for example, which is cheap enough, and at least trading day in, day out, because of this liquidity element. That's a way for you to get beta on the cheap, that you can't really do or replicate with futures and derivatives as they do not provide a similar level of granularity.

Abrams: What we're talking about here, in the main, is 'context'. Everybody has a different situation, a different objective. I can see these as part of the menu options as implementation tools, I can see how ETFs fit, even though I have some concerns on the long-term investment side. So, it's really got to come down to what suits each individual investor, and what the situation is.

Lesne: And the constraints that you have in your trustee or in your fiduciary position.

Cheseldine: It also depends on the market context as well, because it's liquid until it isn't, and some of us still have the bruises from 2008.

Chair: One liquidity element which is important to note is, as banks have been forced to reduce their balance sheets, they're now holding less risk. So, as a result, it has become more difficult for investors to trade direct bonds due to the reduced liquidity offered by the banks.

A useful tool

Hollis: All of this discussion is great, if you want liquidity. Our clients however don't have the governance to trade very often. So, therefore, we find ETFs extremely expensive, compared to conventional index trackers. Why would we buy them?

Lesne: That's where the cost of ownership, is clearly coming into play. ETFs have different applications for different types of investors. For example, smaller pension funds might not actually be able to get such low fees on an index fund or on a segregated mandate from large managers. That's the first point.

The second point is, you are starting to see interesting products in Europe. As an example at SPDR, we've have a global agg ETF at 10 basis points TER, for example. How much money do you need to get on the table to get a TER (so not only the management fees, but all the fees bundled into that), to manage a global aggregate? It's likely to be pretty high. You're talking several hundreds of million dollars to get a well-diversified global aggregate portfolio, at a TER of 10 basis points.

Whelan: You can also end up getting paid if you are willing to lend units in certain asset classes, which can increase

the attraction of holding ETF.

Lesne: Yes it's clearly about how to use it, what you should use it for, and maybe it's better for DC than for DB in some cases. It has an application because it's a financial instrument. Our task is to make sure that we provide a sufficient diversification of exposures that you can use at your leisure in the construction of the portfolio.

Whelan: It's almost analogous to the debate over how one accesses credit. Do you buy the physical bonds, or do you do it synthetically? There are pros and cons in both. People will point to historic examples where CDSs have better liquidity, but there's always the other issues. Lots of clients don't like trading CDS because they fear for when it comes off the run which is contradictory to the argument of they don't need all assets to be immediately liquid. So, there's not a right way or wrong way, it just depends on what you're trying to achieve and how to do it.

Hitchman: What proportion of bond ETFs or credit ETFs are passive as opposed to active?

Lesne: Most ETFs in the credit space are index tracking. There are a few which are managed actively with proper active management and they often use derivatives to manage duration, or to manage credit risk and so on.

Abrams: Do you lose that transparency you get with passive, with active?

In association with STATE STREET GLOBAL ADVISORS SPDR®

ETF roundtable

Lesne: You might lose some of the transparency, but it's a choice from the issuer really whether you give transparency or not. For our ETFs in EMEA we give transparency every day. Some providers decide to delay the information, however this may evolve as regulation in EMEA is become tighter, especially in Ireland.

Hitchman: A key issue here for me in considering this is the active/passive debate. If an investor believes these asset classes should be actively managed, then from my perspective there's probably limited scope for the use of ETFs, other than perhaps to help with transitions.

Emerging markets

Chair: That's an interesting point, because one of the trends that we are seeing is an increase in usage of ETFs within emerging markets, which is traditionally an area where investors believe that it benefits to go active.

Kumar: I agree. However, if you look at the top 30 largest active managers in Morningstar, only one outperformed the benchmark in the local currency space last year. The performance in hard currency was something similar, but a large majority of them underperformed the benchmark. This was net of fees and this underperformance was material.

EM is an inefficient asset class and the perception is, the more inefficient it is, the better chance active managers have. But EM is just so inefficient that active managers actually do not have a chance. Sometimes you absolutely do what you should do be doing, what the most sensible person would do, but the market is just too irrational, and it reacts too quickly.

The perception is that the market is illiquid, it's inefficient, so it possibly means that you have to better hedge your risk. You have to diversify exposure far more which active managers tend not to do. As indexed managers we too have to make active decisions. Every bond that we buy is an active decision, because we simply can't fully replicate the index and buy every single bond in the same proportion. However, given that we are so well diversified, our expected loss from unexpected market movements is a lot lower.

Lesne: When you look at the industry in emerging markets, in most volatile periods, when the active manager is supposed to have the right security selection, and promises you that it will actually smooth the drawdown, that's actually when they underperform the most. So, that's why we believe in the diversification element. Whether you like active or passive, diversification will be a key attribute.

Aspinall: There are lots of wrinkles in financial data that I don't think ETFs iron out, but they may well start to address. Down the line though, they may create more wrinkles. That would be my observation. So, does the benchmark have any relevance to my members' objectives? No. Inflation is relevant to their objectives. Their own longevity is relevant to their objectives. Their own job is relevant. So, if the active management and passive management industry want to go off and sniff around meaningless benchmarks, then they're not selling to the needs.

Also, the ownership of a security – and this is probably more of an equity concern – is a key piece of leverage for an institutional investor, because I can now walk into the boardroom and make demands. What does the ETF universe do with that?

Lesne: In the equity space, State Street Global Advisors takes its role in this area very seriously and we are big on stewardship and have a dedicated voting approach that we report on. It's part of the ETF package, that you go with the way State Street Global Advisors will vote on that.

Abrams: In terms of active management in EMD, I would challenge the notion that the benchmark is the best diversified way to access the opportunities there, as a starting point.

If you're doing a good job, as a passive-tracker, you've got to match the index, and all the idiosyncratic risks that come with it. You don't necessarily need to select a particular bond that witnessed that experienced a market jump, versus the other bond. But you do need to track the risk factors of the index in a fairly sufficiently granular manner in order to get your overall exposure. So, perhaps you will tend to own the 'Venezuelas' on the way down, whereas an active manager does not have to do the same thing. In terms of the benchmark itself, weights are capped at 10 per cent. There are some very large constituents, there are some very small constituents, but an active manager – granted, they may hold themselves up versus the benchmark – don't need to have those exact weights.

I will concede the last year was a disappointing year for active management versus the benchmark. Over the last five years or so, what we've

STATE STREET GLOBAL ADVISORS SPDR®

In association with

seen is active managers in the EM space have tended to be long of the asset class in general, certainly EM FX, long the high carry of the asset class looking for value opportunities. I don't believe that's necessarily done in a naïve way, but it hasn't served asset managers well, particularly in an environment where EM as a whole has not performed well. I do believe going forward that active management will prevail in this market place, because it is a market with its idiosyncrasies and you don't need to be exposed to some of the tail risk on the way down.

Chair: Abhishek *[Kumar]*, one of State Street's strengths in the passive space is fixed income and in particular, emerging markets. Why is that?

Kumar: Investors need to remember that EM is an expensive asset class because buying and selling bonds and FX is expensive. There are taxes to be paid. Most of the market, or a big part of the bonds in the market, are not that liquid.

If you go for an active manager, sometimes you might win but most often you might underperform the index. If you go for pure, fully replicated indexing, you are guaranteed to lose a lot more. For a fully replicating fund tracking the J.P. Morgan Index in 2018, you would have lost about 60 basis points versus the index. In the year before, you would have lost about 95 basis points. The cost of full replication is expensive in EM, local currencies, especially.

Given the costs, we are careful about what we buy and sell and how we buy and sell. If you can do that, the cost of replication, or the performance versus your benchmark, can be a lot better. In EM, more so than in other sectors, by making informed choices about the bonds you buy, you can bring in a lot of value and reduce underperformance vs. the benchmark.

We do take active positions in trying to choose the bonds, but they are a lot smaller, and they are much thoughtful, we're careful about the bonds we choose, based on the tax profile, careful about the bonds we sell, if they're too expensive to sell. We spend a lot of time trying to improve the trading capabilities, so that the bid offer that we give to the ETF investors is 15 basis points. All of that has come from being invested in this business and spending a lot of time in improving and what we do.

Whelan: Are you able to try and mitigate things like withholding taxes further, where possible?

Kumar: The cheapest and the easiest way to do this would be to buy the low coupon bonds. But many countries try to create structures which force you not to, in which case we do different things to keep the costs down.

Chair: What sort of flows are we seeing now into the emerging market fixed income space?

Kumar: We have gone from investors shying away from EM exposures, to EM now becoming a consensus trade. Everyone is long EM, or that's what the perception is. We started to see this trend way back in December 2018, from the research that we have done – the State Street Global Advisors Bond Compass report, which shows bond flows and holdings indicators, taken from a data set that represents $10 trillion of assets under custody with State Street.

Lesne: From this report, we are trying to demonstrate what investors like those around the table today are doing; what the long-term pension, insurance, sovereign wealth or central bank money is doing. In order to look at that, however, you can't really put a dollar number on that and compare EM versus US Treasuries. The holdings are very different. Those patterns are very different. So, we use the percentile distribution of where the holdings of this book of investors is, versus its five-year average.

We take five years rolling period every quarter. We do the same for the average buying or selling activity and we rank them in percentiles. For example, according to the underlying universe, investors were in the third percentile of holdings when it came to emerging market debt. So, they have only 3 per cent of the time over the past five years have they been less invested in emerging markets debt than what we see today.

In the period of the fourth quarter of 2018, they had only sold more bonds 17 per cent of the time. So, they were still selling. In short investors were being quite underweight.

Saying that, while we see that investors were mostly selling emerging market debt over that period, they actually – and we're talking local currency – started to buy back at the end of the year on a more tactical basis.

That's an interesting pattern which we have also started to see in ETFs, and which we are expecting to see follow through in ETFs and possibly in the active funds universe too.

For a copy of the latest State Street Global Advisors Bond Compass, please visit www.spdrs.com/fixedincome

Dashboard creation

▶ *Pensions Age* asks: What is the best way to get the pensions dashboard up and running? Is it best to delay the launch until all schemes are ready, including the government's state pension, or will a phased approach to data help with the launch of the dashboard?

Given the different sources of data from different providers, it will be difficult to centralise all of the data and translate it into a useable format. However, this doesn't mean we shouldn't do it. A phased approach is definitely the best option. Start with the cleanest data possible from each provider and build from there. There may be a need to legislate to ensure providers put this at the top of their priority list, which is something the government should consider.

Whilst it is not ideal that members will be unable to see all of their later life savings, it would be a step forward from what is available to them now. It will also enable them to begin building an understanding of what they have saved for their later life and what they might need to save going forward.

▶ Redington head of DC and financial wellbeing at consultancy Lydia Fearn

Our view is that a gradual move towards a comprehensive dashboard is better than no dashboard or a long delay until all the infrastructure is in place.

The dashboard can and will evolve. In the meantime, let's get savers used to checking the dashboard like they check their bank statement and remind them that this is only part of the whole picture for the time being. As demand for the dashboard grows so will the impetus to get it fully populated.

▶ JLT Benefit Solutions head of technical John Wilson

Some schemes will be keen to share data without compulsion, so with this in mind, it might be appropriate to have a phased approach once the framework is in place. The schemes who are keen to be at the forefront could share data first. There could then be compulsion for all remaining schemes to provide their data by a fixed date, much like the automatic enrolment staging dates. The timescales for this should be short.

Considering the proportion of the population for whom state pension will be a significant source of income, this should be available on dashboards as soon as possible, ideally at launch. If there is to be a link to the 'check your state pension' site, this must be a temporary solution and the aim should be to get the actual benefit onto the dashboard within a short period of time. It is likely that this will increase usage and credibility of dashboards in the long run.

If there is a phased approach overall, government and industry need to be transparent with consumers about what the dashboard is able to offer at all stages of its implementation. Consumers need to be aware that at outset, the dashboard will be 'knowingly incomplete'. This is so that they are not misled by the information contained. It is essential we make it known that this is temporary and there is a clear path to achieving full coverage.

Regardless of approach, we need to have full coverage on the dashboard within the shortest possible time period. This will be a balance between getting maximum coverage prior to launch but not delaying the delivery unduly to achieve this.

▶ Fidelity International deputy head of pension products James Carter

Allowing savers to see only some of their savings is hardly the way to go. A half-baked dashboard is almost worse that no dashboard at all. There is a real risk that people would be making poor decisions about their future retirement plans based on incomplete information. In my view, only in the most exceptional circumstances, such as inordinate delay should the launch of the dashboard proceed before all schemes have provided the necessary mandatory member data. The government should also commit to providing the equivalent data for the state pension, ideally before the dashboard is launched but certainly at the earliest possible stage thereafter.

▶ Barnett Waddingham senior consultant Malcolm McLean

Should the launch be delayed until everything is perfect? Frankly no, time and time again our peers from countries who have experienced the difficulties and successes of delivering a pensions dashboard have all had one key piece of advice – don't wait for it to be perfect, deliver what you can, learn from it and move on to the next version.

So a phased delivery of the pensions dashboard seems a sensible approach rather than a big bang attempt at delivering nirvana. As long we don't forget or lose the desire to reach the end game, a delivery of the dashboard over a number of years is better than waiting possibly forever for perfection.

Pensions Management Institute president Lesley Carline

If the dashboard delay runs into years, it would be preferable to curtail its rollout, as having only a partial data view would defeat the object of providing a full picture of an individual's pension position. Given the positive strides that we have made as an industry with rolling out and implementing AE, we need to be careful not to dent this progress by creating frustration among people trying to get a clear sense of their future retirement income.

Newton Investment Management head of defined contribution pensions Catherine Doyle

One way to make quick progress could be via the development of a pensions register. This is the 'find a pension' bit of the service and would be a huge leap forward for the industry and pensions in the UK. This could be adopted in the early phase where all schemes would have to provide some information about whether or not they hold a pension for an individual from day one. This helps people find their pensions and, while it won't give people details of their pension value, at least they will know they've got one and where to go for further information.

This also significantly mitigates the risk of people making decisions on the basis of partial information. Building on that, most modern DC schemes should be able to hook up to the dashboard relatively quickly. For others it will take more time, and perhaps this is where thought needs to be given to introducing a formal phasing approach to ensure momentum is maintained. Such an approach needs to be reasonable, but ambitious, and crucially it would need legislation.

Smart Pension director of policy and communication Darren Philp

Phasing the rollout of dashboard features will allow schemes to cleanse their data in a logical and timely fashion, reducing the pain of a data cleanse exercise by breaking it into manageable chunks. Data quality scores presented to the regulator should give a good picture of who is closest to readiness, and allow the construction of a fair and realistic timetable for staggered delivery.

Intellica head of pensions Garreth Hirons

Now that Guy Opperman has said it will be compulsory for pension schemes to provide data to the pensions dashboard – but we don't yet know from when – it would be helpful if the DWP could say exactly what the data required will be. At least schemes could make a start on pulling that data together.

A phased approach to providing information would help some schemes, particularly if the government set a relatively short deadline for compulsion. Having said that, the amount of information that needs to be collected for each member is likely to be quite small – probably a dozen or so fields. In view of TPR's record keeping standards, schemes should have this information to hand.

Quantum Advisory senior consultant Robin Dargie

The dashboard will clearly not be up and running by 2019, and the only way to launch this is one step at a time. Trying to cover all schemes, all members and all data at the same time will result in long delays and ultimately failure. On schemes, the priority should be DC rather than DB, for two reasons. DC covers the millions of newly auto-enrolled who need to be kept in touch with their benefits, and the data is cleaner. DB is immensely more complex and has much lower quality data, so needs to be given more time.

On members, we should focus on the largest schemes first, to have the biggest impact. Small schemes, SSASs, SIPPs etc are all fair targets in the long run, but in the short term, the effort involved in dealing with them could derail the project.

On data, basic information is more important than full details. Just knowing you have a pension and where to find it is a good start. If we can build full details of that pension then that's better, but we don't need it at the outset, and until the concept is proven schemes may be wary of how much they share.

The Society of Pension Professionals president Paul McGlone

Pensions history

Property investment by pension funds

"There is no doubt in my mind that investment in real property is eminently suitable for a pension fund investment portfolio," said George Ross Goobey when speaking to the London Young Members Group of the Law Society in April 1968 on trustee and pension fund investment policy.

He outlined three main methods of investment in property; mortgages, direct ownership and a link up with a property development/investment group. Whilst mortgages on property for a fixed term at a fixed rate of interest did not interest him with his 100 per cent equity outlook, for those who did not follow such a policy, mortgages on property could form a useful and remunerative alternative to debentures and preference stocks.

His first ventures into property investment for the Imperial Tobacco Pension Fund were by direct ownership of well-developed properties in first class locations and let to well-respected tenants. The returns, although not ungenerous compared to stock exchange securities were not of the same order as one could expect to receive from properties which were not developed. Most of the larger and more worthwhile propositions in the development field fell into the hands of the big developers, such as Jack Cotton and Charles Clore. They were ready to take on more and more propositions but their finance was not limitless. They therefore approached insurance companies and pension funds with a view to forming joint development companies so that although the entire benefit of the equity of a development property was not obtainable for the investing institution, a fair proportion could be secured.

For funds that were not of a size to be able to contemplate investing direct in property, special property unit trusts for pension funds were being introduced.

The full text of the presentation can be found in the Pensions Archive website; www.pensionsarchive.org.uk under "Collections" – "The George Ross Goobey Collection" reference LMA_4481_F_02_033 LMA_4481_C_04_001

Written by The Pensions Archive Trust chairman, Alan Herbert

Fun and games

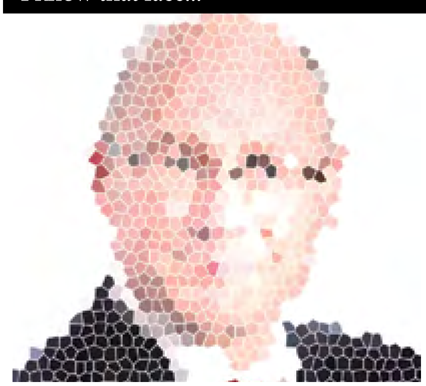
Wordsearch

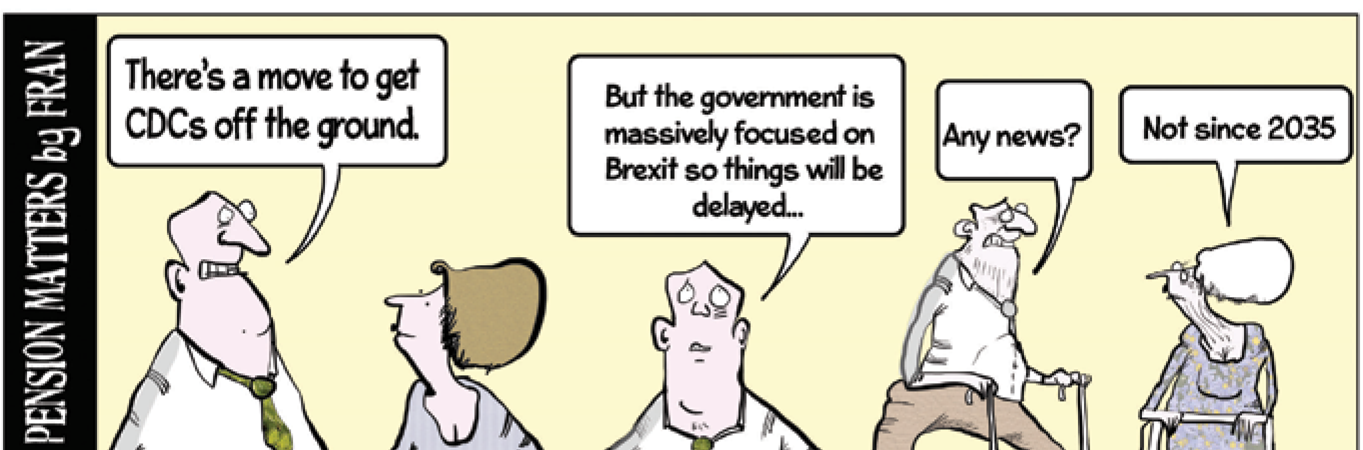
L	B	F	S	E	C	N	A	W	O	L	L	A	I
A	C	N	A	M	S	D	U	B	M	O	Q	N	G
I	U	J	S	V	W	G	B	I	F	E	F	T	T
V	X	T	R	R	A	U	Y	A	J	R	L	V	S
A	U	O	O	E	E	L	I	X	A	A	U	S	E
L	W	Y	T	E	G	I	O	S	E	I	W	S	E
U	A	C	E	R	N	U	T	G	O	R	T	P	T
A	T	X	P	S	Q	R	L	R	R	Q	Y	T	S
T	A	S	O	J	U	O	O	A	W	M	Q	J	U
I	D	F	N	C	A	R	C	L	T	Y	U	C	R
O	R	H	T	M	A	Z	Y	L	M	I	T	T	T
N	A	U	M	N	T	E	U	Q	F	E	O	T	I
S	R	P	N	V	T	S	E	L	U	R	N	N	O
E	S	D	R	A	D	N	A	T	S	R	R	T	S

ALLOWANCES
AUTO ENROLMENT
DATA
INFRASTRUCTURE
OMBUDSMAN
REGULATIONS
RULES
STANDARDS
TRUSTEES
VALUATIONS

I know that face...

Answer at bottom of page





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

***Pensions Age* magazine is now also available as an e-edition for tablets (iPad and Android devices), and can also be read on a PC.**

The new interactive digital format allows readers to easily search, browse and navigate the latest news stories, in-depth analysis, features, commentary and even adverts.

All content is hyperlinked for a richer online experience.

Through the print magazine, website, twitter, videos and now the digital edition, *Pensions Age* ensures that you always receive the latest news from the pensions industry, in the most convenient format for you.

To sign up, visit www.pensionsage.com

PENSIONSAge

Professional Services Guide

To Advertise in the Classified Section contact **Camilla Capece** - Telephone: **020 7562 2438** or email **Camilla.Capece@perspectivepublishing.com**

ACCOUNTANTS AND ADVISERS

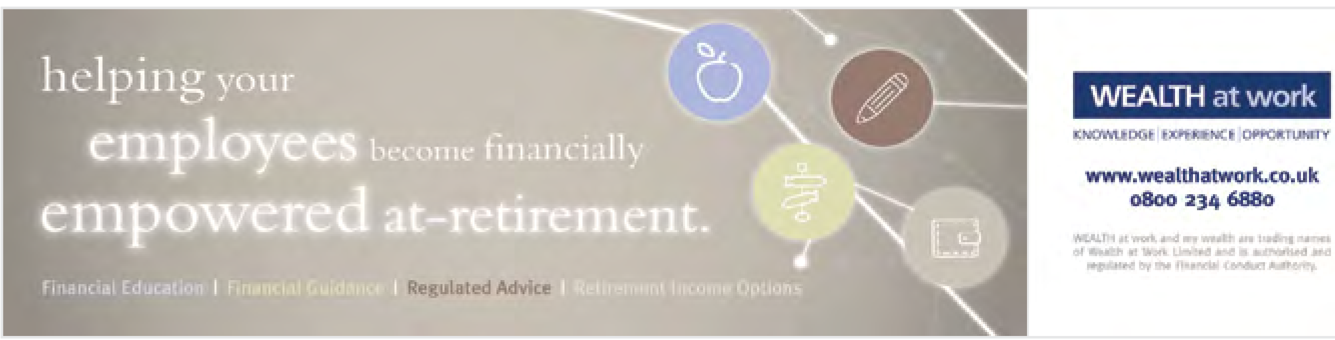
BHP

Offices in Sheffield, Cleckheaton, Leeds, Chesterfield and York.

Call us on 0333 123 7171
Email Howard at howard.ringrose@bhp.co.uk
or visit www.bhp.co.uk

BHP is a UK Top 40 accountancy firm. Our dedicated Pensions Assurance team comprises 15 specially trained, motivated, professional and approachable individuals. We act for over 60 UK pension schemes varying in size from small legacy schemes, to multi-employer hybrid schemes with net assets of over £400m. We excel in giving proactive advice and constructive audit feedback to assist Trustees with their audit compliance requirements. Our team also carries out a wide range of Employer Covenant review assignments for trustees and employers, including desktop reviews, in-depth strategic reviews and advising on the potential impact of corporate transaction activity.

FINANCIAL EDUCATION



INVESTMENT MANAGER

LaSalle INVESTMENT MANAGEMENT

LaSalle Investment Management
One Curzon Street
London W1J 5HD
United Kingdom

Phone: +44 20 7852 4200
Fax: +44 20 7852 4404
www.lasalle.com

LaSalle Investment Management is one of the world's leading real estate investment managers with over 40 years of experience. LaSalle manages $60bn (as of Q1, 2018) of assets on behalf of institutions and private investors across the world, investing in private real estate equity and debt, and public real estate through a complete range of investment vehicles. Our products include separate accounts, open and closed-end commingled funds, joint ventures, and public securities.

From the London office of 168 people we manage £12.6bn assets of which £12.3bn are located within the UK. We have extensive successful experience of managing portfolios to both MSCI relative and real return performance targets as well as assets and strategies targeting index-linked and absolute returns.

PENSIONS ADMINISTRATORS

PENSIONS ADMINISTRATORS

EXPERT ADMINISTRATION

020 7330 0778 joe.anderson@thpa.co.uk

Trafalgar House

Cheapside House
138 Cheapside
London EC2V 6BJ

www.trafalgarhouse.co.uk

TECHNOLOGY PROVIDERS

Pension Software Solutions Limited

- Fully Automated Pension Administration Platform For All Plan Types
- Customisable Screens, Forms, Letters, Dashboards, Calculations & Reports
- Online Dashboard for HR, Members and the Administration Team
- Plan Websites
- Cloud Based With Low Annual Charge Per Member

AURORA

www.pension-software.com Telephone Dolores on: +44 7936 414797 Email: info@pension-software.com

TRUSTEE LIABILITY INSURANCE

OPDU
WWW.OPDU.COM

OPDU
90 Fenchurch Street
London EC3M 4ST
www.opdu.com
Contact: Martin Kellaway
Title: Executive Director
Email: enquiries@opdu.com

OPDU is a specialist provider of pension trustee liability insurance covering trustees, sponsors and pensions employees in a stand-alone policy. Our policy covers all risks including GDPR, Cyber and Regulator Investigations. We can also provide cover for: pursuing third party providers, theft, retired trustees and court application costs. Benefits include our own claims service and free helpline and free CPD training covering trustees protections and how insurance works for groups of 6+

Please contact us for a free no obligation premium indication to see how we can help.

ulp
The PTL Experts
Karen Mansfield
01234 340266
kmansfield@ulpltd.co.uk
www.ulpltd.co.uk

1. ULP is an independent Insurance Broker working for Trustees and their Advisers to achieve the best Pension Trustee Liability Insurance solutions.
2. ULP provide bespoke solutions and approach a wide selection of Insurers to scope the most appropriate and competitive cover.
3. We have a wealth of experience in assisting Trustees and Advisers with Schemes of all shapes and sizes, including complicated placements.
4. We can assist with cover for 'Live' Schemes, and have particular expertise in helping to source long-term Run Off cover for Schemes approaching 'Wind Up'.

PENSIONSAge
Perspective Publishing
Sixth floor, 3 London Wall Buildings, London, EC2M 5PD

To Advertise in the Classified Section contact **Camilla Capece** -
Telephone: **020 7562 2438** or email **Camilla.Capece@perspectivepublishing.com**

Abenefit2u

Recruitment Specialist

Contactus@abenefit2u.com
Call us on 0207 243 3201

Abenefit2u

Specialists in Pensions & Benefits Recruitment.

We can assist with 'one-off' recruitment needs or ongoing staff requirements; on a permanent, contract or temporary basis.

Abenefit2u recruits from trainee administration level upward through to executive management, providing both contingency and executive search services.

www.abenefit2u.com

Finding you the perfect fit...

In-house Pensions & Benefits Specialist		
£45k+bens	South East	DB14561
In-house Senior Pensions Administrator		
£250 a day	Surrey	DB14558
In-house DB Pensions Administrator		
£32k	London	DB14567
DC Technical Specialist		
£DOE	Sussex	CE14570
Delivery Manager for Various Projects		
£DOE	London	CE14577
Pension Calculation Developer		
£DOE	Surrey	CE14576
Trustee Services Administrator		
£DOE	Yorkshire	CE14562
Junior / Trainee Consultant		
£DOE	London/Bucks.	TD14575
Day rate contract Administrators		
£Excellent	Derbyshire	TD14578
Pensions Business Analyst		
£DOE	London	TD14443

mhc

Moorlands Human Capital

Professional executive search tailored to you.

Looking to hire the very best senior leadership talent in the market? **Look no further**.

Our resolve and diligence will locate the ideal senior manager, director or trustee for your organisation on a permanent or interim basis.

Start attracting the right people today by visiting our website: **www.moorlandshumancapital.com**

or call us on: **0203 500 0352**

EXECUTIVE SEARCH AND RECRUITMENT AWARDS 2018 CV MAGAZINE

"Our aim is to make your choice the right one"

BESTRUSTEES

Business Development Manager

Location: London

BESTrustees is looking to appoint a Business Development Manager to join our Head Office team based in the City of London to drive service proposition development, increase the number of new opportunities, and to secure new clients and revenue.

This is a full-time role but consideration will be given to highly experienced candidates who would like to work on a part-time (four days/week) basis.

How to apply:
For a confidential discussion please telephone Simon Holt on 020 7332 4100 or email enquiries@bestrustees.co.uk

BWF BranWell Ford UK PENSIONS RECRUITMENT

EXPERT ADVISERS IN PENSIONS RECRUITMENT

01279 859000 www.branwellford.co.uk

Recruitment & Employment Confederation

Pension Consultant (Actuarial)
Ref: PR17342 London/Suffolk **£40,000 to £70,000 pa**
This is a smart recruitment move for a PQ or newly qualified pensions actuary to have Client Management responsibilities and team management if this is something of interest. The clients are a mix or recognised UK brands, and the role offers significant career advancement.

Senior Pension Consultant
Ref: PR17209 London/Bristol **£40,000 to £60,000 pa**
You will demonstrate CRM for larger clients in your career. This role will manage one high profile DC client with a variety of different schemes. Regular attendance of Trustee & Sub Committee meetings, monitoring and reporting on investment and Governance.

Communications Consultant
Ref: PS17264 London **£40,000 to £50,000 pa**
You will deliver creative, forward thinking communication strategies for pension scheme clients enabling employers to engage with staff on pensions and employee benefits. This is a client facing role, managing projects, client budgets, services in the digital market space.

Pensions Client Relationship Manager
Ref: CB17358 Leeds **£60,000 to £85,000 + pa**
As CRM for a FTSE 100 Client, you will ensure a high level of quality service delivery and continually work to develop and grow the technical and administration services. Experience of managing/developing relationships with clients at both a trustee and corporate level is essential.

Senior Manager - Pensions Administration
Ref: CB17320 Berks./Manchester **Neg**
You will lead the delivery of Scheme Admin consulting projects to a broad selection of clients, including some of the largest pension schemes in the UK. Projects will include ops reviews, data/benefit audit projects, governance reviews and scheme admin outsourcing.

Pensions Administrator
Ref: CB17215 East Mids. **£25,000 pa**
Working for an established TPA whose client base has grown organically over the last 12 months, they are now seeking an experienced DB Pension Administrator who will also assist with project work for pension increases, renewals and benefit statements.

Part time Pensions Officer
Ref: HB17351 Berkshire **£30,000 to £40,000 pro rata pa**
Joining this international company and working 30 hours per week you will be supporting the Pensions Manager with the management of the schemes. In return the company offer a fantastic working environment, including onsite parking, a gym and subsided canteen.

Pensions Administration Manager
Ref: HB17319 Wiltshire **To £60,000 pa**
Are you a strong leader, able to motivate, engage and lead a team of pension's specialists? These skills are essential along with extensive DB/DC pensions experience to manage this in house pensions' team on an 18 month contract.

Pension Administrator
Ref: HB17349 London **£24,000 to £32,000 pa**
Rare chance to join this large in house pensions' team to administer the DB and DC schemes. You will calculate full benefits, manage the online services, deliver scheme events and maintain a good understanding of specific legislation, HMRC guidance and scheme rules.

pip@branwellford.co.uk christine@branwellford.co.uk hayley@branwellford.co.uk

BranWell Ford Associates Ltd
recruit@branwellford.co.uk | www.branwellford.co.uk

4C Twyford Court, High Street,
Great Dunmow, Essex, CM6 1AE
Tel: 01279 859000
BWF Recruitment Consultants

UK Pensions Awards 2009 WINNER
2008 WINNER


DISCOVER
BETTER DC
built on INSIGHT
Our expertise in Defined Contribution pensions is built on our wealth of market data, renowned consultancy services and our range of award-winning pension solutions.
We can offer the complete range of DC services for employers or trustees, helping you find the right solutions to deliver your aim of better outcomes for your members.
Employers and trustees will naturally want to support employees in securing financial adequacy in retirement. But what barriers to saving are employees facing and how can you overcome them? Request a copy of our latest DC and Financial Wellbeing research to find out more about what your members are thinking.
Talk to us now. Call +44 (0)800 279 5588, email talktous@aon.com or visit aon.com/dcpensionsuk
Aon Hewitt Limited is authorised and regulated by the Financial Conduct Authority. Aon Hewitt Limited Registered in England & Wales. Registered No: 4396810. Registered Office: The Aon Centre, The Leadenhall Building, 122 Leadenhall Street, London EC3V 4AN.
AON
Empower Results®